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A journey of transformation

Banks required to comply with new intraday liquidity rules need to overcome a number of challenges in order to source and collate the relevant data – but financial institutions should also be aware that managing intraday liquidity more proactively can result in considerable benefits, both for banks themselves and for their end clients, writes FX-MM's Rebecca Brace.

The last few years have brought numerous regulatory challenges for financial institutions, many of which have been introduced in the wake of the 2007-2008 crisis. While regulatory attention has been directed to many different areas of banking, one topic that has attracted particular focus is that of liquidity – with new rules bringing inconsiderable consequences for the banking landscape.

"The industry is facing greater regulatory scrutiny than ever before," comments Alex Lawton, Head of Securities Finance, Europe, Middle East and Africa at State Street. "Resulting factors, including greater capital requirements, have caused a retrenchment by banks from their traditional lending space. As a consequence, a new liquidity environment is emerging in which trading roles have been transformed, new market entrants such as hedge funds are emerging and electronic platforms and peer-to-peer lending are changing the way firms transact their business."

Against this backdrop, the area of intraday liquidity is one that has been the focus of recent attention, with new rules presenting further challenges for banks. The rules date back to Principle 8 of the Principles for Sound Liquidity Risk Management and Supervision published by the Basel Committee on Banking Supervision (BCBS) in September 2008. Principle 8 states that a bank should "actively manage its intraday liquidity positions and risks to meet payment and settlement obligations on a timely basis under both normal and stressed conditions". As such, banks should, among other things, "have the capacity to monitor intraday liquidity positions against expected activities and available resources".

This was followed in January 2013 by the publication of the Liquidity Coverage Ratio (LCR) under Basel III. Then, in April 2013, the BCBS published Monitoring tools for intraday liquidity management (BCBS 248), which supplement the qualitative guidance in the Sound Principles. Setting out tools which enable banking supervisors to identify and monitor banks' intraday liquidity risk, BCBS 248 states that "Internationally active banks will be required to apply these tools" and that the tools "may also be useful in promoting sound liquidity management practise for other banks".

Under the new rules, banks are required to provide regulators with monthly reports for each relevant country and currency, demonstrating that intraday liquidity positions are being managed appropriately. In order to achieve this, banks first need to have clear visibility over their intraday positions. BCBS 248 notes that gathering the necessary data may involve liaising closely with counterparts such as payment system operators and correspondent banks.

Implications of the new rules

Intraday liquidity monitoring is important because of the intraday exposures which arise as a result of banks' daily payment and settlement activities. Risk exposures can arise if a bank's outflows are greater than its intraday balance at any given time, particularly if expected receipts are delayed. As a result, banks could find themselves unable to meet time-specific obligations.

These concerns have become more pressing over the last few years as payment systems have evolved. "The increased inter-connection and inter-dependency between payments systems is amplifying the speed and scale of a potential impact if a party is unable to meet its payment obligations," says Rob Hetherington, GM and Global Head of Financial Services Industries at SAP. "The ability to react to such an issue quickly and efficiently is what the new intraday liquidity rules aim to address."

In addition, Hetherington says that the new rules are "providing transparency into how settlements are executed intraday, the level at which intraday liquidity is being used and by who, and how intraday credit lines are given and utilised. As a result of all of this data and information, banks will start to make behavioural and services changes."

It is clear that by making these changes, banks stand to benefit from more than just regulatory compliance. Christos Elefteriadis, Global Program Manager, Corona Cash and Liquidity at SmartStream,

says that many of SmartStream's customers have stated that they will be able to considerably reduce their operational intraday liquidity buffers as a result of managing their liquidity more actively. "Some are even estimating that they will reduce this by as much as 90%," he adds.

By reducing their liquidity buffer, banks can also reduce their cost of liquidity and achieve a lower FTP (Funds Transfer Price), resulting in higher margins for banks, as well as the ability to provide payment services more competitively. "I even see that the future pricing for payments could vary depending on what time of day clients want to do payments," Elefteriadis adds. "I can imagine that the market might move in that direction because the cost of liquidity can be different depending on when during the day a payment is settled."

The new intraday liquidity rules, or the transformation banks have to implement as a result of these rules, will provide more intraday visibility to corporate treasurers on their flows and positions, helping them to improve working capital management

Banks' end customers may also benefit from improved visibility as a result of the new rules. "The new liquidity risk framework has already had a big impact on corporate cash management services and the way corporate treasurers are managing cash," says Hetherington. "The new intraday liquidity rules, or the transformation banks have to implement as a result of these rules, will provide more intraday visibility to corporate treasurers on their flows and positions, helping them to improve working capital management."

Overcoming the challenges

As such, the new rules should be seen not only as a regulatory requirement, but as an opportunity to achieve business benefits. However, there are a number of obstacles that need to be overcome before these benefits can be realised. For one thing, banks need to have a clear understanding of the implications of the new rules – but for many financial institutions, this has yet to be achieved.

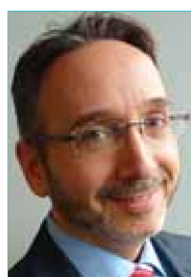
Alex Lawton
State Street

A Deloitte Advisory survey published last year found that 88% of the bank leaders surveyed said their institutions are affected by the new intraday liquidity rules. However, only 40% of those leaders said they have a clear understanding of the new regulations. In addition, the research found that half of the executives surveyed said their primary motivation for adopting changes in this area was the new regulations, rather than the opportunity to benefit internally from enhanced capabilities.

The survey also highlighted some other challenges faced by banks as they work to comply with the new rules. For example, the report notes that intraday reporting requires banks to "source, centralise and standardise the relevant data". However, only 7% of the bank executives surveyed said that their institutions had fully centralised their data sourcing. Where data quality is concerned, data on available cash was found to be better than data on the expected timing and inflow of payments.

While banks may face a number of different challenges in complying with the new rules, Hetherington cites data as a particular challenge, noting: "There has been a gap in data availability and also in the granularity, consistency and lack of standard business practice in the data exchanged." According to Hetherington, these issues are most pronounced in the context of correspondent banking services. He says that while the gap is being addressed by the industry, it will take time to get to the level of consistency required.

A further challenge noted by Hetherington is that the nature of the new rules requires a global approach to implementation – "one that stretches across entities, currencies, activities, functional divisions, geographies and time zones; all of which adds complexity."


Christos Elefteriadis
SmartStream

Beyond these issues, banks should also be cognisant of the costs involved in achieving intraday visibility. "Traditionally, banks have not always had intraday visibility, and have managed a lot of accounts, including nostro accounts, on an end-of-day basis rather than an intraday basis," says Elefteriadis. "Under the new rules, they need to get real time or near real time information during the day on an intraday basis, instead of just end-of-day information. There are ways to get the data of course – banks can, for instance, use SWIFT intraday messages."

However, Elefteriadis also notes that using more messages can have cost implications. "Receiving more messages through the SWIFT network can lead to higher costs," he says. "Also, some

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Rob Hetherington
SAP

correspondent banks have agreements with their serviced banks that allows them to charge quite a lot of money per message. So that's an issue for many banks." That said, Elefteriadis believes that as the market increasingly moves towards real-time payments, "the prices for these kind of messages, as the information is needed in order to have intraday capabilities and visibility, will basically go down."

Progress to date

While BCBS 248 had called for banks to implement the relevant monitoring tools by January 2017, progress in adopting the new rules has been mixed. "We are still at the early stage of adoption," says Hetherington. "The scope of the new intraday liquidity rules, as well as the timeline for their implementation, differ significantly between local regulators and supervisors."

That said, implementation is gaining momentum. "We are seeing a huge pickup in interest," says Elefteriadis. "People want to do this now because in many countries banks will be expected to comply towards the end of this year or next year. As such, they need to be prepared and understand what data they need, as well as how to do the different calculations for the metrics in the BCBS 248 report because there is room for interpretation."

It is also worth noting that different banks are approaching the implementation of the new rules differently. Hetherington points out that some have opted for a strategic approach, "seeing the transformation of their intraday liquidity management operating model as an opportunity to derive many other benefits, for example, to optimise working capital, reduce operational costs, improve intraday liquidity risk mitigation, support the transformation of their global transaction banking services, etc." Others, meanwhile, are opting for a more tactical approach in the first instance – "one driven by the new regulatory requirements as and when required."

Tools and best practices

As banks take steps to comply with the new rules, they should consider which tools they can use to support their activities. A number of solutions have been developed in order to help banks streamline the collection of the relevant data and calculate intraday liquidity positions, as well as enabling electronic filing of reports.

> *Rather than simply achieving compliance, banks should take the time to understand fully the impact of the new rules and how these can be leveraged to achieve greater benefits*

"Banks taking the strategic approach should consider tools that will enable them to holistically report, analyse, monitor, manage, and control cash and collateral positions in real-time," says Hetherington. "Ideally, this can be done within a single, integrated, global platform that gives visibility into all activities, legal entities, currencies, counterparties, time zones, etc."

Hetherington notes that this holistic coverage and visibility is required to derive the full benefits of the new rules, and that it is also the "enabler for future transformation". He adds: "With it, banks are prepared to take advantage of new disruptive technologies that will impact intraday liquidity, such as predictive analytics, machine learning and blockchain."

"Best practice would be that the data is reconciled, so banks should have one system in which they have all their expected cash flows, meaning their projections and forecasts throughout the organisation and throughout the different accounts," adds Elefteriadis. "The interest is huge in having all that information in one system and to reconcile forecasts with what is actually happening on the accounts. When you're just seeing what's booked on the account right now – which you could do through a SWIFT message from your nostro agent, for instance – this doesn't tell you much about what is in the pipeline. So both sides are quite important to have in a solution."

The growing focus on intraday liquidity is bringing considerable changes for the banking landscape. Rather than simply achieving compliance, banks should take the time to understand fully the impact of the new rules and how these can be leveraged to achieve greater benefits. As Hetherington concludes: "No matter which approach financial institutions take, it's clear that the initial changes being implemented by the industry on this topic are uncovering new opportunities. We are at the start of a long journey of transformation."