



KINGDOM OF CAMBODIA
NATION RELIGION KING

NATIONAL BANK OF CAMBODIA

Number... B7-017-301 Prokor...

Unofficial Translation

PRAKAS
ON
LIQUIDITY RISK MANAGEMENT FRAMEWORK FOR BANKING AND
FINANCIAL INSTITUTIONS

The Governor of the National Bank of Cambodia

- With reference to the Constitution of the Kingdom of Cambodia;
- With reference to the Royal Decree NS/RKT/0515/417 of May 11, 2015 on the reappointment of His Excellency Chea Chanto as Governor General of the National Bank of Cambodia, equivalent to Senior Minister;
- With reference to the Royal Kram NS/RKM/0196/27 of January 26, 1996 promulgating the Law on Organization and Conduct of the National Bank of Cambodia;
- With reference to the Royal Kram NS/RKM/1206/036 of December 29, 2006 promulgating the Law on the Amendment of article 14 and 57 of the Law on Organization and Conduct of the National Bank of Cambodia;
- With reference to the Royal Kram NS/RKM/1199/13 of November 18, 1999 promulgating the Law on Banking and Financial Institutions;
- With reference to Prakas N°B8-98-385 Prokor dated July 20, 1998 on Organization structure of National Bank of Cambodia and all department of the National Bank of Cambodia
- With reference to Prakas N° B1-010-194 Prokor dated November 26, 2010 on the amendment of Article 3, Article 4, Article 5, Article 12 and Article 13 of Prakas on Organization Structure of the National Bank of Cambodia and all departments of the National Bank of Cambodia;
- Pursuant to the recommendation made by National Bank of Cambodia Management meeting on September 15, 2017.

Decides
Chapter 1
General Provisions

Article 1.-

The purpose of this Prakas is to set up a framework for liquidity risk management of banking and financial institutions hereinafter referred to as “Institutions”.

Article 2.-

The aim of the Prakas is to reduce the severity of potential liquidity problems, lower their impact on the banking system and protect depositors and creditors.

Article 3.-

This Prakas is applicable to the institutions, under the National Bank of Cambodia's (NBC) supervisory authority.

Article 4.-

For the purposes of this Prakas, the following terms are defined as follow:

Liquidity: is the ability of an institution to fund increases in assets, meet its obligations, either expected or unexpected, as they come due, and unwind or settle its positions, without incurring unacceptable losses. Liquidity may be impacted by both on- and off-balance sheet financial instruments.

Liquidity risk: is the risk that, in a given economic and financial context and market situation, the institution might not be able to fulfill its obligations or to unwind or offset positions. Typically it is the risk of loss arising from a situation where (1) there will not be enough cash and/or cash equivalents to meet the needs of depositors, borrowers and contingency liabilities, (2) the sale of illiquid assets would yield less than their fair value, and (3) illiquid assets would not be sold at the desired time due to a lack of buyers.

Risk Appetite: is an articulation of the nature and level of risk that is acceptable in the context of achieving an institution’s strategic objectives.

Risk Tolerance: is a quantitative articulation of the maximum level of acceptable risk after having taken into account appropriate mitigates and controls to reduce the risk.

Encumbered assets: are assets not free of legal, regulatory, contractual or other restrictions on the ability of an institution to liquidate, sell, transfer, or assign these assets.

Unencumbered assets: are assets free of legal, regulatory, contractual or other restrictions on the ability of an Institution to liquidate, sell, transfer, or assign these assets.

Liquid assets: are cash or its equivalents, any asset that is readily convertible to cash. Liquid assets can be sold quickly without significant loss.

Eligible liquid assets: are those assets defined as eligible assets in the Prakas B7-015-349 dated December 23, 2015 on the Liquidity Coverage Ratio.

Chapter 2

Governance Requirements

Article 5.-

An institution shall establish a robust liquidity risk management framework that ensures it maintains sufficient liquidity at all times, including the holding of unencumbered eligible liquid assets, to withstand a range of stress events, including the loss of funding sources, either internally such as deposits, borrowings, raising additional capital, and other matters.

An institution must ensure that its activities are funded with stable sources of funding on an ongoing basis.

An institution must inform the NBC without any delay of any concerns it has about its current and future liquidity, and its plans to address these concerns. In particular, if an institution experiences a severe liquidity stress, it must notify the NBC immediately and advise the action that is being taken to address the situation.

Article 6.-

An institution should clearly articulate a liquidity risk tolerance that is appropriate for its business strategy and its role in the financial system.

In setting the liquidity risk tolerance, the Board and senior management must ensure that this risk tolerance allows the institution to effectively manage its liquidity in such a way that it is able to withstand a prolonged period of stress. An institution's liquidity risk tolerance must be designed with the particular vulnerabilities of the institution in mind. The liquidity risk tolerance must be reviewed, at least annually, to reflect the institution's financial condition and funding capacity.

Article 7.-

Liquidity risk management involves active participation by the Board of Directors and senior management.

Senior management should develop a strategy, policies and practices to manage liquidity risk in accordance with the risk tolerance and to ensure that the bank maintains sufficient liquidity. Senior management should continuously review information on the bank's liquidity developments and report to the board of directors on a regular basis. A bank's board of directors should review and approve the strategy, policies and practices related to the management of liquidity at least annually and ensure that senior management manages liquidity risk effectively.

In formulating its strategy, an institution must consider its legal structure, key business lines, the breadth and diversity of products, markets and jurisdictions in which it operates, as well as home and host (when applicable) regulatory requirements.

An institution must have adequate policies, procedures and controls in place to ensure that the Board and senior management are informed immediately of 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 liquid assets, and changes in market conditions that could signal future difficulties.

The Board is responsible for ensuring that reports are comprehensive to the extent that they provide enough information for the Board to make informed decisions in order to take appropriate remedial actions to address the concerns.

Article 8.-

The senior management must, at a minimum:

1. develop a liquidity management strategy, policies, procedures and processes;
2. ensure that the institution maintains sufficient liquidity at all times, including a cushion of unencumbered liquid assets to withstand a range of stress events;
3. determine the structure, responsibilities and controls for managing the liquidity risk and for overseeing the liquidity positions of all legal entities, branches and subsidiaries in the jurisdictions in which the Institution is active, and outline these elements clearly in the institution's liquidity policies;
4. ensure that the institution has adequate internal controls, to ensure the integrity of its liquidity risk management processes;
5. ensure that stress tests, contingency funding plans and holdings of liquid assets are effective and appropriate for the institution's activities;
6. establish a set of reporting criteria, specifying the scope, manner and frequency of reporting and the parties responsible for preparing the reports for various recipients such as the Board, senior management and the asset/liability committee. The information on the institution's liquidity developments should be continuously reviewed and reported on a regular basis to the Board;
7. closely monitor current trends and potential market developments that may present significant, unprecedented and complex challenges for managing the liquidity risk so that appropriate and timely changes to the liquidity management strategy can be made as needed;

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;
9. communicate internally the liquidity management strategy, key policies for implementing the strategy and the liquidity risk management structure; and
10. 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.

Article 9.-

A bank should incorporate liquidity costs, benefits and risks in the internal pricing, performance measurement and new product approval process for all significant business activities (both on- and off-balance sheet), thereby aligning the risk-taking incentives of individual business lines with the liquidity risk exposures their activities create for the bank as a whole.

Article 10.-

The liquidity risk management framework must be subject to effective and comprehensive independent review on an ongoing basis. The daily oversight function must be operationally independent and staffed with personnel who have the skills and authority to challenge the bank's treasury and other liquidity risk management businesses.

An independent review of the liquidity risk management framework must be undertaken at regular intervals and at least annually by the internal audit, and the results of such audits be reported to the Board and senior management. Institution shall promptly address any deficiencies identified either by the persons in charge of activities related to the implementation and operation of liquidity management or by the auditors.

Chapter 3

Liquidity Risk Management

Article 11.-

The liquidity risk management framework approved by the Board, must include, at a minimum:

1. a statement of the institution's liquidity risk appetite and tolerance,
2. the liquidity risk management strategy and policies,
3. the institution's operating standards (e.g. in the form of policies, procedures and controls) for identifying, measuring, monitoring and controlling the liquidity risk in accordance with its liquidity risk tolerance,

4. methods and procedures for the use of stress testing and scenario analysis (see Article 19 of this Prakas),
5. an institution's funding strategy and a contingency funding plan (CFP) as defined in Article 21 of this Prakas.

Liquidity risk management should include the risks associated with intraday liquidity as well as short, medium, and long-term liquidity.

An institution's liquidity risk management framework must be fully integrated into the institution's overall risk management process.

Article 12.-

The Board's risk appetite statement shall articulate the institution's liquidity risk appetite and identify its liquidity risk tolerance of the institution.

The liquidity risk tolerance at an Institution must be documented and appropriate for the nature, complexity and scale of its business activities. It shall reflect:

1. potential demands for liquidity from the Institution's balance sheet and off-balance sheet,
2. the nature of the Institution's relationship with its shareholders and other related parties, and
3. the nature of the local banking environment.

Article 13.-

The liquidity management strategy must include, at a minimum, specific policies on the liquidity risk management, describing:

1. the composition and maturity of assets and liabilities and off-balance sheet items,
2. the diversity and stability of funding sources,
3. the approach to managing liquidity in different currencies, across borders, and across business lines and all legal entities that are subsidiaries or branches to the Institution,
4. the approach to intraday liquidity management,
5. liquidity needs under normal conditions as well as liquidity implications under periods of liquidity stress and the strategy may include various high-level quantitative and qualitative targets.

An institution's approach to measuring, monitoring and controlling the liquidity risk must enable the Institution to meet demands for liquidity, in the form of cash outflows in a given period, with an additional quantity of funding (or buffer) above the regulatory threshold, consistent with the institution's risk tolerance.

An institution must set specific limits to control its liquidity risk exposure and vulnerabilities. Where a liquidity risk limit is breached, action should be taken to immediately rectify the breach. Limits to liquidity risk exposure and corresponding escalation procedures must be reviewed regularly.

An institution must actively manage its intraday liquidity positions and risks in order to meet payment and settlement obligations on a timely basis under both normal and stressed conditions, thus contributing to the orderly functioning of payment and settlement systems.

Article 14.-

The institution should 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 Institution. This should include the preparation of preform a liquidity projections that produce a ‘cash flow mismatch’ or ‘liquidity gap’ analysis that can be based on assumptions of the future behavior of assets, liabilities and off-balance sheet items, and be used to calculate the cumulative net cash flows over a given time frame. Measurement can be performed over incremental time periods to identify projected and contingent flows.

Article 15.-

Liquidity risk management processes at an institution must incorporate granular cash flow forecasts such that they capture all material sources of potential liquidity risk. In addition, assumptions about future short- and long-term liquidity needs should reflect the complexities of the institution’s underlying businesses and products.

When forecasting cash flows, the institution shall take into account:

1. as for retail deposit flows, the factors that influence the ‘stickiness’ of those retail deposits such as the size, interest-rate sensitivity and nature of the deposit channels (direct, internet, and brokers).
2. projections of the potential consequences of all undrawn commitments being drawn, considering the nature of the commitments and the creditworthiness of the counterparties as well as exposures to business and geographical sectors.
3. active identification and management of collateral positions, with clear differentiation between encumbered and unencumbered assets.

Article 16.-

An institution is required to develop an annual funding strategy that provides effective diversification of funding sources. This funding strategy should include, but is not limited to:

1. an ongoing presence in funding markets and strong relationships with funds providers;
2. regular assessment of the capacity of the Institution to raise funds quickly. The institution 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;

3. robust assumptions in line with the institution's liquidity risk management strategy;
4. both qualitative and quantitative items, a base case balance sheet and key outcomes.

The funding strategy must be reviewed by the senior management and reported to the board on a regular basis and updated as necessary in light of changed funding conditions and/or a change in the institution's strategy.

Article 17.-

The NBC may require institutions, either individually or collectively, to increase liquidity requirements as determined to be necessary given an individual institution's risk, or that of the banking system as a whole, or to require other remedial actions to maintain sufficient liquidity based on regulatory requirements at all times.

Chapter 4

Early Warning Indicators

Article 18.-

An institution 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 risk position or potential funding needs. Such early warning indicators must be structured so as to assist in the identification of any negative trends in the institution's liquidity position and lead to a consecutive assessment and potential response by the management in order to mitigate the institution's exposure to these trends.

Early warning indicators can be qualitative or quantitative by nature and shall include, but are not limited to:

1. growing concentrations in assets or liabilities,
2. increases in currency mismatches,
3. increases in maturity mismatches,
4. a decrease of weighted average maturity of liabilities,
5. repeated incidents of positions approaching or breaching internal or regulatory limits,
6. significant deterioration in the institution's earnings, asset quality and overall financial condition,
7. negative publicity,
8. a credit rating downgrade,
9. stock price declines,
10. rising debt or deposits costs,

11. counterparties that begin requesting additional collateral for credit exposures or that resist entering into new transactions,
12. correspondent banks that eliminate or decrease their credit lines,
13. increasing retail deposit outflows,
14. increasing redemption of time deposits earlier than maturity,
15. difficulty accessing longer-term funding,
16. difficulty placing short-term liabilities,
17. increasing in short-term contingent liabilities,
18. difficulty accessing foreign funding.

Chapter 5

Stress Testing and Scenario Analysis

Article 19.-

Institutions must conduct liquidity stress tests on a regular basis, at least once a year or as frequently as necessary, for a variety of scenarios, including short, medium and long-term, institution-specific and market-wide stress and should be able to justify their rationale for assumptions used in stress testing. Stress testing shall include testing both on- and off-balance sheet financial instruments.

Stress test scenarios of institutions and related assumptions must be well documented and reviewed together with the stress test results.

Stress test results and vulnerabilities and any resulting actions must be reported for action by the Board. The results of the stress tests must be integrated into the institution's liquidity management strategy and its day-to-day risk management procedures and processes as well as in the shaping of the institution's contingency funding plan. The results of the stress tests must be explicitly considered in the setting of internal limits.

The stress testing program shall cover forward looking scenarios to incorporate changes in the portfolio composition, new information and emerging risk possibilities that are not covered by relying on historical analysis or replicating previous stress episodes. Senior management dialogue and judgment should be used as the basis for scenario analysis. Stress tests and scenario analysis shall include reverse assumptions that are relevant to the business activities of institution such as but not limited to:

1. asset market illiquidity and the erosion in the value of liquid assets;
2. the run-off of retail funding;
3. the operational ability of the Institution to monetize assets
4. the correlation between funding markets or the effectiveness of diversification across sources of funding;
5. additional margin calls and collateral requirements;
6. funding providers;
7. estimates of future balance sheet growth;

8. contingent claims and potential draws on committed lines extended to third parties or the institution's subsidiaries, branches or head office;
9. the liquidity absorbed by off-balance sheet vehicles and activities;
10. the availability of secured and unsecured wholesale funding sources;
11. the availability of contingent lines extended to the Institution.

Article 20.-

Stress test scenarios and results shall be reported to the NBC at least annually or as required.

Chapter 6

Contingency Funding Plan

Article 21.-

An institution should be prepared to respond promptly and decisively to periods of liquidity stress. As part of such preparedness, all Institutions must establish a contingency funding plan (CFP), which is a compilation of policies, procedures and action plans for responding to severe disruptions to an institution's ability to fund some or all of its activities in a timely manner and at a reasonable cost.

The plan's design, scope and procedures must be closely integrated with the institution'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.

An institution's CFP must be commensurate with the nature, complexity, and scale of its business activities. The plan must articulate available contingency funding sources and the amount of funds the institution estimates can be derived from these sources, clear escalation/prioritization procedures detailing when and how each of the actions can and must be activated, and the lead time needed to benefit from additional funds from each of the contingency sources. The contingency funding plan must provide a framework with a high degree of flexibility so that the institution can respond quickly in a variety of situations.

The CFP shall clarify (1) how the institution will deal with various types of stress environments, (2) establish clear lines of responsibility, and (3) shall be regularly tested and updated to ensure that it is still valid. An institution must review and update its plan at least annually for the Board's approval, or more often as changing business or market circumstances require.

For institution with reliance on retail deposits, the plan must address a retail deposit run and must include measures to repay retail depositors as soon as practicable. A retail run contingency plan must not rely upon closing distribution channels to retail depositors; It must seek to ensure that in the event of a loss of market confidence, 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.

Institution shall ensure that contact information in the CFP is up to date and the necessary legal and operational procedures are in place to execute the plan at short notice.

The CFP shall be documented and communicated to those who would be affected by its execution.

Chapter 7

Final Provisions

Article 22.-

The General Secretary, the General Director of Banking Supervision, the General Director of Central Banking, the General Cashier, the General Inspector, Directors of all relevant Departments in the National Bank of Cambodia, and all Banking and Financial Institutions under the National Bank of Cambodia's supervisory authority shall strictly implement this Prakas.

Article 23.-

This Prakas shall take effect from the signing date.

Phnom Penh, September 27, 2017

The Governor

Signed and Sealed: **Chea Chanto**

To:

- As stated in article 22 "for implementation"
- Files - archives

Cc:

- All members of the Board of Directors
- Council of Minister
"for information"
- Administrative Department of CM
"for publication in the National Gazette"