AFB Seminar:
ICAAPs and ILAAPs in a post-Basel 3.1 Landscape

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Association of Foreign Banks (AFB)

foreignbanks.org.uk

Your presenters



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Extensive experience supporting firms on complex prudential assurance and regulatory change programmes, including ICAAP, ILAAP, ICARA, Recovery and Resolution Planning, Basel 3.1 readiness, risk appetite frameworks, model risk reviews, and capital and liquidity assessments. He also leads Skilled Person reviews for the PRA and the FCA covering prudential risks, regulatory reporting, risk management, market abuse, board effectiveness, and governance and culture.

While at Grant Thornton, Kantilal was seconded to the PRA, where he worked on Basel capital requirements, Pillar 3 disclosures and Enhanced Disclosure Task Force initiatives, reporting into the Bank of England's Financial Policy Committee.

Before joining Grant Thornton, he spent 18 years at Bank of America Merrill Lynch as a Senior Director, holding a number of senior finance leadership positions including management of finance functions in 15 regional offices across EMEA, international treasury, and global technology and operations finance.



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John is an expert in prudential regulation and risk and leads our internal audit reviews for bank and building society clients. His work covers risk management frameworks, capital and ICAAP, climate risk, model risk management, IFRS 9 and credit risk.

He has 15 years' experience in prudential supervision at the Bank of England, where he supervised large banks and Uk branches of overseas firms in relationship-managed teams.

He conducted reviews of corporate governance, risk management frameworks, capital (C-SREP), liquidity (L-SREP), remuneration and s166 matters, and credit risk and IRB models.

John then spent seven years at the ICAEW as Technical Manager for risk and regulation. He coordinated responses to UK and international consultations, supported the ICAEW's Risk and Regulation Committee, and wrote thought leadership for financial services members



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Erin is an expert in financial regulation, with a specialisation in capital requirements. She has over 20 years' experience in financial regulation and economic policy.

Working in the Capital Assessment Team within the PRA for four years, Erin conducted numerous C-SREPs for small and medium sized banks and building societies and helped to shape the PRA's policy with respect to the implementation of Basel 3.1, the Strong and Simple Regime and the Pillar 2A Review.

Erin has also worked as a PRA Supervisor for small banks for three years. She has undertaken various financial policy roles within the PRA and FCA including on the Mortgage Market Review and in shaping the UK's negotiating position for the European Mortgage Credit Directive.

Prior to this, Erin worked in central government in both HM Treasury and the Australian Government Treasury, advising Ministers on competition policy and tax policy.

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ICAAP

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The ICAAP moves to a Basel 3.1 basis from 1 January 2027

THE TIMETABLE

ICAAPs signed in 2026

include an impact assessment of Basel 3.1.

1 January 2027

Basel 3.1 and the PS15/26 Pillar 2A changes start together.

ICAAPs from 1 January 2027

Prepared on a Basel 3.1 basis, with the PS15/26 changes included.

2027 to 2030

Output floor for IRB firms: 60% in 2027, 72.5% from 2030.
Pillar 2A Review Phase 2 consultation due in 2027.

WHAT IT MEANS FOR YOUR FIRST POST BASEL 3.1 ICAAP

Closer look at Pillar 1

The PRA is likely to scrutinise your RWA and Pillar 1 calculations in greater detail in the first C-SREP after go-live.

New Pillar 2A numbers

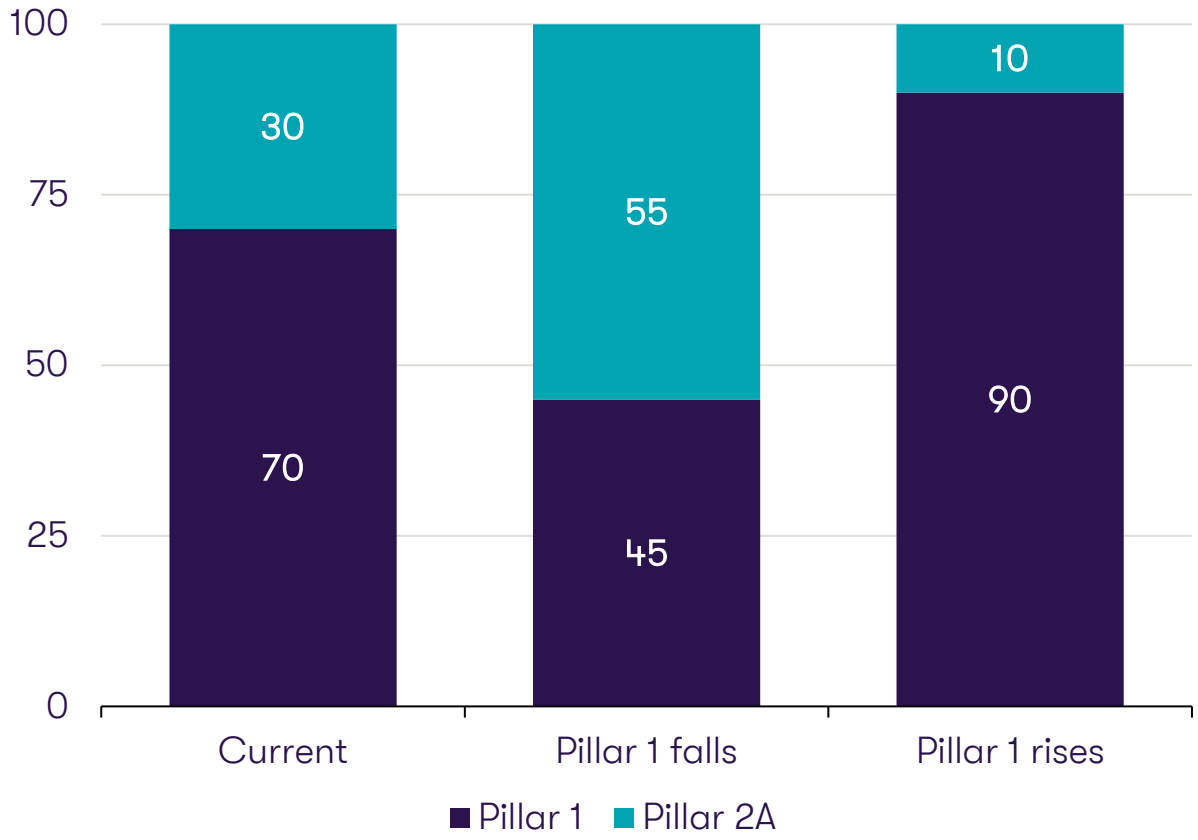
Credit, market, operational and concentration add-ons all move, because they are set net of, or as multiples of, Pillar 1.

New methods for credit risk P2A add-ons

Scenario analysis for some portfolios. Sovereign exposures could be subject to the new systematic P2A add-on.

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Pillar 1 moves, Pillar 2 responds: compare nominal capital



Illustrative: capital needed to cover the risk is 100 in each case.

In many cases, all else being equal, overall capital remains similar

A fall in Pillar 1 RWAs is matched by a rise in Pillar 2A or 2B. A rise is matched by a fall in Pillar 2B.

But the effect is not always balanced

A Pillar 1 rise is offset only if there is Pillar 2A or 2B above the assessed risk to cut. Some falls need no top-up because Pillar 1 now reflects the risk.

Compare nominal capital, not TCR %

£25m is 12.5% of £200m RWAs and 16.7% of £150m RWAs. Same capital, different percentage.

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Credit risk Pillar 2A: benchmark, scenario analysis and systematic add-ons

Minimum effective risk weight	CQS 1	CQS 2-3	CQS 4-6 or unrated
Central governments and banks (not UK)	None	5%	20%
Regional governments, local authorities (not UK devolved)	5%	20%	100%

Add on: Sovereign exposures

Regardless of risk weights under Pillar 1, non-UK sovereign exposures are subject to the minimum effective risk weights above. Pillar 2A add-ons will be applied to achieve these risk weights.

IRB benchmarks removed

The PRA will not publish replacement benchmarks. Under Basel 3.1 the Standardised Approach captures risk better, so the focus moves to your own ICAAP analysis.

Add-on: Retail unconditionally cancellable commitments (UCCs)

Add-on applied to bring effective credit conversion factor (CCF) for retail UCCs from 10% to 20% (or another robustly evidenced point). SMEs exposures are excluded.

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Credit risk P2A: scenario analysis

1

Only where risk may be understated

Niche markets, new products, higher-than-market pricing, high default variance over 12 months, and sub-prime, near-prime, shared equity, lifetime and retirement interest-only mortgages.

2

Choose a proportionate approach

Credit scenarios, proxy-IRB or another robust method.

3

Severe calibration

Scenarios expected to be high severity tail event over 12-month period. More severe than the P2B scenario.

4

Netting needs compelling evidence

Netting undercapitalisation against overcapitalisation requires a high standard of evidence.
Systematic add-ons are the baseline and cannot be reduced.

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Other Pillar 2A risks: what moves and what does not

Risk	What changes from 1 January 2027
Operational risk	Method unchanged. Pillar 2A is net of Pillar 1 so overall nominal operational risk capital stays constant for most firms.
IRRBB	Method unchanged. Potential for changes in Phase 2 of Pillar 2A review.
Concentration risk	Method unchanged. Multipliers apply to RWAs, so the nominal add-on moves as RWAs change under Basel 3.1. Potential for changes in Phase 2 of Pillar 2A review.
Pension obligation risk	PRA published stress scenarios removed. Lighter reporting if the scheme is fully bought-in or at least 130% funded.

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Pillar 2B and what else may move

1

Pillar 2B

The capital surplus reduction in your stress underpins the buffer. Higher risk weights on some lending mean a default costs less capital in the stress, so the level of capital depletion may change.

2

Rebased requirements

The PRA set these pragmatically, not precisely, in its off-cycle review. Expect movement as more precision is applied in next C-SREP.

3

Lending adjustments

The SME and infrastructure support factors leave Pillar 1. Firm-specific Pillar 2A adjustments are designed to compensate.

4

Phase 2 of the review

A further consultation in 2027 on individual Pillar 2A methodologies. Concentration risk and Credit Spread Risk in the Banking Book (CSRBB) are possible areas for change.

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Top tips for a post Basel 3.1 ICAAP

Board challenge

Build in time for Board and committee challenge on scenarios, results, management actions and the final document, and evidence it.

Risk appetite

Explain how capital risk appetite was calibrated and why it suits the business.

Credit analysis

Show that P2A credit risk scenarios are sufficiently severe (e.g. compare impairment rates in the stress against business as usual) and show the impact on different portfolios.

Operational risk

Scenario analysis should cover a variety of costs.

Last C-SREP feedback

Evidence that feedback from the last C-SREP was followed up.

Climate risk

Explain how consideration of climate risk is built into the ICAAP.

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ICAAP stress testing: five tips

1. **Test your own business model**
   If a PRA scenario barely impacts your business model, design one that does.

2. **Show trough and recovery**
   Without the recovery, it is not certain that the trough has been reached.

3. **Evidence severity**
   For example, the impairment rates, PDs, LGDs reached in the stress.

4. **Make it realistic**
   When are risk appetites triggered, and how would the firm respond?

5. **Disclose management actions not used**
   Give details of management actions you could have used but chose not to.

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ILAAP

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ILAAP: what is in force, what is coming, what has changed

THE RULES AND THEIR SCOPE

In force: SS24/15 and ILAA rules

What your 2027 ILAAP is reviewed against: stress testing, intraday, funding and board ownership.

Proposed: CP5/26, not yet final

Consultation closed 17 June 2026. Phase 1 on final rules, phase 2 twelve months later.

Scope: subsidiaries, not branches

The ILAA rules apply to UK banks. UK branches of overseas banks are supervised under SS5/21.

WHAT HAS CHANGED AROUND THEM

Reserves are falling

£643.5bn at end-February 2026, from a £979bn peak. £18.4bn of TFSME matures on 31 March 2027.

Basel 3.1 from 1 January 2027

Selling liquid assets at a loss hits CET1. Size it as a friction in the stress.

Industry pushback

UK Finance and AFME ask for more time and less prescription. Plan to the proposal anyway.

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Stress testing today: what the PRA expects, and where ILAAPs fall short

Area	What the PRA expects now	Where ILAAPs fall short
Scenarios	Institution-specific, market-wide and combined, including a macroeconomic stress	Generic scenarios, not built around the firm's own funding weak points
Granularity	Daily cash flows; the low point inside 30 days and over the survival horizon	Weekly or monthly buckets hide the low point
Behaviour	Retail run-off by segment, channel and size; wholesale by counterparty and tenor	Assumptions taken from the group or a vendor, not evidenced for the UK book
Intraday	Robust analysis of intraday risk, in normal times and in stress	Payment and nostro peaks left out of the stress
Currency and group	Outflows by currency; limits on moving liquidity across entities	Group support assumed, not tested
Conservatism	Explain how conservative it is; sensitivity or reverse stress testing	No defined point of failure; management actions not timed

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The seven-day run is coming: dry-run it in the 2027 cycle

85%

of Silicon Valley Bank's deposit outflows came in two days

25%

of Credit Suisse's came over seven days

The LCR assumes 30 days.

1

You design it

Sudden, severe outflows that peak in the first days. Focus on week one. You set the outflow rates and show the drivers.

2

You assess the frictions

Selling or repoing in markets, drawing at the central bank, your own sign-off delays, and the capital hit of selling at a loss.

3

What the industry is asking for

Fold it into existing scenarios, no day-by-day outflow rules, and clarity on calendar or working days.

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Liquidity only counts if you can use it quickly

Bank of England facilities

Short-Term Repo: seven days, Bank Rate
Indexed Long-Term Repo: six months, weekly
Operational Standing Facility: overnight, Bank Rate + 0.15%
Discount Window: bilateral, on demand

Ready to draw

Regular facilities would count towards the adequacy rule if you are onboarded, eligible, collateral in place, and tested.

Emergency liquidity assistance never counts.

Drawing capacity

After haircuts, by legal entity and currency, plus what a full draw would give.

Example: £2,000m of gilts at a 5% haircut gives £1,900m.

Test sales of Level 1 assets

A yearly sale or repo of a representative sample, gilts included. The current exemption would go.

Relying on your home central bank? Show sufficient certainty of access. Some jurisdictions make that hard.

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Foreign groups: test the group support you assume

FIVE THINGS TO EVIDENCE

Transfer limits

Legal, regulatory and operational limits on moving cash and assets between entities

Trapped liquidity

At entity, sub-group and group level, and how conservative your estimate is

Group repayment

What happens if a group entity fails to repay you on time

Currency

Outflows by currency, with foreign exchange markets assumed impaired

Parent support

The PRA may ask for evidence of the parent's capacity and intent to support

Branches

Outside the ILAA rules. Supervised under SS5/21.

Limits: £130m FSCS-covered, £300m total retail instant access, 5,000 transactional customers.

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Where firms will struggle, and what to start now

Start now

Phase 1 has no transition period.

1. Map your ILAAP to SS24/15 and CP5/26, with an owner for each gap
2. Onboard to the Bank, pre-position collateral, run a test draw
3. Dry-run the seven-day stress in the 2027 ILAAP



Data

Daily cash flows by entity and currency. Many firms design the stress before the data exists.



Evidence for assumptions

Little UK deposit history. Show what each assumption rests on and how conservative it is.



Collateral and facilities

Onboarding, eligibility checks and collateral approvals take months.



UK board ownership

The group sets the assumptions. The UK board must understand, challenge and approve them.

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ICAAP and ILAAP: preparing for the SREP

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Preparing for a C-SREP and L-SREP

1

Refresh interviewees

Key interviewees know the ICAAP and ILAAP content and process.

2

Board knowledge

Board members should be able to discuss the challenge they gave and the key messages they took from the document.

3

Second line contribution

Risk should show what difference they made.

4

Reconcile to returns

ICAAP figures should align with the regulatory returns submitted.

5

Know your gaps

Be ready to discuss the improvements still to make.

6

Questions on notice

It is fine to take a question on notice and revert.

First post Basel 3.1 C-SREP likely to focus on Pillar 1 - Be prepared with documented interpretations.

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