FINANCIAL SUPERVISORY COMMISSION OF THE COOK ISLANDS

Banking Prudential Statement

BPS07

<u>Liquidity Risk</u>

Objectives and key requirements of this Prudential Statement

This Prudential Statement requires a bank to adopt prudent practices in managing its liquidity risks and to maintain an adequate level of liquidity to meet its obligations as they fall due across a wide range of operating circumstances.

The key requirements of this Prudential Statement are that a bank must:

- have a risk management framework to identify, measure, monitor, and control liquidity risk that is commensurate with the nature, scale and complexity of the institution;

- develop and adhere to a liquidity management strategy that maintains a portfolio of high-quality liquid assets sufficient in size to enable the institution to withstand a range of liquidity stresses;

- maintain a robust funding structure appropriate for its size, business mix and complexity; and

- create and perform stress testing of a contingency funding plan to ensure the bank can withstand a wide range of liquidity stresses.

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Authority

1. This Prudential Statement is issued by the Financial Supervisory Commission (FSC) pursuant to Section 65, of the Banking Act 2011 (the Act).

Application

2. This Prudential Statement is applicable to all financial institutions licensed under the Banking Act 2011.

3. The FSC recognises that foreign licensees that are part of banking groups may delegate the liquidity risk management function to their Head Office as part of group wide liquidity risk management. However, responsibility for compliance with the requirements of this Prudential Statement rests with the foreign licensee.

Definitions

4. This Prudential Statement has used the following terms, which unless otherwise indicated have the meanings specified below:

   4.1. **Bank** – an entity licensed under the Banking Act 2011.

   4.2. **High Quality Liquid Assets (HQLA) -** limited to excess cash, investable/excess central bank reserves, and highest quality sovereign or quasi sovereign marketable instruments that are of undoubted liquidity, even during stressed market conditions, or specified liquid assets described in Attachment A of this Prudential Statement.

   4.3. **Liquidity Risk Appetite** – a statement providing a clear direction from the Board and senior management of its expectations for the level of liquidity risk it is willing to accept in pursuit of its strategy and business objectives. A risk appetite is expressed in the form of both high-level qualitative statements and, where appropriate, quantitative measures.

   4.4. **Liquidity Risk Management Framework** – systems, structures, policies, processes and people within a Bank that identify, measure, monitor and control liquidity risk.

   4.5. **Name Crisis** - refers to the behavior of cash flows in adverse operating circumstances specific to the bank, where it has significant difficulty in rolling over or replacing its liabilities.

   4.6. **Stress Testing** – details on stress testing are set out under paragraphs 54 to 60 of this prudential statement.

4.7. **Sufficient Liquidity** – refers to liquidity available to the bank to keep it operating for at least five business days in a name crisis.

Board and Senior Management Responsibilities

5. It is the responsibility of the Board to ensure that appropriate systems are in place for the sound and prudent management of the bank's liquidity risk. They must ensure the bank has a robust liquidity risk management framework to manage this risk accordingly.

6. The Board must establish a liquidity risk management framework and risk strategy commensurate with the level and extent of liquidity risk to which the bank is exposed from its activities and approved by the Board.

7. The Board must ensure that:

   7.1. senior management and other relevant personnel have the necessary experience to manage liquidity risk;

   7.2. the bank's liquidity risk management framework and liquidity risk management practices are documented and reviewed at least annually; and

   7.3. a bank shall adhere to its liquidity management strategy at all times and review it regularly (at least annually) to take account of changing operating circumstances.

8. The Board must review regular reports on the liquidity of the bank and, where necessary, information on new or emerging liquidity risks.

9. Board and committee minutes, and other appropriate documents, should clearly reflect discussions and decisions regarding liquidity risk, providing details where necessary.

10. A bank's senior management must, at a minimum:

    10.1. develop a liquidity management strategy, policies and processes in accordance with the Board approved liquidity risk appetite;

    10.2. ensure that the bank maintains sufficient liquidity;

    10.3. determine the structure, responsibilities and controls for managing liquidity risk and liquidity positions, and outline these elements clearly in the bank's liquidity policies;

    10.4. develop a liquidity policy that includes, at a minimum, review of its current liquidity position with emphasis on the 30, 90, and 180-day liquidity positions, loan to deposit guidelines and limits, loans to capital limits, and borrowing limits;

10.5. ensure that the bank has adequate internal controls to enforce the integrity of its liquidity risk management processes;

10.6. ensure that stress tests, contingency funding plans and holdings of HQLA are effective and appropriate for the bank;

10.7. establish a set of reporting criteria, specifying the scope, manner and frequency of reporting for various recipients and the parties responsible for preparing the reports;

10.8. establish the specific procedures and approvals necessary for exceptions to policies and limits, including the escalation procedures and follow-up actions to be taken for breaches of limits;

10.9. closely monitor current trends and potential market developments that may present challenges for managing liquidity risk so that appropriate and timely changes to the liquidity management strategy can be made as needed; and

10.10. continuously review information on the bank's liquidity developments and report to the Board on a regular basis.

11. The Board and senior management must be able to demonstrate a thorough understanding of the links between funding liquidity risk (the risk that a bank may not be able to meet its financial obligations as they fall due) and market liquidity risk (the risk that liquidity in financial markets, such as the market for debt securities, may reduce significantly), as well as how other risks, including credit, market, operational and reputation risks, affect the bank's overall liquidity risk management strategy.

Liquidity Risk Management Framework

12. The liquidity risk management framework must include, at a minimum:

12.1. a statement of the bank's liquidity risk appetite;

12.2. a robust management information system that produces data and other information required for adequately assessing the liquidity risk exposure of the bank;

12.3. a defined organisational structure;

12.4. the liquidity management strategy and policy of the bank;

12.5. the bank's operating standards in the form of policies, procedures and controls for identifying, measuring, monitoring and controlling its liquidity risk in accordance with its liquidity risk appetite;

12.6. the bank's funding strategy;

12.7. a contingency funding plan; and

12.8. minimum reporting requirements to board and management.

13. A bank's liquidity risk management framework must be formulated to ensure that the bank maintains sufficient liquidity, including a cushion of unencumbered HQLA, to withstand a range of stress events, including those involving the loss or impairment of both unsecured and secured funding sources.

14. A bank's liquidity risk appetite defines the level of liquidity risk that the bank is willing to assume. The liquidity risk appetite must be documented and appropriate for the bank's operations.

15. The liquidity risk appetite must be reviewed, at least annually, to reflect the bank's financial condition and funding capacity.

16. In setting the liquidity risk appetite, the Board and senior management must ensure that the risk appetite allows the bank to effectively manage its liquidity in such a way that it can withstand a prolonged period of stress.

17. A bank's liquidity risk management framework must be well integrated into the bank's overall risk management process.

18. A bank must inform the FSC immediately of any concerns it has about its current or future liquidity, as well as its plans to address these concerns. Indicators of liquidity concerns may include one or more of the following:

18.1. regular breaches of internal liquidity limits;

18.2. experiencing difficulty or inability to borrow in the wholesale markets;

18.3. lenders demanding a higher than standard funding premium or seeking collateral for funding provided;

18.4. deteriorating cash flow positions as evidenced by widening negative maturity mismatches, especially in the short-term time bands;

18.5. unusual volatility in the deposit base;

18.6. frequent utilisation of overdraft or standby facilities;

18.7. deterioration in asset quality or profitability;

18.8. adverse ratings changes, if applicable; and

18.9. problems with related entities.

Liquidity Management Strategy

19. The liquidity management strategy must be appropriate for the nature, scale and complexity of the bank. In formulating this strategy, the bank must consider its legal structure, key business lines, and the breadth and diversity of markets, products and jurisdictions in which it operates.

20. The liquidity management strategy, key policies for implementing the strategy and the liquidity risk management structure must be communicated throughout the organisation by senior management.

21. The liquidity management strategy must include specific policies and procedures on liquidity management, approved by the Board. For foreign licensees, the policy statement should, at a minimum, be approved by the Senior Overseas Officer. The strategy should include:

    21.1. the composition and maturity of assets and liabilities;

    21.2. the diversity and stability of funding sources;

    21.3. acceptable types, duration and minimum levels of HQLA;

    21.4. acceptable type, duration and limits on borrowings;

    21.5. the approach to managing liquidity in different currencies, across borders, and across business lines and legal entities;

    21.6. a system for measuring, assessing and reporting liquidity by individual currency as well as for all currencies;

    21.7. clearly defined managerial responsibilities and controls;

    21.8. the approach to intraday liquidity management;

    21.9. liquidity sources, diversification, concentrations of funds, targets and limits; and

    21.10. a formal contingency plan for dealing with a liquidity crisis.

22. A bank must have adequate controls in place to ensure that the Board and senior management are informed immediately of new and emerging liquidity concerns. These include increasing funding costs or concentrations, increases in any funding requirements, the lack of availability of alternative sources of liquidity, material and/or persistent breaches of limits, a significant decline in the cushion of unencumbered HQLA, or changes in external market conditions that could signal future difficulties.

23. Senior management must be satisfied that all business units conducting activities that have an impact on liquidity are fully aware of the liquidity management

strategy and operate in accordance with approved policies, procedures, limits and controls.

24. Foreign licensees with branch operations in the Cook Islands should identify in their policy statements where responsibility resides for monitoring the liquidity of their Cook Islands operations, and should include in the statement details of reporting arrangements to Head Office.

Controls for Liquidity Risk Exposure

25. A bank must have a sound process for identifying, measuring, monitoring and controlling liquidity risk. This process must include a robust framework for comprehensively projecting cashflows arising from assets, liabilities and off-balance sheet items over an appropriate set of time horizons.

26. A bank must set limits to control its liquidity risk exposure and vulnerabilities. Limits and corresponding escalation procedures must be reviewed regularly. Limits must be relevant to the business in terms of its location, complexity of activity, nature of products, currencies and markets served.

27. Where a liquidity risk limit is breached, a bank must implement a plan of action to review the exposure, the cause for the breach, and timetable to achieve compliance with the limit.

28. A bank must actively manage its collateral positions, differentiating between encumbered and unencumbered assets.

29. A bank must design a set of early warning indicators to aid its daily liquidity risk management processes in identifying the emergence of increased risk or vulnerabilities in its liquidity position or potential funding needs. Such early warning indicators must be structured to assist in the identification of any negative trends in the bank's liquidity position and lead to an assessment and potential response by management to mitigate the bank's exposure to these trends.

30. A bank must have a reliable management information system that provides the Board, senior management and other appropriate personnel with timely and forward-looking information on the liquidity position of the bank.

31. A bank must actively manage its intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions.

32. A bank must develop and implement costs and benefits allocation process for funding and liquidity that appropriately apportions the costs of prudent liquidity management to the sources of liquidity risk, and provides appropriate incentives to manage liquidity risk.

33. A bank active in multiple currencies must:

    33.1. maintain HQLA consistent with the distribution of its liquidity needs by currency;

    33.2. assess its aggregate foreign currency liquidity needs and determine an acceptable level of currency mismatches; and

    33.3. undertake a separate analysis of its strategy for each currency in which it has material activities, considering potential constraints in times of stress.

Systems for Measuring, Assessing and Reporting Liquidity

34. A bank, as part of its liquidity management strategy, should put in place a management information system capable of measuring, assessing and reporting liquidity on a regular basis as appropriate for the operations of the bank.

35. While the sophistication of a bank's management information system will depend on the nature and complexity of the bank's operations, the system must produce timely, accurate and relevant information for managing and monitoring the liquidity positions of a bank in all operating circumstances. At a minimum, the management information system must be able to:

    35.1. report on the composition and market values of a bank's liquid holdings; and

    35.2. construct maturity profiles of a bank's cash flow to identify cumulative net funding positions for at least the following maturity gap periods:

        35.2.1. less than 7 calendar days;

        35.2.2. 7 to 30 calendar days;

        35.2.3. 1 to 3 months;

        35.2.4. 3 to 6 months; and

        35.2.5. 6 to 12 months.

Liquidity Maturity Profile

36. In constructing the above required maturity profile, a bank needs to make assumptions about future cash flows associated with its assets, liabilities, and off-balance sheet activities. In principle, the cash flows will be allocated to time bands in accordance with the contractual maturity dates. In practice the bank must determine:

36.1. the proportion of maturing assets and liabilities that it will rollover or renew;

36.2. the behaviour of assets and liabilities with no clearly specified maturity dates (e.g. repayments of overdrafts, at call deposits and those with early withdrawal options);

36.3. potential cash flows from off-balance sheet activities, including drawdowns under loan commitments and contingent liabilities;

36.4. its ability to access various markets for funds and to undertake transactions in different markets;

36.5. the convertibility of foreign currencies; and

36.6. access to standby facilities and intra-group funding.

37. A bank should document in its liquidity management policy statement the underlying assumptions used in constructing the maturity profiles of its cash flows as well as the reasoning behind them. There should be provisions to review these assumptions regularly to take account of available statistical evidence and/or changing business profile. The FSC will review these assumptions with each bank.

Guide on Procedures for Managing Liquidity

38. A bank may pursue a range of procedures to manage its liquidity. The relevance and effectiveness of particular procedures will depend on the nature of a bank's business and its standing in the market. As a guide, the FSC expects the following procedures to be adopted:

38.1. **Maturity Mismatch Limits** - a bank should establish maturity mismatch limits for its cumulative funding positions as identified under the maturity profiles for the various time bands noted above. These mismatch limits should be realistic and commensurate with the bank's funding capacity.

38.2. **Liquid Holdings**

38.2.1. A bank should establish a minimum ratio of HQLA to liabilities, or other liquidity measure/s, which, based on the unique characteristics of its depositors, it believes is adequate to cater for any unexpected liquidity pressures or fluctuations under both normal and adverse operating conditions. These HQLA can provide a bank with the capacity to meet its obligations while the underlying problems affecting liquidity are being addressed. This also lowers the likelihood of a bank needing to undertake an urgent sale of illiquid assets, purchasing liabilities or borrowing from the interbank market at a higher cost than is sustainable over the medium term.

38.2.2. A bank should clearly identify the composition of such a liquid portfolio, define its role, and establish minimum levels (including trigger ratios to warn management of potential breaches) and concentration limits in its liquidity management policy statement.

38.2.3. The liquid portfolio should be diversified to ensure there will not be an undue reliance on any one class of liquid assets.

38.3. **Diversification of Liabilities**

38.3.1. A bank should seek to maintain a diversified and stable funding base. This can be achieved by establishing a policy limiting the concentration in funding sources to avoid excessive reliance on any one counterparty (including related counterparties), product or market as well as by building strong and lasting relationships with depositors and other liability holders.

38.3.2. A bank should also undertake appropriate analysis on the pattern of its liabilities and the potential impact this may have on the bank's liquidity position (e.g. to detect any signs that the deposit base is becoming more volatile).

38.4. **Access to Wholesale Markets**

38.4.1. The ability to obtain funds in the inter-bank and other wholesale markets is an important source of liquidity for a bank in both normal and crisis conditions. However, in formulating its liquidity management procedures, a bank should recognise that its ability to access funds from these markets may be radically reduced or delayed in crisis conditions.

38.4.2. If applicable, a bank should be able to estimate its "normal" borrowing capacity in the wholesale markets and to establish a policy regarding dealing in markets against that capacity. A bank making unusual demands on the wholesale markets may face difficulties due to the exposure limits set by counterparties.

38.4.3. A bank may maintain standby credit lines with other banks or counterparties as a potential source of liquidity. A bank should recognise that its right to draw on these facilities may be denied in a crisis or there might be calls for early repayment of drawings under these facilities triggered by events of default or breaches of any material adverse change clauses. In formulating standby arrangements, a bank should ensure that the facilities are fully committed and irrevocable. Where standby facilities form an integral element of a bank's crisis liquidity management, the FSC will seek to be satisfied as to the certainty of these arrangements.

38.5. **Foreign Currency and Other Markets**

38.5.1. A bank with active involvement in multiple currencies and/or with significant positions in specific foreign currencies should adopt procedures for liquidity measurement and management of foreign currencies. The bank should assess the convertibility of individual currencies, the timing of access to funds, and the impact of potential disruptions to foreign exchange markets and exchange risks before presuming that surplus liquidity in one currency can be used to meet the shortfall in another currency. The bank should have in place backup liquidity procedures for circumstances in which normal access to funding in individual currencies is disrupted.

38.5.2. A bank active in securities and other markets should, in a similar vein, take account of the impact of disruption in those markets on its liquidity management.

38.6. **Intra-group Liquidity**

38.6.1. A bank's liquidity management procedures should address any regulatory or legal impediments to accessing liquidity from related sources. Excess liquidity in or provided to related entities and overseas branches may not be readily available to the bank when needed.

38.6.2. Branches and subsidiaries of foreign licensees operating in the Cook Islands may have lines of liquidity support from their Head Office or overseas parent (or associates). While this support would be of particular value in a crisis affecting only local operations, it could prove ineffective if the crisis impinged upon the group as a whole. Conversely, where a foreign owned subsidiary bank has excessive placements with its overseas parent banks, these funds may not be readily available in the event of a crisis affecting the parent.

38.6.3. Subsidiaries of foreign banks should have adequate procedures in place for managing their liquidity in their own right. In the case of foreign bank branches, the FSC is prepared to consider their liquidity management in a global context, having regard to:

38.6.3.1. the extent to which liquidity of the foreign bank is managed, and supervised, on an integrated global basis;

38.6.3.2. the reliance placed on funding from head office and other branches;

38.6.3.3. the particular policies governing the branch's liquidity management in the Cook Islands.

38.7. **Use of Assets -** a bank's ability to use assets (e.g. through sales, repurchase agreements or securitisation structures) may provide much needed liquidity and support in adverse circumstances. Prearrangements to convert less liquid assets (e.g. mortgages or other loans) to generate additional funding when required can be an important part of a bank's liquidity management procedures.

Liquidity Risk Monitoring

39. A bank should set internal limits consistent with its liquidity management strategy and have appropriate control mechanisms in place to ensure that the internal limits and procedures established for managing liquidity are adhered to at all times.

40. At the core of a bank's liquidity management strategy there should be a well-defined management responsibility and control structure for monitoring, reporting and responding to the bank's liquidity in a timely and effective manner. Senior management should be responsible for reviewing a bank's liquidity management information on a regular basis. The monitoring and review should, where appropriate, cover:

40.1. the maturity profiles of a bank's cash flows;

40.2. the stock of and concentrations in liquid assets available to the bank and their market values;

40.3. concentration in sources and application of funds;

40.4. the ability to borrow in various markets;

40.5. intra-group cash flows and the accessibility of intra-group funding;

40.6. potential sources of volatility in assets and liabilities (and claims and obligations arising from off-balance sheet business);

40.7. credit standing and the capacity of providers of standby facilities to meet their obligations;

40.8. the impact of market and/or operational disruptions on cash flows and on customers;

40.9. the impact of adverse trends in asset quality on future cash flows and market confidence in the bank;

40.10. the ability to undertake asset sales in various markets; and

40.11. periodic comparison of actual results to projections.

Annual Funding Strategy

41. A bank must:

    41.1. develop and document an annual funding strategy, which must be provided to the FSC on request;

    41.2. maintain an ongoing presence in its chosen funding markets and strong relationships with funds providers; and

    41.3. regularly gauge its capacity to raise funds quickly. It must identify the main factors that affect its ability to raise funds and monitor those factors closely to ensure that estimates of fund-raising capacity remain valid.

42. The annual funding strategy must be approved by the Board and supported by robust assumptions in line with the bank's complexity, liquidity management strategy, and business objectives.

43. The funding strategy must be reviewed on a regular basis and updated as necessary for changed funding conditions or a change in the bank's strategy.

44. A bank must advise the FSC of any material changes to the bank's funding strategy.

Contingency Planning

45. Each bank will formulate a formal contingency plan for dealing with a liquidity crisis. In the case of a locally incorporated bank, the plan must be approved by the board of directors or a board committee. In the case of a branch of a foreign licensee, the plan must be approved by an appropriate Senior Officer from outside the Cook Islands. The contingency plan, among other things, should:

    45.1. designate who would be responsible for identifying crises (including speedy notification of the problems to the FSC) and crisis management. Responsibilities should be clearly assigned so that all personnel understand what is expected of them during a crisis;

    45.2. specify the early warning signals indicative of an approaching crisis and the mechanisms to facilitate constant monitoring and reporting of these signals;

45.3. establish reporting procedures to deliver all necessary information to senior management to enable them to make quick decisions;

45.4. set out procedures for making up cash flow shortfalls in crisis situations, including trigger points and timeframes within which each action should be taken. The procedures should identify all key sources of funds, their expected reliability and the priority in which those funds would be accessed. The plan should also include an assessment of the cost of alternative funding strategies and the impact on the bank's capital;

45.5. outline courses of action for altering asset and liability behaviour (e.g. plans to market assets more aggressively, raise deposits, etc.);

45.6. provide procedures to determine priority of customer relationships in the event of liquidity problems e.g. the order in which lines of credit would be withdrawn from specific customers; and

45.7. detail plans for dealing with staff and the public including customers, key market participants and the media. Astute public relations management is important to avoid the spread of rumors which could result in a significant run-off of funds.

46. The plan’s design, scope and procedures must be closely integrated with the bank’s ongoing analysis of liquidity risk and with the assumptions used in its stress tests and the results of those stress tests. As such, the plan must address issues over a range of different time horizons, including intraday.

47. The plan must address a retail deposit run and must include measures to repay retail depositors as soon as practicable. The retail run contingency plan must not rely upon closing distribution channels to retail depositors. The retail run contingency plan must seek to ensure that in the event of a loss of market confidence in the bank, retail depositors wishing to retrieve their deposits may do so as quickly and as conveniently as is practicable in the circumstances, and within the contractual terms and conditions applicable to the relevant deposit products

48. A bank’s contingency funding plan must be commensurate with its complexity, risk profile, scope of operations and role in the financial systems in which it operates. The plan must articulate available contingency funding sources and the amount of funds a bank estimates can be derived from these sources, clear escalation and prioritisation procedures detailing when and how each of the actions can and must be activated, and the lead time needed to tap additional funds from each of the contingency sources.

49. A bank should review, update, and test its contingency plan regularly (at least annually) to ensure that it remains robust over time and reflects the bank's changing operating circumstances. A bank should have adequate procedures in place to ensure relevant staff (including those nominated as back-ups) involved

in the implementation of the plan are well-informed of their role under the plan and of any subsequent changes to the plan.

Minimum Liquidity Holdings (MLH)

50. A bank is required to maintain a minimum liquidity holding of ten percent (10%) as described in Attachment A.

51. A bank is required to meet this minimum liquidity holding on a continuous basis.

52. The ten percent (10%) MLH is the minimum standard and the FSC expects that a bank will conduct analysis of its own liquidity needs and set internal MLH limits to account for the bank's specific circumstances and risks.

53. Where the FSC is not satisfied with the adequacy of a bank's liquidity management framework or where it has particular concerns about a bank's liquidity, it can require the bank to hold a higher specified amount of liquid assets.

Stress Testing

54. A bank must complete going concern scenario analysis. The 'going concern' scenario requires a bank to model the expected behaviour of cashflows in the ordinary course of business for a future period at least equal to 12 months, as described in Attachment B.

55. In creating their liquidity management strategy banks should give consideration to developing a scenario analysis of domestic and foreign currency liquidity to ensure that the bank can operate under a wide range of operating conditions. At least two scenarios should be addressed:

    55.1. "going-concern" refers to the "normal" behavior of cash flows in the ordinary course of business; and

    55.2. "name crisis" refers to the behavior of cash flows in adverse operating circumstances specific to the bank, where it has significant difficulty in rolling over or replacing its liabilities.

56. The scenario analyses should be able to demonstrate:

    56.1. how obligations and commitments are met on a day-to-day basis; and

    56.2. that there is sufficient liquidity available to the bank to keep it operating for at least five business days in a name crisis.

57. For foreign licensees operating in the Cook Islands as either a branch or subsidiary, a name crisis should take two forms - a name crisis restricted to:

57.1. local operations; and

57.2. the foreign bank's global operations.

58. Scenario analysis depends heavily on the assumptions of future cash flows associated with the behaviour of a bank's assets, liabilities and off-balance sheet activities under different operating scenarios. Considerable judgment and discretion are involved in making these underlying assumptions, which may vary substantially among banks depending on their individual business profiles. Banks are expected to take a conservative approach in assessing future cash flows. A bank should be in a position to provide analysis and evidence to justify the assumptions underlying these two scenarios.

59. Banks should pay particular attention to policies to address a name crisis. Assumptions under this scenario would represent a 'worst case' for a bank, as evidenced by significant difficulty in rolling over or replacing liabilities. In addition to assumptions regarding the behaviour of maturing and at call assets and liabilities, and estimates of cash flows from off-balance sheet activities, a bank must assess the effect of pressure on it to support its paper in the market and of requests to redeem term liabilities before their due dates. A bank should evaluate the marketability of its assets, and the likely values generated from a fire sale. For inflows from standby facilities and intra-group funding to be included, the arrangements must either be fully committed and irrevocable or demonstrate an acceptable level of certainty.

60. A bank must document in its liquidity management policy statement, or separately, the underlying assumptions adopted for its scenario analysis. The assumptions should be subject to regular review to take account of changes in the bank's operations and/or market environment.

Issuance Details

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By Commissioner	
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Attachment A -Minimum Liquidity Holdings (MLH)

1. A bank is required to maintain a minimum liquidity holding (MLH) of High Quality Liquid Assets (HQLA) as defined in paragraph 3, of at least ten percent (10%) of its total liabilities,

2. For this Prudential Statement, liabilities are defined as total on-balance sheet liabilities and irrevocable commitments (except where approved for a prudential purpose by the FSC).

3. For the MLH requirement, HQLA are liquid assets free from encumbrances (except where approved for a prudential purpose by the FSC) and include:

    3.1. notes and coin and settlement funds **in excess** of amounts needed for daily business activities (excess capacity);

    3.2. debt securities guaranteed by the Cook Islands Government;

    3.3. debt securities issued by supranational and foreign governments;

    3.4. bank bills, certificates of deposits (CDs) and debt securities;

    3.5. excess deposits (at call and any other deposits readily convertible into cash within two business days) held with other Financial Institutions net of placements by other Financial Institutions; and

    3.6. any other securities approved by the FSC.

4. A bank must ensure it has the operational capacity to liquidate any securities held as liquid assets within two business days.

5. Notwithstanding paragraph 1 of this Attachment, the FSC may, where it is not satisfied with the adequacy of a bank's liquidity management framework, or where it has particular concerns about a bank's liquidity, require the bank to hold a higher amount of liquid assets, as defined in paragraph 3 of this Attachment.

6. To ensure that the MLH requirement is not breached, a bank must set a trigger ratio(s) above its MLH requirement and must ensure that it manages its liquidity in accordance with its trigger ratio(s).

7. A bank must inform the FSC immediately when it becomes aware that its liquid assets may fall below its MLH requirement and advise the FSC of the remedial action taken or planned to restore its liquidity position above its MLH requirement.

Attachment B – Liquidity Stress Testing using ‘Going Concern’ Scenario

1. Banks must address a ‘going-concern’ scenario, which refers to the normal behaviour of cash flows in the ordinary course of business. A bank’s going concern reporting must show how obligations and commitments are met on a day-to-day basis.

2. To demonstrate that a bank can meet commitments and obligations under normal operating conditions, the deficits reported under the ‘going concern’ scenario (up to 12 months) must not exceed the bank’s normal capacity to fund.

3. Scenario analysis reports provided to the FSC under the ‘going concern’ scenario must take the form of maturity profiles of cashflows (in domestic and foreign currencies separately) based on assumptions agreed with the FSC.

   3.1. Scenario analysis depends heavily on the assumptions of future cashflows associated with the behaviour of a bank’s assets, liabilities and off-balance sheet activities under different operating scenarios. The FSC recognises that considerable judgement and discretion is involved in making these underlying assumptions, which may vary substantially among banks depending on their individual business profiles. A bank is expected to take a conservative approach in assessing future cashflows. The FSC will assess the suitability of the assumptions made. A bank must be able to provide analysis and evidence to justify the assumptions underlying this scenario. The FSC may require, where it is not satisfied with the suitability of a bank’s assumptions, that the bank revise those assumptions as directed by the FSC.

4. A bank must document in its liquidity management policy statement the underlying assumptions adopted for its scenario analyses. The assumptions must be subject to regular review to take account of changes in the bank’s operations and market environment. A bank must consult the FSC prior to making any material changes to these agreed assumptions.