Ssm guides icaap ilaap

Banks' inadequate and low-quality capital and liquidity often increase the severity of financial shocks in the banking sector. Two important processes play a central role in making banks more resilient and avoiding adverse situations: the Internal Capital Adeament Assessment Process (ICAAP) and the Internal Liquidity Compliance Assessment Process (ILAAP). ICAAP and ILAAP aim to encourage banks to think in a structured manner about their capital and liquidity risks, using bank-specific approaches to measuring and managing these risks. Both processes should ensure that banks identify, manage and cover their capital and liquidity risks at all times. The proportionate implementation of ICAAP and ILAAP is the responsibility of the banks themselves. In other words, all banks must ensure that they are proportionate to the business model, size, complexity, riskiness and market expectations of ICAAP and ILAAP. In January 2016, with the aim of encouraging banks to develop and maintain high-quality ICAAP and ILAATs, the ECB published its supervisory expectations for ICAAP and ILAAP for major banks. These expectations were based on the ECB's interpretation of the requirements of the ICAAP and ILAAP in the Capital Requirements Directive (CRD IV) and their publication was the first significant step towards convergence in these important areas. However, following the publication of the new expectations, further improvements between banks were needed on several fronts. In particular, the concept of ensuring the adequacy of capital and liquidity from two different perspectives, both normative and economic, and the interaction between ICAAP and ILAAP, was a challenge for many banks. Further clarification was needed and as a result, the ECB launched a multi-annual project to develop comprehensive guides for ICAAP and ILAAP for major banks. Expectations published in 2016 have been revised as part of the project. The first draft guides to ICAAP and ILAAP were made available in February 2017 alongside an informal call for comment. This was followed by a public consultation in March 2018. The guides were amended and refined on the basis of the comments received. The final guides to ICAAP and ILAAP were published in November 2018, replacing expectations published in 2016. Although the general direction of expectations has not changed (e.g. as regards the nature of ICAAP's outlook or the assumption of continuity of operations), the ECB has established more detailed ICAAP and ILAAP principles and provided further explanations and examples. Major banks are now encouraged to follow the supervisory expectations set out in these guides, which the ECB has been using in its assessments of banks' ICAAP and ILAATs since January 2019. a appropriateness of capital and liquidity. The supervisory review and evaluation process(SREP) recognises that good ICAAs and ilaaps reduce the uncertainty of banks and supervisors about banks and their actual risks. They also provide supervisors with greater reliability in maintaining adequate capitalisation and effectively managing its risks. The information from the two processes is integrated into all SREP assessments and supervisors' decisions on capital and liquidity requirements. ICAAP and ILAAP are expected to play an even greater role in the SREP in the future, prompting banks to continually improve these processes. Among other things, both the qualitative and quantitative aspects of ICAAP, focusing on the identification and quantification of risks, may play an enhanced role in the calculation of additional capital requirements by risk. Media contacts Twitter facebook linkedin Whatsapp email regulators consider banks' internal capital aailing and valuation process (ICAAP) and internal liquidity compliance assessment process (ILAAP) important tools for managing risks. The updated Guidelines of the European Central Bank (ECB), which came into force last year, highlighted the shortcomings of existing practices and stressed the need for robust and efficient capital and liquidity planning before the likely turnaround of the economic cycle. Burcu Guner of Moody's Analytics and Jeff Simmons of MUFG Securities discuss the key challenges facing banks and how to maximize business value with Burcu Guner, head of moody's analytics risk and finance expert group, Moody's Analytics chief Jeff Simmons, risk director/chief operating officer of MUFG Securities (Europe) NV. Burcu Guner, Moody's AnalyticsBurcu Guner, Moody's Analytics: The ICAAP and ILAAP guide is the first time in more than a decade I've seen a supervisory authority emphasize the need for a robust economic perspective with complementary regulatory and accounting views. Several period horizons, including baselines and adverse conditions, make it very interesting. Another useful feature is the independent validation of the ICAAP and ILAAP frameworks, which is particularly useful for smaller institutions in setting priorities and establishing a roadmap. Emphasis will also be placed on the involvement of management teams to ensure that ICAAP and ILAAP integrate into the risk-taking framework and examine their interaction with other strategic processes. These are typically processes managed and managed by different departments. Senior management is increasingly involved not only in the risk and financial field, but also in the business lines of financial institutions, which is quite new. Many organisations are reorganize their risk functions and models to and in accordance with the Applications. Jeff Simmons, MUFG Securities: I agree – capital management and liquidity management have grown up almost independently, for good organizational reasons. Capital is managed at the very top of the house – almost at portfolio level – while liquidity is usually managed in the treasury function near the money stock. As a result, different processes and different governance frameworks were followed. If we are rooted in the same economic basis and then coordinate the governance structure around them, philosophy and organisation need to evolve – especially if we see closer coordination between risk and finances. For example, if you're thinking of International Financial Reporting Standard (IFRS) 9 and a basic overview of the trading book, it's natural to align between risk and financial spaces at the top of the house's capital liquidity. What are the most important challenges for banks in terms of tightening up the new rules? Jeff Simmons, MUFG SecuritiesJeff Simmons: The main challenge is opposing timelines. The capital affects a longer maturity, such as three or five years, while liquidity can kill you in a week. Inevitably, the timeline and methods to support them are different. Then throw into the mix different organizational structures between capital and liquidity, and consistent mitigating measures are difficult to achieve. Burcu Guner: The scenario analysis includes a variety of time horizons and interpretations, even in the capital area, if we talk about surveillance rather than ICAAP stress testing. IFRS 9 changes the image again. The final part is the economic perspective, which is typically considered unconditional and a one-year horizon, and therefore challenges the introduction of conditional scenarios and multiannual valuations in the area of economic capital compliance. It needs to find a holistic methodological framework that complements these different areas, brings together scenario analysis and multi-annual evaluation, and creates different time horizons. The other main challenge is how to take into account risk concentrations and risk correlations. These, even for different types of risk, are placed on an economic focus, but less so on provisions and stress test models, so some development will be needed. Assessing differences in different accounting, regulatory and economic areas is challenging for the banks' analytical framework, as well as for data, data quality and processes. Jeff Simmons: If scenarios are put aside in terms of complexity, the question asked through ICAAP is: Do you have sufficient capital? If you look at where you are, you apply some very high-level macroeconomic stressors and throw in a little second pillar assessment for good action. With ILAAP and liquidity, is this a matter of stress testing and can you survive the shocks? They ask different questions, so other skill groups, organisations, governance structures and so on. The challenges around why the silos were there in the first place, and that's where the difficulty lies. The quality of data and data is a challenge for all banks. But in the case of alignment, it again comes down to the cause of silos. The data required are very different. To get this extreme to do an ILAAP, you have to go all the way down to the cashflow data and time horizons, and so on, while ICAAP has the data needed at a higher level and another slice. Even if data quality was not a problem, data coordination is a challenge in itself. The concealment of models only increases the shift. What are the main aspects of icaap and ILAAP integration for banks in addition to existing regulatory and stress testing requirements? Burcu Guner: The possibility of influencing decision-making is a key factor. Whether it's streaming or modeling, success determines the business relevance of metrics. Jeff Simmons: EmbeddingICAAP and ILAAP in the business isn't always as strong as it should be. Most ICAAA conclude that there is enough capital. So what steps do you need to take? What is your relationship to the recovery resolution plan, and so on? It's hard for the organization to be inferior. Ilaap takes precedence over some top-management thinking because of the impact it will hit quickly. However, at a lower level of organisations, most businesses are not really interested in the bigger picture and the bank's overall liquidity situation. It's something they're handing over to the Treasury, and they're about to forget it until they're compensated. Burcu Guner: I think the credit cycle plays a role here. The ICAAP side is to some extent overlooked because of our stage. As the cycle turns, you get more control over the supervisors as well as the boards. As I understand it, the ECB intends to use economic perspectives that do not obscure the real picture of risk and prepare financial institutions for a turnaround. Jeff Simmons: The stress test provides a different lens for the body. It does everything ICAAP – and in some cases ILAAP – does, but supervisors check methodology and scenarios to get the results of the ICAAP, ILAAP and stress tests side by side to get different perspectives on the same organisation. IFRS 9 means that accounting is now more model-based and similarly more stress-testable. Regulatory initiatives such as Basel II and Basel III were aimed at curbing banks' risk-grouping practices and underestimating certain risks. How confident can we be that banks are showing a complete picture under ICAAP/ILAAP? Are their processes sufficiently robust? Jeff Simmons: In some ways, there is little incentive for the bank to be completely transparent. If the aim is to demonstrate to the regulator that banks have sufficient capital you can then where the answer is No, there is not enough. The incentive should be as positive as possible. But the same is true of banks' financial statements and glossy annual reports. How sure are we that everything will come out? You just don't know what's not in it. Again, the challenge is to aggregate these financial components at the top of the house and see what decisions these numbers make. I'm sure the processes are robust as they've been playing for years. I'm just not sure the answer is always what you expect. Burcu Guner: The process is deliberately conducted within a harmonised framework, so the ECB's benchmarking and comparability will be an element between these institutions. If you deviate from the norm, you may get more control from supervisors and the market, so it encourages discipline to look at these things more widely. ICAAP provides a stronger internal picture of the bank's portfolios, taking into account all material risks and, from an economic point of view, new risks that have not been previously presented, such as risk concentrations. What does a proven ICAAP and ILAAP process look like? What are the main aspects of data quality, modelling and management procedures? Burcu Guner: It's important to have a rich and complete scenario and modeling skills in capital and liquidity areas. The focus should be on the creation of an additional and interactive framework. We never explicitly consider correlations between different types of risk and do not always look at the effects of contagion, such as second-rate effects on the credit market and potential risk concentrations. There are definitely improvements that could be made when defining best practices. You may have all these great things in the risk and financial field in terms of modeling data, scenario analysis and so on, but ultimately you need to accept the front line as they will affect your profits and losses (P&R; L) and volatility. This acceptance shall be regarded as a business advance. Jeff Simmons: The organization needs to live these things. If you don't integrate into every area of life within your organization, you're not going to achieve the goal you've set. At MUFG Securities, ICAAP production is a centralized feature that essentially plays the organization's conductor for various comments. One of the advantages is manual consistency – components are placed in the central area so you can see gaps or overlaps. The consistency of methodologies and practices. One drawback may be that it's almost as if the ICAAP and ILAAP are outsourcing. It can be difficult to put leading stakeholders above this central function and for the contributors below it to be included as real and sufficiently detailed understudies in what is happening. There may also be some confusion as to who actually owns the ICAAP. Risky? The council? Who owns - - so where is this coordination function? I've seen it positioned both risk and funding with equal efficiency because ultimately an ICAAP emphasizes the business plan. It's a financial thing with a risk premium. ILAAP is similar – it can be confusing to see where ownership is. Burcu Guner: To influence decision-making, financial institutions need to invest in infrastructure, data and IT and simplify the process by asking: How does this help me enable business decisions, business engagement, and the relevance of the models and indicators we use for current, future and emerging states in multiple risk/return dimensions? Whatever you're doing with stress testing from an economic or liquidity perspective should make sense to be on the front lines of being truly embedded. The process is a way to enable some of this debate and manage capital, liquidity and income volatility. Jeff Simmons: The way to embed it on the front line is to fill it up - make sure whatever action you're trying to use is cost and then work distribution. There is now more attention at the top level to what is going on in stress testing, regulatory interaction, and recovery resolution and similar areas. When the European Banking Authority began to publish the results of the stress test, at the bottom of which the capital was firmly below the target capital ratio, senior management became increasingly noticed. Now there is much more participation, and increased governance - which is good. To what extent should the process be adapted to changing risks, such as climate change? Jeff Simmons: It depends on what you're trying to measure. You need to quantify what you model and how it affects your customers and business. It then becomes much more complicated in scenario production, causation, correlation and so on. Back to the question of what ICAAP is trying to do. If you say: Is there sufficient capital resources in the next three years? the reality is that climate risk is not yet considered a significant risk factor – despite everyone's concern about it. You have to consider some way, but how you do it while staying true to the question is trying to answer hard. Burcu Guner: Climate risk will have a significant impact on credit risk, portfolio management, expected loan losses and a fair valuation of assets that are within ICAAP. Climate scenarios will certainly be introduced and risk quantified. I see that stress testing domain as well as ICAAP. The Bank of England will introduce the climate as part of the 2021 biennial exploratory scenario, and other European supervisors are counting on the following example. Aside from identifying as a potential risk, I think the bottleneck is due to quantification. Severe climatic events which may cause event-driven risks and climate shocks in the There is also debate about the impact of the transition to a low-carbon economy and whether early, late or normal transitions will take place in different regions, sectors, industries and so on - to be managed within credit portfolios. There is still work to be done in ICAAP and stress testing for the introduction of climate risks and scenario modelling. I think it's going to happen in the next year or two. We need to bear in mind how we introduce these factors into the existing framework, because the horizons and patterns can be very different. Jeff Simmons: We already have capital and liquidity analyses and in the Netherlands we have systematic integrity risk analysis. The climate may have to be a fourth pillar. The danger of any long-term issue is that you don't get dealt with until the last minute. We have to avoid that. How can banks ensure that their numbers are fully aligned with business strategy? Jeff Simmons: The key is integration between risk and finance. If you already have a business strategy that can be modeled, you'll have to stress test it. With that foundation, you can overlay different macroeconomics, emphasizes, and so on. Then, if you solve the time horizon issue of capital and liquidity, you have a very solid valuation model. Burcu Guner: We have recently run a number of studies aimed at comparing banks' performance according to different initiative strategies, such as limited views on regulatory accounting and economic outlook, as well as adding different balance sheet and liquidity features to the picture. We found that there was an increase in volatility between accounting measures and provisions. Using different baseline strategies with different metrics can be quite different. It is essential to address this volatility and the risk of negative revenues due to the interaction of certain measures. The ECB is trying to highlight this in the latest guidelines of ICAAP and ILAAP, encouraging businesses to assess their portfolios from an economic, regulatory and accounting point of view. The key factor determining successful alignment with the business strategy is the way in which companies ensure this combined view on the front line. Jérôme Henry, senior adviser on macroprudential policy and financial stability at the European Central Bank (ECB), discusses the evolution of capital and liquidity in the wider context of prudential stress tests. What is the role of stress tests in the assessment of solvency/liquidity and how does this develop? Jérôme Henry, ECB: According to the supervisory guidance provided to banks by the European Banking Authority (EBA) or the Bank for International Settlements, stress tests should play a key role in determining capital and liquidity planning. In addition, a number of decisions at a firm level from willingness to take risks to capital and increase funding. In addition, reverse stress testing should be contributing to recovery and resolution planning; it may also help to identify the severity and relevance indicators of the internal capital a aa and the internal liquidity matching assessment process (ILAAPS). Since the financial crisis, which began in 2007-2008, sector-wide stress tests have become a standard supervisory tool. The objectives of such practices now go beyond the clean recapitalisation or backstop calibration target. For example, liquidity and sensitivity analyses are now given greater prominence in the Single Supervisory Mechanism (SSM). Stress tests can also provide relevant information on profitability forecasts, credit risk control and the accuracy of market risk modelling. On the other front, the development of macroprudential stress tests is relatively new, building on or complementing systemic supervisory assessments. In particular, the United Kingdom uses

a macroprudential perspective in its simultaneous stress test process, which uses the result to calibrate buffers system-wide. In 2016 and 2019, the ECB published the results of its model-based practices, which use EBA/SSM stress test data as inputs but take a more macroprudential approach, including real financial feedback, contagion elements and other characteristics that are typically not covered by microprudential practices. As far as more distant values are concerned, the use of stress tests to help calibrate macroprudential policy measures, in particular the countercyclical buffer, is an ambitious and challenging task. To this end, the results should go beyond purely bank-by-bank solvency and liquidity assessment to include credit supply and the development of activity in a stressful situation with and without additional policy measures. To what extent does the current stress testing framework allow for an adequate overview of banks' solvency and liquidity? Henry Jérôme: Firstly, the supervisory requirements for the framework are quite clear, asking companies to pay particular attention to the coverage and severity of the scenarios and to show the related impact on the bank's balance sheet. Additional elements, including risk correlation, non-linearity, structural breaks and the interaction between solvency and liquidity, as well as second-rate effects on credit risk and market risk, shall then be recognised. In order to provide a proper picture of such quantitative exercises, two things are needed. Firstly, the right infrastructure, including data and IT infrastructure, ensures flexibility in providing fast and efficient numbers. Secondly, good governance, the involvement of senior management in business areas – so the results are relevant and comprehensive. Although framework and what needs to be done are clear, there is always a risk that some businesses will deviate from them – and in practice it is difficult to ensure that all boxes are checked both internally and for supervisors. There is always a chance that a surprise risk factor will be achieved, which the risks in the planned scenarios. A stress test doesn't guarantee every chance. A particularly difficult area should be addressed for a single undertaking is the requirement to examine the infection and the effects of the second round. A bank can, of course, estimate such feedback – but only at a micro, internal-specific level. It is difficult for a single bank to assess the externality and impact of the activities of others, as well as aspects such as fire sales, financing, solvency interconnection, collateral valuation, credit interest risk correlation and market risk correlation. Central authorities using their own instruments, although not perfect, are better placed for this type of analysis. How do banks cope with the operational challenges of external/internal stress tests? Henry Jérôme: Banks may have different views, but once the internal adjustment of stress tests is in place – with the infrastructure for risk identification, modelling and management, as well as a pretty experienced team – operational risks should be limited and external exercises should be relatively simple. Banks should model their models on the basis of any new scenario and apply their judgment before finalising the results. Accordingly, interactions with supervisors for quality assurance purposes would require the results to be updated. These are also facilitated by the necessary internal setting. Where this may become more difficult, it is for larger cross-border groups dealing with a number of different external stress tests. Methods evolve and can vary considerably between supervisors. Similarly, reporting requirements and templates can change over time, which is a challenge around data collection and availability. To what extent is the operational complexity of stress tests hampering effective decision-making? Henry Jérôme: From a prudential point of view, the development and implementation of systemic stress tests can be complex, and collecting and interpreting results can be difficult. For supervisors, for example, this is a contribution to the supervisory review and evaluation process (SREP) and there is also interaction with pillar two processes, which are already complex. The results of the stress test are not always comprehensive enough as an indicator of the recording of bank-specific capital needs. There is a gap between results, SREP requirements and management measures that need to be reduced by monitoring conversations between banks and supervisors - especially if the results are based on static balance sheet assumptions. From a macroprudential point of view, there are now two ways to use stress testing results. The first is to inform policy measures such as calibrating the countercyclical buffer, as in the UK. The second the resilience and financial stability of the banking sector, which is subject to shock. It is also challenging to use stress test information in a macro policy environment. This is partly due to the fact that – it is difficult to incorporate new risks such as climate change and cyber risk into an existing stress test process, for example – and partly in communication; stress tests typically involve multiple complex channels, making it difficult to summarize and interpret results and build a coherent narrative. The stress test could be like a black box. Unless you can simplify and identify the main drivers of results, it is difficult to convince policymakers that there are measures that can address the key issues that arise unless you go deeper into the source of the impact. Other tools and assessments are likely to be needed to complement the results of the stress test. The views expressed here strictly reflect the views of the author and do not necessarily reflect those of the ECB. For more information about Moody's Analytics ICAAP and ILAAP, see Q&A below. As video: Video Q&a; With Antonios Kastanas – ICAAP/ILAAP: How can banks improve the process? Video &Q&2 The Burcu Guner - ICAAP / ILAAP: What's new and what's next? What's next?