Liquidity Risk Management

Impact on banks & consequences for Treasurers

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Banks that failed during the crisis

- Banks operate via maturity transformation, taking contractually short-term / callable deposits and lending at term.
- If significant numbers of customers wish to withdraw their deposits at the same time the bank will run out of liquidity, and the loss of confidence will trigger a bank run.
- This happened to Northern Rock during the financial crisis.

If liquidity risk crystallises solvent banks can fail rapidly

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Liquidity Risk – what is it?

"Liquidity risk is the risk arising from our potential inability to meet all payment obligations when they come due or only being able to meet these obligations at excessive costs. The objective of the Group's liquidity risk management framework is to ensure that the Group can fulfill its payment obligations at all times and can manage liquidity and funding risks within its risk appetite. The framework considers relevant and significant drivers of liquidity risk, whether on-balance sheet or off-balance sheet. "

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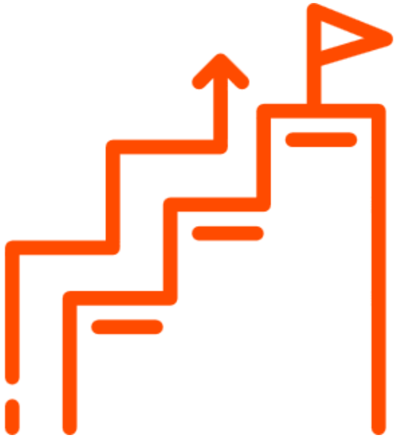
Regulatory Liquidity

- 2008 Financial crisis –
  - fundamental restructure of approach to risk & regulation

- Basel III framework is a set of global regulatory international standards whose objectives is to determine how much capital the bank needs to hold to manage the exposures it faces

Purpose

1. To strengthen global capital and liquidity regulations with the goal of promoting a more resilient banking sector
2. To promote the banking sector's ability to absorb shocks arising from financial and economic stress which in turn, would reduce the risk of a spillover from the financial sector to the real economy



Other regulation impacting liquidity

Liquidity regulation continues to evolve; capital measures affecting liability business.

- **Liquidity Coverage Ratio (LCR)**
  - A 30 calendar day, acute liquidity stress. It requires the coverage of stressed outflows with an eligible Liquid Asset Buffer (LAB) on a daily basis

- **Leverage Ratio**
  - Additional capital requirement from Basel III, implemented fully within the UK.
  - Calculated as Tier 1 Capital / Leverage Exposure.
  - For the first time the capital framework impacts the liability side of banks' balance sheets – short-dated financial deposits now have a capital as well as a funding impact.

- **Net Stable Funding Ratio (NSFR)**
  - Additional liquidity requirement from Basel III, not yet implemented within Europe.
  - Requires that long-term / illiquid assets are funded with long-term / stable liabilities
  - Long-term generally means commercial or >1Y wholesale.
  - Calculated as Available Stable Funding / Required Stable Funding.

Consequences for Treasurers

- ✓ Notional pooling trends
- ✓ Intraday limits
- ✓ Demand for stable deposits
- ✓ Embedded relationships
- ✓ Yields for surplus cash
- ✓ Premiums on operational balances

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2018 and beyond: Continued regulatory challenges

IFRS 9

Open Banking

MIFID2

GDPR

Brexit

Ringfencing

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