Deposit Guarantee Corporation of Manitoba
La Société d’assurance-dépôts du Manitoba

Guideline

Subject: ICAAP Guidelines (Credit Unions)

Effective Date: December 31, 2024

Table of Contents

1.0 Overview

On July 1, 2022, DGCM issued new Standards of Sound Business Practice (SSBP) pursuant to s. 159.1 of *The Credit Unions and Caisses Populaires Act*. All credit unions must comply with SSBP that apply to them (s. 159.1).

The SSBP are available at this link:

https://web2.gov.mb.ca/laws/regs/annual/2022/089.pdf

The SSBP contain rules respecting credit union capital, liquidity, investments, lending, and other matters. The SSBP also contain a set of principles that assist credit unions to direct and manage their institution in a prudent, effective, and appropriate manner. These are further defined in DGCM's **SSBP Guidance Framework**.

These ICAAP Guidelines better define DGCM's expectations on how a credit union can comply with Standard 3 – Risk Management with respect to managing capital risk.

2.0 Application to Designated Credit Unions

The ICAAP Guidelines apply to any credit union that is designated by DGCM as a Systemically Important Financial Institution (SIFI). DGCM may require other credit unions to comply with the ICAAP Guidelines based on considerations of size, complexity, and level of risk.

3.0 Internal Capital Adequacy Assessment Process

A designated credit union must establish and maintain an Internal Capital Adequacy Assessment Process (ICAAP).

Maintaining adequate capital is critical to a credit union's overall safety and soundness and should be assessed in view of the risks facing the organization. An ICAAP is a credit union-led process that is assessed by DGCM. DGCM expects the Board and Senior Management to be engaged in the process and set the credit union's internal capital targets based on their understanding and analysis of the inherent risks associated with their business activity.

As part of its prudential oversight function, DGCM evaluates a credit union's inherent risks, identifies and reviews each significant activity undertaken by the credit union, and evaluates the quality of credit union's risk management practices used to mitigate these risks. DGCM's assessment of a credit union's ICAAP is intended to enhance DGCM's oversight work.

3.1 Background on ICAAP

ICAAP is a concept that originates with the Basel Committee on Banking Supervision's (BCBS) Basel III capital framework.

Basel III requirements include both Pillar 1 and Pillar 2 requirements (Pillar 3 is not addressed in this document). Pillar 1 describes the minimum capital requirements for banks. DGCM's SSBP adopted many of these rules for Manitoba credit unions. A credit union's Pillar 1 results are documented in the **Capital Adequacy Report (CAR)** which is filed quarterly.

Pillar 2 (ICAAP) capital requirements address a collection of risks that are not addressed in Pillar 1. DGCM has made a number of modifications to the Pillar 2 (ICAAP) framework to adapt the framework to local conditions including the credit union business model.

A credit union that would like to learn more about the Basel III ICAAP framework should consult either BCBS's Basel III publications: https://www.bis.org/bcbs/basel3.htm?m=76 or the ICAAP materials published by the Office of the Superintendent of Financial Institutions (OSFI): https://www.osfi-bsif.gc.ca/en/guidance/guidance-library/internal-capital-adequacy-assessment-process-icaap-deposit-taking-institutions-guideline-2010.

OSFI's equivalent input form, OSFI ICAAP Data Return, is available here: https://www.osfi-bsif.gc.ca/en/data-forms/reporting-returns/filing-financial-returns/financial-reporting-instructions/instructions-complete-icaap-data-return .

3.2 ICAAP and Minimum RWC Requirements

Pillar 1 capital requirements include risk-weighted capital (RWC) requirements. A Manitoba credit union's minimum Total RWC ratio requirement is established under DGCM's SSBP. For most credit unions, the minimum Total RWC ratio is 10.5%. A Systemically Important Financial Institution (SIFI) must meet a minimum ratio of 11.5%. These minimum capital requirements are calculated in the quarterly CAR.

One of the core outputs of an ICAAP is for a credit union to reassess its capital risk in order to set internal capital targets that exceed the Total RWC. For the purpose of ICAAP, Pillar 1 capital (the minimum Total RWC requirement) forms the baseline for a credit union's internal capital targets. Any capital requirements identified in the Pillar 2 assessment process are added to this baseline.

4.0 Overview of the Process

The ICAAP can be broken down into six components:

1. Board and Senior Management oversight
2. Sound capital assessment and planning
3. Comprehensive assessment of risks
4. Stress testing
5. Monitoring and reporting
6. Internal Control Review

A credit union's ICAAP should be as simple or complex as needed. It should not be established solely to fulfill a regulatory requirement. The sophistication of a credit union's ICAAP and resources devoted to the work will depend on the credit union's complexity, range of business activities, risk profile, and operating environment.

4.1 Board and Senior Management Oversight

The credit union's Board of Directors is responsible for overseeing the ICAAP. Senior Management is responsible for designing and implementing the ICAAP.

Senior Management should understand the nature and level of risks taken by the credit union and whether those risks require adequate levels of capital. The Board should be engaged in discussions in this area. As part of its strategic planning process, the credit union should perform an analysis of its current and future capital requirements in relation to its strategic objectives. Strategic plans should clearly describe the credit union's capital needs in relation to, among other things, anticipated balance sheet growth, Board approved risk tolerances, and access to capital.

Senior Management and the Board should view capital planning as a crucial element in the credit union's ability to achieve its desired strategic objectives.

The Board is responsible for setting the institution's tolerance for risk. It should ensure that Senior Management:

- Establishes detailed policies that set controls on the credit union's activities that are consistent with its risk-taking capacity and appetite

- Effectively communicates these policies throughout the credit union

- Establishes a framework for assessing the various risks
- Develops an ICAAP that ties the credit union's capital level to its assessment of risk
- Establishes strong internal controls and a method for monitoring compliance with internal policies.

4.2 Sound Capital Assessment and Planning

A sound capital assessment process should include the following elements:

- A documented process for evaluating quantifiable or qualitative risks and determining whether or not a risk should result in an explicit amount of capital being held
- Policies and procedures designed to ensure that the credit union identifies, measures and reports all material risks requiring capital
- A process that ties capital holdings to current and anticipated levels of risk, and accords with Board approved risk tolerances
- A process that identifies capital adequacy goals with respect to risk, taking account the credit union's strategic, business, and annual plans
- An internal control framework that ensures the integrity of the overall risk management process.

Capital adequacy can be evaluated based on several external factors including international and local (DGCM) regulatory standards and industry or peer comparisons.

The credit union should identify the time horizons over which it is assessing capital adequacy. It should evaluate whether long-term capital targets are consistent with short-term goals, based on current and planned changes in risk profile and the recognition that accommodating additional capital needs can require significant lead time.

Capital planning should factor in the potential difficulties of increasing capital during downturns or other times of stress and the limitations on how a Manitoba credit union can raise capital.

4.3 Comprehensive Assessment of Risks

The ICAAP should address all material risks faced by the credit union as they relate to the adequacy of capital. The techniques used in assessing material risks should be commensurate with the scope and complexity of the credit union's risk-taking activities.

DGCM requires designated credit unions to prepare an annual **ICAAP Report** based on two templates: the **ICAAP Input Form** and the **ICAAP Report Template**. These documents are supported by the **ICAAP Report Instruction Guide**.

The **ICAAP Report** describes the types of risks a credit union must assess as part of its ICAAP risk assessment. However, the report allows a credit union to identify other risks beyond the listed risks.

4.4 Stress Testing

The credit union's capital planning process should incorporate rigorous, forward-looking stress testing that identifies possible events or changes in market conditions that could adversely impact capital. In its ICAAP, the credit union should examine future capital resources and capital requirements under adverse scenarios. The results of forward-looking stress testing should be considered when evaluating the adequacy of the credit union's capital.

4.5 Monitoring and Reporting

The credit union should establish an adequate system for monitoring and reporting risk exposures and assessing how changes to its risk profile affects the need for capital. The credit union's Board should receive regular reports on the credit union's risk profile and capital needs.

Reports should allow Senior Management and the Board to:

- Evaluate material risks and their effect on capital levels
- Evaluate the sensitivity and reasonableness of assumptions used in any capital assessment measurement system or process
- Determine whether the credit union is holding sufficient capital against the various risks and is in compliance with established capital adequacy targets

- Assess future capital requirements based on the credit union's reported risk profile and make necessary adjustments to its strategic plan

The credit union's Board must receive the annual **ICAAP Report** and review the results to determine if the credit union has established sufficient capital targets.

4.6 Internal Control Review

The credit union's internal control structure is essential to the capital assessment process. As the credit union establishes and matures its ICAAP, it can benefit from conducting an independent review of the process and, where appropriate, the involvement of internal and external audits.

The credit union should conduct periodic reviews of its capital planning and risk management process to ensure its integrity, accuracy, and reasonableness. Areas that can be reviewed include:

- The capital assessment process and whether it is sufficient given the size, complexity, and business model (including level of risk) of the credit union

- Whether large exposures and risk concentrations are appropriately identified and measured

- The accuracy and completeness of data inputs used in the credit union's assessment of capital needs

- The reasonableness and validity of scenarios, stress testing, and assumptions used in the assessment process.

5.0 DGCM Oversight

A designated credit union must file an annual **ICAAP Report** with DGCM based on year-end data. Reports must be filed within 120 days of the year end. DGCM will assess this report and provide feedback on the report, ICAAP process, and underlying assumptions.

Ultimately, ICAAP Pillar 2 is designed to facilitate a dialogue between regulators and regulated entities. A robust ICAAP will assist DGCM in conducting its own assessment of risk.