



cutting through complexity

FINANCIAL SERVICES

# Creating a world class central bank

Central banking services

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KPMG INTERNATIONAL





# Best of the best

Central banks must evolve to keep pace with economic, technological and marketplace developments. Nowhere is this truer than in the world's high growth countries, which face a race against time to modernize as local economies expand rapidly.

Central banks are crucial to a nation's economic wellbeing, tasked with developing and implementing policy within its mandate, including monetary policy, currency and funds management. Many also regulate and supervise the commercial banking system and stand ready to act as a lender of last resort – a scenario all too familiar during the latest global financial crisis.

Although the range of responsibilities of central banks can differ widely between countries, all share a common goal of maintaining the highest possible standards, to preserve the stability of the economy and retain public trust.

In high growth markets, central banks also face a race against time to modernize, in order to keep pace with the rapid expansion of their national economies and the increasing sophistication of their financial services sectors.

KPMG's Central Banking practice engages actively with the world's central banks, helping formulate and implement strategies and improve performance.

## Case study

### Implementing major change

Following the global financial crisis, the central bank of a European nation was asked to deliver a broader mandate with more vigorous regulation. KPMG helped the central bank prioritize its objectives, and bring in new technology and business processes, along with appropriate governance. With this assistance, the bank revamped its technology function, introduced online returns and updated security policies, and set up a new, outsourced credit register. Our role in stress testing and loan assessment was vital in assessing commercial banks' capital requirements and collateral. In addition to improving its regulatory capabilities, the central bank has saved an estimated €10 million in annual operating costs.

### Seven major priorities for central banks

1. Governance, risk management and internal controls
2. Regulation, supervision and financial stability
3. Payment systems and oversight
4. Technology and processes, integrity and security
5. Outsourcing
6. International cooperation and currency unions
7. Accountability and transparency

# 01 Stepping up **governance, risk management** and **internal controls**

Good governance is not just a box-ticking exercise for central banks; it underpins the integrity and stability of a country's financial system.

Eager to avoid a repeat of the financial meltdown, the financial sector as a whole has had a big push on governance in recent years. As the standard bearers of quality, central banks need to visibly raise the bar in terms of independence, expertise and professionalism, not just as an example to other institutions but to ensure the smooth running of the wider economy. In addition to robust policies and systems, the governor and the executive and non-executive board members should possess exceptional skills and independence in order to manage and oversee the bank's activities.

Like any organization, central banks have to manage performance, approve budgets, use resources efficiently, and build strong teams with the right capabilities. They need clear reporting frameworks and benchmarking of performance against comparable institutions.

The public and other stakeholders expect full accountability and transparency, to uphold political independence, and demonstrate that central bank policies are contributing to lasting economic growth.

Not all central banks are yet equipped to meet such demands, while others are undergoing fundamental changes – such as increasing/decreasing their scope of responsibilities and introducing new organizational processes. This may call for new organizational design and policies, as well as training and recruitment to bring in new skills.

## How KPMG can help

Our member firm's banking professionals work with central banks of varying degrees of size and sophistication, to advance governance, risk management and overall operating standards, including:

- rethinking the organizational structure, including core processes and systems for banking activities and reserves management
- refining the operation of the audit committee, executive management or risk management roles
- assessing the quality of internal audit
- enhancing financial reporting processes and associated internal controls.

### Case study

#### Rehabilitating the national banking system

In a substantial exercise to value the assets and liabilities, KPMG assisted the central bank and two commercial banks in the country to recapitalize. We mobilized a cross-border team of specialists in valuations, real estate, insurance and accounting, whose work has underpinned discussions between international creditors, the Ministry of Finance and the central bank. The subsequent full recapitalization (via the conversion of uninsured deposits into shares in the commercial banks) has formed a vital part of the restructuring and rehabilitation of the national banking system.

# 02 Supervising stability and regulatory compliance

Since the financial crisis, central banks have been at the heart of discussions and new rules on regulating and supervising commercial banks.

Commercial banks face a huge increase in regulatory demands for liquidity, capital requirements, recovery and resolution planning and customer-centric operations. Not surprisingly, many struggle to cope with the organizational and cultural change and the associated reporting and data aggregation requirements.

Central banks often have regulatory and supervisory authority over financial institutions, to ensure they are safe and operating in a stable financial environment, to retain the trust of customers and the wider financial markets.

Central banks may assess which banks (if any) pose a risk to financial stability, and work more closely with these institutions. They also coordinate with central banks and financial supervisors of other countries when managing international financial crises and overseeing multinational groups.

Regulatory oversight has taken on new urgency in the wake of the global financial downturn, and central banks want to be confident that they can perform this task competently, spot systemic or institutional weaknesses and reassure financial markets.

The recent crisis starkly demonstrated the need for stability in the economy, the currency, the financial sector and within individual financial institutions. Through monetary policy and macro- and micro-supervision, central banks can steady the economic conditions. To achieve this, they may also have to redesign their internal processes and systems.

## How KPMG can help

KPMG's outstanding Regulatory Centers of Excellence offer telling insights into the implications of regulatory change and the direction of developments around the world, including Basel III, Solvency II, EU initiatives and the Dodd-Frank Act. This expertise is invaluable in:

- improving regulatory supervision, to ensure that commercial banks adapt their structure, conduct and culture, data and reporting, and risk governance
- providing up-to-date knowledge and understanding of regulatory changes around the world.

### Case study

#### Getting up to speed with Basel

Basel compliance is a critical objective for all commercial banks, and an emerging markets central bank asked KPMG to carry out a comprehensive training program for all the country's banks. We prepared and delivered country-specific training, covering necessary reforms, risk management and regulatory reports. Through a mix of classroom and breakaway sessions, the participants made huge progress ahead of a January 2014 deadline, giving far greater confidence in the banks' ability to meet the new standards.

# 03

## Overseeing payment systems

A national economy could be severely damaged if key processes such as money issuance and central payments systems fail to run smoothly.

Payments form the heart of the banking industry and contribute to an efficient means of exchanging goods and services. Any weaknesses can impact the stability of the national economy and reduce confidence in the overall financial system. A range of stakeholders are involved, including retail banks, major corporations and payment schemes. Strategic retail and wholesale payment infrastructures must adhere to recognized standards, with payments increasingly made in real-time. In addition to the national payment network, some central banks also oversee commercial banks' payment systems, although the level of oversight varies from country to country.

The flurry of new payment systems is taxing the abilities of even the most sophisticated central bankers, who must keep on top of a continual pipeline of innovations such as mobile phone-based payments (e.g. M-Pesa), peer-to-peer lending (e.g. Zopa), and digital currencies (e.g. Bitcoin).

## How KPMG can help

KPMG member firms have worked across global, regional and local markets to develop our understanding of the complexity of the payments industry. Firms have advised a number of central banks on their payments systems, with expertise in people and processes and, crucially, the ability to come up with sound technical solutions. With a strong track record in delivering real-time gross settlement (RTGS) systems solutions, our firms can help clients with:

- strategic advice and support, as well as business process reengineering and information technology (IT) solutions for new payment systems
- workshops and training on payment systems.

### Case study

#### A new era in payments

KPMG in the UK supported the UK banking industry through the successful launch of the UK Faster Payments Service, putting it at the forefront of the world's financial sectors. The biggest payments change in over two decades involved a huge, industry wide exercise requiring complex changes to the banks' systems. KPMG was contracted by the Association for Payments Clearing Services (APACS) and worked with 13 major banks, an infrastructure provider and payments scheme operator – with the Bank of England as an important stakeholder. KPMG brought transparency, clarity and discipline to the program, coordinating essential industry testing of end-to-end payments and ensuring participants were ready to process the high volumes of payments expected to go through the system. Our efforts made a significant impact in meeting the regulatory deadline.

# Optimizing **technology** and **processes**, protecting **integrity** and tightening up **security**

A central bank's IT systems are critical to the efficient functioning of the national economy.

Like all organizations, central banks are heavily reliant upon technology for operational continuity. A smooth, uninterrupted process gives the central bank, the government, and the wider population confidence that transactions – which are increasingly in real time – will proceed smoothly. Those central banks that oversee commercial banks' payment systems need to have the necessary skills, IT and reporting structures in place.

On an operational level, central banks' own IT systems must be efficient and reliable, to avoid any outages or breakdowns in data flow or reporting and preserve business continuity.

Some central banks manage much of their national currency operations, and may even have an extensive branch network, all of which requires highly efficient, cost-effective processes and tight security. Others choose to outsource some or all of these activities to commercial banks and security firms.

Given the highly sensitive nature of central bank activities, confidentiality and data security are paramount to avoid information leaks. Speculators could benefit unfairly from advance knowledge about interest rate changes, while details about failing commercial banks could spread unnecessary panic.

Any kind of negative incident could attract unwelcome publicity and undermine trust and confidence in the central bank, so management will be keen to develop strong defenses against external threats.

## How KPMG can help

In helping to develop a clear IT strategy that fully supports central banks' objectives, our firms focus on the economic and business impact of technology. With organizational continuity as a key objective, the main risks facing organizations are addressed. As trusted advisors to governments and industry around the world, KPMG member firms work to find creative and forward-thinking ways to address cyber security and enhance internal controls. This includes:

- project management, vendor selection and system testing
- establishing data center strategy
- carrying out business process reengineering and recommending new IT infrastructure and applications for existing and new payment systems
- carrying out IT security assessments
- evaluating and improving controls over insider trading, money laundering and procurement
- performing security checks on payment systems.



## Case study

### A step change in IT performance

Through our understanding of the unique challenges of IT in central banking, along with our commercial banking experience, KPMG was able to help a European central bank with a wide range of important programs. We worked on IT strategy (including infrastructure architecture), IT management (such as process optimization and IT compliance) and systems design. The central bank now has a far more comprehensive reporting and analysis capability, and greater confidence in managing the monetary infrastructure, with higher levels of resilience, continuity and security.

## Case study

### Transforming core banking services

Over 3 years, we worked closely with the central bank in one of the largest high growth markets to produce a step-change in efficiency, improving transaction processing, introducing real-time reporting, internet banking for customers and automated settlements, and enhancing liquidity management processes. KPMG's team led the business process reengineering, helped with tenders and subsequent vendor evaluation, contracts and service level agreements, and project managed the transition. The client now provides a far more effective core banking service to its stakeholders, with better funds flow.

# 05

## Reliable, efficient out- and in-sourcing

Whether outsourcing the management of entire portfolios or back office functions, any third parties must be rigorously assessed.

There is a growing trend among central banks to outsource business activities such as foreign reserves management or the collateralization of repo transactions. Conversely, some governments may also entrust the management of their foreign reserves or sovereign wealth funds to their national central banks.

In common with most organizations, back office functions such as Human Resources and IT can be outsourced to third parties.

Given their high profile and the confidential nature of information, central banks have to be comfortable with the reliability of any supplier, and perform thorough checks to ensure that third parties are reliable and secure.

## How KPMG can help

The KPMG network is one of the world's largest outsourcing advisors and has been ranked number one in the list of the world's best outsourcing advisors for the past 5 years by the International Association of Outsourcing Professionals. Our firms' proven sourcing and shared services methodology, which covers the entire sourcing life cycle and is fully independent, assists with:

- assessing which functions could be outsourced and identifying the main risks
- carrying out due diligence and other assurance checks on third-party providers
- preparing service level agreements (SLAs) and monitoring third-party performance.

### Case study

#### Transforming the operating model

The bank had suffered considerable duplication of efforts, along with high operating costs and low staff productivity. Through the application of lean principles, along with rigorous benchmarking against similar organizations, KPMG helped to transform the operations. Together we defined the core functions and outsourced non-core activities to shared service providers, producing a significant improvement in efficiency, along with lower costs and staffing levels.



# 06 International cooperation and currency unions

Currency unions cannot function without harmonized rules and systems.

As free trade zones proliferate in various regions around the world, a number of currency unions have been formed or are under discussion in Europe, Africa, Asia, the Gulf, Latin America and the Caribbean. Additionally, many countries already peg their currencies (formally or informally) to the US dollar, the euro or other currencies.

An effective currency union requires common standards, operations and procedures.

## How KPMG can help

- developing harmonized standards across a zone
- implementing common processes and systems.

### Case study

#### Currency union

In this major, region-wide currency union, KPMG advised on creating harmonized accounting rules across the zone. We also helped two central banks with designing and testing their accounting systems including building one of those systems. All of this took place under tight time pressure with an immovable deadline, and our international perspective and banking network came to the fore to help the clients achieve their goals and be fully ready for the new currency.



# 07

## Accountability and transparency through external audit services

Central banks have specialized auditing requirements that call for a high level of technical expertise.

High quality, external financial reporting is a vital tool to help central banks demonstrate their accountability and transparency. Audited financial statements – prepared in accordance with recognized standards – can show the market, external organizations (such as the IMF) and the public how a central bank’s activities and policies are impacting the national and international environments.

### How KPMG can help

KPMG’s network of member firms has extensive experience in providing external audit services to central banks around the world. Member firm professionals combine the experience required to audit a central bank with significant technical know-how in International Financial Reporting Standards (IFRS), the Eurosystem Accounting Guidelines and other recognized standards. Member firm services can increase the value of the external audit including:

- helping prepare financial statements for the external audit (e.g. when the audit is performed by the government auditor)
- technical accounting assistance with complex matters
- assistance with reporting to other organizations such as the IMF.

KPMG firms currently audits or have audited (in the last 3 years) many central banks in the world’s largest economies and has extensive experience in emerging markets. External audit clients include:

- Reserve Bank of Australia
- Banco Central do Brasil
- Bank of Canada
- Bank of England
- Banco de España
- Banque de France
- Bank of Israel
- Bank of Korea
- Qatar Central Bank



# KPMG's Central Banking practice

KPMG's Global Central Banking practice brings together knowledge and experience from KPMG member firms around the world to help central banks deal with their unique challenges.

The practice has a wealth of industry experience and specialist knowledge, tapping into a global network of over 34,000 financial services professionals that offer operational and strategic advice and support. With audit, tax and advisory services, we have worked with central banks in mature and emerging economies, and have close relationships with many of the major market players, regulators and leading industry bodies. Member firm specialists engage closely with central banks around the world, advising them and providing input on key strategic challenges. In addition, the practice's advisory group regularly considers emerging issues and studies central bank accounting practices through benchmarking studies and other thought leadership publications.

KPMG's Regulatory Centers of Excellence help drive and shape the latest regulatory developments and provide cutting-edge advice and support in supervising compliance. For central banks in fast growing economies, our Financial Services High Growth Markets network champions new innovations, and coaches and challenges financial institutions and their regulators on strategies and operations.

## Relevant KPMG publications



*Evolving Banking Regulation*  
**January 2014**



*Frontiers in Finance magazine*  
**April 2014**



*Current trends in central bank reporting practices*  
**October 2012**



*High Growth Markets magazine*  
**December 2013**



*Payments Transformation*  
**November 2012**



*Central bank accountability and transparency*  
**October 2009**

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