New European Central Bank guidelines extend active monitoring to intraday liquidity – but are banks ready to meet the ECB's latest expectations?

November 2018 saw the publication of the ECB's final guides on banks' internal capital and liquidity management. The non-legally binding guidelines, which came into effect on 1 January 2019, focus on financial institutions' internal capital and liquidity adequacy assessment processes (ICAAPS and ILAAPS).

The new guidelines make clear the ECB's desire for banks to strengthen their capital and liquidity adequacy assessment processes. Turning to the case of liquidity adequacy, they mark a shift in approach by the ECB: assessment of liquidity adequacy is set to change from a task undertaken on a periodic basis to satisfy a regulatory obligation, to an activity carried out regularly and proactively, as an essential part of good management.

The ECB reminds institutions that the ILAAP is an integral part of the overall management function, pointing to Article 86(1) CRD IV: "Competent authorities shall ensure that institutions have robust strategies, policies, processes and systems for the identification, measurement, management and monitoring of liquidity risk over an appropriate set of time horizons, including intraday, so as to ensure that institutions maintain adequate levels of liquidity buffers."

Furthermore, the ECB guide adds: "In addition to an adequate quantitative framework for assessing liquidity adequacy, a qualitative framework needs to ensure that liquidity adequacy is actively managed. This includes the monitoring of liquidity adequacy metrics to identify and assess potential threats over different time horizons, including intraday, in a timely manner, drawing practical conclusions and taking preventive action to ensure that regulatory and internal liquidity buffers remain adequate."

So are financial institutions in a position to monitor and manage intraday liquidity adequacy as actively as regulators would like them to?

Over the past few years, there has been a tendency for banks to concentrate on developing advanced solutions to support their customers' cash management needs – for example, online dashboards which display all the balances at the banks a client holds accounts with – while, due to other priorities, the same level of sophistication has not been a focus for banks' own operations. All too often, information on cash flows is held in disparate IT systems, rather than in one central repository, while liquidity requirements are shared between different business lines and treasuries using spreadsheets.

As data on cash flows is frequently held by banks in a web of IT systems that do not connect with each other, the picture these companies have of their financial position is far from real-time. Institutions are likely to struggle to understand, in a timely fashion, how demands on liquidity are generated, making both active intraday liquidity monitoring and management, and delivering accurate reporting on it, difficult to accomplish.

Treasury teams currently do not have the luxury of time to collate, monitor and manage intraday liquidity data efficiently. Increasing headcount is not the way ahead, either: it does not provide the necessary speed and, in any case, banks are under pressure to reduce operational overheads. Companies would do well, when looking to meet the ECB guidelines, to consider the potential offered by an advanced cash and liquidity management solution – one which rapidly identifies and consolidates cash flow information, as well as measuring, monitoring and managing it.

Such a solution may be built in house, although the cost of development and maintenance tends to be high. Another option is to invest in best-in-class third party technology. Such a system will be able to integrate data from disparate systems and create a single, comprehensive, up-to-the-minute view across nostros and financial accounts. This provides an immediate update on intraday liquidity, allowing decision-making based on real-time information and facilitating active cash management. The ability to generate cash ladders is another useful feature, enabling accurate forecasting of short-term liquidity and further promoting active cash management.

In conclusion, it is important that financial institutions do not view meeting the new ECB guidelines just as a box-ticking exercise. Where intraday liquidity is concerned, there are powerful economic arguments for getting one's house in order. Introducing advanced technology which allows a clear, comprehensive, real-time view of liquidity enables a bank to operate more efficiently and cost-effectively. It reduces reliance on expensive intraday overdrafts, allows the identification of idle balances which can then be made available for use, and enables reporting to be carried with far less operational cost than traditional approaches. And in today's tough financial markets, these are surely powerful incentives. **b**t

By Nadeem Shamim, Strategic Advisor, Cash & Liquidity Management, SmartStream Technologies