

**BANK OF BOTSWANA**

**PRUDENTIAL AUTHORITY AND PAYMENTS OVERSIGHT  
DEPARTMENT**



**GUIDELINES ON LIQUIDITY COVERAGE RATIO**

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## 1. AUTHORITY, PURPOSE, AND SCOPE

### (a) Authority

1.1 These guidelines are issued by the Bank of Botswana (Bank), pursuant to its authority set forth in section 4C (1) of the Bank of Botswana (Amendment) Act, 2022.

### (b) Purpose

1.2 The purpose of these guidelines is to outline the requirements for calculating the liquidity coverage ratio (LCR) for licensed and supervised banks (hereafter “bank”) by the Bank. The objective of the LCR is to promote the short-term resilience of the liquidity risk profile of banks, which is achieved by requiring banks to hold adequate stock of unencumbered high-quality liquid assets (HQLA), which can be converted into cash to meet its liquidity needs for a 30 calendar-day liquidity stress scenario.

### (c) Scope of Authority

1.3 The guidelines apply to a bank licensed by the Bank under the Banking Act, 2023 (Act), which fall within the purview of the Bank’s supervision in terms of Section 3(2) of the Act and other statutes. The guidelines apply on a stand-alone basis.<sup>1</sup>

1.4 Any question that arises as to the interpretation and application of the guidelines should be addressed to the director responsible for banking supervision. The guidelines shall come into effect six months from the date of issue.

## 2. DEFINITION OF THE TERMINOLOGY USED IN THE GUIDELINES

2.1 In the guidelines, the following definitions shall apply:

(a) **Act:** The Banking Act, 2023 (Cap. 46:04).

(b) **Affiliates:** a type of inter-company relationship in which one company owns less than a majority stake in the other company's stock. Affiliations can also indicate a type of inter-company relationship in which at least two companies are subsidiaries of a larger parent company.

(c) **Aggregated LCR:** the LCR denominated in Pula and all other currencies on an aggregated basis.

(d) **Asset-backed commercial paper:** a short-term monetary-market debt instrument collateralised by an underlying pool of assets.

(e) **Bank:** the Bank of Botswana established under the Bank of Botswana Act (Cap. 55:01) (as amended by the Bank of Botswana Amendment Act, 2022).

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<sup>1</sup> This also includes cross-border operations, if any.

- (f) **bank:** a person, including a subsidiary of a foreign bank, which is licensed under the Banking Act, 2023 to engage in banking business, and does not include the Central Bank.
- (g) **Cash-management relationship:** the provision of cash-management and related services to customers. Cash-management services refer to those products and services provided to a customer to manage its cash flows, assets, and liabilities, and conduct financial transactions necessary to the customer's ongoing operations. Such services are limited to payment remittance, collection and aggregation of funds, payroll administration, and control over the disbursement of funds.
- (h) **Clearing relationship:** a service arrangement that enables customers to transfer funds (or securities) indirectly through direct participants in domestic settlement systems to final recipients. Clearing relationship services are limited to transmission, reconciliation, and confirmation of payment orders; intra-day overdraft, overnight financing, and maintenance of post-settlement balances; and determination of intra-day and final settlement positions.
- (i) **Cliff-effect:** the sudden decrease in high-quality liquid assets.
- (j) **Conduits or securities investment vehicles:** investment vehicles that issue asset-backed commercial paper (ABCP) to fund purchase of long-term structured finance products like asset-backed securities (ABS).
- (k) **Correspondent banking:** arrangements under which one bank (correspondent) holds deposits owned by other banks (respondents) and provides payment and other services in order to settle foreign-currency transactions (for example, nostros and vostro accounts used to settle transactions in a currency other than the domestic currency of the correspondent bank for the provision of clearing and settlement of payments).
- (l) **Custody relationship:** the provision of safekeeping, reporting, processing of assets or the facilitation of the operational and administrative elements of related activities on behalf of customers in the process of their transacting and retaining financial assets. Such services are limited to the settlement of securities transactions, the transfer of contractual payments, the processing of collateral, and the provision of custody-related cash-management services. Also covered under custodial services is the receipt of dividends and other income, client subscriptions and redemptions. Custodial services can extend to asset and corporate trust servicing, treasury, escrow, funds transfer, stock transfer and agency services, including payment and settlement services, and depository receipts.
- (m) **Foreign exchange risk:** possible direct loss (as a result of an unhedged exposure) or indirect loss in the bank's cash flows, assets and liabilities, net profit and, in turn, its stock market value from an exchange rate movement.
- (n) **High-quality liquid assets:** cash or assets that can be converted into cash easily and immediately through sales (or by being pledged as collateral) with no significant loss of value.

- (o) **Inflow rate:** the rate at which payments are expected from counterparties during the 30-day stress period.
- (p) **Legal person:** includes a body corporate and an unincorporated body and a natural person, a human being.
- (q) **Liquid asset:** freely transferable assets, unencumbered by any charge or lien whatsoever, including treasury bills and other securities issued by government or central bank itself, negotiable instruments of such type as the central bank may approve.
- (r) **Liquidity coverage ratio:** the proportion of high-quality liquid assets in total net cash outflows, over a 30-day stress period.
- (s) **Operational deposits:** deposits maintained with a bank by the depositor in order to facilitate their access and ability to use payment and settlement systems and otherwise make payments.
- (t) **Prime brokerage:** a package of services offered to large active investors, particularly insituational hedge funds. The services include clearing, settlement and custody; consolidated reporting; financing (margin, repo or synthetic); securities lending; capital introduction; and risk analytics.
- (u) **Retail deposits:** these are deposits placed with a bank by a natural person.
- (v) **Run-off /Drawdown rate:** rate at which deposits, and undrawn commitments are withdrawn.
- (w) **Segregated accounts:** custody accounts created to hold cash and securities pledged as margin collateral
- (x) **Significant currency:** a currency is considered significant if the aggregate liabilities denominated in that currency amount to at least 5 percent of a bank's total liabilities.
- (y) **Small and medium enterprises (SMEs) customer:** an entity with a turnover/revenue of a maximum of P4 million per annum.
- (z) **Special purpose entity (SPE):** a legal entity created by a particular firm to meet specific objectives, and the activities of the entity are limited to those appropriate to achieving the objective of the SPE.
- (aa) **Total net cash flows:** total expected cash outflows minus total expected cash inflows in the specified stress scenario for the subsequent 30 calendar days.
- (bb) **Unencumbered:** free of legal, regulatory, contractual, or other restrictions on the ability of a bank to liquidate, sell, transfer, or assign an asset.

- (cc) **Unsecured wholesale funding:** for the purposes of the LCR, is liabilities and general obligations that are raised from legal persons (that is, legal entities, including sole proprietorships and partnerships) and are not collateralised by legal rights to specifically designated assets owned by the borrowing institution in case of bankruptcy, insolvency, liquidation, or resolution. Obligations related to derivative contracts are explicitly excluded from this definition.
- (dd) **Wholesale deposits:** these are deposits from legal entities, sole proprietorships, or partnerships.

### 3. IMPLEMENTATION CONSIDERATIONS

- 3.1 In implementing the guidelines, and notwithstanding that the guidelines will apply to banks operating in Botswana as stated in paragraph 1.3 of these guidelines, a bank shall apply the rules and parameters as specified in these guidelines to its cross-border operations, except for retail and SME deposits. The bank shall apply the host jurisdiction's run-off parameters to retail and SME deposits, except for the situation that the Bank decides that the requirements of these guidelines are stricter than host requirements. In the case where the host jurisdiction has recognised eligible HQLA in accordance with alternative liquidity approaches<sup>2</sup> as prescribed under the Basel III rules, the bank can include these assets in total stock of HQLA in computing LCR at an entity level.
- 3.2 While banks are expected to meet the LCR in domestic currency, they are also expected to monitor the LCR in significant currencies. The monitoring of LCR in significant currencies will allow banks and the supervisor to identify potential currency mismatches that could give rise to cash outflow. Furthermore, assets eligible for inclusion in HQLA are expected to remain liquid across various stress scenarios, and the liquidity should not be impaired in the event of materialisation of a certain type of risk, for example, foreign-exchange risk. In that regard, banks should take into consideration HQLA by currency and foreign-exchange risks as prescribed and submit the LCR report in accordance with the format and timeline indicated below.
  - (a) Currencies
- 3.3 A bank is required to meet and report LCR in domestic currency (Botswana Pula). Banks, however, should also be aware of liquidity needs in each currency, that amount to 5 percent or more of the total liabilities (significant currencies) to be able to meet its foreign currency denominated obligations. In that regard, a bank is required to understand the extent to which it can use the stock of HQLA to generate liquidity in the currency in which net cash outflows arise, given that in a stressed period, a situation can arise whereby currencies are no longer transferable and convertible, even those that in normal times are freely transferable and highly convertible.
- 3.4 To manage liquidity coverage ratio requirements in individual currencies, banks are required to measure and report to the Bank LCR by significant currency. Monitoring of

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<sup>2</sup> Refers to paragraphs 55 to 68 of the Basel III rules text relating to alternative approaches to determining HQLA: (a) contractual committed liquidity facilities from the relevant central bank; (b) foreign currency HQLA to cover domestic liquidity needs; or (c) additional use of Level 2 assets with higher haircuts.

the LCR in significant currencies will allow banks to monitor any potential mismatch in the currency denomination of the HQLA and the net outflows in individual currencies, which could arise in times of stress.

3.5 In managing foreign-exchange liquidity risk, a bank should consider the risk that its ability to swap currencies and access relevant foreign exchange markets may be impaired under stressed conditions. The bank should be aware that sudden, adverse exchange-rate movements could sharply widen existing mismatched positions and alter effectiveness of any foreign-exchange hedges in place. These considerations should be incorporated in the bank’s liquidity risk management policy and strategy.

(b) Minimum requirements

3.6 Banks are required to comply with the aggregated LCR daily to help monitor and control their liquidity risk. For purposes of supervisory oversight, banks shall submit their respective LCR returns to the Bank in the manner prescribed in Table 1.

**Table 1: Liquidity Coverage Ratio Implementation Timeline**

Item	Aggregated LCR	LCR significant currency
Currency level	All currencies (aggregated)	For each significant currency
Requirement	100 percent	No minimum requirement: monitoring only
First reporting date	1 December 2025	1 December 2025
Reporting frequency	Monthly	Quarterly
Reporting date	Calendar month-end	Quarter-end
Submission deadline	10 days after the last day of each month	10 days after the last day of each month

3.7 The Bank will apply a gradual approach for implementing the LCR requirements by which the minimum ratio is set at 60 percent and increases by 10 percentage points to reach 100 percent in December 2029, as indicated in the timeline in Table 2.

**Table 2: Liquidity Coverage Ratio Implementation Timeline Continued**

Effective Date	1 December 2025	1 December 2026	1 December 2027	1 December 2028	1 December 2029 and going forward
Minimum LCR Requirement (Percent)	60	70	80	90	100

3.8 Banks should have the operational capability to increase the frequency of submission of returns to the Bank, particularly during stressed situations.

3.9 In the event a bank fails to comply with the minimum prescribed LCR, it should notify the Bank no later than a business day after the LCR has fallen below 100 percent. In such circumstance, a bank shall notify the Bank in writing and provide an explanation on

- (a) the factors that contributed to falling of the LCR below 100 percent.
  - (b) the measures that have been or will be taken to restore the LCR position.
  - (c) the expected duration of the prescribed minimum remaining below the minimum level.
- 3.10 The Bank will assess the situation where a bank’s reported LCR falls below 100 percent, and the supervisory response will be proportionate to the drivers, magnitude and duration of the reported shortfall. A bank shall comply with any condition imposed by the Bank, which may include specific actions to be taken by the bank to reduce its liquidity risk.
- 3.11 Notwithstanding the provisions of paragraphs 3.9–3.10, a bank that consistently, intentionally or negligently fails to maintain the minimum LCR requirements will be subjected to intense supervision; a penalty could also be imposed on a bank.

#### 4. THE LIQUIDITY COVERAGE RATIO

- 4.1 The LCR is the proportion of HQLA in total net cash outflows over a 30-day stress period. The LCR requires banks to hold sufficient HQLA to cover net cash outflows arising from a stress scenario that lasts for 30 calendar days. The LCR is determined by dividing the value of HQLA by the total net cash outflows over a 30-day stress period as shown in the mathematical formula below

$$\text{LCR} = \frac{\text{Stock of HQLA}}{\text{Total net cash outflows over the next 30 calendar days}} \geq 100\%$$

- 4.2 The minimum LCR requirement is set at 100 percent. Banks are required to hold HQLA equal to or more than the total net cash outflows for 30-calendar days on an ongoing basis.
- 4.3 The LCR stress test scenario, fundamental to the concept of LCR, is modelled on the Basel Committee on Banking Supervision (BCBS) LCR scenario; the scenario combines idiosyncratic and market-wide shocks lasting 30 calendar days, which would result in
- (a) the run-off of a proportion of retail deposits.
  - (b) a partial loss of unsecured wholesale funding capacity.
  - (c) a partial loss of secured, short-term financing with certain collateral and counterparties.
  - (d) additional contractual outflows that arise from a downgrade in the bank’s public credit rating by up to and including three notches, as well as collateral posting requirements.
  - (e) increases in market volatilities that affect the quality of collateral or potential future exposure of derivative positions and thus require larger collateral haircuts or additional collateral or lead to other liquidity needs.
  - (f) unscheduled drawdown on committed but unused credit and liquidity facilities that the bank has provided to its clients.

- (g) the potential need for a bank to buy back debt or honour non-contractual obligations in the interest of mitigating reputational risk.

4.4 The LCR stress-test scenario described above is a minimum supervisory requirement for banks. In that regard, banks are expected to conduct their own stress tests to assess the level of liquidity they should hold beyond the minimum and construct own scenarios that could cause difficulties for their specific business activities. Such internal stress tests should be for longer time horizons than specified in the guidelines. Banks should refer to Chapter 7 of the Liquidity Risk Management Guidelines for specific stress-test requirements for liquidity risk.

- (a) Stock of High-Quality Liquid Assets

#### Characteristics of HQLAs

4.5 Banks are required to maintain a stock of HQLA above the total net cash outflows over a 30-day period. In order to qualify as HQLA, an asset should be liquid in markets during a time of stress—the asset should be cash or an asset that can be converted into cash quickly through sale, or by being pledged as collateral to obtain funding from the central bank, with no significant loss of value. In addition, liquid assets should possess certain fundamental and market characteristics, and satisfy certain operational requirements as indicated below:

- (i) Fundamental Characteristics of HQLA:

- Low risk: assets that are less risky tend to have higher liquidity. High credit standing of the issuer and a low degree of subordination increase an asset's liquidity. Low sensitivity to changes in interest rates, low legal risk, low inflation risk and denomination in a convertible currency with low foreign-exchange risk all enhance an asset's liquidity.
- Ease and certainty of valuation: an asset's liquidity increases if market participants are more likely to agree on its valuation. Assets with more standardised, homogenous and simple structures tend to be more fungible, promoting liquidity.
- Low correlation with risky assets: the asset should not be subject to wrong-way (highly correlated) risk. For example, assets issued by banks are more likely to be illiquid in times of liquidity stress in the banking sector.
- Listed on a developed and recognised exchange: being listed increases an asset's transparency, which results in large trading volumes, thus enhancing asset liquidity.

- (ii) Market-related Characteristics of HQLA

- Active and sizable market: the asset has an active outright sale or repo markets.
- Low volatility: assets whose prices remain relatively stable and are less prone to sharp price declines over time will have a lower probability of triggering forced sale to meet liquidity requirements.

- Flight to quality: historically, the market has shown a tendency to move into high-quality assets in a systemic crisis.

(iii) Operational requirements

4.6 A bank should ensure that the stock of HQLAs is managed in such a way that the bank can and is able to demonstrate that it can immediately use the stock of assets as a source of contingent funds, and that the stock of assets is available for the bank to convert into cash through outright sale or repurchase agreement (repo). The aim is to fill funding gaps between cash inflows and outflows that may arise at any time during the 30-day stress period with no restriction on the use of the liquidity generated. In that regard, a bank should ensure that

- all assets in the stock of HQLAs are unencumbered, that is, free of legal, regulatory, contractual or other restrictions on the ability of the bank to liquidate, sell, transfer, or assign the asset. Pledged assets do not fulfil this requirement. In addition, assets received in reverse repo and securities financing transactions that are held at the bank have not been rehypothecated and are legally and contractually available for the bank's use can be considered as part of the stock of HQLAs.
- the stock of HQLA is under the control of the function charged with managing the liquidity of the bank (for example, a treasury department) and the function should have authority, and legal and operational capability to monetise any asset in the stock
- the stock of those assets, in addition to meeting the definition of unencumbered, the bank will have the operational capability to monetise to meet outflows during the stress period. Operational capability to monetise assets requires having procedures and appropriate systems, including providing the treasury function with access to all necessary information to execute monetisation of any asset at any time. Monetisation of an asset must be executable, from an operational perspective, in the standard settlement period for the asset class in the relevant jurisdiction.
- the bank has a policy or framework that identifies legal entities, geographical locations, currencies and specific custodial or bank accounts where HQLAs are held. In addition, the bank can determine whether any such assets should be excluded for operational reasons, and therefore have the ability to determine the composition of its stock on a daily basis.
- assets received as collateral for derivative transactions that are not segregated and are legally able to be rehypothecated may be included in the stock of HQLA, provided that the bank records an appropriate level of derivative cash outflows.
- if an eligible liquid asset becomes ineligible, such asset is kept in the stock of liquid assets for an additional 30 calendar days to mitigate cliff effects that could arise. This would allow the bank additional time to adjust its stock as needed or replace the asset.

## Categories of HQLA

4.7 There are two categories (levels) of assets that can be included in the stock of HQLA: level 1 and level 2 assets. Level 1 assets are typically of the highest quality and the most liquid, and there is no limit on the extent to which a bank can hold these assets to meet the LCR. Level 2 assets, which are further categorised into level 2A, discounted at 15 percent, and level 2B, the discount of which ranges from 25 percent to 50 percent, are less liquid, and can constitute only up to 40 percent of the stock of HQLA. The 40 percent cap on level 2 assets should be determined after the application of required haircuts.<sup>3</sup> Assets to be included in each category are those that a bank is holding on the first day of the stress period, irrespective of their residual maturity. It is worth noting that because of unavailability of level 2B assets in the Botswana market, the asset category has been excluded from the guidelines.

4.8 Level 1 assets comprise

- (i) cash (coins and banknotes) currently held by the bank;
- (ii) central bank reserves (excluding required reserves);
- (iii) marketable securities<sup>4</sup> representing claims on or guaranteed by sovereigns (Government), central banks, public sector entities (parastatals), the Bank for International Settlements, the International Monetary Fund, or multilateral development banks<sup>5</sup>, and satisfying all of the following conditions:

- assigned a zero-credit risk weight under the Bank's capital adequacy rules;
- traded in large, deep and active repo or cash markets characterised by a low concentration level;
- have a proven record as a reliable source of liquidity in the markets (repo or sale) even during stressed market conditions; and
- not an obligation of a financial institution<sup>6</sup> or any of its affiliated entities.

4.9 Level 1 assets are not subject to a haircut, unless specified by the Bank. In this context, banks are expected to apply haircuts to Botswana government bonds and bills as prescribed by the Bank.

4.10 Although Botswana securities do not meet fundamental characteristics for qualifying as high-quality liquid assets, government bonds of all maturities and treasury bills subject to haircuts as may be prescribed by the Bank, should be considered HQLAs for as long as they are accepted by the Bank as collateral for access to funding by banks. Further, Bank-issued securities are eligible for inclusion in level 1 assets.

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<sup>3</sup> And if applicable, after taking into account the unwinding of short-term securities financing transactions and collateral swap transactions maturing within 30 calendar days that involve the exchange of HQLA.

<sup>4</sup> For purpose of calculating the LCR, level 1 assets in the stock of HQLAs should be measured at an amount no greater than their current market value.

<sup>5</sup> Examples of multilateral development banks are the World Bank, International Finance Corporation, and European Bank for Reconstruction and Development.

<sup>6</sup> Financial institutions (financial institutional units) refer to the central bank, commercial banks, other depository corporations and other financial corporations.

#### 4.11 Level 2 assets consist of

Marketable securities representing claims on or guaranteed by sovereigns (government), central banks, public sector entities (parastatals) or multilateral development banks (MDBs)<sup>7</sup> that satisfy all of the following conditions:

- assigned a 20 percent risk weight under the Basel II standardised approach for credit risk;
- traded in large, deep and active repo or cash markets characterised by low concentration levels;
- have a proven record as a reliable source of liquidity in the markets (repo markets) even during stressed market conditions; and
- not an obligation of a financial institution or any of its affiliated entities.

#### (b) Total Net Cash Outflows

4.12 Total net cash outflows<sup>8</sup> over the next 30-calendar days is defined as the total expected cash outflows minus total expected cash inflows in the specified stress scenario for the next 30 calendar days. Total expected cash outflows are calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance-sheet commitments by the rates at which they are expected to run off or be drawn down. Total expected cash inflows are calculated by multiplying the outstanding balances of various categories of contractual receivables by the rates at which they are expected to flow in under the scenario up to an aggregate unit of 75 percent of total expected cash outflows.

<b>Total net cash outflows over the next 30-calendar days = Total expected cash outflows minus total expected cash inflows, limited to 75 percent of total expected cash outflows</b>
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4.13 Banks are not permitted to double count items in the calculation of the LCR; that is, cash inflows arising from maturing assets that have been included in the stock of HQLAs (that is, the numerator), should also not be recognised as cash inflows (that is, part of the denominator). Where there is potential that an item could be counted in multiple outflow categories (for example, committed liquidity facilities granted to cover debt maturing within the 30-calendar day- period), a bank only has to assume up to the maximum contractual outflow for that product.

4.14 In calculating cash outflows and inflows with uncertain maturities, a bank must make the most conservative assumptions for determining the maturity or transaction date for an instrument or transaction.

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<sup>7</sup> Examples of multilateral development banks include the World Bank, African Development Bank, Inter-American Development Bank, Asian Development Bank and European Bank for Reconstruction and Development.

<sup>8</sup> Where applicable, cash inflows and outflows should include interest that is expected to be received and paid during the 30-day time horizon.

## Cash Outflows

### (i) Retail deposit run-off

- 4.15 For the purpose of LCR, retail deposit run-off rate is a rate at which retail deposits are expected to be withdrawn during a 30-day stress period. Retail deposits subject to LCR include demand and term deposits, unless otherwise excluded under the criteria set out in paragraph 4.20 and 4.21. Deposits from legal entities, sole proprietorships or partnerships are part of the wholesale deposit category. Retail deposits are divided into stable and less stable deposits.
- 4.16 A bank shall assign a run-off rate of 5 percent to stable deposits. Stable deposits, for the purposes of LCR, are the amount of retail deposits that are fully insured by an effective deposit insurance scheme<sup>9</sup> up to the maximum coverage limit or by a public guarantee that provides equivalent protection.
- 4.17 Deposit balances up to the deposit insurance limit may be treated as fully insured even if a depositor has a balance in excess of the deposit insurance limit. However, any amount in excess of the deposit insurance limit must be treated as less stable. An effective deposit insurance scheme refers to a scheme
- that guarantees that it has the ability to make prompt payouts.
  - for which the coverage is clearly defined.
  - of which public awareness is high.
  - in which the deposit insurer has formal legal powers to fulfil its mandate, and has operational independence, and is transparent and accountable.
- 4.18 A bank shall categorise retail deposits, which do not meet the criteria of stable deposits as less stable deposits and shall assign a run-off rate of 10 percent to such deposits.
- 4.19 The Bank might decide to classify and develop additional categories with higher run-off rates than 10 percent, as deemed necessary. In that case, the Bank will inform banks about the specific categories, the rationale for including them, and the corresponding run-off rates. Examples of specific categories could be high-value deposits, and foreign-currency deposits.
- 4.20 Cash outflows related to retail term deposits with a residual maturity or withdrawal notice period of greater than 30 days should be excluded from LCR calculations if
- the depositor has no legal right to withdraw deposits within a 30-day horizon of the LCR; or
  - if early withdrawal results in a significant penalty that is materially greater than the loss of accrued interest.

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<sup>9</sup> To eliminate doubt, all deposits insured by the Deposit Insurance Scheme of Botswana shall be deemed as deposits insured by an effective deposit protection scheme and therefore stable.

4.21 If a bank allows a depositor to withdraw such deposits without applying the corresponding penalty or despite a clause that indicates that the depositor has no legal right to withdraw, the entire category of these funds shall be treated as demand deposits and be subjected to the run-off rates specified at paragraphs 4.17 and 4.19.

*(ii) Unsecured Wholesale Funding*

4.22 For the purpose of LCR, unsecured wholesale funding is defined as those liabilities and general obligations that are raised from legal persons, including sole proprietorships and partnerships, and are not collateralised by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation or resolution. Obligations related to derivative contracts are explicitly excluded from this definition.

4.23 A bank shall recognise as wholesale funding under the LCR all funding that is callable within the LCR's horizon of 30 days or that has its earliest possible contractual maturity date within this horizon (such as maturing term deposits and unsecured debt securities) as well as funding with an indeterminate maturity. The funding category should include all funding with options that are exercisable at the fund provider's discretion within the 30-calendar-day horizon.

4.24 A bank shall recognise unsecured wholesale funding provided by SMEs customers the same way as retail deposits under these guidelines, effectively distinguishing between a stable portion of funding provided by SMEs and less stable funding as defined in these guidelines and applying the run-off rates as applied for retail customers (5 percent, 10 percent). Term deposits from SMEs must be treated in accordance with the treatment for term retail deposits.

*(iii) Operational deposits generated by clearing, custody, and cash management activities: 25 percent*

4.25 A bank is required to identify the portions of unsecured wholesale funding that qualify as operational deposits. Activities that generate operational deposits in the context of LCR are clearing, custody and cash management. The funds generated by these activities may receive a 25 percent run-off rate only if the following conditions are met:

- (a) The customer must be reliant on a bank to perform the services as an independent third-party intermediary to fulfil its normal banking activities over the next 30 days.<sup>10</sup>
- (b) These services must be provided under a legally binding agreement to institutional customers.
- (c) The termination of such agreements must be subject either to a notice period of at least 30 days or to significant switching costs (such as those related to transaction, information technology, early termination, or legal costs) to be borne by the customer if the operational deposits are moved before 30 days.

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<sup>10</sup> This condition would not be met if an entity is aware that the customer has adequate back-up arrangements.

- 4.26 Operational deposits generated by such an activity are those where the deposits are
- (a) by-products of the underlying services provided by a bank and not sought out in the wholesale market in the sole interest of offering interest income.
  - (b) held in specifically designated accounts and priced without giving an economic incentive to the customer to leave excess funds on these accounts.
- 4.27 Deposit balances in excess of those required for the provision of operational services shall be treated as non-operational deposits, and do not qualify for the 25 percent factor; in other words, only that part of the deposit balance with the service provider that is proven to serve a customer's operational needs can qualify as stable. Excess balances must be treated in the appropriate category for non-operational deposits. If banks are unable to determine the amount of the excess balance, then the entire deposit must be assumed to be excess requirements and therefore considered non-operational.
- 4.28 A bank must determine the method for identifying excess deposits that are excluded from this treatment. The assessment should be conducted at a sufficiently granular level to adequately assess the risk of withdrawal in an idiosyncratic stress scenario.
- 4.29 The portion of the operational deposits generated by clearing, custody and cash-management activities that are fully covered by a deposit insurance scheme may receive the same treatment as stable retail deposits (thus receiving a 5 percent run-off rate).
- 4.30 Notwithstanding the operational categories, if the deposit under consideration arises out of correspondent banking or from the provision of prime brokerage services, it must be treated as if there were no operational activity for the purpose of determining the run-off rate. A bank should recognise the deposits as non-operational deposits and be assigned a run-off rate of 100 percent.
- (iv) *Unsecured wholesale funding provided by non-financial corporates, sovereigns, central banks, multilateral development banks, and Public Sector Entities: 20 percent or 40 percent*
- 4.31 Unsecured wholesale funding provided by non-financial corporates, sovereigns, central banks, multilateral development banks, and public sector entities includes all deposits and other extensions of unsecured funding from non-financial corporate customers (that are not categorised as small and medium enterprises customers) and (both domestic and foreign) sovereign, central bank, multilateral development banks, and public sector entities customers that are not specifically held for operational purposes. The run-off factor for these funds is 40 percent.
- (v) *Unsecured wholesale funding provided by other legal entity customers: 100 percent*
- 4.32 This category consists of all deposits and other funding from other institutions (including banks, securities firms, insurance companies), fiduciaries, beneficiaries, conduits and special purpose vehicles, affiliated entities of a bank and other entities that are not specifically held for operational purposes and not included in the categories listed under category (ii). The run-off rate for these funds is 100 percent.

4.33 All notes, bonds and other debt securities issued by a bank must be included in category (v), regardless of the holder, unless the bond is sold exclusively in the retail market and held in retail accounts (including small and medium enterprises customer accounts) in which case the instruments may be treated in the appropriate retail or small and medium enterprises customer deposit category.

*(vi) Secured funding run-off*

4.34 For the purpose of these guidelines, secured funding is defined as those liabilities and general obligations that are collateralised by legal rights to specifically designated assets owned by the borrowing institution in the case of bankruptcy, insolvency, liquidation, or resolution. Unless the counterparty is a central bank, secured funding does not include borrowings collateralised by assets that are not tradeable in financial markets, such as property, plant and equipment.

4.35 A bank’s ability to continue to access secured funding during the 30-day stressed period is limited by the quality of the collateral. In that regard, there will be no reduction in funding availability for banks with maturing secured funding transactions for example repos, which are collateralised by level 1 assets, as the transactions are expected to be rolled over, given the high quality of collateral. Moreover, no reduction in funding availability is expected for any maturing secured funding transactions with the Bank. A reduction in funding availability will be assigned to maturing transactions backed by level 2 assets equivalent to the required haircuts of the respective assets. A 25 percent run-off rate may be applied for maturing secured funding transactions with the bank’s domestic sovereign, multilateral development banks, or domestic public sector entities that have a 20 percent or lower risk weight, when the transactions are backed by assets other than level 1 or level 2A assets, in recognising that these entities are likely to withdraw secured funding from banks in time of market-wide stress. The 25 percent run-off rate indicates loss of funding. This treatment may be applied only to outstanding secured-funding transactions. Unused collateral or merely the capacity to borrow, as determined at the end of the day for the reporting date must be excluded from the LCR calculation.

4.36 For all other maturing transactions, the run-off rate should be 100 percent, including transactions where a bank has satisfied customers’ short positions with its own inventory. Table 3 summarises the applicable outflow rates.

**Table 3: Applicable Rates to Transactions Maturing within 30 Days**

Categories of outstanding maturing secured funding transactions	Amount to add to cash outflows (percent)
Backed by level 1 assets or with central banks	0
Backed by level 2A assets	15
Secured funding transactions with domestic sovereigns, PSEs, or multilateral development banks that are not backed by level 1 or 2A assets. PSEs that receive this treatment are only those that have a risk weight of 20 percent or lower	25
All others	100

(vii) *Additional Required Cash Outflows*

- *Derivative net cash outflows*

4.37 The sum of all derivative net cash outflows must receive a 100 percent factor. A bank should calculate expected contractual derivative cash inflows and outflows using its existing valuation methods. Cash flows may be calculated on a net basis (that is, inflows can offset outflows) by counterparty, only where a valid master netting agreement exists. A bank should exclude from such calculations those liquidity requirements that would result from increased collateral requirements, which arise from market value movements or declines in value of collateral posted.

4.38 Where derivative payments are collateralised by HQLAs, cash outflows should be calculated net of any corresponding cash or collateral inflows that would result, all other things being equal, from contractual obligations for cash or collateral to be provided to the bank, provided that upon receipt of the collateral, the bank is legally entitled and operationally capable of reusing it in new cash-raising transactions. This is in line with the principle that a bank should not double count liquidity inflows and outflows.

- *Increased liquidity needs related to the potential for valuation changes on posted collateral securing derivative and other transactions*

4.39 Where banks have entered into contracts of derivatives, which require them to secure the mark-to-market valuation of their derivative positions, a bank posting non-level 1 HQLA collateral for securing mark-to-market derivative positions should treat the collateral as cash outflow and be assigned a run-off rate of 20 percent. The cash outflow should be 20 percent of the notional amount required to be posted as collateral after applying the relevant haircuts, and net of collateral received (provided that such collateral received can be reused or rehypothecated without limitations) in the calculation of total expected cash outflows.

- *Increased liquidity needs related to excess non-segregated collateral held by a bank that could contractually be called at any time by the counterparty*

4.40 Where a bank holds non-segregated collateral more than the counterparty's current collateral requirements and the collateral can be contractually called at any time by the counterparty, the banking institution shall include 100 percent of the excess non-segregated collateral in the calculation of total expected cash outflows.

- *Increased liquidity needs related to contractually required collateral on transactions for which the counterparty has not yet demanded the collateral to be posted*

4.41 A bank shall include 100 percent of the value of any collateral, which is contractually due to a counterparty in the calculation of total expected cash outflows in situations where the counterparty has not yet demanded the collateral to be posted.

- *Increased liquidity needs related to contracts that allow collateral substitution for non-HQLA assets*
- 4.42 In a situation where a bank enters into a contract that allows collateral received to be substituted for non-HQLA assets without the banking institution's consent, a bank shall include 100 percent of the collateral amount received in the calculation of total expected cash outflows if the collateral received is not segregated and is used to secure another transaction.
- *Increased liquidity needs related to market-valuation changes on derivative or other transactions*
- 4.43 In a situation where a reporting entity has entered into collateralisation arrangements to secure against mark-to-market exposures on derivative and other transactions, it shall include any outflows related to market-valuation changes in the calculation of expected cash outflows by identifying the largest absolute net 30-day collateral flow realised during the preceding 24 months. The absolute net collateral flow shall be based on both realised outflows and inflows, regardless of the direction of these flows. To the extent that these transactions are executed under a valid and enforceable master netting agreement, the collateral inflows and outflows from the same counterparty shall be calculated by the reporting entity on a net basis.
- *Loss of funding on asset-backed securities and other structured financing instruments*
- 4.44 A bank shall assume that a refinancing market for the outstanding debt raised through funding instruments issued by the entity itself and which are maturing within 30 calendar days will not exist. The bank shall assign a 100 percent outflow rate to the total outstanding amount of these instruments maturing within 30-calendar days.
- *Loss of funding on asset-backed commercial paper, conduits, securities investment vehicles and other such financing facilities*
- 4.45 Where a bank has issued structured financing facilities that remain outstanding, such as short-term asset-backed commercial paper, the bank shall assume that it is potentially unable to refinance the maturing debt and shall include 100 percent of the amount of the structured finance instrument maturing within the next 30 calendar days in its expected cash outflows.
- 4.46 In circumstances where the contract to the financing arrangement includes derivatives or derivative-like provisions that allow the return of assets to a bank or require the bank (as asset originator) to provide liquidity, the bank shall include 100 percent of the amount of assets that could potentially be returned, or the liquidity required, in its expected cash outflows.
- *Drawdown on Committed Credit and Liquidity Facilities*
- 4.47 Credit and liquidity facilities are defined as explicit contractual agreements or obligations to extend funds at a future date to retail or wholesale counterparts. These facilities only include contractually irrevocable (committed) or conditionally revocable

agreements to extend funds in the future. In a stressed environment, it will likely be difficult for customers drawing on facilities of any maturity, even short-term maturities, to be able to quickly pay back the borrowings. Therefore, for purposes of these guidelines, all committed facilities that are assumed to be drawn will remain outstanding at the amounts assigned throughout the duration of the stress test, regardless of maturity.

- 4.48 The undrawn portion of each committed obligation shall be calculated net of HQLA eligible for the stock of HQLA if the the counterparty has posted HQLA as collateral to secure the facility or the contract requires colateral to be posted for the counterparty to draw down the facility. The netting provision will apply only if
- (a) the banking institution is legally entitled and operationally capable to reuse the collateral in new cash raising transactions once the facility is drawn
  - (b) there is no undue correlation between the probability of drawing the facility and the market value of the collateral and
  - (c) the collateral can be netted against the outstanding amount of the facility to the extent that this collateral is not already counted in the stock of HQLA, in line with the principle in paragraph 4.15, which prohibits banks from double counting HQLA for the purpose of computing LCR.
- 4.49 To determine the expected cash outflows arising from the undrawn portion of the committed credit facilities, a bank shall apply the run-off rates in Table 4

**Table 4: Expected Cash Outflows from the Undrawn Portion of Committed Credit Facilities.**

Conterparty	Run-off Rates (percent)
Retail and small and medium enterprises customers	5
Non-financial corporates, sovereigns and central banks and PSEs credit facilities	10
Other financial institutions including securities firms, insurance companies	40
Banks subject to prudential supervision by Bank of Botswana	40
Other legal entity customers, credit and liquidity facilities	100

- 4.50 A liquidity facility is defined as any committed, undrawn back-up facility that would be used to refinance the debt obligations of a customer in situations where such a customer is unable to roll over that debt in financial markets (for example, pursuant to a commercial paper programme, secured financing transactions). The liquidity facilities provided to hedge funds, money market funds and special-purpose funding vehicles, or conduits, or other vehicles for financing the financial assets of these financial institutions should be recognised under other legal entities and be assigned a run-off rate of 100 percent.
- 4.51 For the purpose of these guidelines, the amount of the commitment to be treated as a liquidity facility is the amount of the outstanding debt issued by a bank’s customer (or a proportionate share, if a syndicated facility) maturing within a 30-day period that is backstopped by the facility. A bank shall exclude from the scope of the definition of liquidity facility the portion of the facility that is backing debt maturing beyond the 30-day window, and the remaining commitment above the amount required for

backstopping the outstanding debt. The remaining commitment would be treated as a committed credit facility with its associated drawdown rate as specified in paragraph 4.51.

- 4.52 To determine the expected cash outflows arising from the undrawn portion of the liquidity facility, a bank shall apply the run-off rates in Table 5.

**Table 5: Expected Cash Outflows from the Undrawn Portion of Committed Liquidity Facilities.**

<b>Counterparty</b>	<b>Run-off Rates (percent)</b>
Retail and small and medium enterprises customers	5
Non-financial corporates, sovereigns and central banks and PSEs credit facilities	30
Other financial institutions including securities firms, insurance companies	40
Banks subject to prudential supervision by Bank of Botswana	40
Other legal entity customers	100

- *Contractual obligations to extend funds within a 30-day period.*

- 4.53 Any contractual lending obligations to financial institutions not included elsewhere in these guidelines should be assigned a run-off rate of 100 percent.

- 4.54 If the total of all contractual obligations to extend funds to retail and non-financial corporate clients within the next 30 calendar days (not included in the prior categories) exceeds 50 percent of the total contractual inflows due in the next 30 calendar days from these clients, the difference should be reported as a 100 percent outflow.

- *Other Contractual Cash Outflows*

- 4.55 A bank should apply a 100 percent run-off factor for any other contractual cash outflows maturing within the next 30 calendar days, such as outflows to cover unsecured collateral borrowing, uncovered short positions, dividends, or contractual interest payment. Outflows related to operating cost are, however, excluded from these guidelines.

- *Contingent Funding Obligations*

- 4.56 Contingent funding obligations may be either contractual or non-contractual and are not lending commitments. Non-contractual contingent funding obligations include associations with, or sponsorship of, products sold or services provided that may require the support or extension of funds in the future under stressed conditions. The contingent obligations include products and instruments for which a customer or holder has specific expectations regarding the liquidity and marketability of the product or instrument and for which failure to satisfy customer expectations in a commercially reasonable manner would likely cause material reputational damage to the institution or otherwise impair ongoing viability.

- 4.57 Some contingent funding obligations are explicitly contingent upon a credit or other event that is not always related to the liquidity events simulated in the stress scenario but may nevertheless have the potential to cause significant liquidity drains in times of stress.
- 4.58 A bank shall calculate the expected cash outflows for liquidity calls arising from non-contractual contingent funding obligations according to the rates shown in Table 6.

**Table 6: Outflow rates for contingent funding obligations**

Category	Outflow Rates
Unconditionally revocable (uncommitted) credit and liquidity facilities	0 percent
Contingent funding obligations related to trade finance (for example, documentary trade letters of credit, documentary, and clean collection, import bills and export bills, guarantees directly related to trade finance obligations)	5 percent of trade finance obligations
Non-contractual contingent funding obligations related to potential liquidity draws by consolidated joint ventures or minority investments in entities.	10 percent of the investment value
Guarantees and letters of credit unrelated to trade finance obligations.	10 percent of the amount of guarantees and letters of credit
Potential request for debt repurchases of the banking institutions own debt or that of related conduits, SIV and other such financing facilities.	10 percent of the total outstanding amount
Structured products where customers anticipate ready marketability, such as adjustable-rate notes and variable-rate demand notes.	10 percent of the total outstanding amount
Managed funds that are marketed with the objective of maintaining a stable value (for example, money market mutual funds, other types of stable collective investment funds.)	10 percent of the total outstanding amount
Outstanding debt securities having maturities greater than 30 days whereby the banking institution or its affiliate is a dealer or market maker.	10 percent of the total outstanding amount.
Non-contractual obligations where customers short positions are covered by other customers' collateral, where the collateral does not qualify as level 1 or level 2 assets.	50 percent of the collateral amount used to cover customer's short position.
Any other contingent funding obligation not covered above.	10 percent of the total outstanding amount.

### Cash Inflows

- 4.59 When considering its available cash inflows, a bank must only include contractual inflows (including interest payments) from outstanding exposures that are fully performing and for which the entity has no reason to expect a default within the 30-day time horizon. Contingent inflows, including facilities obtained from a central bank must not be included in total net cash inflows.
- 4.60 In order to prevent banks from relying solely on expected inflows to meet their liquidity requirement, and also to ensure a minimum level of HQLA holdings, the amount of inflows that can offset outflows is capped at 75 percent of total expected cash outflows

as calculated in these guidelines. The 75 percent limit requires that a bank must maintain a minimum amount of stock of HQLAs equal to 25 percent of its total cash outflows.

4.61 For the purposes of LCR, sources of cash inflows are divided into four broad categories: inflows relating to secured lending, committed facilities, identified counterparties, and other cash inflows.

*(i) Secured lending, including reverse repos and securities borrowing*

4.62 A bank shall assume that maturing reverse repurchase or securities borrowing agreements secured by level 1 assets will be rolled over and will not give rise to any cash inflows, have an inflow rate of zero percent. However, maturing reverse repurchase, or securities lending agreements secured by level 2 HQLAs must lead to cash inflows equivalent to the relevant haircut for the specific assets, while those secured by non-HQLA assets will not be rolled over; the bank may assume to receive 100 percent of the cash related to those agreements, thus attracting an inflow rate of 100 percent.

4.63 As an exception to paragraph 5.65, if the collateral obtained through the reverse repo, securities borrowing, or collateral swaps, which mature within the 30-day horizon, is reused (that is, rehypothecated) and is used to cover short positions that could be extended beyond 30 days, a bank must assume that such reverse repo or securities borrowing transactions will be rolled over and not give rise to any cash inflows, reflecting its need to continue to cover the short position or to repurchase the relevant securities.

4.64 If the collateral obtained from secured lending transactions is not used to cover a bank's short position, the bank shall apply inflow rates from maturing reverse repurchase or securities borrowing agreements based on the type of asset securing the transaction as in Table 7.

**Table 7: Inflow rates from maturing reverse repurchase or securities borrowing agreements**

Maturing secured lending transactions backed by the following asset category	Inflow rate
Level 1 assets	0
Level 2A assets	15
Margin lending backed by all other collateral	50
Other collateral	100

*(ii) Committed facilities*

4.65 No credit facilities, liquidity facilities or other contingent funding facilities that the bank holds at other institutions for its own purposes are assumed to be able to be drawn. Such facilities shall receive a 0 percent inflow rate.

*(iii) Other inflows by Counterparty*

4.66 For all other types of transactions, secured or unsecured, the inflow rate will be determined by the counterparty. To reflect the need for a bank to conduct ongoing loan

origination/roll-over with various counterparties, even during a time of stress, a set of limits on contractual inflows by counterparty type is applied.

4.67 When considering loan payments, a bank should only include inflows from fully performing loans. Further, inflows should only be taken at the latest possible date, according to the contractual rights available to counterparties. For revolving credit facilities, a bank shall assume that the existing loan is rolled over, and that any remaining balances are treated in the same way as a committed facility.

4.68 Inflows from loans that have no specific maturity, that is, have non-defined or open maturity should not be included; therefore, no assumptions should be applied as to when maturity of such loans would occur. An exception to this would be minimum payments of principal, fee or interest associated with an open maturity loan, provided that such payments are contractually due within 30 days. These minimum payment amounts should be captured as inflows at the rates prescribed in Table 8 under retail and small and medium enterprises customer inflows and other wholesale inflows.

*(iv) Retail and small and medium enterprises customer inflows*

4.69 A bank is assumed to receive all payments (including interest payments and instalments) from retail and small-business customers that are performing and contractually due in a 30-day horizon. At the same time, however, reporting entities are assumed to continue to extend loans to retail and small business customers, at a rate of 50 percent of contractual inflows resulting in a net inflow number of 50 percent of the contractual amount.

*(v) Other Wholesale inflows*

4.70 A bank is assumed to receive all payments (including interest payments and instalments) from wholesale customers that are performing and contractually due within the 30-day horizon. In addition, banks are assumed to continue to extend loans to wholesale clients at 50 percent of expected inflows from corporates, including non-financial corporates, sovereigns, multilateral development banks, and public sector entities, while no credit is expected to be issued to commercial and central banks, hence an inflow rate of 100 percent. This will result in an inflow percentage as in Table 8.

**Table 8: Cash inflows by Counterparty**

Counterparty	Inflow Rates (percent)
Retail and small and medium enterprises customers	50
Non-financial wholesale counterparties	50
Financial institutions and central banks	100

*(vi) Operational deposits*

4.71 A bank will apply zero inflow rate for all deposits held at other financial institutions for operational purposes. It is assumed that operational deposits for activities such as clearing, custody and cash management purpose are kept at those institutions and no inflow can be counted for these funds.

*(vii) Other cash inflows*

- 4.72 Derivatives cash inflows: the sum of all net cash inflows should receive a 100 percent inflow rate. The amounts of derivative cash inflows and outflows should be calculated in accordance with the method under *derivative net cash outflows* at paragraph 4.39.
- 4.73 Where derivative payments are collateralised by HQLA, the bank shall determine the expected cash inflow net of any corresponding cash or collateral outflows that would result, all other things being equal, from contractual obligations for cash or collateral due to the derivative counterparty, owing to the fact that these contractual obligations would reduce the stock of HQLAs.
- 4.74 Other contractual cash inflows: banks should explain to the Bank all other contractual cash flows included in this category. These items receive an inflow rate of 100 percent. Cash inflows related to non-financial revenues are not considered in the calculation of the net cash outflows for the purposes of the LCR.

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**DIRECTOR**  
**PRUDENTIAL AUTHORITY AND PAYMENTS OVERSIGHT DEPARTMENT**