



GUIDELINES ON INTERNAL LIQUIDITY ADEQUACY ASSESSMENT PROCESS (“ILAAP”)

SECTION I GENERAL PROVISIONS

Article 1 Introduction

1. The Instruction 22/2023 dated July 04, on Liquidity Risk Management has adopted the best international practices on the management of the liquidity risk in Timor-Leste, in accordance with the sound principles for the management of liquidity risk set by BCBS (Basel Committee on Banking Supervision). The document has also defined two relevant indicators for the management of liquidity:
 - the Liquidity Coverage Risk (LCR) and
 - the Net Stable Funding Ratio (NSFR).
2. The Instruction requires that banks maintain an appropriate level of liquidity resources, uphold a sound and prudent funding profile, and establish comprehensive systems for the management and control of liquidity and funding risks.
3. Banks shall also ensure that their internal liquidity adequacy assessment process integrates disclosure requirements in line with Basel III and IFRS 7, including public reporting of liquidity risk exposures, key assumptions, and liquidity metrics such as LCR and NSFR.
4. Article 15 of the above-mentioned Instruction also required banks to adopt an internal liquidity adequacy assessment process (ILAAP) and prepare at least yearly an ILAAP report to be submitted to BCTL, for a supervisory review and examination process (SREP) to ensure that banks have adequate liquidity and funding to support all the risks in their business and encourage good risk management.
5. The Internal Liquidity Adequacy Assessment Process (ILAAP) is expected to play a fundamental role in risk management of banks, especially the liquidity risk. ILAAP should include a clear assessment of the risks to liquidity, a well-structured risk governance and risk escalation processes, and a risk strategy that is translated into an effective risk limit system.

6. The primary objective of the Internal Liquidity Adequacy Assessment Process (ILAAP) is to ensure that banks maintain not only sufficient liquidity to meet the minimum regulatory requirements but also adequate liquidity to support their current operations, future business plans, and associated risks.
7. Banks should have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intraday, to ensure they maintain adequate levels of liquidity buffers.
8. A good ILAAP must reduce a bank's uncertainty concerning the risks that the bank is or may be exposed to, providing the stakeholders with an increased level of confidence in the bank's ability to continue operating by maintaining adequate liquidity buffers and stable funding and by managing its risks effectively. This requires the bank, in a forward-looking manner, to ensure that all material risks are identified, effectively managed (using an appropriate combination of quantification and controls) and covered by a sufficient level of high-quality liquidity buffers.
9. These guidelines do not substitute or supersede the Regulation 2000/8 or applicable BCTL Instructions. When the guidelines are not in line with those documents, the documents must prevail.

Article 2

Definitions

1. In this Guideline, unless reasonably implied by contextual usage, the following expressions and words shall mean:
 - a) *"Internal Liquidity Adequacy Assessment Process (ILAAP)"*: the bank's process for the identification, measurement, management and monitoring of internal liquidity and funding considered adequate to cover all material risks to which it is exposed.
 - b) *"Supervisory Review and Evaluation Process (SREP)"*: the process of the regular review of bank's strategies, processes and mechanisms implemented and the evaluation of risks to which the banks are or might be exposed, or poses risk to the financial system
 - c) *"Risk appetite"*: the aggregate level and types of risk the bank is willing to assume within its risk capacity, in line with its business model, to achieve its strategic objectives.
2. The definitions in Instruction 22/2023 on Liquidity Risk Management apply to these Guidelines.

Article 3

Purpose and scope

1. These guidelines are aimed at assisting banks in strengthening their ILAAP and at encouraging the use of best practices by providing details of the BCTL expectations on the ILAAP, leading to more consistent and effective supervision. The document provides guidance on how a bank establishes, operates, maintains and reports its ILAAP.
2. The purpose of the Internal Liquidity Adequacy Assessment Process (ILAAP) is to inform the Board of Directors of the ongoing assessment of the bank's liquidity risks, how the bank intends to mitigate those risks and how to keep adequate liquidity and funding having considered other mitigating factors.
3. The guidelines apply to all banks, including branches of foreign banks licensed to operate in Timor-Leste, and other deposit taking banks licensed to operate in accordance with Regulation 2000/8.
4. Each bank bears full responsibility for establishing and maintaining its own ILAAP. The ILAAP shall be proportionate to the bank's size, nature, complexity, risk profile, and operating environment, and must be implemented in a manner adequate to its specific circumstances

5. ILAAP shall be proportional to the size, nature, complexity of the bank's business, risk profile, and operating environment.
6. Banks shall ensure that all liquidity risk identification, measurement, and stress testing are aligned with IFRS 9 expected credit loss (ECL) modelling assumptions and IFRS 13 fair value considerations for liquid assets.
7. Banks should consider the Instruction 22/2023 on Liquidity Risk Management as well as the literature and the documents issued by the BCBS (Basel Committee on Banking Supervision), in special 'Principles for Sound Liquidity Risk Management and Supervision' of September 2008.
8. The Instruction establishes the minimum requirements for liquidity risk management, and all the requirements should be discussed on ILAAP.

SECTION II

GUIDING PRINCIPLES FOR ILAAP

Article 4

Governance

1. The Board of Directors and Senior Management shall retain overall responsibility for the governance and implementation of the Internal Liquidity Adequacy Assessment Process (ILAAP). All key elements of the ILAAP shall be approved by the Board of Directors. The Board of Directors, Senior Management, and relevant committees shall discuss and challenge the ILAAP effectively and on a regular basis.
2. The Board of Directors shall provide, at least annually, a documented assessment of the bank's liquidity adequacy through the issuance and formal approval of a Liquidity Adequacy Statement.
3. The Board shall approve, at a minimum, the following elements of the ILAAP:
 - a) The ILAAP governance framework, including clear assignment of responsibilities and adherence to the segregation of functions;
 - b) The internal documentation framework relevant to the ILAAP;
 - c) The scope of entities covered by the ILAAP, the risk identification process, and the Bank's internal risk taxonomy and inventory;
 - d) The methodologies used for liquidity risk quantification, including assumptions and parameters such as time horizon, confidence levels, and maturity profiles;
 - e) The framework for assessing liquidity adequacy, including stress testing methodologies and the definition of liquidity adequacy;
 - f) Quality assurance arrangements, including validation processes, controls over input data, self-assessment mechanisms, model validation, and review of stress test results.
4. Banks shall establish policies and procedures for the regular internal review and validation of the ILAAP. These reviews shall address both qualitative and quantitative aspects of the framework. Internal review shall be conducted by the three lines of defense:
 - a) Business lines (first line);
 - b) Independent control functions such as risk management and compliance (second line);
 - c) Internal audit (third line).
5. Internal reviews shall include assessments of:
 - a) Use and reliability of ILAAP outcomes;

- b) Functioning of the stress testing framework;
 - c) Risk capture methodologies and data aggregation processes;
 - d) Accuracy and suitability of internal risk quantification models.
- 6. Banks should ensure that ILAAP frameworks are promptly adjusted to reflect material changes, including the introduction of new products, services, markets, or structural changes within the bank or its group.
- 7. Outcomes and assumptions of the ILAAP shall be subject to proportionate and effective internal review. The nature of this review, qualitative or quantitative, shall be determined by the characteristics of the specific ILAAP components under assessment.
- 8. The review process shall include verification of the appropriateness of methodologies and assumptions, and may include back-testing to ensure soundness of results. All findings shall be documented and reported to Senior Management and the Board of Directors, with timely corrective actions taken as needed.
- 9. Liquidity Adequacy Statement. The Liquidity Adequacy Statement shall provide the Board of Directors' coherent assessment of the bank's liquidity adequacy. It shall articulate the rationale for its conclusions, drawing on ILAAP results and other relevant internal information. The Liquidity Adequacy Statement shall demonstrate that the Board of Directors understands:
 - a) The bank's liquidity position and key risk drivers;
 - b) The vulnerabilities in its liquidity profile;
 - c) The key inputs and outputs of the ILAAP;
 - d) The assumptions and methodologies employed;
 - e) The coherence of the ILAAP with the bank's strategic objectives.

Article 5

Integration of ILAAP to the Management Framework

1. Banks shall establish and maintain robust strategies, policies, processes, and systems to identify, measure, manage, and monitor liquidity risk across all relevant time horizons (up to one year), including intraday, as prescribed by Instruction 22/2023 on Liquidity Risk Management. These arrangements shall ensure the maintenance of adequate liquidity buffers at all times.
2. Banks shall implement both a quantitative framework and a qualitative framework to assess and manage liquidity adequacy:
 - a) The quantitative framework shall ensure sound measurement and analysis of liquidity risk;
 - b) The qualitative framework shall promote active management of liquidity adequacy through ongoing monitoring of key indicators, timely identification of threats, and the initiation of preventive actions to preserve regulatory and internal liquidity buffers.
3. The ILAAP shall be fully integrated into the bank's business strategy, decision-making processes, and risk management framework. Quantitative and qualitative components of the ILAAP shall be consistent with each other and aligned with the bank's risk appetite and overall business objectives.
4. Banks should ensure that the ILAAP is applied consistently across the group and that all relevant elements are embedded within the group's governance and control architecture.
5. The ILAAP shall support both strategic and operational decision-making. It shall serve to maintain adequate liquidity continuously and foster a prudent balance between risk and reward. All processes, tools, and methodologies used for liquidity steering, whether strategic or operational, shall be subject to approval by the Board of Directors, properly documented, and thoroughly reviewed for inclusion in the ILAAP framework.

6. Banks shall ensure that the ILAAP is embedded in all material business processes and risk-related decisions, including:
 - a) Strategic planning at group and legal entity levels;
 - b) Allocation and optimization of liquidity resources;
 - c) Liquidity planning and risk scenario analysis;
 - d) Execution and maintenance of the risk appetite framework;
 - e) Timely identification and mitigation of potential liquidity shortfalls.
7. ILAAP-based risk-adjusted performance indicators shall be used in managerial decision-making processes, including but not limited to remuneration design and variable compensation assessments, asset and liability management, risk management committee discussions and deliberations of the Board of Directors.
8. The Board of Directors shall ensure the design and maintenance of a coherent and effective ILAAP architecture. This includes a clear and documented framework that demonstrates the interconnection between all ILAAP components and their integration into the bank's overall management system.
9. Banks shall maintain comprehensive documentation describing the overall ILAAP architecture. This shall include, at a minimum:
 - a) A summary of the key ILAAP components;
 - b) An explanation of how these components interact;
 - c) A description of how the ILAAP supports the bank's governance, risk, and funding strategies;
 - d) The alignment between business objectives, funding plans, risk identification, risk appetite statements, limit structures, quantification methods, stress testing programs, and management reporting mechanisms.
10. The ILAAP shall be implemented as an ongoing process. Banks should ensure that ILAAP outcomes, such as the evolution of material risks and liquidity indicators, are reflected in regular internal reports.
11. ILAAP related reporting shall be provided to all relevant managerial levels at frequencies proportionate to the bank's size, complexity, business model, and liquidity risk profile.
12. As a minimum, reporting to the Board of Directors should occur on a quarterly basis. More frequent reporting may be required to ensure timely management action.
13. Banks shall ensure that their risk appetite framework formalizes the integration and alignment of strategic processes, including the Internal Liquidity Adequacy Assessment Process (ILAAP), Internal Capital Adequacy Assessment Process (ICAAP), the recovery plan, and the remuneration framework.
14. The risk appetite framework shall be structured around a comprehensive risk appetite statement, which shall explicitly define the Bank's tolerance and strategic stance towards liquidity risk and serve as a central component of sound liquidity risk management.
15. The risk appetite statement shall:
 - a) Provide a clear, unambiguous view of the bank's risk profile in alignment with its business model;
 - b) Include justifications for accepting or avoiding certain risk types, products, or geographies;
 - c) Extend beyond regulatory liquidity metrics to include a diversified and risk-sensitive set of internal liquidity indicators, appropriate to the bank's size, complexity, and risk exposure.
16. The risk appetite framework shall explicitly align with IFRS 7 disclosure requirements by ensuring that contractual and expected cash flow obligations, by significant time bands, are systematically captured and disclosed.

17. If the bank is part of a group, the group-wide risk appetite framework shall determine and constrain the bank's overall risk profile. The risk appetite framework shall support both the development and execution of strategic objectives and shall incorporate the bank's internal liquidity management buffers.
18. Banks shall clearly articulate the role of the ILAAP in implementing and monitoring the risk appetite. It shall demonstrate how the ILAAP enables compliance with risk limits set out in the risk appetite framework and facilitates the development of a granular risk monitoring, reporting, and limit system. This system shall:
 - a) Allocate limits to risk categories, entities, and business areas;
 - b) Include defined escalation procedures;
 - c) Promote alignment with the risk appetite framework across the bank and its subsidiaries.
19. Banks shall ensure that the ILAAP and recovery plans are part of a unified risk management continuum. A recovery plan is aimed at ensuring the survival of the bank in times of distress that pose a threat to its viability. The ILAAP shall be aimed at maintaining business continuity under normal and mild stress conditions, while recovery plans shall define extraordinary measures to restore the financial position in the event of significant deterioration. Banks shall ensure consistency and coherence between the ILAAP and the recovery plan, particularly in the following areas:
 - a) Early warning indicators and recovery thresholds;
 - b) Escalation and governance procedures;
 - c) Potential management actions and corresponding triggers.
20. Material ILAAP actions or decisions with significant impact shall be promptly incorporated into the recovery plan. Conversely, significant changes to the recovery plan shall be reflected in the ILAAP to ensure both processes remain aligned and up to date.
21. Banks shall ensure that the ILAAP ensures liquidity adequacy at all relevant levels of consolidation, including for individual entities and sub-groups when it is the case.

Article 6

ILAAP Contribution to Ensure Liquidity Adequacy

1. Each bank shall ensure the adequacy of its liquidity position to maintain operational continuity under both normal and adverse conditions. The ILAAP must provide a comprehensive, forward-looking framework that supports the bank's ability to meet its financial obligations, withstand liquidity shocks, and follow a sustainable business strategy. This objective must be reflected in the bank's risk appetite framework, as above defined.
2. Similarly to ICAAP, a bank shall implement a proportionate, prudent, and conservative ILAAP that integrates the two complementary internal perspectives:
 - a) Economic Perspective: The bank must identify, quantify, and ensure coverage of all material liquidity risks using internal liquidity measures. This perspective requires:
 - i. Assessment of both a credible baseline scenario and adverse scenarios over a multi-year planning horizon.
 - ii. Identification and quantification of expected and unexpected liquidity outflows.
 - iii. Use of stress testing to assess resilience and incorporate the findings into strategic and operational decisions.
 - iv. Maintenance of internal liquidity buffers sufficient to support ongoing viability and strategic execution.

- b) Normative Perspective: The bank must assess its ongoing ability to meet all regulatory and supervisory liquidity requirements and external financial constraints over a medium-term horizon. This includes:
 - i. Projection of compliance with applicable regulatory metrics, including the LCR and other ratios.
 - ii. Inclusion of baseline and adverse scenarios in the forward-looking liquidity and funding plan, with a minimum horizon of three years for funding.
 - iii. Consideration of upcoming regulatory, legal, and accounting changes.
- 3. Banks shall also prepare quantitative liquidity disclosure tables consistent with IFRS 7, showing both contractual maturities of financial liabilities and expected behavioral flows, reconcilable to published financial statements.
- 4. Within the ILAAP framework, the bank shall determine management liquidity buffers above regulatory minima. These buffers must reflect:
 - a) Internal liquidity needs.
 - b) External expectations (e.g., counterparties, investors).
 - c) Flexibility to maintain strategic choices during stress such as dividend payments.
 - d) Uncertainties in liquidity forecasts and changes in market perception.
- 5. Banks must maintain a formal Liquidity Contingency Plan, which:
 - a) Addresses liquidity shortfalls under stress scenarios.
 - b) Is aligned with the risks identified in the ILAAP and the liquidity section of the recovery plan.
 - c) Includes a clear escalation process, actionable measures, expected timeframes, contingent liquidity generation potential, and adverse implications.
- 6. A bank shall ensure the integration of the economic and normative perspectives within its liquidity and funding planning. Differences in assumptions, scenarios, and management actions under each perspective must be identified, justified, and reconciled. The bank must:
 - a) Use internally consistent assumptions across both perspectives.
 - b) Validate the feasibility and quantitative impact of any management actions.
 - c) Ensure alignment between the Liquidity Contingency Plan, the ILAAP, and the recovery plan.
- 7. The outputs of the ILAAP must directly inform business strategy, client interactions, and market actions. The bank shall:
 - a) Reassess its risk appetite based on liquidity constraints.
 - b) Identify in advance and implement timely measures to address liquidity deficiencies.
 - c) Demonstrate that it remains viable and strategically flexible under stress.

Article 7

Material Risks

- 1. Each bank shall implement a regular, systematic process to identify all material liquidity and funding risks to which it is, or may become, exposed. This process must cover both the economic and normative perspectives of the ILAAP and shall be applied at a frequency of no less than once per year.
- 2. Banks are required to develop and maintain a comprehensive internal risk inventory based on a clearly defined internal risk taxonomy. This taxonomy shall not merely replicate the BCTL Instructions classification, but reflect the bank's specific risk profile, organizational structure, and business model.

3. The risk identification process shall be applied across all relevant legal entities, business lines, and exposures, regardless of whether these are within or outside the prudential consolidation perimeter.
4. Any bank must ensure that the internal risk inventory is kept up to date and must promptly revise it in response to material changes in the business model, operational environment, or product offerings.
5. The identification of material risks shall follow a gross risk approach, meaning that risks shall first be identified and assessed without consideration of mitigation measures. Subsequently, the effectiveness of any mitigation strategies shall be evaluated.
6. Banks must identify risks emerging from its strategic plans, including any forward-looking risks and risk concentrations that may arise from changes in its operations, markets, or environment.
7. Banks must identify risks emerging from their strategic plans, including any forward-looking risks and risk concentrations that may arise from changes in their operations, markets, or environment. Banks shall integrate expected credit loss (ECL) impacts under IFRS 9 into their liquidity adequacy assessment, ensuring that credit deterioration assumptions feed into stress testing of liquidity buffers and funding plans.
8. The bank's Board of Directors shall be ultimately responsible for:
 - a) Determining which risk types are considered material;
 - b) Deciding which of the material risks are to be covered by liquidity resources;
 - c) Providing written justification for any risk deemed immaterial or for which liquidity coverage is not maintained.
9. Banks must identify, assess, and incorporate into the ILAAP all significant risks arising from financial and non-financial participations, subsidiaries, and other connected entities, when it is the case.
10. A bank must also address reputational, and operational risks, as well as obligations arising from letters of comfort or other support arrangements. These risks must be reflected in the internal risk taxonomy and inventory.
11. The depth of the assessment of such underlying risks shall be proportionate to the size, complexity, and risk profile of the relevant entities and the bank's risk management approach.
12. For all risks identified as material, the bank shall either hold sufficient liquidity to cover the risk or provide robust and documented justification for not doing so.
13. This coverage must include both on-balance sheet and off-balance sheet risks, including contingent liquidity risks such as:
 - a) Collateral and margin call due to market volatility or credit deterioration,
 - b) Voluntary buybacks of own debt to maintain market access,
 - c) Product-specific risks, such as call features on funding instruments,
 - d) Collateral swap transactions affecting liquid asset composition.
14. For banks with cross-border operations, the ILAAP shall include:
 - a) Identification and quantification of impediments to the free flow of liquidity between legal entities, countries, and currencies,
 - b) Assessment of the impact of these impediments on group-wide liquidity availability.
15. Banks shall establish a sound process to determine and monitor which currencies are considered material for liquidity and/or funding risk. The ILAAP must quantify risks arising from any currency mismatches between:
 - a) Liquidity risk or funding risk exposures, and
 - b) Corresponding liquid asset buffers.

16. Banks shall assess currency-related risks under both normal and stressed conditions, including:
 - a) Expected inflows/outflows per material currency,
 - b) Liquidity value of liquid assets in each currency under stress,
 - c) Balance sheet mismatches and foreign currency dependencies.

Article 8

Internal Liquidity Buffers and Stable Funding

1. Each bank shall define, assess, and maintain internal liquidity buffers under the economic perspective of liquidity adequacy. These buffers must align with the bank's internal risk quantification framework and the economic concept of liquidity adequacy.
2. Internal liquidity buffers shall consist of assets and expected inflows that are available to meet liquidity needs under both normal and stressful conditions. The bank must apply a prudent and conservative approach in defining and evaluating these buffers.
3. Banks shall establish a clear internal classification of liquidity sources based on their usability and reliability. Specifically, it must:
 - a) Distinguish between assets likely to remain liquid during stress periods and those which can only be monetized through central bank facilities;
 - b) Formulate an explicit internal view on the desired composition of its buffer of liquid assets.
1. The bank shall set internal limits for each component of the liquidity buffer. These limits must be linked to the liquidity risks that may materialize over multiple time horizons, including a minimum horizon of at least one year.
2. The internal liquidity buffers shall be of high quality, and their composition and size shall be determined in a manner that ensures coverage of identified risks and the continuity of operations.
3. A bank shall be capable of clearly demonstrating how internal liquidity is available and mobilizable to absorb liquidity shocks and ensure operational continuity, assuming a going-concern basis.
4. The bank shall define and assess the stability of its internal sources of funding for the purpose of ensuring funding sustainability over both the short and long term.
5. Each bank must adopt a prudent and conservative approach in identifying funding sources that are to be regarded as stable. This includes developing an internal view on the stickiness of liabilities, particularly deposits, and the behavioral characteristics of associated cash flows.
6. The assessment of funding stability shall incorporate:
 - a) Behavioral assumptions related to the withdrawal patterns of funding sources;
 - b) The diversity or concentration of funding providers, instruments, and markets;
 - c) The bank's ability to access funding markets in terms of both volume and pricing;
 - d) The current and projected level of asset encumbrance and its impact on market access during execution of the funding plan.
7. Banks shall maintain a funding profile that supports the continuity of business operations under varying conditions, including stress scenarios, and shall periodically reassess its funding definitions to ensure their ongoing relevance and robustness.

Article 9

Risk Quantification

1. Banks shall implement and maintain risk quantification methodologies that are adequate, robust, and tailored to their individual circumstances, and that capture liquidity and funding risks under both the economic and normative perspectives.
2. Banks shall apply a high level of conservatism in risk quantification methodologies to ensure the appropriate consideration of rare or tail-risk events in both perspectives.
3. Risk quantification methodologies shall:
 - a) Reflect the bank's risk appetite, business model, market expectations, and risk profile.
 - b) Remain consistent across the group and between risk types.
 - c) Be capable of estimating liquidity impacts under both normal and stressful conditions using parameters such as confidence levels and scenario assumptions.
4. Risks shall not be excluded from assessment due to data limitations or methodological complexity. Where quantitative models are unavailable, conservative estimates using expert judgment and alternative methodologies shall be employed.
5. Methodologies shall be consistent with the definition of liquidity and stable funding, and shall be proportional to the size, complexity, and risk profile of the bank.
6. Banks shall not adopt methodologies they do not fully understand or use for internal decision-making. Vendor models shall be internally assessed, understood, and tailored to the bank's specific context.
7. Banks shall establish and maintain a comprehensive data quality framework that ensures the accuracy, completeness, consistency, timeliness, validity, uniqueness, and traceability of all data used in ILAAP-related risk measurement and decision-making.
8. Risk quantification methodologies shall be subject to regular, independent internal validation. Such validation shall be proportionate to the materiality of the risks and the complexity of the methodologies used, and aligned with the principles applicable to internal models under Pillar 1.
9. Independence between the development and validation functions shall be ensured. The validation function shall not be performed by the internal audit function and may follow one of the following arrangements:
 - a) Separation into two distinct units reporting to different Senior Management members;
 - b) Separation into two units reporting to the same senior manager;
 - c) Separate staff within the same unit.
10. The conclusions of validation exercises shall be reported to Senior Management and the Board of Directors and shall inform the review, enhancement, and ongoing appropriateness of the bank's risk quantification methodologies and liquidity adequacy assessments.

Article 10

Stress Testing

1. Banks shall develop and maintain a comprehensive stress-testing program that captures all material risks impacting liquidity adequacy under both normative and economic perspectives.
2. The program shall be based on a bank-wide analysis of vulnerabilities, including business model and external operating environment factors, and updated at least annually, or more frequently as needed.
3. The program should incorporate both historical and hypothetical stress events, and reflect multiple time horizons, including intraday liquidity risk.

4. Banks should define adverse scenarios that are severe yet plausible and that reflect their material vulnerabilities. These scenarios shall be used to assess the evolution of liquidity positions and regulatory ratios such as the LCR over time.
5. Liquidity transferability, particularly in cross-border operations, should be assessed under stress. Banks shall:
 - a) Evaluate impediments to liquidity transfer in stressful conditions.
 - b) Identify and document appropriate contingency measures.
6. The program shall include baseline assessments reflecting expected conditions and adverse scenarios representing extreme but plausible shocks to the bank's liquidity position.
7. Adverse scenarios shall address:
 - a) Severe economic downturns;
 - b) Market disruptions;
 - c) Financial shocks;
 - d) Bank-specific vulnerabilities;
 - e) Dependence on major funding providers; and
 - f) Plausible combinations of the above.
8. Banks shall ensure consistency between ILAAP and ICAAP stress testing. Common assumptions, impacts on liquidity buffers, and related management actions shall be coherently reflected across both frameworks.
9. Banks shall conduct reverse stress testing at least annually. This testing shall begin with a predefined outcome (e.g., business model failure) and identify scenarios that would lead to such outcomes.
10. Reverse stress tests shall be used to challenge the adequacy and conservatism of the ILAAP framework and inform recovery planning. Where scenarios are deemed plausible, management shall take pre-emptive measures as appropriate.
11. Banks should monitor environmental changes on at least a quarterly basis and revise stress scenarios accordingly to ensure continued relevance and adequacy of their liquidity stress testing.

SECTION III

ILAAP REQUIREMENTS AND REPORT

Article 11

Minimum Content Requirements for the ILAAP Report

1. The ILAAP report must consider and comment all the requirements of Instruction 22/2023 on Liquidity Risk Management, including the Leverage Coverage Ratio, the Net Stable Funding Ratio, maturity gap, concentration of funding, available unencumbered assets and other metrics used by the bank.
2. In consequence, the ILAAP report shall, at a minimum, include the following components: Board and Senior Management oversight, risk appetite and liquidity risk tolerance, liquidity risk strategy and management, liquidity risk practices, liquidity risk environment, funding policies, liquidity policies and procedures, intra-group liquidity, intraday liquidity, limits and ratios (including LCR and NSFR), management information system, early warning indicators, liquidity stress testing, contingency funding plan, and internal controls and audit.

3. The ILAAP report shall also include a section reconciling liquidity risk reporting with IFRS disclosures (IFRS 7, IFRS 9, IFRS 13), covering:
 - a) Contractual vs expected cash flow mismatches;
 - b) Impact of expected credit losses on funding/liquidity;
 - c) Valuation of high-quality liquid assets under fair value measurement principles
4. The ILAAP document shall contain an assessment of the bank's liquidity and funding profile as at the end of previous year and quarterly projections for the next one year.
5. Banks can choose the best presentation to ILAAP Report since they consider all elements of the principles referred in Section II and the requirements of the above-mentioned Instruction.
6. The report should have descriptive and analytical elements.
7. The Annex I to the Guidelines is a template with a suggested structure for the presentation of the ILAAP Report. Banks are not obliged to follow the template. However, banks should provide complete information on the components of the template.

Article 12

Reporting and Review Process

1. On an annual basis, banks shall transmit to the BCTL the ILAAP report approved by the Board of Directors, in accordance with Article 9, paragraph 3, of Instruction 24/2023, on Reporting and Publication.
2. Independently of the format, the ILAAP report shall contain an executive summary, a description of the business model and strategic initiatives, a summary of financial indicators, details of the governance structure, definition of the risk profile in terms qualitative and quantitative, analysis of the risks under Pillar I and Pillar II, assessment of capital requirements and capital resources, summary of capital projections for next three years, impact of stress testing, integration of ICAAP to risk management, documentation, reporting and review.
3. Banks must be able to demonstrate to the BCTL that the liquidity risk targets are well founded and managed, and that these targets are consistent with their overall risk profile and current operating environment.
4. In addition to supervisory reporting, banks shall disclose to the public, at least annually, their LCR, NSFR, liquidity risk management practices, and governance, in accordance with Basel III Pillar 3 disclosure standards.
5. Banks do not need to submit the documents used for the preparation of the ILAAP Report to the BCTL, except those already required by Instruction 24/2023, on Reporting and Publication. However, such documents should be kept available at the bank's headquarter for evaluation by the BCTL.
6. BCTL may require banks to submit ILAAP outcomes more than once a year if necessary for adequate supervision.
7. BCTL has the ability to review the submitted ILAAP using the methods available:
 - a) off-site analysis;
 - b) on-site reviews; and
 - c) discussions with the bank.
8. BCTL can require adjustments to the bank's management of liquidity risk as a consequence of the ILAAP Report and its supervisory assessment, according to Regulation 2000/8 on Banking Licensing and Supervision and Instruction 22/2023 on Liquidity Risk Management.

Annex I: Template for the LCAAP Report

1. Executive Summary

Purpose: Summarize the ILAAP's objectives, scope, and key findings.

- Brief overview of the bank's overall liquidity risk profile
- Statement on adequacy of liquidity under current and stressed conditions
- Key liquidity metrics (LCR, NSFR, survival horizon, HQLA, unencumbered assets, concentration)
- Summary of major findings, key improvements, and action points

2. Overview

The bank shall prepare:

- A description of the bank's business model, its scope of operations, and its systemic relevance.
- A summary of internal and external developments since the previous liquidity review.
- A description of any changes in the scope of the report since the last assessment by the Board and Senior Management.

3. Summary Conclusions

The bank shall provide:

- A consolidated assessment of liquidity adequacy, outlining the bank's position with respect to overall liquidity sufficiency and its framework for managing liquidity and funding risks.
- Identification of any deficiencies in liquidity risk management, along with corresponding remediation plans.
- An evaluation of any additional liquidity the bank considers necessary in light of risks referred in the Section III of the Guidelines on the ICAAP – Internal Capital Adequacy Assessment Process.

4. Governance and Oversight

The bank shall comment:

- The governance structure overseeing ILAAP, including the role of the Board of Directors. Discuss the roles and responsibilities of Board of Directors, Senior Management and committees (e.g., ALCO, Risk Management Committee).
- The risk management framework specific to liquidity and funding risks, including supporting technical and human resources. Analyze the three lines of defense model adopted by the bank: the liquidity management, the risk oversight and monitoring, and the independent audit and assurance.
- The approach to maintaining continuous market access.

5. Liquidity Risk Appetite and Strategy

- The Liquidity Risk Appetite Statement should specify tolerance for liquidity risk under both normal and stressful conditions with quantitative and qualitative elements.

- It should also set risk limits and thresholds to be adopted. The key metrics should include LCR (Liquidity Coverage Ratio), NSFR (Net Stable Funding Ratio), survival horizons, maturity gaps, concentration, and internal stress indicators.
- The Strategic Liquidity Management Objectives should define the targets for the liquidity metrics under usual conditions, the funding structure objectives and considerations on currencies/counterparties.

6. Identification and Measurement of Liquidity Risk

- The bank should assess the main sources of liquidity risk, such as funding liquidity risk, market liquidity risk, intraday liquidity risk, and contingent liquidity risk
- The bank should discuss the risk measurement tools used in the framework as liquidity gap analysis, cash flow forecasting (up to one year), monitoring of early warning indicators (e.g., credit spreads, market sentiment), and internal models to assess behavioral aspects.
- Analyze the data sources used for liquidity reporting and stress testing, the controls for data accuracy, timeliness, and completeness. Comment the level of automation and manual interventions.

7. Liquidity Coverage Ratio (LCR)

- Assessment of the Liquidity Coverage Ratio, covering the composition of High-Quality Liquid Assets (HQLA), projected outflows, and inflows. The bank should comment on the HQLA breakdown by level (Level 1 and 2), currency and jurisdictional diversification, when it is the case. Comments on the non-HQLA classified as unencumbered assets are important.
- Reference to applicable guidelines on LCR computation in accordance with the above mentioned Instruction.

8. Liquidity Risk Assessment

- A detailed evaluation of short- and medium-term liquidity needs, covering time horizons of one, 3, 6, 9 and 12 months.
- An analysis of gross and net sources and uses of liquidity under both business-as-usual and stressed conditions.
- A discussion of any material liquidity risks not adequately captured by the Liquidity Coverage Ratio metric and the bank's strategy for managing such risks.

9. Intraday Liquidity Risk Assessment

The bank shall provide:

- A description of how intraday liquidity risk arises within its operations, irrespective of participation in payment systems.
- An explanation of the bank's risk appetite and risk management approach for intraday liquidity, including stress testing methodologies and related conclusions.

10. Evaluation of the Liquidity Buffers

This section shall outline:

- The procedures for calculating, monitoring, and controlling the liquidity buffers and counterbalancing capacity.
- An assessment of their effectiveness under various scenarios, including those impairing asset liquidity or access to counterbalancing capacity.

- The liquidity buffer policy should include the management of the size and composition of the targets, as well as the use of stress testing to verify the adequacy of buffers.

11. Funding Profile and Diversification

The bank should:

- Discuss its funding sources and structure, like the funding mix (retail, corporate, wholesale, central bank), the maturity profile, and the reliance on short-term funding.
- Articulate its funding risk appetite and strategy, along with an overview of its funding profile, including gross and net positions by source and use.
- Assess the stability of liabilities and conditions under which they may become volatile. Analyze its current market access and identify actual or potential threats, including the impact of negative news or short-term liquidity shocks
- Assess how its funding plan is expected to influence its liquidity and funding risk profile, detailing the underlying assumptions and mitigation strategies.
- Evaluate exposure to market developments such as changes in collateral valuations, maturity mismatches, asset encumbrance, and concentration risks.
- Assess the Net Stable Funding Ratio (NSFR) and the components stable inflows and outflows.

Under this section, the bank shall also analyze the funding concentration and risk mitigation, as limits on counterparty exposure, intragroup and cross-border funding risks, and diversification strategy.

12. Stress Testing and Scenario Analysis

The bank should provide:

- Stress Testing Program: Overview of the stress testing program used to support liquidity and funding adequacy assessment and management.
- Scenario Development: Development of bank-specific, forward-looking scenarios aligned with the business model and risk profile, including market-wide stress (e.g., systemic liquidity crisis) and combined stress scenarios.
- Results and Management Actions: Discuss the results of stress scenarios like survival horizon (days of liquidity available) and breach triggers. Comment on the articulation of potential management actions in response to stress scenarios, including feasibility assessments and implementation timeframes.

13. Liquidity Contingency Plan (LCP) and Contingency Funding Plan (CFP)

- Comment on the preparation of the LCP and CFP and its approval. Comment on the early warning indicators adopted, the activation criteria and escalation process, the roles and responsibilities, the available emergency liquidity sources (e.g., repo lines, central bank facilities), and the communication strategy (internal and external).
- This section shall describe the bank's contingency planning for severe funding disruptions, including relevant policies, procedures, and action plans. The bank shall submit its comprehensive funding plan, demonstrating how planned business activities will be supported under both normal and stressed conditions, ensuring compliance with risk appetite and key metrics, and the associated risks.

14. Integration with Other Risk and Planning Processes

- The bank shall analyze the interactions between capital (ICAAP) and liquidity under stress and joint scenario assumptions.
- Comment also the link to Recovery and Resolution Planning, identifying recovery options related to liquidity and feasibility/credibility of liquidity recovery actions.

15. Internal Controls, Validation, and Audit

- Discuss the control framework adopted, including monitoring systems and thresholds, policy reviews and updates. Describe its internal limits and controls related to the liquidity buffer and justify their appropriateness. Outline the structure supporting risk appetite and its alignment with business practices. Detail the pricing framework, including development methodology, control and monitoring processes, and the dissemination of pricing signals to business units for performance evaluation and incentive alignment.
- Comment if there is an independent validation of assumptions, stress models, and behavioral factors. Comment the scope and frequency of internal audit, and the summary of audit findings and remediation actions.

16. Assessment of Liquidity Adequacy

Discuss the overall conclusion on liquidity adequacy, the areas of strength and areas for improvement, as well as the planned actions and timelines for remediation.