EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Template for comments

ECB Guide to the internal capital adequacy assessment process (ICAAP)

Institution/Company

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General comments

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Template for comments

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Please enter all your feedback in this list.
When entering feedback, please make sure that:
- **each comment deals with a single issue only;**
- **you indicate the relevant article/chapter/paragraph, where appropriate;**
- **you indicate whether your comment is a proposed amendment, clarification or deletion.**

Deadline:	4 May 2018

ID	Chapter	Paragraph	Page	Type of comment	Detailed comment	Concise statement as to why your comment should be taken on board	Name of commenter	Personal data

1	Purpose	Example 5.1. Para 43, Principle 5(i)	27, 16, 26	Clarification	According to Example 5.1, the T2/subordinated funds are to be deducted from the economic cover assets because they do not achieve a loss-bearing function in a continuation scenario. It can initially be understood from this line of reasoning that the aim should be long-term survivability. However, Principle 5 (i) rightly requires consistency between the definition of capital and the quantification process. This is a contradiction, as in para. 43, the full fair value perspective is required on the risk quantification side. Various risk components, such as credit spread risk in the asset book, large parts of the migration risk (unless stage migration under IFRS 9), real estate risks on the institution's own portfolio etc., show high risk amounts from a fair value perspective, which are nevertheless never recognised in equity (hold category). Losses from these risks (for example from the sale of assets before maturity) only occur in the event of liquidation and could then be covered by losses for subordinated creditors - according to the liquidation perspective. On the other hand, the new, symmetrical treatment of hidden losses and reserves in Example 5.1 is consistent with the FV concept. It explicitly states that the inclusion of hidden reserves on the capital side must be accompanied by corresponding risk calculations. This creates a meaningful, present-value basic concept, meaning that the risk calculation is finally based on the current cash value of the instrument.	The consistency between the risk calculation and the risk cover assets is of fundamental importance and determines the usability of the overall concept in bank management. In the interests of consistency, for the new ICAAP methodology, it should be decided whether: a) a complete FV-related risk perspective (including risks that materialise during liquidation) is desired (thus taking into account subordinated capital and hidden losses/reserves + the associated broader risk position), or whether b) a perspective on the going concern without subordinated capital, but then limited to the risks directly affecting the capital (according to IFRS) is preferred. This clear separation is also important for Pillar 1+ concepts. Even today, economic risks are compared to regulatory risks and the economic surplus is interpreted as P2R in CET1. This can obscure the fact that parts of the risk quantification are FV-oriented and, in the event of survival, they will not impact on the core capital. This could result in a P2R for the hard core capital ratio that is systematically too high. Here, too, a differentiation may be required between the P2R for total and core capital ratios.	van der Donck, Jeroen	Publish
2	1- Introduction	2	2	Clarification	"Adequate" vs. "prudent": In para. 2, reference is made to Art. 73 CRD IV as the reason for establishing a "prudent" basic orientation. However, Art. 73 CRD IV requires only "sound, effective and comprehensive" processes for assessing internal capital. In our view, the conservative approach demanded in this text passage and later in the Guide cannot be inferred from CRD IV. Instead, it talks about adequate hedging of the risks (see footnote 3). The text of the Guide should be changed accordingly.	At the fundamental level, in our opinion, this also offers room to interpret the balance between "right" and "prudent" more in the direction of "according to the actual impact on the balance sheet". This would allow better usability for the bank management. More details should be discussed in each case and should be determined, in particular, from the point of view of consistency (cf. discussion on hidden losses/reserves).	van der Donck, Jeroen	Publish

3	Principle 1	19	6	Deletion	In connection with the requirement to back-test ICAAP outcomes and assumptions we ask for a deletion of the “capital planning” example. Whereas back-testing risk quantifications methodologies (PDs, VaR models) are established procedures for statistical validation, back-testing the entire capital planning (scenarios, business planning, etc.) is not an adequate method. A useful approach would be to back-test single parameters. A performance measurement is not a proper methodology for capital planning, too. With regard to the entire capital planning process, the methodologies for an essential variance analysis should stay completely with the institution.	Clarification and deletion “capital planning” since no established methodologies are available, respectively	van der Donck, Jeroen	Publish
4	Principle 2	(iii)	5	Clarification	The requirement for consistency and coherence, as we understand it, refers to the inclusion of the consolidated group perspective. Especially in the case of conglomerates in different jurisdictions and sectors, the design of the ICAAP at the level of individual institutions can and, depending on the legal situation, must differ from the consolidated group perspective.		van der Donck, Jeroen	Publish
5	Principle 2	Para. 23	8	Deletion	The general inclusion of risk-adjusted performance indicators required here is in our view too unspecific and far-reaching when determining variable remuneration. Every institution in the SSM has to abide by the provisions of the EBA "Guidelines on Sound Remuneration Policies" (EBA/GL/2015/22). All other stipulations are internal decisions by the respective institutions. The words "and, for example, when determining variable remuneration" should therefore be deleted.	To avoid implementation problems	van der Donck, Jeroen	Publish
6	Principle 2	Para. 27	8	Deletion	This paragraph impinges on the internal management autonomy of the institution. Institutions should be allowed to decide for themselves whether they establish performance benchmarks for individual business units and, if so, which ones. For example, it is not logical to calculate a RAROC ratio for development business. We therefore propose the deletion of para. 27.	The specification in this general form cannot be implemented meaningfully in all areas of a bank.	van der Donck, Jeroen	Publish
7	Principle 2	Para. 29	9	Deletion	Para. 29 requires that the risk appetite statement should contain statements on "avoiding certain types of risks, products or regions". We think this is far too much detail for the RA statement. Such a thing would be found in a specific risk strategy or in limit systems.	Deleting the passage "or avoiding certain types of risks, products or regions" avoids unnecessary detail in the risk appetite statement relevant to the management board.	van der Donck, Jeroen	Publish

8	Principle 2	Para. 32	9	Change	Para. 32 requires the adjustment of the recovery plan without delay to include management actions. In important parts of the EU market, adjustments to the recovery plan during the year are limited to cases that have a significant impact on the recovery plan. We therefore propose the insertion of a materiality condition. In-year adjustments to the plan should remain the absolute exception.	The inclusion of a materiality condition avoids unnecessary work.	van der Donck, Jeroen	Publish
9	Principle 3	Para. 38	12	Clarification	By definition (risk = event affected by uncertainty), no probability can be given for the quantified risks or the probability arises inversely from the confidence level - but this cannot be intended. The economic and normative perspective are the building blocks of the Guide. As such, they should be made totally clear – taken into account proportionality - in order to ensure a common approach both by practitioners as well as the regulator: the type of risks which should be taken into account under each perspective, the interaction, how to avoid double counting, etc	The current provisions of para. 38 have considerable scope for interpretation, which may lead to non-compliance with the supervisory expectations.	van der Donck, Jeroen	Publish
10	Principle 3	Para. 38	12	Clarification	The interaction of the internal --> normative perspective remains partially unclear. Our understanding of para. 38 is that, even in the scenario, the RWAs can only be calculated on the basis of the regulatory requirements of the CRR. Changes to the regulatory method, definition of risk, scale of risks to be covered are not required even in the scenario. In the scenario, however, RWAs may be influenced by economic risk positions. For example, a reduction in the market values of real estate has a reducing effect on the real estate RWAs in the scenario. In addition, economically quantified risks can influence the regulatory ratios via equity in the scenarios. Here, risks have an effect, for example, via risk provisions, changed net interest, exchange rate losses, etc.	The explanation in para. 38 should be clarified.	van der Donck, Jeroen	Publish
11	Principle 3	Para. 39 (footnote 14)	13	Clarification	Footnote 14 requires that even changes that are highly unlikely to occur in future, but which would have such a huge impact in the event that they occurred that contingency measures would be needed, should be taken into account in the normative perspective. Changes (e.g. SA-CCR) should only be taken into account in the capital plan if they are binding. In addition, they should be significant changes. They can generally only be taken into account with a flat-rate surcharge and this would not result in the proper observation of the new regulations.	Clarification regarding the relevant changes in the legal, regulatory and accounting framework	van der Donck, Jeroen	Publish

12	Principle 3	Para. 43	16	Deletion	The hard requirement for capital (adequacy) management according to economic requirements represents interference in the methodologic freedom of the institutions. In addition, it is unclear what management implications the ECB associates with this - especially in light of the finalised Basel III / IV requirements. For some institutions, it can be expected that the capital in Pillar 1 will become the bottleneck factor due to the implementation of the capital floor; management purely in accordance with economic requirements can lead to erroneous management mechanisms.	Interference in the methodological freedom of the institutions should be avoided. In addition, the new ICAAP rules must not lead to erroneous management mechanisms.	van der Donck, Jeroen	Publish
13	Principle 3	Paras 43-47	16	Clarification	Under the economic perspective, the requirement is repeatedly made that from an economic perspective, capital adequacy serves to enable an institution to "remain economically viable" and "follow its strategy". This implies that this perspective is based on a continuation premise.		van der Donck, Jeroen	Publish
14	Principle 3	Para. 49	18	Clarification	It should be clarified to what extent specifically double cover or additional capital backing in the sense of a Pillar 1+ approach is required, or whether a qualitative assessment is required. Methods for measuring risk under the economic perspective unify potential event timings. How should this be reconciled with a 3-year perspective decided under the normative perspective?	There may be significant capital requirement implications.	van der Donck, Jeroen	Publish
15	Principle 3	Para. 51 / Example 3.3	18	Clarification	The interaction of the normative --> internal perspective remains unclear. In particular, larger capital measures, company acquisitions and planned growth should be taken into account here. It should be noted that in the economy, due to the present value concept, it is only meaningful to calculate shock-like scenarios. It is not clear whether the supervision beyond the application of the scenario anticipates a methodological effect on the economy - we cannot think of any meaningful effects here.	It should be clarified that the normative à economic interaction extends to a straightforward transfer of the portfolio- and environment-related scenario into a point-in-time consideration of the economy. Methodological aspects cannot be meaningfully transferred in terms of the present value and periodic basis due to their divergence.	van der Donck, Jeroen	Publish
16	Principle 3	Para. 52 / Example 3.3	18	Clarification	The requirement for a forward-looking view of the economic perspective is mentioned in para. 44 and example 3.3.We recommend clarifying explicitly that a present value (point-in-time) concept by definition adheres to a forward-looking view, because all future cash flows are included..	Unambiguous wording required to prevent misinterpretations.	van der Donck, Jeroen	Publish

17	Principle 3	Example 3.2	20	Clarification	It is not clear from the overall document whether in the normative perspective economic risks are already taken into account in the baseline scenario or "only" in adverse scenarios. We request clarification on this matter in the document. Example 3.2 (p. 22) deals with hidden losses - does the requirement only refer to adverse scenarios or also to the baseline scenario?Furthermore, the concept of hidden losses is broadly defined as the difference between accounting values and fair values which can stem from multiple factors (e.g. change in interest rates, credit spread). It is not clear how such a hidden loss should materialize in the normative perspective. Fair value losses for example disappear due to the pull to par effect. Overall then, the interaction between the economic and normative perspective should be clarified.	A clear alignment (which cannot be misinterpreted) between the baseline scenario and the adverse scenarios is required.	van der Donck, Jeroen	Publish
18	Principle 3	Example 3.2	20	Clarification	Example 3.2 attempts to use the particular example of interest rate income, but unfortunately it does not entirely fulfil its aim. In our view, it does not take into account the fact that under the economic perspective, in the event of a present-value shock, only the effect on the already contracted actual portfolio is considered, while under the normative perspective in the multi-period world, future new business plays the dominant role with regard to future interest income. The nominal coupon payment of the existing business will remain unchanged even after an interest rate shock (at least for fixed business without prepayment). Two effects are therefore mixed together here.	The example is not entirely correct from a technical point of view.	van der Donck, Jeroen	Publish
19	Principle 3	Figure 3 &4	15,16	Change	The figures seem to suggest that the institution is supposed to be operating above it's management buffer both in the base line as well as in the adverse scenario's. Moreover, it is not clear whether the size of the buffer is expected to be of the same magnitude or not. The figures could be changed to more consistently reflect the desired situation.		van der Donck, Jeroen	Publish
21	Principle 4	(ii)	22	Clarification	We propose inserting risk stocktaking as follows: "This risk identification process (risk stocktaking) is expected to result in a comprehensive risk inventory."	To avoid misunderstandings	van der Donck, Jeroen	Publish
22	Principle 4	Para. 55	22	Deletion	The risk identification process should not follow a "gross approach", as otherwise there will be no focus on the actual material risks. It is thus conceivable that, for example, unauthorised access (burglary) is identified as a material risk without consideration of security mechanisms. An assessment of the materiality of risks is only possible based on a "net approach".	For generating realistic risk assessments.	van der Donck, Jeroen	Publish
23	Principle 4	Para. 56	22	Deletion	The explicit requirement regarding shadow banking is redundant to other legislation / guidelines and should not be part of the ICAAP guide.	Deletion of redundant requirements	van der Donck, Jeroen	Publish

24	Principle 4	Example 4.2	24	Clarification	gross approach: If there is fixed contract hedging via derivatives/swaps, this should of course be taken into account and the net position should remain relevant. Here, the decisions have already been made. Of course, residual risks such as counterparty risks etc. have to be considered. The same applies to collateral (physical and financial collateral), which are contractually agreed and proven risk mitigation measures. Potential defaults of contractual collateral should not be treated in the risk inventory, but rather in the scenarios. In any case, a distinction should be made between contractually fixed security measures and hypothetical management actions (in which case critical market situations, if applicable) for each type of risk.	After clarification the proposal is more likely to correspond to current reasonable banking practice.	van der Donck, Jeroen	Publish
25	Principle 5	Para. 66	27	Deletion	In the two perspectives, the capital is based on a different valuation approach (balance sheet-oriented vs. value-oriented), with different view horizons (reference-date view vs. present-value view). A comparison between regulatory own funds and value-oriented risk coverage potential is thus difficult primarily due to the different view horizon (reference date vs. future).	This requirement creates no added value with regard to capital management and is difficult or almost impossible to implement in practice - especially since the current "going concern" will no longer apply in future.	van der Donck, Jeroen	Publish
26	Principle 5	Example 5.1	27	Change	The required fair value considerations of assets and liabilities (see para. 61) also involves taking into account hidden losses and hidden reserves. We request the deletion of the reservation "if at all" in Example 5.1. Even with the inclusion of hidden losses in the definition of internal capital, it makes sense to take it into account in the risk measurement, because otherwise a contradiction arises with the requirement in principle (5) / (i): "The definition of internal capital is expected to be consistent with... internal risk quantifications..."		van der Donck, Jeroen	Publish
27	Principle 6	(i)	29	Deletion	Instead of "apply a high level of conservatism" it should say "adopt a conservative approach": "The institution is expected to adopt a conservative approach..."	To avoid misunderstandings	van der Donck, Jeroen	Publish
28	Principle 6	(ii)	29	Change	The requirement that "all risk quantification methodologies are expected to be subject to independent internal validation" should be qualified here with regard to materiality - it is presented in such a graduated form in Example 6.1.	The inclusion of a materiality condition avoids unnecessary work.	van der Donck, Jeroen	Publish

29	Principle 6	Para. 70	29	Change	It is unclear what exactly is meant by "overall level of conservatism". Is this a kind of "security level" that the bank gives itself (i.e. most closely comparable to a confidence level) or a conservative approach to individual models? In the latter case, it should be borne in mind that conservative modelling simply for the sake of conservatism is not effective. Bank management requires the most realistic possible assessment of the risks. We therefore ask for a clarification of the phrase "overall level of conservatism", taking into account the points mentioned here.	To avoid misunderstandings	van der Donck, Jeroen	Publish
30	Principle 6	Para. 71	30	Deletion	Para. 71 requires a calibration of the risk appetite by considering the accepted loss amount. For this concept to work, a specific time must be set for it. In the high confidence levels, this will be difficult to convey to the management board (99.9% every 1000 years). Therefore, we would at least suggest to delete "on the basis of its own risk appetite", as from our point of view, the insertion makes no sense in the context of risk measurement. The relevant issue is not the risk appetite, but the correctness of the calculation. Further, risk appetite can hardly be backtested. In addition, the methodology should be independent of risk appetite. As item 71 is difficult to understand and, from our point of view, it is also redundant to paragraph 70 (risks are to be quantified conservatively enough), deletion should be considered.	Improvement of the technical correctness of the text	van der Donck, Jeroen	Publish
31	Principle 6	Para. 77	31	Change	The ECB's critical stance on inter-risk diversification is well-known. We believe that it is appropriate to take it into account in the SREP / P2R if individual proof can be provided.	The inclusion of the possibility of including IR correlations in the P2R calculation would give the P2R more risk sensitivity.	van der Donck, Jeroen	Publish

32	Principle 6	Paras 80-82	32	Addition	The ICAAP Guide emphasises the principle of proportionality in the context of the independent validation function. With regard to the proportionate design of the independent validation, according to para. 80, the materiality and complexity of the risks and methods are decisive. Thus, in Example 6.1, the organisational implementation is required according to the nature, size, scale and complexity of the risks. Accordingly, for Pillar 2 models, it should be possible to differentiate the independent validation according to the nature of the risk and its significance for the bank (i.e. the organisational forms described in Example 6.1 may vary depending on the materiality and complexity of the type of risk in a credit institution). However, the TRIM Guide also has to be taken into account here. In our view, however, it is necessary to make a distinction between Pillar 1 and 2 models with regard to the validation function in that the cost of recognition of Pillar 1 models is only worthwhile for material risks, and therefore specifically higher validation requirements should be set here. However, these should not be introduced for Pillar 2 models without reflection. In our view, an institution should be able to choose different forms of separation of model development and validation, depending on the significance of individual models.	Ensures the principle of proportionality with regard to validations.	van der Donck, Jeroen	Publish
33	Principle 6	Paras 80-82	32	Deletion	It does not make sense to have an undifferentiated connection between the design of the validation function and the size of an institution. In this respect, the reference to TRIM in Example 6.1. is not appropriate, as this, for example, rules out a proportionate design of the validation organisation solely on the basis of the G-SII or O-SII status and irrespective of the materiality and complexity of individual risk types. By contrast, according to para. 11, the ICAAP Guide is addressed exclusively to credit institutions that are significant supervised entities within the meaning of Article 2(16) of the SSM Framework Regulation. The reference to the TRIM Guide thus contradicts the proportionality emphasised in the ICAAP Guide. The reference to TRIM should therefore be deleted (particularly as a review of the requirements has already been announced in footnote 13 of the TRIM Guide).	Ensures the principle of proportionality with regard to validations.	van der Donck, Jeroen	Publish

34	Principle 6	Example 6,1	32	Clarification	If any reference is made to the TRIM Guide in the ECB Guide on ICAAP, it should be made (more) clear to both IRB and SA banks how proportionality may be applied. An internal independent validation function as prescribed by the TRIM Guide is not considered to be a proportionate design of the validation function of Pillar 2 models for banks that are not using any Pillar 1 internal models	Ensures that the principle of proportionality can be clearly applied	van der Donck, Jeroen	Publish
35	Principle 7	(iii)	33	Deletion	Principle 7 (iii) requires a quarterly updating of the vulnerabilities and corresponding scenarios. We think that this is excessive, as the risk profile of most institutions does not change so quickly. Of course, this does not affect the updating of the actual metrics on a quarterly basis.	The deletion of the "quarterly" review cycle or changing it to "at least annually" would avoid unnecessary work.	van der Donck, Jeroen	Publish
36	Principle 7	Paras 85/86	34	Clarification	In adverse scenarios under the normative perspective, "severe economic downturns and financial shocks" are expected to be covered. How should this requirement be differentiated from the assumptions for stress scenarios?	Unambiguous wording required to prevent misinterpretations.	van der Donck, Jeroen	Publish
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