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Regulations on Liquidity Requirements, Compliance Procedures and Liquidity Risk Management

Issued in accordance with
Paragraphs one and three of Section 6 and Paragraph two of Section 37 the Credit Institution Law

1. General Provisions

1. Regulations on Liquidity Requirements, Compliance Procedures and Liquidity Risk Management (hereinafter - the Regulations) establish liquidity requirements and compliance thereof and are binding to the banks registered in the Republic of Latvia, and branches of banks of other Member States and foreign countries (hereinafter – the Bank).

2. Requirements referred to in Paragraphs 3.3, 40.2, 48–50 and 59 shall not be binding to branches of banks of other Member States and foreign countries.

3. To ensure liquidity the Bank shall:

- 3.1. develop liquidity management strategy, policies and procedures;
- 3.2. evaluate and plan the term structures of their assets and liabilities on a regular basis;
- 3.3. maintain liquid assets that are sufficient for settling liabilities, but not less than 30 percent of total current liabilities of the Bank (liquidity indicator). Current liabilities are demand liabilities and liabilities with a residual maturity of less than 30 days;
- 3.4. ensure efficient diversification in sources and tenor of funding;
- 3.5. determine the system of indicators for regular analysis and control of liquidity risk.

4. Explanation of terms used in the Regulations:

4.1. funding liquidity risk – risk that the Bank will be unable to ensure its current and future cash flows and collateral for borrowing the funding in the manner that the Bank's routine operation or the Bank's overall financial standing are not jeopardized;

4.2. market liquidity risk – risk that the Bank will be unable to sell its financial assets on desirable term without material loss in case of market collapse or due to insufficient market depth;

4.3. residual maturity – a time period from the last day of the reporting month until the contract expiration date or the repayment date under the contractual conditions;

4.4. liquidity buffer – available liquidity assets to enable the Bank’s ability to fill possible gaps in cash flows arising from a stress situation over a defined short period of time;

4.5. liquid assets – unencumbered funds and investments in financial instruments provided that they have a regular, unlimited market (they can be sold in a short period of time without material loss or used as loan collateral);

4.6. funds – cash at hand and short-term claims (including demand claims) on the central banks and solvent credit institutions;

4.7. other terms are used in compliance with terms used in the Credit Institution Law and Law on the Financial Instruments Market.

2. Liquidity Risk Management Policies and Procedures

5. The Bank’s board of directors and senior management shall be responsible for efficient management of liquidity risk and the development of strategy, policies and procedures and compliance thereof.

6. The Bank shall develop prudential liquidity risk management strategy, policies and procedures that enable the Bank to timely identify, measure, analyze and manage liquidity risk over an appropriate set of time horizons, including intra-day, so as to ensure that the Bank maintain an adequate level of liquidity buffer taking into account both funding liquidity risk and market liquidity risk.

7. Liquidity management strategy, policies and procedures developed by the Bank shall be proportionate to the Bank’s size and profile of liquidity risk, variety, complexity and volume of operations, as well as liquidity risk tolerance set in the Bank and shall reflect systemic relevance of the Bank in each Member State in which the Bank operates. The Bank shall ensure that every significant structural unit is notified of risk tolerance.

8. Liquidity management strategy shall cover qualitative and/or quantitative targets of liquidity management. Liquidity management strategy shall be developed taking into account also an impact of other risks (credit risk, market, operational and reputational risk) on the Bank’s liquidity (liquidity risk).

9. Overall (general) liquidity management strategy, policies and procedures developed by the Bank shall be tailored to the Bank’s business lines, currencies and group entities. The Bank shall calculate liquidity risk cost and benefits for every particular material business line or service provided.

10. The Bank’s liquidity risk management policies and procedures shall determine:

10.1. methodologies for the measurement of liquidity risk in accordance with requirements referred to in Paragraphs 18-23 of the Regulations;

10.2. procedures for the management of funding structure (positions), including identification, measurement and monitoring, in accordance with requirements referred to in Paragraph 24 of the Regulations;

10.3. procedures for the management of assets that can be used as loan collateral in accordance with requirements referred to in Paragraphs 25 and 26 of the Regulations;

10.4. analysis of critical situations (stress testing) in accordance with requirements referred to in Paragraphs 27–36 of the Regulations;

10.5. liquidity risk mitigation tools, including liquidity buffers, in order to ensure withstanding different stress events;

10.6. a contingency funding plan to withstand potential liquidity stress in accordance with requirements referred to in Paragraphs 37–39 of the Regulations.

11. The Bank shall regularly, but not less than once a year, review and enhance, if required, policies and procedures for liquidity management corresponding to changes in the Bank's activities and external events affecting the Bank's activities.

12. The Bank subject to consolidated supervision shall ensure efficient liquidity risk management in the consolidated group overall.

13. The Bank shall develop and document the procedure for notifying the Bank's management, determining detailed structure of the Bank's internal reporting of liquidity risks, reporting procedures and frequency.

14. The Bank's information system shall enable the possibility to evaluate the Bank's cash in-flows and out-flows, liquidity buffers and expected cash in-flows and expected cash out-flows at a fixed date in total and in each foreign currency in which the Bank performs significant amount of transactions (including the currency risk the Bank is exposed to indirectly) or whose market is illiquid.

15. The Bank's board of directors shall approve strategy and policies for liquidity risk management, as well as monitor liquidity risk management performed by the Bank's senior management and compliance of above activity with strategy and policies for liquidity risk management approved by the Bank's board of directors.

16. Implementing strategies and policies set by the board of directors, the Bank's senior management shall ensure liquidity risk management and approve the corresponding procedures, *inter alia*:

16.1. approve internal limits on liquidity indicators and funding concentration limits, monitor their compliance and determine measures in case of non-compliance with internal limits;

16.2. approve stress testing assumptions and frequency of stress testing;

16.3. regularly, but not less than once a year, review and, if required, enhance internal limits, funding concentration limits and stress testing assumptions based on changes in the activities of the Bank and external events that affect the Bank's activities;

16.4. regularly receive information on testing the efficiency of contingency plan to ensure withstanding potential liquidity stress, approve results and make decisions on the necessity to make amendments to the contingency plan to withstand potential liquidity stress based on the results of stress testing, as well as to timely reflect internal or external changes (e.g. changes in the Bank's organisational structure, opening of branches, new counterparties etc.).

17. The Bank shall ensure complete documentation of the liquidity management process, including documentation and approval at relevant managerial level of the Bank's internal procedures documents of the liquidity management (strategy (including the Bank's liquidity risk tolerance), policies, procedures, by-laws etc.) determining the methodology for the calculation of indicators used for the measurement of liquidity risk and their limits, methodology for determining funding concentration limits, methodology for the calculation

liquidity risk cost, stress testing procedure (including a description of stress scenario), determining internal limits, procedure for the measurement of financial instruments liquidity included in the calculation of the liquidity indicator (sale or collateral options), all underlying assumptions and their grounds, as well as other organizational and methodological aspects.

2.1. Liquidity Risk Measurement Methods

18. To measure liquidity risk the Bank shall:

18.1. assess term structure of current and future assets, liabilities and off-balance items broken down by financial instruments, different term bands compliant with the bank liquidity risk profile in total and in each currency, in which the Bank has performed a significant amount of transactions (including the currency risk the Bank is exposed to indirectly) or whose market is illiquid;

18.2. determine liquidity indicators to use in the analysis and monitoring of liquidity risk, for instance:

18.2.1. the share of liquid assets in total assets,

18.2.2. the share of loans granted to non-banks in total assets,

18.2.3. core funding (may include, for instance, capital and reserve, retail deposits and long-term wholesale deposits) versus illiquid assets,

18.2.4. loans granted to non-banks versus deposits,

18.2.5. the share of wholesale customer liabilities in total liabilities.

19. The Bank shall determine internal limits on:

19.1. assets and liabilities term structure liquidity net positions in lats and in each currency, in which the Bank has performed a significant amount of transactions (including the currency risk the Bank is exposed to indirectly) or whose market is illiquid;

19.2. other liquidity indicators which the Bank has set for the liquidity risk monitoring.

20. In establishing the procedure for the calculation of liquidity indicators and setting limits the Bank shall consider objectives of activities and risk tolerance.

21. The Bank shall determine and regularly analyze a set of early warning indicators that may aid to identification of vulnerabilities in the Bank's liquidity risk position and necessity to raise additional funding.

22. Based on early warning indicators data, the Bank shall identify negative trends that may affect liquidity, analyze them and assess the necessity to mitigate the Bank's exposure to liquidity risk.

23. Early warning indicators can be both qualitative and quantitative and may include the following ratios:

23.1. rapid asset growth (e.g. above the average in the sector), in particular when the Bank has a high concentration of volatile funding sources;

23.2. growing concentrations in certain assets (asset group) or liabilities (liabilities group) (changes in asset and/or liabilities concentration);

23.3. increase in asset and liabilities term structure mismatches, including in certain currencies;

23.4. a decrease in weighted average duration of liabilities;

23.5. repeated incidents of breaching internal limits (frequent modification of limits);

23.6. significant deterioration in the Bank's earnings, asset quality and overall financial condition;

23.7. negative trends in the national economic sectors where significant loans are issued to enterprises;

23.8. negative publicity in the mass media regarding the Bank or related persons that undermine the Bank's reputation;

23.9. the Bank's credit ratings downgrade;

23.10. material increase in debt costs;

23.11. an increase in the number of cases where counterparties (correspondent banks) reduce their credit lines for transactions with the Bank;

23.12. increasing number of requests for additional collateral for credit exposures or refusals to enter into new transactions;

23.13. encumbered refinancing options in the interbank markets;

23.14. deposit outflows, including increasing number of deposit withdrawals before maturity.

2.2. Funding Structure

24. To manage and monitor funding structure (positions) the Bank shall:

24.1. evaluate the Bank's funding structure on a regular basis, i.e. dependence of the Bank on the certain types of attracted resources, in particular, on the loans in the interbank, money and capital markets;

24.2. evaluate sources of funding and the ability to quickly raise funds from the funding sources;

24.3. ensure effective diversification of sources and tenors of funding, including determine limits on concentration, where appropriate, for instance, limits on the maximum amount permitted to attract from one customer (groups of connected customers), limits on resources of the Bank's group entities and other entities, secured versus unsecured market funding, certain types of financial instruments, repayment terms (contractual or projected), currencies, geographical regions, residents and non-residents.

2.3. Management of Assets that can be Used as Collateral

25. The Bank shall measure and monitor its collateral positions (assets that the Bank can use as loan collateral (for raising resources)) in each currency and in the state where the Bank has been carrying out a significant amount of transactions, including:

25.1. the Bank shall constantly have accurate information on the unencumbered assets and the assets currently pledged as loan collateral (to attract funds) that are available in particular during emergency situations;

25.2. the Bank shall regularly assess the eligibility of each asset (asset class) for pledging as loan collateral (central bank eligibility, acceptability of asset as collateral with other potential counterparties (in the interbank market), minimum timing requirements for conclusion of transaction and receiving funds, the difference between the funds and fair value of their collateral) and shall be aware of all legal, regulatory and operational impediments for pledging unencumbered assets and transfer of liquid assets across the Banks (group entities) both within and outside the European Economic Area;

25.3. the Bank shall be aware of physical location of assets acceptable as collateral (e.g., a custodian bank of financial instruments or securities settlement system) and possibilities of their mobilization.

26. The Bank shall diversify the assets that can be used as collateral, taking into account possible (legal, regulatory and operational) impediments for availability of funds (conclusion of transactions), price fluctuation, discounts (possible decline in the price, difference between accepted funds and fair value of their collateral), additional requirements for collateral in stress situations etc.

2.4. Stress Testing

27. To identify sources of potential liquidity problems and identify the required amount of liquidity buffer, the Bank shall regularly, but not less than once a half-year, conduct stress tests (i.e., analyze and evaluate potential development scenarios for different timing horizons and degree of stress conditions), including the scenarios as follow:

27.1. institution-specific stress scenario – the Bank’s internal adverse events, for instance:

27.1.1. the Bank’s liquidity problems resulting from reputational risk events,

27.1.2. the Bank’s credit rating downgrade,

27.1.3. significant utilization of the Bank’s credit lines before their expected historic maturity,

27.1.4. retail deposit outflows, decrease in long-term deposits,

27.1.5. rapid outflow of legal entities (large customers), in particular non-residents,

27.1.6. stringent limitation on pledging assets, additional collateral request;

27.2. market-wide stress scenario – changes in general market conditions, for instance:

27.2.1. simultaneous inaccessibility of resources in previously highly liquid markets and decrease in the Bank’s liquid assets value,

27.2.2. liquidity loss in the security markets,

27.2.3. withdrawal of major systemic market participant from the particular market,

27.2.4. constraints in the interbank market,

27.2.5. restrictions on the currency convertibility,

27.2.6. payment and settlement system disruptions, in particular, if the Bank operates with a reliance on the funding of the Bank’s group;

27.3. combined stress scenario (both institution-specific and market-wide, simultaneously).

28. The scenarios used for stress testing shall be extraordinary, with sufficiently severe impact, but not impossible. The number of scenarios and their granularity shall depend on the variety and level of complexity of the Bank’s business lines, the business model and the size of the Bank.

29. In the development of assumptions underlying the "Institution-specific Stress Scenario", the Bank shall assess an impact of the scenario on the sources of funding, taking into account behaviour of different customers. For instance, the Bank can project that due to exacerbation of market stress the Bank’s unsecured wholesale funding will be not extended but secured funding will be not affected, that the outflow of deposits fully covered by guaranteed compensation in accordance with the provisions of the Deposit Guarantee Law (or similar provisions of laws of other countries) will be less than the outflow of deposits above the guaranteed amount, that the outflow of deposits placed by the customers related to the Bank will be less than the outflow of deposits placed by the customers that are not related to the Bank, that in case of credit rating downgrade the repayment of syndicated loans will be required before maturity, that counterparties will require additional collateral from the Bank

or the credit lines granted by Bank will be prematurely utilized etc. The Bank shall consider also other possible changes in liabilities. The Bank, which acts as sponsor in relation to a securitisation special purpose entity or provides material liquidity support to such special purpose entity, shall also consider an impact of the activities of above entity on the Bank.

30. In the development of assumptions underlying the scenario "Market-wide Stress Scenario" the Bank shall consider an impact of scenario on the Bank's asset liquidity and shall develop assumptions regarding the deterioration in sale and pledging possibilities for certain financial instruments. For instance, the Bank can project an increase in the sale and pledging discounts (haircut, i.e., likely loss due to rapid asset sale or the difference between the value of loan and the value of the collateral securing that loan).

31. In the stress testing the Bank shall analyze at least two phases of stress, i.e. short-term acute phase (for instance, between one and two weeks) and protracted but less acute phase of stress (for instance, between one and two months).

32. The Bank shall develop and apply underlying assumptions of stress scenarios for the Bank's expected cash out-flows and expected cash in-flows and liquid assets, and shall consider appropriate liquidity buffer for a particular time horizon.

33. Liquidity buffer shall be adequately diversified in line with currency, residual maturity and counterparties to ensure that the Bank does not rely only upon one particular type of liquidity provision (for instance, only on borrowings from the Bank of Latvia).

34. The Bank shall provide for establishment of conservative, statistically and economically justified assumptions.

35. Based on stress testing outcomes, the Bank shall develop an effective contingency funding plan to withstand potential liquidity stress, as well as enhance, if required, liquidity risk management strategies, policies and procedures, including limits.

36. The Bank shall ensure conducting stress tests also in accordance with the scenario and assumptions determined by the Financial and Capital Market Commission (hereinafter – the Commission), if requested.

2.5. Contingency Funding Plan

37. Contingency funding plan to withstand potential liquidity stress shall comprise of procedures and internal coordination measures that the Bank's management projects to implement in case of the occurrence of adverse scenario in order to mitigate an impact of the adverse events on the Bank in a timely manner and at a reasonable cost.

38. Contingency funding plan to withstand potential liquidity stress shall determine:

38.1. responsible persons (as well as designation of alternates and all related persons), their functions, their authority, including enabling them to take necessary measures in stress situations, specification of responsibilities, information exchange and management communicating procedures;

38.2. description of trigger events;

38.3. detailed action plan, i.e. measures to be taken and required timeframe (for instance, in order to raise funds);

38.4. potential accessible sources of funding and amounts that could be attracted in case of the occurrence of adverse scenario;

38.5. communication (time and manner the measures are taken) with the Bank's staff, customers, depositors, borrowers, shareholders, the Bank of Latvia, the Commission and foreign supervisory authorities, where appropriate, and mass media representatives.

39. The Bank shall regularly, but at least once a year, review efficiency of the contingency funding plan to withstand potential liquidity stress (test internal procedures, topicality and credibility of underlying assumptions (for instance, assess the difference between accepted funds and fair value of their collateral)).

3. Reporting for Supervisory Purposes

40. The Bank shall draw up the following reports for supervisory purposes:

40.1. "Report on Term Structure of Assets and Liabilities";

40.2. "Calculation of Liquidity Indicator";

40.3. "Report on Expected Cash Flows ";

40.4. "Report on Funding Concentration".

3.1. Report on Term Structure of Assets and Liabilities

41. The Bank shall prepare the "Report on Term Structure of Assets and Liabilities" in accordance with the form (Appendix 1 of the Regulations).

42. In the "Report on Term Structure of Assets and Liabilities" assets are grouped by residual maturity to repayment or sale, while liabilities and off-balance sheet liabilities are grouped by residual execution term.

43. Off-balance sheet liabilities shall be included in the Report where there is a reason to deem that the counter-party will request honouring of such liabilities. Off-balance liabilities that are secured with a deposit placed with the Bank shall not be included in the Report.

44. Agreements on receiving loans with parent companies may be stated as off-balance claims.

45. Assets for which special provisions have been made shall be reported in accordance with residual value.

46. In preparing the "Report on Term Structure of Assets and Liabilities", the following conditions shall be observed:

46.1. residual maturity or sale term of assets shall be determined in accordance with the repayment or sale term as stated in the effective agreement or in accordance with accepted notifications of early repayment;

46.2. assets invested with the option to receive them on demand shall be included in the maturity group "On demand";

46.3. regardless of requirements of Paragraph 46.1 of the Regulations, available-for-sale financial instruments, which can be sold in a short period of time without considerable loss, as well as financial instruments, which can be used as collateral for loans, shall be reported as

assets "On demand" or in the maturity group according to the possible sale term for the respective financial instrument or term for likely receiving a loan;

46.4. assets without definite repayment or sale term shall be deemed termless deposits and shall be presented in the maturity group "Over 361 days";

46.5. assets or any part thereof where the payment is overdue for more than 14 days shall be reported as overdue assets;

46.6. assets or any part thereof where the payment is less than 14 days overdue shall be reported as assets "On demand";

46.7. assets or any part thereof that are encumbered to secure liabilities of the Bank or Bank's branch, including those involved in repo transactions, shall be reported as pledged assets. Commitments whose execution is secured by the above assets shall be reported as borrowing against asset collateral;

46.8. the residual maturities of liabilities shall be determined in accordance with the execution term under the effective agreement or in accordance with accepted notifications of early repayment;

46.9. liabilities with an indefinite execution term where there is an obligation to meet them upon demand shall be reported in the maturity group "On demand";

46.10. deposits pledged by the customer with the respective Bank or Bank's branch to receive a credit (guarantees and other similar collateral) shall be reported in the respective maturity group according to the residual collateral term;

46.11. liabilities for deposits that have fallen due, but that are not demanded by the customer shall be reported in the maturity group "On demand".

47. The term structure of assets and liabilities shall be evaluated by calculating the net liquidity position as difference between assets and liabilities in each maturity band and the overall liquidity position – as difference between assets and liabilities in ascending order of maturities.

3.2. Calculation of Liquidity Indicator

48. The Bank shall prepare the "Calculation of Liquidity Indicator" in accordance with the form (Appendix 2 of the Regulations).

49. In the "Calculation of Liquidity Indicator", the following unencumbered assets shall be deemed as liquid assets:

49.1. cash at hand;

49.2. demand claims on the Bank of Latvia and solvent credit institutions;

49.3. those claims on the Bank of Latvia and solvent credit institutions with a residual maturity of less than 30 days, and deposits with other maturity, where the contract provides for their early withdrawal (except the amount of penalty for early settling liabilities; if any provided in a contract);

49.4. investments in financial instruments provided that they have a regular and unlimited market, i.e. they can be sold in a short period of time without material loss or used as loan collateral.

50. When evaluating the sale options of a certain financial instrument, the Bank shall consider the safety of financial instruments market, as well as factors characteristic of liquidity of financial instruments, for instance, the number of daily transactions and the proportion of the amount of financial instruments available for the Bank to the amount of daily sales and purchases.

3.3. Report on Expected Cash Flows

51. The Bank shall prepare the "Report on Expected Cash Flows" in accordance with the form (Appendix 3 of the Regulations).

52. In the "Report on Expected Cash Flows" the Bank shall state the expected cash out-flows and expected cash in-flows (out-going and incoming payments), as well as estimated liquid assets and potential funding sources for seven days broken by currencies, i.e. in the lats, euros, US dollars, as well as in all currencies in the total.

53. In the "Report on Expected Cash Flows" the Bank shall project cash out-flows and cash in-flows in a prudent manner and shall ensure that the underlying assumptions are conservative, based on the Bank's experience and economically justified.

54. Upon request of the Commission, the Bank shall ensure an option to prepare the "Report on Expected Cash Flows" for the situation as of the date set by the Commission.

3.4. Report on Funding Concentration

55. The Bank shall prepare the "Report on Funding Concentration" in accordance with the form (Appendix 4 of the Regulations), where the following information shall be provided:

55.1. 10 customers (groups of connected customers) having largest deposits at end of the reporting period;

55.2. total amount of deposits of all persons related (associated) with the Bank, except credit institutions;

55.3. if the Bank's liabilities to credit institutions exceed 10 percent of the Bank's total liabilities (i.e. the amounts given in row 2000 of the "Report on Term Structure of Assets and Liabilities"), the Bank shall indicate five credit institutions to which the Bank has the largest liabilities at end of the period.

56. In preparing the report on 10 customers having largest deposits, following conditions shall be observed:

56.1. calculating deposits of a customer, all the funds in the customer's accounts shall be considered in any currency converted in the lats in accordance with exchange rate set by the Bank of Latvia on the last date of the reporting period;

56.2. customer's number shall be given as a consecutive number (without dot) and each customer of the group of connected customers shall be granted with the same number that corresponds to the number of group in the Report.

57. Largest liabilities to credit institutions shall be calculated in net value, i.e. claims on the relevant credit institution shall be taken from all liabilities to the credit institution arising from transactions with that credit institution. All the Bank's liabilities and claims on the relevant credit institution shall be considered in any currency converted in the lats in accordance with exchange rate set by the Bank of Latvia on the last date of the reporting period.

4. Reporting Procedures

58. "Report on Term Structure of Assets and Liabilities" shall be compiled for the situation as of the last date of the reporting month and shall be submitted to the Commission by the 15th of the next month.

59. "Calculation of Liquidity Indicator" shall be compiled for the situation as of the last date of the reporting month and shall be submitted to the Commission by the 15th of the next month.

60. "Report on Expected Cash Flows" shall be compiled on the situation as of the last date of the reporting month and shall be submitted to the Commission within next business day (for instance, the Bank prepares the Report for the period 1 April to 7 April 2010 (inclusive), presenting estimated liquid assets and potential funding sources for the situation at the beginning of reporting period and submits the Report to the Commission on 1 April). Upon request, the Bank shall submit to the Commission the "Report on Expected Cash Flows" on the situation as of the business day, indicated by the Commission, within next business day.

61. "Report on Funding Concentration" shall be compiled for the situation as of 31 March, 30 June, 30 September and 31 December of the reporting year and shall be submitted to the Commission by the 15th of the next month.

62. Reports shall be prepared in accordance with the Regulations for Submission of Electronically Prepared Reports of 14 October 2008 approved by Decision No.146 of the Board of the Commission.

63. If the Commission ascertains that a Report is compiled erroneously, the submitter of the report shall be notified thereof. Unless another time limit is set by the Commission, the corrected report shall be submitted repeatedly no later than the next business day upon receipt of the notification from the Commission regarding the possibility of errors.

5. Closing Provisions

64. The Regulations shall take effect on 01.04.2010.

65. With the Regulations taking effect, the Commission's Regulations for Compliance with Liquidity Requirements (Regulations No.166) of 23.12.2005 shall become null and void.

Chairwoman
Financial and Capital Market Commission

I. Krūmane

**THIS DOCUMENT IS SIGNED ELECTRONICALLY WITH
A SAFE ELECTRONIC SIGNATURE AND CONTAINS A TIME STAMP**