

Pursuant to Article 44 paragraph (2) item 3) of the Central Bank of Montenegro Law (OGM 40/10, 6/13, 70/17, 125/23), and Article 136 paragraph (4) of the Law on Credit Institutions (OGM 72/19, 8/21, 24/25), the Council of the Central Bank of Montenegro, at its meeting held on 18 December 2025, passed the following

DECISION

ON THE INTERNAL LIQUIDITY ADEQUACY ASSESSMENT PROCESS OF A CREDIT INSTITUTION

I. BASIC PROVISIONS

Subject matter

Article 1

This Decision governs the process of internal capital adequacy assessment of a credit institution, the method of and the time limits for reporting to the Central Bank of Montenegro (hereinafter: the Central Bank) on the adequacy of internal liquidity of a credit institution, including the internal liquidity calculation.

Definitions

Article 2

The terms used in this Decision shall have the following meaning:

- 1) **internal liquidity adequacy assessment process** (hereinafter: ILAAP) means the process of identification, measurement, and monitoring of internal liquidity implemented by a credit institution;
- 2) **internal liquidity** means the amount of funding of the credit institution that, under the economic perspective referred to in Annex 1 that is provided in Annex to this Decision and makes an integral part thereof, is used for:
 - covering risks and expected outflows arising from such risks the credit institution is exposed to in its operations;
 - maintaining business continuity on a permanent basis.
- 3) **small and non-complex credit institution** shall have the meaning as laid down in the Law on Credit Institutions (OGM 72/19, 8/21, 24/25) - (hereinafter: the Law);
- 4) **risk profile** means the measurement or assessment of all risks to which a credit institution is or might be exposed in its operations;
- 5) **stress testing** means the assessment of the impact of certain developments and processes, including micro or macroeconomic scenarios, on the overall

financial position of a credit institution or sources of funding and liquidity, as well as the requirement or the impact of shocks on the overall liquidity position of a credit institution, including determining liquidity and/or liquidity requirements;

Internal liquidity strategy

Article 3

(1) A credit institution shall adopt an internal liquidity planning strategy that should ensure that the maintained liquidity levels are supportive of the expected placement growth, future sources of funds and their use, dividend policy and any changes in the levels of minimum requirements.

(2) For the purposes of determining internal liquidity adequacy, a credit institution shall, as a part of the strategy referred to in paragraph (1) of this Article, adopt a funding plan clearly defining the following:

- 1) the strategic objectives and time limits for their realisation, considering the impact of macroeconomic factors and changes in the economic cycle on strategic plans;
- 2) the method by which a credit institution is to comply with liquidity requirements in the future;
- 3) the relevant limits related to liquidity (e.g. the impact of a change in regulations or of the adoption of new regulations);
- 4) general contingency plans (e.g. the way of raising additional funds, business activity restriction or the application of risk mitigation techniques).

Establishment and implementation of ILAAP

Article 4

(1) A credit institution shall establish an adequate process of ongoing assessment and maintenance of internal liquidity, taking into consideration its risk profile, risk management and risk mitigation techniques.

(2) When establishing the process for determining and applying an adequate internal liquidity level, in addition to factors referred to in paragraph (1) of this Article, a credit institution may also take into consideration the following factors: the target external rating, market position, entrance to new markets, liquidity accessibility and acquisition of other undertakings, and other strategic goals.

(3) A credit institution shall analyse and document the impact of the factors referred to in paragraphs (1) and (2) of this Article on its internal liquidity level.

(4) The process of an ongoing assessment and maintenance of internal liquidity referred to in paragraph (1) of this Article shall be considered adequate if:

- 1) 1) it is based on the identification, measurement or assessment, aggregation and monitoring of significant risks;

- 2) 2) it ensures adequate internal liquidity, taking into consideration the risk profile of a credit institution; and
- 3) 3) it is adequately incorporated into the governance arrangements of a credit institution.

(5) A credit institution shall document the process referred to in paragraph (1) of this Article.

(6) The internal audit of a credit institution shall assess the appropriateness of the process referred to in paragraph (1) of this Article at least once a year.

(7) When establishing and implementing the process referred to in paragraph (1) of this Article, a credit institution shall use guidelines provided in Annex 1 of this Decision.

II. ILAAP

2.1 Scope of ILAAP

Phases of ILAAP

Article 5

(1) ILAAP shall include the following phases:

- 1) the identification of risks;
- 2) the measurement or assessment of individual risks and the determination of related internal liquidity requirements; and
- 3) the comparison of the prudential liquidity requirements and the required internal liquidity.

(2) A credit institution shall perform ILAAP at least once a year, and more often in the case of a significant change in the risk profile of a credit institution.

2.2 Risk identification

Material risks

Article 6

(1) A credit institution shall, when performing ILAAP, on the basis of its risk profile, identify material liquidity and funding risks to which it is or might be exposed in its operations, taking into account the type, scope and complexity of its activities and the markets in which it operates.

(2) In order to identify material risks in accordance with paragraph (1) of this Article, a credit institution shall take into account risks arising from deposit run-off, risks due to

the inability to access sufficient amounts of liquidity resources in foreign currency, including other short-term and intra-day liquidity risks, as well as funding sustainability risks.

(3) The identification of all risks and the determination of their significance must be based on a comprehensive assessment of the risks to which a credit institution is or might be exposed, which are inherent in individual operations, products, activities, processes and systems of a credit institution, both on the portfolio and individual product basis.

(4) The risk identification process must also include an assessment of the financial position of a credit institution and the environment in which it operates.

Risk definitions

Article 7

(1) For the purposes of managing risks referred to in Article 6 of this Decision, a credit institution may, in addition to the indicators set out in the Law and regulations governing risk management in credit institutions, determine other risk definitions, provided that it gives a detailed explanation to the Central Bank thereof.

(2) Where a credit institution in its ILAAP uses risk definitions that are different from the definitions prescribed by regulations governing risk management in credit institutions, it shall explain the impact of the application of these definitions on the level of liquidity requirements of the credit institution.

2.3 2.3. Measurement and assessment of individual risks and the determination of related internal liquidity requirements

Risk measurement or assessment of methodology

Article 8

(1) When calculating internal liquidity requirements, a credit institution shall by quantitative methods measure or, if the risks are difficult to quantify, assess significant risks using the methodology and approaches which are the most suitable for its organisation and business activities.

(2) When determining internal liquidity requirements, a credit institution shall establish for which liquidity risks it is appropriate to use quantitative methods, and for which risks it is more suitable to exclusively use risk mitigation techniques or control measures instead of determining internal liquidity requirements.

(3) A credit institution may use various approaches to calculate internal liquidity requirements for various types of risk, provided that it defines an adequate

methodology to measure or assess each risk and that it documents and explains the following:

- 1) the risk assessment methods/approaches;
- 2) the assessment of non-measurable risks; and
- 3) all corrections in risk amounts undertaken when a credit institution establishes that the methods used to measure or assess a specific risk fail to show the current exposure of the credit institution to that risk.

Stress testing

Article 9

(1) In order to make a quality assessment of its risk exposure, a credit institution shall regularly, and at least once a year, carry out scenario and sensitivity analyses for all significant risks and internal liquidity, and take into account the results obtained when assessing and maintaining an adequate level of internal liquidity.

(2) Stress testing must be appropriate for every risk factor significant for a credit institution's operations, which is specific to the business and legal environment in which a credit institution operates and to the part of the business cycle in which it is located, whereas the stress testing programme should at least cover those risks identified as material in accordance with Article 6 of this Decision.

(3) A credit institution shall analyse the impact of changes to the existing or adoption of new regulations, competition activities or other factors that have an impact on its operations, in order to determine the changes in the operating environment of the credit institution and how these changes can affect its liquidity and funding position.

(4) A credit institution shall determine in its risk management policies the scope and frequency of stress testing and the procedures and actions it will take in cases of unfavourable stress testing results.

2.4 Determining total internal liquidity

Calculation of total internal liquidity requirements

Article 10

(1) A credit institution shall define the categories and constituent elements of liquidity used to calculate the available internal liquidity.

(2) A credit institution shall determine total internal liquidity requirement by adding up liquidity requirements for all material risks referred to in Article 6 of this Decision that require the calculation of liquidity requirements.

(3) A credit institution shall maintain internal liquidity at least at the level of total internal liquidity requirements referred to in paragraph (2) of this Article.

(4) Notwithstanding paragraph (2) of this Decision, a small and non-complex credit institution may allocate an internal liquidity requirement in the amount of at least 5% instead of the risk assessment referred to in Article 6 of this Decision.

III. INTEGRATION OF ILAAP INTO GOVERNANCE ARRANGEMENTS

Use of assessment results

Article 11

(1) The ILAAP must be a constituent part of a credit institution's governance arrangements.

(2) A credit institution shall make use of the ILAAP results when:

- 1) defining and monitoring the realisation of the risk management policy and strategy;
- 2) adopting decisions on lending and financial plan; and
- 3) adopting major strategic decisions (e.g. to launch a new product, enter a new market, etc.).

(3) The ILAAP must enable the management and supervisory boards of a credit institution at all times to assess and/or evaluate all material risks to which a credit institution is or might be exposed in its operations.

Outsourcing

Article 12

(1) A credit institution may outsource a part of a phase of ILAAP referred to in Article 5, paragraph (1) of this Decision.

(2) The provisions of the regulation governing the management of outsourcing related risks shall apply to outsourcing referred in paragraph (1) of this Article.

Assessment process on a consolidated basis

Article 13

(1) A credit institution which in accordance with the Law applies the provisions of this Decision on a consolidated basis for a group of credit institutions in Montenegro shall:

- 1) when managing risks at the level of the group, define and align the processes and procedures, tasks and responsibilities of individual employees and organisational units as well as reporting lines within the group;
- 2) ensure that the methodologies for risk measurement and/or assessment are aligned at the level of the group;

- 3) assess significant risks of all undertakings within the group including its own risks and the risks inherent in the conduct of business with persons outside the group which have an impact on the overall risk profile of the group;
- 4) calculate the required internal liquidity on a consolidated basis and on an individual basis and adjust the required internal liquidity and required liquidity resources;
- 5) integrate the ILAAP on a consolidated basis into the management and decision-making processes of a credit institution; and
- 6) report to the Central Bank on ILAAP on a consolidated basis, in line with Articles 14 and 15 of this Decision.

IV. REPORTING TO THE CENTRAL BANK

Report content

Article 14

(1) A Credit institution shall submit to the Central Bank a report on the implementation of ILAAP, which shall include the following in particular:

- 1) general information and summary;
- 2) business model and strategy description;
- 3) management information;
- 4) the description of the manner for determining significant risks;
- 5) the manner of managing significant risks (individually for each risk);
- 6) the manner of measuring or assessing significant risks and determining adequate amounts of internal liquidity requirements;
- 7) the methods for determining total internal liquidity and liquidity/funding plans;
- 8) other information the credit institution deems relevant for ILAAP implementation.

(2) The report referred to in paragraph (1) of this Article shall include a list of internal acts of a credit institution, indicating the dates of their adoption and their last amendments, as well as a list of internal reports of a credit institution relevant for internal liquidity adequacy assessment process, specifying the time frames of their production and the management bodies they are intended for.

(3) A credit institution shall accompany the report referred to in paragraph (1) of this Article with specific information referred to in Annex 2, which is provided in Annex of this Decision and forms an integral part thereof.

Time limits for reporting and reporting template

Article 15

(1) A credit institution shall prepare Report on ILAAP as at 31 December of the previous year and submit it to the Central Bank at the latest until 30 April of the current year.

(2) The report referred to in paragraph (1) of this Article shall be prepared using a template provided in Annex 3, which is provided in Annex of this Decision and forms an integral part thereof.

V. TRANSITIONAL AND FINAL PROVISION

Submission of the first report on ILAAP

Article 16

A credit institution shall submit the first report in ILAAP in accordance with this Decision to the Central Bank at the latest until 20 April 2027 using the financial information as at 31 December 2026.

Entry into force

Article 17

This Decision shall enter into force on the eighth day following that of its publication in the "Official Gazette of Montenegro".

THE COUNCIL OF THE CENTRAL BANK OF MONTENEGRO

**CHAIRPERSON
GOVERNOR**

Irena Radović, m.p.

Decision number: 0101-10024-13/2025

Podgorica, 18 December 2025

ANNEX 1

ILAAP GUIDELINES

Principle 1 – The management body is responsible for the sound governance of the ILAAP

1. In view of the major role of the ILAAP for the credit institution, all of its key elements are expected to be approved by the management body of the credit institution. The management body, senior management and relevant working bodies of the management body are expected to discuss and challenge the ILAAP in an effective way.
2. Each year, the management board is expected to provide that the credit institution assesses internal liquidity adequacy of the credit institution, supported by ILAAP outcomes and any other relevant information, by producing and signing a clear and concise statement, the liquidity adequacy statement (LAS).
3. The management board has full responsibility for the implementation of the ILAAP, and it is expected to approve an ILAAP governance framework with a clear and transparent assignment of responsibilities, adhering to the segregation of functions. The governance framework should include a clear approach to the regular internal review and validation of the ILAAP.

The management body approves key elements of the ILAAP

4. The management board is expected to produce and sign the LAS, and approve the key elements of the ILAAP, for example:
 - the governance framework;
 - the internal documentation framework;
 - the perimeter of entities captured, the risk identification process, and the internal risk inventory and taxonomy, reflecting the scope of material risks as well as the coverage of those risks by liquidity;
 - risk quantification methodologies, including comprehensive risk measurement assumptions and parameters (e.g. time horizon, confidence levels, and maturity profile), supported by a reliable liquidity adequacy assessment approach (including the stress-testing framework and a precise definition of liquidity adequacy);
 - quality assurance of the ILAAP, particularly with regard to key inputs for the LAS (including the set-up and role of internal validation, the use of self-assessment against applicable rules, regulations and supervisory expectations, controls in place for validating the credit institution's data, stress test results, models applied, etc.).

Internal review and validation

5. The ILAAP shall be subject to regular internal review. The credit institution should use the regular internal review to cover both qualitative and quantitative aspects, including, for example the use of ILAAP outcomes, the stress-testing framework, risk capture, and the data aggregation process, including proportionate validation processes for internal risk quantification methodologies used.
6. For this purpose, the credit institution should have in place adequate policies and processes for internal reviews, which should be conducted by the three lines of defence, consisting of the business lines and the independent internal control functions (risk management, compliance and internal audit), in accordance with their respective roles and responsibilities.
7. The credit institution should have in place a defined process in order to ensure proactive adjustment of the ILAAP to any material changes that occur, such as entering new markets, providing new services, offering new products, or changes in the structure of the group.
8. ILAAP outcomes and assumptions are expected to be subject to adequate internal review, covering, inter alia, liquidity planning, scenarios, and risk quantification. The extent to which this review is expected to be quantitative as opposed to qualitative depends on the nature of the element assessed. This review is expected to take due account of the limits and constraints arising from the methodologies employed, the underlying assumptions and the input data used in quantifying the risk.
9. The purpose of the review is to scrutinise whether the internal processes, chosen methodologies and assumptions have led to sound outcomes (“back-testing”) and whether they remain appropriate with a view to the current situation and future developments. The outcome of this review should be thoroughly assessed, documented and reported to senior management and the management body. In case any weaknesses have been identified, effective follow-up actions are expected to lead to a quick rectification of the findings.

Liquidity adequacy statement(LAS)

10. In the liquidity adequacy statement (LAS), the management body provides its assessment of the liquidity adequacy of the credit institution and explains its main supporting arguments, backed by information it considers relevant, including ILAAP outcomes. The credit institution should provide a sound LAS which demonstrates that the management body has a good understanding of the liquidity adequacy of the credit institution, its main drivers and vulnerabilities, the main ILAAP inputs and outputs, the parameters and processes underlying the ILAAP, and the coherence of the ILAAP with the credit institution's strategic plans.

Principle 2 – The ILAAP is an integral part of the overall management framework

11. The credit institution should establish adequate strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intraday, to ensure that it maintains adequate liquidity buffers.
12. In addition to an adequate quantitative framework for assessing liquidity adequacy, a qualitative framework needs to ensure that liquidity adequacy is actively managed. This includes the monitoring of liquidity adequacy metrics to identify and assess potential threats over different time horizons, including intraday, in a timely manner, drawing practical conclusions and taking preventive action to ensure that regulatory and internal liquidity buffers remain adequate.
13. The quantitative and qualitative aspects of the ILAAP should be consistent with each other and with the credit institution's business strategy and risk appetite.
14. The ILAAP should be integrated into the business, decision-making and risk management processes of the credit institution. The ILAAP is expected to be consistent and coherent throughout the group.
15. The credit institution should maintain a sound and effective overall ILAAP architecture and documentation of the interplay between the ILAAP elements and the integration of the ILAAP into the credit institution's overall management framework.
16. The ILAAP should support strategic decision-making and, at the same time, be operationally aimed at ensuring that the credit institution maintains adequate liquidity on an ongoing basis, thereby promoting an appropriate relationship between risks and rewards. All methods and processes used by the credit institution to steer its liquidity as part of the operational or strategic liquidity management process should be approved, thoroughly reviewed, and properly included in the ILAAP and its documentation.

The ILAAP as an integral part of a credit institution's management framework

17. In order to assess and maintain adequate liquidity to cover risks, the credit institution's internal processes and arrangements should ensure that quantitative analysis of risks, as reflected in the ILAAP, is integrated into all material business activities and decisions
18. This integration may be achieved by using the ILAAP for, for example, the strategic planning process at group level, monitoring liquidity adequacy indicators to identify and assess potential threats in a timely manner, drawing practical conclusions and taking preventive action, determining liquidity allocation, and ensuring the ongoing effectiveness of the *risk appetite framework* (RAF).

19. ILAAP-based risk-adjusted performance indicators should be used in the decision-making process, and, for example, when determining variable remuneration or when discussing business and risks at all levels of the credit institution, including, inter alia, in asset and liability management committees, risk committees and meetings of the management body.

The overall ILAAP architecture

20. The management board shall be responsible for maintaining a sound and effective overall ILAAP architecture, ensuring that the different elements of the ILAAP fit coherently together and that the ILAAP is an integral part of the credit institution's overall management framework. The credit institution should have a clear view of how these elements are consistently integrated into an effective overall process that allows credit institution to maintain liquidity adequacy over time.
21. The credit institution should include, as part of its ILAAP documentation, a description of the overall ILAAP architecture, for example an overview of the key elements of the ILAAP and how they work together, explaining how the ILAAP is integrated into the credit institution's functioning and how its outcomes are used in the credit institution. This ILAAP architecture description should explain the high-level structure of the ILAAP, how its outcomes are used in decision-making, and the connections between, for example, business and risk management strategies, funding plans, risk identification processes, the risk appetite statement, limit systems, risk quantification methodologies, the stress-testing programme and management reporting.

Reporting to management bodies

22. The ILAAP is an ongoing process. The credit institution should integrate ILAAP outcomes (such as how material risks, key indicators, etc. are evolving) into its internal reporting to different managerial levels, with appropriate reporting frequencies.
23. The frequency of reporting to the management body should be at least quarterly, but, depending on the size, complexity, business model and risk types of the credit institution, reporting might need to be more frequent to ensure timely management action, given the potentially rapid changes in the liquidity and funding situation and the immediate impact that an inadequate liquidity position could have on the continuity of the credit institution.

The ILAAP and the risk appetite framework (RAF)

24. The risk appetite framework (RAF) of the credit institution should formalise the interplay between the RAF and other strategic processes such as the ICAAP, the

recovery plan and the remuneration policy. The credit institution's RAF should be closely interlinked with the ILAAP and a cornerstone of sound liquidity risk management.

25. In its risk appetite statement, the credit institution should set out both a clear and unambiguous view on and intended actions with regard to its risks in line with its business strategy. In particular, the statement should include motivations for taking on or avoiding certain types of risks, products or geographical regions in which it operates. Furthermore, the credit institution should widen the monitoring of the liquidity risks to other metrics than the regulatory ones and to select a diversified set of metrics proportionate to its business model and risk profile.
26. The credit institution's overall risk profile should ultimately be constrained and driven by the group-wide RAF and its implementation. Furthermore, the RAF is a critical element of the credit institution's strategy development and implementation process. In a structured manner, the RAF links risks taken to the credit institution's liquidity adequacy and its strategic objectives.
27. The credit institution should clearly state how the implementation and monitoring of its strategy and risk appetite are supported by its ILAAP, and how this effectively allows it to comply with the agreed risk boundaries set out in the risk appetite statement. In order to facilitate sound and effective risk management, the credit institution should use the ILAAP outcomes when setting up an effective risk monitoring and reporting system and an adequately granular limit system (including effective escalation procedures) that allocates specific limits to, for example, individual risks, sub-risks, entities and business areas, promoting the risk appetite statement of the group.
28. The credit institution should have a policy in place regarding the use of public funding sources. Such policies should differentiate between the use of such sources during business as usual and during times of stressed conditions and be explicitly considered in the risk appetite (timing and amount) and liquidity adequacy statements. The credit institution should monitor the actual and potential future use of such sources. This monitoring should take place in all material currencies. In order to quantify both the timing and the amount of potential future use of such sources, stress testing should be used.

Consistency between ILAAP and recovery plan

29. A recovery plan aims at providing measures to be taken by the credit institution to restore its financial position following a significant deterioration. Since insufficient liquidity is one of the key threats to business continuity/viability of the credit institution, the ILAAP and the recovery plan should be parts of the same risk management continuum. While the ILAAP is aimed at maintaining the continuity of a credit institution (within its strategy and intended business model), recovery plan sets out measures (including extraordinary measures) to restore

the credit institution's financial position following a significant deterioration.

30. The credit institution should ensure consistency and coherence between its ILAAP, on the one hand, and its recovery plans and recovery related mechanism (e.g. thresholds for early warning signals and recovery indicators, escalation procedures, and potential management actions) on the other. Moreover, potential ILAAP management actions with potential material impact should be reflected without delay in the recovery plan, and vice versa, to ensure that the processes and the information included in related documents are consistent and up to date.

Principle 3 – The ILAAP contributes fundamentally to the continuity of the credit institution by ensuring its liquidity adequacy from different perspectives

31. The ILAAP plays a key role in maintaining the business continuity of the credit institution by ensuring its adequate liquidity and funding position. In order to ensure this contribution to its business continuity, the credit institution should implement a proportionate ILAAP that is prudent and conservative and integrates two complementary internal perspectives.
32. The credit institution should implement an economic perspective, under which it should identify and quantify all material risks that may negatively affect its internal liquidity position.
33. Under the economic perspective, the credit institution should ensure that any risks that may affect its liquidity position are adequately covered by internal liquidity in line with its internal liquidity adequacy concept. This includes the assessment of a credible baseline scenario and adequate, institution-specific adverse scenarios, as reflected in the multi-year liquidity and funding planning and in line with the overall planning objectives of the credit institution.
34. The credit institution should implement a normative perspective which is an assessment of the credit institution's ability to fulfil all of its liquidity-related regulatory and supervisory requirements and demands and to cope with other external financial constraints on an ongoing basis in the medium term.
35. The credit institution should have a formal liquidity contingency plan (LCP) referred to in Article 113 paragraph (5) item 7) of the Law on Credit Institutions that clearly sets out the measures for addressing liquidity difficulties under stressed circumstances. The LCP should address the risks identified in the credit institution's ILAAP and to set out the relationship with its recovery plan.

Objective ILAAP: to contribute to the continuity of the credit institution

36. The objective of the ILAAP is to contribute to the credit institution's continuity from a liquidity perspective by ensuring that it has sufficient liquidity to fulfil its obligations when they fall due, to bear its risks and follow a sustainable strategy,

even during a prolonged period of adverse developments. The credit institution should reflect this continuity objective in its RAF (as specified under Principle 2) and to use the ILAAP framework to reassess its risk appetite and tolerance thresholds within its overall liquidity constraints, taking into account its risk profile and vulnerabilities.

37. Within these liquidity constraints, the credit institution should assess and define management buffers above the regulatory and supervisory minima and internal liquidity needs that allow it to sustainably follow its strategy. When aiming for sufficient management buffers over the short-term horizon, the credit institution should take into account, for example, the expectations of markets, investors and counterparties and the reliance of the business model on the ability to pay out bonuses, dividends and payments on Additional Tier 1 instruments. In addition to such external constraints, the management buffers are expected, for example, to cushion uncertainties around projections of, and possible resulting fluctuations in, liquidity ratios, to reflect the credit institution's risk appetite and to allow it some flexibility in its business decisions.

Economic internal perspective

38. Economic internal perspective of liquidity adequacy requires the internal liquidity of the credit institution to be sufficient to cover its risks and expected outflows and to support its strategy on an ongoing basis. Under this perspective, the credit institution's assessment should cover the full universe of risks that may have a material impact on its liquidity position, taking into account cash flows and the applicable liquidity value of liquid assets. The credit institution should manage economic risks and adequately assess them in its stress-testing programme and its monitoring of liquidity adequacy.
39. The credit institution should use its own processes and methodologies to identify, quantify, and provide internal liquidity for the expected and unexpected outflows that it might be subject to, taking into account the principle of proportionality. The credit institution should perform a point-in-time risk quantification of the current situation as at the reference date. This should be complemented by a forward-looking liquidity adequacy assessment for the medium term that takes into account future developments, like changes in the external environment. The credit institution should capture at least three years for the funding position and an appropriate time horizon for the liquidity position.
40. For this purpose, in addition to assessing the available liquidity against liquidity needs in its daily operations and funding planning under a baseline scenario, the credit institution should also consider adverse scenarios. Where relevant, the assumptions used should be consistent with the recovery plan.
41. The credit institution should use the outcomes and metrics of the economic

liquidity adequacy assessment in its strategic and operational management, when reviewing its risk appetite in its interactions with clients (stopping new business, enforcing repayment at contract date without refinancing, etc.) and markets (fire sales and other actions that affect market perception when executed) and when reviewing its business strategies. In addition to prudent internal liquidity buffers definition and risk quantification, the credit institution should present an economic liquidity adequacy concept that enables it to remain economically viable and follow its strategy. This includes management processes to identify in a timely manner the need for action to overcome emerging internal liquidity deficiencies and to take effective measures (e.g. increasing liquidity buffers, changing the cash flow profile).

Normative perspective

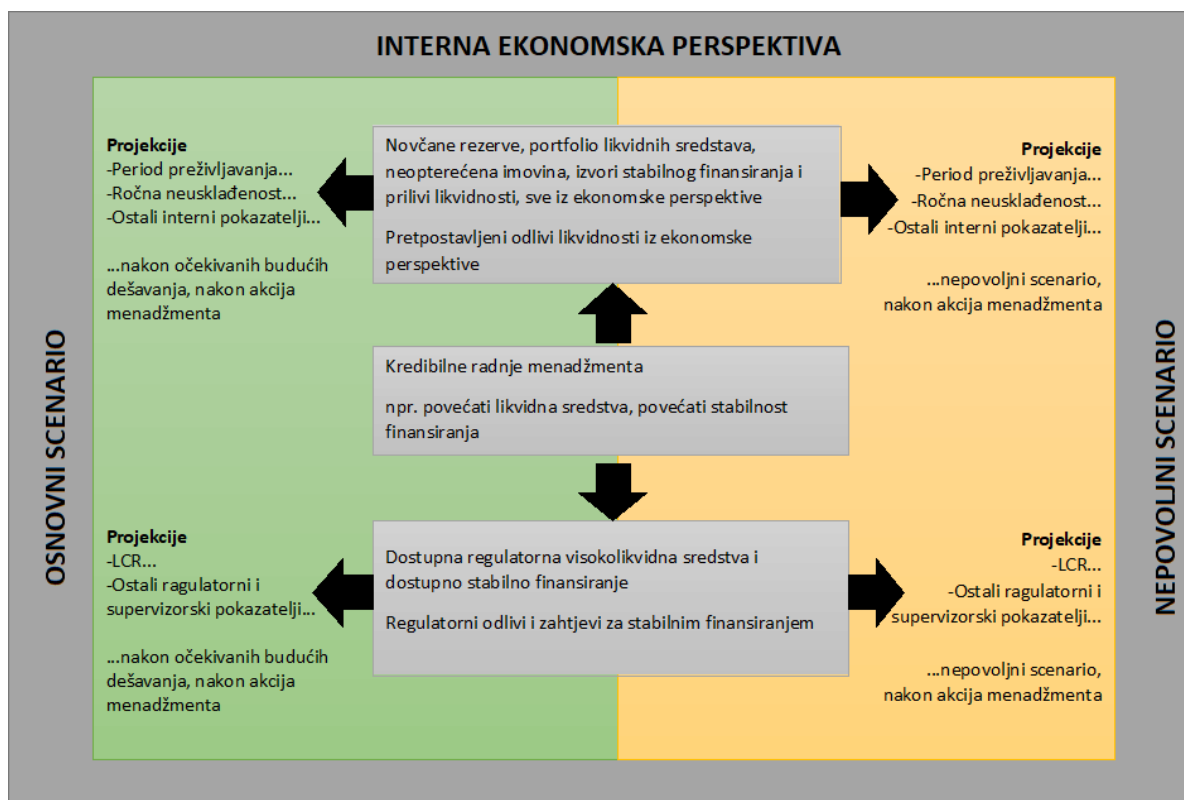
42. The normative perspective is a multi-year assessment of the credit institution's ability to fulfil all of its liquidity-related (quantitative) regulatory and supervisory requirements and demands, and to cope with other external financial constraints, on an ongoing basis.
43. The normative perspective should take into account all aspects that could affect relevant regulatory ratios, including inflows, outflows and liquidity buffers, over the planning period. Therefore, although its outcomes are expressed in regulatory metrics, the normative perspective is not limited by the assumptions underlying the calculation of the Pillar 1 ratios. Rather, when assessing its liquidity adequacy under the normative perspective, the credit institution should take into account the assumptions it uses under the economic perspective when calculating the Pillar 1 ratio.
44. The credit institution should maintain a robust, up-to-date liquidity and funding plan that is compatible with its strategies, risk appetite and liquidity resources. The liquidity and funding plan should comprise baseline and adverse scenarios, and to cover a forward-looking horizon capturing at least three years for the funding position and an appropriate time horizon for the liquidity position.
45. When preparing those projections the credit institution should account for the economic situation as reflected in the economic perspective. The credit institution should also take into account the impact of upcoming changes in legal, regulatory, and accounting frameworks and make an informed and reasoned decision on how to address them in the liquidity and funding planning.
46. To assess the expected evolution of key normative and economic internal metrics under adverse developments in ongoing business expectations, the credit institution needs to assess the level of these metrics under adverse conditions against internal thresholds as defined in the risk appetite statement. This does not mean that the credit institution needs to comply with the liquidity coverage ratio (LCR) under severe stress conditions, but that it should present a concept

that enables it to remain viable and pursue its strategy, e.g. by taking concrete action (change in liquidity profile) as a result of the projections it has made. This also implies that the credit institution should monitor the potential decline in the LCR under such conditions and link this to its risk appetite, LCP and recovery plan.

Interaction between the economic and the normative perspectives

47. Figure provided in the text below gives an overview of the aspects, measures and outcomes that should be taken into account under the economic and normative perspectives for the assessment of both the liquidity and the funding position. Although the calculations of the projections under the normative perspective mechanically follow Pillar 1 provisions, the credit institution nonetheless should form an internal view on the scenarios used and on the impacts of those scenarios on projected Pillar 1 and Pillar 2 figures. Under the economic perspective, it should also select adequate scenarios and determine the impact on the respective projections. In addition, under the economic perspective it is also expected to determine adequate assumptions and measures for all supply, demand and surplus-relevant calculation methodologies. The differences in methodologies, measures and assumptions used can lead to very different outcomes of the assessments between the two perspectives, even if the same scenario is applied.
48. The same is true with regard to management actions taken into account in liquidity or funding planning under the two perspectives. Moreover, such differences can even occur within the same perspective, depending on the scenario assessed. Figure provided in the text below shows that the same management actions may have materially different impacts, depending on the perspective and the scenario considered. The credit institution should take this into account in its liquidity and funding planning and ensure that the management action assumptions under the different perspectives are consistent with each other.

Different impacts of credible management actions, depending on the perspectives and scenarios considered – illustrative example



49. If the credit institution assumes management actions in its liquidity and funding plan, it should assess the feasibility and expected impact of such actions under the respective scenarios, and to be transparent about the quantitative impact of each action on projected figures.
50. The economic and normative perspectives should mutually inform each other and be integrated into all material business activities and decisions as outlined under Principle 2 of these Guidelines.
51. In addition to measuring its current ability to fulfil liquidity obligations, the credit institution should have a clear and concise plan on how to act when (unexpected) difficulties arise in meeting obligations as they fall due. The ILAAP is therefore expected to contain detailed information on liquidity contingency measures (in the form of an LCP) that can be taken, including an assessment of the potential contingent liquidity that can be generated during stress, the time the measures would take to execute, potential negative effects (on profit and loss account, reputation, business model viability, etc.) and the likelihood of completion of the measures under stressed conditions. Such liquidity contingency measures should be consistent with the risks identified and quantified in the ILAAP. The

credit institution should make clear (in its ILAAP architecture) the relationship between the LCP and the liquidity part of the recovery plan and how these relate to the risks identified on an ongoing basis, as described above, and under stress circumstances.

Principle 4 – All material risks are identified and taken into account in the ILAAP

52. The credit institution is responsible for implementing a regular process for identifying all material risks it is or might be exposed to under the economic and normative perspectives. All risks identified as material should be addressed in all parts of the ILAAP in accordance with an internally defined risk taxonomy.
53. Taking a comprehensive approach, including all relevant legal persons, business lines and exposures, the credit institution should identify at least annually risks that are material using its own internal definition of materiality. This risk identification process should result in a comprehensive internal risk inventory.
54. In the case of financial and non-financial participations, subsidiaries, and other connected entities, the credit institution should identify the significant underlying risks that it is or may be exposed to and take them into account in its ILAAP.
55. For all risks identified as material, the credit institution is expected either to cover the risk with sufficient liquidity or to document the justification for deciding not to do so.

Risk identification process

56. The credit institution should implement a regular process for identifying all material risks and include them in a comprehensive internal risk inventory. Using its internal definition of materiality, it should ensure that the risk inventory is kept up to date. In addition to regular updates (at least yearly), the credit institution should adjust the inventory whenever it no longer reflects the risks that are material, e.g. because a new product has been introduced or certain business activities have been expanded.
57. The risk identification should be comprehensive and take both normative and economic perspectives into account. In addition to its current risks, the credit institution should consider in its forward-looking liquidity adequacy assessments any risks, and any concentrations within and between those risks, that may arise from pursuing its strategies or from relevant changes in its operating environment.
58. The risk identification process should follow a “gross approach”, i.e. without taking into account specific techniques designed to mitigate the underlying risks. The credit institution should then assess the effectiveness of these mitigating actions.
59. The management body is responsible for deciding which risk types are to be

considered material, and which material risks are to be covered by liquidity. This includes a justification of why a certain risk the credit institution is exposed to is not considered material.

Internal risk inventory

60. When determining its internal risk inventory, the credit institution is responsible for defining its own internal risk taxonomy. It should not simply adhere to a regulatory risk taxonomy.
61. In its risk inventory, the credit institution should take into account the underlying risks, where material, stemming from its financial and non-financial participations, subsidiaries and other connected entities (for example, intragroup risk, reputational and operational risks, risks stemming from letters of comfort, etc.).
62. In a proportionate way, the credit institution should look beyond participation risks and identify, understand and quantify significant underlying risks, and take them into account in its internal risk taxonomy, regardless of whether the entities concerned are included in the prudential perimeter or not. The depth of the analysis of the underlying risks should be commensurate with the business activity and the risk management approach.
63. The credit institution should look at all relevant products, clients, contracts (triggers) from a maturity and behavioural perspective for the different time horizons considered, including intraday. Such risks may, for example, stem from increased outflows, reduced inflows or reduced liquidity value of liquid assets. Both on- and off-balance-sheet items should be considered in this regard, including contingent liquidity impacts from collateral calls and margin calls owing to market movements or a reduction in own creditworthiness (including voluntary buy-backs of own debt to ensure market access in the future).
64. One example is innovative funding instruments with call options that amend the maturity of the funding (not limited to evergreen deposits and repos) which need to be identified and captured as a source of possible contingent liquidity risk. Another is collateral swaps that can influence the size and composition of the stock of liquid assets. The credit institution should clearly identify any potential risk stemming from such transactions and include them in the set of risk indicators.
65. In the case of cross-border activities, a credit institution should include in ILAAP an assessment of impediments to the transfer of liquidity between legal entities, countries and currencies and quantify the impact of such impediments on the availability of liquidity throughout the group.
66. The ILAAP should ensure a sound process for determining and monitoring what

currencies are considered material for liquidity risk and/or funding risk. The credit institution should clearly identify any material risks, including those stemming from cross-border activities, resulting in liquidity or funding risk being (partly) taken in a currency other than the currency of the corresponding liquidity buffers. Such risks should be quantified in the ILAAP both under normal conditions (balance sheet positions and currency differences) and under stressed conditions (liquidity value of liquid assets in foreign currency versus stressed net outflows in foreign currency) for each currency that is considered material.

Principle 5 – The internal liquidity buffers are of high quality and clearly defined; the internal stable sources of funding are clearly defined

67. The credit institution should define, assess and maintain internal liquidity buffers and stable sources of funding under the economic perspective. The definition of internal liquidity buffers should be consistent with the economic liquidity adequacy concept and internal risk quantifications of the credit institution.
68. The internal liquidity buffers should be of sound quality, and determined in a prudent and conservative manner. The credit institution should show clearly, assuming the continuity of its operations, how its internal liquidity is available to cover risks, thereby ensuring that continuity.
69. The sources of funding should be stable to ensure that business operations can also continue in the longer term.

Internal liquidity buffers definition

70. The credit institution should define which assets and future inflows can be considered to be liquidity available for the purpose of assessing its liquidity adequacy, taking a prudent and conservative approach. This internal definition should be based on the likelihood of the liquidity sources being used to obtain liquidity under normal and stressed conditions. The credit institution forms an explicit internal view on the desired composition of the buffers of liquid assets used to cover liquidity risks. The credit institution should differentiate between assets that are highly likely to remain liquid during times of stress and assets that can only be used to obtain liquidity from the Central Bank.

Internal stable sources of funding definition

71. For the purposes of assessing its funding sustainability, the credit institution should define which funding sources can be regarded as stable, taking a prudent and conservative approach. In order to define this, an explicit internal view should be formed on the stickiness of deposits and the (behavioural) cash flow profile, taking behavioural assumptions into account. The credit institution should assess the stability of its funding profile, accounting for the diversity (or concentration) of funding providers, markets and products, and assess its market access in terms

of volume and pricing. The financing plan should be executed taking into account current asset encumbrance and expected changes.

Principle 6 – ILAAP risk quantification methodologies are adequate, consistent and independently validated

72. The credit institution is responsible for implementing risk quantification methodologies that are adequate for its individual circumstances under both the economic and normative perspectives. In addition, the credit institution should use adequate methodologies for quantifying the potential future changes in its liquidity and funding position in its adverse scenarios. The credit institution should apply a high level of conservatism under both perspectives to ensure that rare/tail events are considered appropriately.
73. The key parameters and assumptions should be consistent throughout the group and between risk types. All risk quantification methodologies should be subject to independent internal validation. The credit institution should establish and implement an effective data quality framework.

Comprehensive risk quantification

74. The ILAAP should ensure that risks that the credit institution is/may be exposed to are adequately quantified. The credit institution should implement risk quantification methodologies that are tailored to its individual circumstances (i.e. they should be in line with its risk appetite, market expectations, business model, risk profile, size and complexity).
75. Risks are not expected to be excluded from the assessment because they are difficult to quantify or the relevant data are not available. In such cases, the credit institution should determine sufficiently conservative risk figures, taking into consideration all relevant information and ensuring adequacy and consistency in its choice of risk quantification methodologies.
76. The key parameters and assumptions cover, inter alia, confidence levels and scenario generation assumptions.

Level of conservatism

77. The risk quantification methodologies and assumptions used under the economic and normative perspective should be robust, sufficiently stable, risk-sensitive and conservative enough to quantify liquidity outflows that occur rarely. Uncertainties arising from risk quantification methodologies should be addressed by an increased level of conservatism.

Choice of risk quantification methodologies

78. It is the responsibility of the credit institution to implement adequate methodologies both to quantify its risks and to determine projections. This means that there is no predetermination as to whether, for example the credit institution should use (amended) Pillar 1 methodologies (e.g. to take into account concentration risk), stress test results or other methodologies, such as multiple scenarios, to quantify the risks it is or may be exposed to.
79. The methodologies used should be consistent with each other, with the perspective considered and with the definition of liquidity and stable funding. They should capture the risks to which the credit institution is exposed in an adequate and sufficiently conservative manner, taking into account the principle of proportionality. This means, for example, that larger or more complex credit institutions, or credit institutions that have more complex risks, should use more sophisticated risk quantification methodologies to capture the risks in an adequate manner.
80. However, the credit institution is not expected to implement risk quantification methodologies that it does not fully understand and which, consequently, are not used for its own internal risk management and decision-making. The credit institution should be able to demonstrate the adequacy of the methodologies for its individual situation and risk profile. In the case of vendor models, this includes the expectation that such models are not expected to be imported automatically, but rather they should be fully understood by the credit institution and well-suited for, and tailored to, its business and its risk profile.

Data quality

81. The credit institution should deploy adequate processes and control mechanisms to ensure the quality of data. The data quality framework should ensure reliable risk information that supports sound decision-making, and it should cover all relevant risk data and data quality dimensions.

Independent validation

82. ILAAP risk quantification methodologies should be subject to regular independent internal validation, respecting, in a proportionate way, the principles underlying the respective standards established for Pillar 1 internal models, taking into account the materiality of the risks quantified and the complexity of the risk quantification methodology.
83. Depending on the size and complexity of the credit institution, various organisational solutions may be adopted to ensure independence between the development and validation of risk quantification methodologies. However, the concepts underlying the various lines of defence should be respected; i.e. the

independent validation should not be conducted by the internal audit function.

84. The overall conclusions of the validation process should be reported to senior management and the management body. These conclusions should be used in the regular review and adjustment of the quantification methodologies, and taken into account when assessing liquidity adequacy.

Principle 7 – Regular stress testing is aimed at ensuring liquidity adequacy in adverse circumstances

85. The credit institution should perform a tailored and in-depth review of its vulnerabilities, on a yearly basis and more frequently, when necessary, depending on the individual circumstances. This review should capture all material risks on a credit institution-wide basis that result from its business model and operating environment in the context of stressed macroeconomic and financial conditions. On the basis of this review, the credit institution should define an adequate stress-testing programme for both normative and economic perspectives.
86. As part of the stress-testing programme, the credit institution should determine adverse scenarios to be used under both perspectives, taking into account other stress tests it conducts. The application of severe, but plausible, macroeconomic assumptions and a focus on key vulnerabilities should result in a material impact on the credit institution's internal and regulatory liquidity position. In addition, the credit institution should conduct reverse stress testing in a proportionate manner.
87. The credit institution should continuously monitor and identify new threats, vulnerabilities and changes in the environment to assess at least quarterly whether its stress testing scenarios remain appropriate and, if not, adapt them to the new circumstances. The impact of the scenarios should be updated regularly (e.g. quarterly). In the case of material changes, the credit institution should assess their potential impact on its liquidity adequacy over the course of the year.

Determination of the stress-testing programme

88. The stress-testing programme should cover both the normative and the economic perspective. It should capture different time horizons (including intraday), and take the relevant currency split into account. When defining the set of internal stress scenarios and sensitivities, the credit institution should use a broad set of information on historical and hypothetical stress events. It is the credit institution's own responsibility to define scenarios and sensitivities in the manner that best addresses its individual situation and to translate them into liquidity inflows and outflows and applicable liquidity values of liquid assets. The normative perspective should be covered under the stress-testing programme in such a way that the impact of the stress events on the evolution of the projected regulatory ratios such as the LCR is analysed at various points in time.

89. When defining stress testing scenarios, the credit institution should capture their material vulnerabilities, given its individual business model, risk profile and the external conditions it faces. Other stress tests conducted, e.g. sensitivity analysis, should inform the scenarios used by revealing the material vulnerabilities of the credit institution.
90. As liquidity transferability can be very different during periods of stress when compared with normal times, a credit institution with significant cross-border activities should assess the transferability of liquidity within the group and take this into account in its stress-testing programme. It should analyse the impact and likelihood of additional impediments to liquidity transferability under stressed conditions, in particular for operations outside the euro area; and to identify remedial actions and contingency measures for such a scenario.

Severity level of adverse scenarios

91. In its baseline assessment, the credit institution should assume developments that it would assume under expected circumstances, taking into account its business strategy, including credible assumptions regarding inflows and outflows, risk materialisations, etc.
92. In adverse scenarios, the credit institution should assume exceptional, but plausible developments with an adequate degree of severity in terms of their impact on its liquidity position. The level of severity should correspond to developments that are plausible, but as severe from the credit institution's perspective as any stress event that might be observed during a crisis situation in the markets, factors or areas that are most relevant for the credit institution's liquidity adequacy.
93. The range of adverse scenarios should adequately cover severe economic downturns, severe market disruptions and financial shocks, relevant institution-specific vulnerabilities, reliance on major funding providers, and plausible combinations of these.

Coherence versus targeting key vulnerabilities

94. In stress testing, the credit institution should focus on its key vulnerabilities when attempting to define plausible adverse scenarios. ICAAP and ILAAP stress tests should inform each other; i.e. the underlying assumptions, stress test results and projected management actions should be mutually taken into account. For instance, if the ILAAP stress tests apply a stress event to the credit spread or ratings of assets in the liquidity buffer, the impact shall be considered in ICAAP stress tests and vice versa.

Reverse stress test

95. In addition to stress-testing activities that assess the impact of certain assumptions on its liquidity position, the credit institution should conduct reverse stress-testing assessments. These assessments should start from the identification of the pre-defined outcome, such as the business model becoming unviable.
96. Such reverse stress tests should be used to challenge the comprehensiveness and conservatism of the ILAAP framework assumptions. Reverse stress tests should be conducted at least once a year. Depending on the likelihood of the resulting scenarios, it may be necessary to immediately address the scenarios by taking or preparing management actions in the ILAAP in order to prevent a recovery situation that would occur if one or more of the reverse stress testing scenarios assessed in the ILAAP were to become reality. Moreover, reverse stress testing in the ILAAP context could be seen as a starting point for developing recovery plan scenarios.

ANNEX 2**ILAAP GUIDELINES**

A credit institution should submit to the Central Bank the following information so as to enable it to perform appropriate supervisory assessments:

A. Information on liquidity and funding risk management framework.**Methodology and policy documentation**

On evidencing the set-up of a process that ensures a credit institution has a robust and specific framework for liquidity and funding risk management, including a process for identifying, measuring and controlling liquidity and funding risks, a credit institution shall submit to the Central Bank the following:

- 1) description of the scope of ILAAP including an overview of and reasoning for any deviations from the prudential scope of liquidity requirements recognising possible waivers;
- 2) description of the set-up of ILAAP explaining the relation between all its components and providing reasoning about how that set-up ensures the credit institution has access to sufficient liquidity;
- 3) the criteria applied by the credit institution for the selection of significant risk drivers for liquidity and funding risks, including the selection of significant currencies for monitoring the liquidity and the funding positions;
- 4) the criteria applied by the credit institution 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.

Operational documentation

On evidencing the full implementation of a process that ensures a credit institution has a robust and specific framework for liquidity and funding risk management, including a process for identifying, measuring and controlling liquidity and funding risks, a credit institution shall submit to the Central Bank the following:

- 1) an assessment of the intragroup liquidity flows and funding positions, including any possible legal or regulatory impediments to the transfer of liquidity within the group;
- 2) reasoning for the selection of the significant risk drivers and a quantitative overview

of these risk drivers, updated at an appropriate frequency;
- 3) quantitative overview of the funding profile and its perceived stability in all significant

currencies;

- 4) evidence of the monitoring of compliance with minimum and additional prudential requirements related to liquidity and funding risks, including the forecast of compliance with these requirements under different scenarios over an appropriate time horizon within the scope of ILAAP coverage.

B. Methodology and policy documentation

On the funding strategy, a credit institution shall submit to the Central Bank the following:

- 1) description of the general set-up of the funding plan, including sources of funding, tenors, key markets, products used, etc.;
- 2) where applicable, a policy on maintaining presence in markets in order to ensure and periodically test market access and fund-raising capacity of the credit institution, where relevant;
- 3) where applicable, a policy on funding concentration risk, including documents on the principles for measuring and monitoring of correlation between funding sources and economic connection between depositors and other liquidity providers;
- 4) where applicable, a policy on funding in foreign currencies, including the most relevant assumptions with regard to availability and convertibility of these currencies.

Operational documentation

On evidencing the full implementation of the funding strategy, a credit institution shall submit to the Central Bank the following:

- 1) the current funding plan;
- 2) 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, taking into account (changes in) market volatility;
- 3) a forward-looking view on the (desired) development of the funding position over a forward-looking time horizon;
- 4) an assessment of the funding position and funding risk after the execution of the funding plan;
- 5) information on back-testing of the funding plan;

C. Information on strategy regarding liquidity buffers and collateral management

Methodology and policy documentation

On liquidity buffers and collateral management strategy, a credit institution shall submit to the Central Bank the following:

- 1) its methodology for determining the internal minimum size of the liquidity buffer, including its definition of liquid assets, the criteria it applies for determining the liquidity value of liquid assets and the constraints relating to concentration and other risk characteristics of the liquid assets;
- 2) policy 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;
- 3) policy 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 institution's (liquidity and funding) risk appetite;
 - 4) principles for testing the assumptions relating to the liquid assets included in the liquidity buffer, and the time needed to sell or repo such assets;
 - 5) policy 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.

Operational documentation

On evidencing implementation of the strategy regarding liquidity buffers and collateral management, a credit institution shall submit to the Central Bank the following:

- 1) quantification of the minimum volume of liquid assets considered adequate to meet internal requirements;
- 2) quantification of the current liquidity buffer, including its distribution over products, counterparties, regions/subsidiaries, etc.;
- 3) description of differences between the definitions of the elements of the "counterbalancing capacity" and "high quality liquid assets" including reasoning to show that the counterbalancing capacity is capable of covering risks not included in regulatory requirements;
- 4) 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;
- 5) 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;
- 6) 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;
- 7) analysis of the testing of assumptions relating to the value of liquid assets included in the liquidity buffer, and the time needed to sell or repo such assets;

D. Information on the cost-benefit allocation mechanism

Methodology and policy documentation

On the set-up of the liquidity cost-benefit allocation mechanism, a credit institution shall submit to the Central Bank the following:

- 1) 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 costs and benefits are taken into account, as well as any adjustment frequency of the prices;

- 2) description of the interlinkages between the liquidity cost-benefit allocation mechanism and the risk management and overall management of the credit institution.

For a credit institution with liquidity transfer pricing (LTP) mechanisms in place, a credit institution shall also include in the information referred to in the previous paragraph a description of the set-up and functioning of the LTP, and in particular of the interlinkages between the LTP and strategic decision making, as well as front office decision making on asset and liability generation.

Operational documentation

On evidencing cost-benefit allocation of the implementation of the liquidity mechanism, a credit institution shall submit to the Central Bank the following:

- 1) 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.);
- 2) 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;
- 3) 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 a credit institution with the LTP mechanisms in place, the information referred to in the previous paragraph should also cover the functioning of the LTP, and in particular the relation between the LTP and key risk indicators.

E. Information on intraday liquidity risk management

Methodology and policy documentation

Where applicable, on the set-up of intraday liquidity risk management, a credit institution shall be able to submit to the Central Bank the following:

- 1) description of the criteria and tools for measuring and monitoring intraday liquidity risks;
- 2) description of the escalation procedures in the case of intraday liquidity shortfalls which ensure that payments and settlement obligations due are met on a timely basis under both 'business as usual' and stressed conditions.

Operational documentation

Where applicable, on the implementation of intraday liquidity risk management, a credit institution shall be able to submit to the Central Bank the following:

- 1) quantitative overview of intraday liquidity risks over the past year at an appropriate frequency;
- 2) the total number of missed payments and an overview with explanation of

material payments missed or significant obligations not met by the credit institution in a timely manner.

A. Information on liquidity stress testing

Methodology and policy documentation

In addition to the general information on stress testing, on the set-up of liquidity stress testing, a credit institution shall submit to the Central Bank the following:

- 1) 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;
- 2) description of the criteria for calibrating scenarios, selecting appropriate time horizons (including intraday, where relevant), quantification of the impact of stress on the value of the liquidity buffer.

Operational documentation

On evidence of the full implementation of liquidity stress testing, a credit institution shall submit to the Central Bank the following:

- 1) 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;
- 2) quantitative and qualitative analysis of the outcomes of stress testing on the funding profile.

F. Information on liquidity contingency plan

Methodology and policy documentation

On the set-up of the liquidity contingency plan, a credit institution shall submit to the Central Bank the following:

- 1) description of the lines of responsibilities for designing, monitoring and implementing the liquidity contingency plan;
- 2) description of the strategies for addressing liquidity shortfalls in contingency situations;
- 3) description of a tool to monitor market conditions that allows a credit institution to determine in a timely manner whether escalation and/or execution of measures is warranted;
- 4) description of testing procedures, where available (e.g. examples of sales of new asset types, pledging collateral with the central bank, etc.).

Operational documentation

On the implementation of liquidity contingency plan, a credit institution shall submit to the Central Bank the following:

- 1) the current liquidity contingency plan;
- 2) information on the possible management body actions including the assessment of their feasibility and liquidity generating capacity under different stress scenarios;
- 3) the management body view on the implications of all liquidity-related public disclosures made by the credit institution for the implementation and timeliness of management body actions included in the liquidity contingency plan;
- 4) recent analysis of testing, including conclusions on the feasibility of the management body actions included in the liquidity contingency plan;
- 5) description of the internal view on the impact of executing the management body actions included in the liquidity contingency plan, e.g. on the access the credit institution has to relevant markets and on the overall stability of its funding profile in the short and longer terms.

G. Supporting documentation

In addition, a credit institution shall submit all relevant supporting information including minutes of relevant committees and management body meetings evidencing the sound set-up and implementation of ILAAP, and in particular:

- 1) approval of the overall set-up of ILAAP;
- 2) 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, targeted size and composition of liquidity buffer, etc.;
- 3) evidence of discussion on (changes in) the liquidity and funding risk profiles, limit breaches, including decisions on management body actions or the explicit decision not to take any action;
- 4) examples of significant committees' decisions on the approval of new products evidencing, if applicable, the use of the liquidity transfer pricing (LTP) and risk views in these decisions;
- 5) evidence of discussion of the analysis of the feasibility of the funding plan based on (changes in) market depth and volatility;
- 6) evidence of decisions on management body actions related to intraday liquidity risk after internal escalation due to specific intraday liquidity events;
- 7) evidence of discussion of the outcome of liquidity stress tests and decision on any management body (non-)action;
- 8) evidence of discussion on the regular testing of the liquidity contingency plan and decisions on adjusting the management body actions listed in the liquidity contingency plan;
- 9) decision relating to the level and composition of the liquidity buffer;
- 10) evidence of discussion regarding the testing of the liquidity value of the liquid

assets included in the liquidity buffer, and the time needed to sell or repo such assets;

- 11) where available, internal self-assessments in which credit institutions can take the opportunity to justify their level of compliance against publicly available criteria regarding risk management and control that affect the ILAAP.

H. Conclusions and quality assurance

A credit institution shall submit to the Central Bank the conclusions of the assessments of internal liquidity and internal liquidity adequacy and their impact on the risk and overall management of a credit institution, including also the following:

- 1) summary of main conclusions on ILAAP in order to form a concise view on the current liquidity position of the credit institution, its capacity to cover the risks to which it is or might be exposed, and any measures planned by it to ensure that liquidity remains at, or is restored to, an adequate level in the near future;
- 2) material changes (made or planned) to the risk management framework based on ILAAP results;
- 3) material changes (made or planned) to business models, strategies or risk appetite frameworks based on ILAAP results, including management body actions (e.g. changes of risk positions);
- 4) material changes (made or planned) to the ILAAP framework, including improvements to be introduced following the observation of internal validations, internal audit reports and the outcomes of the dialogue with the Central Bank.

A credit institution shall submit the information specified in the previous paragraph that have been approved by the pertinent body responsible for ILAAP and that are accompanied by a specific time frame for the planned changes.

A credit institution shall also submit an adequate explanation of how the credit institution ensures that the ILAAP frameworks and models used provide reliable results (e.g. validation concepts, validation reports) and a description of both the internal validation approach (process, frequency) and the validation content, where available.

In particular, a credit institution shall submit all available results of the internal validations/reviews of the ILAAP methodologies and outcomes of calculation performed by the independent validation function.

A credit institution shall submit the internal audit reports covering ILAAP.

ANNEX 3

ILAAP GUIDELINES

1. GENERAL INFORMATION AND EXECUTIVE SUMMARY

Full name and head office of the credit institution	
Period which the report concerns	1 January 20xx – 31 December 20xx
Date of compilation of the report	
Person/persons in charge of coordinating the report	
Name of the work position of the contact person/persons who have coordinated the report	
Organisational unit	
Telephone and e-mail address the contact persons/person	
Date of the most recent internal auditor's report with regard to the ILAAP	
Date of approval by the management board and signature	
Management board member responsible for the content of the report	
The scope of application of the ILAAP in the credit institution	<i>Indicate if the ILAAP is being implemented on an individual or consolidated basis at credit institution group level in Montenegro. If ILAAP is applied on a consolidated basis, identify the legal persons included in the report, the direct and indirect percentage of participation, and the methodology for integrating their assets and liabilities on the consolidated perimeter (full consolidation or proportional consolidation)</i>

Signature of the management board member _____

1.1 Liquidity targets

The credit institution identifies its liquidity targets and identifies if currently the credit institution's liquidity is adequate, (i) considering the minimum liquidity requirements (ii) the internal liquidity requirements, (iii) the liquidity needs stemming from the credit institution liquidity planning, including the foreseen asset or risk growth during the projected periods, (iv) the availability of liquidity measures and sources, including in a recovery situation, as evidenced by the recovery plan, (v) any liquidity shortfalls that may stem from the stress testing exercises conducted by the credit institution and (vi) the internal management buffer with which the credit institution intends to operate

1.2 Business model

Briefly describe the business model and the present financial condition of the credit institution, specifying the amount of total assets and the most important asset items, total revenues, total expenses, and profit. Specify any expected changes in the current business model, the expected future business environment, business plans and the projected financial condition for the following year.

Briefly describe the link between the business strategy and ILAAP.

1.3 Governance

Briefly explain the governance framework for the preparation, approval, monitoring and review of the ILAAP document, including explicitly the units involved and the process of approval. In addition, state whether the document has been reviewed by the internal audit function.

1.4 Risk identification and assessment

The credit institution provides a list of material risks and their assessment, concluding in the credit institution's self-assessment of its own risk profile (to be stated in Table 1)

1.7 Liquidity decisions

--

1.8 Own assessment of adequacy of the ILAAP

The credit institution provides a brief description of its own self-assessment of adequacy of ILAAP, also listing the weaknesses and shortcomings, and the plan for improvement of the ILAAP and deadlines for the implementation of that plan.

--

2. BUSINESS MODEL AND STRATEGY

2.1 Business model and strategy

Describe the business model, indicating core business lines, geographic concentrations, subsidiaries, and key products offered by the credit institution, as well as main income and cost drivers by core business lines, markets, and subsidiaries. Specify any expected changes in the present business model, the expected business environment, business plans and the projected financial condition for the next year for main core business lines, markets, and subsidiaries. Describe in more detail if the credit institution intends to make operating changes to its business (e.g., IT infrastructure). This section can be met by cross-refer to the Business Plans.

--

3. GOVERNANCE

3.1 Organisational structure

The credit institution submits attached to this report a detailed organisational scheme, as well as the description of the position and corresponding obligations and responsibilities of the managerial authorities of the credit institution and the board. The flow chart of the reporting lines in connection with risk management and the ILAAP shall be provided in this part or attached to the organisational scheme.

The credit institution presents the manner in which the ILAAP had been established, lists the factors that had been considered in the course of defining the ILAAP, provides a list of reports related to the ILAAP and list how often they are being compiled and to whom they are being submitted, explains the internal policies and procedures, the procedure for the preparation of the ILAAP report, including the roles and responsibilities related to the ILAAP.

--

--

3.2 Role of the supervisory board

Describe the role of the supervisory board in the ILAAP preparation, approval, monitoring and review. Describe the role of the Audit Committee in the ILAAP process. List the decisions that the supervisory board have made on the basis of analysis of reports relating to the ILAAP.

--

3.3 Role of the management board

Describe the role of the management board in the ILAAP process

--

3.4 Strategy, risk management and risk control

The credit institution lists the most material principles of assuming and managing risks, as well as the list of internal acts in which they are provided. Describe how often the harmonization of the risk management strategy and business strategy is being performed.

The credit institution provides the description of the strategy for assuming risks and lists who is responsible for the implementation of that strategy. Asserts the risk appetite and express it in a quantitative manner, in the same way in which the limits are defined in the internal enactments of the credit institution.

The credit institution lists the internal acts that define the strategy for assuming risks as well as the results of the self-assessment of adequacy of the internal control system.

--

3.5 Supervision and self-assessment of the ILAAP

A credit institution provides a description of the method of implementation of the assessment of adequacy of the ILAAP performed by internal audit and other independent control functions within the organisation, such as the risk management function and the compliance monitoring function.

A credit institution provides a list of reports of internal audit and provides a brief review of the most material findings determined for the period to which this report relates. List the measures that have been undertaken on the basis of the findings of internal audit.

A credit institution states how it is organised and who is implementing the self-assessment, i.e., verification and re-examination of the ILAAP, and describes the results and the manner in which the adjustment and improvement of the procedure has been performed/or shall be performed.

4. RISK IDENTIFICATION

4.1 4.1. Risks to which a credit institution is or might be exposed

A credit institution lists the risks to which it is exposed – the internal risk inventory, explains whether the definition of a certain risk also includes specific sub-risks. If a credit institution diverges from the regulatory definition of risks, it should map its internal risk inventory to the regulatory taxonomy.

A credit institution describes the manner and the pace of identification of risk and determining its materiality. It lists and explains the factors considered in the course of that procedure.

A credit institution should provide a clear explanation about why a risk has not been considered as material.

Risks/sub-risks that are not material	Explanation of the reasons because of which the bank deems that the exposure to those risks is not material

5. RISK ASSESSMENT

5.1 Level of materiality

For each material risk, indicate the assigned risk materiality score (1 (low), 2 (medium-low), 3 (medium-high) and 4 (high)), providing an explanation for that score, and indicate how that risk is treated in ILAAP.

Indicate whether it is a qualitative and/or a quantitative treatment of risk in the ILAAP framework.

A credit institution should identify if the material risks have been properly considered in the stress testing.

Table 5. Treatment of material risk under the ILAAP

Material risk (main risk of material sub-risk)	Risk Level score (1-4)	Treatment of risk under the ILAAP		Included in the stress testing (Y/N)
		Qualitative (Y/N)	Quantitative (Y/N)	

6. RISK APPETITE

6.1 Risk level and risk appetite

Describe the liquidity targets and how the risk appetite framework is linked to the business strategy, liquidity and liquidity planning and risk management / governance, etc.

Description of the risk appetite/tolerance levels, thresholds and limits set for the identified material risks, as well as the time horizons, and the processes applied to keeping such threshold and limits up to date.

Table 6. RAF metrics and liquidity targets

Ratios	Objective - %	Early warning Indicator - %	Limit - %	Recovery Indicator - %

7. INTERNAL LIQUIDITY

7.1 Risk level and risk appetite

A credit institution should identify its internal liquidity requirements for material risks.

For internal liquidity purposes, a credit institution should employ the definition of liquidity resources.

A credit institution should provide a clear mapping between its identification of material risks, the assessment of those risks and the internal liquidity that has been allocated to them.

Table 7. Assessment of internal liquidity requirement for material risks

Material risk	Amount of assessed internal liquidity requirement (in EUR 000):	Amount of regulatory liquidity (in EUR 000):
		<i>(required amount of liquidity resources to meet all regulatory requirements)</i>

Material risk	Amount of assessed internal liquidity requirement (in EUR 000):	Amount of regulatory liquidity (in EUR 000):
TOTAL		

7.2 Where a credit institution applies the simplified method of calculation of internal liquidity requirements for material risks

A credit institution should explain the reasons for selecting the percentage of regulatory liquidity that it shall be using for the coverage of all the other material risks.

--

7.3 Where a credit institution applies other methods of calculation of internal liquidity requirements for material risks

A credit institution should explain the basic assumptions and the method of measurement of each of the other material risks.

A credit institution should list the internal policies where it prescribes in detail the methodology for assessment of internal liquidity requirements for each of the other material risks.

--

8. FINANCIAL PROJECTIONS AND FUNDING PLAN

8.1 Financial and liquidity planning

A credit institution provides a description of the planned absolute amount and the structure of liquidity, with which it shall cover all the material risks from its operations for the coming three years.

A credit institution provides a description of the general set-up of liquidity planning, including dimensions considered (e.g., internal, regulatory), time horizon, liquidity instruments, liquidity measures etc.

A credit institution provides a description of the most material elements of the plan for management of liquidity and submits the plan on individual basis and on consolidated basis (if applicable).

A credit institution provides an analysis of the differences between the planned amount of liquidity for the year for which it is compiling this report and the determined total internal liquidity requirements calculated in accordance with the results of the ILAAP on the same date.

A credit institution provides a description and assessment of the current conclusions from liquidity planning such as planned issuances of various liquidity instruments, other liquidity impacts (e.g., dividend policy) and planned changes to the balance sheet (e.g., sales of portfolios).

Table 8. Liquidity measures identification

Liquidity measures	Brief description

Liquidity measures	Brief description

9. STRESS TESTING

9.1 Stress testing

A credit institution should identify whether all the material risks that the it has identified within the ILAAP have been properly considered in the stress testing. A credit institution should map the main risk drivers used in the stress test to the material risks.

A credit institution provides a description of the stress testing programme, including, inter alia, the types of stress tests undertaken, their frequency, methodological details and models used, the range of assumptions and relevant data infrastructure.

A credit institution provides a description of the governance arrangements of the stress testing programme, the uses of stress testing and its integration into the risk management and control framework.

A credit institution provides a description of adverse scenarios considered under ILAAP, including specification of the scenario assumptions, key macro variables, management body actions, business assumptions regarding balance sheet, reference dates, time horizons, etc.

A credit institution provides a description of the quantitative outcome of the scenarios taking into consideration the proposed tables.

Table 9. General quantitative information on ILAAP stress testing

	LCR based	Survival period	Survival period (excl. the Central Bank)	Reverse stress test	Other
Type of internal stress test used					
Internal scenario horizon					
Type of internal stress scenario*					
Internal risk appetite / limit					
Outcome of stress testing					

10 ILAAP IMPROVEMENT

10.1 Measures for ILAAP improvement

A credit institution provides an explanation of the main weaknesses and shortcomings of the ILAAP noticed by the credit institution.

If necessary, a credit institution should refer to internal acts that concern the plan of activities for adjustment and improvement of the ILAAP.

A credit institution provides a list of the planned changes in the risk management strategy.

11 OTHER INFORMATION

11.1 Inclusion into the consolidated ILAAP

If a credit institution is a member of a banking group from another country, it should, in addition to this report, also submit the report on ILAAP it submits for the requirements of consolidated report on the level of the parent bank, and to describe the differences between those two reports.

11.2 Other

<i>A credit institution describes all other information and results of the ILAAP - that were not covered under the other parts of this report.</i>
--