

Pursuant to Article 27, paragraph (9), item d), Article 79, point e) and Article 80, paragraph (5) of the Banking Law (Official Gazette of the Federation of BiH, No. 27/17) , and Article 5, paragraph (1), item h), Article 19, paragraph (1), point c) of the Law on the Banking Agency of the Federation of Bosnia and Herzegovina (Official Gazette of the Federation of BiH”, No. 75/17) and Article 12, paragraph (1), point d) od the Statute of the Banking Agency of the Federation of Bosnia and Herzegovina (Official Gazette of the Federation of BiH”, No. 3/18) , the Management Board of the Banking Agency of the Federation of Bosnia and Herzegovina, at its session held on February 27, 2019, adopted

## **DECISION**

### **ON THE INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS AND THE INTERNAL LIQUIDITY ADEQUACY ASSESSMENT PROCESS IN A BANK**

#### **I GENERAL PROVISIONS**

##### **Article 1**

##### **Subject**

(1) This decision lays down requirements for a bank related to:

- a) implementation of the Internal Capital Adequacy Assessment Process (hereinafter: ICAAP), in accordance to the risk profile of a bank,
- b) implementation of the Internal Liquidity Adequacy Assessment Process (hereinafter: ILAAP), u in accordance to the risk profile of a bank,
- c) methods and deadlines for reporting to the Banking Agency of the Federation of Bosnia and Herzegovina (hereinafter: the Agency) on application of the ICAAP and ILAAP.

(2) This Decision shall apply to the banks with headquarter in the Federation of Bosnia and Herzegovina, which hold a licence issued by the Agency.

(3) Bank shall apply provisions of this Decision as on individual as well on consolidated basis, in accordance to the regulations.

(4) For issues related to risk management in banks, which are not regulated by this Decision, but regulated by the law or other regulations, the provisions of that law or regulations shall be applied.

##### **Article 2**

##### **Strategies, plans and processes capital planning in a bank**

(1) Bank shall adopt the strategy on capital which implementation shall ensure adequate, efficient and comprehensive capital planning, which along to the required minimum and structure of the regulatory capital, shall cover all other risks to which a bank is or might be

exposed in its operations, same as the processes for a continuous assessment and maintenance of capital, which is result of the ICAAP implementation

(2) Bank shall adopt a capital management plan, which shall clearly define:

- a) strategic objectives and deadlines to be achieved, taking into account macroeconomic surrounding and stages of economic cycle,
- b) processes, including procedures of capital planning and responsibility for that processes,
- c) a method to reach and maintain an adequate level of capital as a result of planning in the future, and at least for the next three years,
- d) Contingency plan, which shall identify measures to maintain an adequate level of capital as a result of capital planning (eg. method of obtaining additional capital, the restriction of business activities etc.)
- e) Dividend policy, aligned with regulatory requirements for maintaining regulatory and equity capital as a result of ICAAP,
- f) Determinants in regard of policy and practice for determining and paying variable remuneration to the management and key employees of the bank that significantly influence the risk profile of the bank, with reference to compliance with regulatory capital requirements.

### **Article 3**

#### **Strategies, policies, processes and systems for liquidity planning**

In accordance with Article 4 of the Decision on liquidity risk management in a bank, when implementing ILAAP as a continues process which result is the Report on ICAAP and ILAAP application, a bank shall assess the strategies, policies, processes and systems for liquidity planning, including liquidity plans and financing plan, in accordance with the ILAAP results, aiming to ensure adequate liquidity of a bank at all times.

### **Article 4**

#### **Establishing and implementation of ICAAP and ILAAP**

(1) Bank shall, on a continues basis, identify and implement the appropriate documented procedure for identification and provision of an adequate level of capital and liquidity which is result of ICAAP and ILAAP and which correlates to the nature, scope and complexity of bank operations, thereby taking into account risk profile, risk management system and risk mitigation techniques used by a bank.

(2) When selecting the procedures for identification and provision of an adequate level of capital and liquidity of a bank, which are result of ICAAP and ILAAP, a bank may take into account other factors, such as market positon, entering new markets, availability of capital and liquidity, the acquisition of other companies, and other strategic goals. Bank shall adequately analyse and document the impact of those factors to the amount of estimated capital and liquidity, as a result of ICAAP and ILAAP.

- (3) Procedure from paragraph (1) of this Article shall be deemed as appropriate when:
- a) it is established on identification, quantification or assessment and monitoring of the material risks to which a bank is or might be exposed in its operations, in accordance to the applicable regulatory requirements governing risk management in banks,
  - b) ensures an adequate level of capital and liquidity, as a result of the ICAAP and ILAAP, considering the risk profile of a bank,
  - c) is appropriately involved in the system of internal bank management and decision-making processes in a bank.
- (4) Bank shall establish, document and regularly monitor the assessment process from paragraphs (1), (2) and (3) of this Article.
- (5) Internal audit of a bank shall, at least once a year, conduct the assessment of appropriateness of the ICAAP and ILAAP, to ensure that the ICAAP and the ILAAP are proportional to the nature, scope and complexity of a bank in a manner that is clear and comprehensive.
- (6) When establishing and implementing ILAAP, a bank shall take into account importance of liquidity for a bank business continuity, and provision and maintenance of an adequate level of the internal liquidity requirements.
- (7) Adequacy of an established ICAAP and ILAAP in a bank is subject to supervisory review and assessment, on the basis of which the Agency shall take a decision on further supervisory measures, in accordance with a legislation and regulations issued by the Agency.

## **II PROCEDURES OF ICAAP AND ILAAP IN A BANK**

### **Article 5**

#### **Stages of ICAAP and ILAAP procedure**

- (1) Bank shall, within its methodology, establish quantitative and qualitative criteria on which basis it shall define material risks to be included in the ICAAP and ILAAP, taking into account a type, scope and complexity of its operations, as well as specificities of the market in which it operates. Through ICAAP and ILAAP, a bank shall include the following stages:
- a) identification of material risks, with an aim to identify all material risks and appropriately included into ICAAP and ILAAP,
  - b) quantification or assessment of an individual risk and determination of respective amounts of internal capital and liquidity requirements as the results of ICAAP and ILAAP,
  - c) determination of the total capital as a result of ICAAP,
  - d) comparison of a regulatory capital and capital determined as a result of ICAAP.

(2) Bank shall implement the procedure from paragraph (1) of this Article at least once a year, and more frequently in case of a significant change in a risk profile.

## **Article 6**

### **Material risks**

(1) Bank shall, on the basis of its risk profile, define material risk it is or might be exposed in its operations, and which shall be covered by the ICAAP and ILAAP. When assessing the material risks, bank shall take into account a type, scope and complexity of its activities and the market where it operates.

(2) For the purpose of implementation of the process from paragraph (1) of this Article, a bank shall carry out a continuous and comprehensive assessment of all risks to which it is or might be exposed in its operations, and to analyse the causes of exposures to some risks, in accordance with the applicable regulatory requirements for risk management in banks, as well as impact of the external factors (economic, regulatory and business environment).

(3) For the individual risks which are not included in the ICAAP and the ILAAP in accordance with the paragraph (2) of this Article, a bank shall provide documented clarification why have not been included, i.e. the reason why it considers that bank exposure to those risks is not material.

## **Article 7**

### **Methodology for quantifying or assessment of material risks**

(1) When performs an internal capital and liquidity adequacy assessment process, the Bank shall use a quantitative methods to measure or, when it is unable to quantify material risks, it shall assess a material risks using the most appropriate methodology and approaches for its organisation and business activities.

(2) Bank shall define for which risks, in ICAAP and ILAAP, it is appropriate to use quantitative methods, and for which it is more appropriate to use solely risk mitigation or control measures, instead of quantification of internal capital and liquidity requirements in ICAAP and ILAAP.

(3) Bank may use a different approach for internal process of calculation, i.e. assessment of internal capital and liquidity requirements for different types of risk, wherein it shall define an appropriate methodology of quantification or assessment of each risk, and to document and clarify the following:

a) methods, i.e. the approaches to risk measurement,

b) assessment of risks to which quantification methodology could be applied, and

c) any corrections of the risk amount whenever it determines that methods for quantification or assessment of the specific risk does not show current exposure to that risk.

(4) Without prejudice to application of paragraph (3) of this Article, when calculating internal capital requirements for credit risk, based on rating of the external credit assessment institutions for credit risk, bank shall take into account other relevant information as well.

(5) When calculating internal capital requirements, bank shall take into account the following:

a) the risks for which minimum capital requirements are calculated (credit risk, market risk, operational risk),

b) the risks which are not fully covered by minimum capital requirements (possible underestimation due to different approaches used in calculation of capital requirements for credit, market and operational risk);

c) the risks for which minimum capital requirements are not calculated,

d) the factors resulting from the economical, regulatory and business environment, unless included into risks listed in the preceding points of this paragraph.

(6) Where a bank has not identified in its methodology, the methods for assessment of internal capital requirement for other material risks, it shall allocate 5-15% of the total regulatory capital for those risks.

(7) When calculating internal liquidity requirements, a bank shall take into account the following:

a) the risks for which minimum liquidity requirements are calculated and

b) the risks for which minimum liquidity requirements are not calculated.

(8) Bank is responsible to establish and implement adequate, consistent and independently internally validated risk quantification methodologies in ICAAP and ILAAP, starting from the individual risk profile of a bank and its risk appetite, same as on type, nature, size and complexity of its activities.

(9) Requirements in terms of the methodology from paragraph (8) of this Article are prescribed by the Guidelines on reporting to the Banking Agency of the Federation of Bosnia and Herzegovina on the application of ICAAP and ILAAP in a bank.

(10) Application of methodologies for quantification of risks identified in ICAAP and ILAAP, a bank shall ensure an adequate measurement, i.e. quantification of the future changes in a capital, liquidity and source of funding, in accordance with the economic and normative perspective, all of it with the aim of contributing to ensuring continuity of bank operations.

(11) Economic perspective from paragraph (10) of this Article shall mean ensuring the continuity of bank operations by identification and quantification of all material risks resulted from macroeconomic and business environment in which a bank operates and which may adversely affect a capital and liquidity of a bank.

(12) Normative perspective from paragraph (10) of this Article shall mean ensuring the continuity of bank operations, fulfilling all the regulatory and supervisory requirements related to capital and liquidity of a bank.

## **Article 8**

### **Stress testing for purposes of ICAAP and ILAAP**

Bank shall regularly, and at least once per year, to conduct a stress testing for all material risks in accordance with the applicable regulatory requirements and for purposes of ICAAP and ILAAP, and to use results of a stress testing when calculating internal capital and liquidity requirements.

## **Article 9**

### **Definition of available capital for the purpose of ICAAP**

Bank shall define categories and components of the capital which it uses for a quantification of available capital for the purpose of ICAAP, taking into account that some capital components well demonstrate a real value of assets and liabilities, and loss-absorption capacity.

## **Article 10**

### **Identification of internal objectives to ensure ICAAP and ILAAP application**

(1) The Bank shall identify the appropriate internal objectives to ensure the implementation of ICAAP and ILAAP. Internal objectives are appropriate if, as a minimum, they identify an approach for provision of the required capital and liquidity:

- a) during the normal course of bank's operations,
- b) in exceptional circumstances.

(2) Under the internal objectives set out in paragraph (1), item a) of this Article, the Bank shall also consider an adequate protection of the depositor's interests and other clients of the Bank, the Management and Supervisory Board, employees, shareholders and other interested parties. The protection of these interests is adequate if the availability of ICAAP and ILAAP implementation provides protection against events that could adversely affect the proper functioning of the bank's activities. The Bank will also consider internal objectives to cover less material risks, which occur frequently.

(3) Under the internal objectives set out in paragraph (1), item b) of this Article, the Bank shall also consider an appropriate protection of the interests of the Bank's creditors. Protection of these interests is appropriate if the application of ICAAP and ILAAP provides protection against events that could adversely affect the payment of liabilities to the creditors of the bank.

(4) When setting the internal objectives to ensure an adequate level of capital adequacy and liquidity resulting from ICAAP and ILAAP, the bank shall consider its own ability to access sources of capital and liquidity.

## **Article 11**

### **Calculating the internal capital requirements**

- (1) Bank shall calculate the total internal capital requirements by aggregation of:
  - a) internal capital requirements for risks which are required to aggregate minimum capital requirements (credit risks, including settlement risk, market risk and operational risk) and
  - b) internal capital requirements for other material risks in operations of a bank, which are not covered by point a) of this paragraph.
- (2) Bank shall maintain the capital resulted from ICAAP at least in the amount of internal capital requirements, thus amount can never be less than the total minimum capital requirements calculated in accordance to the regulatory requirements.

## **Article 12**

### **Identification of internal liquidity requirements and stable sources of financing**

- (1) The Bank is responsible to clearly define, assess and maintain the internal liquidity requirements and stable sources of financing within the ILAAP.
- (2) For the purposes of ILAAP, and in accordance with paragraph (1) of this Article, a bank shall define internal liquidity requirements, which include high quality liquid assets and future liquidity inflows that may be considered as available liquidity when assessing the adequacy of the bank's liquidity position, taking into account prudent and a conservative approach. When defining internal liquidity requirements, the bank should consider the liquidity sources available under both normal and stress conditions.
- (3) For the purpose of assessing the sustainability of financing, and in accordance with paragraph (1) of this Article, the bank shall define which sources of financing may be considered stable, taking into account a prudent and conservative approach. When carrying out the assessment, the bank shall take into account the stability of its financing profile, starting from diversification, i.e. concentration of sources and their availability on the market, including an explicit internal review of stable deposits based on continuous monitoring of deposit behaviour.
- (4) Bank shall maintain a liquidity resulting from ILAAP, at least in the amount of the total internal liquidity requirements, thus amount can never be less than the total minimum liquidity requirements calculated in accordance to the regulatory requirements.

## **Article 13**

### **Comparison process**

- (1) The Bank shall compare the estimated capital resulting from ICAAP and the regulatory capital, calculated in accordance with regulatory requirements, and provide their similarities and differences.

(2) At the end of the business year (situation as of 31.12), the bank shall calculate:

- a) the amount of total required capital as a result of ICAAP,
- b) target level of available capital for ICAAP and regulatory capital at the end of the current financial year, which is in line with the bank's business plan for a period of at least three years.

(3) The Bank shall ensure that measures to improve ICAAP and ILAAP, which resulted from an analysis of the risks to which the bank is or may be exposed in its operations, the results of ICAAP and ILAAP, that is, identified weaknesses and weaknesses in ICAAP and ILAAP are included in the annual business plan.

### **III. ICAAP AND ILAAP IN THE INTERNAL MANAGEMENT SYSTEM**

#### **Article 14**

##### **Inclusion of ICAAP and ILAAP into internal management system**

(1) ICAAP and ILAAP shall constitute an integral part of internal management system of a bank.

(2) Bank shall use the results of ICAAP and ILAAP at least in the following processes:

- a) definition and monitoring progress towards the achievement of the strategy and policies for risk management,
- b) allocation of capital and liquidity to business functions of a bank,
- c) taking lending decisions and adoption of financial plan (budget) and a
- d) taking important strategical decisions (ex. new products, services and/or systems, entering new markets etc.).

(3) The Supervisory Board and the Bank's Management Board are responsible to ensure that through ICAAP and ILAAP application the capital and liquidity of the bank at all times support all risks to which the bank is exposed or could be exposed in its operations.

(4) The Supervisory Board and the Bank's management shall ensure that the bank regularly, and at least annually or more frequently, if pursued under circumstances, conduct, check and review ICAAP and ILAAP, and that this process is appropriately audited, when it seems necessary.

(5) In addition to regular annual review of the at ICAAP and ILAAP process, the bank shall review and revise ICAAP and ILAAP whenever it is exposed to new risks and significant changes in operations, both in its strategic commitments and operational plans, and in its external environment.

#### **Article 15**

##### **Duties of the supervisory board and management of a bank in ICAAP and ILAAP**

(1) Supervisory Board of a bank shall:



- a) ensure that ICAAP and ILAAP constitute an integral part of the internal management system in a bank, in accordance with the decision on risk management in a bank, i.e. Article 14 of this Decision;
- b) adopt strategy and capital plan from Article 2 of this Decision,
- c) adopt strategy and policies, establish processes and systems for liquidity planning in a bank, in accordance with Article 3 of this Decision,
- d) upon management proposal, adopt the structure of procedures in ICAAP and ILAAP, and in a case of procedure adjustment monitor its implementation, as per significant changes in strategies, policies, organisation and business environment,
- e) monitor if the results of the procedure in ICAAP and ILAAP are used in decision making process, and in accordance with adopted strategies, policies and plans,
- f) analyse the achievement of risk management strategy in relation to capital and liquidity resulted from ICAAP and ILAAP's capital and liquidity risk management strategy
- g) review and adopt reports on application of ICAAP and ILAAP which bank submits to the Agency in accordance with prescribed regulatory requirements, including the assessment of bank's capital and liquidity provided in the Report on ICAAP and ILAAP application, explaining the assessment conducted with ICAAP and ILAAP results, and
- h) adopt internal acts of the bank governing the content, manner, dynamics and reporting lines on ICAAP and ILAAP, as well as the framework for the implementation of ICAAP and ILAAP, with clearly and precisely defined activities, bearers and responsibilities for its implementation , and the documentation used for ICAAP and ILAAP purposes, method for verification and control of data, information and procedures used in ICAAP and ILAAP, including their internal independent validation, and any other requirements it deems necessary in the implementation of ICAAP and ILAAP, in order to achieve compliance with regulatory requirements and internal regulations of the bank and an appropriate system of internal controls in the implementation of ICAAP and ILAAP

(2) Management of a bank shall:

- a) ensure implementation of ICAAP and ILAAP procedures and its compliance with the provisions of a law, regulations, provisions of this Decision, and internal acts of a bank, adopted in compliance with this decision,
- b) ensure that all material risks are included into ICAAP and ILAAP,
- c) determine in detail the elements of procedure in ICAAP and ILAAP (methods to be applied, assumptions, assessment procedure, maintaining adequate level and structure of a bank capital,
- d) ensure the use of adequate methods for quantification, i.e. assessment of a material risks,
- e) prescribe a detailed procedure for allocation of capital and liquidity as the results of ICAAP and ILAAP,

- f) establish the appropriate internal control system in the ICAAP and ILAAP, as well as in the procedure for ensuring the level and structure of capital and liquidity,
- g) ensure that ICAAP and ILAAP procedure is documented,
- h) ensure adequate resources for implementation of the ICAAP and ILAAP procedure and its fully understanding by all employees involved in the procedure,
- i) prescribe duties and responsibilities assigned to individual functions and organisational units of a bank, in manner which shall ensure a clear reporting lines accordingly,
- j) ensure that the procedure in ICAAP and ILAAP constitute an integral part of the internal management system,
- k) ensure a regular appropriateness assessment of the procedure in ICAAP and ILAAP,
- l) ensure reliable, accurate and timely reporting to the Agency in accordance with the prescribed regulatory requirements and internal acts adopted by the Supervisory board of a bank on ICAAP and ILAAP procedures in a bank,
- m) ensure timely and comprehensive reporting to the Supervisory Board on the conducted ICAAP and ILAAP procedure, in accordance to requirements listed in point I) of this paragraphs.

## **Article 16**

### **Role of control functions in ICAAP and ILAAP**

In accordance with legislation, for ICAAP and ILAAP a bank shall ensure that:

- a) analysing, monitoring and reporting on ICAAP and ILAAP is performed within the risk management function, same as verification of strategies and procedures for assessment of needed capital and liquidity as the result of ICAAP and ILAAP,
- b) internal audit, as an independent function in a bank, performs assessment of strategies, policies and procedures for identification of needed capital and liquidity as the result of ICAAP and ILAAP, proportionally to the risk profile of a bank,
- c) compliance function monitors a compliance of ICAAP and ILAAP with legislations, regulations and other administrative provisions and standards of prudent banking, same as with internal acts, identifies omissions and estimates risks resulting from non-compliance, assessing the effects of changes of relevant regulations to bank operations etc.

## **IV REPORTING TO THE AGENCY**

### **Article 17**

#### **Report on ICAAP and ILAAP application**

- (1) Bank shall submit printed and electronic format of the Report on ICAAP and ILAAP application to the Agency.
- (2) Bank shall prepare the Report form paragraph (1) of this Article with situation as of December 31 of the previous year, and submit it to the Agency as latest by April 30 of the current year.
- (3) Bank shall, in addition to the Report form paragraph (1) of this Article, submit the additional information and documentation upon a request of the Agency, and for the purposes of the supervisory review and assessment of ICAAP and ILAAP of a bank.
- (4) Bank shall draw up a comprehensive document (handbook, manual, instruction or similar internal act) which shall constitute an accompanying document of the Report on ICAAP and ILAAP application, with the aim to ensure easier and better understanding and follow-up of Report on ICAAP and ILAAP application.
- (5) Requirements in terms of scope and content of the document from paragraph (4) of this Article are described in details in the Guidelines on reporting to the Banking Agency of the Federation of Bosnia and Herzegovina on the application of ICAAP and ILAAP in a bank.
- (6) Bank shall submit relevant supporting documents with the Report on ICAAP and ILAAP application, which is described in more details in Articles 13 and 22 of the Guidelines on reporting to the Banking Agency of the Federation of Bosnia and Herzegovina on ICAAP and ILAAP application in a bank.

## **Article 18**

### **IT support to ICAAP and ILAAP**

- (1) Within the bank's information system development strategy and information system security policy, banks shall also define adequate IT support to ICAAP and ILAAP in accordance with the provisions of this Decision so as to ensure comprehensive, reliable, timely and accurate data processing, i.e. the IT basis to adequately determine internal capital and liquidity requirements to cover all material business risks and reporting to the Agency on the application of ICAAP and ILAAP.
- (2) Bank shall apply and maintain an adequate flow of information, which shall ensure efficient implementation of the strategy, plans and procedures for capital planning in a bank, i.e. strategies, policies, processes and systems for liquidity planning in a bank, which constitute an integral part of the information system of a bank.

## **V TRANSITIONAL AND FINAL PROVISIONS**

### **Article 19**

#### **Transitional Provisions**

- (1) Within 60 (sixty) days from the day this Decision enters into force, the Director of the Agency shall adopt Guidelines for reporting on ICAAP and ILAAP application in the bank to the Banking Agency of the Federation of Bosnia and Herzegovina, shall prescribe the content and format of the Report referred to in Article 17 of this Decision, as well as method for filling it.
- (2) On the date of application of this Decision, Decision on Internal capital adequacy assessment process (Official Gazette of the Federation of BiH, no. 81/17) in a bank shall cease to be valid.
- (3) Reports from banks on ICAAP application as of December 31. 2018, shall be submitted to the Agency in accordance with the provisions of the Decision on Internal capital adequacy assessment process in a bank, through April 30,2019.
- (4) In the process of compliance with the provisions of the Decisions, banks shall submit the first Reports on ICAAP and ILAAP application as of December 31, 2019, to the Agency through April 30, 2019.

### **Article 20**

#### **Entry into force**

This Decision shall enter into force on the eighth day from the date of its publication in the Official Gazette of the Federation of BiH and shall apply from 01 January 2020.

**No: U.O.-31-03/19**

**Sarajevo, February 27, 2019**  
**BOARD**

**CHAIRWOMAN**

**OF THE MANAGEMENT**

**Ljerka Marić, M.Sc, sgd.**