# KPMG's SSM Insights

kpmg.com/ecb

## June 2018

We are delighted to introduce the early summer edition of our ECB Office Update.

As we anticipated in our March newsletter, there has been substantial political uncertainty in the first half of the year which is being felt by the banks as they balance the political climate with the demands of their supervisors.

Of course, maintaining compliance remains a key priority for banks. European supervisors continue to push for greater harmonisation. And they always have the potential to surprise! But the good news is that many banks feel able to address these requirements while still prioritising the optimisation of their own business models.

As highlighted in our last edition, the speed of technological evolution is a key factor. This poses challenges and opportunities for supervision, just as it does for the industry as a whole.

The articles in this edition explore all of these themes.

- One focuses on supervisors' continued and growing focus on internal governance, and the need for banks to target 'expectation gaps' in this area.
- Another looks at misconduct risk, highlighting the FSB's unique new Toolkit and setting out the potential benefits to banks in this area.
- Further to our previous article on banks' managing bodies, we look at the increasingly stringent expectations for the composition, tasks and skills of supervisory boards.
- Turning to technology, we review European authorities' evolving attitudes to FinTech, which they hope to encourage… but also plan to keep a watchful eye on.
- Under the heading of potential surprises, we highlight how the EBA is pushing for an end to double counting – something that could drive up effective CET1 demands for some banks.
- Lastly, we review the ECB's growing interest in the subjective judgements that banks make when classifying Level 2 and 3 assets and liabilities – and how banks should respond.

As ever, we hope this newsletter will help readers to stay ahead of the changing European supervisory landscape.

### Internal Governance: Supervisory attention is only growing

The arrival of new EBA Guidelines on internal governance will only reinforce supervisors' growing focus on this wide-ranging topic. Banks should ensure that they understand where supervisors see the greatest 'expectation gaps', that they are prioritising their responses effectively, and that they are taking the right steps to achieve lasting improvements in internal governance.

Read more | Share on LinkedIn

### Misconduct: Reduce risk, reap the benefit

The Financial Stability Board has issued a new and unique Toolkit aimed at reducing misconduct risks. This complements a number of European initiatives focused on banking conduct and behaviour. Taking an active, self-critical approach to misconduct risks not only allows banks to reduce risks - it can help them to achieve a range of strategic benefits.

Read more | Share on LinkedIn

### Supervisory Boards and their 'invisible members'

As for management boards, it is vital for banks' supervisory boards to be fit for the future. European banking authorities are increasingly focused on the composition, tasks and operations of supervisory boards. It is essential for banks' supervisory boards, to ensure they understand supervisory expectations and to pro-actively address any weaknesses – sooner rather than later.

Read more | Share on LinkedIn

## FinTech: A fast-growing area of supervisory focus

In response to an increasingly evolving market, European Supervisory Authorities (ESAs) are keen to encourage the development of FinTechs, but also determined to exercise appropriate oversight over innovative technology. Recent months have seen a number of important publications by the European Commission (EC), the European Banking Authority (EBA) and the European Central Bank (ECB). These all point towards a growing supervisory focus. Banks should be aware of supervisors' likely priorities and prepare for fresh challenges ahead.

Read more | Share on LinkedIn

## Will SREP 2018 bring a new look capital stack?

The EBA is pushing the ECB to modify its current approach to the double counting of Common Equity Tier 1 capital. A change to the stacking order seems certain to follow, and could drive up effective CET1 demand by as much as 150 bps. Banks should urgently review their current funding mix, and consider whether they may need to issue fresh convertible or hybrid capital.

Read more | Share on LinkedIn

## Illiquid securities and derivatives: Can banks stay 'on the level'?

Though supervisory scrutiny has been very much focussed in the last few years on banks' backlog of non-performing loans, the valuation and governance of banks' Level 2 and 3 assets continues to be an important topic. Banks with large trading operations especially should be aware that supervisory attention has been growing in the last months, especially in subjective areas such as observability and the associated financial statement impacts. Understanding likely supervisory challenges is vital if banks are to ensure they have appropriate controls and processes in place.

Read more | Share on LinkedIn

# Further insights

## Basel 4: the way ahead

KPMG's EMA FS Risk & Regulatory Insight Centre and ECB Office are pleased to announce the full 'Basel 4: The way ahead' series is now live. With six individual articles considering the different elements of Basel 4, the series leverages the insights from across our global network to assess the full impact of the final rules.

Read more | Share on LinkedIn

# Useful Links

- **ECB Office Website**
- **Get in touch with us**

# Contacts

Henning Dankenbring
Partner, Co-Head
KPMG's ECB Office

Daniel Quinten
Partner, Co-Head
KPMG's ECB Office

**kpmg.com/socialmedia**



Designed by CREATE | 180625 | CRT100033