



cutting through complexity

SSM

The auditors's view

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ECB/SSM Conference

21st October 2014 in Frankfurt



01 How the SSM functions

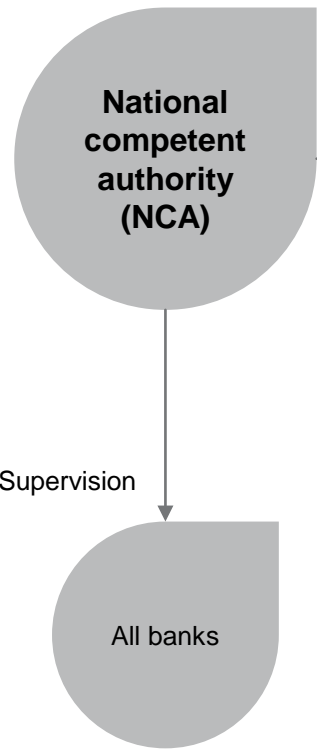
02 What we tell our clients...

03 The auditor's view

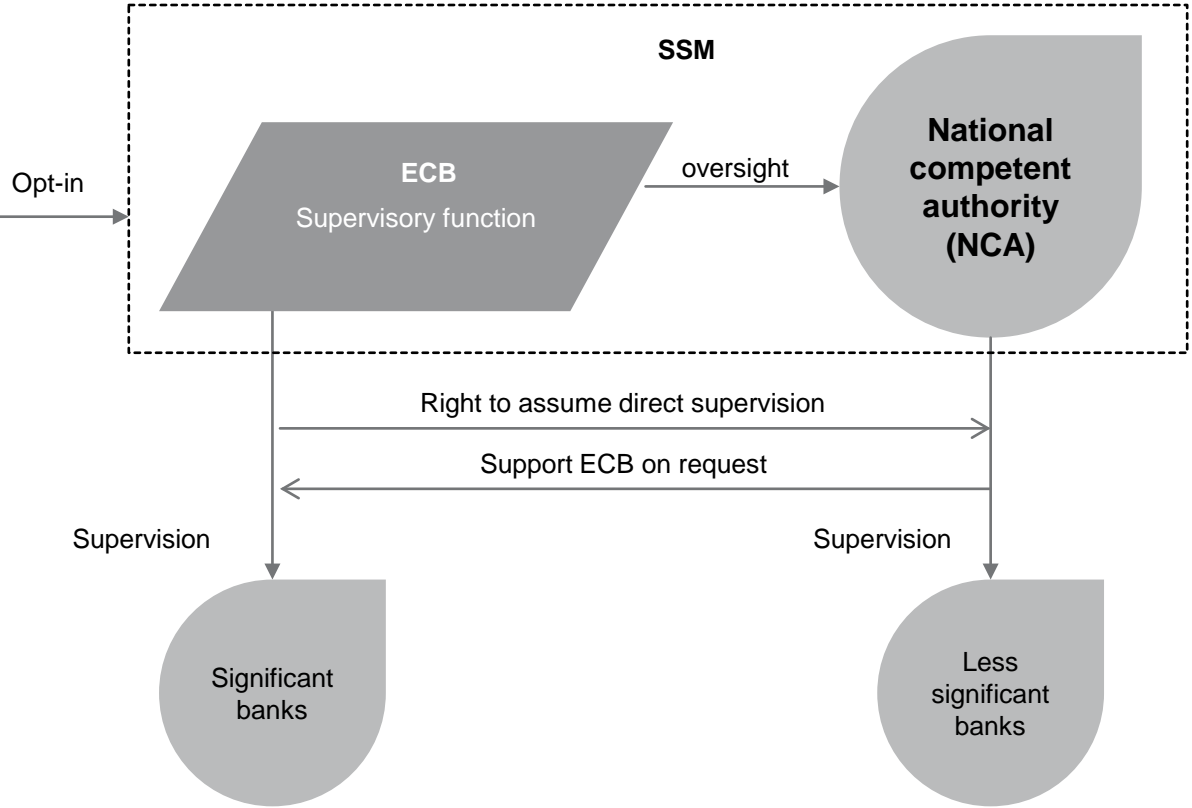
How the SSM functions

The system

NON-EUROZONE, BUT EU



EUROZONE



ECB Supervision - “The Regulatory Melting Pot”

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 surprises during audits
- ✓ Reduces risk of additional capital requirements due to pillar 2- rules

Get the ECB's understanding

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.

Gain an understanding of ECB

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

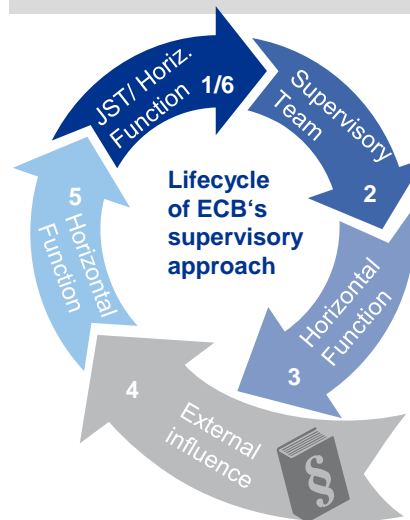
- This will lead to an increasing number of requests also in terms of the amount of data.
- The ECB will require harmonized data: Option for regulators in Art. 99 CRR to require FINREP reporting by bank which use IFRS-Data to report COREP.
- e.g. SPE 3 (Supervisory Pilot Exercise 3), Stresstesting data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

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.**

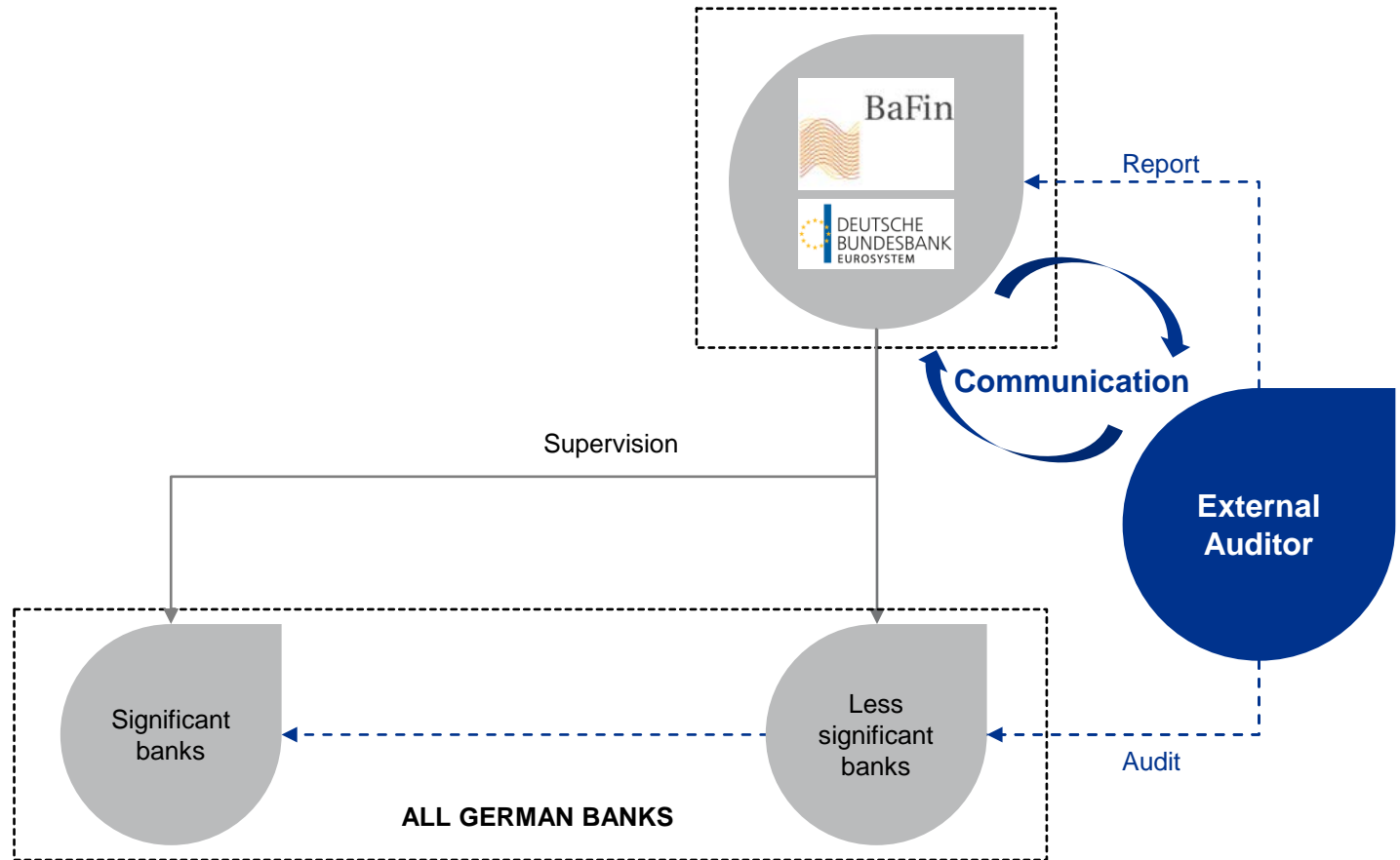
6 **New standards are applied and then the quality will be controlled again...**

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)

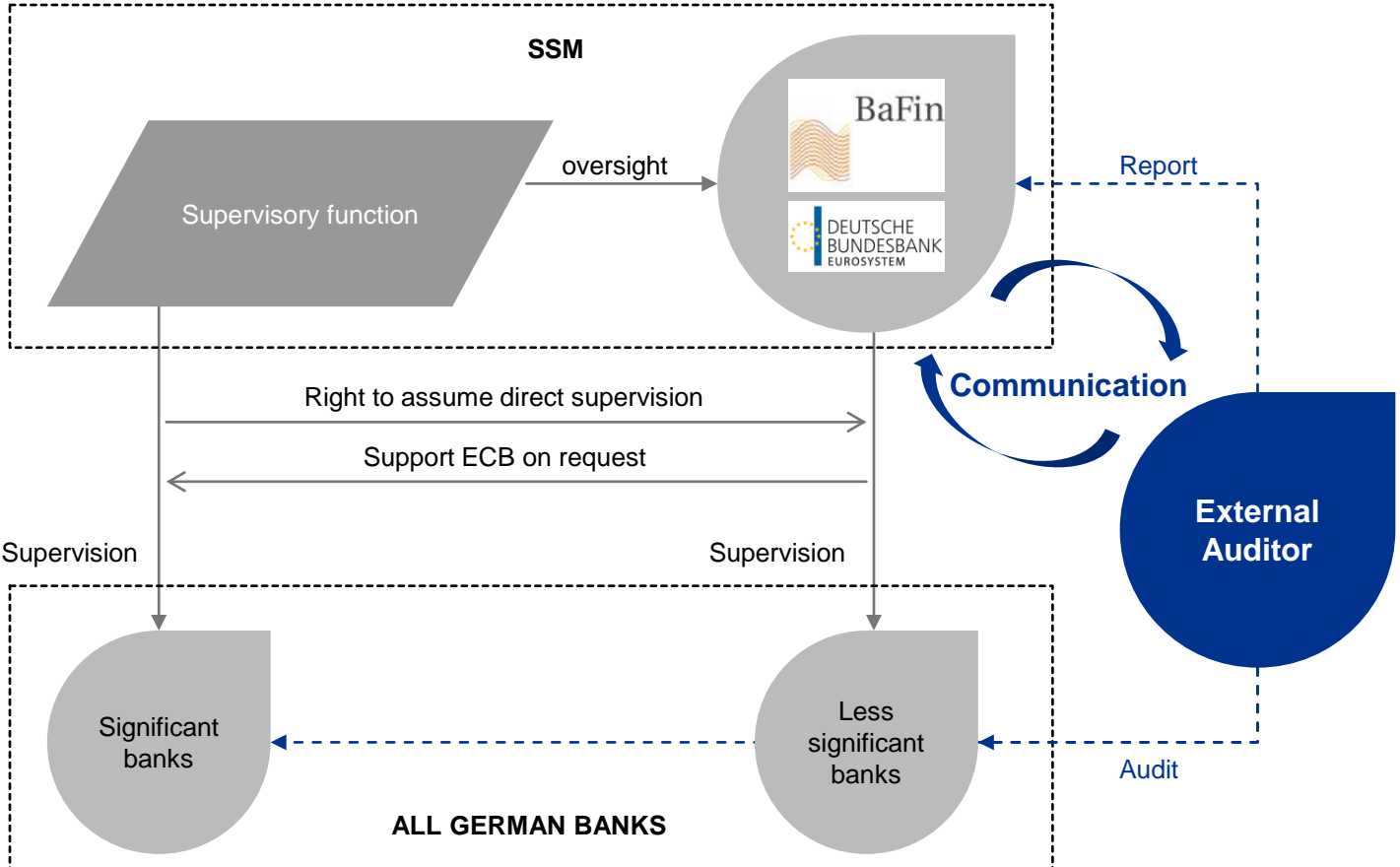
The auditor's view Before SSM...

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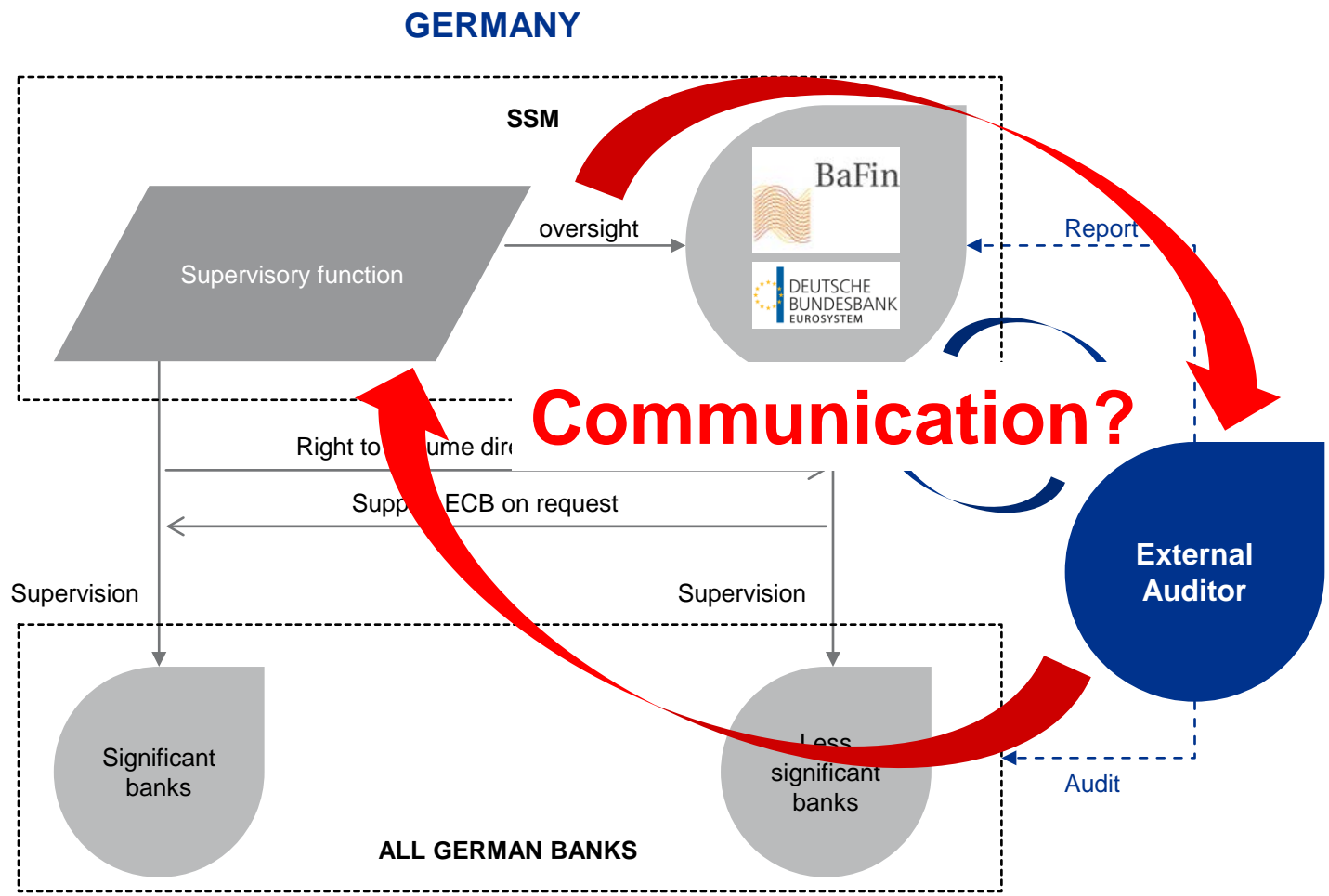
The auditor's view With the SSM...

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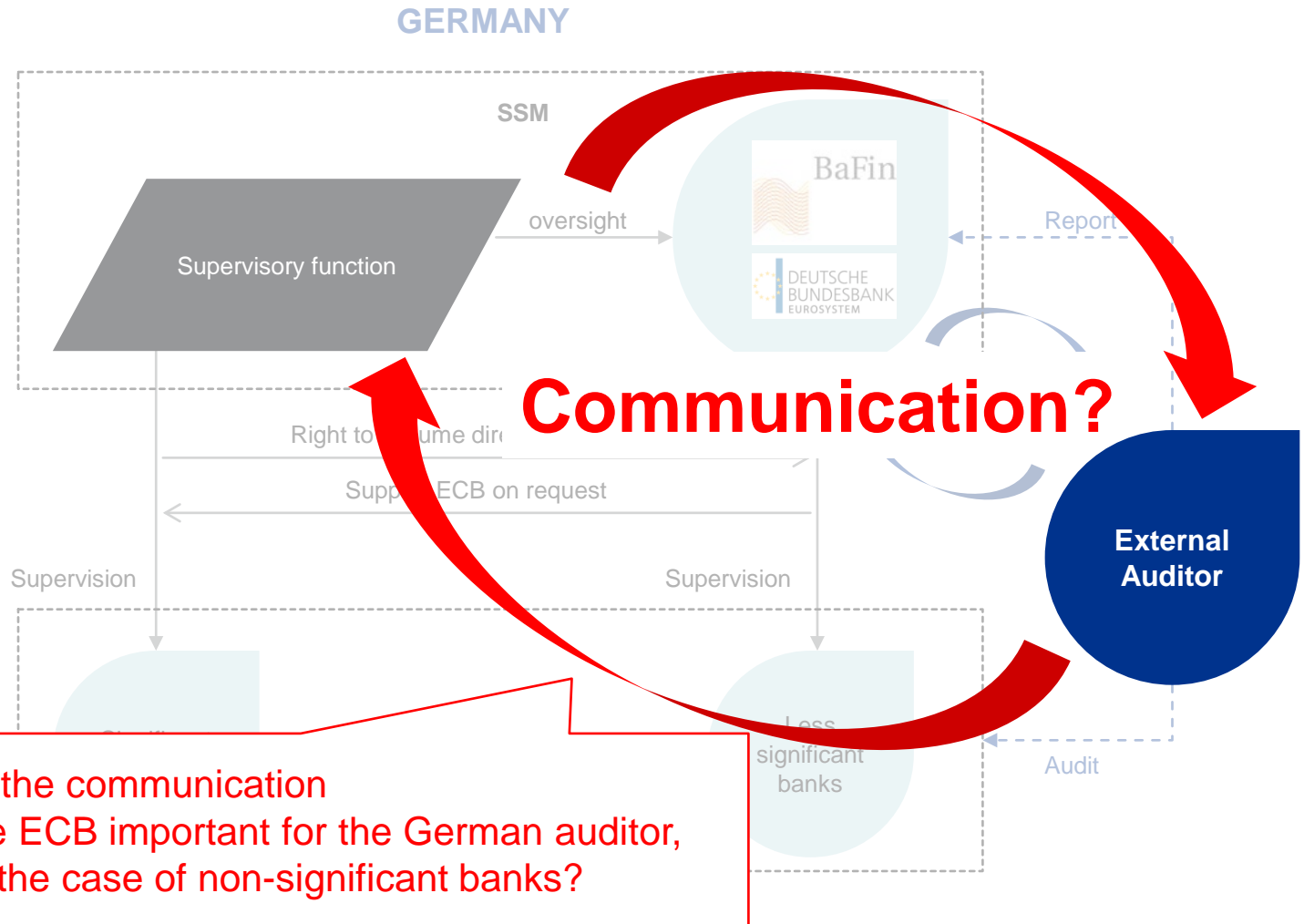
* Two NCAs according to EBA Homepage. Technically BaFin has lead and Bundesbank assists.

The auditor's view Implications – Communication (1)

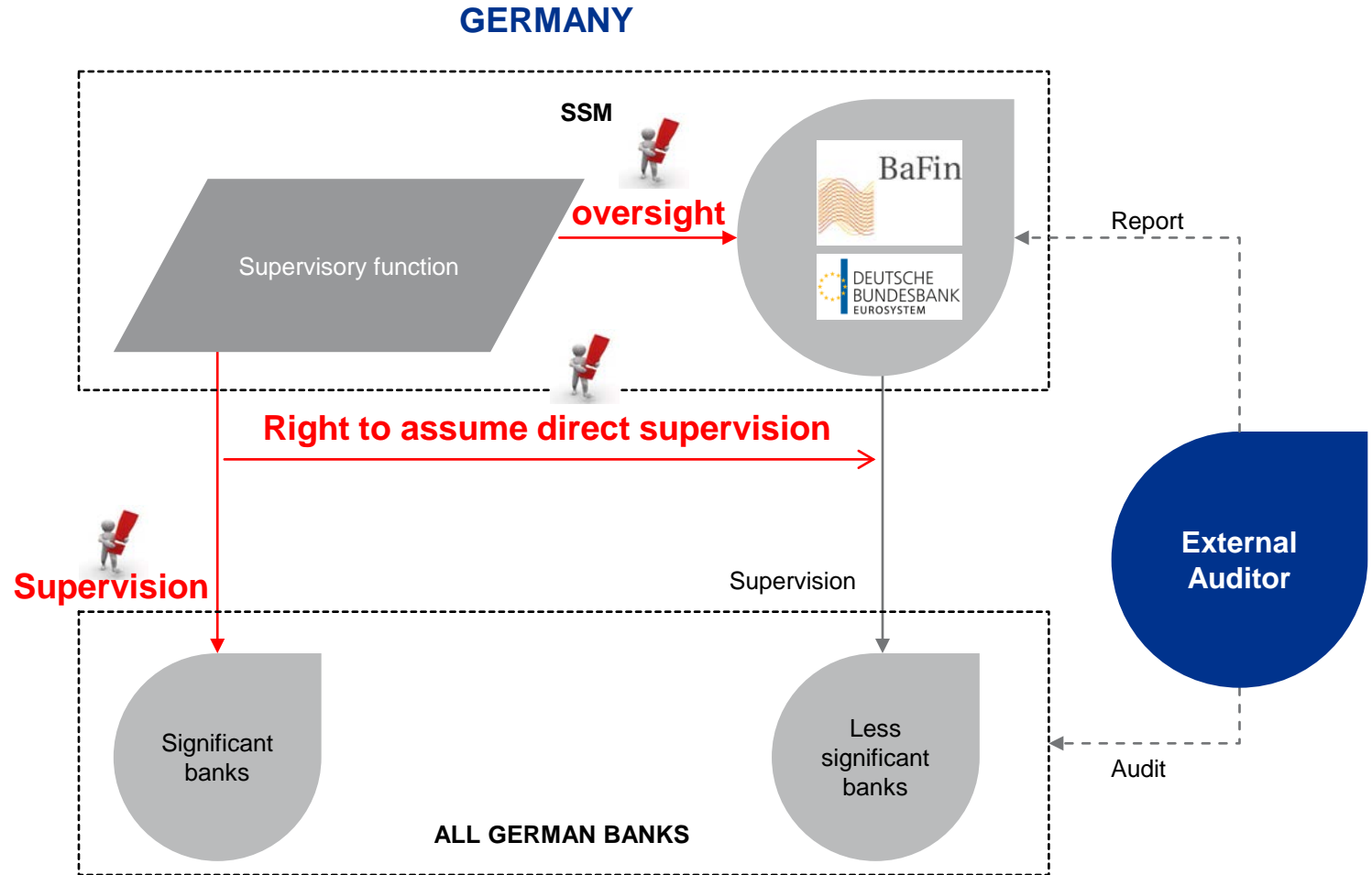


The auditor's view

Implications – Communication (2)



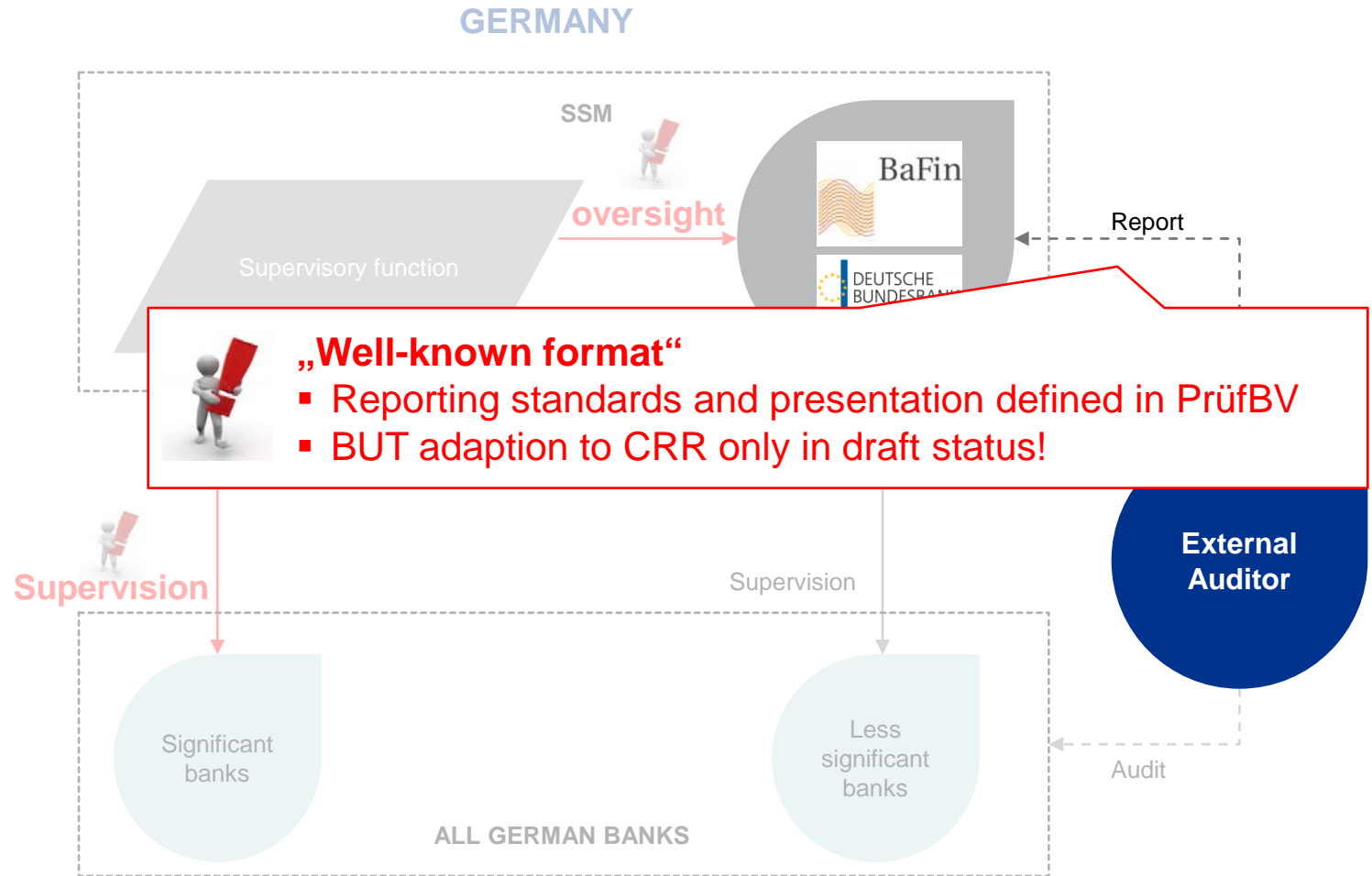
Implications – ECB's overall say in every aspect of regulation



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The auditor's view

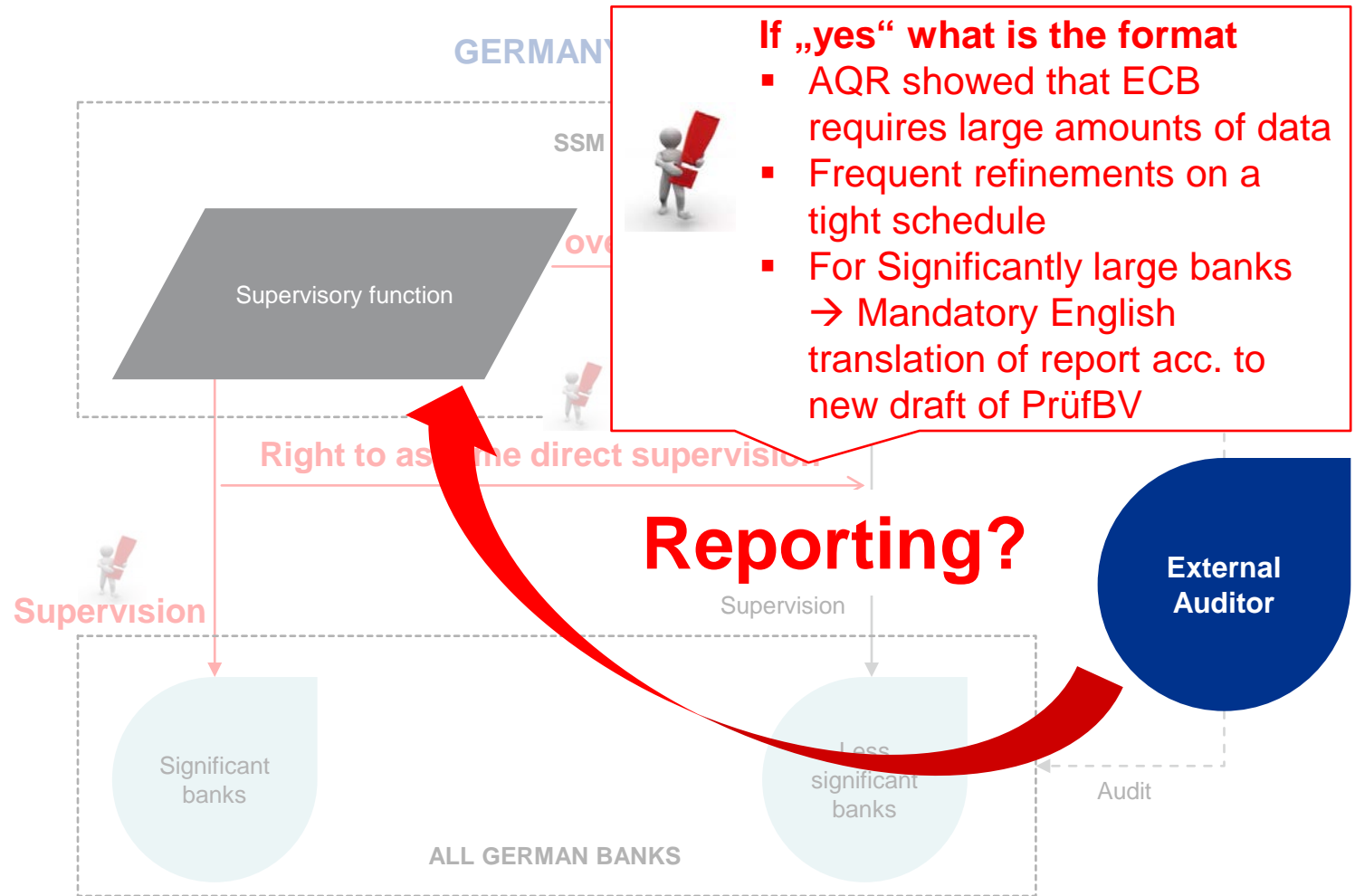
Implications – Reporting format (1)



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The auditor's view

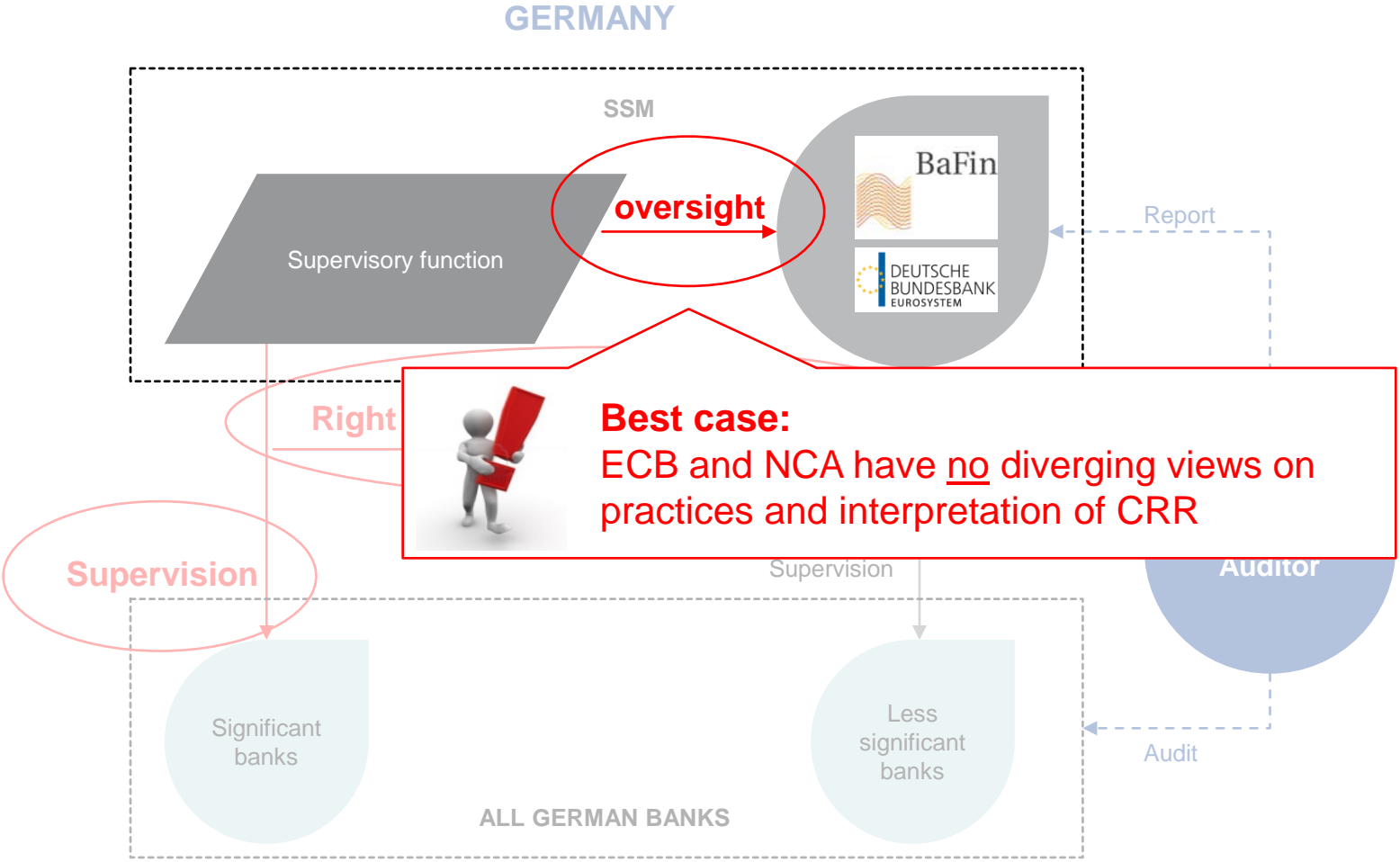
Implications – Reporting format (2)



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The auditor's view

2 regulators, 1 voice?

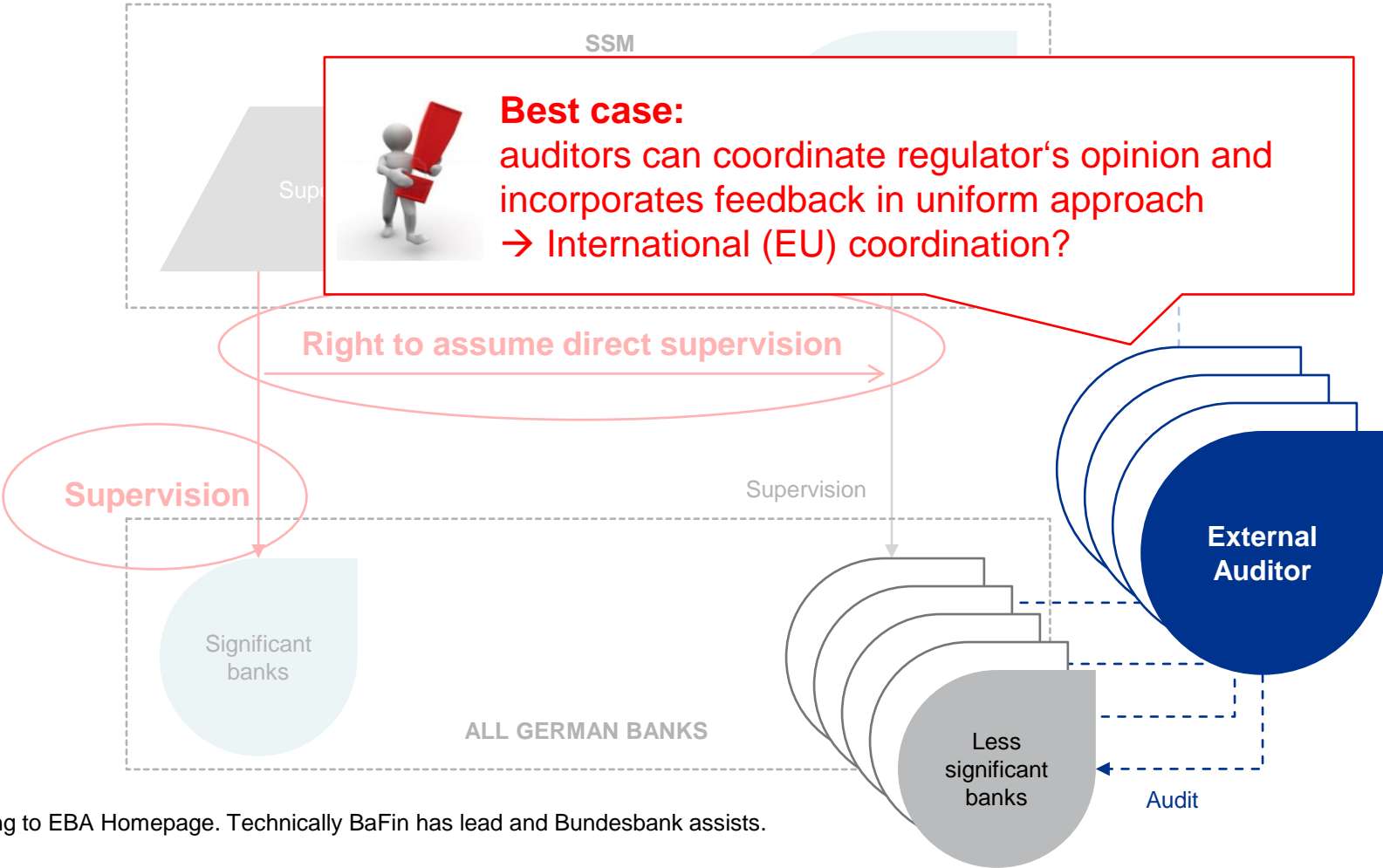


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The auditor's view

X auditors, 1 voice?

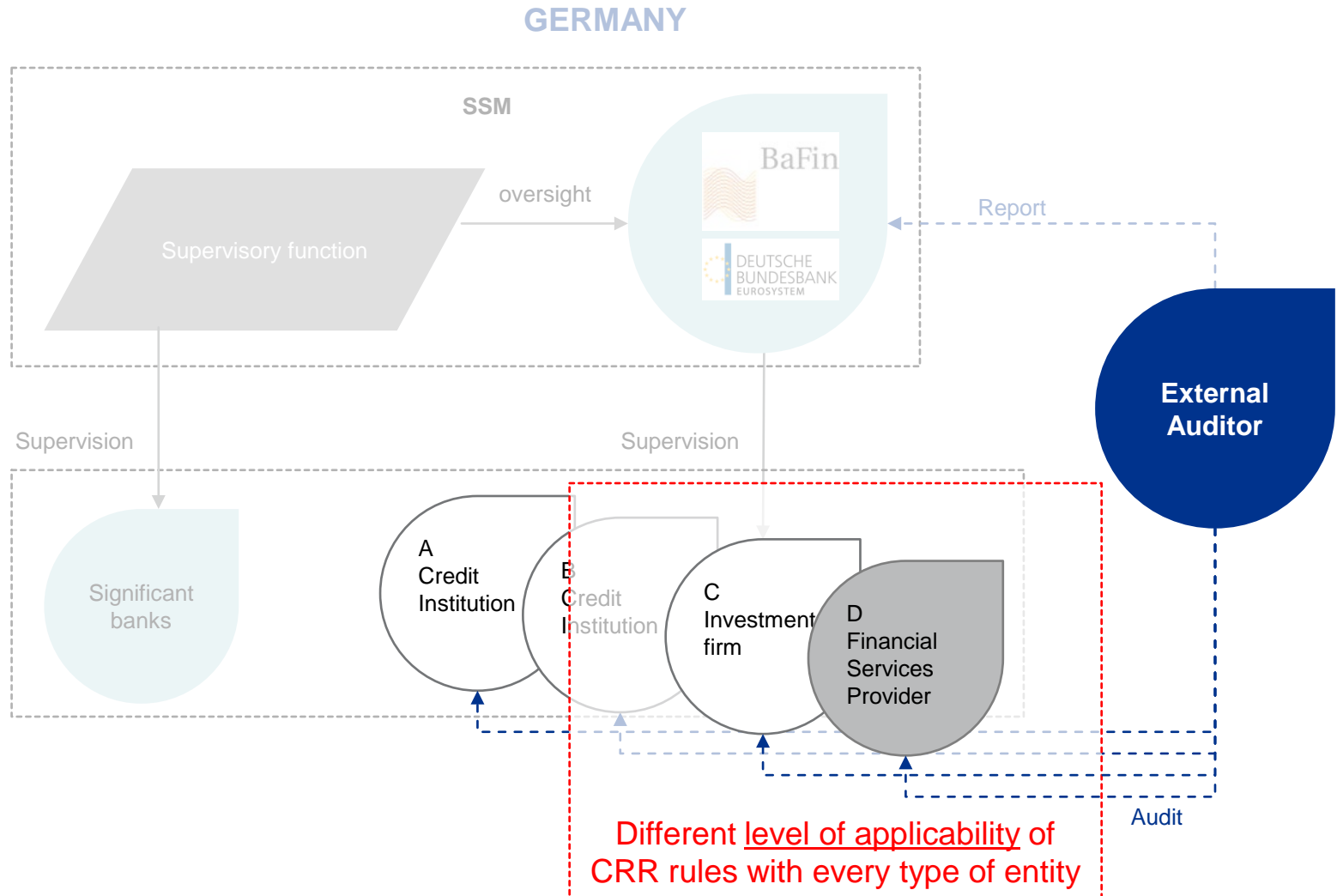
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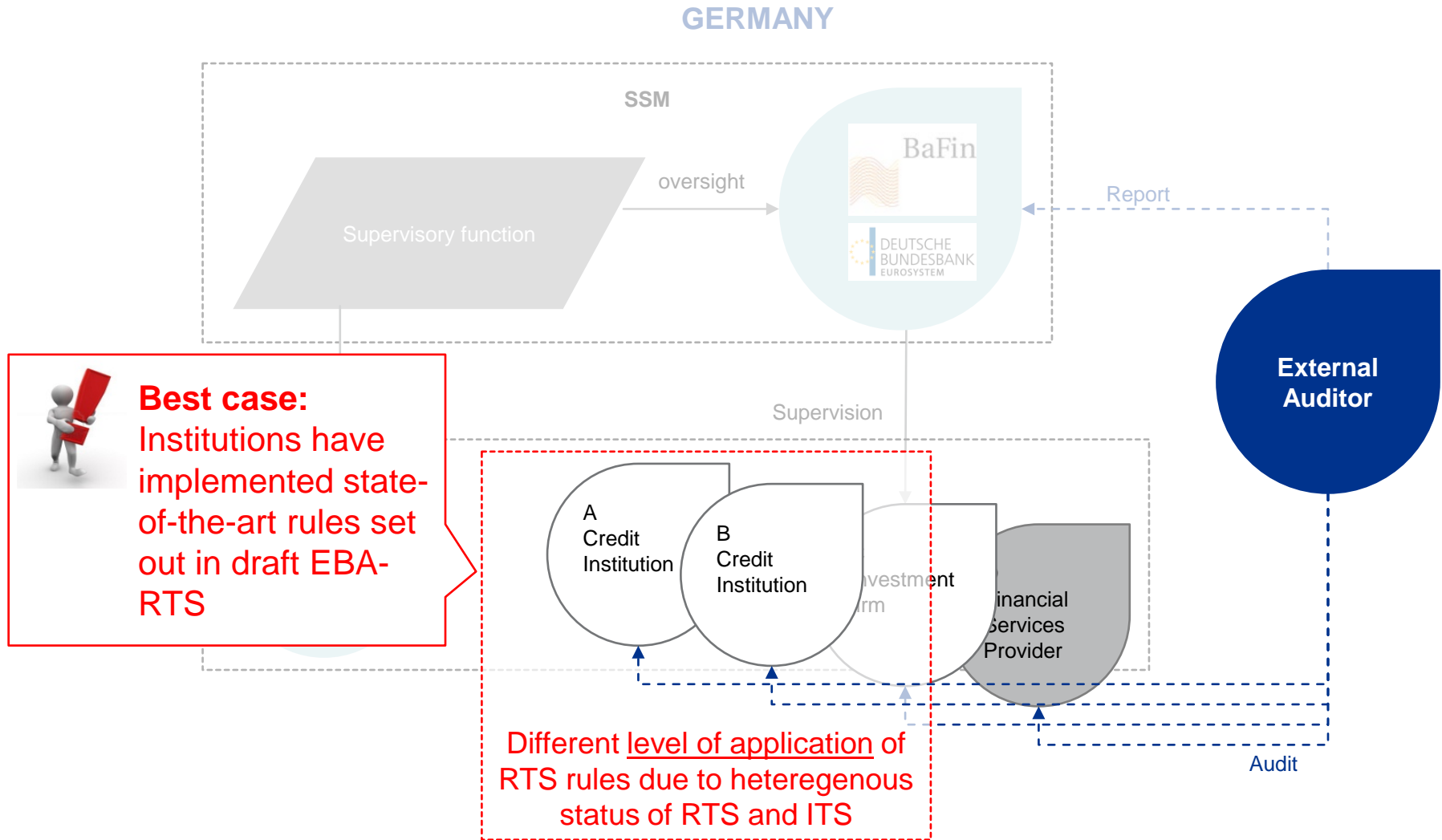
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The auditor's view

Different entities – different rules? (1)



Different entities – different rules? (2)



Effects, the SSM possibly has...

Positive

- Supervision of international organisation might become more feasible → e.g. supervisor knows German subsidiary and its foreign EU-mother
- Eventually harmonization of rules lowering benefits of EU-cross border regulatory arbitrage
- ...

Negative

- Implementation of convergence of rules and practical harmonization will take time.
- Conflict resolution among the three main supervisory bodies at play?
- Risk of heterogeneous approaches taking too long to converge with material burden on institutions AND the final auditor due to legal uncertainty.

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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