SPI ALBANIA PROJECT:
ENHANCING LIQUIDITY RISK MANAGEMENT
July 2009

ISSUE	PRESENT REGULATORY FRAMEWORK	NEW BANK OF ALBANIA REGULATORY PROPOSAL (*BANKS CONCERNS ACCEPTED*)	BANKS' COMMENTS IN PROJECT WORKING GROUP DISCUSSIONS
A. General			
1. Legal form	Guideline	Regulation	
2. Definitions	- Liability degree - A group of related depositors	***- Illiquidity*** - Liquidity Risk - Emergency situations - Contingency plan - Net cash flows - Contractual Maturity (of assets and liabilities) - Relying on funding sources - Stress testing - GAP	Banks required a clearer definition of illiquidity, which was provided in the final draft.
B. Systems for liquidity risk management			
3. Systems for liquidity risk management	No provisions	Systems for liquidity risk management should include: 1. Strategies and policies; 2. Organizational framework; 3. Internal control system; 4. Information administration system; 5. Emergency plan	Banks do have already structures and strategies for the management of liquidity risk, therefore the requirements of the new proposed regulation were well accepted.
4. Strategies and policies	No provisions	Banks establish strategies and policies to support the procedures of liquidity risk management. The	Banks argued that in those who have a foreign

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		strategy should include at least: - Objectives of the strategy, - Principles of Liquidity risk management; - General methodology to be followed in the short and medium term; - General methodology of the bank to enter in financing markets; and - Policies for liquidity risk management. Policies for liquidity risk management should include at least: a) identification of liquidity risk deriving from new products and activity; and b) measuring of liquidity risk, especially: - actual liquidity position; - forecast of inflows and outflows of cash; - maturity match of funds and sources of financing; - concentration of deposits and other sources of financing by maturity type and customer structure; - fluctuation and vulnerability of deposits; - setting of liquidity indicators and their monitoring process in the bank; - use of stress tests to monitor liquidity risk.	parent bank, the strategies and policies, including indicators on liquidity to be monitored, might be established and defined by the parent bank. However, they have to be included in the strategies and policies of the bank as of the regulation.
5. Organizational		The bank shall establish a robust organizational	

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framework for liquidity risk management		framework to manage liquidity risk, which clearly set out the competences and responsibilities of the bank organizational units, which monitor and manage liquidity risk. Steering Council of the bank should mainly: - Approve the Strategy and policies for liquidity risk management, including contingency plans - Review the appropriateness of the Strategy and policies annually; - Approve internal limits for liquidity management, - Review stress tests reports ***Steering Council of the bank should establish a committee / structure for the managements of risk/s.*** The **Committee Structures** should mainly: - Develop and implement and monitor Strategy and policies, - Establish and develop methods for liquidity risk management and stress tests methodologies, - Report to Board on status and perspective of bank's liquidity;	Banks discussed on the Risk Management Committee that banks should have, with the argument that different banks might have different structures with the role of managing different risks within the bank. Therefore BoA changed the definition into a broader one, covering for different types of committees and structures, with defined functions.
6. Internal control system	Bank's internal control shall review: a) whether the	The internal control system for liquidity risk management, integrated in the overall system of internal control, should include:	No comments

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	report compiling system is designed in such a way as to truly reflect the actual liquidity of the bank, b) whether liquidity reports as of December 31 are correct.	- Monitoring and reporting on limits exceeding; - Regular check of timelines, accuracy and comprehensiveness of data and assumptions used; - Implementation of measures to correct the concluded weaknesses; - The continuing development of methods and methodologies to measure and control liquidity risk and; - the compliance with all the laws, regulations and other bylaws of the Bank of Albania and the internal regulations of the bank.	
7. Management Information System	Through its information system, the bank shall classify its assets, liabilities and off-balance sheet items, according to: a) the maturity date of fixed term assets, liabilities and off-balance sheet items; b) the expected development of fixed term liabilities;	Banks should develop an information system to assure measurement, monitoring, and control of the liquidity risk management. It should provide for: - Measuring and monitoring bank's liquidity position on a daily basis and in predetermined time periods, and for each foreign currency that considerably affects bank's liquidity; - Monitoring observance of established liquidity risk exposure limits ; - Generating information in order to calculate liquidity indicators and prepare reporting forms; - Concentration report and monitoring on bank deposits; - Spreadsheets for Stress tests performing and	No comments

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	c) the depositor's behavior in the past; d) the liquidity degree of assets; e) the amount of deposits by a individual depositor or a group of joint depositors; f) the type and the degree of liability for off-balance sheet items given or received by the bank; g) the currencies in which assets, liabilities and off-balance sheet items are denominated, with special focus on Lek, convertible and non-convertible currencies.	scenario analysis.	
8. Stress-testing	No provisions	Banks should perform periodical stress tests and / or scenarios analysis, to identify situations that	Most of banks already perform stress testing for their internal control on liquidity.

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		influence its liquidity position The frequency of stress tests is chosen by the bank but should not be less than twice in a year. Bank of Albania can require more frequent stress tests. The results of stress tests are reviewed by the banks' Board and used to improve the strategy, identify main issues, and develop effective contingency plans. ***Scenarios could be developed as bank specific, based on factors within the banks, and scenarios arising from market or macro economical conditions (exogenous factors). The proposed regulation gives several possible scenarios that banks can use; however, it is up to banks to use the scenarios that better fit them.*** Banks should define the methodology of performing stress tests including the periodicity, the scenarios used, the periodical revision of assumptions used, the form and reporting of the results, and the actions to be undertaken based on the stress tests results.	The issue raised by banks is that there should be a clear definition in the regulation about the required number and formats of the basic scenarios to be followed for the stress tests. Two banks suggested the proposal from BoA of 2 or three models of Stress tests as obligatory but the decision of the PWG was for the models to be only indicative, and banks to choose the ones that better suit them.
9. Contingency planning	The banks should draft and report to BoA a contingency	The bank shall adopt a contingency plan for liquidity risk management that should include: - Clear distribution of tasks, powers and	

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	plan for unusual events, which may threaten bank's liquidity, that should comprise a compiling method and its terms of use including designation of a responsible employee, identification and value (volume) of assets, which, according to the plan, are held to promote and secure bank's liquidity. The bank should regularly update the contingency plan with respect to changing internal (asset and liability structure of the bank) and external	responsibilities in the bank regarding the plan implementation; - ***Early Warning Signals*** that indicate the emergency conditions (some of them are shown in Annex 1.) - Conditions in which the plan is to be applied; - Define actions to be undertaken, identify possible fund sources, the priorities and time limits within which the actions should be undertaken; - Forms of communication with key depositors, commercial partners, other customers and general public; - Contacts of persons responsible for the implementation of the plan The bank shall, periodically and whenever needed, review and revise the plan and, in difficult economic-financial situations, collaborate and exchange information with Bank of Albania.	The early warning signals are a novelty of this draft regulation, and banks had neither comments nor objections on them.

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	(situation in the interbank market) conditions.		
C. Indicators for measuring monitoring and managing liquidity risk			
10. Measuring and Monitoring Funds Flows		The planning of cash flow should include all types of actual and expected inflows and outflows including those regarding off-balance sheet items. Expected inflows are those from deposits, loan repayments, sales of securities, interbank loans, inflows from off balance items (for derivative instruments) and all other inflows that could be materialized in the future. Expected outflows are those for: approved loans, purchases of securities, interbank loans, repayment of clients' deposits, as well as off balance sheet items (for derivative instruments) and all outflows of funds that are expected to materialize for the respective period.	No comments
11. Maturity Gaps		The bank monitors maturity structure of assets and liabilities in order to identify the possible gaps of maturity. It groups incoming and outgoing flows of assets (rights), liabilities (obligations) and off balance sheet items according to their maturity (the date of collection of the rights is considered the latest date	

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		possible and that of payment of obligations the first possible): a) up to 7 days b) 7 days to 1 month c) 1 month to 3 months d) 3 months to 6 months e) 6 months to 12 months The proposed regulation provides guidelines on how to determine the maturity bucket based on the contractual and remaining maturity of assets and liabilities. The bank shall perform the analysis gaps liquidity based mainly on: a. the classification of assets, liabilities, and off-balance sheet items according to maturities; b. the assessment of deposits' stability based on historical data and stress tests' results; c. the establishment of limits for liquidity gaps; ***d. the accounting of gaps on weekly basis and by currencies;*** e. expectation of future liquidity gaps; f. etc.	Banks argued that it is very difficult to achieve realization of daily gap analysis. BoA reconsidered and established as obligatory only weekly gap analysis.
12. Monitoring and	In order to ensure the necessary	The bank should monitor periodically its funding sources in order to preserve diversification and	No comments

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concentration of funds resources	liquidity, the bank should: - obtain funds from stable sources within agreed terms, - diversify funding sources according to maturity, type of bank instrument and bank's clientele,	identify concentrations. The proposed regulation gives guidelines on monitoring funding sources and their concentration. Large depositors are considered to be the first 20 depositors with the largest weight in the total banks deposits.	
13. Monitoring of guarantees		The bank should manage its collateral positions in order to identify free assets from assets blocked as guarantees. An effective management should comply with several requirements regarding the collateral, related with the insurance of long term, short term and daily liquidity. The bank should hold sufficient amount of collateral to answer to expected or unexpected needs for borrowing.	No comments
14. Liquidity Indicator And Liquid Assets Ratios	Bank calculates certain liquidity ratios, which are: highly-liquid assets	The bank shall maintain liquidity at an amount, structure and ratios that allow it to meet all is obligations and commitments, timely, at a reasonable cost and at a minimum risk.	

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	to total assets, the ratio of highly-liquid assets to short-term liabilities, the ratio of net cumulative balance sheet position (GAP) for a period up to 3 months, to total assets, as well as other ratios established by it. The bank shall establish the degree and methodology of their calculations.	The bank shall set out the needed procedures for the measurement and monitor of net cash flows and for the monitor of liquidity in the main currencies and as total. ***The bank should monitor and respect in every moment the ratio of liquid assets to short term liabilities at a minimal level of 20%, on weekly basis.***	After hearing banks' concerns, Bank of Albania reconsidered the ratios with the aim to accommodate all banks and their specifics, holding to the best practices of liquidity risk management, and opted for only ratio limit on liquid assets. **Banks have argued that liquidity ratio limits established in the first draft :** **a)minimum 0.8x – within a working day;** **b)minimum 0.9x – in 3 consequent working days;** **c)minimum 1x – up to one month (calculated as average of the working days)** **could not be fully monitored on a daily basis. BoA removed from the draft regulation such limits.**

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			Banks have argued that the ratios of liquid assets to total assets proposed by BoA in the first draft: **a. ratio of liquid assets to total assets at a minimal level of 20%;** **b. ratio of liquid assets in foreign currency to total assets in foreign currency at a minimal level of 30%;** **c. ratio of loans in foreign currency to deposits in foreign currency at a maximum level of 100%.** **are very difficult to reach even in the medium term.**
15. Liquid Assets Definition	Liquid-assets minimally include the integrity of the following elements: - Monetary assets, - other accounts in the central banks, - T-bills and other re-financing bills accepted by the	a. Cash; b. Accounts with Bank of Albania including the legal reserve up to 50% of its usable amount; c. Treasury Bills (up to 80%) and obligations issued by BoA or Government of Republic of Albania; d. other re-financing bills accepted by the central bank; e. Current accounts with banks, credit institutions and other financial institutions; f. Deposits with banks, credit institutions and other financial institutions with remaining maturity up to 7	There were some clarifications needed on the definition of liquid assets in terms of:

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	central banks, relationship with the other banks, - securities operations (net). Highly liquid assets shall mean cash values, current accounts with other banks, short-term deposits with other banks with maturity up to 7 days, treasury bills, short-term bonds of central banks and other similar instruments, and excess reserves with the Bank of Albania	days; g. Loans to banks, credit institutions and other financial institutions with remaining maturity up to 7 days (excluding subaccount 157); ***h. securities issued by central government and central banks with rating assigned by internationally recognized rating agency equivalent to rating of S&P not less then A+ (investment grade);*** ***i. securities issued by financial institution with rating assigned by internationally recognized rating agency equivalent to rating of S&P not less then A^+;*** j. securities that have not been rated but issued by international development banks listed in the regulation of Bank of Albania "On risk management arising from the large exposures of Banks"; k. Securities with remaining maturity up to one month; l. Securities purchased in a repurchase agreement with a remaining maturity up to one month; Liquid assets are included on a net basis excluding accrued interest and subtracting provisions, and when rated by different agencies, the lower rating will be considered.	- Securities issued by financial institutions to be considered liquid. Banks argued that the A^+ rating might be questionable as an indicator of liquidity for the security. However, in the PWG meeting, in the presence and with the advice of a Bank of Albania foreign expert, it was agreed that in the present conditions, this is the optimal indicator for the liquidity of securities. - **Banks suggested that the rating of securities to be included in liquid assets should be the latest available rather that performed no earlier than six months from the reporting period as suggested in the first draft, and BoA removed the 6 months condition.** - Percentage of overdrafts (on and off balance sheet) to be considered as liquid. Therefore BoA ***removed point m***. (irrevocable credit facilities approved to the bank) based on the information provided by banks through SPI

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			Secretariat, on their historical data and average percentages used for their internal control on liquidity.
16. Short Term Liabilities Definition	Short – term liabilities are minimally the integrity of the following elements: - Interbank operations (class 1), - demand deposits (class 2), - 10% of current accounts of credit outstanding (class 2).	***Short term liabilities are considered all banks liabilities with maturity up to one year.***	Banks argued that in the first detailed definition of short term liabilities given by BoA in the first draft, there were many clarifications needed main ones being: - Percentage of overdrafts (on and off balance sheet); - Percentage of current accounts and on sight deposits to be considered as short term liabilities (items (i) and (j) of article 8 of the draft regulation – banks argued that 30% figure is quite high) BoA through SPI Secretariat collected information on banks' historical data and average percentages used for their internal control on liquidity, and revised the definition of short term liabilities.
17. Other		a. Cumulative GAP up to one month / liquid assets;	**Banks required a clearer definition of the**

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Indicators		b. Cumulative GAP up to three months / liquid assets; c. Loans / Deposits (calculated in total and separately in Lek and foreign currency) d. Loans / Deposits and financing lines e. Liquid Assets / Total Deposits f. Cash / Short Term Liabilities g. Liquidity Ratio by maturity bands; h. Ratio of maturity transformation of short term sources in long term placements; i. Indicator of deposits concentration (by type of depositor, currency, sector, ect.) and their volatility; j. Average marginal cost of liquidity k. Limits of placements in other banks; l. Forecasting future needs for liquidity (disposable liquid assets – necessary liquid).	**composition and maturities of the assets composing the buckets used to calculate GAPs.** **Bank of Albania has provided indicative tables attached to the regulation.**
		D. Reporting to Bank of Albania	
18. Forms	The reporting form attached each month.	Banks report to BoA each month the forms attached to the regulation. In case of failure to meet the ratio limit, banks should report to the Supervisory Department at BoA.	No comment
19. Liquidity Management Structures	Name and organizational structures responsible for the management of	Banks create systems of liquidity risk management and make sure that these systems suit the typology, size and risk nature of the bank.	No comment

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	Liquidity and the respective policies.		
20. Policies	The internal regulation that stipulates, the principles for composing the contingency plan for unusual events threatening bank's liquidity.	BoA estimates continuously the general liquidity conditions of the bank and might require further and more frequent information in situations of liquidity constrains.	No comment