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Enabling real-time liquidity management

Heather McKenzie | 2/07/2019 9:00 am

Moving from retrospective to active, real-time liquidity management is the way of the future, yet challenges remain. What still needs to be done to make it a reality? Heather McKenzie reports.

Intraday liquidity management has been a thorn in the side of financial institutions for many years, and it became even more problematic following the financial crash of 2007/08. Whether it is liquidity to fund wholesale market business operations or for the provision of funds to corporate clients, financial institutions are under increasing pressure to ensure they effectively monitor and manage liquidity.

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The retrospective management of liquidity, where banks rely heavily on forecasts, is now deemed to be insufficient; banks can no longer afford to have funds languishing unused in accounts. But cost is not the only driver; to prevent a repeat of the global financial crisis, regulators have put pressure on banks to move from daily liquidity reporting to effective real-time liquidity management and monitoring.

On the positive side, key enablers of real-time liquidity management are converging, according to Ronan O’Kelly, London-based partner in the corporate and institutional banking practice at Oliver Wyman. “Domestic real-time payments, the rollout of Swift gpi for cross-border payments, open banking and the adoption of application programming interfaces, virtual accounts and so on are coming together,” he says. “However, we believe that sustained corporate treasurer demand and a concrete business case will be required for real-time liquidity management to take off.”

Non-bank competitors are also putting pressure on incumbent banks and Swift, adds Mr O’Kelly. However, these competitors have not yet reached scale. “At the very least, they are spurring incumbents into action and driving innovation elsewhere in the market,” he says.

Jerry Norton, head of strategy for IT consultancy CGI’s global financial services business, agrees that competition is spurring the move towards real-time liquidity management. “Swift and

other incumbents realise there is a lot of competition out there from fintechs such as Earthport and Ripple, who are showing how it can be done. This is a good thing,” he says.

Blockchain application?

An October 2018 report, ‘An Intraday Liquidity Market Using Blockchain Technology’, by consultancy Baringa with fintechs Fintium and R3, proposes and describes an intraday market solution using distributed ledger technology to help financial institutions better manage their intraday cashflows. The authors state that the direct cost and opportunity costs of holding excess liquidity are increasing, as are client demands for self-clearing. In addition, there is pressure on existing infrastructures for earlier availability of funds, while multiple stakeholders are also looking for more frequent and transparent reporting of intraday flows.

The paper suggests that an actively traded market for intraday liquidity, based on blockchain and a fiat-linked digital currency, would enable financial institutions to “walk the fine line of investing liquidity for a return and thus minimise opportunity costs associated with holding a large cash reserve, while still ensuring a sufficient pool is available to support unexpected outflows”.

Operational and efficiency issues could be addressed by combining retrospective intraday liquidity management with active intraday management. “The two goals are closely connected. An effective active intraday liquidity management process ensures that the retrospective intraday liquidity management tools are well positioned to serve the desired purpose and vice versa,” says the report. “As firms develop more robust data analytics capabilities for retrospective intraday liquidity management, the resulting operational improvements shape intraday forecasting and subsequent funding actions by helping firms better anticipate the ‘unexpected’ flows and efficiently meet all obligations in a timely manner.”

Conversely, as firms are better able to manage active intraday liquidity management via enhanced forecasting, they can move away from excessively conservative assumptions when calibrating the intraday liquidity buffer, reducing buffer costs and enabling the more efficient deployment of liquidity.

In discussions with banks, the report’s authors found that as the industry was moving closer to real-time active management, a blockchain-based solution could create industry value as an alternative to aged technologies. Blockchain, they say, is an attractive solution because securely shared data records across multiple parties can enable re-engineering of the related business processes, rather than incremental enhancement.

Breaking down silos

Many banks recognise the urgency of managing intraday liquidity more proactively, according to Nadeem Shamim, head of cash and liquidity management at SmartStream Technologies, particularly as it relates to liquidity buffers. If a financial institution can demonstrate it is effectively managing and monitoring intraday liquidity, then it can then talk to regulators about reducing its liquidity buffers. Moreover, better management of liquidity can also address profitability. “There is a lot of liquidity in institutions that is wasted,” says Mr Shamim. “Some reports say as much as 100 basis points of costs sit in liquidity reserves. With proactive intraday liquidity management that can be improved by between 10% and 30%, which could have a significant impact.”

The challenge rests in gathering information – not just from outside counterparties, such as

agent banks and central banks, but also from within an institution – in real time, says Mr Shamim. To address the internal challenge, SmartStream’s solution breaks down information silos by integrating data from core banking, credit and trading systems into a real-time feed. This creates a single, enterprise-wide solution for cash management, treasury management, exceptions management and reconciliations management. It also enables a global, real-time view of all money movements, cash and liquidity positions, to support optimal investment and lending opportunities.

How information is collected and disseminated is crucial, according to CGI’s Mr Norton. To achieve real-time liquidity management, four elements must be in place:

- A set of standards to simplify the collection of information;
- Networks to collect the information, including Swift and others;
- Information about accounts and transactions that have occurred must be available in real time;
- The involvement of market infrastructures.

“The logic is simple: a financial institution needs timely data on account balances and transactions,” says Mr Norton. “For that to happen, the standards, network, correspondent and market infrastructures all need to play ball. And for the first time, they are doing this.”

For example, Swift gpi’s Unique End-to-end Tracking Reference (UETR) number, which has now been adopted into ISO standards, is a critical first step. In March 2018, Swift extended its gpi Tracker, which uses the UETR, to cover all payment instructions sent across the network. This enables gpi user banks to track their Swift payment instructions at all times and provides full visibility over their payment activity to provide a better liquidity picture for their clients.

In the correspondent banking market, other network providers need to adhere to the tracking standard as well and have similar service level agreements in order to avoid fragmentation, according to Mr Norton. Market infrastructures are also important and could hinder progress if they do not have real-time capabilities. “As these market infrastructures renew their systems, they must ensure they can adhere to the universal tracking standard,” he says. “Some are beginning to do this, but banks cannot get a real-time position report in some markets.”

Liquidity buffers

Real-time clearing and settlement mechanisms, which will become quite distinct from the familiar territory of cut-off times, end-of-day processing and periodic updates to intraday liquidity positions, will have a fundamental impact on liquidity and collateral management, according to Vanessa Manning, head of liquidity and investment solutions, global transaction banking, at Deutsche Bank, in her introduction to a Deutsche Bank white paper entitled ‘Preparing for Real-time Liquidity’.

The way that banks calculate their intraday liquidity buffers is based on end-of-day batch processing and does not necessarily reflect the different risks associated with real-time flows and dynamic intraday liquidity due to the speed of liquidity changes and associated counterparty exposures. “Banks, regulators and infrastructure providers need to prepare for this in their risk and liquidity modelling and forecasting,” says Ms Manning. “The issue now is to understand the extent to which the industry is prepared for this shift, and what more needs to

be done.”

Collaboration across the industry will be essential to create, shape and realise the next generation of liquidity and collateral management. “Such collaboration is ambitious but achievable with the right inspiration, co-ordination and common objectives,” says Ms Manning.

The Deutsche Bank report identifies financial institutions’ real-time liquidity challenges, which include a lack of a standardised definition of real-time liquidity, a lack of consistency between banks in the analysis and management of real-time liquidity, obstacles posed by legacy technology, and different conditions across currencies.

These challenges are being met through collaboration, the sharing of expertise and presenting a single voice to regulators through industry associations such as the Bankers Association for Finance and Trade, as well as technology solutions to analyse and manage liquidity, and taking a regional or global view of liquidity.

Mr Norton believes real-time liquidity monitoring and management can deliver a competitive edge for financial institutions in commercial banking. “In retail banking, customers have different services and apps that offer real-time capabilities,” he says. “These have yet to percolate through to the corporate banking world, but they are beginning to emerge. If you are a bank that can offer corporates the ability to receive real-time balances, you’ll have a competitive edge because many banks can’t do that.”



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