

Pursuant to Article 100 of the Banking Law of Republika Srpska ("Official Gazette of Republika Srpska", No. 4/17, 19/18 and 54/19), Article 5, Paragraph 1, Item b, Article 20, Paragraph 2, Item b and Article 37 of the Law on the Banking Agency of Republika Srpska ("Official Gazette of Republika Srpska", No. 59/13 and 4/17), and Article 6, Paragraph 1, Item b and Article 19, Paragraph 1, Item b of the Statute of the Banking Agency of Republika Srpska ("Official Gazette of Republika Srpska", No. 63/17), the Management Board of the Banking Agency of Republika Srpska, at its 28th session, held on 16 December, 2020 adopted the

DECISION
ON
INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

Subject of Decision

Article 1

(1) This Decision shall stipulate:

- 1) minimum requirements for banks regarding the implementation of the Internal Capital Adequacy Assessment Process (hereinafter: ICAAP),
- 2) the manner and deadlines for reporting to the Banking Agency of Republika Srpska (hereinafter: the Agency) on the implementation of the ICAAP.

(2) This Decision shall apply to banks with their registered office in Republika Srpska, to which the Agency has issued an operating license.

(3) The provisions of this Decision shall be applied by the bank on an individual and consolidated basis.

(4) For issues related to risk management in banks that are not defined by this Decision, but are defined by law or other by-laws, the provisions of that law or other by-law shall apply.

Strategies, plans and procedures for capital planning

Article 2

(1) The bank shall adopt a capital strategy that will ensure adequate, efficient and comprehensive capital planning at a level that, in addition to maintaining the minimum stipulated amount of own funds, also provides maintenance of capital required to cover all risks to which the bank is exposed or may be exposed in its operations, i.e. procedures for continuous assessment and maintenance of capital in accordance with the results of ICAAP.

(2) The bank shall adopt a capital management plan, which clearly defines:

- 1) strategic objectives and deadlines for their realization, taking into account the macroeconomic environment and phases of the economic cycle,
- 2) capital planning procedures and responsibilities for its implementation,
- 3) the manner of achieving and maintaining an adequate level of capital in accordance with the plans for the future period, and at least for the period of the next three years,
- 4) a plan for procedures in contingency situations, which will define measures for maintaining an adequate level of capital (e.g. the manner of obtaining additional capital, limiting business activities, etc.),

- 5) dividend policy, which is in line with the stipulated requirements of the Decision on calculating capital in banks and the results of ICAAP and
- 6) determinants regarding the policy and practice for determining and disbursement the variable part of remuneration to bank employees, which are harmonized with the requirements from the regulations of the Agency which define the requirements regarding the policy and practice of remuneration to bank employees.

Establishing and implementing ICAAP

Article 3

- (1) The bank shall, on a continuous basis, establish and implement an appropriate documented procedure for determining and providing an adequate level of capital that according to the bank's internal assessment corresponds to the nature, scope and complexity of the bank's activities, taking into account the risk profile, risk management system and risk mitigating techniques.
- (2) When selecting the procedure for determining and providing an adequate level of capital referred to in Paragraph 1 of this Article, the bank may take into account other factors, such as market position, entry into new markets, availability of capital and other strategic objectives. The bank is obliged to analyze and document the impact of these factors on the amount of estimated required capital based on the results of ICAAP.
- (3) The bank shall ensure that the procedure referred to in Paragraph 1 of this Article is based on the following seven principles:
 - 1) the bank supervisory board and the bank management are responsible for the establishment and implementation of an adequate ICAAP,
 - 2) ICAAP is an integral part of the comprehensive management and decision-making system in the bank,
 - 3) ICAAP provides a key contribution to the continuity of the bank's operations, providing an adequate level of capital,
 - 4) all significant risks have been identified and included in ICAAP,
 - 5) available capital is of high quality and clearly defined,
 - 6) methodologies for determining internal capital requirements are adequate, consistent and independently validated,
 - 7) regular capital stress testing should ensure capital adequacy even in contingency situations.
- (4) The bank shall define, document and regularly monitor the adequacy of the procedures referred to in Paragraphs 1–3 of this Article.

Responsibility of the bank supervisory board and the bank management in ICAAP implementation

Article 4

- (1) The bank supervisory board and the bank management are obliged to ensure the implementation of ICAAP in accordance with the provisions of this Decision.
- (2) The bank supervisory board and the bank management are obliged to ensure the implementation of ICAAP at least once a year, or more often if circumstances so require, on which a Report on the internal capital adequacy assessment process (hereinafter: ICAAP Report) is prepared.

(3) The supervisory board shall provide an assessment of the bank's capital adequacy in the ICAAP Report, explaining its assessment by the ICAAP results.

(4) The supervisory board of the bank shall, at the proposal of the bank management, adopt an internal act defining the implementation of ICAAP, and it shall contain at least:

- 1) framework for the implementation of ICAAP with a precise definition of activities and division of tasks and responsibilities, including the obligation of regular internal review and validation within ICAAP,
- 2) list of internal documentation used in ICAAP,
- 3) the method of checking input and output data, as well as the method of quality control of procedures and processes in ICAAP,
- 4) other requirements that the bank deems necessary in the implementation of ICAAP.

(5) The bank supervisory board is obliged to:

- 1) adopt the capital strategy referred to in Article 2 of this Decision,
- 2) adopt the proposal of the management on the structure of ICAAP,
- 3) monitor and approve the adjustment of ICAAP when the bank is exposed to new risks and significant changes in its strategic commitments and operational plans and business environment,
- 4) ensure that ICAAP is an integral part of the bank's management system,
- 5) ensure that the results of ICAAP are used in the decision-making process, in accordance with the adopted strategies and policies,
- 6) analyze the implementation of the risk management strategy in relation to the required capital of the bank in accordance with the results of ICAAP,
- 7) define the powers and responsibilities assigned to individual functions and organizational units so as to ensure a clear division of powers and clear lines of responsibility,
- 8) establish an appropriate system of internal controls of ICAAP,
- 9) provide regular verification and review of ICAAP,
- 10) adopt the ICAAP Report and ensure reliable, accurate and timely reporting to the Agency in accordance with Article 17 of this Decision, and
- 11) adopt internal acts regulating the content, manner, deadlines and lines of reporting to the supervisory board on ICAAP.

(6) The bank management is obliged to:

- 1) ensure the implementation of ICAAP and its compliance with the provisions of the law, this Decision and the internal acts of the bank adopted in accordance with this Decision,
- 2) ensure that all significant risks are included in ICAAP,
- 3) ensure the use of appropriate methods for measuring / assessing significant risks,
- 4) stipulate in detail the procedure for the implementation of ICAAP (methods used, assumptions, assessment procedure, manner of maintaining an adequate level of capital),
- 5) provide documentation of ICAAP,
- 6) provide adequate resources for the implementation of ICAAP and its full understanding by all employees involved in the process and
- 7) provide timely and comprehensive reporting on the implemented ICAAP in accordance with the acts adopted by the supervisory board.

ICAAP as an integral part of the bank management system

Article 5

- (1) The bank shall ensure the inclusion of ICAAP, as an integral part, in the comprehensive management system in the bank.
- (2) The ICAAP must be appropriately involved in business processes, decision-making processes and risk management processes.
- (3) In order to include ICAAP in the management system in the bank, the bank is obliged to ensure adequate connection and compliance of ICAAP with:
 - 1) management system in the bank, strategy and business policy of the bank,
 - 2) risk management strategy, policy, procedures and processes, including capital management system, strategies, policies, procedures and processes,
 - 3) capital plan,
 - 4) the bank's recovery plan, including the bank's capital recovery plan,
 - 5) reporting system,
 - 6) the bank's internal liquidity adequacy assessment process (ILAAP),
 - 7) remuneration policy and practice in the bank,
 - 8) as well as with other processes and acts of the bank important for the implementation of ICAAP.
- (4) The bank shall use the results of ICAAP at least in the following processes:
 - 1) defining and monitoring the implementation of risk management strategies and policies, including the establishment of internal limits,
 - 2) distribution of capital to individual business functions of the bank,
 - 3) making decisions on lending and adoption of the financial plan (budget) and
 - 4) making significant strategic decisions (e.g. new products, services and / or systems, entering new markets, etc.).
- (5) The bank supervisory board and the bank management shall, by implementing ICAAP, ensure that the bank's capital is at all times sufficient to cover the risks to which the bank is exposed or may be exposed in its operations.
- (6) The bank is obliged to regularly, and at least once a year, verify and review ICAAP, as well as, if necessary, to adjust this process accordingly.
- (7) In addition to the regular annual review of ICAAP, the bank is obliged to review and adjust this process whenever it is exposed to new risks and significant changes in its strategic commitments and operational plans and business environment.

ICAAP phases

Article 6

- (1) Within the methodology for the implementation of ICAAP, the bank is obliged to establish quantitative and qualitative criteria on the basis of which it determines the significant risks that will be included in ICAAP, taking into account the type, scope and complexity of its operations, as well as the specificity of markets in which it operates. The bank is obliged to cover the following phases by ICAAP:
 - 1) identification of significant risks,
 - 2) measuring or assessing individual significant risk and calculating internal capital requirements for individual significant risks,

- 3) determination of total internal capital requirements, as the sum of all internal capital requirements for individual significant risks, and
 - 4) comparison of total capital requirements calculated in accordance with the Decision for calculating capital in banks and total internal capital requirements.
- (2) The bank is obliged to carry out the procedure referred to in Paragraph 1 of this Article at least once a year, and in the event of a significant change in the risk profile - more often.

Determining significant risks

Article 7

(1) Based on its risk profile, the bank is obliged to determine the significant risks to which it is exposed or could be exposed in its operations, which will be covered by ICAAP. In the process of determining significant risks, the bank takes into account the type, nature, scope and complexity of the bank's activities and the markets in which it operates.

(2) In order to determine the significant risks to which it is exposed in its operations, the bank shall analyze the following:

- 1) risks for which it calculates capital requirements in accordance with the provisions of the Decision for calculating capital in banks,
- 2) risks that are not fully covered by the minimum capital requirements from the Decision for calculating capital in banks (credit and foreign exchange risk, residual risk, possible underestimation of credit risk due to the application of the standardized approach, possible underestimation of operational risk due to the basic indicator approach or standardized approach, etc.),
- 3) market liquidity risk, concentration risk, interest rate risk in the banking book, country risk, strategic risk, business risk, model risk, conduct risk, money laundering and terrorist financing risk, information system risk, outsourcing risk, reputational risk and excessive leverage risk,
- 4) other risks to which the bank is exposed or may be exposed, and which are not covered in Items 1–3 of this Paragraph, and
- 5) factors arising from the macroeconomic or business environment.

(3) The determination of the significance of risks must be based on a comprehensive assessment of the risks to which the bank is exposed or may be exposed, taking into account the risks that are characteristic of certain operations, products, activities, processes and systems of the bank.

(4) For individual risks that are not, in accordance with Paragraphs 1–3 of this Article, covered by ICAAP, the bank is obliged to explain in a documented manner the reasons for their non-inclusion, i.e. the reasons why it considers that the bank's exposure to these risks is not significant.

Methodology of measuring and assessing significant risks

Article 8

(1) When calculating internal capital requirements, the bank shall measure significant risks using quantitative methods or assess significant risks that cannot be quantified, using the methodology and approaches that best correspond to the organization and business activities of the bank.

(2) The bank may use different approaches to calculate internal capital requirements for different types of risk, and in doing so shall define an appropriate methodology for measuring or assessing each risk, and document and explain the following:

- 1) methods / approaches for measuring risk,
 - 2) assessment methods of risks that cannot be measured by quantitative methods and
 - 3) all adjustments to the amount of risk when the bank determines that the methods for measuring or assessing a particular risk do not indicate the bank's current exposure to that risk.
- (3) The bank shall determine the methodology for measuring or assessing the risk referred to in Paragraph 2 of this Article for at least credit risk, concentration risk, market risk, operational risk, market liquidity risk, credit and foreign exchange risk and interest rate risk in the banking book.
- (4) If the bank has not established a methodology for measuring / assessing other significant risks that are not listed in Paragraph 3 of this Article, it shall calculate internal capital requirements for these risks in the total amount of 5–15% of the sum of minimum capital requirements for credit, market and operational risk, in accordance with the Decision for calculating capital in banks.

Stress testing

Article 9

The bank is obliged to regularly, and at least once a year, conduct stress testing for all significant risks in accordance with the stipulated regulatory requirements for risk management in banks, and to use the results of stress testing for the purposes of ICAAP.

Defining internal objectives for ensuring the ICAAP implementation

Article 10

- (1) The bank shall define appropriate internal objectives to ensure the application of ICAAP. Internal objectives are appropriate if they define as a minimum the approach for providing the required capital:
- 1) for the normal operation of the bank and
 - 2) in contingency situations.
- (2) When defining the internal objectives referred to in Paragraph 1 of this Article, the bank shall also consider the following:
- 1) adequate protection of the interests of shareholders, management and supervisory boards and other employees of the bank, as well as creditors of the bank. The protection of these interests is adequate if the application of ICAAP provides protection against events that could adversely affect the normal performance of the bank's activities and the payment of obligations to the bank's creditors,
 - 2) less significant risks that are often generated and
 - 3) own ability to access sources of capital.

Defining available capital

Article 11

- (1) Available capital means the amount of capital available to cover all risks to which the bank is exposed or may be exposed in its operations.
- (2) The bank is obliged to define the categories and constituent elements of its available capital, taking into account that individual parts of capital best indicate the true value of assets and liabilities, as well as the ability to cover losses.

Calculating total internal capital requirements

Article 12

- (1) The bank calculates total internal capital requirements by adding:
 - 1) internal capital requirements for risks for which, in accordance with the Decision on calculating capital in banks, it is obliged to calculate capital requirements, and
 - 2) internal capital requirements for other significant risks in the bank's operations, which are not covered in Item 1 of this Paragraph.
- (2) The bank is obliged to maintain the available capital at least at the level of the total internal capital requirements.
- (3) If by means of ICAAP it is determined that the internal capital requirements for individual risks are lower than the capital requirements for those risks calculated in accordance with the Decision on calculating capital in banks, the bank shall maintain the level of regulatory capital at least at the level defined by that Decision.

Comparison procedure

Article 13

- (1) The bank is obliged to compare:
 - 1) capital requirements for individual risks calculated in accordance with the Decision on calculating capital in banks and internal capital requirements for individual risks determined within ICAAP,
 - 2) total capital requirements calculated in accordance with the Decision on calculating capital in banks and total internal capital requirements, and
 - 3) regulatory capital and available capital.
- (2) At the end of the business year (as of 31 December), the bank is obliged to calculate:
 - 1) the amount of total internal capital requirements and
 - 2) target level of available capital and regulatory capital, which should be harmonized with the business plan of the bank.
- (3) The bank shall ensure that measures for the improvement of ICAAP are included in its business plan, which must be undertaken in case of identified errors in the calculation of internal capital requirements, and other weaknesses and shortcomings of ICAAP.

Role of control functions in ICAAP

Article 14

- (1) The bank shall, within the risk management function, perform analysis, monitoring and reporting on ICAAP, as well as verification and review of the capital strategy and ICAAP.
- (2) Within the compliance function, the bank shall verify the compliance of the capital strategy and ICAAP with the law, this Decision and the internal acts of the bank adopted in accordance with this Decision.
- (3) The bank shall, within the internal audit function, conduct an assessment of the capital strategy and ICAAP.

Accompanying documentation

Article 15

(1) In addition to the ICAAP Report, the bank is obliged to submit to the Agency all relevant information and accompanying documentation, which includes minutes from relevant meetings of the bank management and the bank supervisory board proving adequacy, efficiency and prudence in establishing, i.e. organizing and implementing ICAAP. This information and documentation shall in particular cover the following aspects, relevant to the assessment of the bank's ICAAP:

- 1) approval of the overall framework for the implementation of ICAAP in the bank, in accordance with the provisions of Article 4 of this Decision,
- 2) approval of the main elements of ICAAP, i.e. phases of the ICAAP procedure, which minimally relate to general objectives and main assumptions, risk measurement and assessment (calculation of internal capital requirements), their adding, determination and distribution of available capital, capital planning, stress scenarios and their main assumptions, stress test results based on these scenarios and similar,
- 3) proof that changes in the bank's risk profile, i.e. individual risks, condition and capital structure, possible exceedances of established internal limits, etc. have been discussed, including decisions of the competent governing body on undertaking or not undertaking measures,
- 4) documenting significant decisions of the bank supervisory board, the bank management, special committees formed by the supervisory board or other bodies on the approval of new products, services or systems which prove that the effect of their introduction on the risk profile and capital of the bank has been taken into account,
- 5) documenting decisions on governing measures related to the calculation of internal capital requirements, their adding and comparison with available capital, from the perspective of the current situation and future condition,
- 6) documentation proving that the results of stress testing have been discussed, as well as the decision-making procedure on undertaking or not undertaking measures in accordance with those results,
- 7) internal self-assessment of ICAAP, by which the bank can argue the level of compliance in relation to the stipulated elements of risk management that affect ICAAP and
- 8) internal audit report on the independent assessment of the established risk management system in the bank, the adequacy of the established ICAAP and similar.

(2) In addition to the ICAAP Report, the bank shall submit all other internal acts referred to in that report.

(3) The bank shall submit the internal audit report on the adequacy of the established ICAAP referred to in Paragraph 1, Item 8 of this Article to the Agency no later than 30 June of the current year.

Manual

Article 16

(1) The bank is obliged to draft a manual (Reader's Manual) which is an accompanying document to the ICAAP Report (hereinafter: the Manual).

(2) The Manual is a comprehensive document that facilitates the understanding and monitoring of the ICAAP Report, providing an overview of all supporting documents related to ICAAP and clear references between reporting information and data with accompanying documentation.

(3) The Manual contains complete and up-to-date information on the status of accompanying documentation (e.g. date of adoption, date of application, date of last amendments, scope of amendments in relation to the previous document, date of last review by internal audit, etc.).

Reporting on ICAAP

Article 17

(1) The bank is obliged to submit to the Agency the ICAAP Report in printed and electronic form with the balance as of 31 December of the previous year no later than 30 April of the current year.

(2) The content and form of the report referred to in Paragraph 1 of this Article are set out in Annex 1, which shall be published on the official website of the Agency.

ICAAP information support

Article 18

(1) Within the strategy of development of its information system, the bank is obliged to define adequate information support to ICAAP, which provides comprehensive, reliable, timely and accurate data processing, i.e. information basis for adequate determination of internal capital requirements to cover all significant risks in bank operations and reporting to the Agency on ICAAP.

(2) The bank is obliged to apply and maintain an adequate information flow that enables efficient implementation of the capital strategy, capital management plans and ICAAP, and which is an integral part of the bank's information system.

Transitional and final provisions

Article 19

(1) This Decision shall enter into force on the eighth day from its publication in the "Official Gazette of Republika Srpska".

(2) This Decision repeals the Decision on internal capital adequacy assessment process in banks ("Official Gazette of Republika Srpska", No. 75/17).

Number: UO-202/20

Date: 16 December, 2020

PRESIDENT OF THE
MANAGEMENT BOARD
Bratoljub Radulović