7 April 2010

GUIDELINES FOR THE JOINT ASSESSMENT OF THE ELEMENTS COVERED BY THE SUPERVISORY REVIEW AND EVALUATION PROCESS (SREP) AND THE JOINT DECISION REGARDING THE CAPITAL ADEQUACY OF CROSS BORDER GROUPS (CP39)

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Chapter 1: Introduction and executive summary

1. The revised Capital Requirements Directive (CRD, article 129(3))[1], approved by the European Parliament on 6 May 2009 (2009/111/EC) and whose provisions will be applicable from 31 December 2010, requires that the consolidating supervisor and supervisors of subsidiaries involved in the supervision of an EEA cross-border banking group do everything within their power to reach a joint decision on the application of the Pillar 2 provisions related to the Internal Capital Adequacy Assessment Process (ICAAP) and to the Supervisory Review and Evaluation Process (SREP). The joint decision should cover the determination of the adequacy of the consolidated level of own funds held by the group with respect to its financial situation and risk profile, as well as the required level of own funds, above the regulatory minimum, applied to each entity within the group.

2. The consolidating supervisor and supervisors of subsidiaries (hereafter called host supervisors) shall carry out this task within the colleges of supervisors established in accordance with the CRD provisions and operating under the framework provided by CEBS Guidelines on the operational functioning of colleges[2].

3. In order to facilitate the joint decision process and to avoid inconsistencies in the approaches followed by the various colleges, the CRD also requires that CEBS elaborates guidelines for the convergence of supervisory practices with regard to the joint decision process and, with a view to facilitating joint decisions, with regard to the application of the provisions related to the SREP, the ICAAP, and the determination of additional levels of own funds under article 136(2) of the CRD.

4. Accordingly, these guidelines set out a common process for the joint assessment and decision process, with the aim of:

   a. providing the consolidating and host supervisors with guidance in order to coordinate the individual results of the SREP of the entities under their supervision, facilitate discussion within the colleges, enhance mutual understanding and encourage reliance on each others' assessments;

[1] Capital Requirements Directive (CRD) is a technical expression which comprises Directive 2006/48/EC and Directive 2006/49/EC. Please note that in general references to "Directive 2006/48/EC" and "Directive 2006/49/EC" or "CRD" refer to the versions of the Directives as amended in May 2009. The amending Directive can be found under: http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P6-TA-2009-0367&language=EN&ring=A6-2009-0139

[2] CEBS Draft Guidelines for the operational functioning of colleges, CP34 (17 Dec 2009) http://www.c-ebs.org/Publications/Consultation-Papers/All-consultations/CP31-CP40/CP34.aspx

b. facilitating the joint decision process and helping achieving consistency on the adequate levels of own funds, above the minimum regulatory level, throughout cross-border groups;

c. easing the implementation of other prudential measures, pursuant to article 136(1) of the CRD, that may be coordinated by the college members on a voluntary basis; and

d. enhancing convergence of practices across colleges (horizontal convergence) in the field of joint assessments and joint decisions on the risk-based capital adequacy.

5. This document takes as its starting point that the members of the college have each carried out a supervisory review and evaluation process for the entities under their supervision using their national methodologies and Risk Assessment Systems (RAS), where applicable.

6. In accordance with what is stated in the CEBS Guidelines on the Application of the Supervisory Review Process under Pillar 2 (GL03)[3], the SREP should encompass the following elements:

a. identification, review and evaluation of all material risk and control factors;

b. assessment, review and evaluation of the ICAAP; and

c. assessment, review and evaluation of the compliance with the various minimum requirements of the CRD.

7. The results of the SREP assessments of individual entities are then brought along to the college and should serve as the basis for meaningful discussion and exchange of views among college members, which should in turn result in a joint understanding of the different elements of the SREP and in a joint decision on their risk-based capital adequacy. Where appropriate, the joint decision should contain the requirement(s) to hold own funds above the minimum regulatory level at the group and/or sub-consolidated or individual entity level.

8. Cross-border banking groups often centralise key functions, in particular in the area of risk management functions, while at the same time retaining their presence in existing host markets through local subsidiaries. As a result, there may not be a clear alignment between the legal structure of the groups, on the basis of which supervisory competences are allocated, and the operational structures through which risks are measured and managed.

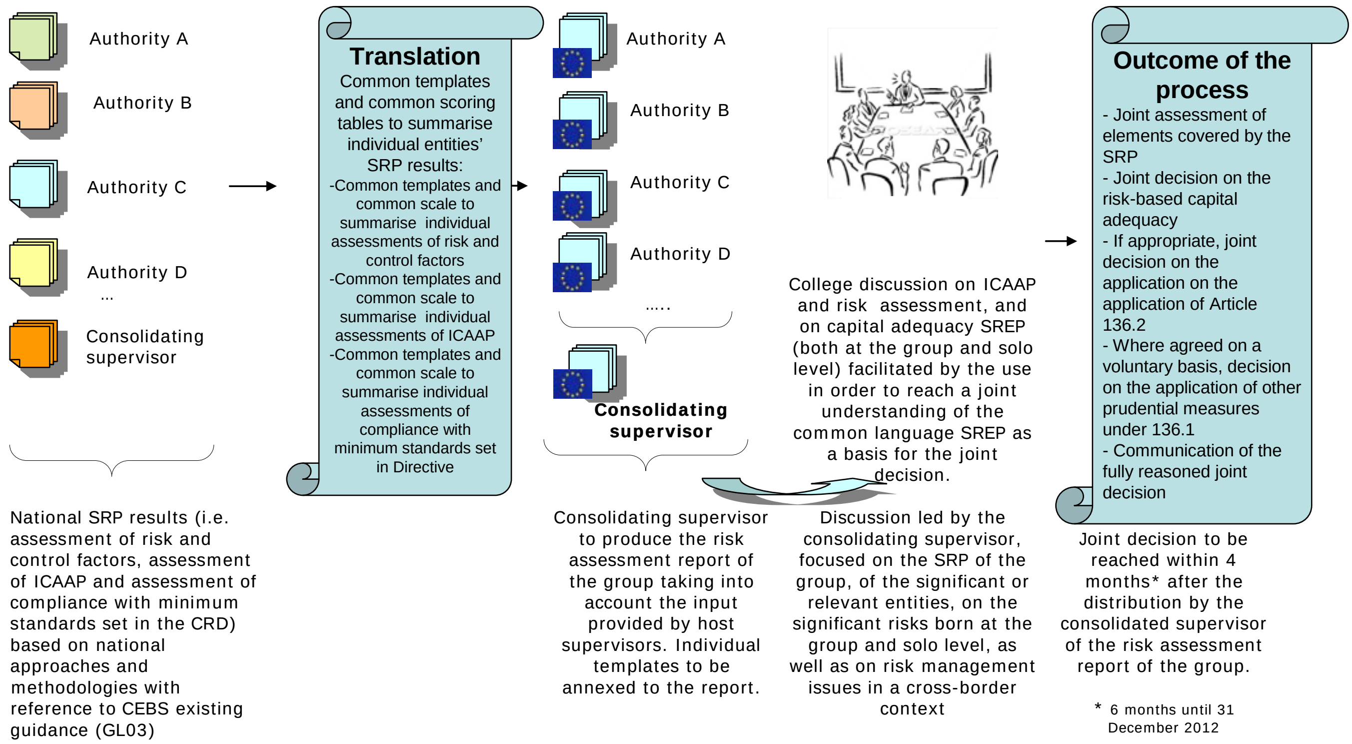
9. To address these misalignments and enhance the assessment of the group and its entities, these guidelines are intended as a tool to facilitate the joint assessment and decision process described above.

[3] See http://www.c-ebs.org/getdoc/00ec6db3-bb41-467c-acb9-8e271f617675/GL03.aspx

10. These guidelines complement the CEBS GL03 and the CEBS Draft Guidelines for the operational functioning of colleges[4]. Where appropriate, reference is made to other supervisory guidance as well.

11. Picture 1 below provides an overview of the joint assessment and joint decision process. The cooperation procedure to be followed within the college framework by the authorities involved in the joint decision on risk-based capital adequacy is further developed in the Draft Guidelines for the operational functioning of colleges.

Picture 1: Overview of the process for the joint assessment and decision on the risk based capital adequacy



12. These guidelines aim to facilitate cooperation and coordination between the authorities involved in the joint assessment and decision process mainly by providing them with tables and scoring scales for summarising the results of their respective SREPs, in particular:

a. tables and scoring scales for summarising the results of the assessment by each competent authority of the risk factors and risk management and control factors;

b. tables and scoring scales for summarising the assessment of the ICAAP framework and processes by each competent authority; and

[4]CEBS Draft Guidelines for the operational functioning of colleges, CP 34 (17 Dec 2009) http://www.c-ebs.org/documents/Publications/Consultation-papers/2009/CP34/CP34.aspx

c. tables for summarising the assessment by each of the competent authorities of the compliance of the supervised entities with various minimum requirements of the CRD.

13. The guidelines also aim to provide supervisory authorities with a methodology for facilitating the college discussion leading to the shared assessment and joint decision on the risk-based capital adequacy.

14. **Chapter 2** provides guidance on how to translate the results of individual assessments of risk and control factors performed in accordance with national practices and using Risk Assessment Systems (RAS), where applicable, into a common format for the purposes of reporting the results of those assessments and easing their integration into the risk assessment report on the group to be produced by the consolidating supervisor. A template, which can be used for translating the individual assessments of entities, as well as a summary table containing the joint assessment of risk factors and risk management and control factors, is provided in this chapter. The guidance contained in Chapter 2 also aims at facilitating the discussion regarding risk factors and risk management and control factors within the college which should lead to a shared view or joint assessment of the risk factors and risk management and control factors of the group and its entities.

15. **Chapter 3** provides guidance on how to translate the results of individual ICAAP framework assessments into a common format for the purposes of reporting these results and easing their integration into the report to be produced by the consolidating supervisor. The chapter also gives guidance on how college members should reach a shared view or joint assessment of the quality and robustness of the ICAAP framework, methodologies and related governance structure of the cross-border group and its entities. The Chapter is not intended to provide supervisors with prescriptive and comprehensive guidance for assessing the ICAAP but provides tools to facilitate the discussion and coordination of ICAAP assessments within the college, in particular when discussing methodologies, institutions' stress testing and governance and internal control, as well as the comparison between the internal capital assessments and Pillar 1 regulatory capital. A common template is proposed for reporting the results of ICAAP assessments within the college.

16. **Chapter 4** addresses aspects of the coordination of supervisory assessments of compliance with the various minimum requirements of the CRD, such as the evaluation of the methods and models used in advanced approaches under Pillar 1, and an evaluation of disclosures under Pillar 3. A common template is proposed for reporting the results of the assessment of compliance with the CRD requirements within the college.

17. **Chapter 5** provides insights into the reconciliation of the institution's own assessment of capital needs related to its risk profile and the evaluation and expectations of the members of the college of supervisors, based on the shared view or joint assessment of the three elements covered by the SREP (i.e. risk factors and controls, ICAAP framework and compliance with the CRD) for the group and its entities. The Chapter also focuses on some of the main topics to be discussed in the college in the process of reaching a joint

decision on an adequate level of capital at the group, sub-consolidated and individual levels. These topics are: (i) stress tests and their effects on the level of capital; (ii) the allocation of group diversification effects and transferability of capital between the different entities in the cross border group; as well as (iii) the types of capital that can be accepted to cover additional capital requirements. A summary table which can be used to present the overall outcome of the joint assessment and decision is also provided.

Chapter 2: The joint assessment of risk factors and risk management and control factors in the college of supervisors

2.1 The coordination and translation of individual risk assessments by using a common template and a common scoring scale

Guideline 1. Consolidating and host supervisors should present the results of their assessment of the entities' risk factors and risk management and control factors under their supervision through a common template and scoring scale, accompanied by explanations clarifying the drivers and rationale for the scores assigned .

18. College members should agree on a common format for reporting the outcome of their assessments as regards the exposure to material risks and the quality of risk controls and the control environment, as well as the adequacy of corporate and internal governance.

19. The Table 1 below provides an example of a common template, which could be used to present a summary of the assessments done by each authority. Putting all individual assessments into a common scoring format, together with explanations of the rationale behind each score, should facilitate the college discussion and enable the consolidating supervisor to produce a report containing the risk assessment of the group. If deemed necessary by college members, in order to better understand the risk profile of the respective entities, supervisors should supplement the summaries of the assessments provided in the table below with additional qualitative and quantitative information.

20. Depending on the specificities of an entity, exposure to risks or deficiencies in controls identified by supervisors, the template could be supplemented by more detailed information and deliberation.

Table 1. Common template for translating the assessment of the risk profile (risk factors and risk management and control factors)

1. Business activities and overall risk profile	**score:**
Assessment of the general risk profile of an entity/group (narrative information following by main conclusions and deficiencies identified)	
2. Financial position	**score:**
Assessment of profitability and financial development (narrative information following by main conclusions and deficiencies identified)	
3. Overall strategy and risk tolerance	**score:**
Assessment of the business strategy and risk strategy of an entity/group (narrative information following by main conclusions and deficiencies identified)	

4. Corporate governance including internal governance score:

Assessment of the adequacy (including implementation) of the corporate governance and internal governance (narrative information following by main conclusions and deficiencies identified) addressing: • *roles, responsibilities and organisation of the management body(ies);* • *roles, responsibilities, organisation and performance of the internal control framework (risk control function, compliance function, internal audit function).*

5. Summary table on the assessment of the material risks

Risk types	**Score for risk factor assessment, where applicable**	**Score for risk management and control assessment, where applicable**	**Combined score[5] (assessment of risk and control factors), where applicable**	**Explanation**
Credit risk				
Risks related to risk transfer through securitisation activities				
Market risk				
Operational risk				
Liquidity risk				
Concentration risk				
Interest rate risk from non-trading activities				
Other risks (please specify)				

Note: For the purposes of these guidelines the list of risk factors in Table 1 is limited to the commonly agreed classification. However other risk factors – or subsets of the above-mentioned risk factors - could be considered by supervisors depending on the specificities and risk profile of the group (e.g. insurance, pension, counterparty, compliance, accounting and auditing risks etc).

21. Given the fact that the national RAS used by individual authorities to prepare the assessments of their respective entities differ in their methodologies and output parameters, the "translation" of outcomes is required in order to facilitate the joint assessment and decision process.

[5] The combined score is the score which reflects the assessment of both risk and control factors. Depending on the methodology and specification of individual RAS systems, supervisors may provide scores for the assessment of risk factors and the assessments of risk management and control factors or only the combined score which takes into account both, or all three, if applicable.

22.The different elements mentioned in the common template for translating the assessments of risk factors and risk management and control factors are further described in Chapter 2.2.

23.Under national RAS a variety of methods may be used by the national supervisors to derive scores and/or judgments on the different types of risks. In some cases risk levels on the one hand, and the quality of risk management and control factors on the other hand could be measured separately; while in other cases the assessment process combines the two aspects. The college members should agree either on using separate scores for risk level and quality of risk management and control that are then aggregated in a net score, or on just using a net score combining the two elements, based on the definitions provided in these guidelines. These guidelines do not provide any formula or instructions for the determination of the combined score mentioned in the table above.

24.To translate their assessments of the risk levels associated with different risk factors (parts 1 to 5 of Table 1) college members should use the following scoring scale (i.e. risk assessments derived from the national RAS should be converted at the judgement of the respective supervisor into the scales below).

Table 2. Common scores for the assessment of risk factors[6]

Score	Description
1	Low risk of significant impact on the prudential elements[7] of the group or its entities.
2	Medium-Low risk of significant impact on the prudential elements of the group or its entities. Nonetheless, a change in the situation could relatively quickly have a significant impact, and thus the risks or weaknesses considered must be monitored.
3	Medium-High risk of significant impact on the prudential elements of the group or its entities. The entity's risk control thus requires supervisory attention.
4	High risk of significant impact on the prudential elements of the group or its entities. The entity's risk control thus requires heightened supervisory attention.

25.To translate their assessments of the effectiveness of risk controls and the risk control environment (part 5 of Table 1), college members should use the following scale (i.e. risk control assessments derived from the national RAS should be converted at the judgement of the respective supervisor into the scale below):

[6] In addition to the scores defined in this table, depending on the situation, supervisors may use "not applicable" when the assessment element is not applicable to the functional activity of an entity, or "not assessed" when supervisor has not yet assessed the element for the respective entity.

[7] Prudential elements, as referred to in the table above, are understood to be elements such as an institution's current and future solvency and profitability, its reputation on the market, its liquidity and the adequacy of its organisation.

Table 3. Common scores for the assessment of risk controls

Scores	Description
1	A high level of risk management and control. The risk management and control framework is clearly defined and fully compatible with the nature and complexity of the institution's activities[8].
2	An acceptable level of risk management and control. The risk management and control framework is adequately defined and sufficiently compatible with the nature and complexity of the institution's activities.
3	The risk management and control needs improvement. The risks are insufficiently mitigated and controlled, leaving too high a residual risk for the institution. The risk management and control framework is hardly defined or insufficiently compatible with the nature and complexity of the institution's activities.
4	The risk management needs drastic and/or immediate improvement. The risks are not or hardly mitigated and poorly controlled. The risk management and control framework is neither defined nor compatible with the nature and complexity of the institution's activities.

2.2. Methodology to structure the dialogue between college members and reach a joint assessment of risk factors and risk management and control factors

Guideline 2. The report containing the risk assessment of the group, prepared by the consolidating supervisor, should serve to structure the discussion leading to a joint assessment of the risk factors and risk management control factors of the group and its entities within the college, under the lead of the consolidating supervisor.

26. The report containing the risk assessment of the group - produced by the consolidating supervisor after taking due account of the individual assessments delivered by college members - serves as an input for dialogue between the college members. A meaningful discussion should allow college members to get a shared understanding of the risk factors and risk management and control factors of the group and its entities.

27. The identification and discussion of such risks within the college should be facilitated by the use of the common risk scoring template referred to in Chapter 2.1. The consolidated risk assessment report should contain a table summarising the scores attributed by the college members to each of the assessment criteria when reporting the results of their risk assessments.

28. Organised by the consolidating supervisor, the discussion among college members leading to a joint assessment of the risk factors and risk management and control factors of the group and its entities should be mainly focused on:

[8] CEBS High-level principles for risk management contain guidance for assessing the risk management and control framework of an institution.

a. The assessments of the group and of the relevant entities within the group as well as of the significant entities in local markets. The assessments of relevant or significant entities should be duly reflected in the report containing the risk assessment of the group. The mapping of the group's entities, as defined under CEBS Guidelines for the operational functioning of colleges[9], should be used in this regard.

b. Material risks for the group and its entities. Material risks should be understood as risks, borne either at the consolidated or at the entity level, which may significantly impact the financial situation of the group.

c. Material deficiencies in risk management and control and other internal governance elements (e.g. quality of management body, internal audit). Material deficiencies in internal governance should be understood as ones, whether occurring at the consolidated or at the entity level, which may significantly impact the control environment of the group.

d. Intra-group risk relationships, including concentration of risks in particular entities of the group, intra-group contagion channels and intra-group transactions, which may significantly change the risk profile of the group or individual entity. This issue might be of particular importance to a group classified as a financial conglomerate and subject to the supplementary requirements of the Financial Conglomerates Directive (2002/87/EC), and in particular its provisions on Risk Concentration in Article 7 and on Intra-group transactions in Article 8 and also Annex II of the Financial Conglomerates Directive (2002/87/EC).

e. Risk management and internal governance issues of importance in a cross-border context (e.g. the know-your-structure principle). In situations, when the risk management systems, functions, or some elements of both, are centralised at the group level, the college members should discuss their adequacy for all entities which are covered by these centralised systems or functions. Where risk management systems, functions, or some elements of both, are decentralised, the college members should assess the adequacy of the integration of individual elements into the overall group risk management and control as well as the aggregation of risk management information and processes across the group. In addition, host supervisors should inform the college on how group policies and risk management instruments are implemented in their respective entities, and on the efficiency of these policies, procedures and processes in relation to the local market and the specificities of the entities.

Guideline 3. To facilitate a meaningful dialogue in the college, suited to the characteristics of the group, the college members should agree on the main elements to be covered in the college discussion in order to reach a joint assessment of the risk factors and risk management and control factors of the group and its entities.

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[9] CEBS Guidelines for the Operational Functioning of Colleges, CP34 (17 December 2009, chapter 1: Operational organisation of colleges
http://www.c-ebs.org/documents/Publications/Consultationpapers/2009/CP34/CP34.aspx

29. To facilitate a meaningful dialogue within the college, suited to the characteristics of the group, the college members should agree on the main elements to be discussed and exchange quantitative and qualitative information to back their assessments.

30. In their dialogue, the consolidating and host supervisors should focus at least on the following five elements:

Element 1: *Overview of the group's business activities and overall risk profile*

31. Through discussion within the college, the college members should get an adequate understanding of the overall business model and overall risk profile of the group and its entities. Based on the individual assessments provided by the college members, the actual degree of consistency of the business models of the parent company and of the subsidiaries (at least the relevant ones) should be considered within the college in order to detect possible governance problems and/or co-ordination failures.

32. Through the information shared within the college, its members should discuss the group legal and functional structure, based on the mapping of the different business activities (by market size, income generating capacity, assets' distribution and size and risk characteristics) and taking due consideration of the institution's business mix.

33. Special attention should be paid to recent material changes in key business lines, areas of activities, and range of products (e.g. in cases of merger or acquisition) to understand changes in the risk profile and/or to assess the long term sustainability of the business model in all markets in which the group operates. Supervisors should also discuss the strategic/business plans and the main goals established by the institution in the medium term.

34. The discussion within the college should also cover the asset structure and funding sources of the institution, significant (expected) changes in the balance sheet structure and the (expected) impact of these changes on the risk profile of the institution.

Element 2*: Financial position*

35. Based on the consolidating and the host supervisors' views on the financial condition of each significant entity, the college members should develop a shared view of current and future financial conditions of the group and its entities.

36. When discussing the financial position of the group and its entities, college members could focus on the sources and levels of income generated, assessing whether the institution's income base will cover any expected losses stemming from the operations (e.g. credit risk/other risks cost, market losses, operational risk losses), provides a buffer against unexpected risks, and offers adequate remuneration of the institution's capital.

37. In order to get a joint view on the stability and sustainability of the institution's income base and income generating capacity, supervisors should

also discuss the income and costs composition, i.e. what are the main sources of income and main expense items.

38. The shared supervisory assessments should also aim to highlight significant planned changes in the institution's profitability as well as evaluating the group's potential earnings' weaknesses.

39. Chapter 5 of these guidelines provides more insights into issues related to the joint assessment of the capital position of a group and its entities.

Element 3: *Overall strategy and risk appetite and risk tolerance*[10]

40. The members of the college should reach a common understanding of the institution's overall strategy, including the consistency between the business strategy and risk strategy, as well as the overall risk appetite and risk tolerance of the group and its entities, and how it is reflected in strategies or other targets.

41. Based on the individual assessments provided by the respective supervisors, the college members should discuss the consistency of business strategies throughout the group and whether significant changes in local strategies are duly reflected at the group level or vice versa.

42. Members of the college should discuss the forward-looking planning of business activities to generate revenue as well as profits and capital resources taking account of the expected development of costs. The discussion should also cover the definition of the types and levels of risks that the institution is willing to take, i.e. its risk appetite/tolerance. Furthermore the discussion should include the planning of more concrete steps with which strategic aims are to be implemented (e.g. sufficient staffing, technical and organisational resources and finance, and adequate control structures).

43. The consolidating and host supervisors should discuss whether the institutions' business strategy is accompanied by adequate capital plans, risk policies, and limit structures as well as an adequate risk management and control structure.

Element 4: *Corporate governance, including internal governance, at group and entity level*[11]

44. Based on the assessments provided by the consolidating and host supervisors, the college members should get a common understanding of the adequacy of risk management and internal audit and control systems, considering whether these systems provide for a consistent aggregation of the information across the group, in particular when there is no clear

[10] This section should be read in conjunction with CEBS High-level principles for risk management, (16 February 2010) which addresses minimum principles with respect to risk appetite and tolerance.
http://www.c-ebs.org/documents/Publications/Standards---Guidelines/2010/Risk-management/HighLevelprinciplesonriskmanagement.aspx

[11] This section should be read in conjunction with the section on Internal governance of the CEBS Guidelines on the Application of the Supervisory review Process under pillar 2 (GL03) (25 January 2006) and the High-level principles for risk management.

alignment between the legal and operational/business structures of the group.

45. The discussion should also consider remuneration policies and practices, including the decision-making process involved (e.g. remuneration committees) in the group and its entities. The discussion should also cover the assessment of compliance with recommendations from the EU Commission on remuneration policies in the financial service sector and on directors' remuneration on 30 April 2009 and CEBS standards and guidelines in this area[12].

46. College members should also assess the appropriateness of the organisational structure (both legal and functional) with regard to the business model and operations of the group throughout all markets and geographies it operates in, and discuss whether the level of complexity is appropriately counterbalanced by a strong risk control system and internal audit procedures.

47. With regard to internal control, the college members should discuss possible inefficiencies and weaknesses identified in their assessments, based on the elements of internal governance stipulated in GL03[13].

48. In their assessments, college members should not only discuss the appropriateness of the internal control framework but also its implementation across the various levels of the organisation, and divisions of tasks and responsibilities between group and entity level functions.

49. In the assessment of the roles, responsibilities, organisation and performance of the internal audit function, college members should also pay due attention to how the function meets the requirements for specific tasks in relation to the use of advanced models for Pillar 1 purposes[14].

50. When college members have information on the fitness and properness of key members of management in the group or its entities which may be of interest to other members of the college, they should consider bringing such information to the discussion.

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[12] For further details see EU Commission recommendations on remuneration policies in the financial services sector (30 April 2009) http://ec.europa.eu/internal_market/company/docs/directors-remun/financialsector_290409_en.pdf and CEBS High-level principles on remuneration policies (20 April 2009), http://www.c-ebs.org/getdoc/34beb2e0-bdff-4b8e-979a-5115a482a7ba/High-level-principles-for-remuneration-policies.aspx
Moreover, CRD III includes specific requirements regarding remuneration policies and practices.

[13] Internal control as defined in GL03 covers the following elements: risk control function, compliance function and internal audit function.

[14] As some examples, according to point 26 of Part 6 of Annex III of the CRD, an internal audit process should address credit counterparty risk (CCR management system); paragraph 131, Part 5.3 of Annex VII of the CRD requires internal audit or other comparable independent function to review at least annually the credit institution's rating systems and its operations, including the operations of the credit function and the estimation of PDs, LGDs, ELs and conversion factors; and, according to paragraph 56 of Part 3 of Annex VIII of the CRD internal audit should cover an institution’s system for the estimation of volatility adjustments; etc.

Element 5: *Assessment of the main risk types*

51. The college members should individually assess and discuss in the college framework all material risks taken by the group and its entities, evaluating them with reference to the degree of exposure (risk exposure) and the arrangements made for managing and controlling risks (mitigating factors). Although material risks for each entity may vary according to their features and/or of reference markets, the list below enumerates some of the main risk types that should be discussed in colleges, both in terms of risk level and effectiveness of risk management and control:

    a. credit risk, including residual risk associated with the use of recognised credit risk mitigation techniques;

    b. risks related to risk transfer through securitisation activities;

    c. market risk;

    d. operational risk;

    e. liquidity risk;

    f. concentration risk, including compliance with CRD large exposure rules (LER);

    g. interest rate risk from non-trading activities; and

    h. any other material risks identified[15].

52. It should be noted that in addition to the assessment of the overall level of concentration risk and the quality of associated control factors supervisors need to discuss their respective assessments of the compliance of the group's entities under their supervision with the rules on large exposures provided for in Articles 106 to 118 of the CRD, and in CEBS guidelines and standards issued on that subject[16].

53. In the college discussion, particular attention should be paid to situations where exposures are in breach of the LER, and to the measures imposed by the relevant supervisors during the time period given to the institutions to comply with the LER. This is the case in particular where a supervisor requires deduction of such exposures from regulatory capital until the institution is compliant again, as it affects the assessment of the overall level of capital and risk based capital adequacy.

[15] For the purposes of these guidelines the list of risk factors in this summary table is limited to the commonly agreed classification. However other risk factors – or subsets of the above-mentioned risk factors - should be considered by supervisors depending on the specificity and risk profile of the group (e.g. insurance, pension, reputational, counterparty, compliance, accounting and auditing etc.)

[16] CEBS Guidelines on reporting requirements for the revised large exposures regime, 11 December 2009 http://www.c-ebs.org/documents/Publications/Standards---Guidelines/2009/Large-exposures_all/Guidelines-on-Large-exposures_connected-clients-an.aspx

54. With respect to liquidity risk it should be noted that in addition to the assessment of the overall level of liquidity risk and associated control factors, supervisors should discuss the compliance of the group and its entities with the minimum requirements for liquidity management contained in Annex V points 14 to 22 of the CRD, as well as with CEBS Recommendation for liquidity risk management[17].

55. With respect to the assessment of interest rate risk arising from non-trading activities, Article 124(5) requires institutions and supervisors to take measures should the economic value of an institution decline by more than 20% of its own funds as a result of a sudden and unexpected change in interest rates, the size of which shall be prescribed by the competent authorities. In its Guidelines on Technical aspects of the management of interest rate risk arising from non-trading activities under the supervisory review process[18], CEBS provided guidance on how to set the comparable standard shock. College members are encouraged to agree and use the same definition of the shock at group and individual entity levels.

56. Should the economic value of the group or its entities decline by more than 20% as a result of the application of the shock discussed above, the competent supervisors are expected to discuss with the respective entities the measures which might need to be taken to mitigate such a potential decline. Such situations should be discussed in the college.

57. Through their discussion, the college members should be able to agree on the material risks the group is exposed to, as well as on the underlying risk factors, and get a shared view of the risk exposure levels and their distributions within the group.

58. The college discussion should equally enable college members to make a joint assessment of whether the institution's arrangements for managing and controlling risks are adequate in light of the risks taken.

2.3. Reaching a joint assessment of the risk factors and risk management and control factors of the group and its entities

Guideline 4. The dialogue among college members should result in a joint assessment of the risk factors and risk management and control factors of the group and its entities, which highlights the main vulnerabilities in terms of risk exposures and internal controls across the group.

[17] See Second part of CEBS technical advice to the European Commission on liquidity risk management (18 September 2008) http://www.c-ebs.org/getdoc/bcadd664-d06b-42bb-b6d5-67c8ff48d11d/20081809CEBS_2008_147_(Advice-on-liquidity_2nd-par.aspx , and CEBS Guidelines on liquidity buffer and survival period (9 December 2009) http://www.c-ebs.org/documents/Publications/Standards---Guidelines/2009/Liquidity-Buffers/Guidelines-on-Liquidity-Buffers.aspx

[18] See http://www.c-ebs.org/getdoc/e3201f46-1650-4433-997c-12e4e11369be/guidelines_IRRBB_000.aspx

59. Reflecting the discussions held within the college, the agreed joint assessment of the risk factors and risk management and control factors contained in the final report and serving as a basis for the joint decision should be mainly focused on:

   a. the risk assessments of the group and of the relevant entities within the group, as well as of the entities which are significant in local markets;

   b. the significant risks for the group and its entities; and

   c. risk management issues in a cross-border context.

60. A common summary table to report the outcome of the joint assessment of risk factors and risk management and control factors reached through discussion within the college may be designed as set out in Table 4 below. The table is built on the aggregation of the assessments of individual entities as discussed in Chapter 2.1, using combined scoring of risks and controls.

Table 4. Summary table of the joint assessment of risk and control factors

Entity	Entity X (score)	Entity Y (score)	Entity Z (score)	GROUP TOTAL (score)
Business activity and overall risk profile				
Financial position				
Overall strategy and risk appetite and risk tolerance				
Internal governance (incl. internal control)				
Assessment of material risks (using the combined scores)				
Credit risk				
Market risk				
Operational risk				
Concentration risk				
Liquidity risk				
Interest rate risk from non-trading activities				
Business and strategic risk				
Other risks (please specify)				
Major deficiencies and observations	*Narrative information*			
Conclusions and explanations	*Narrative information*			

61. The joint assessment should provide information to be used for comparison with the institution's own assessment of its risk profile and capital adequacy (i.e. it will be helpful for discussing the group's ICAAP and, ultimately, agreeing on its risk based capital adequacy).

Chapter 3: Assessment of the ICAAP processes and methodologies for cross border groups at the group and solo levels

3.1 The coordination and translation of assessments of individual entities' ICAAP processes by using a common template and a common scoring table

Guideline 5. A common template and a scoring scale should be used by the consolidating supervisor and the host supervisors to present and share in the college the results of their assessments of consolidated and individual entities' ICAAP processes.

62. The template below provides an example of a common template which could be used to present a summary of the assessments done by each authority. Putting all individual assessments into a common format using commonly agreed assessment scores, together with explanations of the rationale behind each score, should facilitate the college discussion and enable the consolidating supervisor to produce a report containing the ICAAP assessment of the group. If deemed necessary by college members, in order to better understand the ICAAP process of an entity, supervisors should supplement the summaries of the assessments provided in the template (see Table 5) with additional qualitative and quantitative information.

Table 5. Common template for translating the ICAAP process assessments

Entity		
	Score	**Explanation**
Overall ICAAP score		
Where applicable:		
ICAAP scope, including:		
entities covered (organisational scope)		
risks covered		
ICAAP methodologies, including:		
measurement and assessment processes		
forward looking perspective		
outcomes (capital estimate)		
Diversification assumptions[19]		
Stress testing framework		
ICAAP governance and internal control, including:		
integration into management process		
specification and documentation of the capital policy		
Major deficiencies and observations	*Narrative information*	
Conclusions and explanations	*Narrative information*	

63. The common scoring scale that should be used in the assessments of the accuracy and robustness of the ICAAP methodologies and processes at the group and its entities is defined in Table 6 below. Under this scale, the lower the rating the more adequate the supervisors deem the methodologies and processes developed by the institution for its ICAAP framework, i.e. the more accurate the internal methodology for deriving internal capital estimates is considered to be for the assessment of capital adequacy from a supervisory point of view. These scores serve as a tool which reflects the assessment, but should not be considered as a replacement for the rationale behind them. When reporting to the consolidating supervisor and discussing in the college

[19] The assessment of diversification assumptions used in the economic capital model for ICAAP purposes is seen as a part of the assessment of the ICAAP framework and processes and should not pre-empt the discussion regarding the recognition of diversification benefits in the final capital estimates by supervisors (SREP capital).

the results of their ICAAP reviews, each supervisor should also contribute specific written explanatory comments in order to make clear the determinants and rationales for the scores assigned.

Table 6. Common scores for assessment of the accuracy and robustness of the ICAAP methodologies and processes

Scores	Description
1	Methodologies and processes are of good quality. They make it possible to determine a precise and accurate estimate of internal capital needs both overall and per risk type, where applicable.
2	Methodologies and processes are of satisfactory quality. They make it possible to determine an estimate of internal capital both overall and per risk type, where applicable, which - if not precise - is conservative and prudent.
3	Methodologies and processes are of unsatisfactory quality. They potentially underestimate the internal capital needs both overall and per risk type, where applicable.
4	Methodologies and processes are insufficient. They largely underestimate the internal capital needs both overall and per risk type, where applicable.

64. The scores may be assigned by risk type captured under the ICAAP to reflect whether the methodologies and processes provide sufficiently adequate estimates of the internal capital requirements. However, a single score may be assigned reflecting the overall review of the ICAAP framework when it suits better the methodologies followed by the respective supervisors for the assessment of the ICAAP.

65. When the scores are assigned by risk type, a “zero” score may be assigned to the risks that are not covered with internal capital to the extent that this approach has been deemed justifiable under the supervisory assessment, i.e. when this exclusion is fully reasoned and documented.

3.2. Methodology to structure the dialogue between college members and reach a joint assessment of the ICAAP process

3.2.1 ICAAP scope

Guideline 6. Through dialogue within the college, the consolidating and the host supervisors should reach a joint view on whether the ICAAP framework, at the group and entity levels and subject to Article 123 of the CRD, adequately captures all relevant entities and business lines, as well as current and expected material risks.

66. In accordance with CEBS GL03, the ICAAP should be comprehensive both in terms of risks captured and in terms of business lines and entities. Therefore,

when discussing the results of their assessments of ICAAP, the consolidating and host supervisors should reach agreement on whether significant material risks (including so called Pillar 1 risks, risks not fully captured under Pillar 1, so called Pillar 2 risks, and risk factors external to the institution), entities or business lines are adequately captured under the ICAAP for their respective entities.

67. In other words, the supervisors should reach a joint understanding of how the group and its entities meet the criteria set out in principles ICAAP 1, ICAAP 6 and ICAAP 7 of CEBS GL03.

3.2.2 ICAAP methodologies

Guideline 7. The college members should, subject to the principle of proportionality, discuss the extent to which processes and methodologies used by the institutions generate reasonable, comprehensive, risk-based, robust and sufficiently precise ICAAP outcomes, both overall and per risk type.

68. Several overarching elements in the supervisory evaluation of the group's ICAAP require the specific attention of the college. In particular, the college should assess whether the methodologies used for risk measurement under ICAAP are consistent across the group, allow for the construction of a consolidated view, and take due account of the nature, size and complexity of the different activities performed throughout the group, including the non regulated activities.

69. The consolidating and host supervisors should discuss the quality, methodologies and processes used for internal capital purposes per risk-type taking due account of proportionality concerns. They should determine whether their outcome provides an adequate estimate of the internal capital requirements and is sufficiently forward looking. To this end, they should also assess the adequacy of the stress testing programme both as far as stress test used for capital planning purposes and risk-specific stress tests are concerned, in particular their cross-border and cross-sector components.

70. The discussion should be based on supervisory understanding of how the group and its entities meet the criteria set out in principles ICAAP 9, ICAAP 8 and ICAAP 10 of CEBS GL03. The CEBS Guidelines on stress testing[20] also provide guidance that can be used in the college discussion.

Guideline 8. When an economic capital model is used for ICAAP purposes, the college members should discuss how far its methodology is appropriate from a group as well as a single-entity perspective. They should also address, inter alia, the diversification assumptions of the model and the allocation of capital to business lines and entities.

[20] CEBS draft Guidelines on Stress Testing, CP32 (14 December 2009) http://www.c-ebs.org/documents/Publications/Consultation-papers/2009/CP32/CP32.aspx

71. Commonly (large) cross-border groups apply internal (economic capital) models as a key building block of their ICAAP. When discussing ICAAP assessments within the college several elements may require specific attention, e.g. the quality and suitability of the methodology related to the different entities of the group, its level of conservatism, the treatment of correlations and diversification effects and the methodology for capital allocation to business lines or entities[21]. In addition supervisors should look into the ICAAP control environment to ensure the appropriateness of the quantification and avoid over reliance on risk models.

72. Institutions may assume diversification effects within their economic capital models. These can be regarded from different viewpoints, e.g. diversification within risk types (intra-risk diversification), between risk types or risk drivers (inter-risk diversification) and between group entities (cross-border diversification). The latter dimension is of particular interest within the context of the joint decision on capital adequacy.

73. In such cases, the college members should consider whether the ICAAP calculation made at the consolidated level, taking into account diversification effects and dependencies, is performed in an adequate way given the group's specific structure and internal organisation, particularly under stressed circumstances. The college members should consider the overall methodological approach modelling dependencies within and between risks, the quality of the parameter estimates, the degree of conservatism taken into account and the adequacy of the stress tests on the parameters.

74. However, this does not imply that diversification should be modelled along the group dimension. It is the responsibility of the institution to choose how the group dimension is implemented in the ICAAP. Supervisors are aware that diversification is often embedded in the managerial process, since business lines may span different jurisdictions.

75. Another important element concerns the mechanism (criteria and techniques) for allocating the consolidated internal capital numbers to subsidiaries with regard to the respective risk profile of the entities concerned. The college should consider the existence of a risk sensitive allocation of internal capital to the entities they are responsible for.

Guideline 9. The college members should discuss the adequacy of stress tests for capital planning purposes. Particular attention should be paid to the scope of the stress testing framework, the shock transmission mechanisms and the consideration of stress testing within the risk management systems at the consolidated, business lines and relevant entities levels.

76. The consolidating and host supervisors should determine whether the ICAAP has a forward-looking perspective. To this end, they should also consider whether the process is complemented by the conduct of stress tests designed to demonstrate how the institution will perform through an adverse economic

[21] For an overview of issues surrounding economic capital modelling, please refer to: BCBS, March 2009, "Range of practices and issues in economic capital frameworks", www.bis.org.

scenario and the extent to which the internal capital measurement takes into account the institution's position in the business cycle (specific risk stress tests should also be considered, where appropriate).

77. For the assessment of the stress testing programme under ICAAP, supervisors should refer to the CEBS Guidelines on stress testing[22]. In the context of the joint decision process, they should pay particular attention to the scope of the stress testing framework. Capital planning stress testing should for instance be performed for the group and its material entities or business lines in a consistent manner.

3.2.3 ICAAP governance and internal control[23]

Guideline 10. The college members should discuss the appropriateness of the governance aspects related to cross-border banking groups' ICAAP.

78. CEBS GL03 contains principles setting out what supervisors expect from institutions regarding the governance aspects of ICAAP (ICAAP 2, 3, 4, 5 of CEBS GL03). The following elements are of particular importance:

a. The level of involvement of the management body of each entity of the group. The management body should set effective strategies and policies to maintain, on an ongoing basis, amounts, types and distribution of both internal capital and own funds adequate to cover the risks of the entity being considered.

b. Such policies would typically involve the frequency of revision of the ICAAP outcome by the management bodies of the group and the respective entities (including independent reviews), the long term capital goal of the institution (at group and entity level), take into account internal as well as external factors (e.g. market expectations and rating agencies), and cover the (target) distribution of capital over the group entities and composition of capital.

c. The extent to which the ICAAP forms an integral part of the management process and decision-making culture of each entity.

d. The development and maintenance of strong internal control systems by the management body of each entity, including the quality of audit methods and processes regarding the ICAAP.

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[22] CEBS draft Guidelines on Stress Testing, CP32 (14 December 2009) http://www.c-ebs.org/documents/Publications/Consultation-papers/2009/CP32/CP32.aspx
[23] This section should be read in conjunction with CEBS GL03

3.3 Reaching a joint assessment of the group and its entities' ICAAP

Guideline 11. The dialogue among college members should result in a joint assessment of the ICAAP of the group and its entities

79. The joint assessment of the ICAAP of the group and its entities produced within the college should be mainly focused on:

   a. major deviations between the ICAAP outcomes and supervisory assessments regarding capital at the aggregate and/or entity levels;

   b. identified deficiencies in the control environment;

   c. the validity of diversification assumptions; and

   d. identified deficiencies in the modelling approaches that are used by an institution.

80. A common summary table to report the outcome of the joint ICAAP assessment reached through the process described within this chapter may be designed along the following lines. Table 7 below is built on the aggregation of the supervisory assessments of the ICAAP of the entities, using the scoring discussed in Chapter 3.1, where applicable.

Table 7. Summary table of the joint ICAAP process assessment

Entity	Entity X	Entity Y	Entity Z	GROUP TOTAL
Overall ICAAP score				
Detailed score (where applicable):				
ICAAP scope, including:				
entities covered (organisational scope)				
risks covered				
ICAAP methodologies, including:				
measurement and assessment processes				
forward looking perspective				
outcomes (capital estimate)				
Diversification assumptions				
Stress testing framework				
ICAAP governance				

and internal control, including:				
integration into management process				
specification and documentation of the capital policy				
Major deficiencies and observations	*Narrative information*			
Conclusions and explanations	*Narrative information*			

81. The joint ICAAP assessment should provide college members with information on the quality of the institutions' ICAAP and the degree to which the ICAAP outcomes can be relied on.

Chapter 4: The joint assessment of compliance with the various minimum requirements set out in the CRD

4.1 The coordination and translation of individual assessments by using a common template

Guideline 12. Consolidating and host supervisors should present the results of their assessments of compliance with the CRD requirements by the entities under their supervision using a common template.

82. College members should agree on a common format for reporting the outcomes of their assessments as regards the institutions' compliance with the minimum requirements set in the CRD.

83. Table 8 below provides an example of such a common template building on the elements discussed in Chapter 4.2, which could be used to present a summary of the assessments done by each authority. Putting all individual assessments into a common format, together with explanations of the rationale behind each score, should facilitate the college's discussion and enable the consolidating supervisor to produce a report containing the risk assessment of the group.

84. The topics for assessment are provided as an example. Supervisors may agree on including other elements in the template where needed.

Table 8. Common template to report assessments of compliance with the CRD requirements

Entity:			
Topic	Material deficiencies identified	Measures taken or considered	Comments
Advanced approaches under Pillar 1[24]			
Disclosure requirements[25]			
Major deficiencies and observations	*Narrative information*		
Conclusions and explanations	*Narrative information*		

4.2 Methodology to structure the dialogue between college members and reach a joint assessment of compliance with the various minimum requirements set out in the CRD

Guideline 13. To facilitate a meaningful dialogue in the college, suited to the characteristics of the group, the college members should agree on the main elements to be covered in the college discussion in order to reach a joint assessment of compliance with the various minimum requirements of the CRD for the group and its entities.

85. Article 124(1) of the CRD requires consolidating and host supervisors to review the arrangements, strategies, processes and mechanisms implemented by the institutions to comply with the requirement of the CRD. Annex XI of the CRD provides a list of elements, which need to considered in the course of the SREP, including results of stress tests for credit risk (IRB institutions) and market risk (internal models institutions), concentrated exposures and concentration risk management, residual risk stemming from the use of credit risk mitigation techniques, risk transfer through securitisation, liquidity risk management, and the impact of diversification.

86. In addition, GL03 suggests that as a part of the evaluation of compliance with CRD minimum requirements, supervisors should look at the methods used in

[24] For the purpose of these Guidelines the template does not distinguish between advanced models for credit, operational and market risks, and the compliance criteria are put together. In the application of the Guidelines, college members may agree on a more detailed breakdown of the compliance criteria differentiating between credit, market and operational risk models.
[25] College members may agree on using a detailed breakdown of disclosure requirements as stipulated in Annex XI of the CRD and CEBS standards and guidelines on the subject (see Element 2 of Guideline 24)

the advanced approaches under Pillar 1, as well as at large exposures, and should evaluate the quality of disclosures under Pillar 3[26].

87. The discussion in the college should focus , where relevant, on compliance with all of the abovementioned elements, which are covered in detail by various CEBS standards and guidelines, to the extent they were not previously discussed when assessing risks and control factors (see Chapter 2) and the ICAAP process (see Chapter 3). The following elements should be discussed in particular.

Element 1*: Compliance with minimum requirement for advanced approaches under Pillar 1*[27]

88. In addition to the issues related to the model validation and approval process, which may influence the outcome of the assessment of the risk based capital adequacy, the consolidating and host supervisors should exchange information on issues like the constant use of the regulatory approved models in internal risk management (ongoing review of the use test), model modifications, changes to and update of data series, and more formal issues like the roll-out of advanced models across the group, and the fulfilment of conditions, if any, set in the decision (permission) on model use.

89. When discussing this issue, college members should pay particular attention to changes in the conditions of the application of the advance models since their approval by supervisors, such as changes in methodologies, data quality, scope, quantitative and qualitative procedures (e.g. components of the models and their control environment), and technological environment.

90. A particular attention should be paid to the fulfilment of specific terms and conditions attached to the permissions to use advanced measurement approaches when initially approved under Article 129(2) of the CRD, especially when such terms and conditions are related to implicit or explicit capital add-ons (e.g. to mitigate insufficient length and population of data series supervisors may have agreed to impose a floor above the regulatory transitional floor or requested the institution to hold a higher level of own funds).

91. In addition to the specific issues mentioned above, the performance of the independent risk control functions and the internal audit in the process related to the application of advanced measurement approaches to Pillar 1 should be discussed.

92. In assessing compliance with the minimum requirements of the CRD related to post-model validation work and the roll-out of advanced models across the group, consolidating and host supervisors should follow the procedures agreed for the model validation, including division of tasks and responsibilities. CEBS has addressed the organisational and technical matters

[26] See Guideline 6 of the CEBS GL03

[27] This section should be read in conjunction with the CEBS Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches, GL10 (4 April 2006) http://www.c-ebs.org/getdoc/5b3ff026-4232-4644-b593-d652fa6ed1ec/GL10.aspx

of these processes in its Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches[28] and Guidelines for operational functioning of colleges[29].

***Element 2**: Compliance with disclosure requirements under Pillar 3*

93.Pillar 3 requirements as set out in Articles 145-149 of the CRD are (in accordance with Article 72(1)) applicable at the level of the EU parent credit institution / financial holding company, although significant subsidiaries must disclose the information (on capital and minimum requirements) set out in Annex XII, Part 1 point 5 of the CRD. CEBS has issued some views on these disclosures in its June 2009 Assessment of Banks' Pillar 3 disclosures[30]. Additionally CEBS has issued draft disclosure guidelines in response to the lessons learnt from the financial crisis (CP 30)[31]. This work – even when not specifically aimed at Pillar 3 – provides a useful reference basis for the discussion within a college.

4.3 Reaching a joint assessment of compliance with the various minimum requirements set out in the CRD

Guideline 14. The dialogue among college members should result in a joint assessment of the group and its entities' compliance with various minimum requirements of the CRD as discussed in Chapter 4.2. The assessment should highlight the main vulnerabilities and material deficiencies.

94.Reflecting the discussions held within the college, the agreed joint assessment contained in the final report and serving as a basis for the joint decision should be mainly focused on:

a. the assessments of the compliance of the group and its entities with the minimum requirements of the CRD and corresponding CEBS standards and guidelines, clarifying specific CRD requirements;

b. material deficiencies in compliances; and

c. risk management and control issues related to compliance with the CRD requirements in a cross-border context (e.g. centralised modelling or internal model validation function, group-wide data pooling and use of data from other markets/geographies etc).

[28] CEBS Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches, GL10 (4 April 2006) http://www.c-ebs.org/getdoc/5b3ff026-4232-4644-b593-d652fa6ed1ec/GL10.aspx

[29] CEBS Guidelines for the Operational Functioning of Colleges (17 December 2009) http://www.c-ebs.org/documents/Publications/Consultation-papers/2009/CP34/CP34.aspx

[30] Assessment of banks' Pillar 3 disclosures (24 June 2009) http://www.c-ebs.org/getdoc/6efe3a55-b5c5-4f73-a6af-a7b24177e773/CEBS-2009-134-Final-published-(Transparency-assess.aspx

[31] CEBS Draft Disclosure Guidelines: Lessons learnt form the financial crisis (CP30) (October 2009) http://www.c-ebs.org/documents/Publications/Consultation-papers/2009/CP30/CP30-CEBS-Disclosure-guidelines.aspx

95. The agreed joint assessment contained in the final report should make a clear distinction between compliance with the direct requirements of the CRD and CEBS standards and guidelines, and requirements stemming from the application of national discretions and additional to the CRD requirements being implemented in the national legislation (see also the discussion on Guideline 9).

96. A common summary table to report the outcome of the joint assessment of compliance with the CRD requirements throughout the group, reached through the process described within this chapter, may be designed along the following lines (see Table 9 below).

Table 9. Summary table assessment of compliance with the CRD requirements

	Entity X		Entity Y		Group total	
Topic	Material deficiencies identified	Measures taken or considered	Material deficiencies identified	Measures taken or considered	Material deficiencies identified	Measures taken or considered
Advanced approaches under Pillar 1 [32]						
Disclosure requirements[33]						
Major deficiencies and observations	*Narrative information*					
Conclusions and explanations	*Narrative information*					

Chapter 5: Determination of the adequate levels of own funds at the group and entities levels

97. This Chapter provides an overview of the main topics to be discussed by the consolidating and host supervisors within the college in order to reach an agreement and joint decision on risk based capital adequacy for the group and its entities. The successful outcome of this discussion and the preceding joint risk assessment process is based on the following key principles:

a. Supervisors should first reconcile the outcome of the risk and control assessments (see Chapter 2) with the results of the assessments of the respective entities' ICAAP and resulting internal capital estimates (see

[32] For the purpose of these Guidelines the template does not distinguish between advanced models for credit, operational and market risks, and the compliance criteria are amalgamated. In the application of the Guidelines, college members may agree on a more detailed breakdown of compliance criteria differentiating between credit, market and operational risk models.

[33] College members may agree on using a detailed breakdown of the disclosure requirement as stipulated in Annex XI of the CRD and CEBS standards and guidelines on the subject (see Element 2 of Guideline 24)

Chapter 3). This process will determine the extent to which the internal capital estimates meet the current and forward-looking supervisory views on risks.

b. Taking into account the outcome of the ICAAP assessments and internal capital estimates, supervisors should define the extent to which benefits from the diversification effects can be taken into account in the determination of capital adequacy.

c. Looking at the outcomes of the capital planning stress tests conducted as part of the ICAAP, supervisors should consider to what extent they are covered by appropriate capital reserves (buffers) and whether additional levels of capital should be required to cover the impact of the chosen scenarios.

d. Supervisors should take into consideration the deficiencies identified in the assessment of compliance with the various minimum requirements of the CRD (see Chapter 4) to the extent that the capital measure might be affected.

e. When, as a result of this analysis, additional levels of own funds above the regulatory minimum are deemed necessary, supervisors should determine the types of capital (various capital instruments) that can be accepted to cover these additional requirements, and, if necessary, agree with the institution on a capital restoration plan.

98. It should be noted that, in the light of the overall assessment of capital adequacy, supervisors may consider that no corrective action is required or that prudential measures other than additional levels of own funds can more effectively address the identified deficiencies. The college may agree to adopt measures other than additional levels of own funds on a voluntary basis since the provisions of Article 129(3) do not call for a joint decision to be reached on such other actions.

5.1 Translation of the assessment of capital adequacy of individual entities

Guideline 15. The consolidating and host supervisors should present the results of their assessments of risks, ICAAP process assessment and capital adequacy, as well as compliance with the various minimum requirements of the CRD using a common template.

99. College members should agree on a common format to report the outcome of their risk assessments of the components discussed in Chapters 2 to 4, and reconciliation of these assessments with the institution's internal capital estimates and supervisory views on the appropriate level of capital (capital requirements).

100. Tables 10.A and 10.B below provide examples of such common templates which could be used to present a summary of the assessments done by each authority. Putting all the individual assessments into a common format should

facilitate the college discussion on the evaluation of the capital adequacy at the group and individual entity levels. Adequate capital levels as evaluated by the supervisors should be provided in terms of overall requirements or in terms of additional amounts of capital by risk types, depending on the approach taken.

101. Table 10.A provides a summary of:

a. The results of the assessment of risks and controls (column 1), by assessment criterion as referred to in Chapter 2, as well as an overall score reflecting the risk profile of the institution. Instead of a single score for each risk type reflecting both the assessment of the risk profile and risk management and control factors, college members may report separate scores for risk level and quality of management and control as discussed in Chapter 2.

b. Pillar 1 regulatory capital requirements broken down by risk type (column 2).

c. The level of internal capital resulting from the ICAAP of an entity (column 3). This should be provided, if possible, per risk type and category, depending on the approach taken by the institution or required by the supervisor. The table should also mention the amount of available capital.

d. The supervisory view on the levels of capital (column 4) that the respective supervisor would expect the institution to hold taking into account the results of the risk and ICAAP assessments (including under stressed conditions). Depending on the approaches adopted by supervisors, these levels can be provided either in terms of overall requirements or in terms of additional amount of capital by risk types. This column may be amended during the joint decision process to reflect its agreed outcomes.

e. The score for the ICAAP process assessment as discussed Chapter 3.

f. The additional levels of capital that supervisors may require where there is a breach of the CRD requirements as discussed in Chapter 4 or which have been agreed with the institutions to compensate for some deficiencies in the advanced models used for Pillar 1 regulatory capital calculations.

g. The reduction in capital that may be recognised where diversification benefits are accepted.

h. The additional levels of capital (capital buffer) estimated by the institutions or required by the supervisor to cover the impact of stressed conditions (stress testing buffer).

102. The reconciliation of risk and ICAAP assessments made by each supervisor can be carried out, depending on the supervisory approach taken to SREP, on a risk-by-risk or on a more holistic basis and should take place in dialogue with the institutions.

103. Table 10.B provides a summary of the available capital against the different capital needs or requirements. Information can be provided either in terms of amounts or capital ratios depending on the format agreed within the college.

Table 10 A. Common template to report the preliminary individual results of the risk based capital requirements

Entity:					
	Score (1)	Pillar 1 regulatory capital requirements (2) (amount)	ICAAP capital estimate (3) (amount)	SREP capital estimate (4) (amount)	Comments and explanation (5)
Corporate governance (incl. internal governance)			*Where applicable*	*Where applicable*	
Financial position			*Where applicable*	*Where applicable*	
Overall strategy and risk tolerance			*Where applicable*	*Where applicable*	
Business activities and overall risk profile			*Where applicable*	*Where applicable*	
Credit risk			*Where applicable*	*Where applicable*	
Risks related to risk transfer through securitisation			*Where applicable*	*Where applicable*	
Market risk			*Where applicable*	*Where applicable*	
Operational risk			*Where applicable*	*Where applicable*	
Concentration risk			*Where applicable*	*Where applicable*	
Liquidity risk			*Where applicable*	*Where applicable*	
Interest rate risk from non-trading activities			*Where applicable*	*Where applicable*	
Business and strategic risk			*Where applicable*	*Where applicable*	
Other risks (please specify)			*Where applicable*	*Where applicable*	
ICAAP score					
Compliance with CRD requirements				*Where applicable*	

Diversification [34]			*Where applicable*	*Where applicable*	
Stress testing buffer or target ratio			*Where applicable*	*Where applicable*	
Total requirement					

Table 10 B. Common template to report the preliminary individual results of the risk based capital adequacy

Entity:					
	Available capital	**Pillar 1 requirement**	**ICAAP**	**SREP**	**Comments and explanations**
Total capital (amount		*Where applicable*	*Where applicable*	*Where applicable*	
Capital ratio (%)		*Where applicable*	*Where applicable*	*Where applicable*	
Tier 1 capital (amount)		*Where applicable*	*Where applicable*	*Where applicable*	
Tier 1 ratio (%)		*Where applicable*	*Where applicable*	*Where applicable*	
Core Tier 1 capital (amount)		*Where applicable*	*Where applicable*	*Where applicable*	
Core Tier 1 ratio (%)		*Where applicable*	*Where applicable*	*Where applicable*	
Other financial resources to cover ICAAP estimates (amount)					

[34] If deemed necessary the impact of diversification effects could be further broken down to inter-risk, and intra-risk within credit, market, operational, and other risk factors.

104. The tables above serve as an example of the summary of information that should be used for discussion in the college and to present the preliminary assessment of the risk factors and capital adequacy of individual entities. They should not be read as templates providing an automated or mechanistic link between the ICAAP and SREP numbers. The scores only reflect the outcome of the assessment and do not replace the rationale behind them, nor do they relate directly to the capital adequacy of the institution.

105. Both consolidating and host supervisors should complement the tables with written comments drawing the main conclusions from their capital adequacy assessments and the rationale for requiring additional levels of own funds above the regulatory minimum. If the college members agree to include corrective actions other than additional capital requirements under the joint decision process, supervisors should report to the consolidating supervisor and inform other college members of any prudential measures envisaged as well as rationale for them.

5.2 Methodology to structure the dialogue between college members in order to reach a joint decision on risk-based capital adequacy

5.2.1 Reconciliation between the ICAAP outcomes and the supervisory assessments

Guideline 16. The college members should reconcile supervisory risk assessments and ICAAP outcomes, taking due account of the levels of own funds that are available to the institution.

106. The evaluation of capital adequacy by the college members should be based on the results of the joint risk assessment and the joint ICAAP assessment as referred to under Chapters 2 and 3, taking into consideration any additional capital requirements (add-ons) stemming from the assessment of compliance with the various minimum requirements of the CRD (Chapter 4).

107. Additional levels of own funds beyond minimum regulatory requirements can be considered as a remedy to address identified deficiencies (taking into account the level of own funds that is available to the institution). This is to be expected when, for instance, the joint risk and ICAAP assessments indicate that:

a. significant and persistent deficiencies exist in the institution’s internal control system, or deficiencies are likely to materialise in a restructuring;

b. persistent doubts arise concerning the adequate coverage of risks, particularly in the case of uncontrolled growth or excessive concentrations of exposures to counterparties, business sectors, or geographical areas;

c. significant amounts of losses are foreseen, or insufficient profitability, which could reduce the amount of own funds and consequently the solvency ratio; and

d. rapid or significant growth in existing activities or the starting-up of new activities without sufficient safeguards, or when the risks associated with the scale of activity at the level of an institution, a market, or the system as a whole, call for particular caution in assessing the level of own funds needed to cover them.

5.2.2. Treatment of diversification effects and allocation of capital across the group[35]

Guideline 17. The college members should discuss diversification effects for capital adequacy purposes.

108. The college members should assess and discuss the extent to which diversification benefits calculated using an economic capital model play a role in the overall internal capital estimate.

109. In any event, the total capital buffer to be assessed in the SREP should adequately cover all risks an institution is exposed to (including Pillar 1 and Pillar 2 risks) and should allow it to withstand severe systemic and idiosyncratic (institution specific) shocks.

110. As the estimation of the effects of diversification benefits is closely embedded into an institution's economic capital model, the assessment of diversification should be part of the overall assessment of the economic capital model. In their assessment, prior to incorporating the benefits of diversification into the calculation of capital adequacy, supervisors should pay attention to the following:

a. the validity and stability of the correlation assumptions, including the existence of large enough historical data sets and of different time horizons by risk type;

b. the reliability and conservatism of estimations and the adequacy of input data; and

c. the degree of robustness of individual bank calculations, and their stability over an economic cycle.

111. Supervisors should also keep in mind that weaknesses in the assumptions of imperfect correlations at times of crisis, as well as contagion phenomena among risks of different natures (i.e. among credit, market and liquidity risks), should need to be taken into account.

[35] The guidelines are "process-oriented", merely identifying what elements should be discussed within the colleges. They do not propose a common European stance on the acceptance of diversification benefits pending further harmonisation in this field.

Guideline 18. The college members should consider the level of capital for each subsidiary, the scope of their risk management and control structure, and material restrictions to capital transferability to determine whether diversification benefits across the group can be recognised when deciding upon capital adequacy.

112. When deciding upon the adequate levels of own funds at both the group and solo levels, the college members should consider the appropriateness of the allocation of capital across the group as performed under the institutions' ICAAP.

113. The college members should discuss the allocation mechanism of the consolidated internal capital to subsidiaries, with regard to the respective risk profile of the entities concerned. In particular, the college members should determine:

a. to what extent the allocation approach is coherent with the legal and organisational structure of the group;

b. how the internal capital is allocated to subsidiaries;

c. how the allocation approach addresses the actual risk profile of an entity which receives allocated capital, net of group diversification benefits;

d. how the allocation approach deals with regulatory constraints that might be imposed on the different entities of the group; and

e. how the local management ensures the adequacy of the allocated internal capital.

114. The college members should also determine whether the institution is able to demonstrate that the group's capital can be made available in a timely manner, especially in stressed conditions, to entities that need it, i.e. they should obtain sufficient evidence that no material obstacles impede the transferability of capital between group entities.

5.2.3 Determination of capital adequacy with a forward looking perspective and under stressed conditions

Guideline 19. Based on the assessment of the institution's stress tests under ICAAP, the college members may require capital buffers or targets to be put in place, taking into account the outcomes of enterprise-wide stress tests.

115. With a view to determining capital buffers or target ratios, if need be, the consolidating and host supervisors should review how entity-wide stress scenarios for capital planning impact total capital and capital needs, including details of the anticipated sequence of these impacts. In their review, supervisors should evaluate and challenge the scope, severity, assumptions

and mitigating actions of enterprise-wide scenarios. The CEBS Guidelines on stress testing provide further guidance in this respect[36].

116. CEBS acknowledges that the stress testing framework, including the design of the scenarios, used as a part of the ICAAP is the responsibility of an institution which should adequately integrate stress testing into its risk management framework. However, with a view to complementing this framework and to determining the need for capital buffers or targets, the consolidating and host supervisors may agree within the college to prescribe a scenario reflecting potential macro economic developments (see Chapter 5 of the CEBS Guidelines on the operational functioning of colleges[37]).

117. In the evaluation of the capital adequacy of the institution, members of the college need to make sure that the institution holds sufficient capital to withstand a severe economic downturn. When as a result of the joint assessment of the stress-testing programme members of the college consider it appropriate, they may require the institution to hold capital buffers or to respect increased capital targets above the regulatory minima. The college members should refer to the CEBS Guidelines on stress testing which provide further guidance in this respect[38].

5.2.4. Internal capital estimates and regulatory capital requirements

Guideline 20. College members should understand the drivers behind the differences between the internal capital estimates and regulatory capital requirements.

118. Comparison between internal capital estimates and Pillar 1 minimum capital requirements generally helps with understanding the sources of the differences between ICAAP figures and regulatory figures for risks also covered by Pillar 1, and helps with assessing whether the internal capital needs or targets determined by the institution adequately reflect its risk profile. This comparison is of particular importance when the institution is relying on an economic capital model as a building block for its ICAAP capital estimate.

119. The discussion within the college should cover both the quality of internal capital estimates compared to regulatory capital (numerator) and internal capital requirements compared to Pillar 1 capital requirements (denominator), with a view to reaching a common understanding of the differences and their explanation.

[36] CEBS draft Guidelines on Stress Testing, CP32 (14 December 2009) http://www.c-ebs.org/documents/Publications/Consultation-papers/2009/CP32/CP32.aspx
[37] CEBS draft Guidelines for the Operational Functioning of Colleges, CP34 (17 December 2009) http://www.c-ebs.org/documents/Publications/Consultation-papers/2009/CP34/CP34.aspx
[38] CEBS draft Guidelines on Stress Testing, CP32 (14 December 2009) http://www.c-ebs.org/documents/Publications/Consultation-papers/2009/CP32/CP32.aspx

120. Diversification, mentioned earlier, is not the only factor that may lead to differences between ICAAP and Pillar 1 capital figures. Thus, in order to assess the contribution of diversification, supervisors may need to identify the other reasons for differences between internal and regulatory capital calculations, for instance:

a. the use of a different confidence level in the ICAAP model (target rating, supervisory confidence intervals, 1 in 10 events, etc.);

b. any difference in the scope of the risks considered;

c. the removal of floors (like PD floors) or other regulatory constraints;

d. the impact of different methodologies (VaR vs. Expected Shortfall, full economic capital modelling); and

e. any difference in the assumptions used (e.g. granularity of the IRB portfolio).

Guideline 21. College members should agree on a similar approach and common criteria to assess internal capital instruments which are not eligible as regulatory capital.

121. The internal capital used by institutions to cover all material risks (beyond Pillar 1 minimum risks - credit, market, operational risks) may include other financial resources or contingent capital which are not eligible as regulatory capital as defined by the CRD. Similarly, deductions from internal capital can be different from those applicable for the calculation of regulatory capital (e.g. treatment of equity holdings, goodwill, deferred tax assets etc.). Since ICAAP is an institution-driven process, these Guidelines do not intend to prescribe any definition of internal capital or instruments which can be considered against non Pillar 1 risks. The quality of internal capital and its impact on the determination of capital adequacy at the group and entity levels should, however, be discussed within the college.

Guideline 22. When, as a result of the ICAAP assessments the college members consider that additional levels of capital above the Pillar 1 requirements should be imposed, this will be formulated in terms of regulatory capital.

122. The quality of regulatory capital is an important element of the joint decision on capital adequacy. Pending further harmonisation in the definition of capital at the EU level, the level of the requirement should preferably be formulated in terms of original own funds (Tier-1 capital)[39].

[39] CEBS Draft implementation Guidelines on instruments referred to in article 57 (A) of the CRD, CP33 (17 December 2009) http://www.cebs.org/documents/Publications/Consultation-papers/2009/CP33/CP33.aspx

123. In setting the level of additional capital above the regulatory minimum, supervisors should consider the current and prospective levels of regulatory capital requirements.

5.3. Reaching a joint decision on the risk based capital adequacy

Guideline 23. The discussion among college members on the topics described in these Guidelines should lead to a joint decision on the adequacy of the consolidated level of own funds held by the group with respect to its financial situation and risk profile, as well as the required level of own funds, above the regulatory minimum, applied to each entity within the group and on a consolidated basis.

124. Using as an input the joint risk and ICAAP assessment described in the previous Chapters, as well as the main elements to be considered when determining the adequate levels of own funds at the group and individual entity levels, the college members should strive to reach a joint decision on the risk-based capital adequacy of the group and its entities. If appropriate, the joint decision should contain the requirement to hold own funds above the minimum regulatory level both at the group and the solo levels. The college members may also agree, on a voluntary basis, on the application of other prudential measures under Article 136(1).

125. Table 11 below gives an illustrative format that may be used to summarise the outcome of the joint risk assessment and decision on risk-based capital adequacy. The actual templates used within the colleges should reflect the outcome of the college discussion and contain the summary information derived from risk and ICAAP assessments as reflected in the common scoring scales and tables defined in the previous chapters.

126. In accordance with the proportionality principle, the college members should use the defined reporting format in a proportionate manner to reflect the nature, scale and complexity of the activities of the banking group and of its entities.

127. A common template to report the outcome of the joint risk assessment and decision on the risk-based capital adequacy of the group and its entities within the college may be designed along the following lines:

Table 11. Summary information on risk based capital-adequacy of GroupXY

	Entity X	Entity Y	Group total
Available capital (amount or %)			
P1 requirements (amount or %)			
ICAAP estimates (amount or %)			
SREP requirements (amount or %)			