

Abstract

The client was required to undertake its first formal internal capital adequacy assessment process (ICAAP), required by Pillar 2 of the Basel Framework. Advantage Reply was engaged to assist with structuring and executing the ICAAP, by utilising its extensive experience in preparing formal ICAAP submissions for many banks and investment firms. In addition to assisting the client in submitting a credible ICAAP report in good time, Advantage Reply also provided detailed practical recommendations for future improvements.



Internal Capital Adequacy Assessment

THE CLIENT

The client is a significant subsidiary of a large European commercial and consumer bank domiciled in a second European country. The subsidiary has corporate banking, private banking and specialized trading businesses in several locations outside the parent's country of incorporation.

THE CHALLENGE

Avantage Reply was asked to help with structuring and executing the subsidiary's first formal internal capital adequacy assessment process (ICAAP), which was undertaken in fulfilment of the local regulator's requirements under Pillar 2 of the Basel Framework.

Regulated institutions are required to carry out an ICAAP at least annually. They must assess their risk profile, and establish a link between this profile and their internal view of current and future capital adequacy. The firm's strategy for capital adequacy has to take account of base-case planning assumptions, but also alternative stress scenarios to which the firm may be exposed. The institution must look beyond the cardinal Pillar 1 risks - market, credit and operational risk - and form a comprehensive view of all of the institution's risk exposures. With its extensive experience in helping many banks and investment firms to implement Pillar 2 and prepare formal ICAAP submissions, in the UK and throughout Benelux, Avantage Reply was approached by the subsidiary's senior risk manager to help plan, implement and document the assessment process.

APPROACH AND SOLUTION

Two Avantage Reply consultants worked on site with the client's risk control department and with general management. They gathered information on the Bank's risk profile and its risk and capital management processes by document review and through extensive interviews with Bank staff in the relevant departments, both locally and at head office.

Making use of Avantage Reply's proprietary IRPM tool, the consultants reviewed and benchmarked the organisation's risk and capital management disciplines, methodologies and tools. They considered both the sophistication of group methodologies as well as the degree to which these methods were properly implemented and embedded in the business locally.

The first output from Avantage Reply was a gap analysis and diagnostic, including peer comparison, coupled with detailed practical recommendations for the current

ICAAP cycle and for the longer term. The emphasis was on pragmatic steps, avoiding over-delivery, while helping the client to identify and provide transparency to the regulator on areas for future improvement, and on its planning for the future. The situation of the subsidiary, combining dependencies on the parent company for policies, methodologies and tooling, with the equally important local accountability of the subsidiary's management, was properly and proportionately taken into account. The recommendations were presented to senior managers and responsible Board members, and were endorsed by them. Advantage Reply's consultants then provided input on how to structure and present the ICAAP findings in a formal submission to the regulator, drawing on previous experience with the local regulatory authority and with other EU-based regulators.

RESULTS AND BENEFITS

The subsidiary completed its capital adequacy assessment and submitted a credible ICAAP report in good time, and ahead of the parent Group's own ICAAP, providing a useful pilot for the parent. Longer term recommendations were taken on board, and dialogue was initiated between subsidiary and Group on enhancing some of its stress testing and reporting capabilities in order to take the subsidiary's special circumstances into account.

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