



Grant Thornton

An instinct for growth™

Capital, Liquidity, Recovery and Resolution Plans

Helping you manage your SREP framework



The regulatory back drop

Since the credit crisis, governments, regulators, shareholders and the media have placed increasing pressure on financial sector boards to evaluate their institution's financial resilience.

In particular, capital and liquidity survival strategies are now crucial and the capture mechanism for such analyses is presented in key regulatory documents, namely the Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP) and Recovery and Resolution Plans (RRP).

- The heightened scrutiny around ICAAPs, ILAAPs, and RRP, together with the constantly changing regulatory requirements, create challenges for firms who must ensure their planning processes and documentation are up to date and in compliance with the latest rules. Senior management have to remain fully engaged to ensure alignment of capital and liquidity strategy to operating models – to achieve optimal use of the firm's financial resources, and to satisfy ever more demanding regulatory expectations.
- Each document enables boards and regulators to stress an organisation's business strategy under varying scenarios by probing and testing for capital and liquidity weaknesses, culminating in a set of mitigating options that can be deployed ahead of projected market turbulence.
- Projecting an institution's ability to survive under a number of forward looking stress scenarios requires a deep working knowledge of the organisation's DNA. The discipline and insight this provides boards, and in particular nonexecutive directors, allows for more challenging and constructive conversations when linking proposed strategy initiatives with the risk capacity of the organisation.
- Reverse stress tests are also considered and are designed to push the enterprise to breaking point and beyond. Driving the entity to the edge of survival through the reverse stress test process provides another lens through which boards rarely view their organisation and this can crystallise issues not necessarily considered in the normal course of strategy planning.
- Regulators have mandated that these documents shall be updated annually, or whenever the business profile of the organisation changes materially.

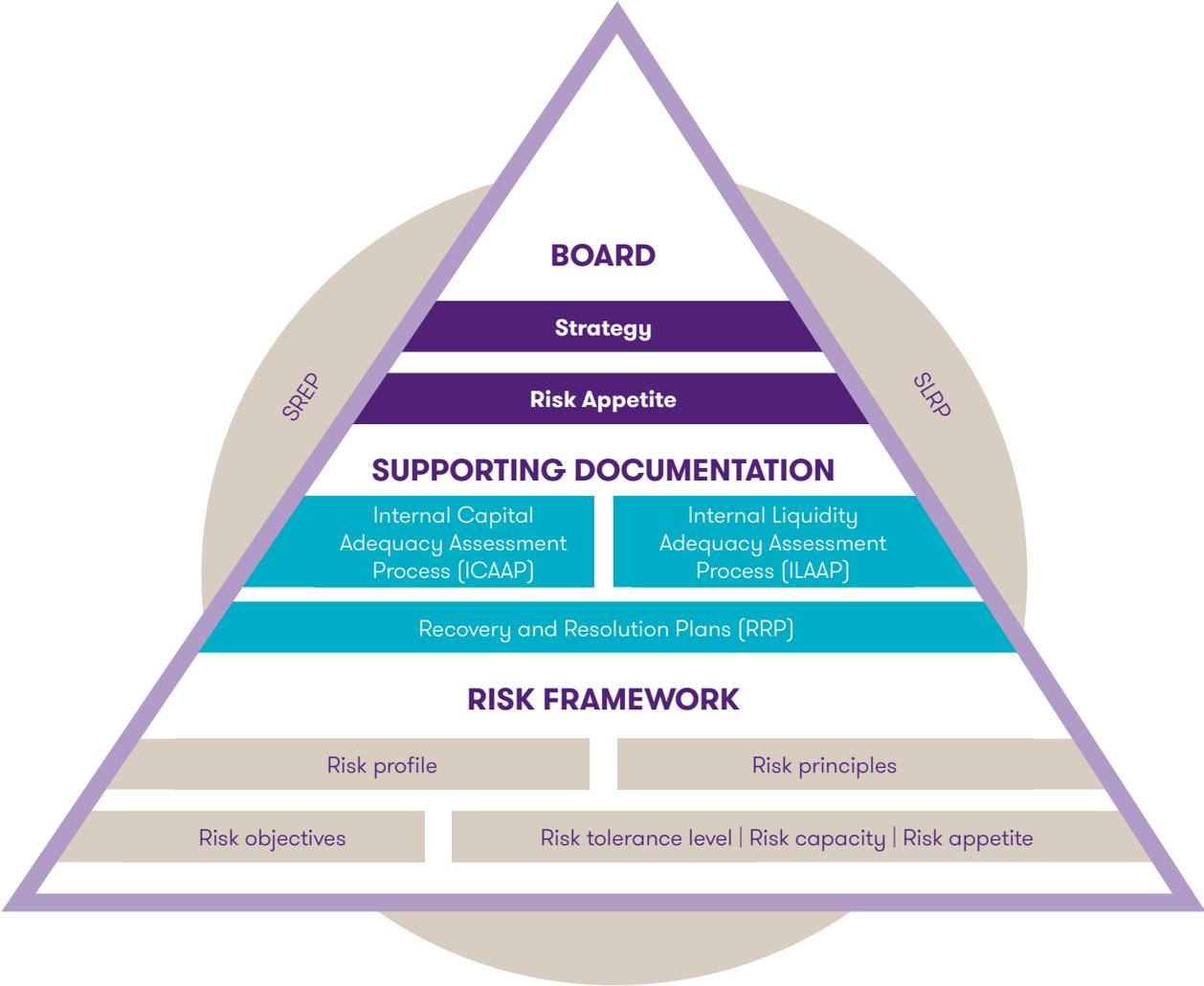


The regulatory risk frameworks

The ICAAP, ILAAP and RRP

As part of the PRA / FCA’s Supervisory Review and Evaluation Process (SREP) and the Supervisory Liquidity Review Process (SLRP), competent authorities will assess the firm’s business strategy, risk framework, ICAAPs, ILAAPs and RRP to assess the overall viability of the organisation and management’s articulation of the risk framework, and the adequacy of capital and liquidity to support the firm’s risk and business strategy.

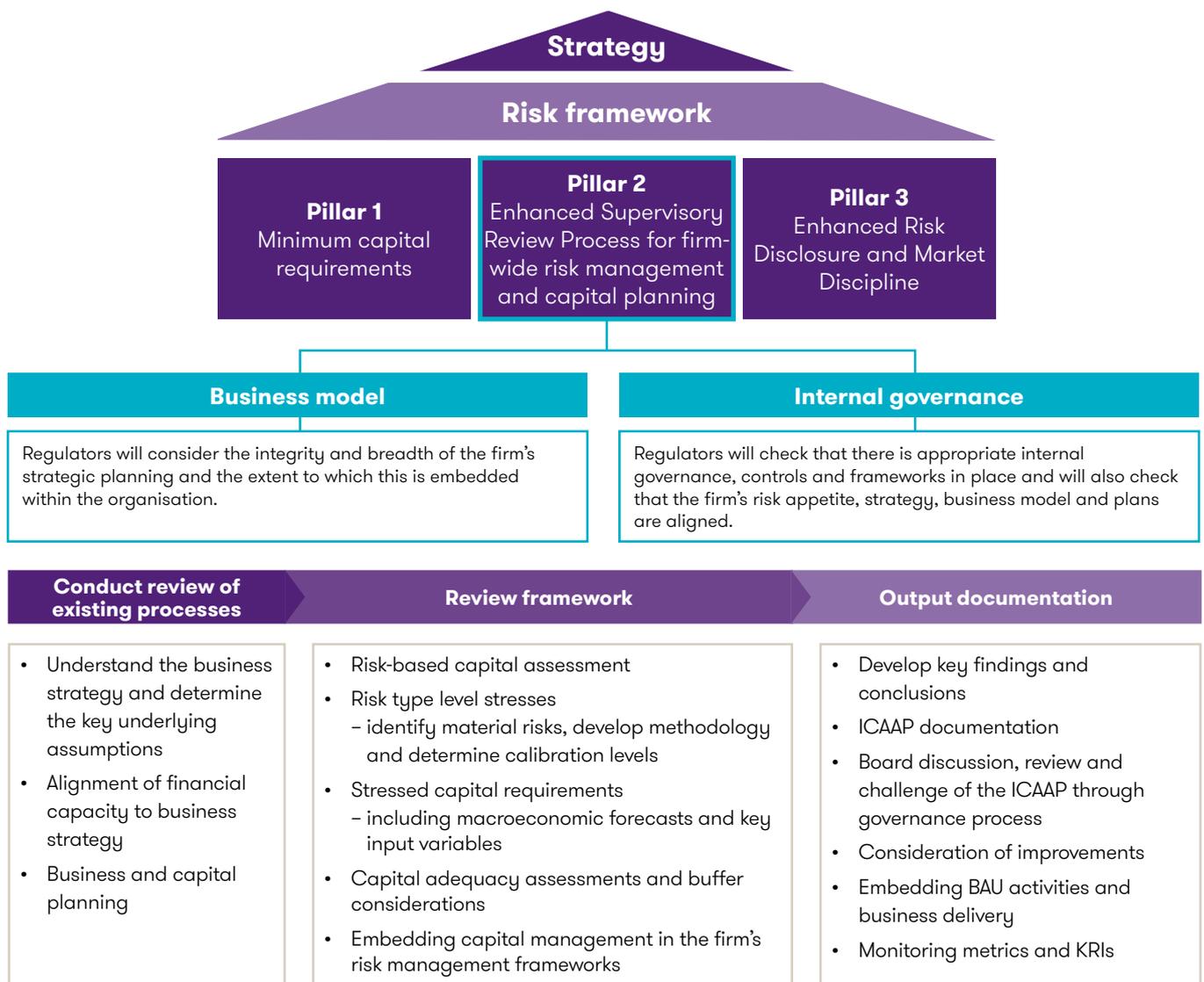
Boards (including NEDs) and executive committees will need to have a pragmatic understanding of potential financial headwinds and capture these in mitigation plans which should then be embedded in any business strategy discussion.



Internal Capital Adequacy Assessment Process (ICAAP)

Adequate capital buffers are required for weathering extreme events and therefore it is of vital importance that banks and investment firms demonstrate business models that are resilient to stressed scenarios.

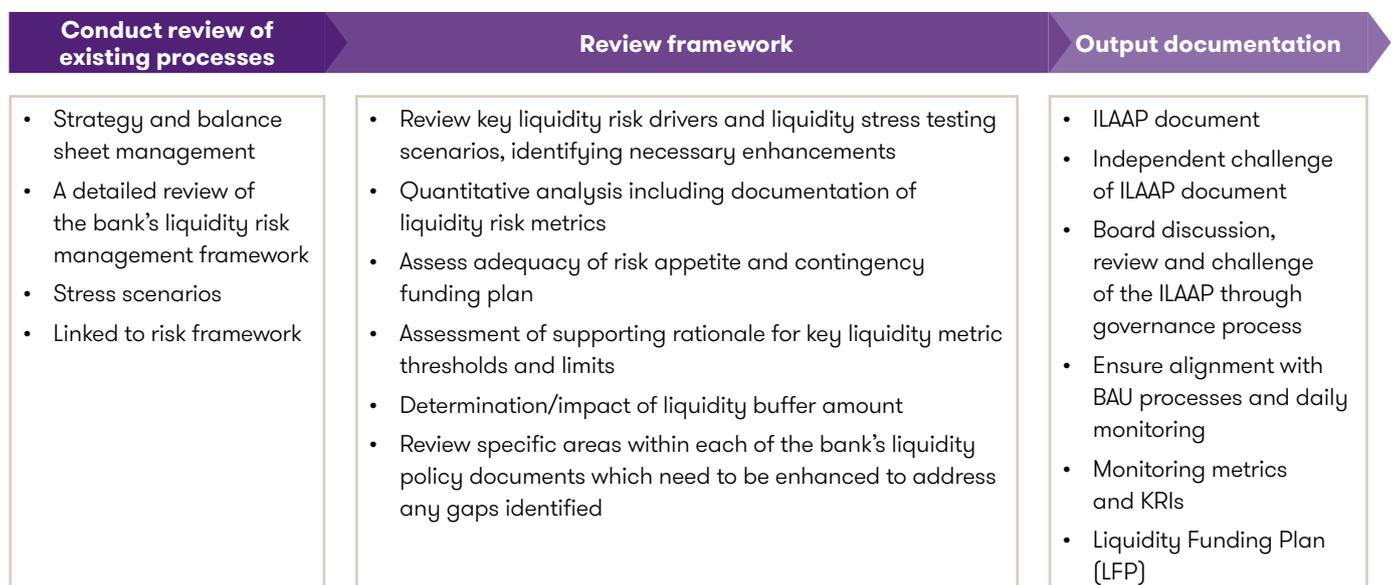
By now, most financial firms comprehend the basic principles of an ICAAP, ie how to encapsulate the capital plan in a document which can be understood, challenged and ultimately approved by the board before final submission to the regulator. Through the SREP, however, the regulator will now visit the firm and review the ICAAP in more detail, through discussions with the Board (including NEDs), to assess management’s understanding of the ICAAP and conclusions drawn from it.



Internal Liquidity Adequacy Assessment Process (ILAAP)

The ILAAP follows a similar structure to that of the ICAAP and the board is expected to understand all the complexities involved in managing the organisation’s particular liquidity profile.

- The ILAAP rules require firms to identify, measure, manage and monitor liquidity and funding risks across different time horizons and stress scenarios.
- Regulatory rules must be consistent with the risk appetite established by the firm’s board, thus ensuring that liabilities can be met in both normal and stressed scenarios.
- Liquidity Coverage Ratio (LCR) and The Net Stable Funding Ratio (NSFR) are key measurement criteria that drive liquidity profile.
- Buffers can be applied by the regulators based on the assessment of quality, thoroughness and management’s understanding of their liquidity management and risk profile.



Recovery and Resolution Plans (RRP)

As regulators come to terms with the survival options of an institution, recovery and resolution plans have attained the same importance as capital and liquidity management.

The Bank of England has published statements laying out guidelines on the minimum list of qualitative and quantitative recovery plan indicators and data collation requirements.

What is a Recovery Plan?

- A recovery plan sets out the menu of actions a firm can use to recover from financial stress or negative financial shocks.

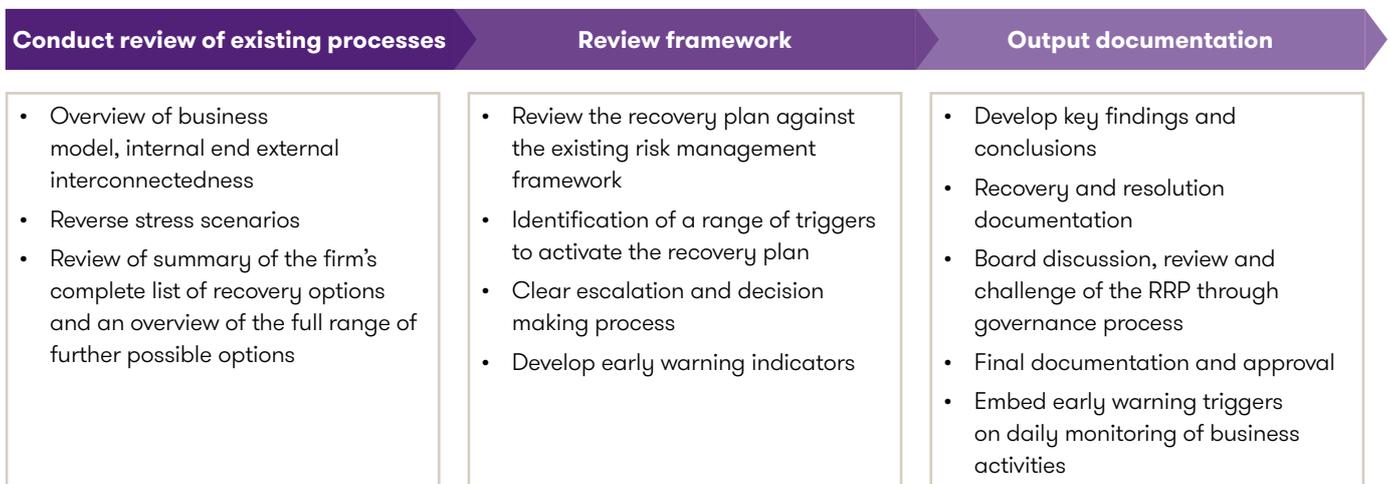
What is a Resolution Plan?

- Resolution planning provides the authorities with sufficient information to enable them to determine a detailed roadmap to resolve a failed financial institution, without resorting to government support.

What are the regulators looking for?

- UK regulated firms are required to produce ICAAP, ILAAP and RRP documents on an annual basis or if the business profile incurs a significant change.

- The regulator has produced statements setting out the minimum requirements of qualitative and quantitative recovery plan 'early warning' indicators, recovery invocation planning, data requirements and conditions for group financial support. Such reports are complex as they attempt to provide recovery options in the face of extreme market conditions.
- There is also a requirement within resolution plans to identify the organisation's critical economic functions and infrastructure description.
- Requirements will vary depending on the type and size of the institution, its systemic importance, its operating model and related activities with other entities.
- For selected firms with trading activity, a solvency wind-down will need to be produced with financial projections over the short and medium term detailing how the firm will reduce its balance sheet and the impact on capital and liquidity.



Credentials

Our Finance and Risk team comprises subject matter experts with backgrounds in senior positions in a number of high profile organisations.

The team has advised businesses of all sizes across a variety of sectors and are able to draw on deep, varied, industry and product knowledge. We have undertaken comprehensive ICAAP, ILAAP and RRP reviews across banks, asset management firms and other financial services institutions. Examples of previous engagements include:

Detailed ICAAP, ILAAP and RRP review for a UK bank

Nature of the work

- A key financial services client requested a detailed assessment of their liquidity risk management framework and compliance with European and UK regulations, including a critical review of their ILAAP. This also included a review of their RRP.

What we did

- This client is a growing force within the UK mortgage industry, and their market offering includes various specialised products alongside their vanilla residential mortgage portfolio.
- They are regulated by the PRA. We deployed our risk experts to conduct a detailed assessment of the ILAAP and ICAAP for the client.
- We reviewed the bank's risk management framework, governance, key policies and procedures, management information and key risks included in the ILAAP, ICAAP and RRP documents.

Value we added

- Our review highlighted a number of areas for improvement, notably in their scenario analysis and stress testing. We also raised some commercial opportunities, where liquidity or capital could be optimised.
- Our report was well received, and enabled the client to prepare for a PRA examination. Subsequent feedback from the regulator was very positive, and the client then commenced an improvement programme to implement our recommendations.

Bank licence application for a UK financial services firm

Nature of the work

- One of our long standing financial services firms specialising in medium to long term lending requested we manage their bank licence application in compliance with new UK regulations. This included drafting their ICAAP, ILAAP and RRP in line with their revised business plan. We also supported their project management and implementation of the Bank Licence Mobilisation Plan.

What we did

- The client is a member of an international group of financial services firms. We worked with the client from the outset in helping articulate and refine their new business strategy.
- We reviewed every aspect of the existing business and operating models, processes (IT and business) and every component of their business, capital and liquidity risk management frameworks. This included working closely with them on the latest regulations and the impact in their business (both business-as-usual and under stressed conditions).
- We then developed a mobilisation (project plan) to enable the firm to meet regulatory requirements and acquire a bank licence in the most cost effective and least disruptive manner to the firm.

Value we added

- Our ongoing project management and support have clearly outlined the key impacts and steps ahead to mobilise into a fully-fledged bank.
- The regulator provided very positive feedback on the state of implementation.

How can Grant Thornton help?

Grant Thornton can help ensure that your ICAAP, ILAAP and RRP are comprehensive, fit for purpose and fully integrated into your firm's existing risk management framework.

We offer best in class finance and risk services, tailored to meet your business needs. Our experts are at the forefront of their field and can support your ICAAP, ILAAP and RRP requirements in three distinct ways:

- Help you document and produce the ICAAP, ILAAP or RRP
- Provide assurance on your ICAAP, ILAAP or RRP documentation processes, and the methodology and models used to derive the adequacy of capital and liquidity and operational preparedness of the firm
- Train staff on SREP requirements and compliance

Our assurance experts can provide assistance in various forms, including:

- review of your business model and strategy and provide assurance that they align with capital and liquidity survival strategies
- formulation of potential management actions in a capital and/or liquidity stress situation
- design and review of capital and liquidity adequacy and allocation
- identification of the business segregation challenges which are required to be described in a firm's recovery and resolution plans
- design and implementation of enterprise-wide risk management framework
- identification of meaningful metrics and construction of monitoring and reporting infrastructure
- strengthening enterprise-wide regulatory compliance programmes
- improvement of governance processes and control frameworks
- supporting improvement of business and strategic risk, reputational risk, operational and financial risk, and people risk.

Contact us



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