

ICAAP

Getting the most out of your firm-wide Risk Management

Developing an effective ICAAP
May 2011

If there is one thing that the recent financial crisis has highlighted, it is the importance of a Risk Management framework which is able to deal with risk types beyond those included within Basel II Pillar 1, i.e. Credit, Market and Operational risks. In the light of the Pillar 2 requirements, financial institutions and investment firms are obliged to strengthen their firm-wide Risk Management to foster the development of a robust risk and capital management process.



The challenges

- The ICAAP is by nature forward-looking. Basel III and a wide new range of regulatory expectations are coming up. Have you considered their far-reaching impacts?
- The ICAAP process represents a significant opportunity to introduce substantial changes in the definition of risk appetite, tolerance and strategy by taking advantage of the new regulatory requirements.
- Although some institutions at first considered their ICAAP as a regulatory compliance exercise, they now leverage on Pillar 2 to strengthen and to promote the full integration of risk, liquidity and capital management within strategic planning and business operations.
- Sound identification and quantification of all material risks, allowing the determination of an economic capital measurement consistent with the institution's risk profile and offering protection to the institution's own funds.
- A correct attribution of roles and responsibilities to different process owners fosters the consciousness that the ICAAP process involves the whole structure of the institution.

The Internal Capital Adequacy Assessment Process (ICAAP) is a system of forward-looking strategies and processes that shall reflect all the risks an institution is or could be exposed to in order to ensure internal capital and liquidity adequacy on an ongoing basis. All financial institutions and investment firms incorporated under Luxembourg Law have to comply with CSSF Circulars 07/301, 08/338, 09/403 and the recent 11/506 on ICAAP.

PwC's ICAAP Health Check for Banks and Investment Firms

PwC has developed a tailored ICAAP Health Check for Banks and Investment Firms targeting ten key areas:

1. In-depth analysis of your existing ICAAP report(s).
2. Challenge of your definition of roles and responsibilities of a.o. Board of Directors, Authorised Management, as well as Audit, Compliance, Internal Control and Risk Management functions.
3. Refine and/or challenge of your definition of a risk strategy, appetite and tolerance, in line with any potential group guidelines.
4. Optimisation of your internal risk-based capital management process, enabling you to link your own funds to the firm's global risk profile.
5. Reassessment of all material risks, through measurement, management and mitigation, to which your institution is or might be exposed to (exhaustiveness principle).
6. Control of documentation and evidences to verify if all the instruments (policies, procedures, reporting) ensure strong communication across the structure.
7. Of particular importance – and this has recently been reinforced by CSSF Circular 11/506 – is the optimisation of stress test scenarios to assess the impact of extreme events that have to be taken into account to determine an adequate measure of internal capital (notably for CSSF Circulars 08/338 on interest rates, 09/403 on liquidity and the current focus of regulators on this topic). PwC has developed a tailored Liquidity Health Check to specifically address this often neglected risk and the compliance with the related BCL & CSSF regulations.
8. Compliance with CSSF special provisions regarding some specific risk types, like concentration risk, interest rate risk arising from non-trading activities or risks linked to wealth management activities.
9. Analysis of the robustness of risk, liquidity and capital governance frameworks.
10. Follow-up of the project implementation, support to Top and Senior Management in the respect of the provisions of Board of Directors.

What are the deliverables?

Our team of experts will meet key representatives of your firm and will analyse your business processes, policies, procedures and documents in order to provide you with:

- A diagnostic, through a status report gathering findings with a severity rating;
- A list of recommendations, related to the findings considered as a pool or on a stand-alone basis;
- An action plan, specifying necessary measures, following a priority table.

Our approach

Our approach is based on four distinctive steps:

Step 1

Diagnostic of ICAAP process

- Analysis of the current ICAAP report set up, risk and capital management framework;
- Identification, where applicable, of the findings, characterised by a severity level, with regulation provisions.

Step 2

Issuance of recommendations

- For each identified finding, proposition of recommendations to align institution's processes and procedures with best practices;
- Definition of the priority degree for each and every recommendation.

Step 3

Elaboration of an action plan

- Definition of suitable time schedule to fill out the identified gaps;
- Validation of key milestones for the implementation of each dedicated task.

Step 4

Assistance to the implementation

- Support in defining appropriate methodologies to calculate internal capital adequacy;
- Assistance to the (Authorised) Management in the proper execution of recommendations.

Selected credentials:

- **Luxembourg subsidiary of a major multinational private bank:** whole design and implementation of an ICAAP framework, including liquidity risk management.
- **North-American commercial bank:** upgrade of an existing ICAAP, implementation of a full size liquidity framework from scratch.
- **Medium-size German investment firm:** review and challenge of ICAAP processes.
- **European investment bank:** whole design and implementation of an ICAAP framework.
- **Luxembourg subsidiary of a Swiss private bank:** design, implementation and yearly update of an ICAAP framework.

Why PwC Luxembourg?

PwC Luxembourg (www.pwc.com/lu) has about 2000 professionals from 53 different countries. PwC firms provide industry-focused assurance, tax and advisory services to enhance value for their clients. More than 161,000 people in 154 countries in firms across the PwC network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

To get started, call

Thierry López Risk Management Services Leader	+352 49 48 48 4141	thierry.lopez@lu.pwc.com
Jean-Philippe Maes Manager	+352 49 48 48 2874	jean-philippe.maes@lu.pwc.com
Benjamin Gauthier Manager	+352 49 48 48 4137	b.gauthier@lu.pwc.com
Dirk Kruse Manager	+352 49 48 48 4102	dirk.kruse@lu.pwc.com

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