REPUBLIC OF ALBANIA
BANK OF ALBANIA
SUPERVISORY COUNTICL

GUIDELINE

Nr 2, dated 1.12.2021

ON
INTERNAL LIQUIDITY ADEQUACY ASSESSMENT PROCESS

Pursuant to Article 3, point 3, Article 12 “a” and Article 43 “c” of the Law No. 8269, dated 23.12.1997 “On the Bank of Albania” as amended, of Article 57, 58 and 66 of the Law No. 9662, dated 18.12.2006 “On banks in the Republic of Albania” as amended, the Bank of Albania’s Supervisory Council having regard to the proposal from Supervision Department,

INSTRUCTS:

General requirements

1.1 Purpose of the Guideline

The purpose of this Guideline is to set out supervisory requirements relating to the strategies, strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intraday, so as to ensure that the banks maintain adequate levels of liquidity buffers.

1.2 Scope of Application

This Guideline will be applied to banks and branches of foreign banks, at both individual and consolidated basis

1.3 Definitions

1. The terms used in this Guideline shall have the same meaning of the terms defined in the Law on banks, in the Regulation on liquidity risk management and in the Regulation on liquidity coverage ratio.

2. In addition to paragraph 1 of this Article, for the purposes of this Guideline, the following terms/definitions shall apply:

   a) **"funding liquidity risk"** shall be the risk that over a specific time horizon the bank will become unable to settle obligations as they fall due;

   b) **"counterbalancing capacity"** shall be the bank's ability to hold, or have access to, excess liquidity over the short-term, medium-term and long-term time horizons, in response to stress scenarios;

   c) **"intraday liquidity"** shall be the funds that can be accessed during the business day, usually to enable the banks to make payments in real time; janë fondet, të cilat mund të aksesohen gjatë ditës së punës, zakonisht për të mundësuar bankat që të kryejnë pagesat në kohë reale;

   d) **"intraday liquidity risk"** shall be the current or prospective risk that the bank will fail to manage its intraday liquidity needs effectively;

   e) "**funding risk**" shall be the risk that the bank cannot meet its financial obligations, such as payments and collateral needs, as they fall due, in the medium to long term, either at all, or without increasing funding costs unacceptably;

   f) "**liquidity and funding risk**" shall be distinct risks that, should they materialise, will have a significant prudential impact on the bank's liquidity, over different time horizons;

   g) **"short term period"** shall be a period up to 3 months, including intraday, and with a strong focus on the first month;

   h) **"medium term period"** shall be a period of 3 to 12 months;

   i) **"long term period"** shall be a period over a 1-year time horizon;

   j) "**survival period**" shall be the period during which the bank can continue operating under stressed conditions and still meet its payments obligations;

   k) **"liquidity contingency plan"** shall be the group of policies, procedures and action plans for responding to severe disruptions to a bank's ability to fund some or all of its activities, in a timely manner and at a reasonable cost;

   l) **"liquidity risk appetite/tolerance"** shall be the level of liquidity risk, that a bank is willing to accept;

m) **“time specific obligations”** shall be the obligations, which must be settled at a specific time within the day, or have an expected intraday settlement deadline.

1.4 General requirements on liquidity adequacy

Banks shall at all times maintain necessary liquidity resources, which are adequate both in terms of amount and quality, and ensure that they (the banks) will not be exposed to significant risks, that cause the non-settlement of their obligations as they fall due. To ensure overall levels of liquidity adequacy, banks shall ensure that:

(a) their liquidity resources contain an adequate buffer of high quality, unencumbered assets; and
(b) they maintain a prudent funding profile.

Banks shall not include in the liquidity resources that are reckoned in the liquidity buffers any emergency liquidity assistance that may be available from Bank of Albania (or from other central banks, in the case of foreign subsidiaries/branches of the banks).

Internal Liquidity Adequacy Assessment Process (ILAAP)

ILAAP consists of the following elements:

(a) liquidity risk assessment;
(b) funding risk assessment;
(c) liquidity and funding risk management;
(d) assessment of additional liquidity requirements under ILAAP.

Liquidity Risk Assessment

Liquidity risk assessment is the first step in conducting ILAAP. The bank should identify and assess its liquidity risk, against the parameters described below in this Guideline.

3.1 Short-term and medium-term liquidity needs

Banks should assess their liquidity needs in the short term and medium term under both normal and stressed conditions. In these assessments, banks should take into account:

(a) the bank’s stressed liquidity needs at different time horizons (before 30 days, between 30 days and 3 months, and after 3 to 12 months, and specifically the effect on the bank’s liquidity needs (net cash outflows) of severe but plausible stresses, to cover idiosyncratic, market-wide and combined shocks;

(b) the size, location and currency of the liquidity needs and, where the bank operates in different material currencies, the separate impact of shocks in the different currencies, to reflect currency convertibility risk;

(c) risks arising in respect of wholesale counterpartes regarding on-balance sheet items and funding concentrations, and taking into account actions the bank may take to preserve its reputation/franchise;

(d) risks arising in respect of contingent cash flows/off-balance-sheet items (for example, credit lines, margin calls[1]) and activities (for example, liquidity support for unconsolidated special-purpose vehicles beyond contractual obligations), taking into account actions the bank may take to preserve its reputation/franchise;

(e) inflows and outflows on a gross basis as well as a net basis. Where there are very high inflows and outflows, there may be risk that inflows are not received when expected;

(f) risks arising in respect of retail counterparties, taking into account actions the bank may take to preserve its reputation/franchise; and

(g) the risk that excessive risks in the medium- to long-term funding profile will adversely affect the behaviour of counterparties relevant to the short-term liquidity position.

3.2 Intra-day management of liquidity

3.2.1 The bank must actively manage its intra-day liquidity positions and any related risks so that it is able to meet its payment and settlement obligations on a timely basis bothe in normal times and under stress. The main objectives of the bank, during the intra-day liquidity management process are to (a) identify and prioritise time-specific and other critical obligations in order to meet them when expected, and (b) settle other less critical obligations as soon as possible. In the assessment of its intraday liquidity risk, the bank should take into account at least six operational elements of liquidity risk management:

[1] A ***margin call*** refers specifically to a broker's demand that an investor deposit additional money or securities into the account, so that it is brought up to the minimum value, known as the maintenance margin.

(a) capacity to measure expected daily gross liquidity inflows and outflows, anticipate the intraday timing of these flows where possible, and forecast the range of potential net funding shortfalls, that might arise at different points during the day;

(b) capacity to monitor intraday liquidity positions against expected activities and available resources (balances, remaining intraday credit capacity, available collateral);

(c) arrangements to acquire sufficient intraday funding to meet its intraday objectives from various sources such as the central bank, correspondent or custodian banks;

(d) ability to manage and mobilise collateral as necessary to obtain intraday funds;

(e) capability to manage the timing of its liquidity outflows, in line with its intraday objectives;

(f) preparedness to deal with unexpected disruptions to its intraday liquidity flows. To minimise such potential disruptions, a bank's stress testing and contingency funding plans should reflect intraday considerations.

3.2.2 Policies, procedures and systems should support these operational objectives in all of the financial markets and currencies in which it has significant payment. The tools and resources applied by the bank should be tailored to the bank's business model and role in the financial system, as well as how it conducts its activities for a particular market, (eg via direct participation in a payment or settlement system or via correspondent or custodian banks) and whether it provides correspondent or custodian services and intraday credit facilities to other banks, firms or systems.

3.3 Adequacy of liquidity buffer and counterbalancing capacity

3.3.1 Banks should assess the adequacy of their liquidity buffer and counterbalancing capacity to meet their liquidity needs within a month as well as over different time horizons, potentially up to 1 year, including overnight. This assessment should take into account:

(a) the directly available liquidity buffers or the bank's survival (normal functioning) periods, under different stress scenarios;
(b) the overall counterbalancing capacity, available to the bank over the full period of the relevant stress scenario;
(c) the characteristics, such as severity and duration of different stress scenarios and periods considered in the assessment of the bank's liquidity needs;

(d) the amount of assets that would need to be liquidated over the relevant time horizons;
(e) whether the actual liquidity buffer and counterbalancing capacity, including the quality of liquid assets, are in line with the banks' liquidity risk tolerance; and
(f) the classification and quality of liquid assets, as specified in the Regulation no. 27, dated 28.3.2019, on Liquidity Coverage Ratio and in the Regulation no. 70, dated 2.12.2020 on Net Stable Funding Ratio.

3.3.2 Banks should be able to monetise their liquid assets in a timely fashion to meet their liquidity needs during a stress period. To ensure this the bank should:
(a) test its market access, by selling or repoing on a periodic basis;
(b) avoid high concentrations that may represent a risk of overestimation of the liquidity buffer and counterbalancing capacity;
(c) ensure that the assets in the buffer are unencumbered, under the control of the relevant staff and readily available, for liquidity management purposes;
(d) ensure that the forecasting/planning of the liquid assets is consistent with the distribution of liquidity needs by currency;
(e) where the bank has borrowed liquid assets, take into account the assets it has to return during a short-term liquidity stress period, which would mean that the bank would no longer have these assets available to meet its stressed outflows, considering the net effect of the transaction; and
(f) take into account the likely value of committed liquidity facilities available from the Bank of Albania, or central banks in other jurisdictions, where the bank may be operating. These facilities should be included in the counterbalancing capacity, only to the extent permitted by Bank of Albania/other central banks.

Inherent funding risk assessment

4.1 Bank's funding profile

4.1.1 Bank's funding profile, including both medium- and long-term contractual and behavioural mismatches, should be appropriate in relation to its business model, strategy and risk tolerance. In evaluation of its funding profile, the bank should take into account:

(a) the extent to which its medium- and long-term obligations are adequately met with a range of stable funding instruments and whether its actual mismatches over the relevant time horizons are within acceptable boundaries in relation to the bank's business model;

(b) any gap between the desired funding profile and the bank's actual funding profile;
(c) regulatory and contractual factors affecting the behavioural characteristics of funding providers (e.g. regulations regarding clearing, bail-in, deposit guarantee schemes, etc., as they may influence the behaviour of funding providers), particularly when there are material changes or differences between jurisdictions in which the bank operates; and
(d) the fact that maturity transformation will lead to a certain level of mismatches, but ensure that these must remain within manageable and controllable boundaries, to prevent collapse of the business model during stress periods or changes in market circumstances.

4.1.2 Banks should keep in view that potential shortcomings arising from their funding profile, such as maturity mismatches breaching acceptable boundaries, excessive concentrations of funding sources, excessive levels of asset encumbrance or inappropriate or unstable funding of long-term assets, could lead to an unacceptable increase in the cost of funding for the bank. They should take into account:

(a) the risk of funding being rolled over at higher interest rates, where there is an excessive dependence on specific sources of funding;
(b) the risk of funding needs of the bank soaring or the sources of funding perceiving the bank as having a riskier profile, especially when it is not likely that those higher costs will be transferred automatically to clients; and
(c) increasing level of asset encumbrance above acceptable limits, which would likely reduce access to and increase the price of unsecured funding.

4.2 Stability of the funding profile

4.2.1 Banks should maintain a stable funding profile. In evaluation of the appropriateness of their funding profile, banks should consider factors that may reduce the stability of the funding profile in relation to the type and characteristics of both assets and liabilities. In this regard, banks should take into account :

(a) the fact that some specific asset classes will be more significant than others to the bank and/or the system;
(b) the structural maturity mismatch between assets and liabilities in different significant currencies, where applicable, as well as in aggregate, and how currency mismatches overlaying structural maturity mismatches affects the overall risk to the stability of the funding profile; and
(c) appropriate structural funding metrics (appropriate to the bank's business model). Examples of structural funding metrics may include loan/deposit ratio, customer

funding gap and behaviourally adjusted maturity ladder (of which the net stable funding ratio metric is a particular example).

4.2.2 Banks should assess risks to the sustainability of the funding profile arising from concentrations in funding sources and they should take into account respectively:

(a) concentrations in different respects, notably and where applicable: the type of funding instruments used, specific funding markets, single or connected counterparties and other concentration risks that may affect access to funding in the future (focusing on the markets and instruments relevant to the long-term funding profile and noting that their view on concentration risk in the short-term liquidity profile may be relevant); and

(b) the risk that asset encumbrance may have an adverse effect on the market's appetite for the unsecured debt of the bank (in the context of the specific characteristics of the market(s) in which the bank operates and the bank's business model).

Factors for this assessment may include:

- the total amount of encumbered and/or borrowed assets compared with the balance sheet;
- the availability of free assets (assets that are unencumbered but that may be encumbered), especially when considered in relation to total unsecured wholesale funding;
- the level of overcollateralization[2] relative to the capital base; and
- the implications of the level of overcollateralization for the deposit insurance scheme, if the bank fails.

4.3 Ease of market access

4.3.1 Banks should be aware of their actual market access and current and future threats to this market access. Banks should take into account the following factors, in determination of market access under stress:

(a) any information of which they are aware, including information from the bank itself, indicating that the bank makes high demands on particular markets or counterparties

[2] Overcollateralization refers to the extent to which the value of the assets used to obtain secured funding exceeds the notional amount of funding obtained (e.g. if ALL 120 of assets are used for ALL 100 of secured funding, the overcollateralization is ALL 20).

(including central banks) that are important to it, relative to those markets'/counterparties' capacity;

(b) any significant or unexpected changes in the issuance of debt of which the bank becomes aware in each significant market (including markets in significant currencies). Banks should also assess whether any such changes are due to the strategic choices of the bank, or whether they are signs of reduced market access;

(c) the risk that news about the bank may negatively influence the market (perception/confidence) and therefore its market access. (such news may, or may not, yet be known to the market); and

(d) signs/warnings that short-term liquidity risks (e.g. when short-term liquidity risk is assessed as high) may reduce the access the bank has to its major funding markets

4.4 Expected change in funding risks based on banks' funding plan

The bank should be aware of the limitations of its funding plan. The bank should assess the expected change in funding risks, based on the funding plan. This assessment should take into account:

(a) the way the bank's funding plan, when executed in full, will affect its funding risks, (bearing in mind that the execution of the funding plan may increase or decrease the risks in the funding profile); and

(b) the feasibility of the funding plan.

Liquidity and funding risk management

5.1 Liquidity risk and funding risk appetite/tolerance

(i) The bank's board must establish the bank's liquidity risk and funding risk appetite/tolerance and document it appropriately. The bank should ensure that its liquidity risk appetite/tolerance and funding risk appetite/tolerance are appropriate for its business strategy and reflect its financial condition and funding capacity. The liquidity risk appetite/tolerance statement should clearly define the duration and type of stresses, that the bank aims to survive

(ii) The bank's board should set the liquidity risk appetite/tolerance of the bank, in light of its business objectives, strategic direction and overall risk appetite/tolerance. The appetite/tolerance should reflect the bank's financial condition, its role in the financial system, its funding capacity and ensure that the bank manages its liquidity strongly in normal times, in such a way that it is able to withstand a prolonged period of stress. The risk appetite/tolerance should be articulated in such a way that all levels of management clearly understand the trade-off between risks and profits.

(iii) The liquidity risk appetite/toleance and the funding risk appetite/tolerance should be communicated to all relevant business lines. This should be disaggregated/detailed in the form of appropriate limits, which may include gap limits or concentration limits around currency, funding sources, the makeup of liquid asset buffers and the bank's structural liquidity position.

(iv) The liquidity risk appetite/tolerance must be reviewed annually, in order to reflect any changes in the bank's financial condition, funding capacity and its role in the financial system.

5.2 Organisational framework, policies and procedures

(i) To meet the liquidity adequacy requirement, the bank must have in place robust strategies, policies, processes and systems that enable it (the bank) to identify, measure, manage and monitor liquidity risk and funding risk, over an appropriate set of time horizons, including intra-day, so as to ensure that it maintains adequate levels of liquidity buffers and an appropriate funding profile. These strategies, policies, processes and systems must be tailored to business lines, currencies, branches and legal entities of the banking/financial group and must include adequate allocation mechanisms of liquidity costs, benefits and risks.

(ii) The strategies, policies, processes and systems to meet the liquidity adequacy requirement must be proportionate to the complexity, risk profile and scope of operation of the bank, the liquidity risk appetite/tolerance and funding risk appetite/tolerance set by the bank's management and must reflect the bank's importance, in each country in which it carries on business.

(iii) The bank must, taking into account the nature, scale and complexity of its activity, have liquidity risk profiles and funding risk profiles, that are consistent with and not in excess of those necessary for a well-functioning and robust system.

(iv) The bank must put in place risk management policies to define its approach to asset encumbrance, as well as procedures and controls that ensure that the risks associated with collateral management and asset encumbrance are adequately identified, monitored and managed.

(v) The bank should have an appropriate organisational framework for liquidity and funding risk management, measurement and control functions, with sufficient human and technical resources to develop and implement these functions and to carry out the required monitoring tasks. The organisational framework should comprise:

a) control of liquidity risk control and monitoring systems and processes by independent control functions;
b) coverage by the risk management, measurement and control functions of liquidity risk in the entire bank, and in particular all areas where liquidity risk can be taken, mitigated or monitored;
c) a set of liquidity and funding policy documents, that are adequate for promoting prudent behaviour by the bank's staff and allowing for efficient operation of the control functions; and
d) creation of appropriate internal written policies and procedures for the management of liquidity and funding risk, as well as the adequacy of the bank's liquidity and funding risk management framework.

(vi) Banks should maintain adequate market access in their significant funding markets. Towards this end, the bank should:

a) test market access periodically;
b) develop strong relationships with funds providers, to lower the risk of its market access being reduced; and
c) demonstrate that the bank would continue to have ongoing market access in times of stress (even though it may be more expensive for the bank to do so, at such times).

5.3 Risk identification, measurement, management, monitoring and reporting

5.3.1 Banks should have an appropriate framework and IT systems for identifying and measuring liquidity and funding risk, in line with their size, complexity, risk tolerance and risk capacity. Specifically, the bank should:

a) implement appropriate methods for projecting its cash flows, over an appropriate set of time horizons, assuming business-as-usual and stress situations, and comprehensively across material risk drivers;

b) use appropriate key assumptions and methodologies, which are regularly reviewed, recognising interaction between different risks (credit, market, etc.), arising from both on- and off-balance sheet items;

c) include all relevant, material legal entities, branches and subsidiaries, in the jurisdiction in which the bank is active; and

d) understand its ability to access financial instruments wherever they are held, having regard to any legal, regulatory and operating restrictions on their use, including, for example, the inaccessibility of assets due to encumbrance, during different time horizons.

5.3.2 Banks should have an appropriate reporting framework for liquidity and funding risk. They should specifically:

a) set out reporting criteria agreed by senior management, specifying the scope, manner and frequency of liquidity and funding risk reporting and who is responsible for preparing the reports set out reporting criteria agreed by the Directorate/executive directors, specifying the scope, manner and frequency of liquidity and funding risk reporting and who is responsible for preparing the reports;

b) ensure that the information systems, management information and internal information flows supporting liquidity and funding risk management are appropriate and the data and information used are understandable for the target audience, accurate and usable (e.g. timely, not overly complex, within the correct scope, etc.); and

c) ensure that specific reports and documentation containing comprehensive and easily accessible information on liquidity risk are submitted regularly to the appropriate recipients (such as the Steering Council, Directorate/executive directors, or the asset-liability committee).

5.3.3 Banks should assess the adequacy of the process of measuring intraday liquidity risk and they should ensure:

a) to adequately monitor and control cash flows and liquid resources available to meet intraday requirements and to forecast when cash flows will occur during the day; and
b) to carry out adequate specific stress testing for intraday operations.

5.3.4 Banks should have a set of indicators, regarding the liquidity and funding position, that are appropriate to the business model, the nature, scale and complexity of the bank's activity.

(i) The indicators should adequately cover the bank's key structural funding vulnerabilities, covering the following aspects, where appropriate:

a) the degree of dependence on a single market or an excessively small number of markets/counterparties;
b) the ‘stickiness’ of funding sources and factors driving behaviour;
c) the concentration of particular instruments;
d) the concentration of activities in different currencies;
e) major concentrations of maturities and maturity gaps over the long term period.

(ii) The indicators should be adequately documented, periodically revised, used as inputs to define the risk tolerance of the bank, part of bank’s management reporting and used for setting operating limits.

5.4 Bank’s liquidity specific stress testing

(i) The bank should conduct stress tests on a regular basis for a variety of short-term and protracted bank-specific and market-wide stress scenarios (individually and in combination) to identify sources of potential liquidity strain and to ensure that current exposures remain in accordance with a bank’s established liquidity risk tolerance. The bank should assess possible impacts of the stress on the bank’s cash flows, liquidity position, profitability and solvency.

(ii) The bank must consider alternative scenarios on liquidity positions and on risk mitigation techniques and must review the assumptions underlying decisions concerning the funding position at least annually.

(iii) Stress tests should be conducted both at the consolidated group level and solo level. The bank should assess whether additional tests are necessary for individual entities (e.g. subsidiaries and branches) within the group, that are exposed to significant liquidity risks. Tests should consider the implication of the scenarios across different time horizons, including on an intraday basis.

(iv) In designing stress scenarios, the bank should take into account the nature of the bank’s business, activities and vulnerabilities so that the scenarios incorporate the major funding and market liquidity risks, to which the bank is exposed.

(v) The bank should specifically take into account the link between reductions in market liquidity and constraints on funding liquidity. This is particularly important for big banks/systemically important, or with heavy reliance upon specific funding markets.

(vi) The bank must consider the potential impact of bank-specific, market-wide and combined alternative scenarios, different time periods and varying degrees of stressed conditions.

(vii) The bank should take a conservative approach when setting stress testing assumptions. Based on the type and severity of the scenario, these assumptions should reflect different sources of risks that can potentially impact the bank's liquidity and funding position. The following is an illustrative list of risk factors relevant for liquidity stress testing:

a) factors affecting banks' ability to liquidate assets or monetise them through sale or repurchase agreements that may change in stress. These may include market access, haircuts, timelines, pricing, operational capacity or eligibility;

b) duration for which the bank would like to withstand the liquidity stress given its risk appetite/tolerance (beyond the 30-day horizon applicable under the Regulation on liquidity coverage ratio);

c) the run-off of retail funding (beyond the run-off rates applicable under the Regulation on liquidity coverage ratio) taking into account various factors such as guarantee cover, maturity, interest rate sensitivity, customer type, product type, deposit size, or the channel through which the deposits were affected;

d) availability of secured and unsecured wholesale funding sources depending on type and geographical location of the counterparty, the level of creditor seniority, the nature of the relationship the bank with the counterparty, the type of underlying collateral (if applicable), and the speed of outflow. The risk of shortening tenors should also be assessed;

e) the correlation between funding markets or the effectiveness of diversification across sources of funding, taking into account instrument type, markets, currency, liability term structure, counterparty and market access, as appropriate;

f) additional margin calls and collateral requirements for derivatives transactions;

g) funding tenors taking into account vulnerabilities within the term structure due to external, internal or contractual events (where the funding provider has call options);

h) contingent claims and more specifically, potential draws on committed lines extended to third parties or the bank's subsidiaries, branches or head office;

i) the availability of contingent lines extended to the bank;

j) the types of collateral which may be required and the speed of outflows, where appropriate, are influenced by credit rating – in terms of contractual and behavioural outflows, resulting from credit downgrades of varying magnitude;.

k) assessment of foreign currencies convertibility and access to foreign exchange markets, in terms of stressed outflows by individual currency and tenor, where appropriate. Banks should assess how liquidity shortfalls can be funded in a stressed market with impaired access to foreign exchange markets and loss of convertibility;

l) the ability to transfer liquidity across entities, sectors and borders taking into account legal, regulatory, operational and time zone restrictions and constraints: Banks should assess the intragroup support that is likely to be available in stress, or the impact of a failure of a group entity to repay loans in a timely manner, where appropriate. This assessment should involve considering existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets amongst entities, business lines, countries and currencies;

m) the access to central bank facilities;

n) the operational ability of the bank to monetise assets;

o) the bank's remedial actions and the availability of the necessary documentation and operational expertise and experience to execute them, taking into account the potential reputational impact, when executing these actions;

p) estimates of future balance sheet growth taking into account how planned or forecast balance sheets may behave in stress and whether the bank’s risk appetite/tolerance would be breached.

(viii) The bank must consider different liquidity risk mitigation tools, including a system of limits and liquidity buffers, in order to be able to withstand a range of different stress events and a diversified funding structure and access to funding sources. The bank must review those arrangements regularly.

(ix) The bank should consider in its stress tests the likely behavioural response of other market participants to events of market stress and the extent to which a common response might amplify market movements and exacerbate market strain. The bank also should consider the likely impact of its own behaviour on that of other market participants.

(x) Directorate/executive directors should review stress test scenarios and assumptions, as well as the results of the stress tests. Directorate/executive directors should integrate the results of the stress testing process into the bank's strategic planning process (e.g. by adjusting its asset-liability composition) and the bank's day-to-day risk management practices (e.g. through monitoring sensitive cash flows or reducing concentration limits). The results of the stress tests should be explicitly considered in the setting of internal limits.

(xi) Directorate/executive directors should decide how to incorporate the results of stress tests in assessing and planning for potential funding shortfalls in the bank's contingency funding plan. To the extent that projected funding deficits are larger than (or projected funding surpluses are smaller than) implied by the bank's liquidity risk tolerance, Directorate/executive directors should consider whether to adjust its liquidity position or to bolster the bank's contingency plan, in consultation with the Steering Council.

(xii) The bank must report the results of its liquidity stress tests to Bank of Albania, in a timely manner.

5.5 Liquidity risk internal control framework

5.5.1 The bank should have a strong and comprehensive internal limit and control system and sound safeguards to mitigate or limit its liquidity risk, in line with its risk tolerance. The bank should ensure in particular that:

a) the limit and control framework is adequate for the bank's complexity, size and business model and reflects the different material drivers of liquidity risk, such as maturity mismatches, currency mismatches, derivatives transactions, off-balance-sheet items and intraday liquidity risk;

b) adequate limits and monitoring systems are implemented, that are consistent with its liquidity risk tolerance and that make use of the outcomes of liquidity stress tests;

c) the risk limits are regularly reviewed by the competent bodies of the bank and clearly communicated to all relevant business lines;

d) there are clear and transparent procedures, regarding how individual liquidity risk limits are approved and reviewed;

e) there are clear and transparent procedures, regarding how compliance with individual liquidity risk limits is monitored and how limit breaches are handled (including clear escalation and reporting procedures); and

f) the internal limit and internal control framework help the bank to ensure the availability of a diversified funding structure and sufficient and accessible liquid assets.

5.5.2 The bank should implement a robust transfer pricing system, as part of the liquidity risk control framework. The bank should ensure in particular that:

a) the bank's funds transfer pricing system covers all material bank's activities;

b) the bank's funds transfer pricing system incorporates all relevant liquidity costs, benefits and risks;

c) the bank's funds transfer pricing system allows the Directorate/executive directors of the bank to give appropriate incentives for managing liquidity risk;

d) the transfer pricing methodology and its calibration are appropriately reviewed and updated, given the size and complexity of the bank;

e) the transfer pricing system and its methodology are communicated to the relevant staff; and

f) the bank's policy on incorporating the funds transfer pricing methodology into the internal pricing framework is used for assessing and deciding on transactions with customers (this includes both sides of the balance sheet, e.g. granting loans and taking deposits).

5.5.3 The bank should have adequate controls regarding the liquid-assets buffer. The bank should ensure in particular that:

a) the control framework covers the timely monitoring of the liquid-assets buffer, including the quality of the assets, their concentration, immediate availability to the group entity, using the assets to cover liquidity risks and any impediments to their timely conversion into cash; and

b) it has an appropriate policy on monitoring market conditions that can affect its (bank's) ability to sell or repo assets quickly in the market.

5.6 Liquidity contingency plans

(i) The bank should ensure and maintain a cushion of unencumbered, high quality liquid assets to be held as insurance against a range of liquidity stress scenarios, including those that involve the loss or impairment of unsecured and available secured funding.

(ii) The bank must adjust its strategies, internal policies and limits on market risk and funding risk and develop an effective liquidity contingency plan, taking into account the outcome of the alternative scenarios, referred to in Paragraph 5.4.

(iii) The liquidity contingency plan must include strategies to address the contingent encumbrance or liability (need for additional collateral arising from adverse market conditions) resulting from relevant stress events, including downgrades in the bank's credit rating, fall in the fair value of pledged assets, depreciation of currencies and increase in margin requirements.

(iv) The liquidity contingency plan must set out adequate strategies and proper implementation measures, in order to address possible liquidity shortfalls. These plans must be tested at least annually, updated on the basis of the outcome of the alternative scenarios set out in Paragraph 5.4 and be reported to and approved by the bank's Directorate/executive directors, so that internal policies and processes can be adjusted accordingly.

(v) There should be no legal, regulatory or operational impediment to using these assets to obtain funding. A bank must take the necessary operational steps in advance to ensure that liquidity contingency plans can be implemented immediately, including holding collateral immediately available for central bank funding. This includes holding collateral where necessary in the currency of third countries, to which the bank has exposures.

(vi) The contingency plan should explain governance arrangements for its activation and maintenance.

(vii) The bank should have a framework of liquidity early warning indicators that are likely to be effective in enabling the bank to identify deteriorating market circumstances in a timely manner and to determine quickly what actions need to be taken.

(viii) The contingency plan should clearly articulate all material (potential) funding sources, including the estimated amounts available for the different sources of liquidity and the estimated time needed to obtain funds from them.

(ix) The contingency plan should contain measures in line with the bank's overall risk strategy and liquidity risk tolerance.

(x) The contingency plan should specify the assumptions regarding the role of central bank funding in the bank's liquidity contingency plan and should include the bank's expectations on:

a) the current and future availability of potential alternative funding sources, connected to central bank lending programmes;

b) the types of lending facilities, the acceptable collateral and the operational procedures for accessing central bank funds; and

c) the circumstances under which central bank funding would be needed, the amount required and the period for which such use of central bank funding would probably be required.

5.7 Funding plans

5.7.1 The funding plan should be feasible and appropriate in relation to the nature, scale and complexity of the bank, its current and projected activities and its liquidity and funding profile. The funding plan should:

a) be robust/stable in terms of its ability to support the projected business activities of the bank under adverse scenarios;
b) be suitable given the bank's activities and business model;
c) support any required or desired improvement in the bank's funding profile;
d) be integrated with the overall strategic plan of the bank;
e) be consistent with its (bank's) liquidity risk tolerance;

f) contain different strategies and clear management procedures, for timely implementation of strategy changes;
g) be properly documented and communicated to all the relevant staff; and
h) be embedded in the day-to-day operations of the bank, especially in the funding decision-making process; and
i) be appropriate and adequate given the bank's current liquidity and funding positions and their projected development.

5.7.2 In addition to the considerations provided for in point 5.7.1, in the ILAAP report the bank should:

a) be able to explain why the funding plan is feasible and where its weaknesses lie;
b) have a policy for determining what funding dimensions and what markets are significant to the bank (and whether it is adequate);
c) ensure that the time horizon envisaged by its for migration to a different funding profile, if required or desired, is reasonable, bearing in mind that there may be risks involved if migration towards the end state is either too fast or too slow; and
d) be able to reconcile/review the funding plan, in line with the data provided to Bank of Albania in the funding plan template.

5.7.3 The bank should set out processes for monitoring the execution of the funding plan and reacting to deviations in a timely manner. The bank should:

a) provide updates to Directorate/executive directors, regarding the current status of the execution of the funding plan;
b) set out alternative fallback (return to the appropriate state) measures, to be implemented if there are changes in the market conditions; and
c) set out the policy regarding the regular review and updating of the funding plan, when the actual funding raised significantly differs from the funding plan.

5.8 Management of collateral

(i) The bank must actively manage collateral positions and distinguish between pledged and unencumbered assets, that are available at all times, in particular during liquidity emergency situations.

(ii) The bank must also take into account the legal entity in which assets reside, the country where assets are legally recorded either in a register or in an account, as well as their eligibility and must monitor how assets can be used in a timely manner.

5.9 Management of asset encumbrance

(i) The bank's board must design and approve risk management policies to define their approach to asset encumbrance, as well as procedures and controls that ensure that the risks associated with collateral management and asset encumbrance are adequately identified, monitored and managed. These policies should take into account bank's business model, the jurisdictions in which the bank operates, the specificities of the funding markets and the macroeconomic situation.

(ii) The bank must include in its contingency plans strategies to address the contingent encumbrance resulting from relevant stress events, which means plausible albeit unlikely shocks, including downgrades in the bank's credit rating, devaluation of pledged assets and increases in margin requirements

(iii) The bank must have in place a general monitoring framework that provides timely information to its executive directors on:

   (a) the level, evolution and types of asset encumbrance or liability and related sources of encumbrance, such as secured funding or other transactions;
   (b) the amount, evolution and credit quality of unencumbered but encumberable assets, specifying the volume of assets available for encumbrance; and
   (c) the amount, evolution and types of additional encumbrance or liability, resulting from stress scenarios (contingent encumbrance or liability).

For the purpose of this Guideline an asset must be treated as encumbered, if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction.

5.10 Management of liquidity across banking/financial group entities, business lines, countries and currencies

In the management of its liquidity risk exposures and related funding, a bank must take into account:

(a) existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets amongst banking/financial group entities;

(b) any other constraints on the transferability of liquidity and unencumbered assets across business lines, countries and currencies; and

(c) strategies and measures to mitigate/decrease the potential for reputational damage/decline which may include, but not be limited to establishing and maintaining effective communication with counterparties, credit rating agencies and other stakeholders when liquidity problems arise, and the need to implement group-wide contingency funding plans, maintaining liquidity cushions and using multiple sources of funding.

5.11 Funding diversification and market access

The bank should:

(a) establish a funding strategy that provides effective diversification in the sources and tenor of funding;

(b) maintain an ongoing presence in its chosen funding markets and strong relationships with funds providers to promote effective diversification of funding sources;

(c) regularly gauge its capacity to raise funds quickly from each source; and

(d) identify the main factors that affect its ability to raise funds and monitor those factors closely, to ensure that estimates of fund-raising capacity remain valid.

5.12 Allocation of funding and liquidity risk costs

(i) The bank should incorporate liquidity costs, benefits and risks in the internal pricing, performance measurement and new product approval process, for all significant business activities (both on- and off-balance sheet), thereby aligning the risk-taking incentives of individual business lines with the bank's liquidity risk exposures.
(ii) The bank's Steering Council should formulate a Funds Transfer Policy (FTP) commensurate with the size and complexity of the bank's business operations and liquidity risk profile, and ensure its proper implementation.
(iii) The FTP should encompass both funding and contingent liquidity risks.
(iv) The FTP should be applied consistently and in transparent manner in terms of methodologies for identifying and allocating costs and benefits across various bank's activities.
(v) The banks (Directorate) should regularly submit a report on FTP to their Steering Council.

5.13 Managing the liquidity buffer

5.13.1 Periodic monetisation of the liquidity buffer to test the market

Banks should regularly monetise a sufficiently representative sample of their holdings of liquidity buffers, other than those that attract zero risk weight, according to the Regulation on capital adequacy ratio. Banks should have ready access to their holdings of liquidity buffers and ensure that there are no legal or operational restrictions to monetising liquidity buffers at any time during the 30-calendar day stress period. In particular, while classifying securities into different accounting categories is a business model decision for the bank, banks that hold liquidity buffers in the held-to-maturity portfolio, should be able to demonstrate that this does not impair their ability to monetise these assets through repo markets and outright sales in times of stress. Banks should take into account relevant factors such as market depth[3], number of regular counterparties, the bank's individual turnover and incremental market access in stress, the need to rollover short-term repo transactions and settlement times etc. Banks should provide evidence of the data used for their assessments in their ILAAP.

5.13.2 Diversification of liquidity buffer

(i) Banks should have in place appropriate internal limits and controls to ensure that they appropriately diversify their liquidity buffer. This should be sufficient to demonstrate that their ability to monetise the liquidity buffer in a short timeframe, without significant loss of value, is not compromised by exposure to a common risk factor. Bank of Albania expects large/systemically important banks to take into account the absolute size of their liquidity buffer holdings and to be able to monetise these without compromising on either speed of disposal or price. Large/systemically important banks should also consider the impact of their actions on the wider market and on financial stability.

(ii) Banks should have due regard to their own business model when determining the appropriate level of diversification in their buffer. In particular, the banks should consider the risk that a particular asset holding makes it (the asset) illiquid, just when the bank itself needs to draw down its buffer, for example, because both the bank and the asset are exposed to a common risk factor. Conversely, the banks should also

[3] Market depth means the market's ability to absorb market orders, without significant impacts on the price of the security.

consider whether their choice of assets is appropriate given their ability to manage properly the risk in those assets, and to access the relevant repo or sale market.

Determination of additional liquidity requirements under ILAAP

6.1 Banks should keep in view the following considerations in identifying the additional liquidity requirements, in terms of higher liquidity buffer and higher Available Stable Funding, to meet the minimum requirements (Pillar 1), including ICAAP (Pillar 2) requirements:

(a) any risk identified by the bank that is not covered in the Regulation on liquidity coverage ratio and in the Regulation on Net Stable Funding Ratio (NSFR);
(b) above average intraday liquidity risk;
(c) need for covering the liquidity risk beyond the 30-day time period;
(d) underestimation of outflows by the regulatory run-off factors;
(e) overestimation of inflows by the regulatory factors;
(f) overestimation of the realisable value of liquidity buffer, or counterbalancing capacity[4];
(g) unavailability from an operational point of view of liquid assets (assets not available for sale, assets that are encumbered, etc.);
(h) specific concentrations of counterbalancing capacity and/or funding by counterparty and/or product/type;
(i) funding gaps in specific maturity buckets in the short, medium and long term;
(j) appropriate coverage of funding gaps in different currencies; and
(k) other relevant outcomes of the supervisory liquidity stress tests.

6.2 Additional liquidity buffer requirement, determined by the bank, should be reported as an addition to minimum LCR requirement (Pillar 1) as follows:

Illustration of reporting additional LCR requirement under ILAAP

1.	Pillar 1 liquidity buffer	ALL 200
2.	Pillar 1 Inflows	ALL 400

[4] 'Counterbalancing capacity' means the bank's ability to hold, or have access to, excess liquidity over short-term, medium-term and long-term time horizons in response to stress scenarios.

3.	Pillar 1 Outflows	ALL 300
4.	Liquidity buffer required to meet minimum LCR	(Max [(25%*300), (300-400)] *100% = (Max (75, -100) *100% =75
5.	Pillar 1 LCR (Actual)	200/(Max [(25%*300), (300-400)] = 200/(Max (75, -100) = 200/75 =267%
6.	Additional Outflows estimated under ILAAP (e.g. due to applying higher run-off factors)	ALL 80
7.	Reduction in inflows estimated under ILAAP	ALL 40
8.	Revised Outflows	ALL (300+80) = 380
9.	Revised Inflows	ALL (400-40) =360
10.	Total liquidity buffer required under ILAAP to meet the 100% LCR considering revised Net Outflows	(Max (25%*380, 380-360) *100% = (Max (95, 20) = ALL 95
11.	Adjustment to Total liquidity buffer requirement (ALL 95) on account of need for applying more stringent eligibility criteria (e.g. need for applying greater haircut than required under the Regulation no. 27 dated 28.3.2019 "On liquidity coverage ratio").	• Suppose, weighted average haircut applied = 30% • Minimum liquidity buffer needed at 30% *haircut* = 95/70% = 136 • Required haircut determined by the bank under ILAAP =35% • Minimum liquidity buffer needed at 35% haircut = 95/65% = 146 • Additional liquidity buffer needed if higher haircut were to be applied =146-136 = ALL 10
12.	Total liquidity buffer requirement under ILAAP	95+10 = ALL105

13.	Additional liquidity buffer requirement	105-75 = ALL 30
14.	Additional LCR requirement	30/75 = 40%
15.	Minimum LCR requirement under ILAAP	140%
16.	Existing LCR	267%
17.	Surplus LCR	267-140 =127%

ILAAP Governance

(i) The bank's Steering Council has the overall responsibility for the application of ILAAP. The granularity and comprehensiveness of ILAAP should be commensurate with the size and complexity of the bank and its liquidity risk appetite/tolerance. The Steering Council should ensure that the ILAAP is fully integrated with the bank's overall risk management, strategic management practices, business decisions and liquidity planning. Although this Guideline seeks to offer guidance on ILAAP, it is for the banks themselves to determine the content, scope and depth of the assessment, applying the principle of proportionality.
(ii) Steering Council should review the ILAAP at least annually.
(iii) The ILAAP should be carried out annually and documented by the bank.
(iv) ILAAP should identify the measures set out in its liquidity contingency plans that it (the bank) would implement in case it is required.

Soundness of ILAAP

(i) The policies, processes, inputs and models of the ILAAP should be proportionate to the nature, volume and complexity of the activities of the bank. The ILAAP must result in sound assessment and maintenance of an adequate level of internal capital and liquidity, in order to cover risks to which the bank is or might be exposed, as well as for the decision-making process, including under stressed conditions.
(ii) The methodologies and assumptions applied by the bank should be appropriate and consistent across risks, are grounded in solid empirical input data, use robustly calibrated parameters and are applied equally for liquidity risk measurement and liquidity management.
(iii) The definition and composition of available internal liquidity resources, considered by the bank for ILAAP, should be consistent with the risks measured by the bank and eligible for the calculation of liquidity buffers; and

(iv) The distribution/allocation of available internal liquidity resources amongst business lines or legal entities should properly reflect the risk to which each of them is or may be exposed, and properly take into account any legal or operational constraint on transferability of these resources.

Effectiveness of the ILAAP

Banks should use ILAAP in their decision-making and management processes (e.g. limit setting, performance measurement, etc.). The ILAAP should be approved by the bank's Steering Council, which should ensure should ensure that the ILAAP is forward-looking and consistent with liquidity plans and strategic plans.

The bank should design and approve policies, procedures and tools to facilitate the following processes:

(i) clear identification of the functions and/or committees established by the Steering Council, that are responsible for the different elements of the ILAAP (e.g. modelling and quantification, internal auditing and validation, monitoring and reporting, issue escalation, etc.);

(ii) the calculation of liquidity resources on a forward-looking basis (including in assumed stress scenarios), in connection with the overall strategy or significant transactions;

(iii) the allocation and monitoring of liquidity resources among business lines and risk types (e.g. risk limits defined for business lines, entities or individual risks are consistent with the objective of ensuring the overall adequacy of the bank's internal liquidity resources);

(iv) the regular and prompt reporting of liquidity adequacy to the Steering Council and executive directors (in particular, the frequency of reporting should be adequate with respect to risks development and the volume of activity, existing internal buffers and the internal decision-making process, to allow the bank's management to put in place remedial actions before liquidity adequacy is jeopardised); and

(v) Steering Council or executive directors awareness and action where the business strategy and/or significant individual transactions may be inconsistent with the ILAAP and available internal liquidity resources.

Comprehensiveness of the ILAAP

(i) ILAAP should be implemented homogenously and proportionately for all business lines and legal entities with respect to risk identification and assessment;

(ii) ILAAP should cover all material risks regardless of whether the risk arises from entities not subject to consolidation (special-purpose vehicles (SPVs), special-purpose entities (SPEs).

ILAAP Report

Banks must submit to Bank of Albania an ILAAP Report annually documenting ILAAP for the completed financial year. The Report must be prepared in the format specified in Annex 1 of the Guideline and must reach Bank of Albania not later than 31 March.

ILAAP information requirements

Banks must submit information specified in Annex 2 along with the ILAAP Report, to enable Bank of Albania to perform the following supervisory assessments as part of SREP (Pillar 2):

(a) assessment of the soundness, effectiveness and comprehensiveness of ILAAP framework;

(b) assessment of the granularity, credibility, understandability and comparability of any additional liquidity requirements determined by banks; and

(c) as an additional source of information for assessment of risks to liquidity and funding and liquidity adequacy.

The required information may either be contained in the body of the ILAAP Report or provided as an Appendix to the Report, as considered appropriate. In the case where part or whole of the information is contained in the body of the ILAAP Report, the bank should provide a clear mapping of the sections of the report containing the information, with reference to each section of Annex 2.

Supervisory measures

Bank of Albania shall review and evaluate the ILAAP, with the aim of ensuring adequate liquidity levels, to monitor risks undertaken by the bank and to use, develop and improve risk management methods. Bank of Albania shall review and evaluate the ILAAP, overall, on the basis of the ILAAP Report and the dialogue with the bank regarding the liquidity adequacy.

Bank of Albania, in the cases when the solution or the improvement of the deficiencies of ILAAP, in accordance with the dispositions of the Law on banks and the regulatory framework into force, shall undertake the necessary supervisory measures. The supervisory measures may include, among others, the decisions of the Bank of Albania mainly for setting particular (specific) liqudity requirements, including restrictions for maturity mismatches of assets and liabilities.

Bank of Albania, with the aim of setting the appropriate level of particular liquidity requirements, according to the paragraph 2 of this Article, based on the review and assessment performed, evaluates whether it is necessary the setting of a particular (specific) liquidity requirement to monitor the liquidity risks, to which the bank is or may be potentially exposed, taking into consideration the following elements:

a) bank's specific business model;
b) bank's adjustments, processes and mechanisms, contemplated in this Guideline, in particular strategies, policies and procedures for liquidity management;
c) the outcome of the ILAAP review and assessment process performed by Bank of Albania; and
d) liquidity systemic risk, jeopardising the integrity of the local financial market, where the bank operates.

Bank of Albania, in case of failure to comply with the requirements laid down in this Guideline, shall implement the supervisory and/or punishing measures, stipulated in the Law on banks.

Final provisions

The Supervision Department is responsible for observing the implementation of this Guideline.

The Governor's Office and the Research Department are responsible for publishing this Decision in the Official Journal of the Republic of Albania and in Bank of Albania's Official Bulletin, respectively.

Entry into force

Until the entry into force of this Decision, banks shall take measures and create the necessary conditions for the implementation of the requirements of the Guideline, as well as for the submission of the internal liquidity adequacy assessment process report at the Bank of Albania (Supervision Department) as at the end of 2022 data and according to the defined deadline (31 March 2023).

This Guideline shall enter into force on 31 December 2022.

CHAIR OF THE SUPERVISORY COUNCIL

Gent SEJKO

Annex 1 – Structure of the ILAAP Report

1. Introduction

- Business model including the business lines, subsidiaries and geographical presence.
- Systemic presence of the bank.
- Changes in internal and external operating environment of the bank during last year.
- Comprehensiveness and proportionality of the ILAAP with justifications and explanations.

2. Summary

- Overall conclusions of ILAAP review describing the extent to which the liquidity regulations, guidelines on liquidity risk management and ILAAP approved by Bank of Albania have been complied with by the bank.
- Any deficiencies and improvements proposed to be carried out.
- Assessment of any additional liquidity buffer that the bank will hold on account of risks not captured by LCR.

3. LCR Reporting

3.1 Liquidity buffer

This section deals with the compliance with the regulatory requirements relating to eligibility of the liquidity buffer.

3.2 Outflows

This section deals with the compliance with the regulatory requirements relating to measurement of outflows. This should include meeting the requirement for recalibration of run-off factors taking into account bank's historical experience, changes in business model and changes in liquidity risk profile arising from liability side, off-balance sheet items and reputational risk exposures.

3.3 Inflows

This section deals with the compliance with the regulatory requirements relating to measurement of inflows including the need for recalibration taking into account bank's historical experience and any changes in business model and liquidity risk profile arising from asset side

4. Liquidity risk assessment

4.1 Evaluation of liquidity needs in the short and medium term

In this section, banks should describe their liquidity profile at appropriate time horizons out to 12 months, the sources and uses on gross and net basis, and their activities undertaken to cover such liquidity needs in both normal circumstances and under and stress. The bank should also describe any case when the LCR metric does not capture its liquidity risks, within 30 days, and how that risk will be managed.

4.2 Evaluation of intra-day risk

In this section, banks should describe how intraday risk is created within their business, whether they are part of the payments system or not, their appetite/tolerance for and approach to managing intraday liquidity risk of both cash and securities accounts and in both business as usual and stress conditions. They (the banks) should include the approach to stress testing and its conclusions.

4.3 Evaluation of liquidity buffer and counterbalancing capacity

In this section, banks should describe the procedures for calculating, controlling and monitoring the liquidity buffer and counterbalancing capacity, and their effectiveness in different scenarios, which should include those affecting the liquidity of the assets and counterbalancing capacity.

5. Inherent funding risk assessment

5.1 Evaluation of risks to bank's funding profile

In this section, banks should describe the funding risk strategy and appetite/tolerance, and the profile of this risk, both the sources and uses on a gross and net basis.

5.2 Evaluation of risks to stability of the funding profile

In this section, banks should analyse the stability of the liabilities within the funding profile and the circumstances in which they could become unstable. This could include market shifts including changes in collateral values, excessive maturity mismatches, inappropriate levels of asset encumbrance, concentrations (including single or connected counterparties, or currencies).

5.3 Evaluation of market access

In this section, banks should analyse market access and current or future threats to this access, including the impact of any short-term liquidity stresses or negative news.

5.4 Evaluation of expected change in funding risks based on bank's funding plan

In this section, banks should assess the expected change in funding risks, based on the bank's funding plan.

6. Assessing liquidity and funding risk management

6.1 Assessment of risk strategy and risk appetite/tolerance

In this section, banks should describe the risk appetite/tolerance and strategy, how they were devised, approved, monitored and reported, and how they are communicated throughout the bank.

6.2 Organisational framework, policies and procedures

In this section, banks should describe the governance and management arrangements around the ILAAP, including the involvement of the governing bodies (Steering Council and Directorate). They should describe also the risk framework overall and as it pertains to liquidity and funding risks, the technical and staff resources.

6.3 Risk identification, measurement, management, monitoring and reporting

In this section, banks should describe the framework and IT systems for identifying, measuring, managing and monitoring and both internal and external reporting of liquidity and funding risks, including intraday risk. The assumptions and methodologies adopted should also be described, key indicators should be evidenced and the internal information flows described.

6.4 Bank's liquidity specific stress testing

In this section, banks should analyse the internal stress testing framework, including the process of scenario design and governance, along with the respective challenges, assumptions and definition of sensitivity analysis, and the process of review, challenges and relevance to the risk appetite/tolerance. The process by which the stress results are produced, and incorporated into the risk framework and strategic planning, and the liquidity recovery process should be carefully scrutinised. The results and conclusions must be analysed, with breakdown by each relevant risk driver.

6.5 Liquidity risk internal control framework

In this section, banks should describe their internal limit and control framework, including the limits and controls around liquid asset buffers, and the appropriateness of the limit structure to the risk appetite/tolerance. The transfer pricing framework should also be described here, for example how the methodology was developed, the process controlled, monitored and reviewed, and the results cascaded throughout the bank to drive behaviours and support performance measurement and business incentives.

6.6 Liquidity contingency plans

In this section, banks should detail the policies, procedures and action plans for responding to severe disruptions in the bank's ability to fund itself. The plan should be the same as contained within their Recovery Plan, and it should be either cross referenced or included within the ILAAP document.

6.7 Funding plans

In this section, banks should provide the full funding plan to demonstrate how they will support the projected business activities, in both business as usual and stress conditions, implementing any required improvements in the funding profile and evidencing that the risk appetite/tolerance and key metrics will not be breached by the planned changes. Risks to the plan should be discussed and, where a funding strategy is new, implementation procedures should be detailed.

7. Assessment of any additional liquidity buffer that the bank will hold on account of risks not captured by LCR

This section should describe the process of assessing any additional liquidity buffer that the bank will hold on account of risks not captured by LCR.

The factors contributing to additional requirements and the methodology for determining the additional liquidity requirements as a consequence of undertaking additional risks, in terms of higher minimum LCR under ILAAP, should be clearly detailed.

Annex 2 – ILAAP information requirements

1. Information on liquidity and funding risk management

1.1. Methodology and policy documentation

In order to assess whether the bank has in place a process that ensures the bank has a robust and specific framework for liquidity and funding risk management, including a process for identifying, measuring and controlling liquidity and funding risks, Bank of Albania should ensure that it receives from banks the following:

(a) description of the scope of ILAAP including an overview of and reasoning for any deviations from the prudential scope of liquidity requirements implementation, recognising possible waivers;

(b) description of the set-up of ILAAP explaining the relation between all its components and providing reasoning about how that set-up ensures the bank has access to sufficient liquidity;

(c) the criteria applied by the bank for the selection of significant risk drivers for liquidity and funding risk, including the selection of significant currencies for monitoring the liquidity and the funding position;

(d) the criteria applied by the bank for the selection of appropriate tools and assumptions for ILAAP, such as the method of measuring and projecting current and future cash-flows of assets, liabilities and off-balance-sheet items over appropriate time horizons.

1.2. Operational documentation

In order to assess the full implementation of a process that ensures the bank has a robust and specific framework for liquidity and funding risk management, including a process for identifying measuring and controlling liquidity and funding risks, Bank of Albania should ensure that it receives from banks the following information:

(a) an assessment of the intragroup liquidity flows and funding positions, including any possible legal or regulatory impediments to the transfer of liquidity within the banking/financial group;

(b) reasoning for the selection of the significant risk drivers and a quantitative overview of these risk drivers, updated at an appropriate frequency;

(c) quantitative overview of the funding profile and its stability in all significant currencies;

(d) evidence of the monitoring of compliance with minimum and additional prudential requirements related to liquidity and funding risk, in accordance with the Regulations on LCR and NSFR into force, including the forecast of compliance with these requirements under different scenarios, over an appropriate time horizon and within the scope of ILAAP implementation.

2. Information on funding strategy

2.1. Methodology and policy documentation

(a) description of the general set-up of the funding plan, including sources of funding, tenors, key markets, products used, etc;

(b) where appropriate, a policy document on maintaining presence in markets in order to ensure and regularly test market access and fund raising capacity of the bank, where relevant;

(c) where appropriate, a policy document on funding concentration risk, including on the principles for measuring and monitoring of correlation between funding sources and economic connection between depositors and other liquidity providers;

(d) where appropriate, a policy on funding in foreign currencies, including the most relevant assumptions with regard to availability and convertibility of these currencies.

2.2 Operational documentation

(a) the current funding plan;

(b) a quantitative overview of the characteristics, such as volumes, prices and investor appetite, of recent funds raised and an analysis of the feasibility of the execution of the funding plan taken into account (changes in) market volatility;

(c) a forward-looking view on the (expected) development of the funding position over a forward-looking time horizon;

(d) an assessment of the funding position and funding risk after execution of the funding plan;

(e) information on back-testing of the funding plan.

3. Information on strategy regarding liquidity buffer and collateral management

3.1 Methodology and policy documentation

On liquidity buffer and collateral management strategy, banks should submit the following information:

(a) their methodology for determining the internal minimum size of the liquidity buffer, including the banks' definition of liquid assets, the criteria the bank applies for determining the liquidity value of liquid assets and the constraints relating to concentration and other risk characteristics of the liquid assets;

(b) policy document on collateral management, including principles in relation to the location and transferability of collateral, as well as to their role in relation to meeting minimum prudential requirements;

(c) policy document on asset encumbrance, including principles for measuring and monitoring both encumbered and unencumbered assets and linking the limit and control framework regarding asset encumbrance to the bank's (liquidity and funding) risk appetite/tolerance;

(d) principles for testing the assumptions relating to the liquidity value of, and time to sell or repo, assets included in the liquid asset buffer;

(e) policy document on liquidity concentration risk in the liquidity buffer, including principles for measuring and monitoring of any potential loss of available liquidity due to this concentration .

3.2 Operational documentation

On evidencing implementation of the strategy regarding liquidity buffers and collateral management, banks should submit the following: :

(a) the minimum volume of liquid assets considered adequate to meet internal requirements;

(b) the current level of liquidity buffer, including its distribution over products, currencies, counterparties, regions/group entities, etc;

(c) projections of the development of the internally required minimum volume of liquid assets and available liquid assets over appropriate time horizons under both 'business as usual' and stressed conditions;

(d) quantitative overview and analysis of current and projected levels of asset encumbrance, including details of encumbered as well as unencumbered assets that could be used for generating liquidity;

(e) assessment of the time it takes to convert liquid assets into directly usable liquidity, taking into account legal, operational or prudential impediments to the use of liquid assets to cover cash outflows;

(f) analysis of the testing of assumptions in relation to the liquidity value of, and time to sell or repo, assets included in the liquid asset buffer.

4. Information on the cost-benefit allocation mechanism

4.1 Methodology and policy documentation

On the set-up of the liquidity cost-benefit allocation mechanism, banks should provide the following:

(a) description of liquidity cost-benefit allocation mechanism as well as the criteria for the selection of the liquidity and funding elements that ensure all relevant benefits and costs are taken into account, as well as any adjustment frequency of the price changes;

(b) description of the interlinkages between the liquidity cost-benefit allocation mechanism and the risk management and overall management of the bank;

(c) for the banks with liquidity transfer pricing mechanisms in place, Bank of Albania should ensure that the information referred to in the previous paragraph also includes description of the set-up and functioning of liquidity transfer pricing, and in particular of the interlinkages between liquidity transfer pricing and strategic decision making as well as front office decision making on asset and liability generation.

4.2 Operational documentation

On evidencing cost-benefit allocation of the implementation of the liquidity mechanism, banks should submit the following:

(a) description of the current liquidity cost-benefit allocation mechanism and a quantitative overview of its current calibration (e.g. interest rate curves, internal reference rates for main categories of assets and liabilities in use, etc.);

(b) description of the current integration of the liquidity cost-benefit allocation mechanism into the measurement of profitability for new asset and liability generation, both on-balance-sheet and off-balance-sheet;

(c) description of the current integration of the liquidity cost-benefit allocation mechanism into performance management, where necessary split out into the different business lines/units or regions.

For the banks with liquidity transfer pricing mechanisms in place, the information referred to in the previous paragraph should also cover the functioning of liquidity transfer pricing, and in particular the relation between liquidity transfer pricing and key risk ratios. t.

5. Information on intraday liquidity risk management

5.1 Methodology and policy documentation

Where appropriate, regarding the set-up of intraday liquidity risk management, banks should include in ILAAP the following information:

(a) description of the criteria and tools for measuring and monitoring intraday liquidity risks;

(b) description of the escalation procedures for the purpose of intraday liquidity shortfalls which ensure that payments due and settlement obligations are met on a timely basis under both ‘business as usual’ and stressed conditions of activity.

5.2 Operational documentation

Where appropriate, on the implementation of intraday liquidity risk management, banks should submit in ILAAP the following information:

(a) quantitative overview of intraday liquidity risk over the past year at an appropriate frequency;

(b) the total number of missed payments and an overview with explanation of material payments missed or material obligations not met by the bank in a timely manner.

6. Information on liquidity stress testing

6.1 Methodology and policy documentation

On the set-up of liquidity stress testing, banks should provide in ILAAP the following information:

(a) description of the adverse scenarios applied and the assumptions considered in liquidity stress testing, including any relevant items such as the number of scenarios used, the scope, internal reporting frequency to the management body, risk drivers (macro and idiosyncratic), the applied time horizons and, where relevant, the split in currencies/regions/business units;

(b) description of the criteria for calibrating scenarios, selecting appropriate time horizons (including intraday, where relevant), quantification of the impact of stress on the liquidity value of liquid assets (part of the liquidity buffer), etc.

6.2 Operational documentation

On evidence of the full implementation of liquidity stress testing, banks should submit the following:

(a) quantitative outcome of the stress tests including an analysis of (the main drivers of) this outcome and a clear insight into the relevance of the outcome for the internal limits, liquidity buffers, reporting, modelling and risk appetite/tolerance;

(b) quantitative and qualitative analysis of the outcomes of stress testing on the funding profile.

7. Information on liquidity contingency plan

7.1 Methodology and policy documentation

On the set-up of the liquidity contingency planning, banks should should include in ILAAP the following:

(a) description of the lines of responsibilities for designing, monitoring and executing the liquidity contingency plan;

(b) description of the strategies for addressing liquidity shortfalls in emergency situations;

(c) description of a tool to monitor market conditions that allow banks to determine in a timely manner whether escalation and/or execution of measures is needed;

(d) description of testing procedures, where available (e.g. examples of sales of new asset types, pledging collateral with Bank of Albania, etc.).

7.2 Operational documentation

On the implementation of liquidity contingency plans, banks should submit in the ILAAP report the following:

(a) the current liquidity contingency plan;

(b) information on the possible management actions, including the assessment of their feasibility and liquidity generating capacity under different stress scenarios;

(c) the management view on the implications of all liquidity-related public disclosures made by the bank for the feasibility and timeliness of management actions, included in the liquidity contingency plan;

(d) recent analysis of testing, including conclusions on the feasibility of the management actions included in the liquidity contingency plan;

(e) description of the internal view on the impact of executing the management actions included in the liquidity contingency plan, e.g. on the access the bank has to relevant markets and on the overall stability of its funding profile in the short and longer terms.

8. Supporting documentation

In addition to the information referred to in Sections 1-7 of the Annex 2, banks should submit all relevant supporting information, including minutes of relevant commitees and management body meetings evidencing the sound set-up and implementation of ILAAP, and in particular:

(a) approval of the overall set-up of ILAAP;

(b) approval of the key ILAAP elements, such as the funding plan, the liquidity contingency plan, the liquidity cost-benefit allocation mechanism, stress test assumptions and conclusions on outcomes, specific liquidity and funding risk appetite/tolerance, targeted size and composition of liquid asset buffers, etc.;

(c) evidence of discussion on (changes in) the liquidity and funding risk profile, limit breaches, etc., including decisions on management actions or the explicit decision not to take any action;

(d) examples of significant decisions in new product approval committees evidencing, if applicable, the use of the liquidity transfer pricing and risk views in these decisions;

(e) evidence of discussion of the analysis of the feasibility of the funding plan based on (changes in) market depth and volatility;

(f) evidence of decisions on management actions related to intraday liquidity risk after internal escalation due to intraday liquidity events;

(g) evidence of discussion of the outcome of liquidity stress tests and decision on any management (non-)action;

(h) evidence of discussion on the regular testing of the liquidity contingency plan and decisions on adjusting the management actions listed in the liquidity contingency plan;

(i) decision relating to the size and composition of the liquid asset buffer;

(j) evidence of discussion regarding the testing of the liquidity value of, and of the time required to sell or repo, assets included in the liquid asset buffer;

(k) where available, internal self-assessments in which banks can justify their level of compliance against publicly available regulatory criteria regarding risk management and control that affect bank’s ILAAP.