A clearer picture

Intraday liquidity risk has been a focus for regulators since the start of the financial crisis. Peter Hainz of SmartStream discusses how the banking industry is currently faring with the implementation of the Basel Committee's monitoring tools for intraday liquidity management

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The regulatory picture

Published in April this year, the 14th progress report on the adoption of the Basel regulatory framework sets out the adoption status of Basel III standards for each Basel Committee on Banking Supervision (BCBS) member jurisdiction as of the end of March this year. The report, among other matters, considers how states are progressing with the introduction of the monitoring tools for intraday liquidity management, which the BCBS has recommended supervisors to implement.

The BCBS review found that a number of countries have reached the fourth stage of implementation—stage four is reached when the final intraday rule is in force, and the domestic legal and regulatory framework has been published and is put into practice by banks.

Europe

In the EU, France, Germany, Italy, the Netherlands, Spain, the UK, as well as Belgium and Luxembourg have all achieved stage four of implementation. EU regulation (article 86 (1) of the CRD) sets out that institutions shall have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of intraday liquidity risk. Looking outside the European Union, Swiss Financial Market Supervisory Authority (FINMA) started intraday liquidity monitoring of Switzerland's five largest banks on 1 January 2015. The rule setting out the requirement to monitor intraday liquidity was published in Russia in December 2015 and has been in force there since January 2016. Implementation in Turkey commenced in January 2017.

The Middle East and Africa

BCBS 248 intraday rules are in force in Saudi Arabia, South Africa and India. In Saudi Arabia, the final rule was published in June 2016 and came into operation on 1 January 2017. In South Africa, amended requirements were incorporated into regulations and came into play on 1 July 2016. The rulings came into effect in India on 3 November 2014.

Asia and the Pacific

Australia and Singapore have introduced and implemented BCBS 248, while local licensed banks in Hong Kong began monthly reporting of intraday liquidity positions at the end of October 2015. The final rule is also in operation in Indonesia, where regulation was issued in December 2015 and came into force in January 2016. In contrast, China has not published a draft regulation. Intraday policy, however, is under development. Japan is listed, too, as not having published a draft law, regulation or other official documents. A final intraday draft rule is under development in South Korea.

The Americas

Regulation regarding liquidity management has been in force in Brazil since January 2013. Canada and Argentina have finalised and published local legal and regulatory framework but adoption by their banks is still underway. Mexico has an intraday draft under development, with publication expected later in 2018.

Interestingly, the 14th progress report on the adoption of the Basel regulatory framework notes the US as a country where the draft intraday regulation is not published. Industry participants which have undergone liquidity reviews have, however, provided feedback that the Federal Reserve System has a strong focus on intraday monitoring.

Regulatory interest in the quality of banks' technology

Answering the demands of the new regulatory regime has put banks' IT systems in the spotlight. Financial authorities are now interested in the quality of the technology financial institutions use to meet their intraday liquidity monitoring and management responsibilities. Take the case of the UK, for example. In February this year, the Prudential Regulatory Authority (PRA) published its Statement of Policy Pillar 2 Liquidity. In relation to the overall assessment of intraday liquidity risk, where an add-on is applied to mitigate intraday liquidity risk, the PRA stated it would take into account a firm's mean maximum net debits, its stress testing framework, relevant market characteristics but, importantly, also the quality of the firm's operations, process, technology and policy.

Clearly, the UK regulator is keen to know how good banks' IT systems are and how 'real-time' their monitoring and management of intraday liquidity truly is.

Overhauling technology to meet regulatory demands brings challenges but banks are realising that having the appropriate IT systems can bring advantages, beyond just an ability to satisfy regulators.

Macroeconomics

Financial institutions must now respond to speedily unfolding, sometimes unpredictable geopolitical events—often caused by Twitter messages. Emerging markets are currently subject to greater fluctuation, too. With ultra-low US interest rates, quantitative easing and a relatively weak dollar since the start of the financial crisis, borrowers have piled into dollar-denominated debt. Increasing US interest rates have led to more volatile emerging markets as countries are hit hard, finding that their dollar-denominated debt is suddenly not so cheap.

In the low-interest rate environment, banks held cash buffers. With the Federal Reserve increasing rates and facing markets shaped by often unpredictable geopolitical and macroeconomic events, banks are having to rethink the way they manage cash and liquidity. They want greater visibility into the funds they hold, giving them both more flexibility to respond to events and the ability to manage their money more profitably.

Technology challenges

Achieving clear visibility of cash and liquidity is more easily said than done, however. At many financial institutions—especially tier two and three banks—cash management remains a manual, end-of-day activity. There is no way to track actual positions without real-time automation and so poor management of funds leads to missed opportunities and increased costs. As one senior manager remarked to the author, 'I am flying blind without real-time cash and liquidity data, I need a real-time view on account and currencies'. To make matters worse, banks have inherited a slew of legacy systems—

the result of successive rounds of mergers—further obscuring the understanding they have of their cash and liquidity situation.

To get around these weaknesses, firms must consolidate existing siloed infrastructures into one automated enterprise-wide solution. Ideally, such a cash and liquidity monitoring and management platform should provide a unified, global view across all currencies and accounts.

Only with this type of single system in place can the institution, with all its subsidiaries, ensure that liquidity buffers and limits are set correctly. The technology chosen should also be able to work with different message types, from SWIFT through to Saudi Arabian Riyal Interbank Express (SARIE).

Systems must meet other requirements, too, as a brief overview reveals.

The back office

Banks' back offices are eager to move away from the use of end-of-day data. If there is, for example, a big payment in the afternoon, banks do not have visibility of what happened in the morning with yesterday's end-of-day-data. Real-time automated cash and liquidity monitoring and management solve this problem.

They want systems that allow them to gather and reconcile high quality, real-time data, which can then be channelled into functions such as cash sweeping, account forecasting, exception management and the central control of payments—activities vital for ensuring the efficient management of intraday liquidity.

Financial institutions are keen to establish increased control over and visibility into the payment process in order to resolve issues and to ensure that payments are released on time. This is also in keeping with regulatory objectives, for example, BCBS 144, which states that "a bank should have a robust capability to manage the timing of its liquidity outflows in line with its intraday objectives".

Consequences of the above are that firms looking to enhance their payment scheduling capabilities to throttle payments based on intraday liquidity usage.

The middle office

Banks and supervisors should also consider the impact of a bank's intraday liquidity requirements in stress conditions.

As guidance, four possible (but non-exhaustive) stress scenarios have been identified by BCBS 248—their own financial stress, counterparty stress, a customer bank's stress and market-wide credit or liquidity stress. Risk management and analytics required to support these tests are generally provided by the middle office.

The front office

In the past, cash and liquidity monitoring and management fell, primarily, to the back and middle office. Today, front offices (for example, FX and MM Treasury desk) increasingly ask for a real-time cash ladder view—a cash and liquidity forecast per currency, based on real-time data.

Another issue in the front office concerns the use of longs to cover shorts. All too frequently, one entity within a bank goes to the market to borrow when the necessary funds are, in fact, actually available in another part of the organisation but invisible because of the lack of enterprise-wide transparency. This shortcoming results in extra and unnecessary costs.

Finally, it is important for the front office to be able to prove to regulators that money can be moved rapidly, should that be necessary.

Regulators and technology

Interestingly, there also is an increasing demand amongst supervisors to enhance the quality of their technology. This includes, for example, using artificial intelligence in order to detect anomalies automatically in the vast quantities of reporting data, which financial authorities must gather.

Conclusion

BCBS 248 was published in 2013 but fast forward to the present and banks have gone beyond simply seeing intraday liquidity risk as a regulatory play. Financial institutions are realising that a clear and accurate view of intraday liquidity also allows a more agile response to the shifting tides of macroeconomic events and promotes banks' ability to survive in today's highly competitive, rapidly evolving commercial environment. In order to achieve the necessary visibility, banks must create an accurate, real-time, holistic view of all money movements, that can provide not only the back and middle office with a clear picture of cash and liquidity but the front office, too. AST

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