The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.
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Our Values. We lead by example. We Work together. We respect the individual. We seek the facts and provide insight. We are open and honest in our communication. We are committed to our communities. Above all we act with integrity.
Benefit from a well-defined Basel II Evolution Program

**Basel II compliance**
KPMG’s FRM Services provide Basel II regulatory and compliance advisory services to assist various types of financial institutions in meeting their regulatory obligations effectively and efficiently and keep up with Basel II issues:
- Proactively setup an organization ready to comply with regulatory requirements,
- Mitigate regulatory impact on processes and methods,
- Effectively improve and monitor systems and data, and
- Ultimately obtain competitive advantage through cost-effective compliance.

**KPMG Differentiators**
KPMG’s Basel II Methodology is a structured approach to help clients assess:
- Their actual status concerning the Basel II Accord readiness,
- Existing gaps and shortcomings,
- Activities to be undertaken to fill gaps and reach desired end state.

The objectives of KPMG’s Basel II Methodology are to:
- Define a standard, modular approach to performing Basel II programs in 4 Phases,
- Provide practical guidance based on Basel II leading practices, and
- Provide risk management guidance.

**Pillar 2: Internal Capital Adequacy Assessment Process (ICAAP)**

Banks take on risks in order to earn a return, therefore management system to identify and take on well priced risks becomes ever more important in today’s competitive banking market.

**Internal Capital Adequacy Assessment Process (ICAAP)**
Basel II, Pillar 2 demands banks to put an internal capital adequacy assessment process (ICAAP) in place. Like in any business enterprise that involves the commercial provision of products or services to meet a particular need, owners of banks require to be compensated for the resources that they invest to generate such services. This compensation needs to be explicitly linked to the entrepreneurial risk undertaken by them.

**Economic Capital**
The Basel Committee defines economic capital as the methods or practices that allow banks to attribute capital to cover the economic effects of risk-taking activities. It is a measure of risk rather than capital held, and is distinct from the Pillar I regulatory capital measures. It provides banks with a “common currency” for measuring, monitoring, and controlling different risk types and the risks of different business units.

**KPMG Services: a single view of Risk and Return**
Economic Capital Management is the central notion of integrating the risk and the return perspective of an institution or bank to support the maximization of its value subject to the restriction of remaining solvent.

KPMG proposes a value-oriented review of risk and return processes:
- Alignment of risk and return management process with business model
- Better decision making through risk and return oriented review of business opportunities
- Transparency regarding implications of business decisions along entire value chain.
Integrated Risk, Return, Capital, and Value Management

The Internal Capital Adequacy Assessment Process (ICAAP) focuses on capital management, which ensures the capital adequacy of the bank, and is carried out on the bank level in a dedicated, centralized unit.

The capital management function has to consider first the regulatory view of Basel II: the balance-sheet capital (Tier 1, Tier 2, and Tier 3) constitutes the capital supply side while regulatory capital for credit risk, market risk, and operational risk accounts for the capital demand. Second, the capital management function should consider the view of rating agencies, which base their valuation mostly on Tier 1 capital on the capital supply side.

Third, the capital management function has to consider simultaneously the economic view of matching the capital supply (risk-taking capacity) with the capital demand (economic capital). Capital supply is mainly influenced by planned capital transactions and expected profits. Capital demand is mainly driven by business plans and by risk-profile forecasts in combination with macro-economic scenarios.

Since the requirements for both regulatory and economic capital have to be fulfilled, the bank has to define possible solutions in case of conflicting requirements for regulatory and economic capital. Major differences in capital supply can occur due to hidden reserves, goodwill, other intangible assets, deferred tax assets or liabilities, provisions...

The ICAAP is structured according to the following:

Board and senior management oversight

It is the responsibility of the board and senior management to oversee the ICAAP by setting well-defined risk management strategies and guidelines.

Comprehensive risk assessment

A prerequisite for the ICAAP is the comprehensive assessment of material risks by measuring economic capital. The measurement of economic capital comprises collection of all necessary data and implementation of appropriate models.

Determination of risk-taking capacity

The basis for capital adequacy is to compare economic capital with its risk-taking capacity. Risk-taking capacity is derived from accounting items after considering economic adjustments. In doing so, the bank can differentiate between "creditor-protection" and "going-concern" perspectives.

Capital adequacy maintenance.

Risk-taking capacity should cover economic capital at all times. To serve this purpose, capital adequacy has to be monitored on a continuous basis. The capital strategy for the corning years should be aligned with business planning. Possible measures to maintain capital adequacy can affect either capital demand or capital supply.

Controlling and reporting.

Monitoring the capital planning process and reporting to the board on its effectiveness help to ensure that risk management efforts are implemented appropriately. A robust controlling and reporting framework enables a continuous evaluation of relevant issues and provides access to the necessary reports for parties involved in monitoring capital adequacy.

Internal control review

Internal controls provide a foundation for sound corporate governance. A bank has to make sure that its risk management methods, processes, and systems are adequate in relation to its size and risk profile. To this end, senior management must regularly review the capital framework, ensuring that any methodological changes, process redesign, or reprogramming are tested and verified by a third party, such as the internal or external auditor.