



Pursuant to Article 35, paragraph 1.1 of the Law No. 03/L-209 on Central Bank of the Republic of Kosovo (Official Gazette of the Republic of Kosovo, No.77 / 16 August 2010), and Articles 19 and 85 of the Law No. 04/L-093 on Banks, Microfinance Institutions and Non-Bank Financial Institutions (Official Gazette of the Republic of Kosovo, No.11 / 11 May 2012), the Board of the Central Bank of Republic of Kosovo at the meeting held on November 29, 2012, approved as follow:

REGULATION ON THE LIQUIDITY RISK MANAGEMENT

CHAPTER I GENERAL PROVISION

Article 1 Purpose and Scope

1. The purpose of this Regulation is to set out the minimum requirements and standards to effectively manage the liquidity risk by banks.
2. This Regulation applies to all banks and branches of foreign banks licensed by the CBK to operate in the Republic of Kosovo, hereafter referred to as *banks*.

Article 2 Definitions

1. All terms used in this Regulation are as defined in Article 3 of the Law No. 04/L-093 on Banks, Micro-Finance Institutions and Non-Bank Financial Institutions (hereafter: *the Law on Banks*) and/or as further defined with this Regulation:
 - a. *Liquidity shortfall* - means each situation, where the bank:
 - i. does not own sufficient liquid assets or encounters difficulties to realize them in a market, with the purpose to meet obligations as they come due and to meet any unexpected demands for funds by its depositors or other creditors; or
 - ii. is unable to fund increases in its assets.
 - b. *Liquidity risk* - means the possibility of incurring a financial loss owing to the liquidity shortfall;
 - c. *Emergency circumstances/situations* - means those situations on which a real threat exists that may arise to the bank a liquidity shortfall;

- d. *Liquidity contingency plan* - means the document compiled by the bank, that clearly sets out the policies and procedures to be implemented under stressed environments, and the procedures to provide emergency funds;
- e. *Net cash flow* - means the difference between cash inflows and outflows for a definite period of time, thus reflecting an increase or decrease of cash amount;
- f. *Contractual residual maturity* - shall imply means the time period up to the conclusion of maturity term of contractual asset and liabilities;
- g. *Concentration on funding sources* - means the situation when a sole decision-making or a sole external factor may lead to a subsequent and significant withdrawal of funds, thus making the bank to significantly change its founding strategy;
- h. *Stress-testing* - means the risk management technique employed to analyze the possible impact of one or more internal and external factors on financial stability and/or bank liquidity position.
- i. *Big depositors* - shall be considered the twenty depositors with the highest value of deposits at the bank's total deposits;
- j. *Gap* - means the difference between the bank's assets and liabilities, by maturity spans;
- k. *Haircut* - means the percentage by which a liquid asset's value is reduced for the purpose of calculating the liquidity index, in compliance with the stipulations of this Regulation.

CHAPTER II LIQUIDITY RISK MANAGEMENT SYSTEM

Articles 3 Management System

1. Bank shall establish a liquidity risk management system, with the purpose of well management of their liquidity risk. Banks shall ensure that the liquidity risk management system, in terms of quality and quantity is in line with the bank's size, the business typology and the exposure rate against liquidity risk.
2. The liquidity risk management system shall consist at least as follows:
 - a. The strategy and policies on liquidity risk management;
 - b. The organization structure established for the liquidity risk;
 - c. The internal control system;
 - d. Information management system;
 - e. Liquidity stress testing;
 - f. Liquidity contingency plan.

Article 4 Strategies and Policies

1. Banks should develop the strategy and policies to manage liquidity risk.
2. The strategy on liquidity risk management shall consist at least as follows:
 - a. The strategy objectives;
 - b. The principles on liquidity risk management;
 - c. The general methodology the banks shall implement to manage liquidity risk in short and long term period;
 - d. The overall methodology and the banks' vision to operate in many markets and to have a sufficient number of funding sources and;
 - e. The policies for liquidity risk management.
3. The strategy on liquidity risk management shall be compiled as a separate document or part of the banks strategic plan. This latter shall be reviewed on a regular basis, at least annually.
4. Policies on liquidity risk management shall be reviewed on a regular basis, at least annually and shall minimally include:
 - a. The identification of liquidity risk arising from new products and operations;
 - b. The measurement of liquidity risk, particularly of:
 - i. The current liquidity position, including the assessment of liquid assets and collaterals position;
 - ii. Projection of cash inflows and outflows;
 - iii. Match of funds maturity term and funding sources;
 - iv. Concentration of deposits and other funding sources according to maturities, type and customers' structure;
 - v. Determinant indicators of liquidity and their use in the liquidity monitoring practice in the bank;
 - vi. Use of stress test as an element/part of monitoring liquidity.
 - vii. The regular assessment of markets development where the liquidity needs are met;

Article 5 Organization Structure on Liquidity Risk Management

1. Appropriate organizational structure of liquidity risk management shall imply clearly defined competencies and responsibilities of the bank's bodies and definition of the tasks and responsibilities of the respective organizational parts in the banks, authorized for monitoring the banks' liquidity and managing the liquidity risk.
2. The Board of Directors of the bank, regarding to the liquidity risk management has responsibility to:
 - a. Approve strategy of liquidity risk management;
 - b. Approve liquidity risk management policy and monitoring its implementation, including approval and monitoring of the liquidity contingency plan;

- c. Review the appropriateness of the adopted policy and procedures at least on annual basis;
 - d. Review the liquidity risk reports;
 - e. Approve the liquidity risk exposure limits;
 - f. Monitor the efficiency of internal control, as an integral part of the liquidity risk management system.
3. The Risk Management Committee shall:
 - a. Monitor the liquidity risk management policy and give proposals for its revision;
 - b. Assess the liquidity risk management system;
 - c. Analyze the reports on the bank's liquidity risk exposure and monitor the management of this risk;
 - d. Determine and regularly revise the internal liquidity indicators and liquidity risk exposure limits;
 - e. Define possible exceptions from the defined limits and assign responsible on applying such exceptions;
 - f. establish procedures and the method of performing stress-testing.
 4. Besides the Risk Management Committee, the bank may establish a special body (committee), which is responsibility for the operating implementation of the liquidity risk management through the monitor and daily control of liquidity risk.
 5. As specified by paragraph 4 of this Article, the banks' special body (committee) shall at least:
 - a. Approve and monitor implementation of liquidity risk management procedures;
 - b. Establish and maintain the efficiency of the system for liquidity measurement, monitoring, controlling and reporting, by currency, which significantly influence the banks' overall liquidity and monitor the maturity structure of assets and liabilities in Euro and in foreign currency;
 - c. Create environment for following the liquidity risk management policy;
 - d. Establish an adequate system of reporting to the Board of Director and Risk Management Committee on any noncompliance with the liquidity risk exposure limits;
 - e. Define the financial instruments for liquidity risk management;
 - f. Establish procedures for determining and monitoring the deposit stability;
 - g. Establish a procedure for assessing the effect of new products on the liquidity risk exposure;
 - h. Monitor the potential liabilities and exposure based on bank's off-balance sheet operations.

Article 6

Internal Control System

1. The bank shall have appropriate internal control procedures in place to ensure integration of the liquidity risk management process within the overall risk management process. The internal control of liquidity risk management shall be an integral part of the overall internal control system, established at a bank level.

2. For the purposes of the system of internal control of liquidity risk exposure, the bank shall establish:
 - a. Limits on the approval of cash flows over a certain amount and monitoring of the compliance with the prescribed limits;
 - b. Reporting on the potential noncompliance with the limits referred to sub-paragraph a. of this paragraph;
 - c. Regular verification of data and information used when determining bank's liquidity;
 - d. The assurance of consistency with all the laws, regulations and other bylaws of the CBK, and the internal rules of the bank.

Article 7 **Information Management System**

1. The bank shall establish an information system to ensure timely and ongoing measurement, monitoring, control and reporting in the decision-making process, when managing the liquidity risk.
2. The information system shall at least:
 - a. Measure and monitor the banks' liquidity and liquidity risk on a daily basis and in specific points in time;
 - b. Measure and monitor the banks' liquidity, by currency that significantly affect the overall banks' liquidity, on individual and on aggregate basis;
 - c. Monitor the compliance with the established liquidity risk exposure limits;
 - d. Provide data so as to determine liquidity indicators and prepare reporting forms for the needs of the banks' bodies and other persons involved in the liquidity risk management process;
 - e. Analyze the deposit base developments and determine and monitor the stability of deposits;
 - f. Carry out stress-testing.

Article 8 **Liquidity Stress Testing**

1. Banks shall manage liquidity not only under "normal" circumstances, but it should also be prepared to manage liquidity under stressed conditions.
2. Banks should perform stress tests on a regular basis in order to identify and quantify its exposure to liquidity risks, under normal conditions/situations of the daily activity, as well as in presence of stressed environments. For this purpose the banks shall analyze the impact on cash flow, on the short-term and long-term solvency, the preparation to act in emergency conditions/situations, and assesses its ability to increase assets through the identification of the availability of funding sources.
3. The frequency by which the banks shall carry out stress –tests should be commensurate with the size of the banks' activity, its liquidity risk exposures, as well as with the relative

importance of the banks within banking system, but not less than four times yearly. The CBK may require to the banks the conduction of stress-tests at more frequent periods.

4. The Board of Directors of the banks shall analyze the stress tests results not less than quarterly:
 - a. To improve the strategies and policies on liquidity risk management;
 - b. To compile and improve the needed regulatory framework to work with the purpose the solution of main issues regarding the liquidity position of the banks;
 - c. To develop the effective contingency plans.
5. Stress-tests as conducted by the banks shall include the use of particular scenarios based on internal factors, scenarios based on the market conditions the bank operates within as well as on the macroeconomic factors (external factors).
6. Scenarios on the conduction of stress tests may encompass the assumptions, as follows:
 - a. Deposits withdrawal;
 - b. Possible deterioration of borrowers' ability to settle their obligations, implying the worsening of credit's portfolio quality;
 - c. Impossibility of easily convertible and without considerable loss on assets in cash;
 - d. Possibility of liabilities settlement in advance under the terms of contractual options that provide this settlement;
 - e. Operation risk and its impact degree on the increase of liquidity risk;
 - f. Changes on the economic conditions in sectors against which bank is exposed and the deterioration of the economy as a whole;
 - g. Worsening of markets function where bank act and/or a considerable reduction of confidence on these markets;
 - h. Interest rates and exchange rate shock;
 - i. The effect of considerable changes on the bank' assets value and/or on the collateral;
 - j. The partial or full restriction of funding from main sources, including the possibility of continuing funding from the parent bank;
 - k. The impact of negative regional and global economic developments; and
 - l. Any other possible situation that is assessed as potential source of risk;
7. The assumptions listed in paragraph 6 of this Article are orienting ones, while the banks may make use of those situations that best fit with the complexity, risk profile and its share in the banking system.
8. The bank shall set out the methodology for the conduction of stress tests, the employed assumptions and the operations as a reaction to the derived outcomes, including:
 - a. The implementation, analysis of stress-tests scenarios and the frequency of these latter conduction;
 - b. Realization of stress-tests for individual and combined scenarios as well, under the simultaneous occurrence of some scenarios;
 - c. The regular documenting and review of the assumptions used for the conduction of stress-tests;

- d. The reporting way and frequency of stress-tests outcomes at the managing units;
- e. Operations to be developed by management units and/or special units charged with the risk liquidity management, based on stress-test results.

Article 9

Liquidity Contingency Plan

1. The banks should develop a contingency plan for liquidity risk management in emergency situations. The banks shall review the contingency plan at least annual basis, with the purpose the considering of possible changes of the internal and external conditions of the bank' operations. When deemed necessary, the CBK reserve the right to request from the bank to test the plan
2. The Contingency Plan shall be part of liquidity risk management system and shall include:
 - a. A clear specification of tasks, competences, responsibilities and decision making in terms of plan implementation;
 - b. The early warning indicators used as signals for the occurrence of emergency conditions and the assignment of the responsible persons within the bank for the monitoring and reporting of these indicators;
 - c. The conditions the plan shall be implemented;
 - d. The establishment of operations to be undertaken, identification of possible sources of funds, their level and priorities in use, and the definition of spans these operations be developed within;
 - e. Communication with main depositors, business partners, other customers and public at large; and
 - f. Contact data of person, who are responsible for the plan implementation.
3. In terms of stressed economic-financial situations, the banks shall cooperate closely, with the CBK and shall exchange information on continuous basis regarding its financial position, and the operations undertaken on its recovery at satisfactory parameters.

CHAPTER III

PRINCIPLES, INDICATORS AND MEASURES FOR LIQUIDITY RISK MANAGEMENT

Article 10

Main Elements for the Identification, Assessment and Management of the Liquidity Risk

1. The banks shall identify access and manage liquidity risk based on the following elements:
 - a. The principles of liquidity risk assessment;
 - b. The planning and monitoring of inflows and outflows;
 - c. The establishment and maintenance of an adequate maturity structure;
 - d. The monitoring of funding sources and their concentration;
 - e. The monitoring of collateral for liquidity purposes;
 - f. The monitoring of funding lines; and

- g. The liquidity ratios.

Article 11

Principles of Liquidity Risk Management

1. The banks shall identify access and manage the liquidity risk minimally based on the following principles:
 - a. The principle to provide stable sources of funds;
 - b. the principle on the minimization of contractual maturity gap and behavior maturity gap;
 - c. The principle on diversification of sources of funds according to the type, currency, instruments, maturity, clients and markets number, by taking account of their liquidity;
 - d. The principle on an equilibrated/controlled expansion of the activity and the maintaining of a sufficient liquid assets' value;
 - e. The principle on human resource availability for the effective management of liquidity risk.

Article 12

Planning and Monitoring of Inflows and Outflows

1. The bank shall forecast and monitor the inflows and outflows of funds at defined time periods, which should be forecasting in the minimum one year time periods. This forecast takes account of all type of inflows and outflows, including inflows and outflows based on the banks' off balance-sheet items. The bank shall compare this forecast with the current values of inflows and outflows, at regular intervals.
2. Forecasts on cash inflows shall minimally include:
 - a. Current settlement of credits (where the settlement rate cannot be higher than the inflows, and by discounting the reserve funds founded for the possible shortfalls);
 - b. The current conversion of assets into cash which do not have a definite maturity term;
 - c. Cash values generated from the investment securities;
 - d. Current possibilities of assets sale (where capital investments, nonperforming credits and fixed tangible assets are seen as less liquid assets, excluding the inflows arising from collateral/collaterals execution);
 - e. Expected increase of deposits;
 - f. The banks' ability to provide funds from other sources and the availability of funding market sources;
 - g. Other inflows, based on the analysis of the historic data regarding the inflows rates and performance at previous periods, considering the particularities of banks' operations, the seasonal effect, interest-rate sensitivity and the macroeconomic factors.
3. Forecasts on cash outflows shall minimally include:
 - a. Liabilities that mature;
 - b. The future growth of the banks' lending rate;
 - c. Levels of deposits and other stable liabilities based on their usual volatility and the acknowledgment of depositors' behavior and interests;

- d. Time deposits which may be withdrawn prior to maturity term and demand deposits;
- e. Effect of interest rate change at deposits level;
- f. Deposits concentration level;
- g. Outflows from off-balance sheet items;
- h. Other outflows based on the historic analysis of data on the outflows level and performance at previous periods, considering their seasonal effect, interest-rate sensitivity and the macroeconomic factors.

Article 13
Establishment and Maintaining of an Adequate Maturity Structure

1. The banks should monitor on monthly basis the maturity structure of assets and liabilities with the purpose the identification of possible maturity gaps.
2. The banks, with the purpose the measurement and monitor of gaps, shall classify the inflows and outflows from assets (rights), liabilities (claims) and off-balance sheet items, according to maturity intervals.
3. The banks shall use as cashing date of assets the latest possible date of cashing, and as settlement date the first possible date of settlement according to the following frequencies:
 - a. Up to seven (7) days,
 - b. Seven (7) days to one (1) month,
 - c. One (1) month to three (3) months,
 - d. Three (3) months to six (6) months,
 - e. Six (6) months to twelve (12) months
4. The banks shall monitor on ongoing basis the gaps by the expected residual maturity, by using for this purpose the forecasts on accepted inflows and outflows, for example among other, the probability of assets collection when mature, probability of deposits withdrawal prior to maturity.
5. The banks, in light of forecasting the forthcoming cash inflows, shall ensure that the approved assumptions be reasonable, adequate, documented and reviewed at regular periods.
6. The banks with the purpose to set out the residual maturity of rights and liabilities, shall:
 - a. Possess a database of inflows and outflows on which these assumptions are based;
 - b. Review at regular basis the assumptions employed to reflect the possible changes under internal and external conditions; and
 - c. Provide that assumptions take account of the seasonal and cyclical character of the inflows and outflows.
7. The banks, in accordance with the adopted methodology, may classify (group) flows by the type of customer maturity, currency, sector, etc.

8. The CBK may request the implementation of different assumptions or of correcting factors in the forecasting and monitoring of flows by expected maturity, if deeming these actions may provide a better mirroring of the bank's risk profile.
9. The banks shall analyze liquidity gaps mainly based on the following criteria:
 - a. Classification of assets, liabilities and off-balance items by maturities;
 - b. Assessment of deposits stability based on historic data and on the stress tests results;
 - c. Establishment of limits on liquidity gaps;
 - d. Gap calculation on monthly basis and by currencies which have significant impact on bank liquidity;
 - e. Liquidity gaps forecast in the future;
 - f. Any other criteria deemed as reasonable;

Article 14

Monitoring of Source of Funds and their Concentration

1. The banks shall monitor on a regular basis the source of funds to maintain a diversified base of these sources and to identify the possible concentrations. The concentrations are analyzed by the source of funds, type, market, the geographical concentration, currency and by maturity.
2. The monitoring of source of funds and their concentration shall include:
 - a. Maintaining of stable relationships with the biggest depositors, the correspondent banks, other significant customers and with business partners;
 - b. The setting out of deposits stability, considering the depositors' characteristics and the deposit type;
 - c. The monitoring of the diversification of the source of funds;
 - d. Determining and monitoring the movements in other source of funds.
3. The banks shall establish and monitor the concentration rate of current accounts and demand deposits denominated in the Euro currency and foreign currencies.

Article 15

Monitoring of Collateral for Liquidity Purposes

1. The banks shall monitor its collateral size and guaranties, to distinguish assets placed as collateral from free assets.
2. The effective monitoring of collateral aims to meet a range of demands for collateral to provide long-term, short-term and intraday liquidity.
3. The bank shall own a sufficient collateral size to meet the expected or forecasted needs for borrowing in the financial, intern banks market, market and from the CBK, based on its founding profile.

Article 16
Monitoring of the Financial Lines

1. The bank shall assess the re-negotiation possibility of funding lines and the possibility that funds providers react at the same way at stressed circumstances/situations.
2. The bank shall consider the probability of funding lines shortfalls at contingency circumstances.
3. The bank may not suppose the automated secured renegotiation at 100% (one hundred percent) of the overnight maturity lines.

Article 17
Liquidity Ratios

1. The banks shall maintain its liquidity at such amount, structure and ratios, which allow this latter to meet all its obligations and commitments, timely, at a reasonable cost and at a minimum risk.
2. The banks shall compile and implement the needed procedures to measure and monitor its net cash flows and liquidity denominated in the main currencies and as a total.
3. The banks shall calculate and provide at any time the observation of the ratio of liquid assets against the short-term liabilities:
 - a. Denominated in the Euro currency and in foreign currency at the minimum level 20% (twenty percent) and
 - b. Denominated as total currencies at the minimum level 25 % (twenty-five percent)
4. The following items shall account for the liquid assets:
 - a. Cash - on hand;
 - b. Accounts with CBK;
 - c. Accounts with the banks in Kosovo with maturity up to thirty (30) days;
 - d. T-bills issued by the Government of the Republic of Kosovo, recorded in the balance sheet as “tradable or for sale”;
 - e. 80 % (eighty percent) of bonds, issued by the Government of the Republic of Kosovo, recorded in the balance-sheet as “tradable or for sale”;
 - f. “Investment“ securities of the Government of the Republic of Kosovo (T-bills and bonds) with up to ninety (90) days residual maturity;
 - g. T-bills purchased under repurchase agreements, up-to seven (7) days residual maturity;
 - h. Current accounts with banks and other financial institutions;
 - i. deposits with banks and other financial institutions up-to thirty (30) days residual maturity;
 - j. Credits to banks and other financial institutions with thirty (30) days residual maturity;

- k. Tradable securities issued by central governments and/or central banks with credit rating, given by international rating agencies, equal with that of S&P and not lower than AA-;
 - l. Tradable securities issued by financial institutions with credit rating, given by international rating agencies, equal with that of S&P and not lower than AA-;
 - m. Placement/tradable securities, which are not rated, but issued by multilateral development banks (which are described in annex 1);
 - n. “investment” securities with 1 month residual maturity (excluding Kosovo Government securities included in paragraph 4 (f) of article 17);
 - o. Securities purchased through REPO agreements up-to-7 days residual maturity.
5. **Assets set out in sub-paragraphs “a”, “b”, “c”, “d”, “e”, “f”, “g”, “k”, “l”, and “m” of paragraph 4 of this Article, constitute highly liquid assets.**
6. All liquid assets set out in paragraph 4 of this Article, shall be included as such only in cases where there is no agreement or any commitment on them, which restricts the financial institutions to freely and independently possess them whenever needed, currently and in the future, except CBK required liquidity reserve.
7. Banks shall include in the index of liquid assets, the items set out in sub-paragraphs “h”, “i”, “j”, “n” and “o” paragraph 4 of this Article, by using the haircuts determined in the following table:

No.	Rating of the non-resident counterpart by S&P or equal to it	Haircut
1	above BBB- *	0%
2	BB+	10%
3	BB	20%
4	BB-	30%
5	B+	40%
6	B	50%
7	B-	60%
8	Below CCC+ *	100%

Note: * including: BBB-; *Including CCC+.

8. Liquid assets are included on net basis, excluding accrued interests and by subtracting provisions and in case of ratings from international rating agencies for the same security, the lowest rating shall prevail.
9. The banks shall, when calculating short term-liabilities, include all liabilities with residual maturity up to one (1) year, in addition to the Government’s securities sold accordingly to the repurchase agreement and deposits from third parties pledged as collateral/guarantee based on the agreement signed with the bank. In case of a branch of foreign bank, in calculating these short-term liabilities there are excluded the liabilities to parent bank with residual maturity higher than one month.

10. The banks also, along with indicators stipulated in paragraph 3 of this Article, monitor and set out, if deeming necessary, internal limits on the following indicators:
- a. Cumulative gap to one month against liquid assets;
 - b. Cumulative gap to three-months against liquid assets;
 - c. Loan to deposit ratio (calculated as a total and by currency: in Euro and foreign currency);
 - d. Loan to deposit and funding lines;
 - e. Ratio of liquid assets to total deposits;
 - f. Ratio of cash to short-term liabilities;
 - g. Liquidity ratio by maturity intervals;
 - h. Indicator of deposits concentration (by type of depositor, currency, sector, etc.) and their stability;
 - i. Limits on deposits at other financial institutions;
 - j. Projection on the forthcoming needs for liquidity (available liquid assets – required liquid assets).

CHAPTER IV TRANSITIONAL and CONCLUDING PROVISIONS

Article 18 Enforcement, Remedial Measures and Civil Penalties

Any violation of this Regulation shall be subject to the remedial measures and penalties provided for in Articles 58, 59 and 82 of the Law on Banks.

Article 19 Transitory Provision

Subjects of this regulation, no later than 6 (six) months following the entry into force of this Regulation, shall carry out in accordance with the requirements of this Regulation, the review and/or the approval of the internal rules and procedures, as well as stress-tests implementation on risk liquidity management.

Article 20 Entry into Force

This Regulation shall enter into force on December 3, 2012.

The Chairman of the Board of Central Bank of the Republic of Kosovo.

Sejdi Rexhepi

Annex 1.

List of Multilateral Development Banks:

- a. The International Bank for Reconstruction and Development;
- b. The International Finance Corporation;
- c. The Inter-American Development Bank;
- d. The Asian Development Bank;
- e. The African Development Bank;
- f. The Council of Europe Development Bank;
- g. The Nordic Investment Bank;
- h. The Caribbean Development Bank;
- i. The European Bank for Reconstruction and Development;
- j. The European Investment Bank;
- k. The European Investment Fund;
- l. The Multilateral Investment Guarantee Agency;
- m. The International Finance Facility for Immunisation;
- n. The Islamic Development Bank.