Pursuant to Article 101, paragraph (2), item (1) of the Credit Institutions Act (Official Gazette 159/2013, 19/2015 and 102/2015), and Article 43, paragraph (2), item (9) of the Act on the Croatian National Bank (Official Gazette 75/2008 and 54/2013), the Governor of the Croatian National Bank hereby issues the

Decision
on liquidity risk management

1 GENERAL PROVISIONS

General provisions
Article 1

(1) This Decision prescribes the minimum qualitative requirements for liquidity risk management of credit institutions.

(2) The provisions of this Decision shall apply to credit institutions having head offices in the Republic of Croatia which have obtained authorisation from the Croatian National Bank.

(3) The provisions of this Decision shall also apply, *mutatis mutandis,* to branches of third-country credit institutions which have obtained authorisation to provide services from the Croatian National Bank.

(4) Credit institutions shall apply the provisions of this Decision on an individual basis and on a consolidated basis, in line with Article 97, paragraph (1), item (1) of the Credit Institutions Act.

Definitions
Article 2

For the purposes of this Decision, the following terms shall have the following meaning:

1) **Professional participant in the money market** means a financial institution, pension fund, investment fund, insurance company and reinsurance company. A professional participant in the money market shall also be some other legal person, except credit institutions, which, for the purpose of managing own resources, participates in the money market in the manner at a frequency comparable to that of the activities of credit institutions. It shall be a legal person which, on a daily basis or frequently, makes legally binding quotations or offers of funds in amounts that are considerable, relative to the total volumes achieved in the money market, or a legal person which influences the determination of the final price of (received/given) funds and thus changes the price of a

similar transaction, achieved by credit institutions in dealing with other clients.

2) **Convertible currencies** mean the currencies of the G10 countries (Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, the USA, Sweden and Switzerland), the European Economic Area (the EEA consisting of EU member states and Iceland, Liechtenstein and Norway), Australia and New Zealand.

3) **The allocation mechanism** means the mechanism for the allocation of **liquidity costs, benefits** and **risks.**

4) **Liquidity risk, funding liquidity risk, market liquidity risk, risk profile, stress testing, scenario analysis, sensitivity analysis and reputation risk**' have the meaning as determined in the Decision on risk management.

5) **Internal controls system** have the meaning as determined in Article 104, paragraph (1) of the Credit Institutions Act.

6) **Senior management** have the meaning as determined in Article 3, item (85) of the Credit Institutions Act.

2 MINIMUM QUALITATIVE REQUIREMENTS FOR LIQUIDITY RISK MANAGEMENT

General provisions
Article 3

(1) A credit institution shall adopt and implement appropriate strategies, policies, procedures and systems for liquidity risk management.

(2) The strategies, policies, procedures and systems referred to in paragraph (1) of this Article shall be considered appropriate provided they:

1) are proportionate to the complexity, risk profile, scope of operations and the defined risk tolerance of a credit institution,
2) ensure liquidity risk management during relevant periods including intraday,
3) ensure maintenance of adequate levels of liquidity buffers,
4) reflect the significance of a credit institution in each Member State in which it operates,
5) are adjusted to business lines, currencies, branches and legal persons, and
6) include adequate allocation mechanisms.

(3) A credit institution shall have a clearly defined liquidity risk tolerance in the form of liquidity risk exposure which it is ready to assume and which needs to enable a credit

institution to manage its liquidity under normal conditions in such a way as to withstand protracted periods of stress. All relevant business lines need to be informed on the defined tolerance.

(4) A credit institution shall, taking into account the type, scope and complexity of operations, define the liquidity risk profile which ensures stable operations of a credit institution and a robust risk management system.

(5) Liquidity risk management strategy shall, as a minimum, encompass the objectives and basic principles of assuming and managing liquidity risk.

(6) Policies and other internal bylaws of a credit institution for liquidity risk management, alongside the requirements prescribed in the Decision on risk management, shall comprise as a minimum:

1) structure of assets and liabilities, including off-balance sheet liabilities and assumptions on the liquidity and marketability of assets,
2) liquidity risk reporting system,
3) measuring and monitoring net cash flows, including intra-day liquidity management,
4) policies and procedures with foreign currencies,
5) cross-border liquidity management, liquidity management across different business lines, branches and subsidiaries, and, where applicable, liquidity management within a group of credit institutions,
6) policies for managing encumbered and unencumbered assets,
7) diversity and stability of sources of funding and market access,
8) stress testing and different scenario analyses,
9) credit institution's contingency planning, and
10) liquidity recovery plans.

(7) A credit institution shall ensure that any impediments to international transfer of surplus liquidity are accounted for in the policy and taken into account in liquidity risk management.

(8) A credit institution operating with foreign currencies shall conduct an analysis of liquidity in foreign currencies and an analysis of mutual convertibility of foreign currencies.

(9) A credit institution shall identify and monitor professional participants in the money market when managing liquidity risk and shall prescribe in detail in its internal bylaws the criteria for identification of other legal persons that are professional participants.

Competencies and responsibilities of the management board and senior management
Article 4

(1) Alongside the requirements prescribed in the Decision on risk management, the credit institution's management board shall:

1) subject to approval by the supervisory board, adopt an appropriate liquidity risk management strategy and policies,
2) establish organisational structure and define the activities and the scope of responsibilities of the body and senior management in charge of liquidity risk management and responsible for their activities,
3) ensure that the adopted strategies, policies, internal bylaws and practices for liquidity risk management are revised at least annually, or more frequently if deemed necessary,
4) ensure that the credit institution can meet its daily obligations and that it can withstand periods of stress by maintaining adequate liquidity buffers,
5) ensure usability and timeliness of liquidity risk reports,
6) ensure appropriateness and efficacy of internal controls embedded in liquidity and liquidity risk management system, and
7) approve a contingency plan and a liquidity recovery plan.

(2) The senior management of a credit institutions shall, alongside the requirements prescribed in the Decision on risk management:

1) establish and maintain an efficient system for the management of liquidity risk in kuna and in all foreign currencies,
2) in line with the defined liquidity risk tolerance, define and continuously revise the limits for managing liquidity risk and the limits for authorisation of cash flows above the defined limits,
3) establish an appropriate reporting system on excess of liquidity limits and the procedures in the case of excesses,
4) at least once a year approve and revise the allocation mechanism, and
5) draw up and at least once a year revise a contingency plan and a liquidity recovery plan and adjust internal policies and procedures accordingly.

Management System
Article 5

The liquidity risk management system shall comprise as a minimum:

1) the assumptions on the behaviour of assets, liabilities and off-balance sheet items of a credit institution and the assumptions on other relevant circumstances so as to ensure their appropriateness in terms of activities of a credit institution and market conditions,

2) procedures for the response of the management board and senior management in cases of adverse stress test results,

3) procedures for adequate supervision of encumbered assets providing the management with timely information on the amount and type of encumbered assets and the relevant sources of encumbrance (e.g. repo transactions), the amount and credit quality of unencumbered assets which are subject to encumberance, listing specifically the

volume of assets available for encumbrance and the amount and type of additional encumbrances due to stress (potential encumbrance),

4) examine different possibilities or instruments for liquidity risk mitigation, including systems of limits and liquidity buffers, so as to enable the credit institution to withstand various stress events, and

4) ensure diversification of the structure of funding and access to sources of funding.

Allocation mechanism
Article 6

(1) A credit institution shall ensure that the allocation mechanism is consistent with the liquidity risk management system in place and with the defined liquidity risk tolerance and set up an adequate decision-making process.

(2) A credit institution shall use the allocation mechanism for internal pricing. The credit institution shall include in the allocation mechanism as a minimum:

(a) the impact of current market conditions, i.e. direct costs of funding (e.g. market cost of securing funds, base yield curve), and other direct costs of funding (such as, for instance, the bid/ask spread, transaction price, the cost of physical transfer of cash, etc.),
(b) the conditions in which the credit institution operates (e.g. credit quality, funding sources availability),
(c) different behaviour characteristics of individual products from liquidity point of view (e.g. the cost of early withdrawal, products available through e-banking or products with irregular cash flows), and
(d) indirect costs of the sources of funding (e.g. the cost of liquidity mismatch, the cost of liquidity buffer, the cost of additional collateral, etc.).

(3) A credit institution shall regularly update the allocation mechanism, taking into account the impact of the factors referred to in paragraph (2) of this Article.

(4) A credit institution shall ensure controlling and monitoring of the allocation mechanism by an independent organisational unit (e.g. a risk control unit).

(5) A credit institution shall ensure that all relevant levels of management and all relevant organisational units are fully informed about the allocation mechanism and that they apply it actively and appropriately.

Monitoring and reporting
Article 7

A credit institution shall, alongside the requirements prescribed in the Decision on risk management, include in its reporting system as a minimum the monitoring of liquidity position on an aggregate basis in kuna and in foreign currencies and the monitoring of stress test results.

Net cash flow measuring and monitoring
Article 8

(1) A credit institution shall set up a system for assessing all current and future inflows and outflows, including the assessment of the funds needed for off-balance sheet items. A credit institution shall take into account the accepted clearing and settlement standards and the timeframe used in determining cash flows on individual dates.

(2) A credit institution shall regularly examine the close interaction between funding liquidity risk and market liquidity risk. A credit institution shall also consider the close interaction between liquidity risk and other risks to which it is exposed, such as interest rate, credit, operational, legal and reputational risks.

(3) A credit institution shall manage liquidity risk during relevant periods, including intraday, to ensure that adequate levels of liquidity buffers are maintained. Liquidity buffers especially include maintenance of sufficient liquid assets in the form of reserve, high-quality, unpledged liquid assets which are available to the credit institution at all times and serve as insurance in various stress events (of different intensity and duration), including loss or decrease in unsecured and otherwise available funding sources. There should be no legal or operative impediments to using those funds.

(4) A credit institution shall ensure liquidity risk management in different timeframes. In doing so, it shall consider changes in intraday, short-term and medium-term liquidity needs of a credit institution and how these needs are met, as well as its longer-term (structural) liquidity needs and how these needs are met and potential vulnerabilities to events, activities and strategies of a credit institution. A credit institution shall regularly check the accuracy of input data used in liquidity position calculation.

(5) A credit institution shall actively manage collateral, separate encumbered from unencumbered assets and monitor the amount of available collateral by natural and legal persons holding them and by countries in which those collaterals are legally registered in a register or in an account. A credit institution shall monitor the eligibility of those instruments for their timely use, and especially for use in contingent situations.

(6) A credit institution shall also take into account the existing legal, regulatory and operative impediments to transfer of liquid and unencumbered assets between entities within and outside the European Economic Area.

Sources of funding and market access
Article 9

(1) A credit institution shall draw up a methodology for determining, measuring, monitoring and managing funding positions which shall comprise current and future materially significant cash flows arising from assets, liabilities and off-balance sheet items, including contingent liabilities and the possible impact of reputational risk.

(2) In the context of managing liquid assets and sources of funding, a credit institution shall ensure access to different sources of funding on the financial market and manage the available market sources of liquidity by ensuring that its liquidity policy comprises as a minimum:

1) profile of a source of funding and its projection, taking into account the maturity mismatch in the long term with respect to the business model, strategy and risk tolerance,
2) procedures which ensure continuous active management of market sources of liquidity,
3) procedures for the establishment and maintenance of cooperation with providers of the sources of funding, including monitoring the frequency of use of the available sources of funding,
4) assessment of the access to financial markets and of available funding under normal and stressed conditions,
5) assessment of the stability of sources of funding and the risks affecting their stability,
6) monitoring the concentration of the sources of funding in terms of the assessment of liquidity of individual instruments, geographical locations and providers of the sources of funding, and
7) identification of and procedures for the use of alternative sources of funding.

Stress testing
Article 10

(1) In its liquidity risk management policies, a credit institution shall define stress testing (scenario and sensitivity analyses), in the following way:
1) prescribe and adopt procedures for the implementation and analysis of different stress testing and their frequency (at least annually), taking into account credit institution-specific (internal), market-wide (outside) scenarios and factors and combined alternative scenarios,
2) prescribe that liquidity be tested depending on adverse conditions and their intensity: under usual (foreseeable or normal) conditions and under unusual (extreme) conditions,
3) prescribe that testing be conducted under shorter and protracted stressed conditions,
4) enable analysis of test results by the competent body and senior management of a credit institution,
5) prescribe procedures for actions to be taken in cases of adverse stress test results,

6) determine a schedule of stress testing when making plans for the following year and ensure reporting to the credit institution's management board about the results of the planned tests on an annual level, and
7) provide for alternative scenarios for liquidity positions and instruments for liquidity risk mitigation and at least once a year review assumptions on which the decisions on the sources of funding are based. Those alternative scenarios relate in particular to off-balance sheet items and other contingent liabilities, including securitisation special purpose entities or other special purpose entities, as determined in Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms, in relation to which a credit institution acts as a sponsor or ensures material liquid support.

(2) When conducting stress testing, a credit institution shall take into account the sources with an agreed early withdrawal option.

(3) When conducting stress testing, a credit institution shall calculate the impact of margin calls on the liquidity of all positions with possible margin calls.

(4) When conducting stress testing, a credit institution shall take into account mutual convertibility and liquidity of different convertible currencies and their availability on the foreign exchange markets.

(5) The results of stress testing shall be used as a basis for taking corrective measures or activities for mitigating the exposure of a credit institution, ensuring liquidity buffers and adjustment of the liquidity profile of a credit institution to its risk tolerance.

(6) A credit institution shall use stress test results, and in particular the alternative scenarios referred to in paragraph (1) item (7) of this Article in adjusting liquidity risk management strategy, adopting policies, determining limits, assuming positions and drawing up efficient contingency plans and liquidity recovery plans.

Contingency and liquidity recovery planning of a credit institution
Article 11

(1) A credit institution shall prepare a contingency and liquidity recovery plan which shall constitute an integral part of the liquidity risk management policy.

(2) The contingency plan may be an integral part of a liquidity recovery plan and it shall include as a minimum:

1) early warning indicators which serve to identify the emergence of a crisis and the designation of the persons responsible for monitoring and reporting on these indicators (e.g. breaches of internal limits, a fall in deposits, a fall in stock prices, higher funding costs compared to other credit institutions, credit institution's credit

rating change, difficulties in accessing funds in the money market, asset quality or profitability deterioration),
2) duties and responsibilities of individual employees in case of liquidity shortfall in a credit institution (such as those in charge of client and public relations, relations with key market participants, shareholders and central banks),
3) procedures which ensure timely and relevant provision of information to senior management and the management board of a credit institution for the purposes of decision-taking in crisis situations,
4) procedures and processes ensuring liquidity to cover current liquidity deficits and the timeframes within which individual actions have to be taken (e.g. sale of assets, establishment of new funding lines) under normal and stressed conditions,
5) a strategy for potential asset encumbrance arising from different stress situations (a decline in a credit institution's credit quality, a decline in the value of pledged assets or increased margin calls),
6) identification, size and reliability of all sources of funding, indicating the order of use under different stress situations, and
7) circumstances warranting the execution of contingency plans and contact data (address, telephone, e-mail address and similar data) and the location of persons responsible for the execution of the plan.

(3) A liquidity recovery plan may be an integral part of the general recovery plan and, in addition to the requirements listed in the Decision on recovery plans, it shall comprise adequate strategies and appropriate implementation measures for settling potential liquidity deficits, including liquidity deficits in relation to branches established in another member state.

(4) A credit institution shall at least once a year test the contingency and liquidity recovery plans and update them on the basis of stress test results as defined in Article 10 of this Decision.

(5) A credit institution shall take in advance the necessary actions to enable immediate implementation of liqudity recovery plans, if necessary. Those activities include holding collateral which is readily available for financing with the central bank and if necessary, holding collateral in the currency of another member state or in the currency of a third country that the credit institution is exposed to and, when necessary for operative reasons, within the host member state or within a third country to whose currency it is exposed.

3 TRANSITIONAL AND FINAL PROVISIONS

Article 12

(1) On the date of entry into force of this Decision, the Decision on liquidity risk management (Official Gazette 20/2014, 41A/2014, and 31/2016) shall cease to have effect.

(2) Credit institutions shall prepare the last reports under the Decision on liquidity risk management (Official Gazette 20/2014, 41A/2014, and 31/2016) as at 31 December 2016 and shall deliver them to the Croatian National Bank in the following manner:

1) monthly reports (MI) at the latest by 10 January 2017, and
2) unconsolidated audited reports (NR) within 15 days from the date of receipt of the audit report and at the latest by 30 April 2017.

Article 13

This Decision shall be published in the Official Gazette and shall enter into force on 1 January 2017.

No.: Croatian National Bank
Zagreb, Governor

Boris Vujčić