Is your ICAAP up to the challenge?

Unlock flexibility and business value from the ICAAP

Ongoing geopolitical volatility has significantly impacted the banking sector – and continues to do so. Many banks are looking at their Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) in a new light. Can their internal processes and systems address the greater uncertainty and ensure financial resilience and regulatory approval?

It's a smart question to ask, but it's not easy to answer. The ICAAP is a critical process for ensuring that banks maintain adequate capital to support their business activities and absorb unexpected losses. However, many banks struggle to adjust their ICAAP considering rapidly changing markets and tightened correlations due to the perception of downside risks.

Heightened volatility

In today's uncertain environment, banks must assess many types of risks and understand the potential impact through a variety of lenses. Many of these risks are emerging, making evaluations even more complicated.

1. **Geopolitical risks and macroeconomic volatility**

   Stress testing: Enterprise-wide stress testing (EWST) should incorporate scenarios that reflect geopolitical shocks such as trade wars, energy crises and/or currency devaluations. The scenarios should evaluate capital adequacy under severe but plausible events, like sudden market closures or counterparty defaults.

   Capital buffers: Banks may need to hold additional capital to cover potential losses from geopolitical concentrations, including increased funding costs and market volatility.

2. **Climate consideration: physical and transition risks**

   Stress testing: Bank should consider how physical climate risk – associated with short-dated acute climatic events such as floods and typhoons – can disrupt the domestic real economy and insurability of certain assets and lead to a downgrading of the local sovereign credit rating and, in turn, inflated credit spreads.

   Portfolio strategy: For high-emission sectors such as utilities and oil and gas, banks should conduct longer-dated carbon simulations to understand how their projected financed emissions align with market disclosures net zero transition targets.

   Capital planning: Banks may need to allocate capital for climate-related losses, particularly for exposures to high-emission industries. This could involve adjusting risk-weighted assets (RWAs) to reflect ESG vulnerabilities.

3. **Operational resilience and cyber disruption**

   Operational risk: The ICAAP must account for cyber-related risks including potential losses from system outages, data breaches and/or fraud. Banks could quantify these losses via the Loss Distribution Approach (LDA), historically used under the Advanced Measurement Approach to Operational Risk.

   Stress testing: Scenarios should account for severe cyber incidents and assess their potential impacts on the bank's operational and reputational risk capital allocation. For example, a prolonged IT outage would disrupt the bank's operations, resulting in a loss of confidence (reputational loss) and potentially triggering a retail-run on deposits, whereby the cash outflows are covered via a fire-selling of financial assets at a loss.

   Capital allocation: Banks are increasingly exposed to the risk of disruption from external cloud providers and should mitigate this risk via structured scenario analysis and potential additional capital.

New pressures from regulators and supervisors

As part of the Basel Pillar II process, prudential supervisors evaluate how well banks articulate their capital needs relative to their business model, considering prevailing risks over the planning horizon. Supervisors may take measures to buffer the institution's capital base via add-ons. Outside of structural deficiencies relating to the scope and measurement of Pillar I risks, the supervisor may assign bank specific buffers via:

- **The stress impact:** Assessing the amount of capital a bank needs to keep on hand to handle unexpected losses in a tough, "worse case" stress scenario.
- **The risk management and governance assessment:** Evaluating whether the financial institution has clear gaps in how it oversees and audits the ICAAP. This includes things like managing data according to BCBS-239 principles, having solid documentation, ensuring senior management reviews and getting proper audit sign offs.
- **Supervisory judgment:** Reviewing relevant information about the buffers that protect a bank's safety and soundness. This would be applied when a supervisor determines that the bank's business model, organizational structure or business strategy is risky or difficult to evaluate under the required capital calculations set by the prudential standards.

Operational disharmony

Despite the importance of the ICAAP and the greater pressure from regulators, many banks still struggle to bring together, control and evaluate downside risks in a coherent, integrated and swiftly repeatable way across the risk dimensions and disciplines that contribute to the ICAAP.

Most often, the problem isn't the design of stress tests, the scenario definition or the management commitment to stress testing. In fact, senior management is usually keen to run stress testing, especially in rapidly changing macro environments and volatile markets.

Instead, banks are hamstrung by legacy approaches: tactical model solutions, informal workarounds using Excel and end-user developed applications.

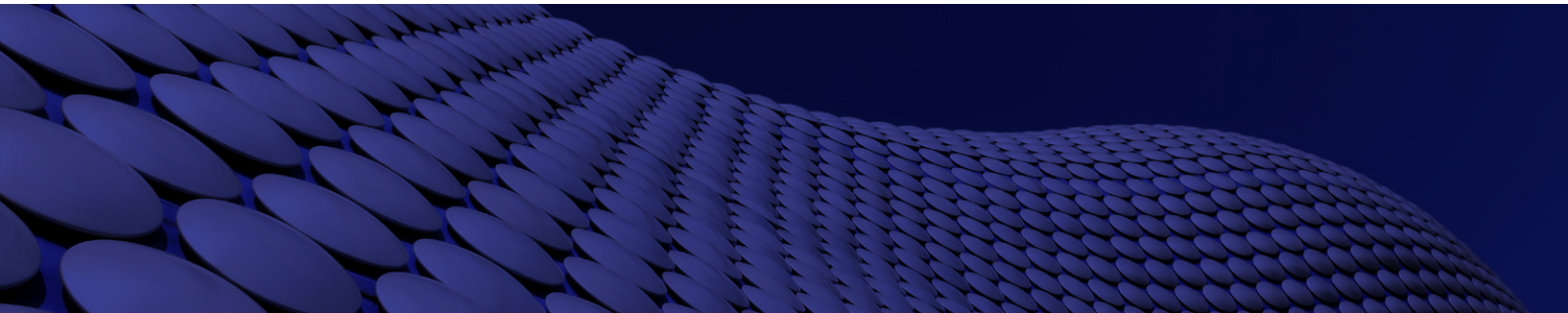
Wait, you say. What's wrong with that – especially if they seem to be working just fine?

In reality, these systems and processes:

- Aren't fully supported, documented or built to a corporate standard
- Lack robust change control
- Are prone to developing errors over time
- Aren't aligned to a centralized, "golden source" risk IT architecture
- Often can't work at the granularity and accuracy required
- Are hard to integrate and lack inter-application data sharing, interoperability and function
- Generate duplications, inefficiencies and infrastructure costs
- Increase operational risk

The end result is an ICAAP that runs off multiple models that are built on different technologies and running on different – often stovepiped – platforms, or on standalone programs that don't easily integrate with other systems. This makes it hard to meet senior management and regulators' expectations and slows down stress test results, analysis and management review. And with such a fast rate of macroeconomic and geopolitical change, the data and analysis quickly becomes stale.

Banks need more timeliness, better orchestration and frequent refreshes. But this isn't a resource issue; it's a technology, business process and tooling issue.



Key ICAAP focus areas

Business model and operating environment

- Balance sheet growth (asset and funding)
- Income generation across interest income, trading and fees and commissions
- Macroeconomic outlook, geopolitical activity, reputational issues and regulatory changes

Material risk assessment

- Pillar I Risks: credit (inclusive of counterparty credit risk), market and operational risk
- Pillar II Risks: concentration risk, IRRBB, strategic risk and reputational risk

Risk appetite statement (RAS)

- Models and scenarios used to assign risk based limits across
  - Solvency and leverage
  - Earnings
  - Funding and liquidity
  - Reputation management

Capital planning and budgeting

- Annual budgeting and capital planning process incorporating business and financial plans
- Projection of pro-forma financial statements over a 3- to 5-year planning horizon

Enterprise-wide stress testing (EWST)

- Assessment of the financial institutions solvency buffer by subjecting the pro-forma financial statements (produced in the planning and budgeting step) to a range of downside scenarios

Management actions and recovery options

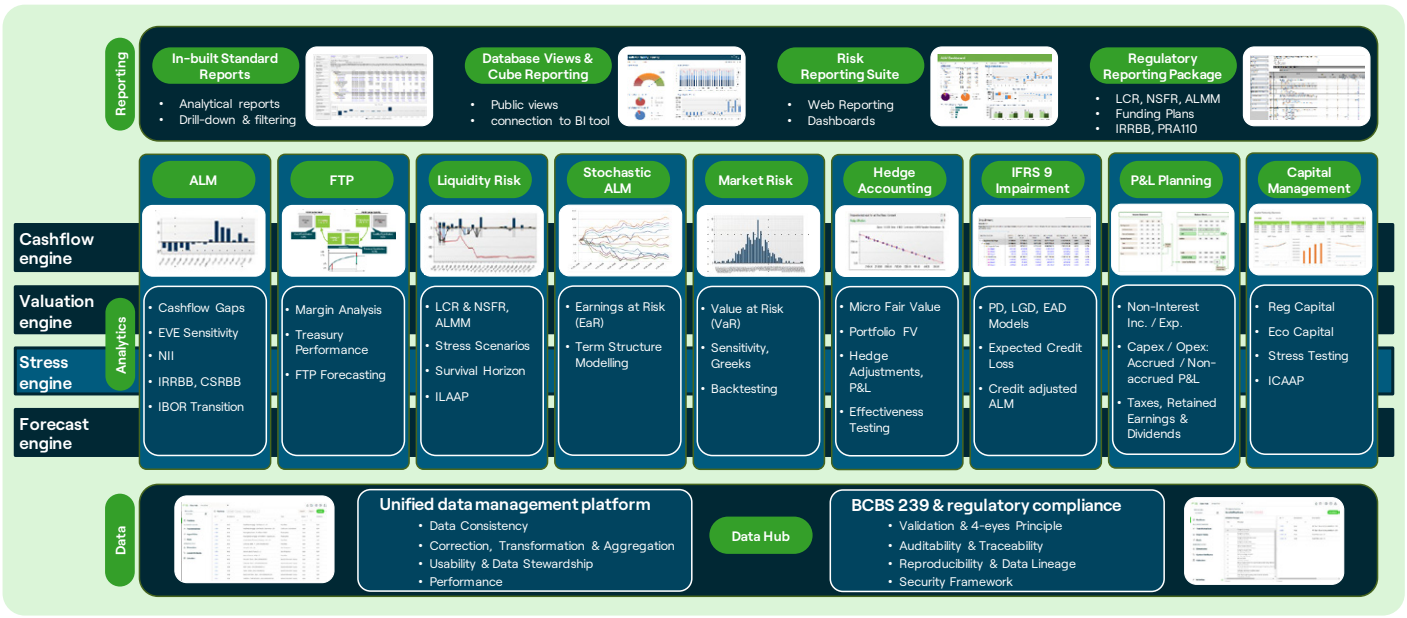
- Process for monitoring solvency
- Analysis of options managing solvency and mitigating risks
- Documentation of action plans and contingent funding/ capital plans

Unlock the power of technology

FIS® Balance Sheet Manager – Integrated Risk Management transforms the ICAAP from a compliance exercise to an opportunity to deliver real business value. An integrated and agile cloud-enabled platform, it gives banks the intelligence to make better informed decisions, optimize the balance sheet and put their capital to work.

Balance Sheet Manager offers a holistic and proactive enterprise risk planning and stress testing process that encompasses management across the stress continuum, including recovery and resolution planning.

FIS Balance Sheet Manager – overview



Unlock precision and capital

Balance Sheet Manager automates and centralizes the ICAAP, facilitating scenario analysis and stress tests, and generating more current and consistent analyses.

Result: You can more easily persuade regulators to reduce or avoid additional capital add-ons – thereby enhancing overall return on equity.

Unlock agility

With a unified system capable of running the entire ICAAP regularly, you get consistent, accurate and easily accessible risk exposure data.

Result: You can increase efficiency, free up staff and swiftly understand the impacts and interdependencies of new developments and potential changes – enabling more frequent strategy updates to capitalize on growth opportunities.

Unlock performance

Cloud computing offers the only scalable and cost-effective means to extract business value from ICAAP. Balance Sheet Manager's cloud-based framework scales according to your immediate and future needs via the AWS elastic cloud.

Result: You can maintain optimal performance and cost efficiency on a continuing basis, with a reduced cost footprint.

With Balance Sheet Manager's rapid, flexible and granular calculations, you can quickly analyze the impact of new developments, forecast responses to potential changes, and make informed decisions based on precise data.

Executives now receive up-to-date intelligence to make better-informed decisions regarding the bank's business model, financial forecasts, risk appetite and capital requirements – so the bank can optimize the balance sheet and more effectively utilize its capital.

Discover how you can both simplify the ICAAP and get true business value out of it.

Talk to us today.

ICAAP self-assessment

Category	Risk	Impact	Response/Remediation
Process – Models	Legacy risk-based models tend to be siloed across risk functions	Risk of divergence/ incongruence of results, which impedes the ability to holistically pivot across risk dimensions	Models need to be closely coupled in an aligned environment
Process – Scenarios	Current scenario testing tends to be siloed and doesn't provide a coherent view of the entire enterprise	Inconsistent results due to inefficient orchestration that is prone to error	Harmonized technology
Process – Consistency	Lack of consistency in scenarios across functions (credit, market, liquidity)	Loss of traceability at an enterprise level; e.g., does it join up? can individual toolsets model the same way?	Common scenario engine and toolset for enterprise modelling
Process – Flexibility	Legacy models are hard coded and built on different technologies without unified architecture	If feeder models are siloed, reruns are time consuming	Single architecture that uses high-performance computing
Process – Repeatability	Limitations on running ad hoc stress tests to react swiftly to changes in the economic environment	Potential for unexpected losses and worsening key ratios, which could have been avoided by ad hoc stress testing capability	Stacking of scenarios by reusing existing scenario setups, while changing shocks/ assumptions to rerun scenarios swiftly
Process – Coverage	Potential missing of risk factors ("risks not in")	Non-completeness of risks, leading to unexpected losses and deterioration of key metrics	Comprehensive view of risk (credit, market and liquidity)
Data Architecture and IT Infrastructure	Different data sets and granularity across systems	Multiple reconciliations required to ensure consistency of data and data granularity	Simulations across disciplines require one source of data
Data Architecture and IT Infrastructure	Non-synchronized data starting points between departments (granularity/ COB dates, etc.)	Inconsistency in results and material misstatement of stress results, resulting in fines	One source of data calculating results across key metrics (liquidity, market, ALM, etc.) using the same engine and transparent scenarios
Reporting	High costs and time inefficiencies of creating recurring reports, especially when relying on tools like MS Excel	Miscalculation and misinterpretation of results, increasing the risk of incorrect decisions	Clear and concise reporting suite with relevant intuitive dashboards and drill-down capability into specific drivers

FIS Balance Sheet Manager allows you to manage material risks to make money work harder, driving sustainable growth.
Our technology powers the global economy across the money lifecycle.

Money at rest

Unlock seamless integration and human-centric digital experiences while ensuring efficiency, stability, and compliance as your business grows.

Money in motion

Unlock liquidity and flow of funds by synchronizing transactions, payment systems, and financial networks without compromising speed or security.

Money at work

Unlock a cohesive financial ecosystem and insights for strategic decisions to expand operations while optimizing performance.

About FIS

FIS is a financial technology company providing solutions to financial institutions, businesses and developers. We unlock financial technology that underpins the world's financial system. Our people are dedicated to advancing the way the world pays, banks and invests, by helping our clients confidently run, grow and protect their businesses. Our expertise comes from decades of experience helping financial institutions and businesses adapt to meet the needs of their customers by harnessing the power that comes when reliability meets innovation in financial technology. Headquartered in Jacksonville, Florida, FIS is a member of the Fortune 500® and the Standard & Poor's 500® Index. To learn more, visit FISglobal.com. Follow FIS on LinkedIn, Facebook and X (@FISglobal).

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