



# AFGAP & ALMA Conference 2008

**Pillar 2 : changing perceptions**

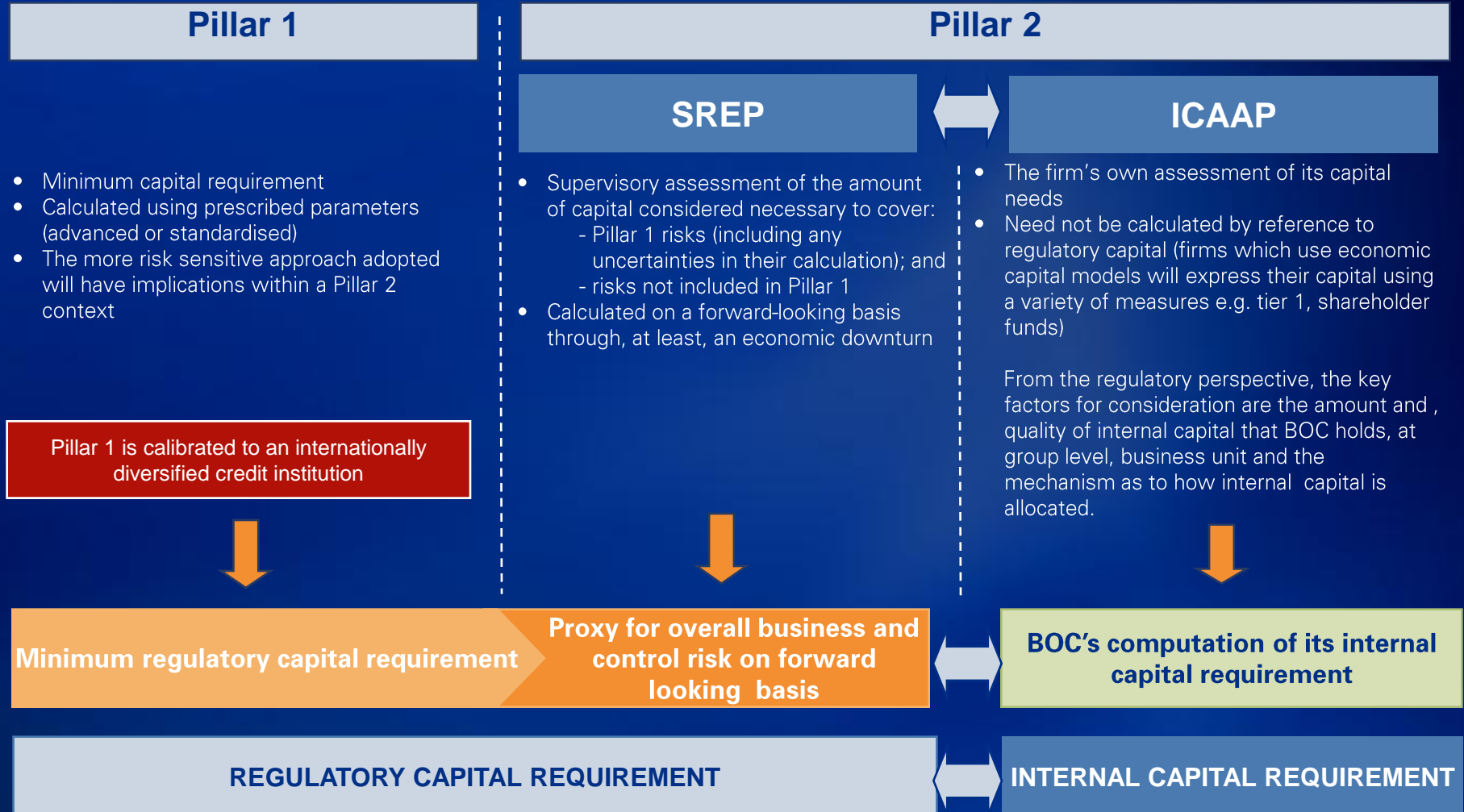
**30 May 2008**

# Agenda

## Pillar 2

- a quick recap
- shifting emphasis
- ICAAP shortcomings
- integrating business, risk and capital/liquidity management
- and don't forget liquidity

# A quick recap



# Or, put another way...



# Shifting emphasis

## *The purpose of the ICAAP*

- *From the firm's perspective:*

Provides the Board with assurance that on an ongoing basis

- the firm's risk management framework properly identifies, quantifies, manages, controls, and reports material risks facing the firm; and
- the level of financial resources held is adequate for those material risks, both current and projected.

- *From a regulatory perspective:*

- provides the regulator with assurance (or not!) regarding the firm's understanding of risk, their Risk Management Framework, and their risk contingency plans (management actions and regulatory capital/liquidity).

# Common (as identified by the FSA) ICAAP shortcomings

## (i) Poorly expressed risk appetites

Firms are expected to have a full understanding of risk appetite and capacity ie:

- A clear articulation of the willingness to take on risk (i.e. risk appetite) given its ability to take on risk (i.e. risk capacity).
- Clearly defined, prudent policies and statements of risk appetite and risk limits in place to manage an organisation's significant risks from all sources.

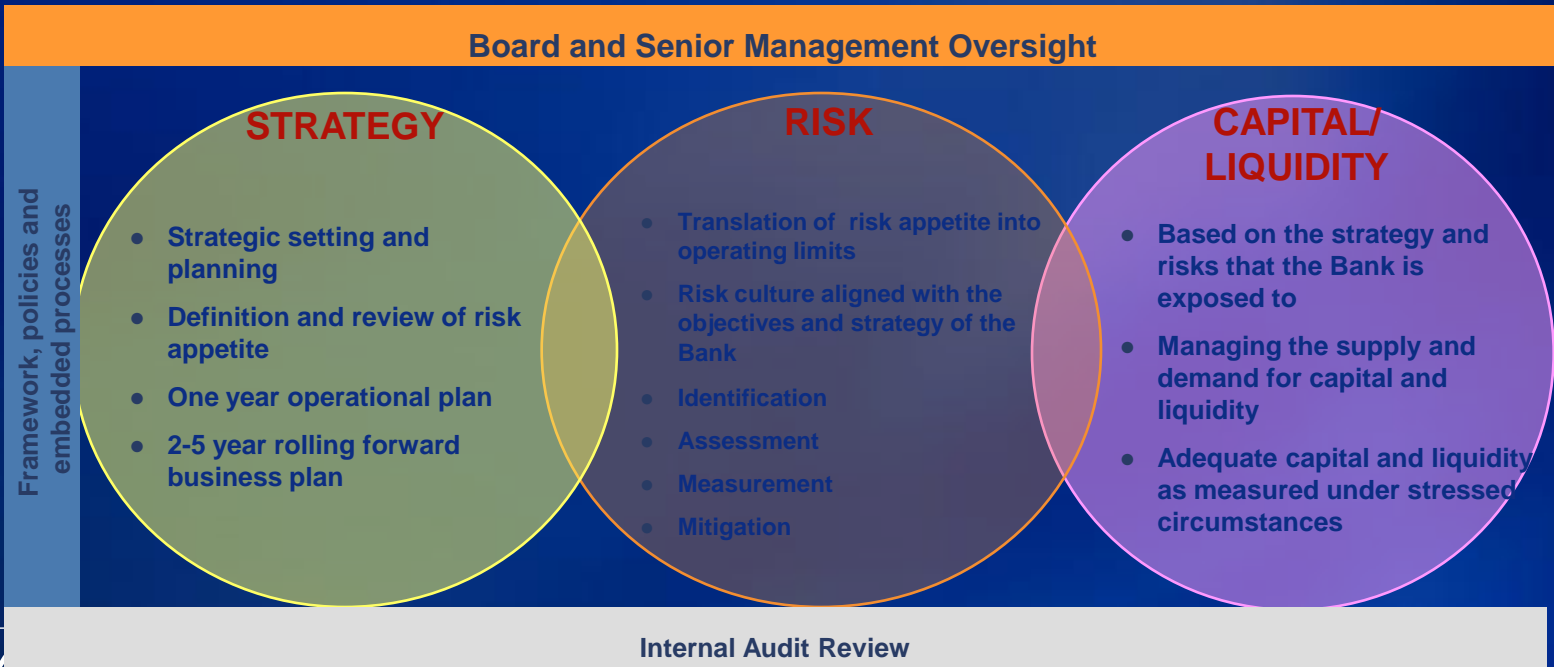
## (i) Inadequate explanations of risk management frameworks, viz:

- Risk Identification - documentation of processes for identifying the firm's business' and ALL potential risk exposures.
- Demonstrating sufficient independent challenge to validate the identification of risks.
- Risk Quantification - a logical/transparent approach to risk quantification.

# INTEGRATING BUSINESS, RISK AND CAPITAL/LIQUIDITY MANAGEMENT - WHAT FUTURE STATE SHOULD BE

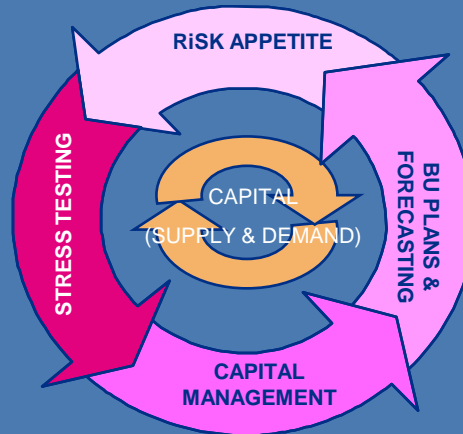
- A framework which fully integrates and assists the coordination of business planning, the determination of associated risks, and the capital and funding implications.
  - The framework must be capable of demonstrating sufficiency of financial resources under stressed conditions and over an appropriate forward time horizon.
- The practical effect is:
- All key business decisions will be assessed against risk, capital and liquidity consideration.

## Governance, oversight and operating framework



# WHAT DOES INTEGRATION LOOK LIKE?

- Business profile expressed in clear risk terms
- Business strategy clearly articulated
- Risk appetite translated into meaningful operating limits



- Strategy formulation and risk appetite fully integrated with the management of the business risks and financial resources
- Rigorous framework for stress testing and scenario analysis which ensures that business strategy/risk appetite is adjusted to ongoing market conditions

**A shared philosophy, and common understanding of business and risk management objectives, across the organisation - driven by a strong top-down management culture**

# Don't forget! Pillar 2 covers both liquidity & capital

- **Most supervisory authorities do not expect capital to be routinely held against liquidity risk**
- **However, they do expect to see within Pillar 2:**
  - **A robust framework for liquidity planning and management**
  - **Liquidity maintained for stressed conditions**
  - **The maintenance of resilient contingency funding plans**
- **Regulatory requirements – have tended in the past to concentrate on the very short-end “survival period” of one week/one month**
- **In the light of events since last summer regulators will redefine the length of the survival period and how this is tested (for stressed conditions )**
- **In the UK the interim approach looks to be measuring how long a firm can meet its obligations assuming withdrawal of retail deposits and non-renewal of wholesale placements – it is understood that this run-rate is being benchmarked against a 13-week period**

# Immediate implications



**Short-term liquidity is just the tip of the iceberg!**

**So, at the very least:**

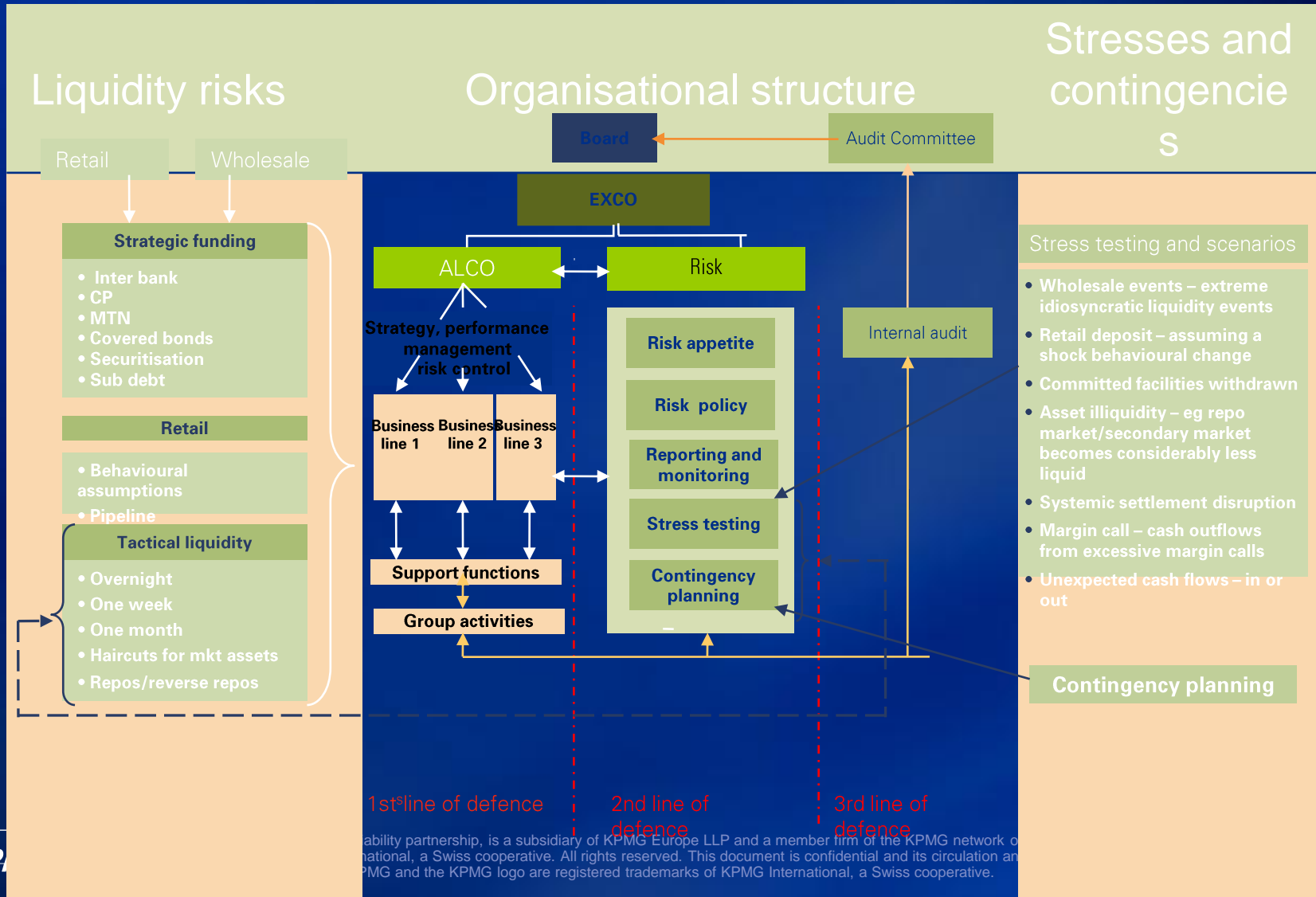
- ensure that tactical management of liquidity is fully integrated with management of strategic funding

**this usually comes together at the level of the ALCO**

**And**

- ensure that liquidity management and planning is fully aligned with strategy setting/ business planning

# LIQUIDITY RISK MANAGEMENT – our idea of the ideal state





## Presenter's contact details

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