

Basel Pillar II for Banks Global Regulations (2025)

1. Pillar 2 Supervisory Review Process (SRP)

- **Process:** The Pillar 2 Supervisory Review Process (SRP) ensures that banks maintain adequate capital to support all risks in their business and develop better risk management techniques. This process involves the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP).
- **Risk:** Inadequate capital buffers to cover risks, leading to potential financial instability.
- **Risk Rating:** High
- **Control:** Regular stress testing and scenario analysis to assess capital adequacy under adverse conditions.
- **Test:** Conduct periodic stress tests and compare results against regulatory thresholds to ensure compliance.

Reference: Overview of Pillar 2 supervisory review practices and approaches

2. Internal Capital Adequacy Assessment Process (ICAAP)

- **Process:** ICAAP requires banks to assess their capital needs based on their risk profile and ensure they have sufficient capital to cover all risks, including credit, market, operational, and liquidity risks.
- **Risk:** Underestimation of risk exposure, leading to insufficient capital reserves.
- **Risk Rating:** Medium
- **Control:** Implement robust risk assessment models and regularly update risk parameters.
- **Test:** Validate risk models through back-testing and sensitivity analysis.

Reference: Basel Framework - Bank for International Settlements

3. Supervisory Review and Evaluation Process (SREP)

- **Process:** SREP is conducted by regulators to evaluate banks' risk management practices and capital adequacy. It includes assessing the quality of governance, risk management, and internal controls.
- **Risk:** Weak governance and risk management practices, leading to regulatory non-compliance.
- **Risk Rating:** High
- **Control:** Establish a strong governance framework and enhance risk management capabilities.
- **Test:** Conduct internal audits and regulatory compliance checks to ensure adherence to SREP requirements.

Reference: Pillar 2 requirement - ECB Banking Supervision

4. Pillar 2 Capital Requirement

- **Process:** Pillar 2 capital requirement is a bank-specific capital requirement that supplements the minimum capital requirement (Pillar 1). It is determined based on the bank's risk profile and the outcomes of the ICAAP and SREP.
- **Risk:** Insufficient capital to cover bank-specific risks, leading to potential solvency issues.
- **Risk Rating:** High
- **Control:** Maintain a capital buffer above the regulatory minimum and conduct regular capital adequacy assessments.
- **Test:** Perform capital adequacy ratio (CAR) calculations and compare against regulatory benchmarks.

Reference: Basel Capital Adequacy Reporting (BCAR) - OSFI

5. Pillar 2 Disclosure Requirements

- **Process:** Pillar 2 requires banks to disclose information on their risk management practices, capital adequacy, and the outcomes of the ICAAP and SREP. This promotes transparency and market discipline.
- **Risk:** Inaccurate or incomplete disclosures, leading to reputational damage and loss of investor confidence.
- **Risk Rating:** Medium
- **Control:** Implement robust disclosure policies and ensure accurate reporting of risk and capital information.
- **Test:** Conduct periodic reviews of disclosure documents to ensure accuracy and completeness.

Reference: Pillar 3 Disclosure Guideline for Domestic Systemically Important Banks (D-SIBs)

PRCT Matrix for Each Point

| Process | Risk | Risk Rating | Control | Test |
|--------------------------------------|---|-------------|--|---|
| Pillar 2 Supervisory Review Process | Inadequate capital buffers to cover risks, leading to financial instability | High | Regular stress testing and scenario analysis | Conduct periodic stress tests and compare results against regulatory thresholds |
| Internal Capital Adequacy Assessment | Underestimation of risk exposure, leading to insufficient capital reserves | Medium | Implement robust risk assessment models and regularly update risk parameters | Validate risk models through back-testing and sensitivity analysis |
| Supervisory Review and Evaluation | Weak governance and risk management practices, leading to non-compliance | High | Establish a strong governance framework and enhance risk management capabilities | Conduct internal audits and regulatory compliance checks |

| Process | Risk | Risk Rat- ing | Control | Test |
|----------------------------------|---|---------------------|--|--|
| Pillar 2 Capital Requirement | Insufficient capital to cover bank-specific risks, leading to solvency issues | High | Maintain a capital buffer above the regulatory minimum | Perform capital adequacy ratio (CAR) calculations and compare against benchmarks |
| Pillar 2 Disclosure Requirements | Inaccurate or incomplete disclosures, leading to reputational damage | Medium | Implement robust disclosure policies and ensure accurate reporting | Conduct periodic reviews of disclosure documents to ensure accuracy |

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