

ILAAP Unpacked

*A Strategic Guide
for UAE Banks*

In good times, liquidity risk in banking is "unknown," but during difficult times, it becomes "known". Over the past decade, global liquidity events have proven that maintaining and monitoring suggested regulatory ratios alone is not enough to ensure survival. "Are we truly liquid when under stress, and are we ready to take the right action when it is most needed?" is now the question instead of "Do we meet regulatory liquidity metrics?"

This is the first in a series of articles explaining the Draft ILAAP Guidelines issued by the Central Bank of the UAE (CBUAE). The purpose of the series is to demystify the regulatory expectations for the Banks licensed by CBUAE, while drawing on the lessons learnt from other global and regional supervisory experiences.

There is considerably more to the Internal Liquidity Adequacy Assessment Process (ILAAP) than merely complying with regulations. Instead, banks and financial institutions should see it as a framework that links strategic decision-making with regulatory requirements.

A. Regulatory *Context*

The Central Bank of the UAE (CBUAE) has formally outlined its expectations on internal liquidity assessment through the issuance of the Draft Internal Liquidity Adequacy Assessment Process (ILAAP) Reporting Guidelines (published in December 2025). This draft guidance considers ILAAP as an integral part of the Liquidity Supervisory Review and Evaluation Process (LSREP) and requires banks to submit an ILAAP report annually for supervisory review.

The Draft Guidelines emphasize that ILAAP should be bank-driven and applied proportionately, taking into account each bank's and financial institution's business model, the structure of its Balance Sheet, and its overall risk profile. Banks must understand liquidity adequacy beyond existing Pillar 1 ratios to facilitate more robust Balance Sheet planning. .



Key regulatory expectations outlined in the draft guidance include:

- The Board and Senior Management must review, challenge, and approve the ILAAP.
- ILAAP should cover all material liquidity risks, with emphasis on identifying risks across assets, liabilities, and off-Balance-Sheet items, including funding, market, intraday, concentration, cross-currency, and off-balance-sheet risks.
- Liquidity stress testing should be comprehensive by considering institution (Bank) specific, market wide & combined stress scenarios across a range of time horizons.
- Definition of liquidity risk appetite, supported by limits, monitoring indicators, and escalation processes.
- Linkage between ILAAP results and funding strategy, contingency funding planning, and business decisions.
- Strong focus on documentation, transparency, and comparability.



Banks are expected to demonstrate not only that the framework exists, but also that it is used appropriately in liquidity risk management.

B. ILAAP:

More than just Compliance- A strategic Imperative

ILAAP's objective is to assess whether a bank's funding structure is adequate, considering its activities and risk appetite.

Typical pillar 1 liquidity ratios, such as LCR, NSFR, ELAR, ASRR, and LDR capture all dimensions and time horizons of liquidity risk. However, these metrics do not incorporate the full range of stress scenarios to which a Bank may be exposed and are inherently static, reflecting the bank's position at a specific point in time rather than forward-looking. Thus, ILAAP necessitates that banks:

- Consider liquidity risk in business planning, balance sheet projections, and ongoing operations.
- Assess short-term liquidity using ratios like LCR and ELAR, and longer-term funding stability via NSFR, ASRR, and LDR
- Evaluate material liquidity risks together and in isolation as well to assess the sensitivity
- Link stress testing outcomes to management actions, funding strategy, and Balance Sheet decisions.

For banks, an effective ILAAP framework supports more informed decisions when it focuses on the following parameters :

01



Understanding Funding Weakness

Identify areas where funding sources are vulnerable

02



Align Growth Plans

Ensure expansion strategies are supported by adequate funding

03



Strengthen Board Oversight

Enhance the Board's role in managing liquidity risk

04



Support Supervisory Discussions

Engage in structured dialogues with regulators

By mixing a flavor of stress testing into this growth plan, the ILAAP framework becomes a further meaningful exercise.

ILAAP Framework

01



Conservatism and stress scenarios

Level of conservatism and severity of stress scenarios

02



Liquidity Risk Governance

How Liquidity risks are governed and escalated

03



Stress Resilience

Banks ability to handle severe liquidity stress

C. Practitioner's Perspective: *Lessons from ILAAP Engagements*

Successful ILAAP framework development depends more on how well the process integrates into a bank's liquidity risk management system than on formal paperwork. Supervisors in well-established regulatory environments, such as those governed by the Saudi Central Bank's (SAMA) ILAAP framework, have expectations that are comparable to those outlined in the CBUAE's Draft ILAAP Guidelines with regard to governance, proportionality, stress testing, and liquidity assessments.

The Banks generally face challenges related to the development of the ILAAP framework, and they may vary depending on the business models, funding sources, and Balance Sheet concentration of banks of various sizes and complexity. Banks with highly concentrated funding or asset profiles tend to witness stricter supervision and must provide a more detailed assessment of risk.

Banks that may primarily view ILAAP as a reporting obligation often struggle to demonstrate how they actively manage liquidity risks or how the results of stress testing influence their decisions. Conversely, more developed ILAAP jurisdictions typically exhibit the following challenges:

- Active involvement of the Board and senior management beyond formal approval processes
- A clear linkage between identified liquidity risks, stress testing outcomes, and defined management actions
- Stress assumptions that present the Bank's actual funding profile, depositor behavior, and market access conditions
- Alignment between ILAAP results, funding strategy, and contingency funding plans



These industry insights are especially relevant as UAE banks prepare to develop an ILAAP framework based on the CBUAE's Draft ILAAP Guidelines, which emphasize the importance of internal ownership, proportionality, and the effective use of ILAAP results in governance and decision-making.

D. Challenges *faced by Banks*

While the principles of ILAAP are well understood and established, the development of the framework These industry insights are especially relevant as UAE banks prepare to develop an ILAAP framework based on the CBUAE's Draft ILAAP Guidelines, which emphasize the importance of internal ownership, proportionality, and the effective use of ILAAP results in governance and decision-making.



The following page highlights the major real-time challenges faced by the banks

Challenges faced by the Banks:

- **Weak Linkage Between Stress Results and CFP**

Outputs from Stress testing often remain theoretical, with limited translation into actionable management responses or CFP triggers

- **ILAAP Treated as a Compliance Exercise**

LAAP is often treated as an annual regulatory submission rather than an embedded decision-making and planning tool.

- **Fragmented Governance**

Liquidity ownership is often split across Risk, Treasury, and Finance, leading to inconsistent assumptions and accountability issues.

- **Designing Stress Scenarios**

Developing severe yet plausible, institution-specific scenarios that reflect actual funding structures remains a key challenge.

- **Forward-Looking Capabilities**

Reliance on static balance sheets and simplified models constrains the ability to assess liquidity resilience over evolving conditions.

- **Weak Risk Appetite Calibration**

Risk appetite metrics can sometimes be backward-looking, which reduces its effectiveness as an early warning indicator.

- **CFPs That Exist Only on Paper**

Many contingency plans lack operational readiness, realistic testing, or clarity of roles during execution under stress.

- **Data and Infrastructure Constraints**

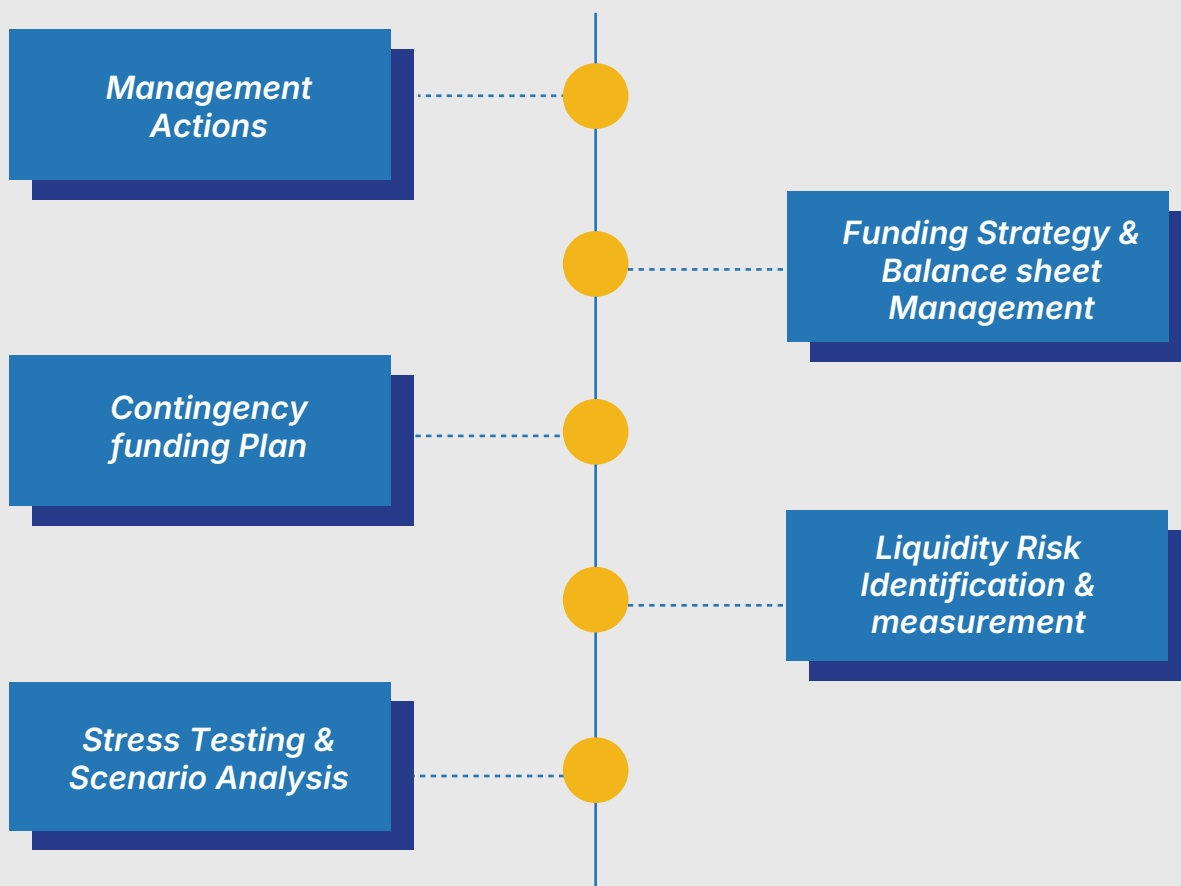
Fragmented data and manual processes impair the timeliness and reliability of liquidity assessments.

E. Closing *Note*

ILAAP has evolved from a regulatory requirement into a critical tool for forward-looking liquidity risk management, enabling banks to move beyond pillar 1 ratio compliance towards a more holistic and materiality based assessment of all potential liquidity risks.

Banks that proactively embed ILAAP into business planning, governance forums, and liquidity risk management processes will be better positioned to reflect resilience, supervisory readiness, and sustainable Balance Sheet management.

Below picture reflects the key elements of ILAAP over and above embedding a governance structure around ILAAP



To give an in-depth understanding of ILAAP, we will be publishing our next blog named "Funding Fortress: Building a Diversified and Resilient Funding Strategy." We will explore how Banks can align funding strategies with their strategic plans, financial forecasts, and macroeconomic conditions, assess their diversification across multiple dimensions, and determine funding requirements in a dynamic environment.

Contacts

Feel free to send your queries too :



Sandip Mukherjee
Co-Founder | Principal Consultant
Email : sandip.mukherjee@aptivaa.com
Phone : +91-98210- 41373



Vivek Gupta
Managing Director
Email : vivek.gupta@aptivaa.com
Phone : +91-77387 44327 | +971 50 764 0863

Authors



Shweta Joshi
Senior Manager
Phone : +91-97734 64399



Yash Sachdev
Senior Consultant
Phone : +91-95211 39397

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This paper provides a high-level overview and interpretation of the Internal Liquidity Adequacy Assessment Process (ILAAP) framework in line with applicable regulatory expectations. It is not intended to represent the official views of the CBUAE nor to substitute regulatory guidance. Institutions should consult a qualified professional advisor before making any decision or taking any action.