



DFSA Outreach Session

Supervisory Review and Evaluation Processes IRAP and ICAAP

19 March 2014

Agenda

- Introduction and objectives
- Overview of IRAP
- Overview of ICAAP
- SREP and ICR
- Questions



Introduction

- Promote **internal** risk assessments to assess risks faced from Firm activities
- Internal Risk Assessment Process ('IRAP') applies to ***all domestic Authorised Firms*** other than Category 4 Firms
- Internal Capital Adequacy Assessment Process ('ICAAP') applies ***only to domestic Category 1, 2, 3A and 5 Firms***

Core Objective

- Financial services is all about managing risk
- Safe and sustainable growth and success in financial services is possible only with effective risk management
- Hence, the need for high level of effectiveness in risk management
- To enhance the risk management standards for all DFSA Firms
- Help Firms achieve very high levels of effectiveness in risk management



At the same time..

- Achieve compliance with global regulatory standards
- Proportionate implementation of Pillar 2 of Basel II
- Enhance supervisory effectiveness
- Assist Firms in effectively complying with existing core regulatory obligations (GEN Rule 5.3.1)
- Effective implementation with the IRAP and ICAAP obligations will go a long way towards demonstrating effective compliance with rules on risk management and capital adequacy



DFSA's approach

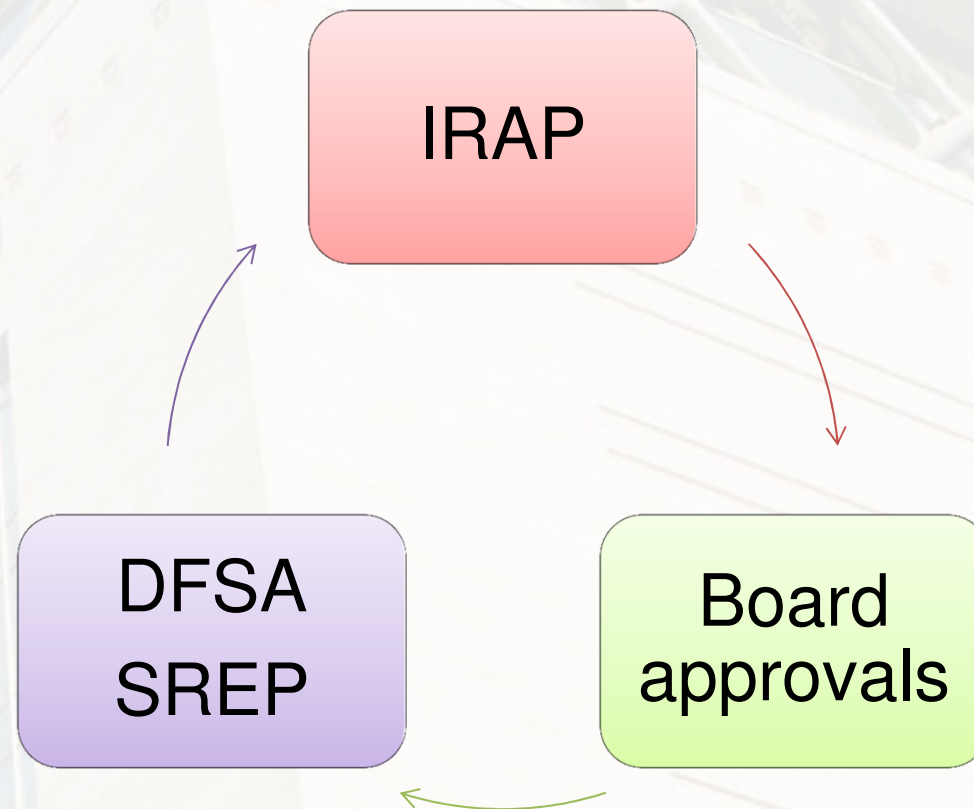
- Use Pillar 2 of Basel II – to enhance risk management standards among authorised Firms
- Promote effective implementation of Enterprise Risk Management (ERM) processes
- Innovative approach to implement pillar 2 in a proportionate manner to non-deposit takers
- Improve risk sensitivity in supervisory efforts
- Optimise supervisory resource allocation on the basis of quality IRAP outcomes

Internal Risk Assessment Process (IRAP)



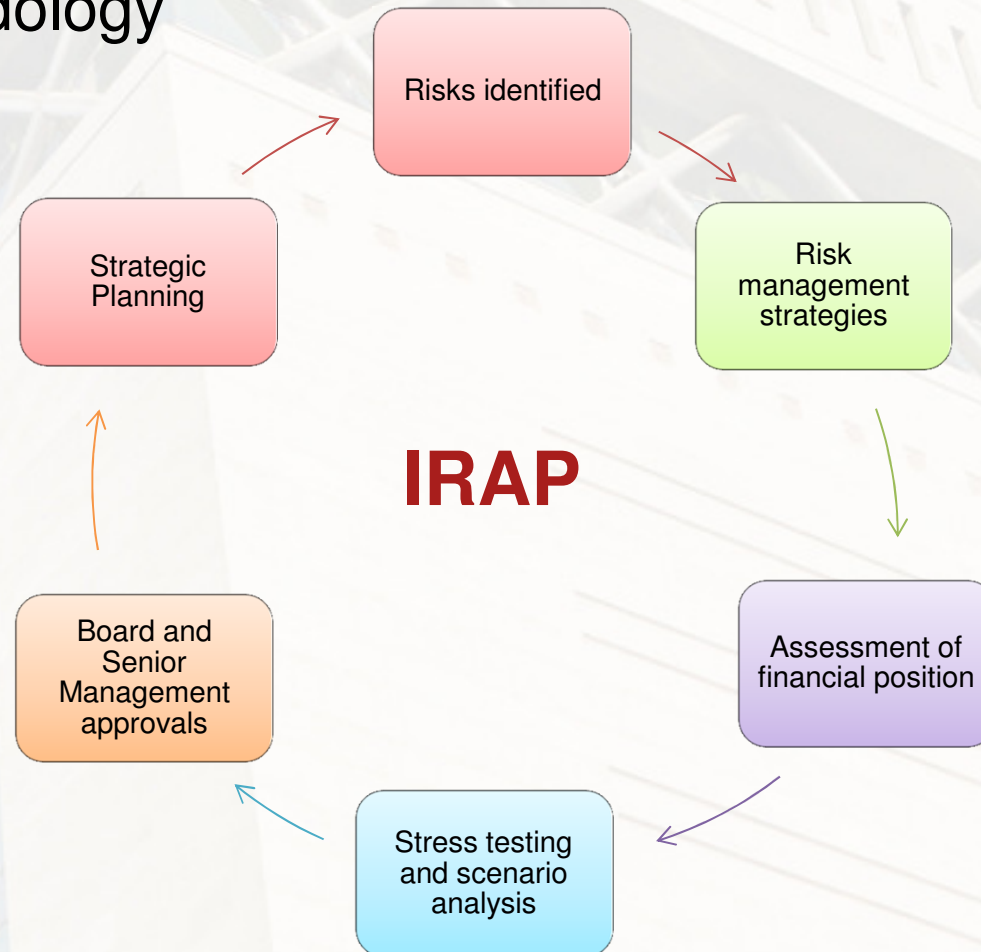
Internal Risk Assessment Process

IRAP is applicable to all domestic Firms other than Category 4. It is a comprehensive internal risk assessment.



Internal Risk Assessment Process

IRAP Methodology



IRAP – Description

- Comprehensive effort to assess all risks faced by the Firm
- A process and not a report
- Outcome is important but the journey is even more important
- Process and approach will be of utmost interest to the DFSA
- First phase of an ICAAP for Firms facing that requirement



IRAP – DFSA’s expectations

- Apply materiality and proportionality appropriately
- Consistency with risk appetite, corporate strategy, capital planning and policies
- Robust governance – reviews at operational and at Board level
- Board engagement, ownership and challenge
- Effective involvement of all key stakeholders in the organisation
- Enhance risk management system - processes, controls, procedures and responsibilities
- Include all the group entities – for a Financial Group

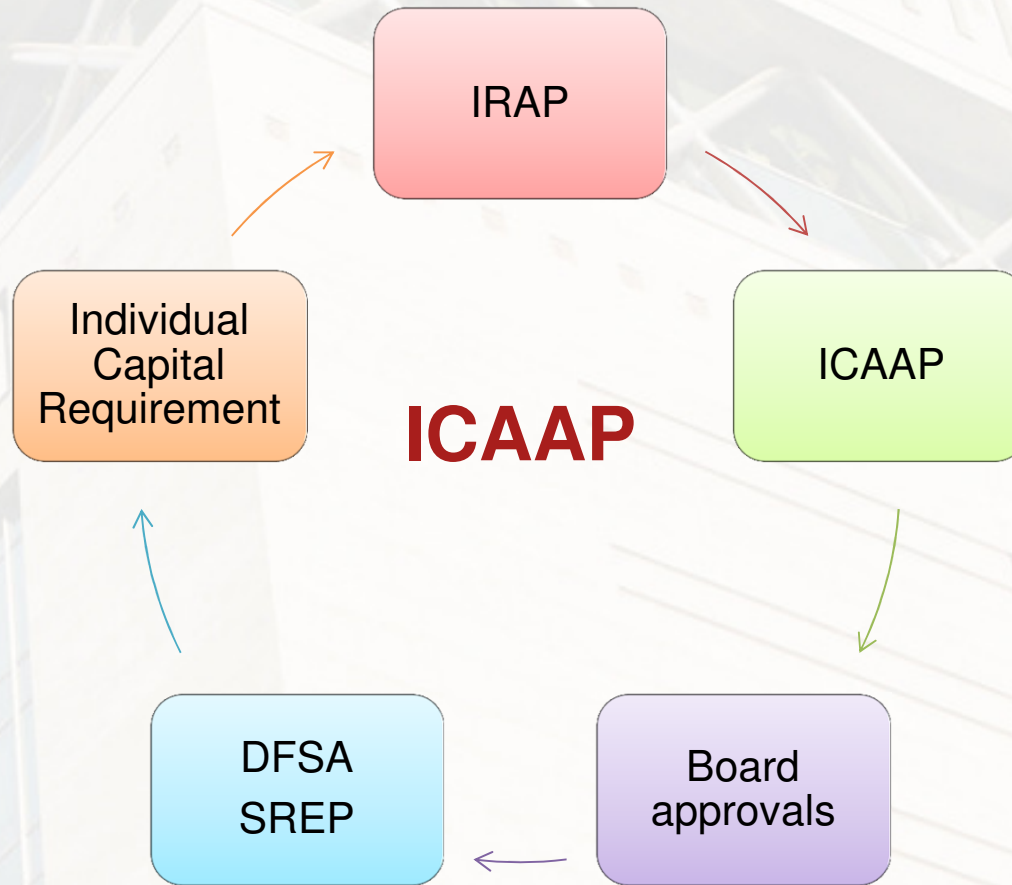
Benefits of IRAP

- Opportunity to enhance your ERM framework
- Integrate risk management with normal business processes – pricing, new products, market entry etc.
- Verification of the Firm's risk appetite and alignment with its activities
- Enhance the governance of risk management – up to Board level
- Identify effective risk mitigation and management options
- Improve the engagement employees at all levels
- Optimise capital usage – in case of ICAAP
- Less time spent with regulator

Internal Capital Adequacy Assessment Process (ICAAP)



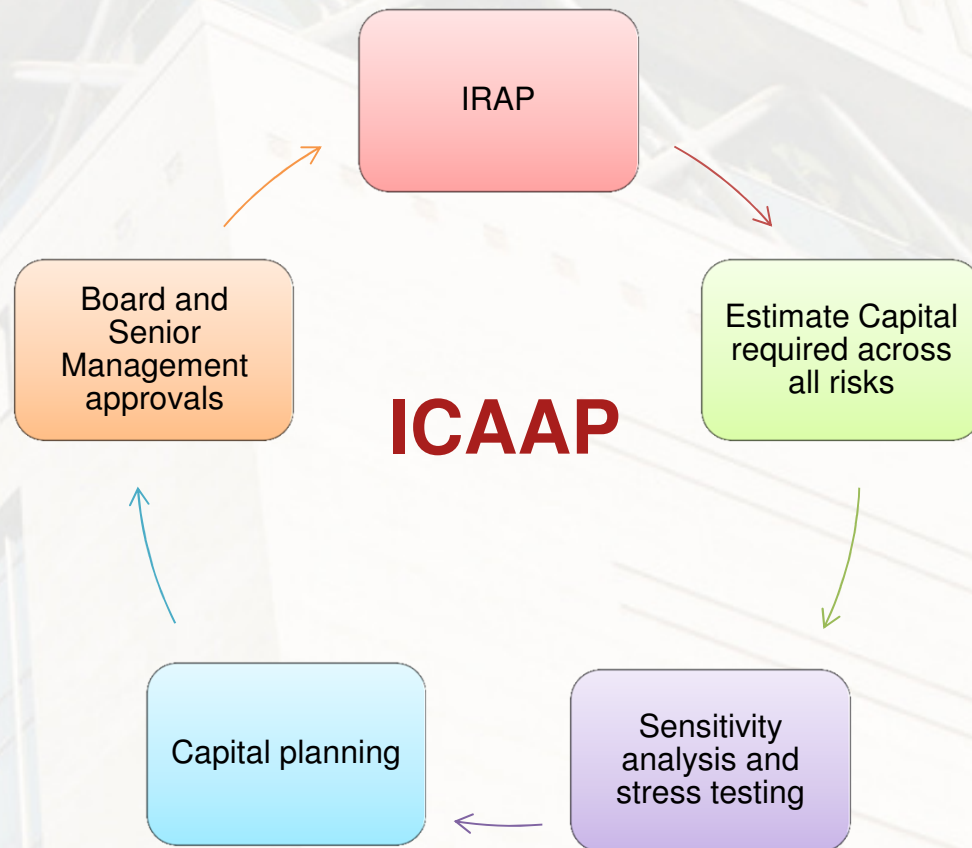
Internal Capital Adequacy Assessment Process



ICAAP – Description

- Applies to domestic Firms in Category 1, 2, 3A or 5
- Calculation of ‘internal’ capital requirement
- Cover all risks – including those covered by PIB rules
- Process to effectively address residual risks identified by IRAP
- Should be proportionate to the nature scale and complexity of operations
- Forward looking and dynamic

Internal Capital Adequacy Assessment Process



ICAAP – DFSA’s expectations

- **Living document** - a process that is responsive to changes in the internal and external environment
- No predefined approaches or models, but ...
 - Capital allocated for risks should be substantiated
 - Satisfies the “use test”
 - Robust governance and challenge at all levels
 - Integrated with Firm’s ERM framework
- Not every risk mitigated by Capital

ICAAP – Description

Elements of ICAAP:

1. Financial and capital forecasts – various approaches
2. Stress testing - severe but plausible
3. Assessment of a capital ‘cushion’
4. Plan for addressing deficiencies

ICAAP – DFSA’s expectations

- Do not require sophisticated models
 - Should be as complex as required but as simple as possible
 - Clear assumptions, parameters and testing
 - Model verification and validation processes
 - Strategy for identified capital deficiencies

Example of Risks

- Risks not fully captured under Pillar 1
- Interest Rate Risk in the Non-Trading Book
- Liquidity Risk (a special case)
- Business and strategic risks
- Reputation Risk
- Regulatory Risk
- External Risks – business cycle





Supervisory Review and Evaluation Processes

Supervisory Review and Evaluation Processes (SREP)

SREP review areas

Suggested Format for IRAP and ICAAP assessments		Applicable for IRAP	Applicable for ICAAP
1.	Executive Summary	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
2.	Background	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
3.	Structure and Governance	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
4.	Statement of Risk Appetite	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
5.	Internal Risk Assessment Process	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
6.	Capital planning (ICAAP only)		<input checked="" type="checkbox"/>
7.	Liquidity Planning (ICAAP only)		<input checked="" type="checkbox"/>
8.	Stress testing and scenario analysis	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>
9.	Integration, review and Approval	<input checked="" type="checkbox"/>	<input checked="" type="checkbox"/>

What we will do with IRAP / ICAAP

- Focus on process and governance
- Process assessment
 - Coverage
 - Involvement of internal stakeholders
 - Internal challenge
 - Engagement of the senior management and the Board
 - Internal reviews
- Integration with the ERM system of the Firm and with its other corporate processes

Supervisory Review and Evaluation Processes

- Supervisory Review and Evaluation Process
 - An integral part of supervisory approach
 - Aim is to evaluate quality, completeness and consistency
 - Ensure appropriate resources to support risks
 - Facilitate assessment of Firms' risk profile
 - Case by case assessment
- Response can be through a risk mitigation programme
- Individual Capital Requirement (ICR) where required

Individual Capital Requirement (ICR)

- Applicable to Firms facing risk capital requirement
- May require additional capital over its Risk Capital Requirement as calculated under the PIB
- The DFSA will set out in writing the methodology and rationale behind the ICR where imposed
- ICR estimation will be driven off the outcome of the ICAAP and SREP
- Adequate opportunities will be given to the Firm to discuss the outcome of SREP and ICR



Thank You