KPMG SSM Insights

kpmg.com/ecb

April 2023

Welcome to 2023's first edition of KPMG's SSM Insights Newsletter.

Last year, European banks experienced unprecedented levels of macroeconomic and geopolitical uncertainty due to the war in Ukraine, rapid inflation and increasing interest rates. Fast forward to 2023, and recent weeks have seen the after-effects of those shocks reverberating around the global banking sector. So far, isolated problems in the US and Switzerland show no immediate signs of spreading to the European Union, and European authorities are confident in banks' strength. Even so, there is no question that investor's confidence in the sector has been shaken. Interest rate risk in the banking book is a point of attention for all banks. Some analysts still point to reduced disposable incomes due to higher inflation rates and rising interest rates as well as other macroeconomic developments that lead to higher credit risks in the area of residential real estate as well as commercial real estate. On the back of these events, we are expecting more supervisory scrutiny for banks rather than less.

Amid such a challenging start to the year, the announcement of the ECB's supervisory priorities for the next three years is of critical importance. The priorities are largely unchanged, but the addition of funding risks and risk data aggregation as areas of focus is noteworthy.

February also saw the ECB publish the results of 2022's SREP assessments. The overall assessment was comparable to 2021, with average P2R increasing from 1.9 percent to 2 percent and average P2G remained steady at 1.3 percent. Despite the sector's strong capital and liquidity positions, the ECB highlighted several areas of concern including credit risk, risk data aggregation, digitalisation and climate risks. Risk data aggregation and reporting was identified as the weakest area of internal governance, and the ECB has already begun a programme of on-site inspections in this space. Recent weeks have also seen banks' submissions for the EU-wide stress tests whereby very severe stress test scenarios were published earlier this year.

The impact of recent market volatility, coupled with the uncertain economic outlook, suggest that European banks should expect unrelenting supervisory scrutiny during 2023. An awareness of the authorities' thinking is crucial to banks' ability to anticipate and prepare. We will continue to keep you up to date as the year progresses.

This edition of the newsletter takes a close look at several of the ECB's renewed priorities, together with other current areas of supervisory focus.

Henning Dankenbring

Partner, Head of
KPMG ECB Office

KPMG insights

Recent events highlight the importance for banks to effectively manage interest rate risk in the banking book (IRRBB) and funding and liquidity risks.

Latest perspectives and recommendations here: IRRBB and funding and liquidity risks

Latest Insights

BCBS 239

BCBS 239 principles were outlined by the ECB some time ago. However, according to the supervisor, progress has been underwhelming here and this is despite the intensity of supervisory pressure in the recent years. Banks will be subject to a campaign of OSIs in this space and should take the necessary steps to ensure there is the required level of focus and oversight.

Read more

Climate risk management

The ECB's intense and diverse methods of supervisory scrutiny of C&E in the last three years can feel somewhat of a pressure cooker for banks. All in all, as we move into springtime and European temperatures begin to rise once more, it is important that banks keep a cool head and focus on their journey towards the deadline of end of 2024 for full compliance.

Read more

2023 EU-wide stress test

Banks are working on the EU-wide stress test's submission deadlines in May and June. The macroeconomic scenario is the harshest we have seen; this, together with methodology changes, poses challenges for banks ranging from a lack of relevant historic comparatives to the need to for risk model adaptation. Banks should remember that further revisions are coming — future stress tests will rely less on bottom-up projections.

Read more

Non-performing loans (NPLs)

Last year's SREP identified some frequent areas of weakness in NPL management for banks to address. Disposals and write-downs are trimming NPL balances, but Stage 2 loans remain stubbornly high and macroeconomic challenges could soon accelerate new inflows. Portfolio sales are a key NPL management tool, but the data requirements of the EBA's NPL transaction data templates are likely to prove challenging for banks.

Read more

Credit risk management

Credit risk remains a major area of supervisory focus, with growing pressure on banks to address expectation gaps. The ECB will roll out a wide-ranging programme of activity in 2023, putting many banks under pressure. Devising a comprehensive remediation programme can help banks reassure supervisors and manage the workload.

Read more

Lombard loans

These personal loans to the wealthy, over-collateralized with liquid financial assets, are an ancient form of credit that has rarely attracted supervisory attention — until now. Banks view them as low risk, but the lack of individual creditworthiness assessments means that supervisors see them as failing to meet the EBA's guidelines on Loan Origination and Monitoring. Banks using Lombard Loans should prepare for closer scrutiny.

Read more

Basel 4 – Moving the dial series

Read KPMG's latest series to understand the regulatory expectations globally and the actions institutions may wish to consider in the immediate term as banks around the world prepare for the implementation.

Perspectives and insights here | **Visit the Basel 4 homepage**

Further KPMG ECB Office Insights

Find all our latest insights here and practical expertise to help you dealing with the ECB supervisory approach under the Single Supervisory Mechanism (SSM).

If your colleagues would like to receive KPMG SSM Insights, they can sign-up here

kpmg.com/ecb

Designed by CREATE | Date | CRT145764