Annexure A

Internal capital adequacy assessment process: suggested submission format

Please note that banks are not required to adopt this format when submitting their internal capital adequacy assessment processes (ICAAPs) to be reviewed by the Bank Supervision Department (BSD) of the South African Reserve Bank (the Bank). They may choose to use a different format.

Some documents – including the risk appetite framework (RAF), the stress-testing framework, and various policy documents – should be referred to although they should not form part of the main body of the ICAAP document.

BSD expects there to be a fair degree of variation in the format and length of submissions; banks' businesses and risk profiles differ, and the ICAAP should be proportional to the nature, size, and complexity of a bank's business. However, banks may find this suggested format convenient as it covers most of the matters which BSD would typically review and which, if not provided in the initial submission, are likely to be covered in follow-up discussions with the bank. Using this format may therefore make the review process more effective and more efficient for both the bank and BSD.

The use of this template is not a substitute for being aware of the relevant regulations.

1. Executive summary

The purpose of this executive summary is to present an overview of the ICAAP methodology and results. This overview would typically include:

- the purpose of the report;
- the entities that are covered by the ICAAP;
- the main findings of the ICAAP analysis;
- the amount of internal capital, and in what composition, the bank considers it should hold as compared with the regulatory Pillar 1 (BA 700) calculation in respect of the bank and the controlling company;
- a summary of the current and forecasted financial position of the bank, including its strategic position, balance-sheet strength, and high-level risk appetite statement;
- the adequacy of the bank's risk management processes;
- the main changes in risk measurement methodologies since the previous ICAAP document, and their capital impact;
- brief descriptions of the capital and dividend plans;
- the way in which the bank intends to manage capital going forward, and for what purposes;
- commentary on the most material risks and why the level of risk is acceptable or, if it is not, the mitigating actions planned;
- commentary on the major issues where further analysis and decisions are required; and
- an indication of who had carried out the assessment, how it had been challenged, and who had approved it.

2. Governance structures

- This section would cover the governance and legal structures of the bank, including the operating and management structure.
- The governance processes to which the ICAAP document was subjected and the frequency of the ICAAP would be included.
- The section would provide a description of the extent of the challenge and testing of the ICAAP. It would include the testing and control processes applied to ICAAP models and/or calculations, and the review and sign-off procedures by the board and/or board subcommittee and senior management. A copy of any relevant report(s) to the board and/or senior management, and their response(s), would be helpful.
- The section would describe the details of the reliance placed on any external supplier(s), e.g. for generating economic scenarios.
- A copy of any relevant report(s) obtained from an independent reviewer or an internal audit would also be included.

3. ICAAP results and the reconciliation between regulatory capital and internal or economic capital

This section would describe and quantify:

- the key differences between regulatory capital demand and internal or economic capital demand (more detailed reconciliations should be provided per risk area, where necessary); and
- the key differences between available financial resources and available qualifying regulatory capital.

4. Strategy

- Update on the current strategy of the bank.

5. Risk appetite framework

This section would describe:

- alignment of the overall risk appetite statement with the business lines, risk areas, and lower tolerance levels;
- risk appetite in a stressed environment;
- amendments made to the risk appetite and risk-tolerance levels during the past year;
- monitoring of actual performance against risk parameters; and
- amendments made to the risk appetite and risk-tolerance levels and thresholds during the past year, including amendments to the confidence interval.

6. Risks areas

This section would describe:

- the process followed to identify material risk exposures;
- a high-level overview of material risks, including the definitions of risk appetite, internal or economic capital, and regulatory capital requirements as well as, to the extent possible, an explanation of any other methods apart from capital used to mitigate the risks; and
- the risk appetite for each material risk area.

7. Methodology and assumptions in respect of each material risk area

This section would contain:

- a description of how the assessments for each of the major risks were approached and the main assumptions made.
- For instance, banks may choose to base their ICAAPs on the results of the regulatory Pillar 1 (BA 700) calculation, with additional risks (e.g. concentration risk and interest-rate risk in the banking book) assessed separately and added to Pillar 1. Alternatively, banks may decide to base their ICAAPs on internal models for all risks, including those covered under Pillar 1 (i.e. credit, market, and operational risks).

- The description would make clear which risks are covered by which modelling or calculation approach. This would include details of the methodology and process used to calculate risks in each of the categories identified, and the reason(s) for choosing a particular method in each case.
- If a bank applies correlations in its economic capital models that differ from the prescribed Basel II formula, the bank should provide details of the correlations being applied.
- should cover any changes made to the correlations since the previous ICAAP and the rationale for the amendments.
- The bank should provide a status update of the validation of both regulatory and economic capital models.
- If a bank uses an internal model for some or all of its risks, this section would cover:
- the key assumptions within the capital modelling work, covering both assets and liabilities (e.g. liquidity risk and interest-rate risk in the banking book) as well as the background information on the derivation of any key assumptions; and
- the way in which parameters were chosen, including the historical period used and the calibration process. If the input parameters for the credit, market, and operational risks are different from those used for the regulations, this section would analyse how these differ.

8. Capital management

- The section would include a detailed review of the capital adequacy of the bank, with a three-year forward-looking capital plan (the core scenario).

The information provided would include:

- capital targets set for the common equity tier 1 (CET 1), tier 1, and total capital ratios;
- the targeted leverage ratio;
- capital triggers set and a description of the escalation process;
- the capital buffer to be maintained in terms of regulation 39(16)(b)(v)(B) of the Regulations relating to Banks (the Regulations); and
- potential sources of capital identified by management.

9. Stress tests and scenario analyses applied

- In cases where stress tests or scenario analyses were used to validate, supplement, or probe the results of other modelling approaches, this section would provide details of the following:

- the simulations to capture the risks that are not well estimated by the bank's internal capital model (e.g. non-linear products, concentrations, illiquidity and the gapping of prices, and shifts in correlations in a crisis period);
- stress-testing scenarios developed and approved by the board during the past year;
- ad hoc stress-testing undertaken during the past year;
- the quantitative results of stress tests and scenario analyses that the bank carried out, and the confidence levels and key assumptions behind those

analyses, including the distribution of outcomes obtained for the main individual risk factors;

- the impact of stress-testing results on internal or economic and regulatory capital demand over a projected period of the capital plan;
- the impact on interest and non-interest income and credit impairments;
- the impact on available financial resources and qualifying regulatory capital over a projected period of the capital plan;
- the impact on capital adequacy ratios and the leverage ratio over a projected period of the capital plan; and
- a comparison of stress-testing results with risk appetite.

10. Capital transferability

This section would contain:

10.1 Details of any restrictions on management's ability to transfer capital into or out of the business(es) covered, for example the proportion of minority interest included in consolidated capital and the contractual, commercial, regulatory, or statutory restrictions that apply. Statutory restrictions could be limited to the maximum dividend that could be declared and paid following certain actions to maximise distributable reserves through, for example, crystallising unrealised gains. Regulatory restrictions could be the minimum regulatory capital position and required capital buffers acceptable to the local regulator, before distributions are restricted, such as the releasing of capital back to the group.

11. Management actions

This section would describe:

- details of the management actions assumed in deriving the ICAAP; and
- an impact assessment of management actions: sensitivity testing of key management actions and revised ICAAP figures with management actions excluded.
- In cases where a bank has an internal ratings-based (IRB) permission, this section might set out the management actions which mitigate the additional capital suggested by the typical credit-rating migration stress test. Alternatively, such actions might be set out in a separate 'capital management plan' or otherwise approved by senior management as actions that the bank is committed to in such circumstances.

12. Aggregation and diversification

(a) This section would describe how the results of the various separate risk assessments are brought together and how an overall view is taken on capital adequacy. At a technical level, this requires a method to combine risks using quantitative techniques. At a broader level, the overall reasonableness of the detailed quantification approaches might be compared with the results of an analysis of key sensitivities and future scenarios, and senior management might take a view on the overall level of capital that is appropriate.

- Dealing with the technical aggregation, this would describe:

    - o any allowance made for diversification, including any assumed correlations within and between risks;
    - o the way in which such correlations have been assessed, including in stressed conditions;
    - o the justification for any credit for diversification benefits between legal entities, and the justification for the free movement of capital between them in times of financial stress; and
    - o the impact of diversification benefits with management actions excluded.

    It might be helpful to include appropriate stress tests to assess the impact of diversification assumptions on the bank's internal assessment of capital adequacy.

- In terms of overall assessment, this would describe how the bank had arrived at its overall assessment of the capital it needs, taking into account matters such as:
    - o the inherent uncertainty in any modelling approach;
    - o weaknesses in the bank's risk management procedures, systems, and/or controls;
    - o the differences between regulatory capital and internal capital; and
    - o the differing purposes that capital serves, including shareholder returns, rating objectives for the bank as a whole or for certain debt instruments that the bank has issued, avoidance of regulatory intervention, protection against uncertain events, depositor protection, working capital, capital held for strategic acquisitions, and demands for capital from subsidiaries.

13. Standardised submission of regulatory capital and economic or internal capital

13.1 BSD collects prescribed information on a biannual basis from domestic systemically important banks (D-SIBs).

14. Use of the ICAAP within a bank

This section would describe:

14.1 This would demonstrate the extent to which capital management is embedded within the bank, including the extent and use of capital modelling or stress-testing and scenario analysis within the bank's capital management policy, e.g. in setting pricing, capital allocation, and performance measurement.

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

15. Enhancements made since the previous ICAAP and future refinements

This section would describe:

15.1 update/ progress made on recommendations made by BSD in prior feedback letters; and

15.2 changes made in the processes and/or methodologies since the previous ICAAP to improve the quality and effectiveness of the ICAAP; and

15.2 details of any future refinements to the ICAAP (highlighting aspects which are work-in-progress). Banks can provide any other information which they believe will help BSD to review the ICAAP, such as the expected timeframe.