INTERNAL LIQUIDITY ADEQUACY ASSESSMENT PROCESS (ILAAP) GUIDELINES FOR BANKS AND FINANCIAL INSTITUTIONS, 2023

BANK OF TANZANIA

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	PART I **PRELIMINARY PROVISIONS**
Citation	1. These Guidelines shall be cited as "*Internal Liquidity Adequacy Assessment Process (ILAAP) Guidelines for banks and financial institutions, 2023".*
Authorization	2. These *Guidelines* are issued under section 71 of the *Banking and Financial Institutions Act, 2006.*
Application	3. These Guidelines shall apply to all banks and financial institutions on solo and consolidated basis and shall come into operation on the 1st day of April 2025.
Definition	4. In these Guidelines, unless the context otherwise requires: "Act" means the Banking and Financial Institutions Act; "Bank" means the Bank of Tanzania; "bank" has the same meaning ascribed to it in the Act; "counterbalancing capacity": the bank's ability to hold, or have access to, excess liquidity over short-term, medium-term and long-term time horizons in response to stress scenarios; "financial institution" has the same meaning ascribed to it in the Act; "intraday liquidity": the funds that can be accessed during the business day to enable the bank to make payments in real time; "intraday liquidity risk": the current or prospective risk that the bank will fail to manage its intraday liquidity needs effectively; "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; "supervisory review and evaluation process is the process of the regular review of bank's strategies, processes and mechanisms implemented and evaluate the risks to which the banks are or might be exposed, or poses risk to the financial system; "survival period" means short period of time when a bank would plan only to survive by maintaining buffers as "insurance" to assure its ability to cope with a crisis while taking other measures in line with its overall liquidity policies and risk appetite for longer-term- survival.

Introduction	5. The Internal Liquidity Adequacy Assessment Process (ILAAP) require banks and *financial* institutions to identify, measure, manage and monitor liquidity and funding risks across different time horizons and stress scenarios, consistent with the risk appetite established by the bank or financial institutions' board of directors.
	6. The ILAAP shall take into account all qualitative and quantitative information necessary to underpin the bank or financial institutions' liquidity risk appetite, including the description of the systems, processes and methodology for measuring and managing liquidity and funding risks.
	7. The ILAAP should reflect the risk management approach embedded in the bank or financial institution as clearly and broadly prescribed in the Risk Management Guidelines, Banking and Financial Institutions (Liquidity Management) Regulations, Guidance Notes on Computation of Liquidity Coverage Ratio and Net Stable Funding Ratio issued by the Bank, to meet not only minimum prescribed regulatory liquidity but also to hold sufficient amount of liquidity to meet its operations, and future business plans and related risks.
	8. These Guidelines therefore, seek to provide guidance on how a bank or financial institution shall establish, operate and maintain its ILAAP that meets the expectations of the Bank with regard to implementation of the ILAAP. The ILAAP Guidelines do not intend either to replace Risk Management Guidelines issued by the Bank or Liquidity Risk Policies, Procedures and Limits applied by banks and financial institutions for management of liquidity risk.
Objectives	9. The key objective of the ILAAP is to ensure banks and financial institutions, not only maintain adequate liquidity to meet prescribed minimum regulatory liquidity requirements, but also keep sufficient liquidity to meet its current and future business plans and related risks. The Bank of Tanzania's approach to liquidity supervision is based on the principle that a bank or financial institution shall have adequate levels of liquidity resources and a prudent funding profile, and that it comprehensively manages and controls liquidity and funding risks.

Features of ILAAP	10. A bank or financial institution shall design its own Internal Liquidity Adequacy Assessment Process, which at a minimum shall incorporate the following main features: (a) Board and senior management oversight; (b) Sound liquidity assessment; (c) Comprehensive risk assessment; (d) Monitoring and reporting; (e) Internal control and review; and (f) Stress testing.
	PART II **THE ILAAP FRAMEWORK**
Board and senior management oversight	11. The Bank expects the ILAAP to be the responsibility of the Board of Directors of a bank or financial institution. The ILAAP document shall be approved by the board and be consistent with the risk appetite set by the board. It shall also be consistent with the bank or financial institution's approach for measuring and managing liquidity and funding risks. The board is also expected to ensure that the ILAAP is well integrated into business & strategic plans, management processes and the bank or financial institution's decision-making culture.
Liquidity and funding risk framework	12. A bank or financial institution shall have in place robust strategies, policies, processes and systems that enable it to identify, measure, manage and monitor liquidity risk and funding risk over an appropriate set of time horizons, including intra-day, so as to ensure that it maintains adequate levels of liquidity buffers and an appropriate funding profile. These strategies, policies, processes and systems must be tailored to business lines, currencies, branches and legal entities and must include adequate allocation mechanisms of liquidity costs, benefits and risks.
	13. The strategies, policies, processes and systems referred to under guideline **12** must be proportionate to the complexity, risk profile and scope of operation of the bank or financial institution, and the liquidity risk appetite and funding risk appetite set by the bank or financial institutions' Board of Directors in accordance with liquidity and funding risks appetite.

	14. A bank or financial institution shall put in place risk management policies to define its approach to asset encumbrance, as well as procedures and controls that ensure that the risks associated with collateral management and asset encumbrance are adequately identified, monitored and managed.
Intra-day management of liquidity	15. A bank or financial institution shall actively manage its intra-day liquidity positions and any related risks so that it is able to meet its payment and settlement obligations on a timely basis.
	16. For the purposes of **guideline 15**, a bank or financial institution shall ensure that its intra-day liquidity management arrangements enable it: (a) to meet its payment and settlement obligations on a timely basis under both normal and stress financial conditions; (b) to identify and prioritize the most time - critical payment and settlement obligations; (c) in relation to the markets in which it is active and the currencies in which it has significant positions, to measure, monitor and deal with intra - day liquidity risk. A bank or financial institution must in particular be able to: (i) measure expected daily gross liquidity inflows and outflows, anticipate the intra-day timing of these flows where possible, and forecast the range of potential net funding shortfalls that might arise at different points during the day; and (ii) manage the timing of its liquidity outflows such that priority is given to the bank's most time-critical payment obligations.
Managing the High Quality Liquid Assets buffer	17. Banks and financial institutions shall assess their ability to convert their buffers of liquid assets into cash in a short timeframe. Banks and financial institutions shall also set a risk appetite and framework which will govern the management and monitoring of their liquid asset portfolio. This includes having appropriate internal limits and controls to ensure that the ability to monetize their stock of High Quality Liquid Assets (HQLAs) in stress is not limited in any way.

Management of collateral	18. A bank or financial institution shall actively manage collateral positions and distinguish between pledged and unencumbered assets that are available at all times, in particular during emergency situations.
	19. A bank or financial institution shall also take into account the legal entity in which assets reside, the country where assets are legally recorded either in a register or in an account as well as their eligibility and must monitor how assets can be mobilized in a timely manner.
Managing liquidity across legal entities, business lines, countries and currencies	20. A bank or financial institution shall actively manage its liquidity risk exposures and related funding needs and take into account: (a) existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets amongst entities; and (b) any other constraints on the transferability of liquidity and unencumbered assets across business lines, countries and currencies.
Funding diversification and market access	21. A bank or financial institution shall ensure that it has access to funding which is adequately diversified, both as to source and tenor.
	22. A bank or financial institution shall develop and apply methodologies for the identification, measurement, management and monitoring of funding positions. Those methodologies shall include the current and projected material cash-flows in and arising from assets, liabilities, off-balance-sheet items, including contingent liabilities and the possible impact of reputational risk.

Management of asset encumbrance	23. A bank or financial institution shall actively manage its assets encumbrance position and must ensure that: (a) its risk management policies take into account: (i) the bank's business model; (ii) the countries in which it operates; (iii) the specificities of the funding markets; and (iv) the macroeconomic situation; (b) its management body receives timely information on: (i) the current and expected level and types of asset encumbrance and related sources of encumbrance, such as secured funding or other transactions; (ii) the amount, expected level and credit quality of unencumbered assets that are capable of being encumbered, specifying the volume of assets available for encumbrance; and (iii) the expected amount, level and types of additional encumbrance that may result from stress scenarios.
	24. For the purpose of guideline **23**, a bank or financial institution shall treat an asset as encumbered if it is subject to any form of arrangement to secure, collateralize or credit enhance any transaction.
Pricing	25. Banks and financial institutions shall ensure that liquidity and funding costs, benefits and risks are fully incorporated into product pricing, performance measurement and incentives, and new product and transaction approval processes. All significant business lines shall be included, whether on or off-balance sheet. Both stressed and business-as-usual costs shall be assessed. The process shall be transparent and understood by business line management, and regularly reviewed to ensure it remains appropriately calibrated.

Stress testing	26. Comprehensive, robust stress testing is vital to ensure compliance with the overall liquidity adequacy. Banks and financial institutions shall consider in their stress testing the impact of a range of severe but plausible stress scenarios on their cash flows, liquidity resources, profitability, solvency, asset encumbrance and survival horizon. Stress scenarios shall be selected to reveal the vulnerabilities of the bank or financial institution’s funding. Stress testing scenarios shall also include macroeconomic stress.
	27. A bank or financial institution shall ensure that its Board of Directors reviews regularly the stresses and scenarios tested to ensure that their nature and severity remain appropriate and relevant to the bank or financial institution.
	28. A bank or financial institution shall have in place description of the policy framework on liquidity stress testing, including items such as the number of scenarios used, scope, reporting frequency, risk drivers (macro and idiosyncratic), and, where relevant, split in currencies / regions / business units.
	29. The policy shall include a description of the criteria for calibrating scenarios, selecting appropriate time horizons (including intraday, where relevant), quantification of the impact of stress on the liquidity value of buffer assets, etc.
	30. The extent and frequency of testing shall be commensurate with the size and complexity of the bank or financial institution and its liquidity risk exposure, as well as with its relative importance within the financial sector.

31 A bank or financial institution shall make appropriate assumptions, both quantitative and qualitative. The assumptions shall include the following:

(a) **The run-off of retail funding**; This includes an assessment of the likely run-off of different components of the retail deposits, taking into account common features such as deposit insurance cover, maturity, interest rate sensitivity, customer type, product type, deposit size, or the channel through which the deposits were affected;

(b) **The reduction of secured and unsecured wholesale funding:** This includes an assessment of the type and geographical location of the counterparty, the level of creditor seniority, the nature of the relationship the bank or financial institution has with the counterparty, the type of underlying collateral (if applicable), and the speed of outflow. The risk of shortening tenors should also be assessed;

(c) **The correlation and concentration of funding:** This includes an assessment that takes into account instrument type, markets, currency, liability term structure, counterparty and market access, as appropriate. The bank or financial institution shall also consider the effectiveness of its diversification strategy;

(d) **Additional contingent off-balance sheet exposures:** This shall include, where appropriate, an assessment of funding commitments (facilities, undrawn loans and mortgages, overdrafts and credit cards), guarantees and trade finance contracts;

(e) **Funding tenors:** Bank and financial institutions shall consider vulnerabilities within the term structure due to external, internal or contractual events (where the funding provider has call options);

(f) **The impact of a deterioration in the bank or financial institutions' credit rating:** Banks and financial institutions shall consider all types of contractual and behavioral outflows resulting from credit downgrades of varying magnitude, the types of collateral which may be required and the speed of outflow where appropriate;

	(g) Foreign exchange convertibility and access to foreign exchange markets: Banks and financial institutions shall calculate stressed outflows by individual currency and tenor where appropriate. This information must support an assessment of how shortfalls can be funded in a stressed market with impaired access to foreign exchange markets and loss of convertibility; **(h) The ability to transfer liquidity across entities, sectors and countries:** Banks and financial institutions shall assess the intragroup support assumed available in stress, or the impact of a failure of a group entity to repay loans in a timely manner, where appropriate. This assessment shall consider existing legal, regulatory and operational limitations to potential transfers of liquidity and unencumbered assets amongst entities, business lines, countries and currencies. Banks and financial institutions shall detail information on their approach for measuring and managing intragroup liquidity risk and develop their own assessment of the risk of contingent trapped liquidity, on solo and consolidated basis; **(i) Estimates of future balance sheet growth:** This shall include considering how planned or forecast balance sheets may behave in stress and whether the bank or financial institution's risk appetite would be breached; **(j) The impact on a bank or financial institution's reputation or franchise:** Banks and financial institution shall include an assessment of implicit liquidity requirements arising from a need to fulfil expectations to acquire assets, rollover or buy back assets, to extend or maintain other forms of liquidity support, or to permit premature termination of retail term or notice liabilities or derivative exposures for reputational reasons or to protect the franchise; and **(k) Marketable asset risk:** Banks and financial institutions shall include a consideration of how factors affecting their ability to liquidate assets or monetize them through sale or repurchase agreements may change in stress. This shall include market access, haircuts, timelines, pricing, operational capacity or eligibility.
	32. A bank or financial institution shall ensure that the results of its stress tests are:

	(a) reviewed by its senior management; (b) reported to the bank or financial institution's Board of Directors, specifically highlighting any vulnerabilities identified and proposing appropriate remedial action; (c) reflected in the processes, strategies and systems established in accordance with guideline 13; (d) used to develop effective liquidity contingency plans; (e) integrated into that bank or financial institution's business planning process and day-to-day risk management; and (f) taken into account when setting internal limits for the management of that bank or financial institution 's liquidity risk exposure.
Liquidity contingency plan	33. Banks and financial institutions shall adjust their strategies, internal policies and limits on liquidity risk and funding risk and develop an effective liquidity contingency plan, taking into account the outcome of different stress test scenarios.
	34. The liquidity contingency plan shall include strategies to address the contingent encumbrance resulting from relevant stress events including downgrades in the bank or financial institution's credit rating, devaluation of pledged assets and increases in margin requirements.
	35. The liquidity contingency plan shall also set out adequate strategies and proper implementation measures in order to address possible liquidity shortfalls. The plan shall be regularly evaluated and tested to ensure its effectiveness and operational feasibility, updated on the basis of the outcome of the different stress test scenarios, and be reported to and approved by the Board of Directors.
	36. A bank or financial institution shall update the liquidity contingency plan at least once a year or more often as business activities or market circumstances change and submit the updated version to the Bank.
	37. A bank or financial institution shall take the necessary operational steps in advance to ensure that liquidity contingency plan can be implemented immediately, including holding collateral immediately available for the bank's funding.

Internal Control and review	38. The Board of Directors shall regularly verify whether the bank or financial institution's system of internal controls is adequate to ensure well-ordered and prudent conduct of business.
	39. Effective control of the liquidity assessment process shall include an independent review, which should include the validation of the models used, the internal audit of the ILAAP and, where appropriate, the external audit. Internal as well as external auditors shall frequently monitor and test risk management processes. The aim is to ensure that the information on which decisions are based is accurate so that processes fully reflect management policies and that regular reporting, including the reporting of limit breaches and other exception based reporting, is undertaken effectively.
	40. A bank or financial institution shall conduct periodic reviews of risk management processes to ensure its integrity, accuracy, and reasonableness. At minimum, the review shall cover the following: (a) appropriateness of the bank or financial institution's liquidity assessment processes given the nature, scope and complexity of its activities; (b) identification of large depositors and risk concentrations; (c) accuracy and completeness of data inputs into the bank or financial institution's assessment processes; (d) reasonableness and validity of scenarios used in the assessment process; and (e) stress testing and analysis of assumptions and inputs.
	41. A bank or financial institution shall review and update its ILAAP at least on an annual basis taking into account actual results against projections, as well as examine and document significant variances and capture any new or additional risks that may have emerged.

	PART III **GENERAL PROVISIONS**
Reporting to the Bank	42. A bank or financial institution shall, not later than end of April, submit to the Bank a board approved ILAAP report as at 31st December of the previous year.
	43. The ILAAP document shall contain an assessment of the bank or financial institution's liquidity and funding profile as at the end of previous year and projections for the next one year.
	44. At minimum, the ILAAP report shall include following information: **(a)** **Overview:** This section is for introductory text describing: (i) The business model, the reach and systemic presence of the bank or financial institution. (ii) Internal and external changes since the last liquidity review shall be described. (iii) Changes in the scope of the document since the last review by the management body shall be included. **(b)** **Summary conclusions**: This section shall include information on the following: (i) Summarized conclusions of overall liquidity adequacy review, stating how and whether the bank or financial institution meet the overall liquidity adequacy, and the bank's approach to supervising liquidity and funding risks. (ii) Any shortcomings and remedial plans shall be discussed. (iii) The bank or financial institution shall present its assessment of any additional liquidity it believes it shall hold on account of risks not captured in Pillar 1. **(c)** **Liquidity Coverage Ratio Reporting:** In this section, banks and financial institutions shall present a discussion on their approaches to ensure compliance with the overall regulatory requirements on liquidity including assessment of Liquidity Coverage Ratio in respect of High Quality Liquid Assets (HQLA), Outflows and Inflows as provided in the Guidelines on Computation of Liquidity Coverage Ratio issued by the Bank

	(d) Liquidity Risk Assessment (i) Evaluation of liquidity needs in the short and medium term: In this section, banks and financial institutions shall describe their liquidity profile at appropriate time horizons out to 12 months. (ii) The sources and uses on gross and net basis, and their activities undertaken to cover such liquidity needs in both businesses as usual and stress. (iii) Banks and financial institutions shall also describe any ways in which the LCR metric does not capture its liquidity risks within 30 days and how that risk will be managed. **(e) Evaluation of Intraday Risk:** In this section, banks and financial institutions shall describe how intraday risk is created within their business (i) Whether part of the payments system or not, their appetite for and approach to managing intraday liquidity risk of both cash and securities accounts and in both business as usual and stress conditions. (ii) They shall include the approach to stress testing and conclusions. **(f) Evaluation of liquidity buffer and counterbalancing capacity:** In this section, banks and financial institutions shall describe the procedures for: (i) Calculating, controlling and monitoring the liquid assets buffer and counterbalancing capacity, and (ii) Their effectiveness in different scenarios which shall include those affecting the liquidity of the assets and counterbalancing capacity. **(g) Inherent Funding Risk Assessment:** **Evaluation of risks to stability of the funding profile** (i) In this section, banks and financial institutions shall describe the funding risk strategy and appetite, and the profile, both the sources and uses on a gross and net basis. (ii) The stability of the liabilities within the funding profile and the circumstances in which they could become unstable.

	(iii) This could include market shifts including changes in collateral values, excessive maturity mismatch, inappropriate levels of asset encumbrance, concentrations (including single or connected counterparties, or currencies). **Evaluation of market access;** In this section, banks and financial institutions shall analyze market access and current or future threats to this access, including the impact of any short-term liquidity stresses or negative news. **Evaluation of expected change in funding risks based on the bank or financial institution's funding plan:** In this section, bank or financial institution shall analyze and evaluate the expected change in funding risks based on the bank or financial institution's funding plan. **(h) Risk Management Assessment (both liquidity and funding)** **Assess risk strategy and risk appetite:** In this section, banks and financial institutions shall describe: (i) the risk appetite and strategy, how they were devised, approved, monitored and reported, and (ii) How they are communicated throughout the bank or financial institutions. **Organizational Framework, Policies and Procedures:** In this section, banks and financial institution shall describe: (i) The governance and management arrangements around the ILAAP including the involvement of the Board of Directors. (ii) They shall describe also the risk framework overall and as it pertains to liquidity and funding risks, the technical and staff resources. (iii) The approach to maintaining market access.

	Risk Identification, Measurement, Management, Monitoring and Reporting: In this section, banks and financial institutions shall describe (i) The framework and IT systems for identifying, measuring, managing and monitoring and both internal and external reporting of liquidity and funding risks, including intraday risk. (ii) The assumptions and methodologies adopted. (iii) Key indicators shall be evidenced and the internal information flows described. **(i) Stress testing:** In this section, banks and financial institutions shall analyze and present the internal stress testing framework: (i) Including the process and governance of and challenge to scenario design, derivation of assumptions and design of sensitivity analysis, and the process of review and challenge and relevance to the risk appetite. (ii) The process by which the stress results are produced, and incorporated into the risk framework and strategic planning, and the liquidity recovery process shall be scrutinized. (iii) The results and conclusions must be analyzed, with breakdown by each relevant risk driver. **(j) Liquidity Risk Internal Control Framework:** In this section, banks and financial institutions shall: (iv) Describe their internal limit and control framework, including the limits and controls around liquid asset buffers, and the appropriateness of the limit. (v) Describe the structure to the risk appetite. (vi) The pricing framework shall also be described here, for example how the methodology was developed, the process controlled, monitored and reviewed, and the results cascaded throughout the bank or financial institution to drive behaviours and support performance measurement and business incentives.

	(k) **Liquidity Contingency Plans**: In this section, banks and financial institutions shall detail the policies, procedures and action plans for responding to severe disruptions in the bank or financial institution's ability to fund itself **(l)** **Funding Plans:** Banks and financial institution shall provide the full funding plan to demonstrate: (i) How it will support the projected business activities in both businesses as usual and stress, implementing any required improvements in the funding profile and evidencing that the risk appetite and key metrics will not be breached by the planned changes. (ii) Risks to the plan shall be discussed. (iii) Where a funding strategy is new, implementation procedures shall be detailed.
Supervisory Review and Evaluation Process	45. A bank or financial institution must be able to demonstrate to the Bank that the chosen internal liquidity target levels are well founded and that these targets are consistent with its overall risk profile and current operating environment.
	46. The Bank shall assess whether a bank or financial institution, in its ILAAP document, has adequately identified its liquidity needs across appropriate time horizons in severe but plausible stresses for all relevant risk drivers, and whether its liquidity resources are adequate to meet those needs. In addition, the Bank shall review the governance arrangements of the bank or financial institution, its risk management culture, and the ability of the board and senior management to perform their duties.
	47. In carrying out Supervisory Review and Evaluation Process, the Bank shall take into account the degree of involvement of the Board of Directors as will the appropriateness of the internal processes and systems underlying the ILAAP. Examples of review topics might cover the bank or financial institution's risk appetite, liquidity contingency plans and non-stressed funding plans, collateral management, the ability to monetize HQLAs and wider liquidity in a timely fashion, the internal audit of the ILAAP, the model validation, intraday arrangements, market access and asset encumbrance.

	48. The Bank may need to request further information and meet with the Board of Directors and senior management of a bank or financial institution in order to evaluate fully the comprehensiveness of the ILAAP and the adequacy of the governance arrangements around it. The Board of Directors should be able to demonstrate an understanding of the ILAAP consistent with its taking responsibility for the ILAAP. The senior management of the bank or financial institution should be prepared to discuss and defend all aspects of the ILAAP, covering both quantitative and qualitative components
	49. The Bank shall review if a bank or financial institution accurately and consistently complies with the regulatory requirements on liquidity.
	50. The Bank shall determine whether the arrangements, strategies, processes and mechanisms implemented by a bank or financial institution and the liquidity it holds provide sound management and adequate coverage of its risks.

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