

Consultation Paper on Guidelines on ICAAP and  
ILAAP information collected for SREP purposes  
and ECB supervisory expectations

European Banking Authority and European Central Bank

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# Introduction

**The EBA published in December 2015 Draft Guidelines (GL) specifying the information on the ICAAP and the ILAAP that competent authorities should collect under the SREP. Following this publication, the ECB published a document requiring significant institutions to follow these GL**

## Introduction

- The CRD IV requires institutions to have in place an internal capital adequacy assessment process (**ICAAP**); and an internal liquidity adequacy assessment process (**ILAAP**). These processes are key risk management instruments for institutions, and competent authorities (CAs) review them as part of the Supervisory Review and Evaluation Process (**SREP**).
- In the European Union, the **European Central Bank** (ECB) assumed responsibility for the supervision of significant institutions within the Single Supervisory Mechanism (SSM) from November 2014 onwards. Thus, the ECB is responsible for carrying out the SREP with respect to these institutions.

### EBA

- The EBA published in December 2015 a Consultation Paper on **Draft Guidelines** intended to ensure convergence of supervisory practices in the assessment of ICAAP and ILAAP as required by the SREP<sup>1</sup>.
- In particular, these Guidelines specify what **information regarding ICAAP and ILAAP CAs should collect** from the institutions in order to perform their assessments.
- In addition to specifying information items, these Guidelines also set **general considerations** for CAs to organise collection of ICAAP and ILAAP information from institutions and using such information for the purposes of their assessments of other SREP elements.

### ECB

- Following the publication of the Guidelines by the EBA, the ECB published in January 2016 a document addressed to the **management of significant institutions** within the SSM on this matter.
- This document specifies that institutions shall submit ICAAP and ILAAP information as spelled out in the EBA Guidelines, but taking into account some **specifications** concerning the delivery dates, formats and content of the information collected.
- Moreover, the ECB sets out some **supervisory expectations** with regard to the ICAAP and ILAAP.

This document analyses the Draft Guidelines published by the EBA. Moreover, an analysis of the ECB document addressed to the management of significant institutions is included.

(1) These Guidelines should be read together with the EBA Guidelines on common procedures and methodologies for SREP.

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# Executive Summary

## GL on ICAAP and ILAAP information

**Information items to be collected by CAs are divided into four categories: information common to ICAAP and ILAAP, ICAAP-specific information, ILAAP-specific information, conclusions and quality assurance**

### Executive summary

#### Scope of application

- Institutions as defined in the CRR/CRD IV: **credit institutions** and **investment firms**.

#### Regulatory context

- **CRD IV** (European Parliament and Council, June 2013).
- Guidelines for common procedures and methodologies for the **SREP** (EBA, December 2014).

#### Next steps

- Comments to this consultation paper shall be submitted by **11 March 2016**.
- The final Guidelines are expected to apply from **30 June 2016**.

### Main content

#### General considerations

- The GL contain general considerations related to operational procedures (i.e. notification to institutions about reference dates, frequency, etc.), the proportionality principle, supplementary information and cross-border banking groups.
- An overarching document shall be included providing an overview of the information items to be collected (reader's manual).

#### Information common to ICAAP and ILAAP

- Business model and strategy
- Risk governance framework
- Risk appetite framework
- Risk data, aggregation and IT systems
- Disclosure of ICAAP and ILAAP

#### ICAAP-specific information

- Overall ICAAP framework
- Risk measurement, assessment and aggregation
- Capital planning
- Internal capital and capital allocation
- Stress testing in ICAAP

#### ILAAP-specific information

- Liquidity and funding risk management
- Funding strategy
- Strategy on liquidity buffers
- Cost benefit allocation mechanism
- Intraday liquidity risk mgmt.
- Liquidity stress testing
- Contingency funding plan

#### Conclusions and QA

- Conclusions on the findings of the ICAAP and ILAAP and their impact on the risk and overall management
- Quality assurance
- Internal audit reports

# Executive Summary

## ECB supervisory expectations

The ECB document applies to significant institutions within the SSM and includes specifications regarding the EBA Guidelines, and supervisory expectations on the ICAAP and the ILAAP

### Executive summary

#### Scope of application

- **Significant institutions** within the SSM, as defined in the Guide to banking supervision.

#### Regulatory context

- **CRD IV** (European Parliament and Council, June 2013).
- Guidelines for common procedures and methodologies for the **SREP** (EBA, December 2014).

#### Next steps

- The first submission of the ICAAP and ILAAP information by significant institutions is expected by **30 April 2016**, with 31 December 2015 as reference date.

### Main content

#### Specifications regarding the EBA GL

##### Specifications on **dates** and **format**:

- Deadline and reference date
- Consolidation level
- Reader's manual

##### Specifications on **content**:

- Risk measurement assessment and aggregation ICAAP
- Internal capital and capital allocation
- Supporting documentation of ILAAP
- Conclusions and quality assurance

#### Supervisory expectations on ICAAP

- Governance.
- General design of the ICAAP.
- ICAAP perspective.
- Risks considered.
- Definition of internal capital.
- Assumptions and key parameters.
- Inter-risk diversification effects.
- Severity level of stress tests.
- Stress testing scenario definition.

#### Supervisory expectations on ILAAP

- General definition of the ILAAP (clear and formal statement, sound economic perspective, etc.).
- ILAAP reporting (information items not covered, short term exercise, etc.)

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# GL on ICAAP and ILAAP information

## General considerations



The EBA GL include general considerations concerning operational procedures, the proportionality principle, supplementary information that may be requested, cross-border banking groups and the overarching document on ICAAP and ILAAP

### General considerations

#### Operational procedures

- CAs should notify institutions about the **dates** by which the information should be provided, the **reference date**, the **frequency** and the **technical means and format** for the submission of information.

#### Proportionality

- The operational procedures should be proportionate to the category of an institution.
  - **SREP Category 1 institutions**<sup>1</sup> → on an annual basis by one single set date.
  - For **non-Category 1 institutions** CAs may determine different frequency, reference dates, etc.

#### Supplementary information

- CAs may request institutions to provide **supplementary information** needed. Furthermore, CAs may request some specific information outside the regular ICAAP and ILAAP submission cycle.

#### Cross-border banking groups

- CAs involved should coordinate the dates, means, format and detailed scope of each information item **consistently for all entities within the group** of institutions.

#### Overarching document

- CAs should collect an overarching document that facilitates the assessment of ICAAP and ILAAP documents by providing an **overview** of them and their **status**.

(1) Global systemically important institutions (G-SIIs), other systemically important institutions (O-SIIs) and, as appropriate, other institutions determined by CAs.

# GL on ICAAP and ILAAP information

## Information common to ICAAP and ILAAP



**Information common to ICAAP and ILAAP refers to items related to the institution's business model and strategy, risk governance framework...**

### Information common to ICAAP and ILAAP

#### Business model and strategy

- Description of the **current business models**, including identification of core business lines, markets, geographies, subsidiaries and products.
- Description of **main income and cost drivers**, allocated to core business lines, markets and subsidiaries.
- Description of the **changes planned** by the institution to the current business model and its underlying activities.
- **Projections of key financial metrics** for all core business lines, markets and subsidiaries.
- Description of how the **business strategy and ICAAP/ILAAP** are linked.

#### Risk governance framework

- Description of the **overall governance arrangements** (e.g. roles and responsibilities within the risk management and control organisation, including at the level of management body and senior management across the group).
- Description of reporting lines and frequency of regular **reporting to the management body** covering the risk management and control of the risks.
- Description of **interaction between risk measurement and monitoring** and **actual risk taking** practice (e.g. limit setting, monitoring, dealing with breaches, etc.).
- Description of **processes** that ensures that the institution has in place a robust framework for the **management of its risks**, the **interaction and integration** of capital and liquidity management (e.g. interaction between ICAAP and ILAAP) and the **overall management** of an institution.
- Where appropriate, description of **separation of tasks** within the banking group, **institutional protection scheme** or **cooperative network** concerning risk management.

# GL on ICAAP and ILAAP information

## Information common to ICAAP and ILAAP



...as well as to the institution's risk framework, risk data aggregation and IT systems and disclosure of ICAAP and ILAAP

### Information common to ICAAP and ILAAP

#### Risk appetite framework

- Description of the correspondence of the **strategy and business model** of the institution with its **risk appetite framework**.
- Description of the **process and governance arrangements**, including the roles and responsibilities within senior management and management body, in respect of the design and implementation of the **risk appetite framework**.
- Information on the **identification of material risks** the institution is or might be exposed to.
- Description of the **risk appetite/tolerance levels, thresholds and limits** set for the identified material risks, as well as time horizons, and the process applied to keeping such threshold and limits up-to-date.
- Description of the **limit allocation framework** covering core business lines, markets and subsidiaries.
- Description of the **integration and use** of the risk appetite framework in **risk and overall management**.

#### Risk data, aggregation and IT systems

- Description of the framework and process to **gather, store and aggregate risk data** across various levels.
- Description of **data flow and data structure** of risk data used for ICAAP and ILAAP.
- Description of **data checks** applied for risk data used for ICAAP and ILAAP.
- Description of **IT systems** used to gather, store, aggregate and disseminate risk data used for ICAAP and ILAAP.

#### Disclosure of ICAAP and ILAAP

- Description of **what information is being disclosed**, including content, frequency, etc.
- An assessment of the **impact of the disclosed information** on the institution's ability to follow its capital and funding plans, its liquidity and funding profile, and management ability to react to changes in the risk profile.
- Where appropriate, explanation of any **deviations** between disclosed information, internal ICAAP/ILAAP information and information reported to the competent authorities.

# GL on ICAAP and ILAAP information

## ICAAP-specific information



With regard to ICAAP-specific information, CAs should collect from institutions both methodology and operational documentation, covering the overall ICAAP framework, risk measurement, assessment and aggregation, and capital planning

### ICAAP-specific information

#### METHODOLOGY AND POLICY DOCUMENTATION

- Description of the **scope of the ICAAP**.
- Description of the approach to the **identification of risks** and the inclusions of them within risk categories and sub-categories.
- Description of **key objectives** and **main assumptions** of ICAAP, including how this ensures capital adequacy.
- Description of whether the ICAAP is focused on the risks' impact on **accounting figures** or on the **economic value**, or both.
- Description of **time horizons**.

- Description of quantification **methodologies and models**, (including metrics, assumptions, and parameters).
- Specification of **actual data used**.
- Descriptions of the main **differences** between models used for ICAAP and those used for minimum own funds requirements<sup>1</sup>.
- Description of the approach to **aggregation of internal capital estimates** for entities and risk categories covered, including the approach to diversification benefits and/or concentrations.

- Description of the **general set-up of capital planning**, including dimensions considered (e.g. internal, regulatory), time horizon, capital instruments, capital measures etc.
- Description of the **main assumptions** underlying the capital planning.

#### OPERATIONAL DOCUMENTATION

- **List of risk categories and sub-categories** (e.g. definitions and perimeter).
- Explanations of **differences** between risks covered by the ICAAP and the risk appetite framework.
- Description of any **deviations** in the ICAAP process and **key assumptions** within the group and entities of the group.

- **Internal capital estimates** to cover all risk categories and subcategories.
- The **results of the calculation of internal capital estimates** on a risk-by-risk basis.
- The results of the **aggregation** of internal capital estimates for entities and risk categories, including the effects of diversification and/or concentrations.

- Forward-looking view on the **development of risks and capital** in terms of both internal capital and regulatory own funds.
- Description of the **current conclusions** from capital planning (issuances, planned changes to the balance sheet, etc.).

Overall ICAAP framework

Risk measurement assessment and aggregation

Capital planning

(1) In case an institution is using advance models approved by the CAs.

# GL on ICAAP and ILAAP information

## ICAAP-specific information



The GL also specify that CAs should collect ICAAP-specific information with regard to internal capital and capital allocation and stress testing in ICAAP

### ICAAP-specific information

#### Internal capital and capital allocation

##### METHODOLOGY AND POLICY DOCUMENTATION

- **Definition of internal capital** used to cover ICAAP capital estimates, including all capital elements/instruments considered.
- Description of the main **differences** between internal capital elements/instruments and regulatory own funds instruments.
- Description of the methodology and assumptions used for the **allocation of internal capital** to group entities, core business lines, and markets.
- Description of the **monitoring process** (comparison of internal capital estimates vs. allocated capital).

#### Stress testing in ICAAP

- Description of the **governance arrangements** for the execution, approval and use of ICAAP stress testing.
- Description of **integration** of ICAAP stress testing into the **overall stress testing programme**, and of its interaction with other stress testing, as well as integration into risk management.
- Description of **adverse scenarios** considered under ICAAP.
- Description of **key assumptions** used in the scenarios.

##### OPERATIONAL DOCUMENTATION

- **Amount of internal capital available** to date.
- **Actual amounts of internal capital allocated** to risks, group entities, core business lines and markets.
- **Quantitative comparison** between the actual internal capital usage relative to the internal capital allocated based on ICAAP estimates.
- **Quantitative outcome** of the scenarios considered and **impact on key metrics**, including P&L and capital, internal and regulatory own funds, etc.
- Explanation of how **scenario outcomes are relevant** to the business model, strategy, material risks and group entities covered by the ICAAP.

# GL on ICAAP and ILAAP information

## ILAAP-specific information



The ILAAP-specific information includes, among others, items on liquidity and funding risk management, such as the scope of the ILAAP, the description of the set-up of the ILAAP, etc.; and items on the funding strategy, such as the description of the funding plan

### ILAAP-specific information

#### Liquidity and funding risk management

#### METHODOLOGY AND POLICY DOCUMENTATION

- Description of the **scope of the ILAAP**.
- Description of the **set-up of the ILAAP** explaining the relation between all its components and providing reasoning how that set-up ensures the institution has access to sufficient liquidity.
- **Criteria** for the selection of **significant risk drivers** for liquidity and funding risk.
- **Criteria** for the selection of appropriate **tools and assumptions** for the ILAAP, such as the method of measuring and projecting current and future cash flows over appropriate time horizons.

#### Funding strategy

- Description of the general **set-up of the Funding Plan**, including sources of funding, tenors, key markets, etc.
- Where appropriate, a policy document on **maintaining presence in markets** to ensure and periodically test market access and fund raising capacity of the institution.
- Where appropriate, a policy document on **funding concentration risk**.
- Where appropriate, a policy on **funding in foreign currencies**, including the most relevant assumptions with regard to availability and convertibility of these currencies.

#### OPERATIONAL DOCUMENTATION

- Assessment of the **intra-group liquidity risk**, including legal impediments to the transfer of liquidity within the (sub)group.
- Reasoning for selection of the **significant risk drivers** and a **quantitative overview** of these risk drivers.
- Quantitative overview of the **funding profile** and its perceived stability in all significant currencies.
- Monitoring of **compliance** with prudential requirements regarding liquidity and funding risk.
- The **current Funding Plan**.
- A quantitative overview of the characteristics of **recent funds raised** and an analysis of the **feasibility of the execution of the funding plan**.
- A forward-looking view on the desired **development of the funding position** over at least three years.
- An assessment of the **funding position and funding risk** after execution of the funding plan.

# GL on ICAAP and ILAAP information

## ILAAP-specific information



**CAs should also collect information on the strategy on liquidity buffers, such as the methodology for determining the minimum level of liquid assets, the policy document on asset encumbrance, etc.; and information on the cost benefit allocation mechanism**

### ILAAP-specific information

#### Strategy on liquidity buffers

##### METHODOLOGY AND POLICY DOCUMENTATION

- Methodology for determining the **internal minimum required level of liquid assets**.
- Policy document on **collateral management**.
- Policy document on **asset encumbrance** (e.g. principles for measuring encumbered and unencumbered assets).
- Principles for **testing the assumptions** relating to the liquidity value of and time to sell/repo assets included in the buffer.
- Policy document on **liquidity concentration risk** in the liquidity buffer.

##### OPERATIONAL DOCUMENTATION

- Quantification of **minimum volume of liquid assets** adequate to meet internal requirements and of the **current buffer of liquid assets**.
- Description of **differences** between the definitions of the elements of the 'counterbalancing capacity' and 'high quality liquid assets'.
- Projections of the **internal required minimum volume of liquid assets** and **available liquid assets** over appropriate time horizons under normal and stressed conditions.
- Quantitative overview and analysis of **current and projected levels of asset encumbrance**.
- Assessment of the **time it takes to convert liquid assets** into directly usable liquidity.
- Analysis of the **testing of assumptions** in relation to the liquidity value and time to sell/repo assets within the buffer.

#### Cost benefit allocation mechanism

- Description of the **mechanism** and **selection criteria** for the liquidity and funding elements and the adjustment frequency of prices.
- Description of the **interlinkages** between the mechanism and the risk management and overall management of the institution.
- The information referred to above should cover the **set-up and functioning of LTP<sup>1</sup>**.

- **Description of the mechanism** and a quantitative overview of its **current calibration**.
- Description of the current integration of the mechanism into the **measurement of profitability** for new asset and liability generation, and into **performance management**.
- The information referred to above should cover the **functioning of LTP<sup>1</sup>**.

(1) For the institutions with liquidity transfer pricing (LTP) mechanisms in place.

# GL on ICAAP and ILAAP information

## ILAAP-specific information



The ILAAP-specific information also includes items related to intraday liquidity risk management, liquidity stress testing and the contingency funding plan

### ILAAP-specific information

#### Intraday liquidity risk management

- METHODOLOGY AND POLICY DOCUMENTATION**
- Description of the **criteria and tools** for measuring and monitoring **intraday liquidity risk**.
  - Description of the escalation procedures for intraday liquidity **shortfalls** which will ensure settlement obligations are met on a timely basis under **normal and stressed conditions**.
  - Description of the interlinkage between **intraday liquidity risk management** and the **Contingency Funding Plan (CFP)**.

#### Liquidity stress testing

- Description of **governance** regarding the execution, approval and use of liquidity stress testing.
- Description of the **policy framework** on liquidity stress testing (number of scenario's used, scope, reporting frequency, etc.).
- Description of the **criteria** for calibrating scenarios, selecting appropriate time horizons, etc.

#### Contingency funding plan

- Description of the **lines of responsibilities** for designing, monitoring and executing the **CFP**.
- Description of **strategies for addressing liquidity shortfalls** in emergency situations.
- Description of a **tool to monitor market conditions** that allow institutions to determine in a timely manner whether escalation and / or execution of measures is warranted.
- Description of **testing procedures**.

- OPERATIONAL DOCUMENTATION**
- Quantitative overview of **intraday liquidity risk** over the past year with an appropriate frequency.
  - Overview with explanation of **any payments missed** or obligations not met in a timely manner.
  - Overview of the **scenario's used, time horizons** chosen and **assumptions** made for the purpose of liquidity stress testing.
  - **Quantitative outcome**.
  - Analysis of the outcomes on the **funding profile** and on feasibility of the **funding plan** and **contingency funding plan**.

- The **current CFP**.
- Information on the anticipated **concrete management actions** (e.g. assessment of their feasibility under stress scenarios).
- Recent **analysis on testing**.
- Description of the internal view on the **impact of executing the management actions** included in the CFP.

# GL on ICAAP and ILAAP information

## Supporting information on ICAAP and ILAAP



**In addition to the information items referred previously, CAs should ensure that they receive from institutions all relevant supporting information, including minutes of relevant committees and management body meetings evidencing the sound implementation of ICAAP and ILAAP**

### Supporting information

- CAs should ensure that they receive all relevant supporting information, including **minutes of relevant committees and management body meetings** evidencing the sound set-up and implementation of ICAAP and ILAAP. In particular, CAs should ensure they receive the information items below.

#### ICAAP

- **Approval** of overall **set-up of ICAAP**.
- **Approval** of **key ICAAP elements** (e.g. general objectives and main assumptions, stress scenarios, capital allocation, etc.).
- **Discussion** on **risk and capital situation, limit breaches**, etc, including decisions on management actions or the explicit decision not to take any action.
- Decisions on **new product approval committees** (or the respective decision making body).
- **Decisions on management actions** related to internal capital estimates, their aggregation and their comparison to the available internal capital.
- **Discussion of the outcome of stress testing** in ICAAP and decision on any management action.
- Where available, **internal self-assessments** in which institutions can justify their level of compliance against publicly available criteria regarding risk management and control that affect ICAAP.

#### ILAAP

- **Approval** of overall **set-up of ILAAP**.
- **Approval** of **key ILAAP elements** (e.g. Funding Plan, CFP, liquidity cos benefit allocation mechanism, etc.).
- **Discussion** on the **liquidity and funding risk profile**.
- Decisions in **new product approval committees**.
- **Discussion** of the **feasibility of the Funding Plan**.
- **Decisions on management actions** related to intraday liquidity risk, where relevant.
- **Discussion of the outcome of Liquidity Stress Tests** and decision on any management action.
- Discussion on the **regular testing of the CFP**.
- Decision relating to the **size and composition of the liquid asset buffer**.
- Discussion regarding the **testing of the liquidity value** of and **time to sell/repo assets** included in the buffer.
- Where available, **internal self-assessments** in which institutions can justify their level of compliance against publicly available criteria regarding risk management and control that affect ILAAP.

# GL on ICAAP and ILAAP information

## Information on conclusions and quality assurance



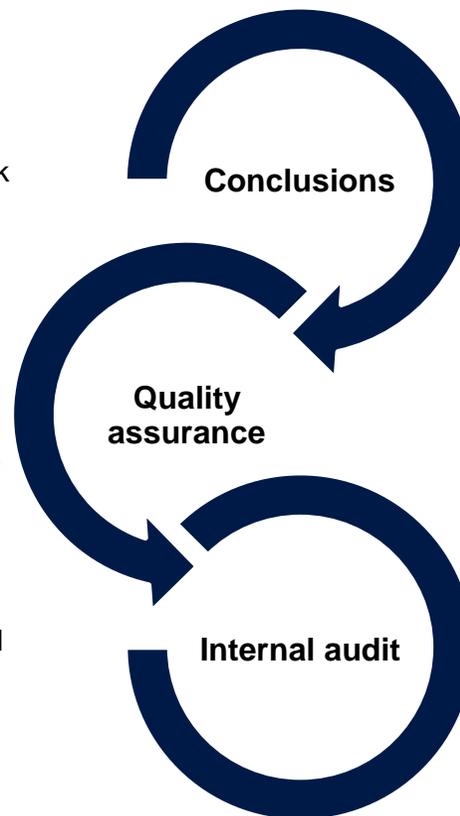
**CAs should collect from institutions the findings arising from the assessments; an adequate explanation of how they ensure that the ICAAP and ILAAP frameworks provide reliable results, including information on validation; and the internal audit reports covering ICAAP and ILAAP**

### Information on conclusions and quality assurance

- Conclusions on the **findings of the ICAAP and ILAAP**.
- Impact on the **risk and overall management** (including changes to the risk management framework; to business models, strategies or risk appetite frameworks; and to ICAAP and ILAAP frameworks)<sup>1</sup>.



- **Internal audit reports** covering ICAAP and ILAAP.



- Adequate explanation of **how institutions ensure** that the ICAAP and ILAAP frameworks used provide **reliable results** (validation concepts, validation reports).
- Description of the **validation approach** (process, frequency) and the **validation content**. This includes all available results of the internal validations/reviews of ICAAP/ILAAP methodologies and calculation outcomes performed by **independent validation function**.



(1) Competent authorities should ensure that this information has the approval by the pertinent body within the governance framework responsible for the ICAAP and ILAAP. Moreover, it should be accompanied by specific timelines associated with the planned changes.

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# ECB supervisory expectations

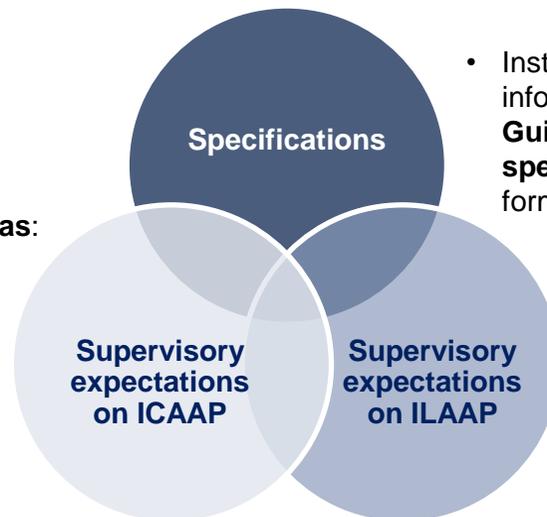
## Overview

Following the publication of the EBA Guidelines, the ECB published in January 2016 a document specifying that significant institutions within the SSM shall follow these Guidelines, and setting out a set of supervisory expectations with regard to the ICAAP and the ILAAP

### Overview

- The experience of 2015 revealed that the **information submitted by significant institutions on their ICAAPs and ILAAPs was often not in line with Single Supervisory Mechanism (SSM) expectations**. This partly reflected a wide range of practices within SSM countries so far.
- In order to encourage institutions to develop and maintain high-quality ICAAPs and ILAAPs, and to clarify the type of information they should share with the SSM on these, the ECB document includes provisions with regard to the **harmonized collection of information**, and **supervisory expectations on the ICAAP and the ILAAP**.

- The document sets out baseline expectations with regard to **9 ICAAP areas**:
  - Governance.
  - General design of the ICAAP.
  - ICAAP perspective.
  - Risks considered.
  - Definition of internal capital.
  - Assumptions and key parameters.
  - Inter-risk diversification effects.
  - Severity level of stress tests.
  - Stress testing scenario definition.



- Institutions shall submit ICAAP and ILAAP information as spelled out in the **EBA Guidelines**, but taking into account the **specifications** concerning the delivery dates, formats and content.
- The document sets out expectations with regard to **2 ILAAP areas**:
  - General definition of the ILAAP.
  - ILAAP reporting.

# ECB supervisory expectations

## Specifications



**Significant institutions within the SSM shall submit the information items as spelled out in the EBA Guidelines, but taking into account some specifications. Regarding dates and format, of particular importance is that institutions shall provide information items by 30 April**

### Specifications: dates and format

#### Deadline and reference date

- ICAAP and ILAAP information shall be provided electronically by **30 April**, with the **preceding year-end** as the reference date<sup>1</sup>.

#### Level of consolidation

- Information should be provided in accordance with the **levels of application of ICAAP and ILAAP** set out in the CRD IV.
- However, for the **2016 SREP**, the assessment will mainly focus on the **consolidated level**<sup>2</sup>.

#### Reader's manual

- Institutions are requested to provide a **reader's manual**, containing:
  - An overview of the documents and their status.
  - An overview of where the information items specified in the GL and in the specifications can be found in the documentation (or if information items are not included, an explanation why the item is not relevant).

(1) There are some exceptions (e.g. institutions with a fiscal year differing from the calendar year).

(2) Exceptions will be communicated to institutions on a case-by-case basis.



# ECB supervisory expectations

## Specifications

**With regard to content, the ECB sets out some specifications concerning the risk measurement assessment and aggregation in the ICAAP, the internal capital, the supporting documentation relating to the ILAAP, and the conclusions and quality assurance items**

### Specifications: content

#### Risk measurement assessment and aggregation ICAAP

- The descriptions of the main **differences** between models used for ICAAP and those used for minimum own funds requirements should be complemented by a **quantitative reconciliation**<sup>1</sup>.
- Institutions should use a **template**<sup>2</sup> to annually provide information on their **risk categories and sub-categories**.

#### Internal capital and capital allocation

- The description of the **main differences** between internal capital element/instruments and regulatory own funds instruments should be complemented by a **quantitative reconciliation**.

#### Supporting documentation ILAAP

- Of particular importance is the **self-assessment** to justify the institution's level of compliance against publicly available criteria regarding risk management and control that affect ILAAP. This self-assessment should be provided using a **template**<sup>2</sup>.

#### Conclusions and quality assurance

- Institutions should provide a **concise statement about their capital adequacy**, supported by an analysis of the ICAAP set-up and outcomes and signed by the management body. It should contain an explicit internal definition of capital adequacy and the relevant outcomes from the ICAAP.
- Institutions should provide a **concise statement on the liquidity adequacy**, signed by the management body. This statement should be in line with current risk appetite and provide an overview of the current liquidity and funding position.

(1) The ECB specifies that the description of the main differences should also be provided by banks not using advanced Pillar 1 approaches.

(2) Included within an Annex of the ECB document.

# ECB supervisory expectations

## Supervisory expectations on ICAAP



Although institutions remain responsible for the design of the ICAAP, the ECB document sets out supervisory baseline expectations. These expectations are related to nine areas of the ICAAP: governance, general design of the ICAAP, ICAAP perspective, risks considered...

### Supervisory expectations on ICAAP

#### Governance

- The **ICAAP key elements** (e.g. governance structure; risks and perimeter captured, time horizon, key risk measurement assumptions and parameters, etc.) should be approved by the **management body**.
- Institutions should produce, at least once per year, a **clear formal statement** on their capital adequacy supported by an analysis of ICAAP outcomes and approved by the management body. Institutions should additionally integrate ICAAP related outcomes into their **internal reporting**<sup>1</sup>.

#### General design of the ICAAP

- The shorter-term perspective of usually one year has to be complemented by a **longer-term forward-looking process**<sup>2</sup>, including capital planning and the use of adverse scenarios.
- All the quantitative parts have to be fully interlinked with institutions' strategies, business decision-making and risk management processes. The strategies/processes have to be consistent throughout the group.

#### ICAAP perspective

- Institutions are expected to implement a proportionate ICAAP approach aimed at the survival of the institution and the fulfilment of requirements. In addition, institutions should take into account a **sound economic perspective** as a basis for their ICAAP (i.e. also consider migration risk, hidden losses, etc.).

#### Risks considered

- Institutions are responsible for implementing a regular **process for identifying all material risks** they are or might be exposed to. Institutions should take into account **at least the following risks**<sup>3</sup>:
  - **Credit risk** (including FX lending risk, country risk, credit concentration risk, migration risk).
  - **Market risk** (including credit spread risk, structural FX risk).
  - **Operational risk** (including conduct risk, legal risk, model risk).
  - **Interest rate risk in the banking book** (also including optionalities such as prepayment options).
  - **Participation risk, sovereign risk, pension risk, funding cost risk, risk concentrations, business and strategic risk** and, in the case of financial conglomerates, **other inherent risks** (e.g. insurance risk).

(1) The frequency of the internal reporting should be at least quarterly, although depending on the institution, its business model and risk types, it should be monthly.

(2) Usually a three-year horizon.

(3) Or where these are not applicable, explain why they are considered immaterial.

# ECB supervisory expectations

## Supervisory expectations on ICAAP



...definition of internal capital, assumptions and key parameters, inter-risk diversification effects, severity level of stress tests, and stress testing scenario definition

### Supervisory expectations on ICAAP

#### Definition of internal capital

- The definition of internal capital has to be consistent with the ICAAP perspective on capital needs. The SSM has the expectation that **internal capital will be of sound quality** (e.g. where the definition is linked to regulatory own funds, it is expected that a large part of internal capital components will be CET1).

#### Assumptions and key parameters

- Institutions are responsible for **setting key parameters and assumptions** (confidence levels, holding periods, etc.) that are **adequate** for their individual circumstances.
- The parameters and assumptions should be in line with their risk appetite, market expectations, business model, and risk profile (i.e. parameters should be consistent with the assumed scenarios at all levels).

#### Inter-risk diversification effects

- Institutions should be aware that the **supervisor will not take into account inter-risk diversification** in the SREP.
- When applying inter-risk diversification effects, institutions are expected to be **transparent** about them. Moreover, institutions should consider that most of the **diversification effects disappear** in times of stress or behave in non-linear ways.

#### Severity level of stress tests

- Scenarios have to be tailored towards the institution's **individual key vulnerabilities**.
- Institutions are expected to conduct **reverse stress testing** in a proportionate manner.

#### Stress testing scenario definition

- At least once a year, institutions shall perform an **in-depth review of their vulnerabilities**.
- On the basis of that review, they shall define a **set of stress testing scenarios** to inform the capital planning process in addition to using a baseline scenario in their ICAAPs.
- Institutions should continuously monitor new threats, vulnerabilities, etc. to assess whether their **stress testing scenarios remain appropriate**.
- It is expected that the scenarios will be **reconfirmed and used periodically** (e.g. quarterly) to monitor potential effects on the relevant capital adequacy indicators over the course of the year.

# ECB supervisory expectations

## Supervisory expectations on ILAAP



Finally, the ECB also lays down some supervisory expectations on the ILAAP, with regard to its general definition and reporting

### Supervisory expectations on ILAAP

#### General definition of the ILAAP

- Institutions should produce, at least once per year, a **clear and formal statement** on their liquidity adequacy, supported by an analysis of ILAAP outcomes and approved by the management body. Institutions should additionally integrate ILAAP outcomes into their **internal reporting**.
- Institutions are expected to implement a proportionate ILAAP approach aimed at the survival of the institution. In addition, institutions should take into account a **sound economic perspective** as a basis for their internal view (i.e. considering all material risks to liquidity and funding, taking into account both macro and idiosyncratic perspectives)<sup>1</sup>.

#### ILAAP reporting

- The institution is requested to state explicitly in the reader's manual and self-assessment which documentation and **information items** are **not covered** owing to the proportionality principle.
- The internal liquidity adequacy statement of the bank should **align with the risk appetite** of the bank and must be signed by the management body.
- The additional information submitted as part of the **short-term exercise** (relating to the liquidity coverage ratio, the net stable funding ratio, etc.) play an important role in the quantitative assessment of the ILAAP in the SREP. Institutions are requested to ensure **reliable and complete reporting**.

(1) In this regard, institutions are encouraged to take into account the existing guidance on liquidity buffers and survival periods (i.e. EBA Guidelines on Liquidity Buffers & Survival Periods), as well as the risk drivers listed in the SREP Guidelines.

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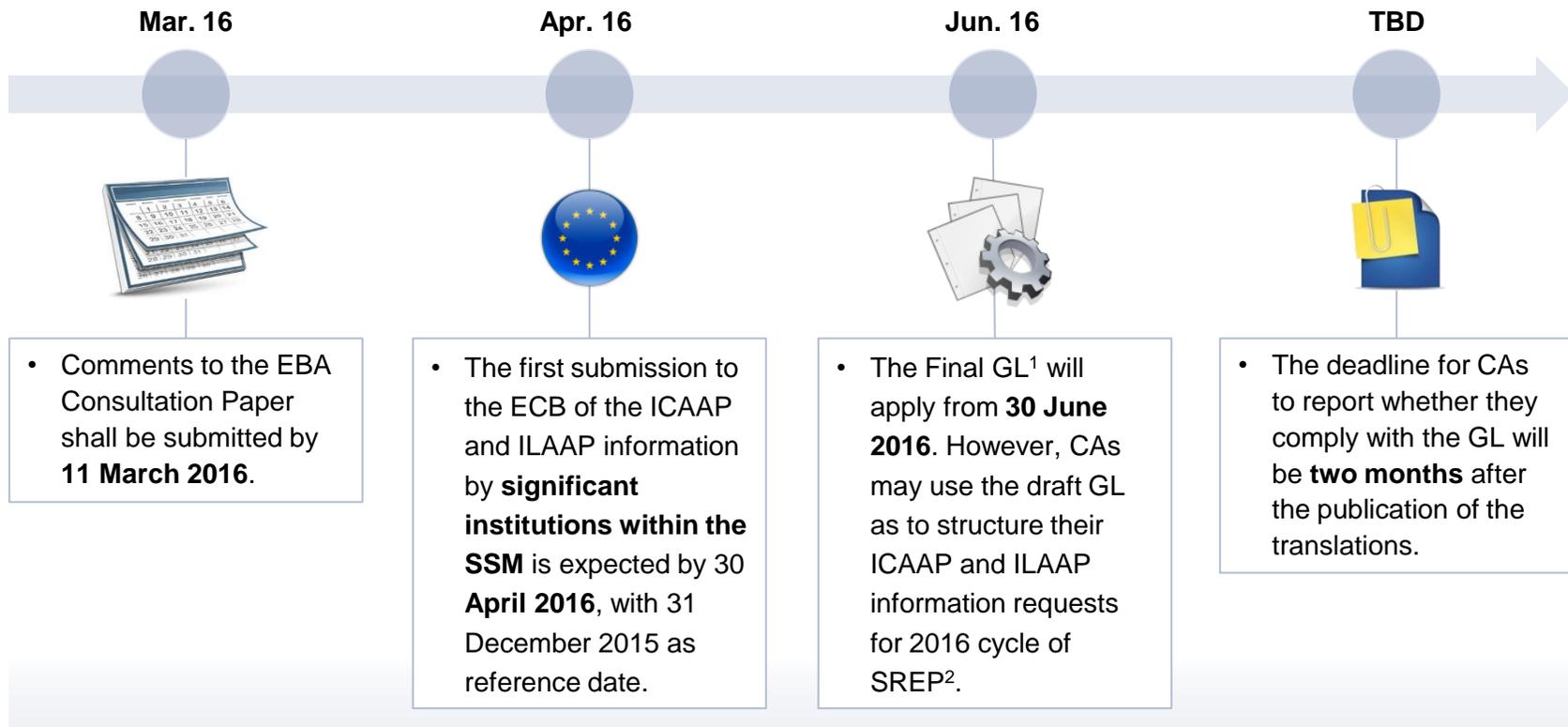
ECB supervisory expectations

➡ Next steps

# Next steps

**Comments to the Consultation Paper shall be submitted by 11 March 2016. In the EU, significant institutions within the SSM shall submit to the ECB the information items on ICAAP and ILAAP by 30 April 2016**

## Next steps



(1) It is not yet known when the Final GL will be published.

(2) For instance, the ECB has established that significant institutions shall follow these draft GL for the 2016 SREP cycle. Nonetheless, should the current draft of those GL be changed as a result of the consultation, such changes will also be applicable to the SSM ICAAP/ILAAP.