Liquidity Risk Management Module

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LM-A.1 Purpose

Executive Summary

LM-A.1.1 The purpose of this Module is to provide a checklist of the key elements of a sound Liquidity Risk Management system which supervisors can expect their banks to observe.

LM-A.1.2 This module provides support for certain other parts of the Rulebook, mainly:
(a) Licensing Requirements;
(b) Principles of Business;
(c) CBB Reporting Requirements;
(d) Audit Firms; and
(f) High-Level Controls.

Legal Basis

LM-A.1.3 **This Module contains the Central Bank of Bahrain's ('CBB') Directive (as amended from time to time) on liquidity risk management requirements for Islamic bank licensees, and is issued under the powers available to the CBB under Article 38 of the Central Bank of Bahrain and Financial Institutions Law 2006 (CBB Law). The directive in this Module is applicable to all Islamic bank licensees.**

LM-A.1.4 For an explanation of the CBB's rule-making powers and different regulatory instruments, see Section UG-1.1.

LM-A.2 Key Requirements

LM-A.2.1 It is the responsibility of the bank's Board of Directors and management to ensure that the bank has sufficient liquidity to meet its obligations as they fall due.

LM-A.2.2 A bank must inform the CBB of any concerns it has about its current or future liquidity profile, and of its plans to rectify/deal with any problems.

LM-A.2.3 The CBB has established certain limits for negative maturity mismatch positions. Positions within such periods should be reported on a monthly basis.

LM-A.2.4 Currencies should be translated into the reporting currency of the bank (which in any case would be either Bahrain Dinar or US Dollar) at the closing spot mid price on the reporting date and entered in the relevant time band. However, the CBB may also require institutions to provide management information on positions in individual currencies in the event of difficulties either in the individual institution or with the currency in question.

LM-A.3 Module History

LM.-A.3.1 This Module was first issued on 1st January 2005 as part of the Islamic principles volume. All regulations in this volume have been effective since this date. All subsequent changes are dated with the month and year at the base of the relevant page and in the Table of Contents. Chapter 3 of Module UG provides further details on Rulebook maintenance and control.

LM-A.3.2 A list of most recent changes made to this Module are detailed in the table below:

Summary of Changes

Module Ref.	Change Date	Description of Changes
LM	01/2011	Various minor amendments to ensure consistency in CBB Rulebook.
LM-A.1.3 and LM-A.1.4	01/2011	Added legal basis

Evolution of the Module

LM-A.3.3 The module incorporates the requirements set out under Section F of the Prudential Information Returns for Islamic Banks (PIRI) pack.

Effective Date

LM-A.3.4 **The contents in this Module are effective from the date depicted in the original circulars/pack (see Paragraph LM-A.3.3) from which the requirements are compiled.**

LM-1.1 Introduction

LM-1.1.1 An important element of banking is managing liquidity. Long-term financing contracts may be financed by amounts received from customers for short-term investments. As a result of this, a bank is exposed to the risk that investors' demands for repayment might outstrip its ability to transform assets into cash.

Liquidity Risk Management Reporting under Section F of the PIRI

LM-1.1.2 The purpose of this Chapter is to introduce the CBB's supervisory approach with respect to reporting requirements and bank's obligations in terms of its liquidity management practices.

LM-1.1.3 **The contents of this Chapter should be read in conjunction with the guidelines set out under Section F of the PIRI (in Appendix BR-5) and PIRI reporting forms (in Appendix BR-4).**

LM-1.2 The Bank's Prudential Obligation

LM-1.2.1 **It is the responsibility of the bank's Board of Directors and management to ensure that the bank has sufficient liquidity to meet its obligations as they fall due.**

LM-1.2.2 **A bank must inform the CBB of any concerns it has about its current or future liquidity profile, and of its plans to rectify/deal with any problems.**

LM-1.2.3 Banks will be expected to have formal written policies which limit liquidity risk to acceptable levels; appropriate liquidity measurement and information systems and clearly defined managerial responsibilities for managing liquidity. These policies, controls and systems are to be observed on a daily basis and reviewed to take account of changing circumstances.

LM-1.3 The CBB's Obligation

LM-1.3.1 The CBB will review with banks their policies, systems and controls for managing their liquidity.

LM-1.3.2 Banks are expected to monitor and maintain adequate liquidity not only for meeting the requirements of the unrestricted investment account holders, but also that arising for the restricted investment account holders.

LM-1.3.3 **The CBB has established the following limits for negative maturity mismatch positions. Positions within such periods should be reported on a monthly basis (see Section BR-4):**

(i)

Self Financed and Current Accounts Only	
Period	**Limit***
0-8 days	*10%*
8 days - 1 month	*20%*

(ii)

Unrestricted Investment	
Period	**Limit***
0-8 days	*10%*
8 days - 1 month	*20%*

(iii)

Restricted Investment Accounts Only	
Period	**Limit***
0-8 days	*10%*
8 days - 1 month	*20%*

(iv)

Self Financed, Restricted/ Unrestricted Investment Accounts & Current Accounts	
Period	**Limit***
0-8 days	*15%*
8 days - 1 month	*25%*

LM-1.4 Liquidity Reporting in Individual Currencies

LM-1.4.1 Section F of the PIRI (Appendix BR-5) should be completed on the basis of all currencies combined.

LM-1.4.2 Currencies should be translated into the reporting currency of the bank (which in any case would be either Bahrain Dinar or US Dollar) at the closing spot mid price on the reporting date and entered in the relevant time band. However, the CBB may require institutions to provide management information on positions in individual currencies in the event of difficulties either in the individual institution or with the currency in question.