

Point of view

Risk-adjusted return on capital (RAROC) 2.0

From profitability metric to capital-allocation engine



How leading banks are rethinking profitability, pricing, and capital allocation in a capital-constrained world.

Executive Summary

In most banks, Risk-adjusted return on capital (RAROC) still functions as a reporting metric, a number reviewed periodically but rarely used to steer real decisions. That is increasingly inadequate. In a world of tighter capital, margin pressure, and rising balance-sheet constraints, RAROC is evolving from a performance metric into the operating language through which banks connect pricing, underwriting, funding, risk, and capital allocation.

The central argument of this paper is straightforward. The next generation of winning banks will not be those with the fastest balance sheet growth or the most sophisticated models. They will be the institutions that allocate scarce capital with greater economic discipline, and that requires RAROC to serve not as a reporting metric but as the bank's operating language.

But RAROC is only as credible as the foundations beneath it. Weak transfer pricing, inconsistent capital assumptions, and arbitrary cost allocations can create an illusion of precision while quietly distorting decisions. The issue is no longer whether banks measure profitability, but whether they measure it consistently enough to allocate scarce balance-sheet capacity effectively.

Takeaways for senior management

- **RAROC must be both ex-post and ex-ante.** A backward-looking number explains historical performance, a forward-looking number shapes origination, pricing, and strategic growth. The economic gap between the two is typically larger than banks expect.
- **RAROC must be paired with Economic Profit.** RAROC measures capital efficiency; Economic Profit measures absolute value creation. A 25% RAROC on a small base creates less shareholder value than a 15% RAROC on a large base. Either alone misleads.
- **Customer-level RAROC must reflect the full relationship and the full group.** Asset-only customer RAROC systematically undervalues the bank's most profitable relationship by ignoring deposit-franchise value and Funds Transfer Pricing (FTP) credit. In conglomerate-heavy markets, the analysis must extend further still: a small subsidiary loan is best evaluated against the parent group's wallet, not the subsidiary's standalone economics.
- **Comparability between retail and wholesale is engineered, not assumed.** Retail and wholesale are fundamentally different profitability architectures - behavioral and diversified versus relationship-led and concentration-sensitive. The challenge is not building separate frameworks; it is creating a unified profitability language that allows capital to be allocated consistently across both.
- **The biggest profitability challenge facing banks today is comparability.** Many institutions produce RAROC numbers that appear precise but are driven by inconsistent assumptions on funding, duration, diversification, and capital attribution. As capital becomes scarcer, governance around profitability frameworks becomes a strategic differentiator.



Sandip Khetan

Co-Founder,
Global Head of Accounting &
Reporting Consulting



Sagar Lakhani

Partner, Accounting &
Reporting Consulting



Suresh Wadhvani

Partner, Accounting &
Reporting Consulting



Shyam Gupta

Associate Partner,
Accounting & Reporting Consulting

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

Why RAROC Matters Again

Why a metric most banks already report has become central to running the bank - and where the cracks in current frameworks show.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

Risk-Adjusted Return on Capital was originally designed to answer a simple but powerful question: Is the bank generating sufficient return for the level of risk and capital it is consuming? For years, many institutions treated it primarily as a reporting metric - useful for performance reviews but peripheral to real decision-making. That is changing. As capital becomes scarcer and balance-sheet constraints intensify, banks are rediscovering RAROC as a strategic tool for pricing, underwriting, portfolio steering, and capital allocation.

The cleanest banking interpretation is the standard one: **RAROC equals risk-adjusted return divided by economic capital**. The numerator is allocated revenues - net of matched funding costs, expected losses, operating costs, and taxes - and the denominator is the capital required to absorb unexpected losses at the bank's chosen confidence level, calibrated to the credit rating the institution wishes to support.

Used well, RAROC measures capital efficiency. But efficiency is only one side of the profitability equation. A smaller business may generate very high RAROC while contributing little absolute profit, whereas a mature franchise with moderate RAROC may create substantial shareholder value on a scale. Leading banks, therefore, evaluate both RAROC and Economic Profit together - Economic Profit being the risk-adjusted return less than the product of economic capital and the hurdle rate. Capital efficiency and absolute value creation answer different questions, and either alone misleads.

Bank Alpha - the running reference throughout this paper

Bank Alpha is a mid- to large-sized universal bank with SAR 200 billion in assets, a balanced retail and wholesale mix, and a 12% cost of equity hurdle. Its group RAROC sits at 18.0%, and its group Economic Profit is SAR 64 million positive. Beneath the group number, however, business-unit dispersion is wide: from 8.5% in long-tenor project finance to 28% in revolving credit cards. The rest of this paper traces how every design choice - FTP basis, capital allocation, cost loading, time horizon - moves these numbers, and more importantly, the decisions that flow from them.



RAROC and RORWA are not the same measure

Many banks treat Return on Risk-Weighted Assets (RORWA) and RAROC as interchangeable indicators of capital efficiency. They are not. RORWA measures profitability against regulatory capital and is useful for external benchmarking and regulatory capital management. RAROC measures profitability relative to internally assessed economic capital and is better suited for pricing, portfolio steering, and strategic capital allocation.

The distinction matters more under the Basel III endgame and the output floor, which are narrowing the gap between regulatory and economic capital for many institutions. As regulatory capital constraints tighten, banks increasingly need both lenses simultaneously - RORWA to understand external regulatory efficiency, and RAROC to understand the underlying economics of risk and capital deployment. The divergence between the two often reveals deeper structural realities inside the balance sheet. Highly diversified retail businesses may appear economically attractive under RAROC, yet remain constrained by regulatory capital requirements. Concentration-heavy wholesale portfolios may appear efficient from a regulatory perspective, but they generate weaker economic returns once concentration and relationship risk are recognized.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

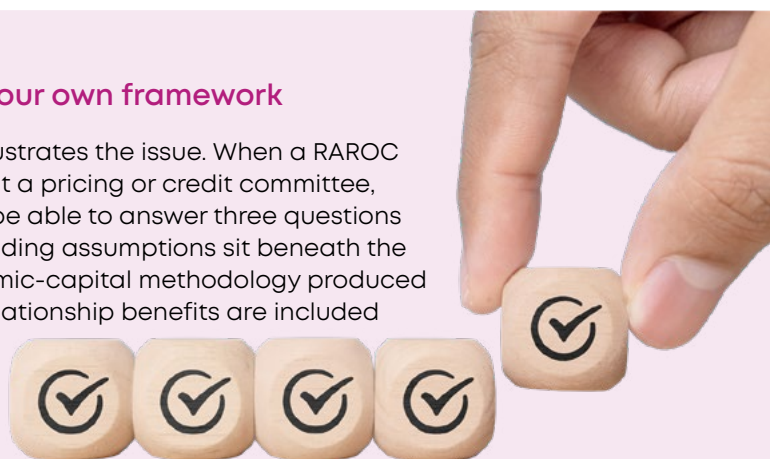
About the Uniquis FRM Practice

The hidden fragility of profitability frameworks

The challenge is rarely the ratio itself - most banks can calculate RAROC. The deeper problem is consistency. Frameworks fail in predictable ways: numerators built on accounting earnings rather than economic ones; FTP architectures that misstate funding and deposit values; regulatory capital used as a proxy for economic risk; and methodologies that vary across business lines, so that comparability quietly collapses. None of these is hard to diagnose. What makes them persistent is that each is governance-resistant - they live inside business-line negotiation rather than central methodology, and they tend to coexist.

Sanity-checking your own framework

A simple diagnostic illustrates the issue. When a RAROC number is presented at a pricing or credit committee, management should be able to answer three questions immediately. What funding assumptions sit beneath the number? What economic-capital methodology produced it? Which costs and relationship benefits are included - and which are excluded? If those answers are unclear, the profitability number may be mathematically precise while economically unreliable.



The Foundations That Must Hold

Four foundations - numerator, FTP, economic capital, attribution - against the 2026 risk and regulatory backdrop.

A credible RAROC framework rests on four foundations: a disciplined numerator that distinguishes accounting profit from economic profit; an FTP layer that prices funding, liquidity, optionality, and behavioral maturity transparently; an economic-capital base that is built independently of regulatory weights; and a defensible cost attribution that does not load every overhead into every transaction. The 2026 regulatory backdrop shapes each: Basel III endgame and the output floor, International Financial Reporting Standard 9 (IFRS 9) expected loss, climate risk, and the standardized-approach reality that dominates Asian and Middle Eastern banking.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Unique FRM Practice

The numerator: accounting profit is not economic profit

Provisions under IFRS 9 are designed to reflect point-in-time credit deterioration and forward-looking macroeconomic expectations. RAROC is fundamentally an economic profitability measure intended to support pricing, underwriting, and capital allocation over longer horizons. Problems emerge when banks mix accounting and economic loss concepts inconsistently across pricing, performance management, stress testing, and capital planning. In benign conditions, point-in-time provisioning artificially inflates profitability; during downturns, it makes otherwise viable businesses appear structurally unattractive - producing procyclical decision-making at precisely the wrong point in the cycle.

The issue is less about methodology than consistency. Whichever expected-loss definition a bank chooses, that definition must flow through pricing models, RAROC scorecards, capital plans, and stress tests. A bank that uses through-the-cycle for pricing, point-in-time for accounting, and an undocumented hybrid for stress testing does not have an expected-loss methodology - it has an expected-loss accident.

The FTP layer: where RAROC lives or dies

Revenue attribution and transfer pricing are inseparable. A bank without a credible FTP framework lacks a credible profitability measurement. In practice, many of the largest distortions in RAROC originate not from credit modeling but from inconsistent funding assumptions, poorly allocated liquidity costs, and an opaque treatment of deposit franchise value.

A RAROC-grade FTP framework must allocate funding, liquidity, optionality, and deposit-franchise value transparently and consistently across businesses. Where FTP becomes opaque or negotiated, profitability measurement quickly loses credibility as a capital-allocation tool.

The challenge is most acute in businesses with significant optionality and behavioral uncertainty. Long-term fixed-rate assets, revolving portfolios, and deposit-rich franchises can all appear materially more or less profitable depending on how funding, liquidity, and behavioral maturity are treated. A simple diagnostic reveals whether an FTP framework is genuinely decision-useful: if business-unit profitability moves materially quarter-to-quarter because "FTP changed", management should be able to explain precisely why. Where FTP outcomes are opaque, negotiated, or poorly understood by the

front line, profitability measurement quickly loses credibility as a capital-allocation tool.

The most contested FTP question inside many banks is deceptively simple: **who owns the economic value of deposits?** Deposit-gathering businesses argue that stable customer balances are a strategic funding advantage that should enhance relationship profitability. Treasury functions often view those balances as centrally managed liquidity and interest-rate resources. Profitability frameworks fail when the same economic benefit is recognized multiple times - or not recognized at all. As balance-sheet constraints intensify, clear ownership of deposit franchise value becomes increasingly important to customer strategy, business-line performance, and capital allocation.

Economic capital, with or without IRB

Most RAROC literature implicitly assumes IRB. That is correct for European, UK, US, and Australian banks - and largely wrong for the bulk of the Asian and Middle Eastern market. The majority of Saudi Central Bank (SAMA) regulated banks, all Indian public-sector banks, most GCC banks, and most Association of Southeast Asian Nations (ASEAN) banks operate on the Standardized Approach for credit risk. They do not need Internal Ratings-Based (IRB) approval to run RAROC; they need a defensible loss distribution. The two are not the same thing.

The single most common conceptual error in Standardized Approach (SA) banks is to use SA risk weights as a proxy for economic capital. This produces a "RAROC" that is mathematically just the inverse of Return on Risk-Weighted Assets (RORWA), adding no information beyond what the regulatory framework already provides. Economic Capital (EC) for internal steering must be built independently of regulatory weights, using internal data, external benchmarks, and pragmatic modeling.

The output floor reinforces the point for IRB banks. Under Basel III endgame, the 72.5% floor means IRB banks cannot drift far from SA-equivalent capital. The IRB-versus-SA gap is narrowing, and the SA-bank EC approach is becoming increasingly relevant worldwide. For an IRB bank running RAROC against pure economic capital, the floor introduces a regulatory cap that should be explicitly modeled - typically as a " $\max(\text{EC}, 72.5\% \times \text{SA})$ " denominator at the binding-constraint level.

Climate as a capital-allocation issue

Climate risk is shifting from a disclosure and compliance question into a capital-allocation question. Three transmission channels are now visible in RAROC frameworks. Probability of Default (PD) and Loss Given Default (LGD) overlays for high-emitting sectors flow through expected loss and economic capital; oil and gas, cement, steel, conventional power, and transport see RAROC visibly degrade under 2°C and below-2°C scenarios. Physical risk shows up as collateral haircuts in mortgage and Commercial Real Estate (CRE) books, where coastal real estate, flood-zone residential, and drought-exposed agriculture see increased LGD. And concentration overlays recalibrate sector- and counterparty-risk to reflect correlated climate exposures, banks heavily exposed to single-sector concentrations, such as real estate-heavy Gulf Cooperation Council (GCC) institutions, face a structural Economic Capital (EC) uplift.

The implications are particularly evident in long-term, high-concentration portfolios. Transition-sensitive sectors may become structurally more capital-intensive over time, while physical climate risk is beginning to reshape assumptions around collateral quality and geographic concentration. The more important shift, however, is conceptual: climate overlays are gradually moving profitability frameworks away from static historical-loss assumptions toward more scenario-based, forward-looking views of risk.



Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Unique FRM Practice

Cost attribution: three layers, not one

Cost attribution is the second most common reason RAROC frameworks lose credibility, behind FTP. If all overhead is forced into transaction-level RAROC, good businesses look bad. If shared cost is ignored, RAROC is overstated. The solution is layered.

Layer one is directly attributable cost - origination, servicing, collection, Relationship Manager (RM) compensation, deal-specific structuring - charged directly to the deal. It belongs to the transaction, customer, and BU RAROC. **Layer two is controllable shared cost** - IT systems, operations, compliance, risk management - driven by business activity and allocated against a clean activity-based driver. It belongs to the **Business Unit (BU)** level RAROC, segment economics, and performance scorecards. **Layer three is non-controllable overhead** - CEO office, group governance, enterprise-wide projects - which should be excluded from decision-useful RAROC and reflected only in a fully loaded P&L for strategic planning and the ROE walk.

The consequences are concrete. The same loan can produce a RAROC of **17.3%** on direct costs alone, 11.8% when controllable shared costs are added, and 9.4% on a fully loaded basis. The right answer is dual reporting: a decision-useful RAROC at Layers 1+2 for pricing and performance management, and a fully loaded view at all three layers for strategic planning and group-level capital allocation. Mixing the two collapses the framework into a set of negotiated numbers.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Unique FRM Practice

The Forward-Looking Lens

Why one-year RAROC systematically misprices long-tenor business - and what to do about it.

The argument that RAROC should be forward-looking rather than ex-post is widely accepted in principle but seldom implemented in practice. Lifetime RAROC requires a real operational build: lifetime PD curves, behavioral Exposure at Default (EAD), forward FTP curves, and an EC profile that evolves with the portfolio. Each is a genuine investment, and most banks have stopped short. The cost of stopping short, as the next pages show, is systematic mispricing of long-tenor business.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

A 25-year mortgage tells the clearest story.

The contrast between one-year and lifetime RAROC is most visible on long-tenor amortizing assets. Take a SAR 1 million, 25-year fixed-rate residential mortgage at 5.80%.

Metric	Year 1 (ex-post)	Lifetime (forward)	Driver of difference
Revenue (Net Interest Margin (NIM))	SAR 9,000	Net Present Value (NPV) SAR 112,000	Compounded over life; reflects amortization profile
Expected loss	(SAR 1,500)	NPV (SAR 19,800)	Lifetime PD × declining EAD; back-loaded distribution.
Servicing cost	(SAR 2,000)	NPV (SAR 33,500)	Annual servicing across the full life cycle
Acquisition cost	(SAR 2,000)	(SAR 6,000 total)	Year-1 expensed in 1Y view; capitalized over life
Risk-adjusted return	SAR 3,500	NPV SAR 32,800	
Economic capital	SAR 35,000 (origination)	Avg SAR 24,500 (declining)	EC declines with amortization and seasoning
RAROC	10.0%	15.4%	+5.4 percentage points
vs 12% hurdle	Below	Above	Decision flips

The mortgage creates value over its life. The early-year drag from acquisition cost reverses as the loan seasons, EC declines as the balance amortizes, and lifetime expected loss, though larger in absolute terms, sits against a much larger Net Present Value (NPV) revenue stream. A bank that prices and originates based on one-year RAROC will systematically reject economically attractive long-tenor business and accept short-tenor business that looks good in year one and poor over the life.

The pattern is not uniform across products.

The mortgage is a particularly clean illustration because the gap between one-year and lifetime is so wide. But the lifetime view is not always favorable - for some products, it is harsher than the one-year view; for others, the two converge.

Product	1-year RAROC	Lifetime RAROC	Interpretation
25-year fixed-rate mortgage	10.0%	15.4%	Investing phase - lifetime economics favorable; 1-year view rejects value-creating business
90-day trade finance	22.0%	22.0%	Short-tenor - both views align; 1-year RAROC fit for purpose
15-year project finance	8.5%	14.2%	Long-dated - 1-year view materially misleading; decision flips on lifetime.
Revolving credit card	28.0%	19.5%	Year 1 inflated by acquisition economics; lifetime diluted by attrition and reward costs
3-year SME term loan	16.5%	16.0%	Medium-tenor - views broadly consistent; either lens works for management.

The credit card line is the one most pricing committees need to see. A one-year RAROC of 28% routinely justifies aggressive growth budgets in retail; the lifetime view, which captures attrition, reward redemption, and revolver-balance decay, is closer to 19% - still good business, but a fundamentally different scaling story. Project finance is the mirror image: a one-year RAROC of 8.5% looks unfundable, but the lifetime view at 14.2% clears the hurdle. **Banks that originate and decide on one-year RAROC are systematically miscalibrated relative to their own product mix.**

Three rules for the long-tenor playbook

1

Always run dual-horizon RAROC. One year for tactical management; lifetime for strategic allocation and origination decisions on assets longer than seven years. Investigate wherever the two views diverge by more than 300 bps.

2

Charge for prepayment optionality on the asset side. Most retail mortgage portfolios in the GCC and India have undercharged for prepayment over the past decade - a cost that has only become visible as rates have moved. The optionality charge belongs on the asset side, not buried in treasury.

3

Treat the affordability cycle as a stress, not a baseline. Floating-rate mortgage RAROC under benign rate conditions is a different number from RAROC under a sustained high-rate environment. Both views should be presented to the pricing committee.

From Deal to Relationship to Group

How the unit of analysis changes the answer - across retail and wholesale, customer and conglomerate.

RAROC plays out very differently across retail and wholesale, and at the deal, customer, and group levels. Treating retail and wholesale as variants of the same calculation - which many banks do - is the source of much of the cross-business friction RAROC frameworks produce. Retail is a price-economics problem; wholesale is a relationship and concentration-economics problem. The cross-business comparison is engineered, not assumed. And in markets dominated by conglomerates, the right “customer” for capital-allocation purposes is rarely the legal entity on the loan agreement.

Retail as pool economics, wholesale as relationship economics

Segment behavior, vintage effects, utilization, attrition, acquisition cost, prepayment, collections, and lifetime customer behavior drive retail RAROC. No individual small loan warrants its own standalone RAROC decision. Retail RAROC is best measured at the product-by-segment-by-vintage level, with the key design choices being how acquisition cost is amortized, how attrition is modeled, and how revolver-balance decay is treated in credit cards.

The credit card line in any retail RAROC scorecard deserves disproportionate scrutiny. A pre-tax RAROC north of 80% is mathematically defensible but headline-grabbing, and is heavily influenced by behavioral assumptions on revolver attrition, charge-off recoveries, and reward-cost loading. Banks should present credit card RAROC alongside its lifetime, attrition-adjusted equivalent, which is typically 30 to 40% lower.

Wholesale RAROC is fundamentally different. Individual exposures are larger, idiosyncratic risk matters more, and sector or name concentration can materially move economic capital. A wholesale loan RAROC that ignores sector concentration, single-name concentration, collateral quality, syndication strategy, undrawn commitments, or relationship wallet is almost certainly wrong. The walk-up from transaction to full relationship makes the point most starkly.

Level	Revenue	Deductions	Risk-adj return	Eco. capital	RAROC
Transaction (SAR 200 million loan)	SAR 5.0M	SAR 2.8M	SAR 2.2M	SAR 18M	12.2%
+ Treasury, trade, cash mgmt	SAR 9.5M	SAR 3.4M	SAR 6.1M	SAR 20M	30.5%
Sector portfolio (RE, 15% of book)	-	-	-	+SAR 40M conc.	~3pp lower
Business line (full wholesale)	-	-	-	-	17.8%

The term loan looks unattractive standalone. But once the full relationship wallet is included, RAROC is 30.5% - a completely different conclusion. This single example carries the central insight of customer-level RAROC, developed below.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

Engineering comparability: the eight-point bridge

Cross-business RAROC comparisons are the single most contentious moment in any bank's capital-allocation cycle. Retail says wholesale is over-rewarded for diversification. Wholesale says retail uses pooled FTP that flatters returns. Treasury says everyone is wrong. Without a documented bridge, the conversation collapses into political weight.

The honest framing is that retail and wholesale RAROC are built differently because the underlying businesses are different, and that is correct. What matters is that the cross-business comparison is engineered to be apples-to-apples on the dimensions that drive the ratio, even when the underlying machinery differs. Eight design choices must be standardized before any cross-business comparison is meaningful.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Unique FRM Practice

Dimension

Time horizon

Standardization requirement

Lifetime / through-the-cycle for both - without this, mortgages always lose to credit cards, and SME term loans always lose to trade finance—the single biggest source of unfair allocation.

Dimension

Numerator scope

Standardization requirement

Pre-tax or post-tax; which cost layers (1, 1+2, or fully loaded). Pick one convention and apply it to both sides.

Dimension

FTP normalization

Standardization requirement

Retail can keep FTP pooled for product pricing, but for the comparability layer, retranslate to matched-maturity-equivalent FTP using the portfolio's actual behavioral life.

Dimension

Capital basis

Standardization requirement

Standalone or fully diversified - but the same choice for both. Standalone for one and diversified for the other is the classic rigging accusation.

Dimension

Confidence level and EC horizon

Standardization requirement

99.95% / 1-year for both. If retail is 99.5% because of granular pool effects, that is a different EC, and the ratios will not compare directly.

Dimension

Liability inclusion

Standardization requirement

If retail is credited for current-account franchise value, wholesale relationships must also receive the deposit-side credit. Symmetric treatment is non-negotiable.

Dimension

Operating-cost convention

Standardization requirement

Amortize acquisition costs over behavioral life for retail; amortize structuring costs over deal tenor for wholesale. Do not expense one upfront and amortize the other.

Dimension

Hurdle rate

Standardization requirement

One bank-wide hurdle, or BU-specific (Section 5)? Defensible either way - but state it explicitly. BU-specific hurdles are more economically correct but politically harder.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Unique FRM Practice

The effect is non-trivial. Applied to the same two exposures - a 25-year retail mortgage and a 5-year wholesale CRE term loan - the raw 1-year numbers tell one story: wholesale 14.5%, retail 10.0%. The fully-bridged comparable numbers tell another: retail 17.0%, wholesale 14.3%. **Neither view is correct in isolation; both are internally consistent given their design choices.** What matters is that capital-allocation decisions are made on the bridged view, not the raw one.

The institutional answer is a single Risk-Adjusted Performance Measurement (RAPM) Methodology Council that owns the bridge - composition and mandate discussed in Part VI. Without a single accountable owner, the bridge erodes into negotiated numbers within two budget cycles.

Customer-level RAROC: the missing liability dimension

Most RAROC implementations focus exclusively on the asset side - the loan, the exposure, the credit risk. This is a fundamental oversight, particularly when RAROC is measured at the customer or relationship level. A corporate customer does not simply borrow from the bank. They also deposit money, maintain operating accounts, use trade-finance facilities, hold guarantees, and generate fee income. The customer's liabilities create significant economic value that the bank should recognize: an FTP credit on deposits reflecting the funding the bank would otherwise have to raise in wholesale markets; a liquidity offset where stable operational deposits qualify as core deposits under Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) and reduce the bank's liquidity buffer; and a capital benefit where stable deposit franchises reduce the EC attributable to liquidity and funding risk.

If customer-level RAROC ignores these contributions, it systematically undervalues the bank's most valuable relationships.

Take "IndustryCo" - a corporate client with a SAR 50M term loan at 7.00%, a SAR 20M revolving facility (60% utilized), SAR 30M of current-account balances paying 1.50%, a SAR 15M time deposit paying 3.50%, and SAR 0.8M of annual fee income.

Level	Revenue	Deductions
Asset-side income (NIM + revolver + fees)	SAR 2.37M	SAR 2.37M
+ Deposit franchise FTP credit	-	SAR 0.80M
Less: EL + operating cost + tax	(SAR 0.91M)	(SAR 1.07M)
Economic capital	SAR 4.96M	SAR 4.56M (liquidity offset)
RAROC	29.4%	46.1%

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

If the bank evaluates IndustryCo only on asset-side RAROC, it undervalues the client by nearly 17 percentage points. In a pricing negotiation, the relationship manager lacks ammunition. In the worst case, the bank declines to renew a loan and pushes a valuable full-service client to a competitor.

Three implementation cautions are worth flagging. Not all deposits are equal - operational balances are stickier than excess liquidity parked temporarily, and FTP credits should reflect this with higher credit for stable, core deposits. The behavioral-versus-contractual distinction must be modeled and validated: a demand deposit with zero contractual maturity may behave like a 2- to 5-year liability, and the FTP framework needs an actual behavioral model rather than a flat assumption. And double-counting must be policed actively - if treasury already captures the full deposit margin centrally, the business unit should not also receive credit; the framework needs a single, clear policy on who owns the deposit franchise value.

A clarification on netting versus separate attribution. Some banks' net assets and liabilities at the customer level before computing RAROC. This is conceptually wrong - it obscures the risk on the asset side. The correct approach is to compute asset-side RAROC and add the liability-side contribution as a transparent, separately reported line item.

The conglomerate dimension

A nuance that asset-side RAROC misses, and that even relationship-level RAROC under-treats, is particularly acute in markets dominated by family-owned conglomerates and state-owned groups - Indian, GCC, and most ASEAN banking. The question is: when the borrower is a subsidiary of a larger conglomerate, what is the right unit of analysis?

In practice, the "customer" in customer-level RAROC has at least three valid definitions, each of which yields a different answer. The **legal entity** - the borrower of record - is the right unit for credit decisions, regulatory single-name limits, and contractual enforcement. The **risk group**, defined under Basel large-exposure rules, the Reserve Bank of India (RBI) group-exposure norms, or SAMA's connected-counterparty regime, is the unit for concentration limits, regulatory aggregation, and single-name capital. The **relationship wallet** - all entities under common beneficial ownership that the bank does business with, including treasury, FX, trade finance, mandates, and employee banking - is the unit for relationship strategy, pricing leverage, capital allocation, and RAROC.

The numbers move materially across the three definitions. "AlphaGroup" is a regional industrial conglomerate. The bank is being asked to renew an SAR 80M loan to a real-estate subsidiary. The deal team's standalone analysis returns a RAROC of 9.2%, below the 12% hurdle. Walking up the group structure tells a different story.



Level	Entities	Net annual contribution	Allocated EC	RAROC	Verdict
Legal entity (RE subsidiary)	RE-Sub only	SAR 0.92M	SAR 10M	9.2%	Below
Risk group (Basel definition)	+ Holdco, sister cos with cross-default	SAR 1.40M (incl. guaranteed exposures)	SAR 12M (conc. adjusted)	11.7%	Borderline
Relationship wallet	+ Treasury, FX, trade, working capital across subsidiaries	SAR 4.20M	SAR 14M (incl. liquidity offset)	30.0%	Renew

The standalone subsidiary loan looks unattractive. The relationship wallet is highly attractive. Decline the subsidiary loan, and the bank is likely to lose the group.

Two operational principles follow. **First, aggregate up for risk; evaluate up for economics.** Risk concentration - single-counterparty limits, sector aggregation, large-exposure rules - must always be calculated at the group level. This is regulatorily required and non-negotiable. Economic value should also be evaluated at the group level for relationship decisions, with explicit transparency about which entity generates each line of revenue. The numbers must be auditable. **Second, do not quietly migrate the subsidiary's PD or LGD up to parent quality.** The temptation in conglomerate lending is to take comfort from the parent's creditworthiness without formal documentation. This is dangerous. If the bank intends to rely on parent support, it should be documented as a parental guarantee, internal credit substitution, keep-well letter, or comfort letter - not as a vibes-based PD adjustment. A large share of GCC and Indian non-performing-loan stories trace back to exactly this mistake: implicit "group halo" PDs that turned out not to reflect actual support when the subsidiary defaulted (IL&FS, NMC Health, and several GCC construction groups in 2015–2020).



Field note: the conglomerate haircut

Several leading regional banks now apply an explicit "conglomerate haircut" to RAROC numbers presented at the credit committee - typically a 50 to 150 bps reduction in claimed relationship RAROC, depending on the strength of cross-default protection and the degree of formal versus implicit group support. The haircut is not punitive; it is a governance device that forces the credit committee to debate the actual structure of group support, rather than waving it through under the heading of "strong relationship".

Architecture: How RAROC Is Built

The deal-level mechanics, beyond credit risk, the hurdle, and the diversification choice.

The mechanics of RAROC are well understood. What separates frameworks that drive decisions from those that produce numbers is the discipline applied at four points: how the deal-level calculation handles funding costs, expected losses, and capital; how non-credit risks are layered in; how the hurdle rate is set; and how diversification is treated. None is conceptually new. All are routinely mishandled.

The deal-level calculation

At its core, RAROC asks whether the return generated by a transaction, customer, or portfolio justifies the amount of scarce capital being consumed. The answer depends heavily on the assumptions embedded beneath the ratio. A SAR 100 million corporate term loan to a BBB-rated borrower with a 5-year bullet illustrates the headline mechanics.

Level	Revenue
Total revenue (NIM 2.50% + fees 0.20% on SAR 100M)	SAR 2.70M
Less: expected loss + operating cost + tax	(SAR 1.26M)
Economic capital (99.95%, 1-yr; standalone)	SAR 8.0M
RAROC · Hurdle · Economic Profit	18.0% · 12% · SAR 0.48M

A point-in-time worked example like this is useful for explaining the mechanics, but it masks four design choices that change the answer materially in practice. The single-period view does not capture the lifetime economics of a 5-year loan (Part III). The static EAD assumption does not hold for revolvers, undrawn commitments, and behavioral products. The standalone EC denominator does not credit portfolio diversification - appropriately, since the deal team should not be rewarded for portfolio effects they do not control. And the through-the-cycle expected loss in the numerator sits alongside a separate IFRS 9 P&L bridge for Stage 1, 2, and 3 movements.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

Beyond credit risk

For pure loan pricing, a credit-only RAROC can serve as a first-pass screen. For business-line performance measurement, capital allocation, or incentive design, limiting the denominator to credit-risk capital is too narrow. A serious framework runs a tiered approach: at transaction level, credit-risk EC plus FTP/liquidity plus direct cost is enough for pricing and deal approval; at business-line level, market and Interest Rate Risk in the Banking Book (IRRBB) capital, operational risk, sector and name concentration and climate overlays are added in for performance management and incentive design; at enterprise level, diversification benefits, management buffers and Pillar 2 add-ons are layered in for group capital adequacy and strategic planning.

Two risk types deserve specific attention. Operational risk is genuinely difficult to allocate below the business-line level - revenue-based allocation creates perverse incentives by penalizing growth. At the same time, activity-based proxies require data that most banks do not have. Concentration risk is hard to attribute to individual transactions and is usually held at the portfolio or BU level rather than charged into deal pricing. Both are real, and both must sit in the denominator at the appropriate level; they should not be ignored simply because they are hard to allocate granularly.

Trading-book RAROC requires explicit treatment of XVAs. A trading-book RAROC that ignores CVA, FVA, KVA, and MVA systematically overstates the economics of long-tenor uncollateralized derivatives. Banks running material derivative books should integrate XVA charges directly into the pricing-grade RAROC; the standalone treatment of XVAs as a separate "desk" is a transitional arrangement, not a target state.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

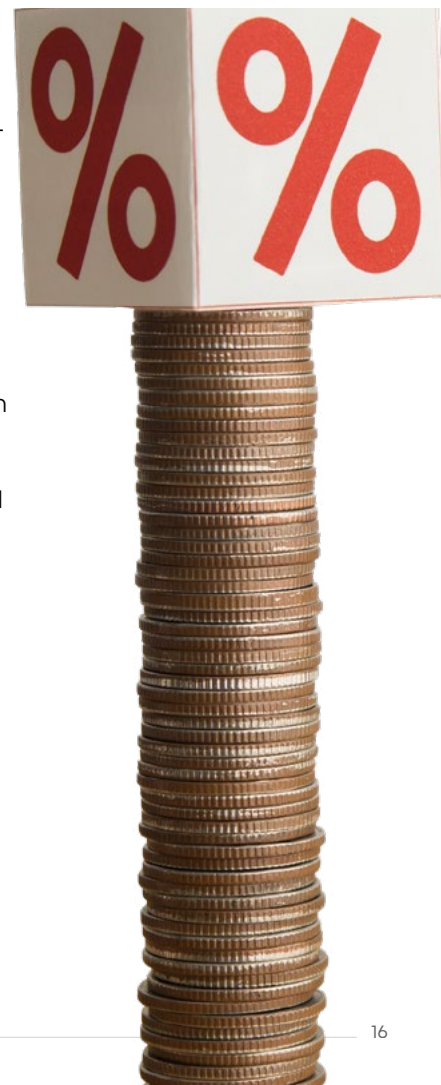
Glossary of Terms

About the Unique FRM Practice

The hurdle rate

A RAROC framework lives and dies by its hurdle rate. Set it too low, and the bank approves value-destroying business; set it too high, and it rejects value-accretive business in favor of competitors. Most banks anchor to a CAPM-derived cost of equity, cross-check against market-implied estimates, and benchmark to peers - settling on a single group hurdle reviewed annually. The methodology debate is well-trodden; the harder question is whether the hurdle should vary by business unit.

A single group hurdle is simpler and reflects the fact that equity is fungible at the group level. BU-specific hurdles are more economically correct because business risk profiles genuinely differ - investment banking is riskier than retail deposit-gathering - but they are politically harder and require sophisticated capital-allocation governance to defend. The pragmatic middle path adopted by several leading banks is a single group hurdle plus a documented "strategic premium" on businesses where execution risk or scale-up requirements genuinely warrant a higher bar, governed by the RAPM Council and reviewed annually.



Diversification: standalone or diversified capital

Diversification is one of the most consequential and least transparent design choices in RAROC. The bank's actual economic capital is well below the sum of the standalone capitals across business units because risks are imperfectly correlated. Where does the diversification benefit go?

The practical answer is to use both standalone and diversified views, but for clearly different purposes. **Standalone capital** is the right denominator for pricing and frontline performance - a deal team negotiating a single transaction does not control the diversification benefit, and rewarding them for it produces moral hazard. **Diversified capital** is the right denominator for enterprise capital allocation and BU-level Economic Profit - group capital is genuinely fungible, and allocation decisions should be made on the marginal cost of capital, which reflects diversification. The "diversification reserve" - the gap between the sum of standalone EC and group EC - should be visible, governed, and reviewed annually. Burying it produces the worst of both worlds: standalone numbers that double-count, or diversified numbers that obscure who gets credit.

The methodological choice - proportional, Euler, or component - is technical. The governance choice - who owns the methodology, who signs off, when it changes - is what determines whether the framework survives contact with the budget cycle.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice



Steering the Bank

Capital allocation, self-sufficiency, compensation, governance, and the implementation journey.

This is where most RAROC programs either translate into management impact or die at the first contact with the budget cycle. The mechanics are now in place; the question is whether the framework actually drives decisions - capital allocation, growth assessment, compensation, governance - or sits decoratively in a finance pack.

RAROC as a capital-allocation engine

RAROC is most valuable when capital is scarce. But the bank should focus on marginal, forward-looking RAROC rather than average historical RAROC. The real question for capital allocation is which incremental capital deployment is expected to generate the best risk-adjusted return, given all constraints. Bank Alpha illustrates the point. It has SAR 2 billion of deployable capital. Three business units submit growth proposals.

Business unit	Marginal RAROC	Capital requested	Binding constraint	Eco. capital
Retail banking	18.5%	SAR 1.0B	None - highest marginal RAROC, low concentration, strategic franchise	SAR 1.0B
Corporate banking	13.5%	SAR 1.2B	Sector concentration (RE 28%); marginal RAROC barely above hurdle	SAR 0.6B
Treasury trading	16.0%	SAR 0.8B	Duration / IRRBB limits	SAR 0.4B
Total		SAR 3.0B		SAR 2.0B

A business with moderate average RAROC but high marginal opportunity may deserve more capital than a mature business with high average RAROC but little scalable growth. RAROC sets the ranking, but it never decides allocation alone - concentration, liquidity, regulatory, and strategic-franchise overlays do the binding work, as the table above illustrates. RAROC should sit within that broader portfolio-steering framework rather than operate as a standalone ranking.



Self-sustaining business units

A strong RAROC indicates that a business generates an acceptable risk-adjusted return. It does not, on its own, prove that the business can fund its own future growth. A second metric - Capital Self-Sufficiency, defined as retained earnings from a BU divided by the incremental capital required for planned growth - answers a different question.

Business unit	Risk-adj profit	Retention	Retained earnings	Growth capital	Ratio	Verdict
Corporate banking	SAR 720M	65%	SAR 468M	SAR 600M	0.78×	Subsidized
Retail banking	SAR 480M	65%	SAR 312M	SAR 250M	1.25×	Surplus
Treasury	SAR 180M	65%	SAR 117M	SAR 100M	1.17×	Self-fund
Transaction banking	SAR 120M	65%	SAR 78M	SAR 150M	0.52×	Subsidized

Corporate banking has a solid RAROC (16.0%) but is capital-hungry. Retail is the star: strong RAROC and self-sustaining. A mature bank should assess both dimensions; a high-RAROC business that consistently consumes group capital is a different proposition from one that funds its own growth.

Linking RAROC to compensation

A RAROC framework that does not influence variable compensation does not run the bank. It is documentation. Mature banks embed RAROC and Economic Profit in BU scorecards alongside revenue and risk metrics, tie a defined slice of variable compensation (typically 20 to 35%) to RAROC and EP outcomes, and hold a portion back against multi-year realized performance with clawback where ex-post returns underperform what was claimed at origination. The structural design is straightforward; the failure modes are not.

The same design that ties pay to RAROC creates incentives to game it. Mature programs counter this by weighting realized over ex-ante RAROC with multi-year deferral and clawback, capping RAROC at 35% of variable comp so it cannot dominate scorecards, and placing methodology authority firmly outside business-line negotiation. The last is what the RAPM Council's independence is fundamentally designed to protect.

Governance: the RAPM Council

The difference between a bank running a credible RAROC framework and one running a decorative one is almost always governance, not methodology. The institutional center of gravity is a Risk-Adjusted Performance Measurement Council, chaired independently of P&L responsibility - typically by Strategy, the CRO, or a dedicated RAPM head, and not by the CFO if the CFO owns financial reporting. The Council comprises heads of major BUs, the CRO or deputy, the CFO or deputy, the head of model risk, and the head of finance or planning. It meets monthly on methodology issues, quarterly on BU RAROC trends, and annually for recalibration of methodology. It reports to Group ALCO and the Board Risk Committee - not buried inside Finance.

The Council owns the four foundations document, the eight-point comparability bridge between retail and wholesale, the hurdle-rate methodology and any business-specific premia, the diversification methodology and the diversification reserve, the cost-

attribution layering and dual-reporting policy, the annual external benchmarking review, and the methodology change protocol - including impact testing before any change goes live. It approves methodology changes that move BU RAROC by more than 50 bps.

Data and technology

Methodology and governance are necessary but not sufficient. Most RAROC programs that fail in implementation fail because the data layer cannot support them. Decision-level RAROC requires unified data across transactions, risk parameters, costs, FTP, and capital - and the binding constraints are usually consistent customer hierarchy across systems and activity-based cost granularity, not the calculation engine itself.

The single most common mistake in RAROC technology programs is to build the calculation engine before the source-of-truth layer. This produces a fast, sophisticated engine running on inconsistent inputs - a more elegant version of the same problem.

The journey: from where banks are, to where they need to be

A RAROC program is multi-year. Four maturity stages describe where a bank sits today.

Stage	Description	Characteristics	Move to the next
Stage 1: Reporting	RAROC appears in quarterly MIS	Backward-looking, no pricing impact, methodology inconsistent	12–18 months
Stage 2: Pricing screen	RAROC used at origination	Forward-looking for deals; not embedded in BU management; cost loading inconsistent	12–18 months
Stage 3: Performance management	RAROC drives scorecards and capital budgets	Standardized methodology; dual reporting; explicit hurdle; council in place	12–24 months
Stage 4: Strategic steering	RAROC + EP embedded across the bank	Marginal RAROC; multi-year lens; full relationship view; comp linkage; embedded in capital plan	Continuous

In our experience, most banks self-assess one stage higher than they actually operate. A practical diagnostic: a bank is at Stage 3 if and only if a deal team would price differently because of RAROC, and a sub-hurdle business has been actively repriced or wound down in the past 12 months. If neither is true, the framework is at Stage 1 or 2, regardless of how it appears on slides.

The journey from Stage 1 to Stage 4 is multi-year, and the sequence matters more than the speed. Banks that try to install RAROC-linked compensation before FTP and EC have settled find that the framework collapses under political pressure. Banks that try to extend RAROC into climate, lifetime, and full-relationship views before the core methodology is consistent produce numbers that do not stand up to first contact with a credit committee. The right starting point is a credible RAPM Council with clear authority, a documented methodology, and three to five visible quick wins - repricing or repositioning decisions that demonstrate the framework actually changes behavior.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

The build of FTP, EC, cost attribution, and the comparability bridge follows. Comp linkage, climate overlays, and full-lifetime RAROC come last, once the foundations are established.

Three principles for the journey



Sequence matters

Build credibility on FTP and EC before extending RAROC into compensation. Linking pay to numbers nobody trusts produces backlash, not behavior change.

The Council is the center of gravity

A RAPM Council with a weak mandate produces methodology drift; the framework will be undone by political weight within two budget cycles.

Communicate in business language, not actuarial.

The audience for RAROC is the CEO, the BU heads, and the front line - not the model risk function. If they cannot articulate why a number changed, the framework is not yet decision-grade.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Unique FRM Practice



The Five Questions RAROC Should Answer

A credible RAROC framework gives the bank crisp, defensible answers to five questions every senior committee asks - but few banks answer with the same number twice. If the framework cannot answer all five consistently, it is not yet running the bank.

#	The question	The RAROC application	Where covered
1	Should the bank book this transaction at this price?	Transaction-level RAROC against hurdle; floor-adjusted RAROC where the output floor binds; XVA-loaded RAROC for derivatives	Parts II, V
2	Which clients and segments deserve more balance sheet?	Customer and segment RAROC, including the liability dimension; group-level relationship RAROC for conglomerates	Part IV
3	Which business lines earn more than their cost of capital?	BU-level RAROC and Economic Profit, on the comparability bridge; floor-adjusted RAROC where regulatory capital binds	Parts II, IV
4	Which units can fund their own growth?	RAROC plus capital self-sufficiency ratio; multi-year EP trajectory	Part VI
5	Where should the next unit of scarce capital go?	Marginal RAROC plus concentration, liquidity, regulatory, and strategic overlays	Part VI

A bank running RAROC at Stage 4 can answer all five questions on a single page, sourced from a single canonical methodology owned by the RAPM Council. A bank at Stage 1 or 2 can typically answer one or two, and is silent, evasive, or politically negotiated on the rest. **The honest test of a RAROC framework is not how sophisticated the methodology is. It is whether the same number falls out of every committee.**

- Executive Summary
- Why RAROC Matters Again
- The Foundations That Must Hold
- The Forward-Looking Lens
- From Deal to Relationship to Group
- Architecture: How RAROC Is Built
- Steering the Bank
- The Five Questions RAROC Should Answer**
- Conclusion: RAROC 2.0
- Glossary of Terms
- About the Uniquis FRM Practice



Conclusion: RAROC 2.0

The argument is not that RAROC is a perfect measure. No single metric can capture the full complexity of bank economics. The argument is that RAROC - when built on the four credible foundations and embedded in real management processes - is the most powerful internal decision tool available to a bank.

It tells management which activities truly earn more than their cost of risk, which businesses consume capital without earning enough, which units can fund their own growth, and where scarce balance-sheet capacity should be deployed next. It does this with a single, consistent language that connects the front line to the C-suite - but only when the four foundations hold: a disciplined numerator, a credible FTP layer, a robust economic-capital base (achievable even on Standardized Approach), and defensible attribution across revenues, costs, and risks.

The banks that will win the next cycle are not the ones that measure RAROC the most precisely. They are the ones that run the bank through it - using it to price deals, steer portfolios, allocate capital, align incentives, and translate genuine value creation into management action.

That is RAROC 2.0.



Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Unique FRM Practice

Glossary of Terms

Terms used throughout this paper. Where multiple definitions exist in regulatory or industry practice, we use the convention applied in this document.

Term	Definition
ALCO	Asset-Liability Committee. The senior committee is responsible for balance-sheet management, including funding, liquidity, IRRBB, and FTP policy.
ASRF	Asymptotic Single-Risk-Factor model. The Vasicek-based foundation of the Basel IRB capital formula is widely used as a starting point for internal EC models.
BCBS 239	Basel Committee's principles for effective risk-data aggregation and risk reporting—the de facto data-quality standard for RAROC infrastructure.
Behavioral EAD	Exposure at default reflects expected drawdowns, prepayments, and utilization patterns - as distinct from contractual EAD.
Capital Self-Sufficiency Ratio	Retained earnings from a business unit are divided by the incremental capital required for planned growth. Measures whether the BU funds its own expansion.
CCF	Credit Conversion Factor. The proportion of an undrawn limit assumed to be drawn at default; key input into EAD for off-balance-sheet exposures.
CVA	Credit Valuation Adjustment. The market value of counterparty credit risk on derivatives is charged into trading-book pricing.
EAD	Exposure at Default - the expected outstanding amount at the time of default.
EC	Economic Capital. Internally calibrated capital required to absorb unexpected loss at a chosen confidence level; the RAROC denominator.
ECB	European Central Bank - supervisor for euro-area banks under the Single Supervisory Mechanism.
ECL	Expected Credit Loss under IFRS 9. Stage-1 (12-month) for performing exposures, Stage-2 / Stage-3 (lifetime) following a significant increase in credit risk or impairment.
EL	Expected Loss - typically through-the-cycle in RAROC: $PD \times LGD \times EAD$.
Economic Profit	Risk-adjusted return less the product of economic capital and the hurdle rate; the absolute value-creation measure is complementary to RAROC.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

Term	Definition
ERP	Equity Risk Premium - the spread of expected equity returns over the risk-free rate; a key CAPM input for hurdle-rate calibration.
Euler allocation	A method of allocating diversified group capital to sub-portfolios such that allocations sum exactly to total EC, based on marginal contribution.
FTP	Funds Transfer Pricing. The internal mechanism by which a bank charges asset-generating units for funding and credits liability-generating units for funding is provided.
FVA	Funding Valuation Adjustment. The cost of funding uncollateralized derivative exposures.
Hurdle rate	The minimum return required on economic capital to create shareholder value; typically, the bank's cost of equity.
ICAAP	Internal Capital Adequacy Assessment Process. Regulatory requirement under Basel Pillar 2 for banks to assess capital adequacy beyond the minimum regulatory framework.
IRB	The Internal Ratings-Based approach to credit-risk capital under Basel permits the use of internal PD, LGD, and EAD parameters, subject to supervisory approval.
IRRBB	Interest Rate Risk in the Banking Book. A Pillar 2 capital concern affects FTP design and treasury risk allocation.
KVA	Capital Valuation Adjustment. The lifetime cost of capital held against a derivative position; trading-book equivalent of forward-looking RAROC.
LCR	Liquidity Coverage Ratio. Basel III short-term liquidity standard; influences contingent-liquidity FTP charges.
LGD	Loss Given Default. The proportion of EAD lost in the event of default after recovery.
MVA	Margin Valuation Adjustment. The funding cost of initial margin under cleared and SIMM regimes for derivatives.
NGFS	Network for Greening the Financial System. Inter-central-bank network publishing climate scenarios for bank stress testing.
NIM	Net Interest Margin. Interest revenue less FTP cost (or interest expense).
NSFR	Net Stable Funding Ratio. Basel III's longer-term liquidity standard influences long-term asset FTP costs.
Output floor	Basel III endgame requirement that bank IRB capital cannot fall below 72.5% of the Standardized calculation; phasing in through 2032 in most jurisdictions.
PD	Probability of Default - typically 12-month for ECL Stage 1; lifetime for ECL Stage 2/3; through-the-cycle for RAROC EL.

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice

Term	Definition
PIT	Point-in-Time - risk parameters reflecting current macroeconomic conditions; used in IFRS 9 Stage 1 PD.
Pillar 2	The supervisory review process under Basel covers ICAAP, capital buffers, and risks not captured in Pillar 1 (concentration, IRRBB, business risk, climate).
RAPM	Risk-Adjusted Performance Measurement. Umbrella terms for RAROC, RoEC, RoRAC, EVA, and related metrics.
RAROC	Risk-Adjusted Return on Capital. Risk-adjusted return divided by economic capital.
RBI	Reserve Bank of India.
ROE	Return on Equity. Net income divided by book equity.
RORWA	Return on Risk-Weighted Assets. Net income divided by regulatory RWA.
SAMA	Saudi Central Bank - regulator for banks in the Kingdom of Saudi Arabia.
SICR	Significant Increase in Credit Risk - the IFRS 9 trigger for moving an exposure from Stage 1 to Stage 2.
SR 11-7	US Federal Reserve / OCC supervisory guidance on model risk management; the de facto global standard for model validation.
Standardized Approach	Basel credit-risk capital calculation using prescribed risk weights, without internal model approval.
TRIM	Targeted Review of Internal Models - ECB program assessing the quality of IRB models in euro-area banks; effectively the European parallel of SR 11-7.
TTC	Through-the-Cycle - risk parameters smoothed across a full credit cycle; used in RAROC EL and EC calibration.
XVA	The collective term for valuation adjustments on derivatives - CVA, FVA, KVA, MVA.

About the Uniquis FRM Practice

The Uniquis Financial Risk Management practice advises banks, financial institutions, and corporates on risk measurement, capital management, valuation, and regulatory transformation. Our work spans credit risk modeling, IFRS 9/ECL, ICAAP, RAROC and capital-allocation frameworks, FTP design, model risk management, and Basel implementation.

Areas of focus

Executive Summary

Why RAROC Matters Again

The Foundations That Must Hold

The Forward-Looking Lens

From Deal to Relationship to Group

Architecture: How RAROC Is Built

Steering the Bank

The Five Questions RAROC Should Answer

Conclusion: RAROC 2.0

Glossary of Terms

About the Uniquis FRM Practice



Profitability and capital frameworks

RAROC and Economic Profit design, FTP architecture, cost attribution, comparability bridges, and capital-allocation governance.



Credit risk and ECL.

IFRS 9 model development and validation, IRB and Standardized Approach implementation, model risk management aligned to SR 11-7/ TRIM.



Capital adequacy and stress testing

ICAAP, Pillar 2 capital build, climate stress testing, scenario design, NGFS-aligned frameworks.



Treasury, ALM, and IRRBB

Behavioral modeling, FTP curves, LCR / NSFR optimization, and IRRBB analytics.



Regulatory transformation

Basel III endgame readiness, regulatory dialogue support, governance, and BCBS 239-grade data architecture.

Engagement model

We work alongside client teams from diagnostic through to live operations - not as outside reviewers but as embedded co-builders. Our delivery typically combines a small senior team with on-the-ground execution capacity, structured against a phased roadmap with visible management deliverables on every horizon. Our methodology is grounded in regulatory practice across the GCC, India, ASEAN, the UK, and Europe.

How to engage

For a diagnostic against the four foundations of RAROC 2.0, or to discuss any of the themes in this paper, please get in touch with the Uniquis FRM practice.

About Uniquus Consultech:

Uniquus Consultech is a global tech-enabled consulting company that specializes in Accounting & Reporting, Governance, Risk & Compliance, Sustainability & Climate, Tech Consulting, and Valuations. The Company is co-founded by consulting veterans Jamil Khatri and Sandip Khetan and backed by marquee investors such as Nexus Venture Partners, Sorin Investments, and UST.

Uniquus has a global team of 800+ professionals led by 100+ Partners & Directors across eleven offices in the USA, the Middle East, and India. The company serves more than 300+ clients, including marquee names in each of the markets it operates in.

Uniquus is committed to leveraging technology and an integrated global delivery model to provide best-in-class consulting services to its clients.

About Our Accounting & Reporting Consulting Services:

In today's dynamic business environment, organizations are continuously required to adapt to the dynamic shifts in accounting & reporting standards and regulations. Enhanced management reporting requirements and accelerated reporting timelines necessitate increased automation within the finance function. Special events, such as preparing for an IPO/capital market transaction or fulfilling the reporting requirements arising from an M&A transaction, introduce additional complexities and challenges for the finance function.

As a result, organizations need to transform their finance functions from time to time with a focus on people, processes, and technology. Our Accounting & Reporting Consulting (ARC) practice is designed to partner with the finance function through these challenges. Our teams function as an extension of your finance teams to execute your plans seamlessly.

We bring the necessary technical expertise, skills, technology, and bandwidth, enabling you to navigate your plans in real time without adding additional manpower costs within the organization.

A Team That You Can Trust To Deliver



Jamil Khatri
Co-Founder & CEO



Sandip Khetan
Co-Founder, Global Head
of Accounting & Reporting
Consulting



Nirav Patel
Partner, Accounting &
Reporting Consulting



Sagar Lakhani
Partner, Accounting &
Reporting Consulting



Suresh Wadhwani
Partner, Accounting &
Reporting Consulting



Shyam Gupta
Associate Partner, Accounting
& Reporting Consulting

Govind Agarwal, Associate Director, Accounting & Reporting Consulting

Shaariq Daredia, Assistant Manager, Accounting & Reporting Consulting

Scan this code to find
more content like this



Visit us at www.uniquus.com

or follow us on

