KPMG SSM Insights

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Welcome to KPMG's first edition of SSM Insights for 2019.

It's hard to believe, but it's now more than five years since the Single Supervisory Mechanism came into force, and over four since it was implemented. During that time we've seen a remarkable degree of harmonisation and convergence in the regulation and supervision of European banks.

That is an achievement in itself, but – as Mario Draghi has recently written[1]- it is the benefits in terms of institutional and systemic stability that are of greater importance. The Euro area's largest banks are better capitalised, better funded and hold fewer non-performing loans (NPLs) than they did when the SSM was created.

This is not to say that the SSM does not see any challenges facing the banks it oversees. In this edition we cover a number of topics that fall within the ECB's stated supervisory priorities for 2019 such as NPLs, internal models, liquidity risk management and asset valuations.

More specifically, we take a close look at:

SREP 2018

With Pillar 2 Requirements appearing broadly stable, the phase-in of capital buffers has lifted MDA triggers to an average of about 10%. Addressing the SREP's qualitative findings looks like the best way to reduce this figure.

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NPLs and provisioning

Banks face a range of NPL initiatives from the ECB, EBA and European Commission. These have some far-reaching effects, and leave banks struggling to reconcile multiple provisioning calendars – let alone develop effective NPL strategies.

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LiST19

The liquidity stress test is well underway, though many banks are unsure how to fulfil all their templates. They should also be aware that LiST19 could have wider implications for liquidity supervision, the ILAAP and future supervisory stress tests.

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Model validation

Supervisory focus on outsourcing and model risk management overlaps when banks outsource model validation. Banks need to ensure independent model validation from model development. Should they outsource model validation, they need to retain adequate in-house skills, meet heightened expectations and remember that they ultimately remain responsible for model validation.

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The ECB and accounting

The ECB is increasing its scrutiny of several areas that affect banks' accounting records. Banks need to ensure they can reconcile accounting and regulatory records, and that they are able to clearly communicate the differences to external parties.

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Valuation for the purpose of resolution

The SRB and the EBA have published their latest work on the topic of valuation, following a similar route as the Bank of England in setting their expectations for banks´ valuation preparedness to support resolvability.

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There's no doubt that the ECB's scrutiny of these and other priority areas will continue as 2019 unfolds. We look forward to keeping you up to date.

Implications of TRIM on CET1 ratio: Reduction in CET1 driven by an increase in RWAs on implementation of TRIM

As one of the supervisory priorities for 2019, the Targeted Review of Internal Model (TRIM) continues to remain an important project for both the ECB and national competent authorities. The TRIM project seeks to reduce unwarranted variability of risk weighted assets (RWAs), reduce complexity of internal modelling and create a level playing field by harmonising supervisory practices across the euro area. Launched in late 2015, the project foresees the execution of on-site investigations on internal models at significant institutions across the SSM and is expected to conclude in early 2020. With the TRIM exercise now well advanced, the ECB recently published a letter to banks giving an overview of the TRIM project and sharing aggregated information on its outcomes. The outcomes of TRIM have already triggered tangible changes in internal models across the SSM to reduce unwarranted (i.e. non-risk-based) RWA variability by ensuring that the shortcomings identified by supervisors are duly remediated by the banks. In addition, the recent public annual financial results of numerous banks suggest that the average risk weight on certain asset classes such as mortgage portfolios, have been raised considerably owing to TRIM, thereby having a negative impact on CET1 ratios, which falls within the range of -210 bps to -3 bps. Looking ahead, the outcomes of the project will continue to play a vital role in enhancing the standards and quality of significant institutions' Pillar 1 internal models and the related framework for using and maintaining them.

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Useful Links

Visit KPMG's ECB Office website for the latest views and publications on pressing issues related to the Single Supervisory Mechanism (SSM).

Source:

1 ECB Annual Report on supervisory activities 2018

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