



INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS MODULE



MODULE	IC: ICAAP
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MODULE	IC: ICAAP
	Introduction

IC-A.1 Purpose

Executive Summary

IC-A.1.1 The Internal Capital Adequacy Assessment Process ('ICAAP') Module sets out the CBB's requirements relating to banks' obligations under Pillar 2 with respect to ICAAP for assessing their overall capital adequacy in relation to their risk profile. It seeks to encourage banks to develop and use better risk management techniques in identifying, monitoring and managing their risks, and to ensure that a licensee has a rigorous process in place for determining the adequacy of its capital to support all risks to which it is exposed.

IC-A.1.2 This Module must be read in conjunction with other parts of the Rulebook, mainly:

- (a) Principles of Business;
- (b) High-level Controls;
- (c) Credit Risk;
- (d) Market Risk;
- (e) Operational Risk;
- (f) Liquidity Risk;
- (g) Reputational Risk;
- (h) Interest Rate Risk in the Banking Book ('IRRBB');
- (i) Capital Adequacy; and
- (j) Stress Testing.

Legal Basis

IC-A.1.3 This Module contains the Central Bank of Bahrain's ('CBB') Directive (as amended from time-to-time) relating to ICAAP and is issued under the powers available to the CBB under Article 38 of the Central Bank of Bahrain and Financial Institutions Law 2006 ('CBB Law'). The Directive in this Module is an important component of the CBB's Supervisory Review Process and is applicable to all Bahraini conventional bank licensees (including their approved persons).

IC-A.1.4 For an explanation of the CBB's rule-making powers and different regulatory instruments, see Section UG-1.1.



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	Introduction

IC-A.2 Module History

Evolution of the Module

IC-A.2.1 This Module is issued in July 2018 as part of Volume One of the CBB Rulebook. All requirements in this Module are effective from the date of issuance. Any material changes that have subsequently been made to this Module are annotated with the calendar quarter date in which the change was made. Chapter UG-3 provides further details on Rulebook maintenance and version control.

IC-A.2.2 The most recent changes made to this Module are detailed in the table below:

Summary of Changes

Module Ref.	Change Date	Description of Changes



MODULE	IC: ICAAP
	General Requirements

IC-1.1 Overview

- IC-1.1.1 A thorough and comprehensive ICAAP is a vital component of a strong risk management framework. The ICAAP should assist in determining the optimum level of capital that is needed to adequately support the nature and level of the bank's risk profile. Nevertheless, if the required economic capital determined under the requirements of this Module falls below risk based regulatory capital determined under Module CA, the latter shall be maintained.
- IC-1.1.2 While the CBB recognises that increased capital is not a substitute for proper controls and risk management processes, higher regulatory capital requirements may be required to buffer banks against the higher risk of unexpected losses resulting from inadequate controls or risk management weaknesses.
- IC-1.1.3 The CBB may intervene at an early stage, to prevent capital levels of banks from falling below the appropriate levels required to support the risk characteristics of the bank, and to require swift remedial action by the bank if the appropriate level of capital is not maintained or restored by the bank.
- IC-1.1.4 Further to the requirements in CA-A.1.5 of Module CA the CBB may set a target capital adequacy ratio ("CAR") for each bank, subject to its specific risk profile rating as determined, based on the CBB's supervisory risk assessment methodology.

MODULE	IC: ICAAP
	General Requirements

IC-1.2 General Requirements

ICAAP Framework

IC-1.2.1

Bahraini conventional bank licensees must develop an ICAAP Framework commensurate with the nature, size, complexity and scale of the bank's activities that includes, but is not limited to:

- (a) An appropriate ICAAP policy, procedures and limits for risk management;
- (b) A description of the process and governance arrangements, including the roles and responsibilities for the Board and senior management, with respect to the design and implementation of the ICAAP Framework;
- (c) The bank's risk appetite statement and capital adequacy objectives;
- (d) Comprehensive and timely identification, measurement, mitigation, controlling, monitoring and reporting of risks;
- (e) A process to relate the bank's capital to its risk profile and for allocation of appropriate capital charges for material risks;
- (f) A process to reconcile, where relevant, the historical amounts used to prudential and financial reporting sources; and
- (g) A process of internal controls and independent review.

IC-1.2.2

The ICAAP Framework must be approved by the CBB, prior to implementation. Any significant amendments to the framework must also be approved by the CBB.

ICAAP Report /Document

IC-1.2.3

Bahraini conventional bank licensees must develop an ICAAP Report and maintain capital levels that are commensurate with their risk profiles and control environments.

IC-1.2.4

The ICAAP Report must be prepared on an annual basis and submitted to the CBB on 31st May of each year.



MODULE	IC: ICAAP
	General Requirements

IC-1.2 General Requirements (Continued)

IC-1.2.5

Bahraini conventional bank licensees must ensure that the outcome of the ICAAP is forward looking (i.e. considers a minimum of 3-years projections) and not a static capital target. Banks must ensure that the ICAAP covers the following:

- (a) All material risks and potential vulnerability to its business and operational environment;
- (b) Capital requirements, benign and adverse forward-looking environment; and considers capital buffers during benign conditions to help meet any surge in capital demand under adverse conditions;
- (c) A business plan and evaluation of short-term and long-term capital needs;
- (d) Rigorous stress-testing and scenario analysis that identifies possible events or changes in market conditions that could adversely impact the bank; and
- (e) Results of stress tests and analyses are incorporated, where applicable, into the capital adequacy assessment.



MODULE

IC: ICAAP

Board and Senior Management Oversight

IC-1.3 Board and Senior Management Oversight

IC-1.3.1

The ultimate responsibility for ensuring that there is a robust ICAAP and a sound risk management framework; setting capital targets that are commensurate with the banks' risk profile and control environment; and ensuring that banks set aside adequate capital to support the risks beyond the regulatory minimum requirements, rests with the Board and senior management of the licensees.

IC-1.3.2

Responsibilities of the Board include:

- (a) Ensuring adequate capital management policies are in place; the Board must also review and approve these policies on an annual basis;
- (b) Understanding the material risks that are impacting the business, and also having an awareness of emerging risks and vulnerabilities;
- (c) Reviewing and approving the capital plan and corresponding capital actions;
- (d) Defining the risk appetite/risk tolerance of the bank;
- (e) Ensuring that the bank has a sound risk management framework in place;
- (f) Ensuring that the accountability and lines of authority are clearly delineated and effectively communicated throughout the organization;
- (g) Ensuring that the bank implements adequate infrastructure and controls to measure, monitor and mitigate risk effectively; and
- (h) Ensuring that the bank has adequate capital proportionate to its risk profile under normal and adverse conditions.

IC-1.3.3

Responsibilities of the senior management include:

- (a) Ensuring that bank personnel involved in ICAAP activities have the adequate skills, including complex financial risk management skills, and that employees are adequately enabled through training.
- (b) Ensuring that they have adequate understanding of the material risks that are impacting the business, as well as an awareness of emerging risks and vulnerabilities;
- (c) Ensuring effective implementation of relevant policies, procedures, systems and controls;
- (d) Communicating the internal controls and written policies and procedures throughout the bank; and
- (e) Monitoring risk exposures in accordance with the risk appetite and limits approved by the Board.

MODULE	IC: ICAAP
Board and Senior Management Oversight	

IC-1.3 Board and Senior Management Oversight (Continued)

- (f) Ensuring that the Board receives adequate information pertaining to risk management and capital management, under both normal and stressed business conditions; and
- (g) Monitoring and reporting of status against ICAAP to the Board.

IC-1.3.4	The roles and responsibilities of Risk Management, Financial Control and Compliance in relation to ICAAP must be clearly documented in the related policies and procedures.
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MODULE

IC: ICAAP

Comprehensive Assessment of Risk

IC-1.4 Comprehensive Assessment of Risk

IC-1.4.1

Bahraini conventional bank licensees must ensure that their ICAAP identifies and assesses all material risks and addresses the following:

- (a) Credit risk, market risk and operational risk, captured under Pillar 1;
- (b) Risks that are not taken into account by Pillar 1 (e.g. IRRBB, liquidity risk, reputational risk, strategic risk and concentration risk); and
- (c) External factors outside the direct control of the licensees, including changes in regulations, accounting rules and the economic environment (e.g. business cycle effects).

IC-1.4.2

For each of the material risks identified in the ICAAP, banks must ensure that the risk management framework (in HC-6.6.2) is comprehensively addressed.

IC-1.4.3

Bahraini conventional bank licensees must ensure that their risk management infrastructure allows for aggregation of exposures and risk measures across business lines.



MODULE

IC: ICAAP

Capital Planning

IC-1.5 Capital Planning

IC-1.5.1

Bahraini conventional bank licensees must develop a comprehensive Capital Planning Policy which clearly articulates the guidelines for capital planning, capital usage, capital distribution (i.e. issuing dividends, share buy-back, etc.), determining capital composition and capital-raising mechanisms under different conditions.

IC-1.5.2

Bahraini conventional bank licensees must state their objectives in deciding how much capital to hold. Banks must ensure that the capital objectives go beyond the regulatory minimum to support risks and to take into account the following considerations:

- (a) Level of creditworthiness of the bank to be achieved in markets, that is higher than that indicated by the minimum regulatory capital requirements;
- (b) Fluctuations in capital adequacy ratios, as a result of changes in type and volume of activities and risk exposures in the normal course of business;
- (c) Cost of capital-raising, especially in situations where capital injections need to be carried out quickly, or at a time when market conditions are unfavourable;
- (d) Potential breach of the minimum regulatory capital requirements and regulatory actions in such an event;
- (e) Risks arising from the features of the jurisdictions and markets in which the bank operates; and
- (f) Limitations in risk assessment infrastructure and methodologies.

IC-1.5.3

Bahraini conventional bank licensees must develop their ICAAP on a consolidated and solo basis. Banks must ensure that their consolidated capital is adequate to:

- (a) Support the volume and risk characteristics of all parent and subsidiary activities; and
- (b) Provides a sufficient cushion to absorb potential losses arising from such activities.

IC-1.5.4

Bahraini conventional bank licensees must ensure that their consolidated ICAAP addresses the following:

- (a) That the total capital estimated as appropriate for the group has been allocated to each group member, according to their respective risk profiles; and
- (b) That the group risks they face (including reputation risk arising from the failure of another group member, and the risks they face due to exposure to, or dependence on, other group members) are fully evaluated.



MODULE	IC: ICAAP
	Capital Planning

IC-1.5 Capital Planning (Continued)

Capital Adequacy Objectives

IC-1.5.5 The CBB may impose specific capital charge, and / or limits, on all material risk exposures, if warranted. This may include risks that the CBB considers not have been adequately transferred, or mitigated, through transactions entered into by the Bank (e.g. securitization transactions)

IC-1.5.6

In stating their capital adequacy, banks must:

- (a) Use formal economic capital models for setting capital objectives and targets and assessing its capital adequacy. The CBB will determine which banks may be exempted from establishing formal economic capital model on a case to case basis;
- (b) Assess whether their long-run capital objectives differ significantly from their short-run capital objectives. As it may take time for a bank to raise new capital, the bank must make allowances for unexpected events, including putting contingency plans in place for raising additional capital;
- (c) State the time horizon for achieving their capital adequacy objectives, and set out in broad terms the capital planning process and the responsibilities for that process. The capital plan should recognise that accommodating additional capital needs requires significant lead time, and take into account the potential difficulties of raising additional capital during downturns or other times of stress. It must also set out how the bank will comply with regulatory capital requirements, any relevant limits related to capital, and a general contingency plan for dealing with divergences and unexpected events;
- (d) Develop an internal strategy for maintaining capital levels which must not only reflect the desired level of risk coverage, but also incorporate factors such as portfolio growth expectations, future sources and uses of funds, and dividend policy. There may be other considerations that the banks consider relevant or important in determining how much capital it must hold (e.g. external rating goals, market image, strategic goals etc.). If these other considerations are included in the ICAAP, the bank must show how the considerations have influenced its decisions concerning the amount of capital to be held; and
- (e) Ensure that capital objectives and targets are reviewed and approved by the Board, on an annual basis at least, to ensure their appropriateness.

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Capital Planning	

IC-1.5 Capital Planning (Continued)

IC-1.5.7

Bahrini conventional bank licensees must ensure that adequate capital is held against all material risks not just at a point in time, but over time, to account for changes in their strategic direction, evolving economic conditions and volatility in the financial environment.



MODULE	IC: ICAAP
	Capital Planning

IC-1.5 Capital Planning (Continued)

Risk Modelling

IC-1.5.8 Bahraini conventional bank licensees using risk-modelling techniques to assess capital adequacy must comprehensively identify their capital needs on the basis of both quantifiable and non-quantifiable risks. Banks must not rely on quantitative methods alone to assess capital adequacy. Non-quantifiable risks, if material, must also be included using qualitative assessment and management judgment.

Design of ICAAP

IC-1.5.9 Bahraini conventional bank licensees must present in their ICAAP report and how risks relate to capital levels under both normal and stressed conditions.

Recovery Plan

IC-1.5.10 Bahraini conventional bank licensees must develop, commensurate with the nature, size, complexity and scale of the bank's activities, a recovery plan in line with Chapter 2 of Module DS. Recovery plans must be approved by the Board and the CBB and must be reviewed regularly. The recovery plan must include information and analysis to reflect the appropriate coverage and granularity of the recovery plan, as well as key elements including:

- (a) Governance arrangements and escalation process following a triggering event;
- (b) Quantitative and qualitative triggers and early warning indicators; and
- (c) Recovery options based on the appropriate number of market-wide (systemic) stress scenarios and bank-specific (idiosyncratic) stress scenarios to assess which recovery options would be effective in a range of stress situations.

IC-1.5.11 Bahraini conventional bank licensees must develop and maintain a recovery plan trigger framework (which must be embedded within the bank's risk management framework), to prompt recovery action in a timely manner.

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Independent Review	

IC-1.5 Capital Planning (Continued)

- IC-1.5.12** Recovery triggers must be well-defined and tailored to the full range of risks faced by banks. Notwithstanding other triggers that might be considered, the capital ratio trigger must not be less than 13%. The threshold level for triggers must be calibrated with impact on the bank's capital and set out clearly in the bank's recovery plan.
- IC-1.5.13** Bahraini conventional bank licensees must establish an adequate monitoring process to support the operation of the trigger framework in their recovery plan.



MODULE	IC: ICAAP
	Independent Review

IC-1.6 Independent Review

IC-1.6.1

Bahraini conventional bank licensees must ensure that the ICAAP framework is subject to independent review by a third party consultant, other than the external auditor upon first implementation of the requirements in this Module, and subsequently, when there are material changes in the relevant Rulebook requirements or to the business conducted by the bank and/or its risk profile.