Interagency Policy Statement on Funding and Liquidity Risk Management: Liquidity Risk Management Policies, Procedures, Assumptions, and Contingency Funding Plans-Implementation of recordkeeping

Section-by-Section Analysis

Section 3 of the Policy Statement provides that banks should use liquidity risk management processes and systems that are commensurate with the bank's complexity, risk profile, and scope of operations. In addition, banks' processes and plans should be well documented and available for supervisory review.

Section 6 of the Policy Statement provides that a bank's liquidity management process should be sufficient to meet its daily funding needs and cover both expected and unexpected deviations from normal operations. Accordingly, banks should have a comprehensive management process for identifying, measuring, monitoring, and controlling liquidity risk, which should be fully integrated into the bank's risk management processes. Section 6 of the Policy Statement also describes the following critical elements of sound liquidity risk management:

- Effective corporate governance consisting of oversight by the board of directors and active involvement by management in a bank's control of liquidity risk.
- Appropriate strategies, policies, procedures, and limits used to manage and mitigate liquidity risk.
- Comprehensive liquidity risk measurement and monitoring systems (including assessments of the current and prospective cash flows or sources and uses of funds) that are commensurate with the complexity and business activities of the bank.

• Active management of intraday liquidity and collateral.

• An appropriately diverse mix of existing and potential future funding sources.

• Adequate levels of highly liquid marketable securities free of legal, regulatory, or operational impediments, that can be used to meet liquidity needs in stressful situations.

• CFPs that sufficiently address potential adverse liquidity events and emergency cash flow requirements.

• Internal controls and internal audit processes sufficient to determine the adequacy of the bank's liquidity risk management process.

Section 7 of the Policy Statement provides that a bank's board of directors or its delegated committee should oversee the establishment and approval of liquidity management strategies, policies and procedures, and review them at least annually. In addition, the board should ensure that it understands and periodically reviews the bank's CFPs for handling potential adverse liquidity events.

Section 9 of the Policy Statement provides that a bank's senior management should determine the structure, responsibilities, and controls for managing liquidity risk and for overseeing the liquidity positions of the bank. These elements should be clearly documented in liquidity risk policies and procedures. For institutions comprised of multiple entities, such elements should be fully specified and documented in policies for each material legal entity and subsidiary. Senior management should be able to monitor liquidity risks for each entity across the institution on an ongoing basis. Processes should be in place to ensure that the group's senior management is actively monitoring and

quickly responding to all material developments and reporting to the boards of directors as appropriate.

Section 11 of the Policy Statement provides that banks should have documented strategies for managing liquidity risk and clear policies and procedures for limiting and controlling risk exposures that appropriately reflect the bank's risk tolerances. The strategies should identify primary sources of funding for meeting daily operating cash outflows, as well as seasonal and cyclical cash flow fluctuations. Strategies should also address alternative responses to various adverse business scenarios. Policies and procedures should provide for the formulation of plans and courses of actions for dealing with potential temporary, intermediate-term, and long-term liquidity disruptions. Policies,
procedures, and limits also should address liquidity separately for individual currencies, legal entities, and business lines, when appropriate and material, and should allow for legal, regulatory, and operational limits for the transferability of liquidity as well.

Section 12 of the Policy Statement states that a bank's policies should
clearly articulate a liquidity risk tolerance that is appropriate for the business strategy of the bank considering its complexity, business mix, liquidity risk profile, and its role
in the financial system. Policies should also contain provisions for documenting and periodically reviewing assumptions used in liquidity projections. Policy guidelines should employ both quantitative targets and qualitative guidelines.

Section 13 of the Policy Statement provides that a bank's policies should specify the nature and frequency of management reporting. Senior managers should receive liquidity risk reports at least monthly, while the board of directors should receive liquidity risk reports at least

quarterly. Management reporting may need to be more frequent, depending on the complexity of the bank's business mix and liquidity risk
profile. Regardless of an institution's complexity, it should have the ability to increase the frequency of reporting on short notice, if the need arises. Liquidity risk reports should impart to senior management and the board a clear understanding of the bank's liquidity
risk exposure, compliance with risk limits, consistency between management's strategies and tactics, and consistency between these strategies and the board's expressed risk tolerance.

Section 14 of the Policy Statement provides that banks should consider liquidity costs, benefits, and risks in strategic planning and budgeting processes. Significant business activities should be evaluated for liquidity risk exposure as well as profitability. More complex and sophisticated banks should incorporate liquidity costs, benefits, and risks in the internal product pricing, performance measurement, and new product approval process for all material business lines, products, and activities. Incorporating the cost of liquidity into these functions should align the risk-taking incentives of individual business lines with the liquidity risk exposure their activities create for the bank as a whole. The quantification and attribution of liquidity risks should be explicit and transparent at the line management level and should include consideration of how liquidity would be affected under stressed conditions.

Section 15 of the Policy Statement provides that the process for measuring liquidity risk should include robust methods for comprehensively projecting cash flows arising from assets, liabilities, and off-balance-sheet items over an appropriate set of time horizons. Banks should ensure that the assumptions used are reasonable, appropriate, and adequately documented. Banks should periodically review and formally approve these assumptions.

Section 18 of the Policy Statement provides that banks should conduct stress tests regularly for a variety of bank-specific and market-wide events across multiple time horizons. The magnitude and frequency of stress testing should be commensurate with the complexity of the bank and the level of its risk exposures. Stress test outcomes should be used to identify and quantify sources of potential liquidity strain and to analyze possible impacts on the bank's cash flows, liquidity position, profitability, and solvency. Stress tests should also be used to ensure that current exposures are consistent with the bank's established liquidity risk tolerance. The results of stress tests should also play a key role in shaping the bank's contingency planning.

Section 20 of the Policy Statement states that liquidity risk reports should provide aggregate information with sufficient supporting detail to enable management to assess the sensitivity of the bank to changes in market conditions, its own financial performance, and other important risk factors. Banks also should report on the use and availability of government support, such as lending and guarantee programs, and implications on liquidity positions, particularly since these programs are generally temporary or reserved as a source for contingent funding.

Section 23 of the Policy Statement provides that liquidity risk management plans should describe assumptions regarding the transferability of funds and collateral.

Section 24 of the Policy Statement provides that senior management should develop and adopt an intraday liquidity strategy that allows the bank to:

- Monitor and measure expected daily gross liquidity inflows and outflows;
- Manage and mobilize collateral when necessary to obtain intraday credit;
- Identify and prioritize time-specific and other critical obligations in order to

meet them when expected;

• Settle other less critical obligations as soon as possible;

• Control credit to customers when necessary; and

• Ensure that liquidity planners understand the amounts of collateral and liquidity needed to perform payment-system obligations when assessing the organization's overall liquidity needs.

Section 25 of the Policy Statement provides that a bank should establish a funding strategy that provides effective diversification in the sources and tenor of funding.

Section 31 of the Policy Statement provides additional guidance concerning the CFP, as described in section 6. The section provides that all banks, regardless of size and complexity, should have a formal CFP that clearly sets out the strategies for addressing liquidity shortfalls in emergency situations. A CFP should delineate policies to manage a range of stress environments, establish clear lines of responsibility, and articulate clear implementation and escalation procedures. It should be regularly tested and updated to ensure that it is operationally sound. Sections 34, 35, and 37 of the Policy Statement include additional guidance concerning CFPs.

Section 34 of the Policy Statement provides that CFPs should be revised to reflect macroeconomic and bank-specific conditions.

Section 35 of the Policy Statement provides that the CFP should identify stress events, assess levels of severity and timing, assess funding sources and needs, identify potential funding sources, establish liquidity event management processes, and establish a monitoring framework for contingent events.

Section 36 of the Policy Statement provides that smaller banks should have plans in place for managing press inquiries that may arise during a liquidity event.

Section 41 of the Policy Statement provides that a bank's internal controls should address relevant elements of the risk management process, including adherence to policies and procedures, the adequacy of risk identification, risk measurement, reporting, and compliance with applicable rules and regulations.

Section 42 of the Policy Statement provides that management should ensure that an independent party regularly reviews and evaluates the various components of the bank's liquidity risk management process. These reviews should assess the extent to which the bank's liquidity risk management complies with both supervisory guidance and industry sound practices, taking into account the level of sophistication and complexity of the bank's liquidity risk profile. Smaller, less-complex banks may achieve independence by assigning this responsibility to the audit function or other qualified individuals independent of the risk management process.

The Addendum to the Policy Statement provides that banks should be aware of the operational steps required to obtain funding from contingency funding sources, including potential counterparties, contact details, and availability of collateral. In addition, banks should:

- Regularly test any contingency borrowing lines to ensure the bank's staff are well versed in how to access them and that they function as envisioned;
- Engage in planning that recognizes the operational challenges involved in moving and posting collateral to access critical funding in a timely fashion;
- Ensure that the CFPs recognize that during times of stress, contingency lines may become unavailable and include a range of contingency funding sources;
- Review and revise the CFPs periodically and more frequently as market conditions and strategic initiatives change in order to address

evolving liquidity risks; and

• Incorporate the discount window as part of their contingency funding arrangements. If the discount window is included in the bank's CFP, establish and maintain operational readiness to borrow from the discount window.