Navigating regulatory change in financial institutions

KPMG Financial Risk Management
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Regulatory and Business Context

Basel III reforms for both Deposit Taking Institutions and their Financial Holding Companies introduce increased granularity and require accounting for additional risks in the Capital Adequacy Framework.

The implementation framework includes Pillar II reporting which require Financial Institutions to have a robust Internal Capital Adequacy Assessment Process (“ICAAP”) which will require evaluating capital adequacy using a comprehensive assessment of risks as well as developing a capital maintenance strategy subject to supervisory evaluation and review.

Supervisory Review will involve Central Bank evaluating ICAAP documentation, Bank’s risk management and controls and the integration of ICAAP within the decision making process of institutions. Process will likely involve Regulator meetings with Senior Management and Board to understand ICAAP process and the quantification of risks.

Based on the regulatory and business context, it is essential for Financial Institutions to able to meet regulatory requirements by developing a robust Capital Planning and Stress Testing Framework and Capital Recovery & Resolution Plan.

KPMG is firmly positioned to assist you in a range of capital management services including regulatory reporting compliance, capital forecasting and stress testing and capital recovery and resolution plans.

We are amongst the leading professional services firms around the world, providing services to clients in various industries and sectors of the economy, including the Banking and Financial Services sector,
Capital Adequacy Framework

Capital Ratios

- Tier 1 & 2 Capital
- Capital Conservation Buffer & Countercyclical Conservation Buffer
- D-SIB Requirement (if applicable)
- Pillar II ICAAP Residual Capital Requirements

As a % of

Risk Weighted Assets

- Operational Risk RWA
- Market Risk RWA
- Credit Risk RWA

Application at level Bank & Consolidated Financial Holding Company
## Implications of Changes to Capital Adequacy Framework

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<th>Impact on Capital Requirements</th>
<th>Increased Operational Complexity in Regulatory Reporting</th>
<th>Increased Focus on Capital Optimization &amp; Forecasting</th>
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<td>Quantitative Impact Study required to understand possible long term capital impacts</td>
<td>More granular data required on multiple risk element assessment and quantification of risks.</td>
<td>Capital Planning and Forecasting crucial as part of performance planning and budgeting exercises.</td>
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<td>Action plans required to re-align business where additional capital is required.</td>
<td>Range of rules and criteria will require robust frameworks and controls to ensure accurate reporting.</td>
<td>Stress Testing Exercises required to evaluate risk capacity and as part of evaluation of capital allocation options.</td>
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<td>Capital Recovery and Resolution Planning will take on increased importance as capital headroom tightens.</td>
<td>Need for automation and rule based templates for reporting to ensure timely and accurate submissions.</td>
<td>Implementation of Risk Adjusted Return on Capital (RAROC) and Risk Based Pricing becomes crucial in order to optimize performance.</td>
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How can KPMG help?

Regulatory Capital Reporting Support

- Rules based templates that incorporate input data and output accurate regulatory calculations.
- Validation of returns calculations.
- Assisting clients in responding to regulatory requests.

ICAAP and Stress Testing Analysis

- Assist in development and validation of Internal Capital Adequacy Assessment Process submissions to Regulatory Authorities.
- Development of Stress Testing scenarios to reflect Base, Adverse and Reverse Stress Test Scenarios.
- Assist in assessing the Impact of stress testing on capital position, RWAs (credit, market, operational) and IFRS 9 provisions.
- Impact on liquidity, and regulatory liquidity ratios.

Capital Recovery and Resolution Planning

- Using stress scenario results to inform recovery actions including reverse stress testing scenario results.
- Identify criteria for Early Warning Indicators and Triggers for activation of resolution options.
- Advise on development of Playbooks that offer implementation guidance for crisis response.

Implementation of RAROC & Risk Based Pricing

- Assisting clients in measurement of Risk Adjusted Return on Capital (RAROC) to evaluate performance.
- Advise on methodologies and best practices to implement Risk Based pricing.
We tailor our approach as depicted above, to satisfy your needs.
# Best Practices in Capital Recovery Planning

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<th>Scenario Development</th>
<th>Identification of Recovery Options</th>
<th>Identification of Warning Indicators &amp; Triggers</th>
<th>Documentation of Recovery Plan</th>
<th>Dry Runs and Table Top Exercises</th>
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<td>Severe scenarios that take the Financial Institution to a near default status (use Reverse Stress Testing from ICAAP as a starting point).</td>
<td>Identification of recovery actions for each of the stress scenarios form the core of the Recovery and Resolution Plan.</td>
<td>FI should develop a crisis identification mechanism that signified identification of various stages of a crisis and activation of Recovery Plan options as needed.</td>
<td>Develop Capital Recovery Plan Document that outlines how the entity would manage a crisis and the recovery options it has formulated.</td>
<td>Development of Playbook that outlines implementation plan and key risk areas during implementation of resolution actions.</td>
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<td>Scenarios based on the events and factors most relevant to the Bank.</td>
<td>FI must identify a menu of actions and strategies to maintain financial soundness in a stress situation.</td>
<td>Early Warning Indicators should be defined that allow FI to either prepare or prevent need for Capital Recovery event.</td>
<td>Provide details of analysis to support scenario outcomes and recovery options. Analysis should ensure that credibility of recovery plan can be defended.</td>
<td>Implement dry run simulation exercise that evaluated ability of FI to be able to execute capital recovery plan in order to train staff and identify areas for improvement.</td>
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<td>Ensure granularity in output of scenario analysis that allows sufficient recovery actions to be formulated.</td>
<td>Strategies identified should be specific e.g. new capital issuance or debt raising, dividend policy adjustments, disposals or business adjustments</td>
<td>Specific Quantitative Capital and Liquidity Triggers should be identified and linked to various Recovery actions.</td>
<td>Outline governance over recovery planning and outline plans for testing and review of plans.</td>
<td>Review capital recovery plan based on dry run results in order to ensure a robust framework exists to respond to crisis.</td>
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A process that is continuously analyzed and reviewed to ensure plan is in line with current risk profile.
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