

## ICAAP REPORT – RECOMMENDED STRUCTURE

### Introduction

The purpose of the Internal Capital Adequacy Assessment Process (ICAAP) is to inform the Board of Directors of the ongoing assessment of the bank's risks, how the bank intends to mitigate those risks and how much current and future capital is necessary having considered other mitigating factors.

It is the responsibility of the credit institution to define and develop its ICAAP. The ICAAP is codified in Article 73 of the [CRD](#) and implemented locally through Article 17C of the Banking Act (the Act). Within a credit institution's internal governance framework, the ICAAP is a process to ensure that the Board of Directors (both supervisory and management functions):

- adequately identifies, measures, aggregates and monitors the credit institution's risks;
- ensures that the credit institution holds adequate internal capital in relation to the credit institution's risk profile; and
- uses sound risk management systems and develops them further.

The onus is on the credit institution to demonstrate that its ICAAP is comprehensive and adequate to the nature of risks posed by its business activities and its operating environment. The framework under which a credit institution should develop its ICAAP is designed to be risk-based and emphasises the importance of capital planning, but also the importance of management and other qualitative aspects of risk management. When assessing their capital needs, all credit institutions should be able to take into account the impact of economic cycles and sensitivity to other external risks and factors. For larger and/or more complex credit institutions, this may mean developing an appropriately detailed and rigorous stress and scenario testing framework.

Various methodologies may be utilised by credit institutions for assessing their risk exposure and setting capital against it. At the same time, the introduction of the ICAAP is not meant to suggest that existing methods, which have met the needs of credit institutions over the years, may necessarily need to be replaced. However, all credit institutions should have adequate processes in place.

The ICAAP should be embedded in the credit institution's business and organisational processes, and not simply regarded as an add-on that permits the Board of Directors (both supervisory and management functions) to indicate that supervisory expectations have been met.

The authority recognises that there may be a fair degree of variation in the length and format of ICAAP submissions since banks' business and risk profiles differ and the ICAAP document should be proportional to the size, nature and complexity of a bank's business. However, while the suggested format by the authority may be considered to be convenient for some banks as on a general basis, it covers most of the matters which typically would be the subject of review through the Supervisory Review and Evaluation Process (SREP) which would be carried out by the authority. Once an ICAAP has been drawn up, the authority stresses that in line with the provisions of Article 17C of the Act, it should be subject to regular internal review and such assessment of the ICAAP is to be conducted at least annually.

Where appropriate, technical information on risk measurement methodologies, capital models and all other works carried out to validate the approach (e.g. Board papers and minutes, internal or external reviews), could be contained in appendices.

## **1. EXECUTIVE SUMMARY**

The purpose of the Executive Summary is to present an overview of the ICAAP approaches and methodology, as well as of results and conclusions. The overview would typically include:

- the purpose of the report (for the purposes of this document, report and ICAAP are used interchangeably and shall be construed to have the same meaning) and entity or entities covered therein;
- the main findings of the ICAAP analysis:
  - how much and what composition of internal capital the bank considers it should hold as compared with its Pillar I calculation; and
  - the adequacy of the bank's risk management processes;
- a summary of the financial position of the business, including the strategic position of the bank, its balance sheet strength, and future profitability;
- a brief description of the capital planning and dividend policy of the bank. In this respect, the report should include forecasts of the capital needs and of the regulatory Own Funds which must be in line with the bank's business plan. Moreover, it is expected that the possible sources of additional funds would be set out, especially in the cases of contingent future adverse events;
- a description of the contingency plans including strategies to address the contingent encumbrance resulting from stress events, which means plausible albeit unlikely shocks, including downgrades in the credit institution's credit rating (if any), devaluation of pledged assets and increases in margin requirements;

- commentary on the most material risks and the mitigation techniques implemented, why the level of risk is acceptable or, if it is not, what mitigating actions are planned;
- commentary on any other major issues where further analysis and decisions are required; and
- details on who has carried out the assessment, how it has been challenged, and who has approved it.

## **2. BACKGROUND**

Credit institutions should, within this section, include all relevant information that would assist towards the best possible understanding of the bank's structure and current financial condition. The information that should be depicted is the following:

- a) group structure;
- b) organisational structure, management team etc ;
- c) various financial data for the last five years e.g. operating profit, profit after tax, shareholders' funds, total assets, loans and deposits, regulatory capital etc. Commentary on the significant changes in the bank's financial condition during these years;
- d) significant developments that have taken place during the past five years e.g. acquisitions, changes in the share capital etc;
- e) the main shareholders of the bank (that is shareholders owning more than 5% of the share capital);
- f) a comparison of the internal capital which is maintained against the risks that are assumed with the minimum regulatory capital over the last years; and
- g) conclusions that may be drawn from the analysis of the historical data which may have implications for the bank's future.

## **3. SUMMARY OF CURRENT AND PROJECTED FINANCIAL AND CAPITAL POSITIONS**

Credit institutions should, within this section, analyse, among other things, the following:

- a) the current financial position of the bank or banking group (if relevant), including any expected changes to the current business profile (e.g. acquisitions, expansion abroad etc.);

- b) the economic environment within which the bank operates, as well as any possible expected changes;
- c) the business plan of the bank. It is expected that adequate information regarding all its business activities will be included;
- d) the projected financial positions of the bank, which should be in line with its business plans; and
- e) the capital planning and the sources of funds that the bank can access. It is expected that the bank will perform the necessary comparisons between the capital available and the capital required to fulfil its business plans. The means of covering the potential capital shortfalls should also be mentioned. It is to be noted that the capital projections may provide the baseline against which adverse scenarios might be compared.

#### **4. CAPITAL ADEQUACY**

Credit institutions may, within this section, commence with a description of the bank's risk appetite as defined by its Board of Directors and used in the ICAAP. It is vital for the authority to understand whether what is being presented in this section of the ICAAP represents the bank's view of the amount of capital required to meet minimum regulatory needs or whether what is being presented is the amount of capital that a bank believes it needs to meet business objectives. For instance, whether the capital required is based on a particular desired credit rating (if relevant) or includes buffers for strategic purposes or to minimise the chance of breaching regulatory requirements. Where economic capital models are used this would include the confidence level, time horizon, and description of the event to which the confidence level relates. Where scenario analyses or other means are used, then some other description of how the severity of scenario has been chosen would be included.

The section would then include a detailed review of the bank's internal capital adequacy.

The information provided would include:

##### ***Timing***

- The effective date of the internal capital adequacy calculations together with consideration of any events between this date and the date of submission which would materially impact the level of estimated capital together with their effects;
- Details of, and rationale for, the time period over which capital has been assessed; and
- An identification of the major risks faced in each of the following categories.

## *Risks analysed*

Pillar I risks	<ul style="list-style-type: none"><li>○ Credit Risk</li><li>○ Market Risk</li><li>○ Operational Risk</li></ul>
Risks not adequately covered by Pillar I	<ul style="list-style-type: none"><li>○ Residual Risk</li><li>○ Securitisation</li></ul>
Pillar II risks	<ul style="list-style-type: none"><li>○ Interest Rate Risk in the Banking Book</li><li>○ Concentration Risk</li><li>○ Liquidity Risk</li><li>○ Strategic Risk</li><li>○ Reputation Risk</li><li>○ Weaknesses in the risk mitigation techniques</li><li>○ Underestimation of credit risk with the adoption of the Standardised approach</li><li>○ Other risks</li></ul>
Other risks	<ul style="list-style-type: none"><li>○ Business risk (including quality of earnings)</li><li>○ General Strategy</li><li>○ Economic and regulatory environment</li><li>○ Stress testing</li></ul>

- For each risk type, an explanation regarding the methodology applied for its monitoring and measurement and the quantitative results of that assessment;
- Where relevant, a comparison of that assessment with the results of the Pillar 1 calculations;
- A clear articulation of the bank's risk appetite separately for each risk category if this varies from the overall assessment; and
- Where relevant, an explanation of any other methods or other specific techniques or arrangements apart from capital used to mitigate the risks e.g. insurance, risk management or control structures.

Accordingly, some of the major risks a bank might face and therefore need to assess as part of its ICAAP, are examined below. It should be stressed that this is not an exhaustive analysis of bank risks. Furthermore, banks might classify certain risks differently.

### ▪ *Residual credit risk*

While banks use credit risk mitigation (CRM) techniques to reduce their credit risk, these techniques give rise to other risks that may render the overall risk reduction less effective. These additional risks are legal risk, documentation risk and liquidity risk and are of supervisory concern. The Commission will expect banks to have in place appropriate written CRM policies and procedures in order to control these residual risks. Banks may be required to submit these policies and procedures to the authority and must regularly review their appropriateness, effectiveness and operation.

- *Credit concentration risk*

A risk concentration is any single exposure or group of related exposures with the potential to produce losses large enough to threaten a bank's health or ability to maintain its core operations. Risk concentrations are arguably the single most important cause of major problems in banks. Credit risk concentration arises in both direct exposures to obligors and may also occur through exposure to protection providers such as guarantors. Such concentrations are not addressed in the Pillar 1 capital charge for credit risk. Banks should have in place effective internal policies, systems and controls to identify measure, monitor, and control their credit risk concentrations. They should explicitly consider the extent of their credit risk concentrations in their assessment of capital adequacy under Pillar 2. These policies should cover the different forms of credit risk concentrations to which a bank may be exposed.

Credit risk concentrations include:

- A significant exposure to an individual counterparty or group of counterparties. Banks might also establish an aggregate limit for the management and control of all of its large exposures as a group;
- Credit exposures to counterparties in the same economic sector or geographic region;
- Credit exposures to counterparties whose financial performance is dependent on the same activity or commodity; and
- Indirect credit exposures arising from a bank's CRM activities (e.g. exposure to a single collateral type or to credit protection provided by a single counterparty).

A bank's framework for managing credit risk concentrations should be clearly documented and should include a definition of the credit risk concentrations relevant to the bank and how these concentrations and their corresponding limits are calculated. Limits should be defined in relation to a bank's capital.

A bank's management should conduct periodic stress tests of its major credit risk concentrations and review the results of those tests to identify and respond to potential changes in market conditions that could adversely impact the bank's performance. A bank should ensure that, in respect of credit risk concentrations, it complies with the Basel Committee document [\*Principles for the Management of Credit Risk\*](#) (September 2000) and the more detailed guidance in the Appendix to that paper. (While the authority has never actually issued a Banking Rule endorsing this Basel Committee document, it expects banks to take account of it as part of its culture to foster the adoption of international best practice guidelines by banks.)

The authority will assess the extent to which a bank considers its credit risk concentrations in its ICAAP and how they are managed. Such assessments should include reviews of the results of any stress tests carried out either locally or at the group level. The authority will review the bank's assessment and consider what action

is necessary where the risks arising from a bank's credit risk concentrations are not considered to be adequately addressed in the ICAAP.

- *Counterparty credit risk*

Counterparty credit risk or CCR is the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows. As CCR represents a form of credit risk, in assessing it, banks are required to meet the CRR requirements regarding approaches to stress testing, "residual risks" associated with CRM techniques, and credit concentrations, as specified in the paragraphs above.

Banks must have counterparty credit risk management policies, processes and systems that are conceptually sound and implemented with integrity relative to the sophistication and complexity of a firm's holdings of exposures that give rise to CCR. A sound counterparty credit risk management framework shall include the identification, measurement, management, approval and internal reporting of CCR.

Banks' risk management policies must take account of the market, liquidity, legal and operational risks that can be associated with CCR and, to the extent practicable, interrelationships among those risks. Banks must not undertake business with a counterparty without assessing its creditworthiness and must take due account of both settlement and pre-settlement credit risk. These risks must be managed as comprehensively as practicable at the counterparty level (aggregating counterparty exposures with other credit exposures) and at the bank-wide level.

A bank's board of directors and senior management must be actively involved in the CCR control process and must regard this as an essential aspect of the business to which adequate resources need to be devoted. Reports prepared on a firm's exposures to CCR must be reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the firm's overall CCR exposure.

The measurement of CCR must include monitoring daily and intra-day usage of credit lines. The bank must measure current exposure gross and net of collateral held where such measures are appropriate and meaningful (e.g. OTC derivatives, margin lending, etc.). Banks must take account of large or concentrated positions, including concentrations by groups of related counterparties, by industry, by market, customer investment strategies, etc.

Banks must have a process in place for ensuring compliance with a documented set of internal policies, controls and procedures covering CCR management.

- *Interest rate risk on the banking book*

The authority will require banks not holding capital commensurate with their level of interest rate risk to reduce their risk, to hold a specific and appropriate amount of capital or some combination of the two. Further guidance on interest rate risk in the banking book may be found in this Rule.

- *Operational risk*

Gross income, used in Pillar 1 under the Basic Indicator and Standardised Approaches for operational risk, is only a proxy for the scale of operational risk exposure of a bank and can, in some cases (e.g. for banks with low margins or profitability) underestimate the need for capital held against potential losses arising from operational risk. Drawing on the Basel Committee document on [\*Principles for the Sound Management of Operational Risk\*](#) (June 2011), the ICAAP should include consideration of whether the capital requirement generated by the Pillar 1 calculation for operational risk gives a realistic picture of the bank's operational risk exposure.

- *Credit risk*

A bank may be aware of particular circumstances that it believes would lead the Standardised Approaches to credit risk under Pillar 1 to give rise to an underestimation of credit risk. An example is where certain banks have adopted the practice of giving indicative credit facilities to clients on an uncommitted basis. Such clients are often significant corporate customers. Commercially a bank may not realistically be able to walk away from that relationship and the credit risk of such uncommitted facilities needs to be recognised. It is important to estimate the "realistic" exposure to the potential borrower (not just the contractual exposure) and reflect that as a credit risk against which there should be a capital charge. As with operational risk, the ICAAP should include consideration of whether the capital requirement generated by the Pillar 1 calculation gives a realistic picture of the bank's credit risk exposure.

- *Reputational Risk*

Reputational risk (to banks and to the jurisdictions from where they operate) is one of the most important risks in international finance centres. The authority will expect banks to have assessed the reputational risk contained in their high risk accounts and relationships and to have used a proxy (which might be the number or proportion of high risk accounts or relationships a bank has on its books) to generate a capital charge for reputational risk and/or provide evidence of measures in place to mitigate that reputational risk. An example of such measures could be robust and clear customer acceptance procedures and implemented processes with no "blind spots" with respect to names of underlying principals (for example the inappropriate use of pooled accounts). A robust customer risk-profiling regime would be a prerequisite.

- *Liquidity Risk*

Liquidity risk is the risk that a bank is unable to fund increases in assets and meet obligations as they come due. Managing this risk is not only crucial to the ongoing viability of a bank; it also transcends the individual bank since a liquidity shortfall at a single bank can have system-wide repercussions. For this reason the analysis of liquidity requires bank management not only to measure the liquidity position of the bank on an ongoing basis but also to examine how funding requirements are likely to evolve under various scenarios, including adverse conditions. As with managing other risks, sound liquidity risk management involves setting a strategy for the bank, ensuring effective board and senior management oversight, as well as operating under a sound process for measuring, monitoring and controlling liquidity risk.



- *Strategic/Business Risk*

Strategic and business risks are the impact on capital arising from adverse business decisions, improper implementation of those decisions, or a lack of responsiveness to political, fiscal, regulatory, economic, cultural, market or industry changes. Banks should constantly review and assess the compatibility of their strategic goals to the prevailing environment in which they have material operations. There will be both quantitative and qualitative dimensions to the resources needed to carry out business strategies but these will include effective communication channels, efficient operating systems, reliable delivery networks, and good quality management and staff.

### ***Methodology and Assumptions***

A description of how assessments for each of the major risks have been approached and the main assumptions made.

a) Minimum capital requirement approach (Pillar I + approach)

Banks may choose to base their ICAAP on the results of the Pillar I calculation with additional risks (e.g. concentration risk, interest rate risk in the banking book etc.) assessed separately and added to Pillar I.

The description here should indicate clearly which risks are covered by which modelling or calculation approach. This would include details of the methodology and process used to calculate risks in each of the categories identified and reason for choosing the method used in each case.

b) Internal model design (structured or advanced methodology)

Alternatively, banks may decide to base their ICAAP on internal models for all risks, including those covered under Pillar I (i.e. Credit, Market and Operational Risks). Where the bank uses an internal model for the quantification of its risks, credit institutions would, within this section, explain for each of those models:

- the key assumptions and parameters within the capital modelling work and background information on the derivation of any key assumptions;
- how parameters have been chosen, including the historical period used and the calibration process;
- the limitations of the model;
- the sensitivity of the model to changes in those key assumptions or parameters chosen; and
- the validation work undertaken to ensure the continuing adequacy of the model.

### ***Economic and regulatory capital***

Credit institutions should, within this section, set out its explanations for any differences between the internal economic models and the regulatory models (if any) approved by the authority. The explanations should refer to the parameters used, the assumptions made and how these affect the capital measures.

In addition, it is expected that a comparison between the calculated internal capital and the minimum required regulatory capital for Pillar I risks is provided. In this respect, the authority expects the bank to comment upon the composition and the adequacy of the capital maintained.

The authority expects that these explanations will be provided, on a sufficiently sound basis to show the differences at the level of all risk categories under Pillar I, that is, credit risk, market risk and operational risk.

It is noted that this information is expected from banks that apply advanced methods for the calculation of capital requirements.

### ***Stress and scenario tests applied***

The authority places special importance on the performance of stress tests or scenario analyses which have been used by credit institutions. Consequently, it expects a detailed and relevant exposition which should provide the following:

- details of all stress tests and simulations carried out by the bank to capture risks not well estimated by the bank's internal capital model (e.g. non-linear products, concentrations, illiquidity and gapping of prices, shifts in correlations in a crisis period);
- details of the quantitative results of stress tests and scenario analyses the bank carried out and the confidence levels and key assumptions behind those analyses, including, the distribution of outcomes obtained for the main individual risk factors;
- details of the range of combined adverse scenarios which have been applied, the reasons for choosing such scenarios and the resulting capital requirements; and
- details of any corrective measures including risk mitigation and/or capital allocations.

### ***Capital transferability***

Details of any restrictions on the management's ability to transfer capital into or out of the business(es) covered, for example, contractual, commercial, regulatory or statutory restrictions that apply. Statutory restrictions could be limited to the maximum dividend that could be declared and paid following certain actions to maximise distributable reserves, through for example, crystallising unrealised gains, the ability for capital transfer within a group (if applicable) and the minimum regulatory restrictions and contractual reserves that should be maintained.

### *Assessment of qualitative factors*

The authority expects to receive information in relation to the internal processes that the bank uses to monitor and control the various risks. This information is expected to cover issues such as the bank's system of internal controls, its organisational structure, its internal governance etc.

## **5. CAPITAL PLANNING**

Credit institutions would, within this section, explain how a bank would be affected by an economic recession or downswings in the business or market relevant to its activities. The authority places particular importance on a bank's ability to manage its business and capital so as to survive a recession whilst meeting minimum regulatory standards. The analysis would include financial projections (including capital projections) based on the expected (basic) scenario as well as on possible adverse scenarios covering three to five years based on business plans and projected capital adequacy ratio calculations.

For that purpose, the severity of the recession would typically be one that occurs only once in a 25 year period. The time horizon would be from the present day to at least the deepest part of the recession. Moreover, the key macroeconomic factors on which the various scenarios are based and the reasons for choosing them are expected to be laid out.

Typical scenarios would include:

- how an economic downturn would affect
  - the bank's capital resources and future earnings; and
  - the bank's capital requirement taking into account future changes in its projected balance sheet;
- in both cases above, it would be expected that these projections showed separately the effects of management actions to change the bank's business strategy and the implementation of contingency plans;
- projections of the future capital requirement would include the effect of changes in the credit quality of the bank's credit risk counterparties (including possible migration in their ratings during a recession) and the bank's capital and its credit risk capital requirement (note that this scenario stress test is a requirement for banks with an IRB permission); and
- an assessment by the bank of any other capital planning actions to enable it to continue to meet its regulatory capital requirements throughout a recession such as new capital injections from related companies or new share issues.

Credit institutions would, within this section, also explain which key macroeconomic factors are being stressed, and how those have been identified as drivers of the bank's

earnings. The bank would also explain how the macroeconomic factors affect the key parameters of the internal model (and for credit risk, the regulatory model) by demonstrating for instance how the relationship between the two has been established.

### ***Management Actions***

Credit institutions would, within this section, expand on the management actions assumed in deriving the ICAAP, in particular:

- the quantitative impact of management actions – sensitivity testing of key management actions and revised ICAAP figures with management actions excluded; and
- evidence of management actions implemented in the past during similar periods of economic stress.

It is to be noted that where a bank has an IRB permission, then credit institutions may, within this section, set out management actions which mitigate the additional capital suggested by the mandatory credit rating migration stress test. Alternatively, such actions might be set out in a separate ‘capital management plan’ or otherwise approved by senior management or the Board of Directors as actions the bank is committed to realistically take in such circumstances.

## **6. LIQUIDITY PLANNING**

Credit institutions would, within this section, summarise how liquidity risk is managed (as distinct from any capital set aside to cover losses incurred in a liquidity stress). In particular, it would set out the key assumptions and conclusions from stress testing of cash flows undertaken to manage the risk. It would generally be helpful for the ICAAP to include as appendices the following, where relevant:

- asset-liability committee (ALCO) papers and samples of management information used day-to-day in Treasury departments: daily cash flow forecasts, weekly, monthly etc;
- liquidity and funding policy documentation (solo and group);
- internal Audit reports relating to Treasury departments;
- an organisation chart that covers liquidity and funding risk management delegated authorities and reporting lines within the bank;
- limit breach, policy documentation;
- securitisation documentation detailing how the programmes function;
- liquidity stress testing documentation;

- an explanation of intra-group liquidity arrangements (if any/applicable), especially if operating in several countries;
- number, scale and timeline of commitments whether formal or informal towards:
  - o off-balance sheet financing vehicles
  - o market counterparties (including margin or collateral obligations) or
  - o towards clients;
- analysis of liquidity demands and sources of liquidity (ie funding risk and market liquidity risk affecting assets) by name and considering strategic and tactical management of the risk; and
- quantified contingency funding plans.

Whilst capital is an imperfect mitigant (i.e. is not a preventative measure) for liquidity risk, there may well be a capital cost of a liquidity stress. Banks should therefore consider here or in the previous section such scenarios as a ratings downgrade or other event which might increase their cost of funding and therefore absorb capital reserves.

Credit institutions should, within this section, also take into consideration the provisions and requirements of Banking Rule BR/05 on Liquidity and Part Six of the CRR(Articles 411 to 428).

## **7. LEVERAGE**

In accordance with Article 521 of the CRR, as from 1 January 2015, credit institutions shall be required to disclose information regarding their leverage ratio and their management of the risk of excessive leverage in accordance with Article 451(1) of the CRR.

Credit institutions should, within this section, disclose the leverage ratio, calculated in accordance with Articles 429 and 499 of the CRR and provide information about the risk of excessive leverage and the processes used to manage such risk. Credit institutions should also refer to the provisions and requirements of the [Final draft Implementing Technical Standards \(ITS\) on Disclosure for Leverage Ratio](#), which were published by the EBA on 5 June 2014. These ITS will enter into force upon their publication on the Official Journal of the European Union.

For the purposes of this section, credit institutions should also take into consideration the provisions and requirements of Article 430 of the CRR.

## 8. AGGREGATION AND DIVERSIFICATION

The processes of risk assessment and stress testing combined with assessments of the impact of risks and the probability of them occurring will enable banks to begin to assign specific quantitative measures to particular risks. These quantitative assessments should help the management of banks to determine the relative importance of the risks facing the bank. This, in turn, will assist bank management to decide whether to allocate additional capital (and, if so, how much capital) or to establish, enhance or maintain other mitigants to address those risks. Other mitigants might be specific procedures, controls or insurance programmes. Where a bank decides to allocate additional capital as a mitigant against particular risks, these additional capital sums should be aggregated to provide an additional capital requirement under Pillar II. This would be added to the minimum capital figure derived from Pillar I to give the bank's overall capital charge.

Credit institutions would, within this section, describe how the results of the various separate risk assessments are brought together and an overall view taken on capital adequacy. At a technical level, this therefore requires some method to be used to combine risks using quantitative techniques. At the broader level, the overall rationality of the detailed quantification approaches might be compared with the results of an analysis of capital planning (see section 5) and a view taken by senior management as to the overall level of capital that is appropriate.

- Dealing with the technical aggregation, this would describe:
  - i) any allowance made for diversification, including any assumed correlations within risks and between risks and how such correlations have been assessed, including in stressed conditions;
  - ii) the justification for any credit for diversification benefits between legal entities, and the justification for the free movement of capital between them in times of financial stress; and
  - iii) the impact of diversification benefits with management actions excluded. It might be helpful to set out revised ICAAP figures with all correlations set to '1' i.e., no diversification; and similar figures with all correlations set to '0' i.e. assuming all risks are independent.
- As regards the overall assessment, this would describe how the bank has arrived at its overall assessment of the capital it needs, taking into account such matters as:
  - i) the inherent uncertainty in any modelling approach;
  - ii) weaknesses in the bank's risk management procedures, systems or controls;
  - iii) the differences between regulatory capital and internal capital; and

- iv) the differing purposes that capital serves: shareholder returns, rating objectives for the bank as a whole or certain debt instruments the bank has issued, avoidance of regulatory intervention, protection against uncertain events, depositor protection, working capital, capital held for strategic acquisitions etc.

## **9. CHALLENGE AND ADOPTION OF THE ICAAP**

Credit institutions would, within this section, describe the extent of challenge and testing of the ICAAP. It would include the testing and control processes applied to the ICAAP models or calculations, and the senior management or Board of Directors review and sign-off procedures. It might be helpful if a copy of any relevant report to senior management or the Board of Directors and their response are duly attached.

Details of the reliance placed on any external suppliers would also be detailed here e.g. for generating economic scenarios.

In addition, a copy of any report obtained from an external reviewer or internal audit would also be included.

## **10. USE OF THE ICAAP WITHIN THE BANK**

This would demonstrate the extent to which capital management is embedded within the bank including the extent and use of capital modelling or scenario analysis and stress testing within the bank's capital management policy, e.g. in setting pricing and charges and the level and nature of future business.

This would also include a statement of the actual operating philosophy on capital management and how this links to the ICAAP submitted. For instance, differences in risk appetite used in the ICAAP as compared to that used for business decisions might be discussed.

Finally, it would be helpful if the bank could detail any anticipated future refinements within the ICAAP (highlighting those aspects which are work-in-progress) and provide any other information that you believe will help us review your ICAAP. The authority will assess the ICAAP to establish whether the amount of capital identified by the ICAAP is sufficient to support the risks faced by the bank.

The authority will review the corporate governance framework around the ICAAP and will pay particular attention to Board of Directors and senior management oversight and involvement, as well as responses to any issues raised by the authority during the review. It will also consider the extent to which the internal capital assessment is used routinely within the bank for decision making purposes.

The authority places particular importance on the integration of the ICAAP within the bank's decision making process. Therefore, it is expected that banks disclose the methods of utilising the results of their internal models, of the various stress tests etc.

in the decision making process e.g. during the determination of their pricing policy, in the course of evaluating investment options etc.

## **11. FUNDING PLANS**

Credit institutions shall be required to refer to Banking Rule BR/16 of 2014 on the Funding Plans for Credit Institutions authorised under the Banking Act. The reporting of funding plans in the ICAAP will enable the authority to monitor and assess the relevant funding risk and funding risk management frameworks.