



March 16, 2016  
Ref. No.: 0966

To: Central 1 Class A Members

**Re: Internal Capital Adequacy Assessment Process (ICAAP) Standards for Central 1  
Credit Union (Central 1)**

In February 2014, FICOM issued the notice [CU-14-001](#) designating Central 1 as a Domestic Systemically Important Financial Institution (D-SIFI). This designation indicates the importance of Central 1's role within the Canadian credit union system. Hence Central 1 is subject to higher standards of regulatory and supervisory oversight, including filing an approved ICAAP report to FICOM annually. Due to Central 1's unique role in the credit union system, FICOM is providing further clarification of the standards (see attached) that Central 1 is expected to meet for its ICAAP.

The ICAAP is a core component of the capital framework promulgated by the Basel Committee on Banking Supervision and is an internationally recognized standard. ICAAP effectively improves risk and capital management and enhances Central 1's ability to manage the risks arising from its activities and to address unexpected events. ICAAP facilitates the supervisory review process by providing FICOM with Central 1's internal perspective of its risk exposure.

If you have any questions regarding the content of this letter, please contact me at [Mehrdad.Rastan@ficombc.ca](mailto:Mehrdad.Rastan@ficombc.ca).

Sincerely,

Mehrdad Rastan  
Executive Director  
Risk Analytics and Reporting  
Financial Institutions Commission

Attachment

PL/db

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- Superintendent of Financial Institutions
  - Superintendent of Pensions
  - Superintendent of Real Estate
  - Registrar of Mortgage Brokers

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## Appendix: Internal Capital Adequacy Assessment Process (ICAAP) Standards for Central 1

| <b>Scope of the ICAAP</b>                    |  |
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| 1.1  | The ICAAP covers the consolidated operations of Central 1. The consolidated operations include operations both provincially and nationally. Capital planning takes into consideration the availability of capital and assets to protect depositors from the business risks of Central 1 and the liquidity risks of the credit union system, including interprovincial transfers of risks.  |
| <b>Board and Senior Management oversight</b> |  |
| 2.1  | The Board approves and oversees the ICAAP implementation. The ICAAP includes the business strategy, risk appetite and tolerance, as well as capital and liquidity plans and related policies.  |
| 2.2  | The Board structures, organizes and tasks itself, its committees and its directors to effectively fulfill its oversight responsibilities with respect to the ICAAP.  |
| 2.3  | The Board has the appropriate level of knowledge to fulfill its responsibilities with respect to the ICAAP.  |
| 2.4  | Senior Management is accountable for designing and implementing the ICAAP, business strategy, risk appetite and tolerance, as well as the capital and liquidity plans.   |
| 2.5  | Senior Management implements comprehensive risk management policies and processes to define, identify, measure, evaluate, monitor, report and control or mitigate all material risks inherent to the business activities and operating environment.  |
| 2.6  | Senior Management implements comprehensive capital management policies and processes. These policies and processes address the capital strategy, the quality and quantity of capital, the roles and responsibilities in capital planning, and the methodology and monitoring of the capital planning functions. These policies and processes produce an internally consistent and coherent view of current and future capital needs. |
| 2.7  | Senior Management implements clear organizational structures with well defined, transparent and consistent lines of responsibilities to govern the ICAAP.  |
| 2.8  | Internal Audit's scope covers reviewing key risk management functions, which include internal capital adequacy and liquidity, regulatory and internal reporting, regulatory compliance and finance functions.  |
| <b>Risk appetite</b>                         |  |
| 3.1  | The risk appetite framework is enterprise-wide, holistic and reflects the business activities and operations. The risk appetite framework addresses all material risks, whether quantifiable or not, and addresses the interests of relevant stakeholders including the credit union system.   |
| 3.2  | The risk appetite framework is approved by the Board, understood and communicated throughout the institution as well as embedded in the culture and operations of the institution.   |
| 3.3  | The risk appetite framework is forward-looking and consistent with the business model, short-term and long-term strategic plans, capital plan, liquidity plan, financial plan, business objectives and corresponding risk mitigation strategies.   |
| 3.4  | The risk appetite framework is supported by information technology and management information systems in order to identify, measure, assess and report risks in a timely manner.   |
| <b>Comprehensive assessment of risks</b>     |  |
| 4.1  | The risk identification and assessment framework takes into consideration Central 1's role within the credit union system, including establishing a comprehensive framework for assessing the impacts to, and the risks from, the credit union system and the credit unions within that system.  |
| 4.2  | Material risks that cannot be directly quantified are closely monitored and mitigated through controls and contingency plans.  |
| 4.3  | Diversification benefits are supported by strong evidence and a robust quantification methodology and are not included for the sole purpose of reducing the amount of capital required.  |

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| 4.4  | The risk identification and assessment framework includes established strategies, governance frameworks, measurement processes, risk management processes, management reporting, and appropriate controls for each category of risk inherent to the business activities. The management processes are commensurate with the size, complexity and strategy of the business activity. |
| 4.5  | Evaluations of additional capital requirements for residual risk or risks that are deemed material but difficult to quantify follow a clear and documented process.   |
| <b>Stress testing and scenario analyses</b>        |   |
| 5.1  | The capital planning process incorporates forward-looking stress testing that identifies possible events or changes in market conditions that could adversely impact Central 1 and the credit union system.   |
| 5.2  | The stress testing framework is enterprise-wide and holistic. It captures the full range of risks, including systemic and emerging risks, and the concentrations and interactions between those risks in stress environments.   |
| 5.3  | Stress testing and scenario analyses are included in risk management activities and decision making by various levels of management.  |
| 5.4  | Stress testing and scenario analyses complement risk quantification methodologies and are based on quantitative models using back-tested data and estimated statistical relationships.  |
| 5.5  | Adequate resources, including information technology resources, are assigned to accommodate flexibility in the stress tests and scenario analyses. The stress tests and scenario analyses are completed at an appropriate level of granularity.   |
| 5.6  | Stress testing and scenario analyses are tailored to assess idiosyncratic risk exposures.   |
| <b>Sound capital assessment and planning</b>       |   |
| 6.1  | The quality of capital is based on the capital instruments' loss absorbing capacity and their permanence. Loss absorbing capacity refers to the ability for the capital instruments to be devalued to absorb losses and the amount to which the capital instruments can absorb losses. Permanence refers to the ability for the capital instruments to remain or become perpetual.  |
| 6.2  | The economic capital assessment and capital planning process states capital adequacy goals, targets and triggers with respect to risk exposure and risk tolerance. The process takes into account the strategic focus, business plan, current levels of risks, anticipated future levels of risk and is forward-looking in nature.  |
| 6.3  | The capital contingency plan includes actions to improve capital ratios if the internal target is breached or under pressure.   |
| <b>Internal controls, monitoring and reporting</b> |   |
| 7.1  | In using internal estimates for risk quantification, those estimates are validated through model validation processes. The ICAAP, stress testing models and forecasting tools also undergo independent reviews.   |
| 7.2  | The control framework ensures reliable, accurate and timely results in the overall ICAAP process.   |
| 7.3  | The Board and Senior Management receive adequate and periodic reporting with respect to the ICAAP.  |
| 7.4  | ICAAP outcomes are incorporated into strategic management and operational management decision making.   |
| 7.5  | The ICAAP report is a self-contained document and is structured to facilitate Board and regulatory reviews.   |