

**AIB Directive on Capital Adequacy and Stress Testing
August 14, 2023**

1. Overriding objectives

- 1.1 This Directive establishes rules, processes and parameters to ensure that the regular capital adequacy and stress test exercises are in compliance with the Bank's Capital Adequacy and Stress Testing (CAST) Policy (Sec2018-061). It shall facilitate the attainment of an efficient utilization of the Bank's available capital using modern and state-of-the-art methodologies of capital adequacy planning and stress testing.
- 1.2 The exercise and interpretation of this Directive shall be consistent with the Bank's Financial and Risk Management Policy, as amended from time to time, and seek to give effect to this overriding objective and to ensure that the Bank's capital adequacy is acceptable in view of the Bank's Risk Appetite Statement (RAS) approved by the Board of Directors on the annual basis .

2. General Principles

- 2.1 Capital must be assigned using Economic Capital (ECap) and measured against the Bank's available capital stock, ensuring the Bank is adequately capitalized, even in times of stress.
- 2.2 To ensure that the Bank's AAA rating can be maintained even under a severe and prolonged crisis period, an additional capital buffer is required, whose size is estimated under stressed conditions. Scenarios are selected to represent crises the severity of which shall correspond to (at a minimum) a 1-in-25-year event. Through these mechanics a buffer is created, not only for capital conservation, but also for having adequate countercyclical lending capacity during times of stress.
- 2.3 Capital Adequacy is primarily assessed as a function of the ECap utilization ratio against Available Capital ($\text{Ecap} + \text{Buffer} / \text{Available Capital}$, ECUR). This ratio is constrained by the Bank's RAS and must be below 100%.

2.4 Stress testing within this Directive is applicable as the assessment of capital adequacy and the RAS. This does not preclude RMD providing additional types of stress testing for Business as Usual (BAU) risk factor exposure evaluation purposes.

3. Definitions

3.1 A Scenario is a plausible event used to determine the Bank's ability to withstand a prolonged and severe shock, used to assess capital adequacy and the RAS.

3.2 The Income test is the portion of the stress test which determines the impact on the Bank's income statement and hence its available capital resources from a Scenario.

3.3 The Solvency test determines the resultant change in the Bank's ECap requirements, arising from a Scenario.

4. Roles and Responsibilities

4.1 The Risk Committee (RC) shall exercise its duties in accordance with its responsibilities. With respect to CAST, RC will review and approve the Scenario choice and the output of the capital adequacy assessment prior to their presentation to the Audit and Risk Committee (ARC).

4.2 The Risk Management Department (RMD) is the central unit for assessing, monitoring and reporting the Bank's capital adequacy status. RMD is responsible for:

- a. Calculating on an: as-is, projected, and additional marginal business bases the Bank's:
 - i. ECap requirements (all bases)
 - ii. Size of available capital (projected basis only)
 - iii. Loan loss provisions (all bases)
- b. Reporting to ARC on the choice of Scenarios, and reporting to the Board on AllB's capital adequacy status.
- c. Determining the necessary size of the buffer to ensure capital adequacy in times of stress for year-end reporting
- d. Developing the processes, methodologies and rules to assess capital adequacy under normal conditions and under a stress Scenario.

- e. Chairing the stress test working group formed of departments across the Bank to ensure a thorough and effective forecast of the capital adequacy, which shall propose the choice of Scenarios.
- f. Developing BAU stress tests as required to provide effective risk management as needed.

4.3 Office of the Treasurer (TRE):

- a. Shall calculate projected net income, inclusive of costs.
- b. Build and provide balance sheet forecasts for long term financial projection purposes, including the projected disbursed and outstanding amounts.
- c. Outline applicable management actions which may be taken under stressed conditions.
- d. Detail the projected composition of the liquidity portfolio

4.4 Policy and Strategy (P&S) shall produce:

- a. 3-year projections on:
 - i) Business volumes
 - ii) Intended composition between sovereign / non- sovereign
 - iii) Subscribed capital forecasts
 - iv) Likely pipeline structure
 - v) Administrative expenses growth rate projections
- b. Potential growth rates thereafter of business volumes to 10 years

4.5 Economics (ECON) shall determine the narrative and severity of the inputs in the macroeconomic Scenarios.

4.6 Investment Operations (IO) shall review that the projected lending under each Scenario is consistent.

4.7 Office of the Controller (CTL) will provide the overall starting positions.

5. Draft business plan review

5.1 The Bank maintains a detailed set of Key Risk and Performance Indicators to ensure that its exposures are within its agreed RAS. As part of the stress testing of a proposed business plan, these will be assessed by RMD to determine whether the draft business plan would remain within the Bank's RAS.

5.2 An assessment will determine the size of the buffer required to ensure that the Bank has sufficient available capital even in the event of stress and is inclusive of projected business growth.

5.3 If remedial actions are required to bring the Bank within its RAS or limits, RMD will inform the Board of these as well as their impact on capital adequacy using the next quarterly Risk update.

6. Information Disclosure by AIB

6.1 The Bank's Public Information Policy and its related Directive and Administrative Guidance governs the disclosure of all information in the Bank's possession, including with respect to this Directive.

7. Implementation

7.1 The CRO shall oversee the CAST Policy, this Directive and introduce any related Administrative Guidance and ensure their efficient and accurate implementation.

8. Authority

8.1 The CRO shall make all final decisions regarding the application of this Directive.