

Unofficial translation from Icelandic



Guidelines no. 1/2008

On Best Practices for Managing Liquidity in Financial Undertakings.

This document is issued in accordance with Article 8, paragraph 2 of Act No. 87/1998 on the Official Supervision of Financial Operations.

June 3 2008

I. Introduction

The Financial Supervisory Authority (FME) issues guidelines on best practices for managing liquidity in financial undertakings. The guidelines apply to both parent companies and consolidated financial institutions as applicable. The guidelines will replace Guidelines no. 2/2004, on Foreign Currency Liquidity Management.

The guidelines contain several core principles on best practices in managing liquidity and are based on Sound Practices for Managing Liquidity in Banking Organizations issued by the Basel Committee. For a more detailed explanation reference is made to the aforementioned document issued by the Basel Committee.

It is of great importance that financial undertakings place emphasis on managing their liquidity and refinancing and follow the guidelines. Liquidity, or the ability to fund increases in assets and meet obligations as they come due, is crucial to the ongoing viability of any financial undertaking. Therefore, managing liquidity is among the most important activities conducted by financial undertakings. Sound liquidity management can reduce the probability of serious problems. In fact, the importance of liquidity transcends the individual financial undertaking, since a liquidity shortfall at a single institution can have system-wide repercussions. For this reason, the analysis of liquidity requires bank management not only to measure the liquidity position of the bank on an ongoing basis but also to examine how funding requirements are likely to evolve under various scenarios, including adverse conditions.

II. Principles for the Assessment of Liquidity Management in Financial Undertakings

Developing a Structure for Managing Liquidity

Principle 1: Each financial undertaking should have an agreed strategy for the day-to-day management of liquidity. This strategy should be made known to key managers.

Principle 2: The board of directors of a financial undertaking 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 financial undertaking and immediately if there are any material changes in the financial undertakings current or prospective liquidity position.

Principle 3: Each financial undertaking should have a management structure in place to execute effectively the liquidity strategy. Senior management must ensure that liquidity is effectively managed, and that appropriate policies and procedures are established to control and limit liquidity risk. Financial undertakings should set and regularly review limits on the size of their liquidity positions over particular time horizons.

Principle 4: A financial undertaking must have adequate information systems for measuring, monitoring, controlling and reporting liquidity risk. Reports should be provided on a timely basis to the financial undertakings board of directors, senior management and other appropriate personnel.

Measuring and Monitoring Net Funding Requirements

Principle 5: Each financial undertaking should establish a process for the ongoing measurement and monitoring of net funding requirements.

Principle 6: A financial undertaking should analyze liquidity utilizing a variety of “what if” scenarios.

Principle 7: A financial undertaking should review regularly the assumptions utilized in managing liquidity to determine that they continue to be valid.

Managing Market Access

Principle 8: Each financial undertaking 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.

Contingency Planning

Principle 9: A financial undertaking 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.

Foreign Currency Liquidity Management

Principle 10: Each financial undertaking should have information and monitoring system for its liquidity positions in the major currencies in which it is active. In addition to assessing its aggregate foreign currency liquidity needs, a financial undertaking should also undertake separate analysis of its strategy for each currency individually.

Principle 11: Subject to the analysis undertaken according to Principle 10, a financial undertaking should, where appropriate, set and regularly review limits on the size of its cash flow mismatches over particular time horizons for foreign currencies in aggregate and for each significant individual currency in which the undertaking operates.

Internal Controls for Liquidity Risk Management

Principle 12: Each financial undertaking 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 systems 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.

Public Disclosure regarding Liquidity

Principle 13: Each financial undertaking should have in place a mechanism for ensuring that there is an adequate level of disclosure of information about the financial undertaking.

III. Disclosure of information on liquidity position on a consolidated basis to the Financial Supervisory Authority (FME).

The Central Bank of Iceland collects monthly reports on liquidity for parent companies, in accordance with its rules, cf. Rules no. 317/2006, on Liquidity Ratio. The FME intends to regularly collect liquidity reports on a consolidated basis. The information collected will be shared by the FME and the Central Bank of Iceland.

Enclosed are samples of forms concerning reports on liquidity on a consolidated basis. It should be stressed that these forms are subject to amendments and new forms can be added without particular amendments to the guidelines.

Reykjavík, June 3 2008

FJÁRMÁLAEFTIRLITIÐ

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Consolidated 0-8 days liquidity report

Bank: _____

ISK millions 0-8 days

Assets / Cash Inflow

Secured liquidity



Explanation of definitions

Cash and cash balances with central banks	
Loans to financial institutions	Assets net of intra-group loans
Unused assets eligible for repo at central banks	Assets eligible for repo according to the rules of the respective central banks
Listed bonds excluding repo	Other listed bond not eligible for repo at central banks
Listed equities OMX-Iceland	All equities at own risk available for sale/hold for trading
Other listed equities	All equities at own risk available for sale/hold for trading
Unused revolvers and other committed backup facilities, without MAC clauses	
Other assets (explain in detail)	Assets at fair valuation, without haircuts
...	
...	
...	
...	
...	

Other liquidity



Unused revolvers and other committed backup facilities, with MAC clauses	
Assets eligible for repo (excluding repo at Central Banks)	Unlisted assets
Other assets eligible for securitization (please specify)	Securitized within the timeperiod
Loan portfolio cash flow - principal and interest	
Bonds used for repo	For netting out debt with repo counterparties
Other assets (explain in detail)	Assets at fair valuation, without haircuts
...	
...	
...	
...	
Other off balance sheet assets	Assets at fair valuation, without haircuts
...	
...	
...	
...	

Total Accumulated

Liabilities / Cash outflow



Deposit from credit institutions and Central Banks	
Deposits from customers (retail) - non domestic	Retail customers are individuals and SME's. Domestic: deposits from customers in the same country where the legal entity (subsidiary) of the consolidation is registered/licensed.
Deposits from customers (retail) - domestic	Retail customers are individuals and SME's. Domestic: deposits from customers in the same country where the legal entity (subsidiary) of the consolidation is registered/licensed.
Other deposits non domestic	
Other deposits domestic	
CP (Commercial Paper) - principal and interest	
MTN (Medium Term Note) - principal and interest	
Unused committed credit lines	
Payable debt - interest and principal	
Gross lending to customers - cash flow	
Debt at Central Banks (used repo)	For netting out debt with repo counterparties
Other liabilities (list them all)	Liabilities without repayment subtraction
...	
...	
...	
...	
Other off balance sheet liabilities	Liabilities without repayment subtraction
...	
...	
...	
...	

Total 0

Accumulated 0

Net Position 0

Accumulated net position 0

Domestic: deposits from customers in the same country where the legal entity (subsidiary) of the consolidation is registered/licensed.

Please indicate if there are any constraints on transferability of assets from subsidiary to parent company. Same applies to liquidity requirements to foreign branches in host-country.

Bank:		Current	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	Month 13	Month 14	Month 15	Month 16	Month 17	Month 18
Assets / Cash Inflow	Haircut																			
Secured liquidity																				
Cash and cash balances with central banks	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Loans to financial institutions	5%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Unused assets eligible for repo at central banks	5%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Listed bonds excluding repo	5%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Listed equities OMX-Iceland	25%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other listed equities	25%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Unused revolvers and other committed backup facilities, without MAC clauses	5%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other assets (explain in detail)	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other liquidity																				
Unused revolvers and other committed backup facilities, with MAC clauses	25%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Assets eligible for repo (excluding repo at Central Banks)	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other assets eligible for securitization (please specify)	35%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Loan portfolio cash flow - principal and interest	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Bonds used for repo	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other assets (explain in detail)	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other off balance sheet assets	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	0%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Accumulated		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Liabilities / Cash outflow																				
Deposit from credit institutions and Central Banks	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Deposits from customers (retail) - non domestic	25%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Deposits from customers (retail) - domestic	5%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other deposits non domestic	25%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other deposits domestic	10%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
CP (Commercial Paper) - principal and interest	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
MTN (Medium Term Note) - principal and interest	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Unused committed credit lines	15%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Payable debt - interest and principal	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Gross lending to customers - cash flow	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Debt at Central Banks (used repo)	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other liabilities (list them all)	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Other off balance sheet liabilities	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
...	100%	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Accumulated		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Net Position		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Accumulated net position		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Domestic deposits from customers in the same country where the legal entity (subsidiary) of the consolidation is registered/licensed.

Please indicate if there are any constraints on transferability of assets from subsidiary to parent company. Same applies to liquidity requirements to foreign branches in host-country.