



Guideline impact analysis statement

Title	Internal Capital Adequacy Assessment Process (ICAAP) – Guideline impact analysis statement (2010)
Category	Sound Business and Financial Practices
Date	October 31, 2010
Sector	Banks Trust and Loan Companies
No	E-19

Table of Contents

[I. Background](#)

[II. Problem Identification](#)

[III. Objectives](#)

[IV. Identification and Assessment of Options](#)

- [Option 1 – Rely solely on existing international guidance](#)
- [Option 2 – Develop domestic guidance on ICAAP](#)

[V. Recommendation](#)

[VI. Consultations](#)

[VII. Implementation & Evaluation](#)

I. Background

Capital requirements set out in the Capital Adequacy Requirements (CAR) guidelines for banks, federally regulated trust and loan companies and for bank holding companies (collectively referred to as institutions) are regulatory minimums that assume an institution has a portfolio of risk exposures that is highly granular and well diversified. The CAR guideline specifies that institutions are expected to conduct internal assessments of the adequacy of the



capital they hold.

A thorough and comprehensive Internal Capital Adequacy Assessment Process (ICAAP) is thus a vital component of a strong risk management process. Each institution is responsible for developing and implementing its own ICAAP for the purpose of setting internal capital targets and developing strategies for achieving those internal targets that are consistent with its business plans, risk profile and operating environment. The ICAAP is not a regulatory compliance exercise.

II. Problem Identification

The Basel II Framework requires banks to have a process for assessing their overall capital adequacy in relation to their risk profile and a strategy for maintaining their capital levels. It also requires supervisors to review these assessments as well as banks' ability to monitor and ensure their compliance with regulatory capital ratios and internal capital targets.

Basel guidance can be found in Part 3 of the Basel II Framework (The Second Pillar – Supervisory Review Process), in the Basel Committee's May 2009 guidance, **Principles for sound stress testing practices and supervision**, and in the July 2009 guidance, **Enhancements to the Basel II framework**.

Having multiple sources for this guidance can lead to uncertainty about OSFI's expectations of domestic institutions and also about interpretation of the Basel requirements. And as the Basel guidance is intended for large, internationally active banks, there is little or no mention of flexibility or proportionality that is needed when this guidance is also to be applied to smaller institutions.

III. Objectives

OSFI would like to put into place domestic guidance that sets out expectations on ICAAP for Canadian institutions that can be applied to both the large internationally active banks and to smaller domestic institutions.

IV. Identification and Assessment of Options

Option 1 – Rely solely on existing international guidance

The advantage of this option is that OSFI would not have to devote resources to developing its own guidance on ICAAP.

However, as mentioned above, there are several Basel sources of this guidance, all intended for large internationally active institutions. This, coupled with the fact that all federally regulated deposit-taking institutions have adopted Basel II, can lead to confusion about what exactly is expected of smaller players and also about how OSFI's review of ICAAP fits into the Supervisory Review Process.

Option 2 – Develop domestic guidance on ICAAP

The advantage of this option is that it results in one single document that clearly lays out domestic expectations for ICAAP and provides flexibility to institutions to tailor ICAAP to reflect the complexity and range of their business activities, their risk profile, and their operating environments.

This option may however result in OSFI needing to update domestic guidance if and when additional guidance is provided by the Basel Committee.

V. Recommendation

Given the uncertainty inherent in having multiple sources of guidance on ICAAP, OSFI is of the view that the creating of domestic guidance is the most appropriate option for ensuring that institutions make full and appropriate use of ICAAP. Further, sole reliance on international guidance does not necessarily take into consideration factors that may be unique to the Canadian marketplace or regulatory environment.

VI. Consultations

The guideline was issued for comment on August 6, 2010. As no substantive comments were received, the guideline is unchanged from the August draft.



VII. Implementation & Evaluation

OSFI will continue to assess institutions' ICAAPs as part of the supervisory review process. This guideline will be reviewed in three years to ensure that the principles outlined in the guideline remain relevant.