



BANKA QENDRORE E REPUBLIKËS SË KOSOVËS
CENTRALNA BANKA REPUBLIKE KOSOVA
CENTRAL BANK OF THE REPUBLIC OF KOSOVO

Prishtina, January 2009

TO THE MANAGING DIRECTORS OF ALL KOSOVO FINANCIAL INSTITUTIONS

Dear Sir/Madam

As you have been informed earlier, CBK will continue the method of communication in the form of Advisory Letters.

These letters are intended to provide assistance and clarity with issues impacting the Kosovo financial sector. As examples, we will discuss new developments in the industry, especially in these times of global financial concerns.

We hope this continued series of Advisory Letters will provide guidance and clarity to you.

Attached herewith is our sixth issuance, Advisory Letter 2009-1, concerning Minimum Standards for Liquidity Risk Management.

Best Regards,


Nexhat Kryeziu
Deputy Governor


Shpendije Himaj
Chief Supervision Officer



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Advisory Letter 2009-01

January 2009

MINIMUM STANDARDS FOR LIQUIDITY RISK MANAGEMENT

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PURPOSE

In the course of performing its supervisory activities, CBK has noted that liquidity risk management is a systemic issue that needs the attention of banks' governing bodies. In general, bank lending in Kosovo is growing faster than the deposit base. Also, as the banking sector is becoming more sophisticated as to financial products offered, the CBK will play its role supervisory role proactively by issuing general guidance to banks on the management of their liquidity

.As such the contents of this letter should be viewed as guidance. It is written in the context of the banking sector as it exists in Kosovo at present and will be revised as the sector evolves. It incorporates those aspects or overriding principles of liquidity risk management that CBK supervision views as essential. It represents the standards that CBK will use in its on-site examinations as to evaluating how well each bank manages its liquidity risk. CBK expects that banks will, on their own, develop or revise their liquidity risk management policies, practices and systems in order to substantively conform to these at all times.

ONGOING LIQUIDITY MANAGEMENT

A. Developing a Structure for Managing Liquidity Risk

- I. **Each bank should have an agreed strategy for the day-to-day management of liquidity, in the form of written policies**

As with managing other types of risk, sound liquidity risk management first involves setting a strategy for the bank ensuring effective board and senior management oversight, as well as operating under a sound process for identifying, measuring, monitoring and controlling liquidity risk. The formality and sophistication of the liquidity management process should be appropriate for the overall level of risk incurred by the bank and the sophistication of its banking activities.

Banks need to place a high priority as to their liquidity strategy. A main activity of banks is raising and maintaining adequate liquidity. Many banking activities depend directly on a bank's

continual ability to provide liquidity to customers. As highly leveraged businesses, banks are particularly vulnerable to liquidity problems, both of an institution-specific nature and those external events which affect markets as a whole. Virtually every financial transaction or commitment has implications for a bank's liquidity. In view of this, banks need put in place a liquidity strategy, policies, and management approach. The liquidity strategy should set out the general approach the bank will have to liquidity, including various quantitative aspects and qualitative (specific) targets.

The liquidity strategy should address the bank's goal of protecting financial strength and the ability to withstand stressful events in the marketplace.

A bank's liquidity strategy should articulate specific policies on particular aspects of liquidity management, such as the composition and quantity of liquid assets, the volatility and/or stability of liabilities (especially funding from deposits and other sources), the level of credit commitments made, the relative reliance on the use of certain financial instruments, and sources of back-up funding for liquidity needs. To a lesser extent in Kosovo, it should also include an approach to managing liquidity in different currencies. There should also be an agreed strategy for dealing with the potential for both temporary and long-term liquidity disruptions.

The strategy for managing liquidity risk should be communicated throughout the organization, particularly in light of the fact that in many banks, managing liquidity is no longer purely the responsibility of the treasury function. A breakdown in operating systems can also have a substantial impact on liquidity risk. All businesses units within the bank that conduct activities having an impact on liquidity should be fully aware of the liquidity strategy and operate under the approved policies, procedures, and limits.

Senior management and the appropriate personnel should have a thorough understanding of how other risks, including credit, market, and operational risk, impact on the bank's overall liquidity strategy. For example, credit problems with specific counterparties may affect the amount of anticipated cash inflows and necessitate alternative actions by the bank.

II. A bank's board of directors should approve the strategy and significant policies related to the management of liquidity. The board should also ensure that senior management takes the steps necessary to monitor and control liquidity risk. The board should be informed regularly of the liquidity situation of the bank and immediately if there are any material changes in the bank's current or prospective liquidity position.

Because of the critical importance of liquidity management to the viability of any bank, the board should approve the bank's strategy for managing liquidity risk. The board should approve significant policies that govern or influence the bank's liquidity risk. The board should also approve policies and procedures that identify lines of authority and responsibility for managing liquidity exposures.

The board of directors should ensure that senior management provides clear guidance on the level of acceptable liquidity risk in order to comply with the bank's liquidity strategy. The board should also ensure that senior management has the policies and procedures in place to effectively monitor and control liquidity risk.

The board should monitor performance and liquidity risk profile of the bank and periodically review information that is timely and sufficiently detailed to allow them to understand and assess the liquidity risk facing the bank's key portfolios and the bank as a whole. Banks holding

significant funding concentrations or having significant changes in the composition of holdings would be expected to have more frequent reviews by their boards.

The board should also review the contingency plans, including all back-up funding, of the bank for handling disruptions to its ability to fund some or all of its activities in a timely manner and at a reasonable cost.

As the CBK has observed, some banks have far more active and engaged board of directors than others. Its examinations will review the extent of proactive engagement from the board itself as to the above, as well as how this is done with a less than fully engaged board.

III. Each bank should have a management structure in place to execute effectively the liquidity strategy. This structure should include the ongoing involvement of members of senior management. Senior management must ensure that liquidity is effectively managed, and that appropriate policies and procedures are established to control and limit liquidity risk. Banks should set and regularly review quantitative limits and targets on the size of their liquidity positions over particular time horizons.

As with other elements of risk management, a bank should have a liquidity management structure in place to execute effectively the bank's liquidity strategy, policies and procedures. Banks should assign ultimate responsibility for setting liquidity policy and reviewing liquidity decisions to the bank's highest level of management. The responsibility for managing the overall liquidity of the bank should be placed with such a specific, identified group within the bank. This might be in the form of an Asset/Liability Committee (ALCO) comprised of senior management, as stipulated by UNMIK Regulation 1999/21 section 20.5, within the treasury function or a risk management department. In all cases, the appropriate checks and balances should be in place.

A schedule of frequent routine liquidity reviews and less frequent, but more in-depth reviews should be established. These reviews provide the opportunity to re-examine and refine a bank's liquidity policies and practices in the light of a bank's liquidity experience and developments in its business.

Bank management must make decisions related to the structure for managing liquidity. It may completely centralize liquidity management, it may decentralize by assigning business units responsibility for their own liquidity, subject to limits imposed by senior management, or it might do a combination of the two. In all instances, the management structure should allow the necessary flexibility while ensuring that the liquidity strategy and written policy approved by the board can be effectively implemented. Whatever structure is used, it is critical that there be close links between those individuals responsible for liquidity and those monitoring market conditions, as well as other individuals with access to critical information such as credit risk managers. This is particularly important in developing and analyzing stress ("what if") scenarios that could seriously affect a bank's liquidity.

Banks' management should set numerical limits and targets to ensure adequate liquidity and these limits will be reviewed by CBK supervisors, especially during on-site examinations. Alternatively, the CBK, using its legal authority, may set the limits individually for a bank. Limits could be set, for example, on the following:

- a. Loans to deposits ratio in light of bank's liquidity risk management practices and capacities.

- b. The cumulative cash-flow mismatches (i.e. the cumulative net funding requirement as a percentage of total liabilities) over particular periods – next day, next five days, next month. These mismatches should be calculated by taking a conservative view of marketability of liquid assets, with a discount to cover price volatility and any drop in price in the event of a forced sale, and should include likely outflows as a result of drawdown of commitments etc.
- c. Liquid assets as a percentage of short term liabilities. Again, there should be a discount to reflect price volatility. The assets included in this category should only be those which are highly liquid – i.e. only those in which there is judged to be a ready market even in periods of stress.

Banks should analyze the likely impact of different stress scenarios on their liquidity position and set their limits accordingly. Limits should be appropriate to the size, complexity and financial condition of the bank. Management should define the specific procedures and approvals necessary for exceptions to policies and limits.

Senior management should ensure that there are adequate internal controls in place to protect the integrity of the established liquidity risk management process.

Senior management, often through an ALCO, should ensure liquidity is managed in a forward looking way, well beyond day-to-day management. Ideally this would be through detailed cash-flow forecasting of a period of at least one month, preferably beyond. The cash-flow forecasting should take into account all aspects that will affect inflows and outflows of liquidity both on the balance sheet and off-balance-sheet (especially credit commitments). The cash-flow forecasting should also take into account formal back-up sources of liquidity that are available to the bank on short notice.

IV. A bank must have adequate information systems for measuring, monitoring, controlling and reporting liquidity risk. Reports should be provided on a timely basis to the bank's board of directors, senior management and other appropriate personnel.

A strong management information system is integral to making sound decisions related to liquidity. Such a system should be flexible enough to deal with various contingencies that may arise.

The management information system should have the ability to calculate liquidity positions in all of the major currencies in which the bank deals, both individually and on an aggregate basis. In the context of Kosovo, this will primarily be liquidity in euros, but significant activities in other currencies will also need attention. All banks should have the ability to calculate their liquidity positions, on a day to day basis for the shorter time horizons (e.g. out to five days) and over a series of specified time periods thereafter, including for more distant periods, in order to enable them to effectively manage and closely monitor their net funding requirements. This is consistent with the cash-flow forecasting mentioned above.

The management information system should be used to check for compliance with the bank's established policies, procedures and limits. Reporting of risk measures should be done on a timely basis and compare current liquidity exposures with any set limits. The information system should also enable management to evaluate the level of trends in the bank's aggregate liquidity

exposure. Assumptions should be set out clearly so that management can evaluate the validity and consistency of key assumptions and understand the implications of various stress scenarios.

B. Measuring and Monitoring Net Funding Requirements

I. Each bank should establish a process for the ongoing measurement and monitoring of net funding requirements.

An effective measurement and monitoring process is essential for adequately managing liquidity risk. At a very basic level, liquidity measurement involves assessing all of a bank's cash inflows against its outflows to identify the potential for any net shortfalls going forward. As previously mentioned, this includes funding requirements for off-balance sheet commitments. A number of techniques can be used for measuring liquidity risk, ranging from simple calculations to highly sophisticated modeling techniques. As all banks are affected by changes in the economic climate and market conditions, the monitoring of economic and market trends is key to liquidity risk management. The CBK will review this process, again usually through its examinations, for ongoing measurement and management of net funding requirements based on the level of liquidity risk and the sophistication of liquidity management appropriate for the bank.

An important aspect of managing liquidity is making assumptions about future funding needs. While certain cash inflows and outflows can be easily calculated or predicted, banks must also make assumptions about future liquidity needs, both in the very short-term and for longer time periods.

One important factor to consider is the critical role a bank's reputation plays in its ability to access funds readily and at reasonable terms. For that reason, bank staff responsible for managing overall liquidity should be aware of any information (such as external audit's report, opinion on financial statements, rating by rating agencies) that could have an impact on market and public perceptions about the soundness of institution. In turn, in the present banking sector of Kosovo, the opportunities to raise funds through the market are presently very limited. Thus banks' liquidity strategy and policy in Kosovo must reflect present day market realities as a limited source for quickly raising liquidity.

The relevant time-frame for active liquidity management is sometimes quite short, including intra-day liquidity and to ensuring the CBK's liquidity reserve requirements are being met. In particular, the first days in any liquidity problem are crucial to maintaining stability. The appropriate time-frame will depend on the nature of the bank's business. Banks which are reliant on short-term or very volatile funding will concentrate primarily on managing their liquidity in the very short term (say the period out to five days). Ideally, these banks should be able to calculate their liquidity position on a day-to-day basis for this period. In turn, sound liquidity management for banks should take into account the level of liquid assets and especially the stability of their funding (often called "core deposits") and using these tools, they should ideally manage their net funding requirements over a longer period, perhaps one to three months ahead.

Using this longer-term approach, banks should collect data and monitor their liquidity positions in more distant periods. Typically, a bank may find substantial funding gaps in distant periods and should attempt to fill these gaps by, if possible, influencing the maturity of transactions so as to offset the gap or using core deposit information or other tools to determine the stability of the funding base. Back-up funding, as is discussed later, should be part of this monitoring process.

II. A bank should analyze liquidity utilizing a variety of “what if” scenarios.

Evaluating whether a bank is sufficiently liquid depends in large measure on the behavior of cash flows under different conditions. Analyzing liquidity thus entails laying out a variety of "what if" scenarios. Under each scenario, a bank should try to account for any significant positive or negative liquidity swings that could occur. These scenarios should take into account factors that are both internal (bank-specific) and external (market-related). Thus, while liquidity will typically be managed under “normal” circumstances, the bank must be prepared to manage liquidity under abnormal conditions.

A bank will need to assign the timing of cash flows for each type of asset and liability by assessing the probability of the behavior of those cash flows under the “what-if” scenario being used. These decisions about the specific timing and the size of cash flows are an integral part forward looking liquidity management.

Thus, while the CBK will expect banks’ to manage their liquidity on a cash-flow basis out into the future (up to several months) using normal assumptions on inflows and outflows, it is also expected, especially for larger and more sophisticated banks, that “what if” scenarios will also be put in place

III. A bank should review frequently the assumptions utilized in managing liquidity to determine that they continue to be valid.

Since a bank’s future liquidity position will be affected by factors that cannot always be forecast with precision, assumptions need to be reviewed frequently to determine their continuing validity, especially given rapid change in many banking markets. The total number of major assumptions to be made, however, is fairly limited. This section attempts to catalogue the liquidity assumptions under four broad categories: (a) assets, (b) liabilities, (c) off-balance-sheet activities, and (d) other.

(a) Assets

Assumptions about a bank’s future stock of assets include: their potential marketability (which is limited within the present Kosovo situation as to markets) and use as collateral which could increase cash inflows, the extent to which assets will be originated and sold (again limited in Kosovo) and the extent to which maturing assets will be renewed, and new assets acquired.

Determining the level of a bank’s potential assets involves answering three questions:

- What proportion of maturing assets will a bank be able and willing to roll over or renew?
- What is the expected level of new loan requests that will be *approved*?
- What is the expected level of draw-downs of commitments to lend that a bank will need to fund?

In estimating its normal funding needs, some banks use historical patterns of roll-overs, draw-downs

and new requests for loans; others conduct a statistical analysis taking account of seasonal and other effects believed to determine loan demand (e.g., for consumer loans). Alternatively, a bank may make judgmental business projections, or undertake a customer-by customer assessment for its larger customers and apply historical relationships to the remainder.

Draw-downs and new loan requests represent a potential drain of funds for a bank. These can be referred to as off-balance-sheet credit commitments and need close measuring and monitoring in proper liquidity management.

In some cases, a bank may have some leeway to control these items depending on current conditions. For example, during adverse liquidity conditions, a bank might decide to risk damaging some business relationships by refusing to approve new loan requests that it would approve under normal conditions, or it might refuse to honor lending commitments, except of course those are binding (usually when a fee has been paid for the commitment).

(b) Liabilities

Analyzing the liability side of the balance sheet for sources of funding requires a bank to understand the characteristics of their fund providers and funding instruments, and, most of all, the stability of their funding base. To value the cash flows arising from a bank's liabilities, a bank would first examine the behavior of its liabilities under normal business conditions.

This would include establishing:

- The normal level of roll-overs of deposits and other liabilities;
- The effective maturity of deposits with non-contractual maturities, such as demand deposits and many types of savings accounts – in other words determining which deposits are core in nature, irregardless of non-contractual maturities or nominal maturity date;
- The normal growth in new deposit accounts.

As in assessing roll-overs and new requests for loans, a bank could use several possible techniques to establish the effective maturities of its liabilities, such as using historical patterns of deposit behavior. For sight deposits, whether of individuals or businesses, many banks conduct a statistical analysis that takes account of seasonal factors, interest rate sensitivities, and other macroeconomic factors. For some large wholesale depositors, a bank may undertake a customer-by-customer assessment of the probability of roll-over. Again, the end result is to determine through analysis a core deposit base that, in general can be relied upon as stable funding, in contrast to “volatile funding” which would be considered far less stable.

In examining the cash flows arising from a bank's liabilities under abnormal circumstances (bank-specific or general market problems), a bank would examine several basic questions:

- Which sources of funding are likely to stay with the bank under any circumstance, and can these be increased – again core deposits or core funding?
- Which sources of funding can be expected to run off gradually if problems arise, and at what rate?
- Is deposit pricing a means of controlling the rate of runoff?
- Which maturing liabilities or liabilities with non-contractual maturities can be expected to run off immediately at the first sign of problems?
- Are there liabilities with early withdrawal options that are likely to be exercised?
- Does the bank have back-up liquidity facilities that it can draw down and under what circumstances?

The first two categories represent cash-flow developments that tend to reduce the cash outflows projected directly from contractual maturities. In addition to the liabilities identified above, a bank's capital and term liabilities not maturing within the horizon of the liquidity analysis provide a liquidity buffer. Long-term liabilities are a particularly important form of liquidity buffer.

The liabilities that make up the first category may be thought to stay with a bank, even under a "worst-case" projection. Some core deposits generally stay with a bank because, retail and small business depositors may rely on the public-sector safety net to shield them from loss, or because the cost of switching banks, especially for some business services such as transactions accounts, may be prohibitive in the very short run.

The second category, liabilities that are likely to stay with a bank during periods of mild difficulties and to run off relatively slowly in a crisis, may include such liabilities as core deposits that are not already included in the first category.

A bank's own liability roll-over experience as well as the experiences of other troubled institutions should help in developing a timetable for these cash flows.

The third category comprises the remainder of the maturing liabilities, including some without contractual maturities. These are often large wholesale deposits, including large time deposits earning market or even above market rates. Under this scenario, the approach should adopt a conservative stance and assumes that these remaining liabilities are repaid at the earliest possible maturity, especially in crisis scenarios, because such money may flow to other safe havens, including outside Kosovo. Factors such as diversification and relationship building are seen as especially important in evaluating the extent of liability runoff and a bank's capacity to replace funds. Nevertheless, when market problems exist, some high-quality institutions with good market reputations may find that they receive larger-than-usual wholesale deposit inflows, even as funding inflows dry up for other market participants. However, banks should be wary of relying on this as a source of funding, as large customers may equally decide to favor holding cash or, as indicated above, transferring their assets outside the domestic banking system.

(c) Off-balance-sheet activities

A bank should also examine the potential for substantial cash flows from its off balance-sheet activities. The contingent nature of most off-balance-sheet instruments adds to the complexity of managing off-balance sheet cash flows. In particular, during stressful situations, off-balance-sheet commitments, especially credit commitments, can have a significant drain on liquidity.

Contingent liabilities, such as letters of credit and financial guarantees, represent potentially significant drain of funds for a bank, but are usually not dependent on a bank's condition. A bank may be able to ascertain a "normal" level of cash outflows under routine conditions, and then estimate the scope for an increase in these flows during periods of stress, usually market instability.

However, a general market crisis may trigger a substantial increase in the amount of draw-downs of letters of credit of other off-balance sheet credit commitments, because of an increase in defaults in the market.

C. Managing market access

I. Each bank should periodically review its efforts to establish and maintain relationships with liability holders, to maintain the diversification of liabilities, and aim to ensure its capacity to sell assets.

A critical component of managing liquidity is assessing market access and understanding various funding options. Quite simply, a bank needs to understand how much funding they can expect to receive from the local market and other sources, both under normal and adverse circumstances. As stated previously, the local money markets in Kosovo are presently not well developed, thus access to funds may often be from outside Kosovo.

Senior management needs to ensure that market access is being actively managed by the appropriate staff within the bank. Relationships might exist with trading counterparties, correspondent banks, corporate customers and payments systems. Building strong relationships with key providers of funding can provide a line of defense in a liquidity problem and form an integral part of a bank's liquidity management. The frequency of contact and the frequency of use of a funding source are two possible indicators of the strength of a funding relationship.

Concentrations in funding sources increase liquidity risk. Consequently, as a check for adequate diversification of liabilities, a bank needs to examine the level of reliance on particular funding sources, both at an individual level and by instrument type, nature of the provider of funds, and geographic market. In Kosovo, a major utility is a provider of significant funding to the banking sector, and reliance on this single large funding source requires close monitoring by banks and contingency planning as discussed in the next section.

In addition, a bank should strive to understand and evaluate the use of intercompany financing for its individual business offices. The treasury function or some other specified group within the bank should be responsible for monitoring the various funding options and the current trends in such options. In all banks, senior management must constantly be aware of the composition, characteristics and diversification of its funding sources.

D. Contingency planning

I. A bank should have contingency plans in place that address the strategy for handling liquidity crises and include procedures for making up cash flow shortfalls in emergency situations.

A bank's ability to withstand either temporary or longer-term disruptions in its ability to fund some or all of its activities in a timely manner and at a reasonable cost can depend on the adequacy of its formal contingency plans. If a bank relies less and less on core deposits as a stable funding source and relies more on secondary sources of funding (often called volatile funding), the need for contingency plans becomes even more critical. Effective contingency plans should address two major questions:

- Does management have a strategy for handling a crisis?
- Does management have procedures in place for accessing funds in an emergency – in other words, are formalized back-up sources of funding in place?

Senior management needs to address these questions realistically in order to determine how the bank may fare under abnormal adverse circumstances. In addition, management needs to identify and understand the types of events that may trigger liquidity contingency plans.

(a) Strategy

A contingency plan for dealing with liquidity problems should consist of several components. Most important are those that involve managerial coordination. A contingency plan needs to spell out procedures to ensure that information flows remain timely and uninterrupted, and that they provide senior management with the precise information it needs in order to make quick decisions. A clear division of responsibility must be set out so that all personnel understand what is expected of them during a problem situation.

Another major element in the plan should be a strategy for taking certain actions, if possible, to alter asset and liability behaviors. While assumptions can be made as to how an asset or liability will behave under certain conditions (as disclosed above), a bank may have the ability to change these characteristics. For example, a bank may conclude that it will suffer a liquidity deficit in a crisis based on its assumptions regarding the amount of future cash inflows from saleable assets and outflows from deposit run-offs.

Other components of the contingency plan involve maintaining customer relationships with liability-holders, borrowers on the asset side of the balance sheet, and off-balance-sheet counterparties. As the intensity of problems increases, banks must decide which assets may provide needed liquidity without loss or with minimum loss. Typically banks review the entire asset side of the balance sheet and select the assets that are least detrimental to business relationships and public perceptions about the bank's soundness. At the same time, relationships with liability-holders become more important under adverse conditions. If a bank's strategy requires liability managers to maintain strong ongoing links with counterparties and large liability-holders (large depositors or other large funding sources) during periods of relative calm, the bank may be better positioned to secure sources of funds under abnormal circumstances.

(b) Back-up liquidity

Contingency plans should also include procedures for making up cash flow shortfalls in adverse situations. Banks have available to them several sources of such funds, including previously unused credit facilities. These should be formalized back-up sources of funding, for which fees are usually required. Depending on the severity of the liquidity problems, a bank may choose - or be forced - to use one or more of these sources. The plan should spell out as clearly as possible the amount of back-up funds a bank has available from these sources, and under what scenarios a bank could use them. Banks must be careful not to rely excessively on back-up lines and need to understand the various conditions, such as notice periods, that could affect the bank's ability to access quickly such lines. Indeed, banks should have contingency plans for times when their back-up lines become unavailable.

As indicated above, banks should consider under what circumstances and for what purposes they would establish committed lines of funding, for which they pay a fee, which will be available to them under abnormal circumstances if uncommitted facilities fail.

E. Internal Controls for Liquidity Risk Management

I. Each bank must have an adequate system of internal controls over its liquidity risk management process. A fundamental component of the internal control system involves regular independent reviews and evaluations of the effectiveness of the system and, where necessary, ensuring that appropriate revisions or enhancements to internal controls are made. The results of such reviews should be available to supervisory authorities.

Banks should have adequate internal controls to ensure the integrity of their liquidity risk management process. The internal controls for liquidity risk should be an integral part of the bank's overall system of internal control. They should promote effective and efficient operations, reliable financial and regulatory reporting, and compliance with relevant laws, regulations and institutional policies. An effective system of internal control for liquidity risk includes:

- A strong control environment;
- An adequate process for identifying and evaluating liquidity risk;
- The establishment of control activities such as policies and procedures;
- Adequate information systems; and,
- Continual review of adherence to established policies and procedures.

With regard to control policies and procedures, attention should be given to appropriate approval processes, limits, reviews and other mechanisms designed to provide a reasonable assurance that the institution's liquidity risk management objectives are achieved.

Many attributes of a sound risk management process, including risk identification, measurement, monitoring, and control functions, are key aspects of an effective system of internal control. Banks should ensure that all aspects of the internal control system are effective, including those aspects that are not directly part of the risk management process.

In addition, an important element of a bank's internal control system over its liquidity risk management process is regular evaluation and review. This includes ensuring that personnel are following established policies and procedures, as well as ensuring that the procedures that were established actually accomplish the intended objectives. Such reviews and evaluations should also address any significant change that may impact on the effectiveness of controls. Management should ensure that all such reviews and evaluations are conducted regularly by individuals who are independent of the function being reviewed.

When revisions or enhancements to internal controls are warranted, there should be a mechanism in place to ensure that these are implemented in a timely manner.

Although procedures for establishing limits and for operating within them may vary among banks, periodic reviews should be conducted to determine whether the organization complies with its liquidity risk policies and procedures. Positions that exceed established limits should receive the prompt attention of appropriate management and should be resolved according to

the process described in approved policies. Periodic reviews of the liquidity management process should also address any significant changes in the nature of instruments acquired, limits, and internal controls that have occurred since the last review.

The internal audit function should be a key component in ensuring proper internal control is maintained. The internal audit function should periodically review the liquidity management process in order to identify any weaknesses or problems. In turn, these findings should be addressed by management in a timely and effective manner.

F. Central Bank Facilities

Currently, the CBK has not yet established liquidity facilities typically found at central banks. Efforts are underway to study, develop and implement the appropriate facilities for the Kosovo banking system; however, when these facilities are developed, they should not become part of a commercial bank's liquidity plan. The banks should not rely on the central bank during their liquidity planning.