



Public consultation

on the ECB Guides to the internal capital and liquidity adequacy assessment processes (ICAAP and ILAAP)

FAQs

1 What are the ICAAP and the ILAAP?

In brief, the internal capital adequacy assessment process (ICAAP) and the internal liquidity adequacy assessment process (ILAAP) are the processes institutions use for managing their capital and liquidity levels in order to ensure that they maintain sufficient levels of capital and liquidity on an ongoing basis. More specifically, the ICAAP as defined in Article 73 of the Capital Requirements Directive (CRD IV) requires institutions to have in place sound, effective and comprehensive strategies and processes to assess and maintain on an ongoing basis the amounts, types and distribution of internal capital that they consider adequate to cover the nature and level of the risks to which they are or might be exposed. Similar provisions regarding the ILAAP are set out in Article 86 CRD IV.

Accordingly, as part of their ICAAPs/ILAAPs, institutions are expected to assess and quantify, cover and manage all risks that may have a material impact on their capital/liquidity and draw conclusions on and ensure their capital/liquidity adequacy from a holistic perspective over a medium-term horizon.

The ICAAP and the ILAAP play a key role in the risk management of credit institutions, and the ECB expects both processes to be prudent and conservative. The ECB is of the view that sound, effective and comprehensive ICAAPs and ILAAPs comprise a clear assessment of the risks to capital and liquidity respectively and have well-structured risk governance and risk escalation processes based on a well thought-out and thorough risk strategy which is translated into an effective risk limit system.

It is acknowledged that good ICAAPs and ILAAPs reduce an institution's and its supervisors' uncertainty concerning the risks that the institution is or may be exposed to and give supervisors an increased level of confidence in the institution's ability to continue its business by maintaining adequate capitalisation, liquidity buffers and stable funding and by managing its risks effectively.

2 What is the purpose of these Guides?

The supervisory experience within the Single Supervisory Mechanism (SSM) after two cycles of ICAAP and ILAAP assessments in the Supervisory Review and Evaluation Process (SREP) shows that there are still several areas in which improvements are necessary across banks, and it will take time to arrive at adequate ICAAPs and ILAAPs. The purpose of these Guides to the ICAAP and ILAAP is to provide transparency by making public the ECB's understanding of the requirements following from Articles 73 and 86 CRD IV. The Guides are aimed at assisting institutions in strengthening their ICAAPs and ILAAPs and at encouraging the use of best practises by explaining in greater detail the ECB's expectations, leading to more consistent and effective supervision.

3 What is the legal nature of the Guides – are they legally binding?

No, the Guides are not legally binding. They do not substitute or supersede any applicable regulatory requirement. However, the Guides deduce from the ICAAP and ILAAP provisions of the CRD IV seven principles that will be considered, inter alia, in the assessment of each institution's ICAAP and ILAAP as part of the SREP. These principles will only serve as a starting point in discussions with individual institutions as part of the supervisory dialogue.

As these Guides follow a principles-based approach with a focus on selected key aspects from a supervisory perspective, they are not meant to provide complete guidance on all aspects relevant for sound ICAAPs and ILAAPs. The ICAAP and the ILAAP are and will remain first and foremost internal processes that are tailor-made for the particular institution. The implementation of an ICAAP and an ILAAP that are adequate for an institution's particular circumstances remains therefore the responsibility of the institution. The ECB assesses the ICAAPs and ILAAPs on a case-by-case basis.

4 How do the current versions of the Guides link to previous publications and guidance in this area?

In January 2016, the ECB published a letter from the Chair of the Supervisory Board, Danièle Nouy, to the banking industry on "Supervisory expectations on ICAAP and ILAAP and harmonised information collection on ICAAP and ILAAP".¹ Annex C of that letter ("Harmonised collection of information on ICAAP and ILAAP") guided institutions with regard to the ICAAP/ILAAP information they were encouraged to submit in 2016. That annex was superseded by the "Technical implementation of the EBA Guidelines on ICAAP and ILAAP information collected for SREP purposes" which was sent to institutions on 21 February 2017.

¹ [Letter](#) on "Supervisory expectations on ICAAP and ILAAP and harmonised information collection on ICAAP and ILAAP".

In Annexes A and B of the January 2016 letter, the ECB published “Supervisory expectations on ICAAP” and “Supervisory expectations on ILAAP”, broadly outlining the ECB’s view on these important processes. This was a major initial step towards convergence in these areas in pursuit of the ECB’s wider objective of harmonised and effective supervision in the euro area.

However, the supervisory experience in 2016 and 2017 showed that there are still several areas in which improvements are necessary across banks, and it will take time to arrive at adequate ICAAPs and ILAAPs.

5 What will be the next steps towards improving the ICAAP and ILAAP Guides?

In 2017 the ECB initiated a multi-year project to foster improvements and develop comprehensive Guides on the ICAAP and the ILAAP for significant institutions.²

As part of that multi-year plan, the ECB revised the 2016 ICAAP and ILAAP expectations. The resulting ICAAP and ILAAP Guides³ were made available in February 2017 with an informal call for comments to develop a more robust set of supervisory expectations and to set out the roadmap that the ECB follows. After carefully assessing the comments provided by banks and consulting all stakeholders, the ECB has now updated both Guides and published them for public consultation. Following this consultation, the final Guides will be published on the ECB website in the second half of 2018 and will replace the 2016 ICAAP and ILAAP expectations with effect from 2019.

6 Given that there is more than one publication providing guidance on the ICAAP and the ILAAP, which one should banks follow?

At present, significant institutions are expected to consider the supervisory expectations set out in the “Supervisory expectations on ICAAP” and “Supervisory expectations on ILAAP” issued in January 2016 and are encouraged to submit the corresponding documentation by 30 April 2018 in accordance with the “*technical implementation of the EBA Guidelines*⁴ on ICAAP and ILAAP information collected for SREP purposes” which was sent to institutions in February 2017. This means that institutions are not expected to take the ICAAP and ILAAP Guides currently published for public consultation into consideration in their ICAAPs and ILAAPs in 2018. As of 2019, however, institutions are encouraged to consider the supervisory expectations set out in the Guides, and ECB supervisors will take them into account when assessing the institutions’ ICAAPs and ILAAPs.

² See the [letter](#) of 20 February 2017 from Danièle Nouy to the management of significant institutions on the multi-year plan on SSM Guides on ICAAP and ILAAP.

³ Ibid.

⁴ See “[Guidelines on ICAAP and ILAAP information collected for SREP purposes](#)”.

7 Should banks wait for the final version of the Guides before considering adjustments to their ICAAPs and ILAAPs?

It may take time for significant institutions to make changes to their ICAAPs and ILAAPs if they decide to follow the supervisory expectations provided in the Guides. Banks are encouraged to address any gaps or weaknesses in their ICAAPs and ILAAPs as soon as possible – in close dialogue with their Joint Supervisory Team (JST).

8 How have banks and industry participants contributed to shaping the principles set out in the Guides?

Overall, the industry participated very actively in an informal call for comments which took place in spring 2017. Approximately 400 comments were received, analysed and discussed internally in the ECB. The industry did not express any fundamental opposition to the Guides, but it asked for further clarification, in particular on the two perspectives (the normative perspective and the economic perspective) and the mutual information concept between them. These aspects have now been further clarified in Principle 3 of the Guides: banks will be encouraged to assess their fulfilment of regulatory and supervisory capital and liquidity requirements (including under stress) (the normative perspective) and to manage their capital and liquidity positions from an economic perspective in order to ensure that their risks are sufficiently covered by available internal capital and liquidity buffers (the economic perspective). Furthermore, the concept of ICAAP and ILAAP architecture was introduced, clarifying the ECB's expectations as regards the interplay between the ICAAP and ILAAP elements and the integration of the ICAAP and the ILAAP into the institution's overall management framework.

9 How will the Guides relate to national laws and other relevant provisions and guidance, and which guidance should banks follow?

Articles 73 and 86 CRD IV are minimum harmonisation provisions and their transposition may therefore have been dealt with in different ways in different Member States. Consequently, institutions' practices are still very heterogeneous.

Supervisory and regulatory differences between euro area countries existed for example, in terms of the overall role of the ICAAP and ILAAP in the supervisory approach and the respective roles of the normative and economic perspectives. The ECB, however, must treat institutions across participating Member States equally, while respecting the ICAAP and the ILAAP as internal bank processes and respecting national laws implementing ICAAP and ILAAP rules.

To that end, the ECB, together with the national competent authorities (NCAs), has developed ICAAP and ILAAP principles and supervisory expectations which explain in greater detail how the current regulations and EBA Guidelines are applied by supervisors within the SSM. These principles and expectations are without prejudice

to national law and in compliance with the EBA Guidelines. However, an important objective of the ECB is “to ensure high standards of supervision”.⁵ Starting with the 2016 ICAAP and ILAAP expectations, the ECB and NCAs have been working closely together on joint ICAAP/ILAAP assessment practices and standards. This cooperation will ensure that all country-specific aspects are taken into account and all internal capital and liquidity adequacy assessment processes are treated in the same manner across the entire euro area.

In addition to the ICAAP and ILAAP Guides, relevant Union law and national law, institutions are encouraged to take into account other ICAAP and ILAAP-relevant publications from the EBA and international fora such as the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB). Institutions should also take into account all ICAAP and ILAAP-related recommendations addressed to them, such as recommendations resulting from the SREP, including those related to sound governance, risk management and controls.

10 How will the ECB encourage banks to take the ICAAP and ILAAP Guides into consideration?

It should be noted that the Guides are not binding on credit institutions. However, as ICAAPs and ILAAPs are considered to be of fundamental importance for the resilience of institutions, the ECB devotes a significant amount of supervisory resources to the assessment of ICAAPs and ILAAPs, e.g. as part of the SREP. If a JST identifies weaknesses, it will discuss them with the institution concerned and consider taking supervisory measures to address the issues.

11 The ICAAP and the ILAAP of a bank are internal processes. Why is the ECB interfering in those internal processes by publishing the Guides?

The ICAAP and the ILAAP are and will remain, above all, internal processes, and it remains the responsibility of individual institutions to implement them in a proportionate and credible manner. It is also in banks’ own interest to know their risks and to effectively managing them in order to be able to continue their operations. In the same vein, banks should naturally be interested in efficiently allocating their capital and liquidity, as this allows them to optimise their risk-return relationships in the long run. In order to support and incentivise banks to do so, the ECB considers it warranted to a certain extent to guide banks’ own plans and ambitions. Therefore, the ECB included this topic in its supervisory priorities in 2017 and 2018. The ICAAP and the ILAAP are key risk management elements for institutions and supervisors. Only a sound management of capital and liquidity will ensure a healthy and stable financial sector.

⁵ See the [letter](#) of 27 January 2015 from Danièle Nouy to the management of significant banks on the approach to existing supervisory processes and practices in SSM Member States.

The ECB communicates broad principles and the general direction it encourages banks to take, leaving banks full flexibility, but also full responsibility, to implement their ICAAP and ILAAP in a way that is adequate for their individual circumstances (the nature, scale and complexity of their activities). The Guides provide transparency to banks on what the ECB will take into account on a case-by-case basis when assessing their ICAAPs and ILAAPs.