SSM
The auditor's view

Dirk Auerbach
ECB/SSM Conference
21st October 2014 in Frankfurt
Agenda

01 How the SSM functions

02 What we tell our clients...

03 The auditor’s view
How the SSM functions
The system

**NON-EUROZONE, BUT EU**

- **National competent authority (NCA)**
  - Supervision
  - All banks

**EUROZONE**

- **SSM**
  - ECB Supervisory function
  - National competent authority (NCA)
  - Right to assume direct supervision
  - Support ECB on request

- **Opt-in oversight**
  - Supervision
  - Significant banks
  - Less significant banks
The regulatory manual of the ECB will presumably be a mix of supervisory practices of all participating countries, in addition to new ideas and approaches set by the ECB.

These will be standards applied by the JSTs. BUT Standards will also extend to the NCA and their supervision of non-significant institutions as they are overseen by the ECB.

Consequences

1. The regulatory approach of the ECB is new to the NCAs as well as the supervised institutions
2. Well-know methodologies and processes will change: e.g. ICAAP and ILAAP

EBA will also publish a supervisory manual. A comparison recommended between manuals, approaches and practices of...

- Will avoid suprises during audits
- Reduces risk of additional capital requirements due to pillar 2- rules
Every institution has a history of ongoing and concluded engagement proceedings with the regulators. In addition, national and european regulators have the right to apply optional rules.

- It is recommended to put together a comprehensive overview and review of all agreements with the regulator, ongoing proceedings, options exercised, permissions, findings from special audits, investigation, etc.

Art. 97f CRD IV or rather § 6b KWG put a supervisory focus on certain topics: e.g. business models, risk bearing capacity, stress testing, prudent valuation, etc.

- Institutions should draft and maintain explicit resolutions and documentation regarding these topics.
Supervision is conducted in form of Joint Supervisory Teams (JSTs)

- Some JST-team members (also head of JST) work for the ECB and are supported by the national authorities.
- Adequate human resources and potential reputational risk will lead to intensive supervision.
- This may lead to: tight schedules, increasing number of requests and audits.

Goals: „be ahead of the curve“ – early identification of threats

- This will lead to an increasing number of requests also in terms of the amount of data.
- The ECB will require harmonized data: Option for regulators in Art. 99 CRR to require FINREP reporting by bank which use IFRS-Data to report COREP.
- e.g. SPE 3 (Supervisory Pilot Exercise 3), Stress testing data exercise.
- ECB-supervised institutions are considering an overhauls of their IT-platforms and the set up of a centralized engagement platform with the ECB.
A closer look to ECB’s supervisory approach

The content: an overview

The manual

- On Wednesday, 1st of October the ECB published a document: “Guide to Banking Supervision”
- This document is a sanitized version of the supervisory manual of the ECB
- According to the manual, the same approach to supervision is assured by all supervisory of the SSM, irrespective of the nationality and supervisory history
- Firstly, the manual is a mixture of the different national supervisory approaches and
- Secondly, it takes into account that the ECB is in the unique position to have access to an enormous amount of data from all credit institutions in Europe

The supervisory approach of the ECB may be seen as an ongoing cycle:

1. Methods and standards are defined…
2. … applied by the JSTs and inspection teams in day to day supervision
3. Quality assurance process by ECB’s horizontal function detects amendments…
4. …national laws or int. standards require changes and amendments…
5. …which trigger changes of the methods and standards.
6. New standards are applied and then the quality will be controlled again…

Consequences

- Useful to compare ECB’s approach carefully with the approach of the national supervisor to detect deviations and prepare for the new supervision
- Deviations:
  - Increasing demand for data: because of ECB’s unique position to perform horizontal, e.g. sectoral analysis
  - Increasing number of inspections: deeper insights into risks combined with the new pillar 2-approach will lead to more inspections on the ground
  - Variety of inspection types: full-scope and targeted inspections, thematic horizontal inspections, planned and ad-hoc inspections, follow-up inspections on previous findings
  - With broad scope: business model and profitability, credit and counterparty risk, interest rate risk in the banking book, market- and securitization risk, OpRisk (incl. legal and compliance) concentration risk, excessive leverage, internal governance and risk management, liquidity risk, capital position etc.
  - Variety of inspection techniques: targeted interviews; walk-through processes; sampling; data confirmation, e.g. by re-calculation or benchmarking
  - Increasing follow-up work on findings: pursuit of findings is high on the agenda of the supervisory teams (JSTs)
The auditor’s view

Before SSM...

GERMANY

Significant banks

Less significant banks

ALL GERMAN BANKS

Supervision

Communication

Report

External Auditor

Audit

BaFin

DEUTSCHE BUNDESBANK
EUROSYSTEM

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The auditor’s view
With the SSM...

**GERMANY**

- **SSM**
  - Supervisory function
  - Oversight

- **BaFin**
  - Support ECB on request
  - Communication

**External Auditor**

**Supervision**

- **Significant banks**
  - Right to assume direct supervision
- **Less significant banks**
  - Support ECB on request

**All German Banks**

* Two NCAs according to EBA Homepage. Technically BaFin has lead and Bundesbank assists.*
The auditor’s view
Implications – Communication (1)

GERMANY

Supervisory function

SSM

oversight

Report

Communication?

External Auditor

Supervision

Significant banks

Supervision

Less significant banks

ALL GERMAN BANKS

Right to assume direct supervision

Support ECB on request

Audit

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Why is the communication with the ECB important for the German auditor, also in the case of non-significant banks?
Implications – ECB’s overall say in every aspect of regulation

**Supervision**

**SSM**

**Oversight**

**Right to assume direct supervision**

**ALL GERMAN BANKS**

**Significant banks**

**Less significant banks**

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**The auditor’s view**

**Implications – Reporting format (1)**

- *Well-known format*:
  - Reporting standards and presentation defined in PrüfBV
  - BUT adaption to CRR only in draft status!

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The auditor’s view
Implications – Reporting format (2)

If „yes“ what is the format
- AQR showed that ECB requires large amounts of data
- Frequent refinements on a tight schedule
- For Significantly large banks → Mandatory English translation of report acc. to new draft of PrüfBV

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The auditor’s view
2 regulators, 1 voice?

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X auditors, 1 voice?

Best case: auditors can coordinate regulator’s opinion and incorporates feedback in uniform approach → International (EU) coordination?

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The auditor’s view

Different entities – different rules? (1)

Significant banks

Credit Institution A

Credit Institution B

Investment firm C

Financial Services Provider D

SSM

Supervision

BaFin

DEUTSCHE BUNDESBANK EUROSYSTEM

External Auditor

Different level of applicability of CRR rules with every type of entity

Audit
The auditor’s view
Different entities – different rules? (2)

Germany

Supervisory function

SSM

BaFin

Deutsches Bundesbank

External Auditor

Internal Auditor

Financial Services Provider

Institution A

Credit Institution

Institution B

Credit Institution

Audit

Supervision

Best case:
Institutions have implemented state-of-the-art rules set out in draft EBA-RTS

Different level of application of RTS rules due to heterogeneous status of RTS and ITS

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Effects, the SSM possibly has...

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<th>Positive</th>
<th>Negative</th>
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<td>- Supervision of international organisation might become more feasible → e.g. supervisor knows German subsidiary and its foreign EU-mother</td>
<td>- Implementation of convergence of rules and practical harmonization will take time.</td>
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<td>- Eventually harmonization of rules lowering benefits of EU-cross border regulatory arbitrage</td>
<td>- Conflict resolution among the three main supervisory bodies at play?</td>
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<td>- ...</td>
<td>- Risk of heterogeneous approaches taking too long to converge with material burden on institutions AND the final auditor due to legal uncertainty.</td>
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Discussion

- Is the extent of the requirement regarding data transmission appropriate?
- What is done with the data collected and will it avoid another banking crisis?
- What about the „reputational risk“ carried by the supervisors in terms „big data“ = „100% oversight“.
- German Institutions should have a single communication channel with ECB.
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