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Digital Framework for Cash and Liquidity Proves its Value Under Stressed Conditions

Adopting effective digital strategies for managing cash and liquidity is vital if banks are to survive the financial chaos caused by the coronavirus pandemic, argues SmartStream Technologies' Nadeem Shamim.

The Covid-19 pandemic is set to have a profound global economic impact, possibly for years to come. The damage is likely to dwarf that caused by the 2008 financial crisis: the pandemic involves wider populations and markets, and has also created higher levels of unemployment.

Recovery is likely to take much longer, too. Kristalina Georgieva, managing director of the International Monetary Fund, recently commented that global economic growth would turn “sharply negative” in 2020, with the world facing the worst economic fallout since the Great Depression. She also forecast that 2021 would only see a partial recovery.

Weathering this storm represents a major challenge for banks. The pandemic is having a deeply disruptive effect on the way individuals and organizations work, and banks are having to reconsider how they can best meet their obligations to customers, staff and regulators.

One area banks need to look at carefully—if they are to succeed in navigating the financial turmoil created by the pandemic—is the way they manage cash and liquidity.

Positives

While the economic outlook is a gloomy one, there are a few positives. Central banks have injected a significant amount of liquidity in order to address fluctuations in the availability of liquidity. In addition, financial institutions have been encouraged to defer or eliminate dividend payments, and the buffers required by central banks have also been reduced to ensure sufficient liquidity is maintained. Importantly, banks are now far better capitalized than they were prior to the 2008 financial crisis.

Regulatory bodies are also cutting financial institutions some slack where compliance is concerned. Take, for example, the decision by the Bank of England and the Prudential Regulation Authority to cancel the Bank's 2020 annual stress test for eight major UK banks and building societies, so that lenders can focus on meeting the needs of UK households and businesses by continuing to provide credit.

Nevertheless, the road ahead in the coming months will be a tough one. Financial institutions have to preserve sufficient liquidity to meet payment obligations—a task made all the trickier given that the collateral they hold is plummeting in value. They must also maintain the capacity to extend loans at favorable rates, in response to pressure from government to lend to businesses. Banks will have to ensure that their balance sheets can cope with delayed payments, as businesses struggle and individuals see their incomes reduced, or even lost altogether.

Crunch Points
To protect themselves effectively, banks need to know exactly where their liquidity crunch points lie. Treasurers must be able to identify potential threats to liquidity, for example, in order to understand which of their nostro agents, clients and counterparties are a possible cause of an increase in liquidity risk. It is important that they can predict the settlement time of receipts and potential missed payments, and it is vital that banks can pinpoint excessive changes in liquidity, which may be indicators of potential fraudulent activity.

It may be tempting for banks in stressed conditions to address only their most immediate concerns, but it is important that best practices are adhered to. Regulators may have delayed stress tests, but rather than taking the opportunity to pause this activity, banks should be carrying out these tests internally to counter liquidity crunch points. The current stress caused by the pandemic shows that managing liquidity actively is no longer a regulatory box-ticking exercise—it is an activity that is vital for survival.

Being able to identify liquidity crunch points depends on accurate, short-term—and preferably real-time—data, as well as the tools to convert this data into useful information. Financial institutions need to know exactly what liquidity they have at their disposal and to be able to pinpoint where it is held.

However, some banks may struggle to obtain accurate, timely information about their liquidity positions, as a result of operational difficulties. Accessing the right information at the appropriate time assumes a bank has the internal capacity to access the required level of detail. Business continuity processes for many banks mean that operational models change. What happens where staff members are working from home as a result of the pandemic, or are not working at all, if unwell? How does a bank manage if a skills shortage occurs, for example, where fully trained staff numbers are reduced through illness? Gathering data also becomes further complicated where resources are scattered across different geographical locations.

Compounded Challenge
The operational challenge is compounded due to the ageing IT systems still used by some banks to manage cash and liquidity. Where these legacy systems operate on an inter-day basis rather than in real time, banks will be prevented from accessing up-to-date information, and thus will not have clear visibility of the risks they face. Getting a timely picture of their actual liquidity position will therefore be extremely difficult, potentially making them more vulnerable.

Ageing systems and staffing shortages will not simply reduce banks' abilities to generate accurate, timely liquidity position reports, but may have other knock-on effects, too. For example, they may slow down banks' abilities to support day-to-day business processes, or cause errors and increase risk.

Under these difficult circumstances, banks that have in place an enhanced liquidity management system will find themselves more adept at managing stress conditions. Such a system can give banks a clear, up-to-date picture of their liquidity, enabling them to protect themselves more effectively by issuing early warnings on excessive changes in liquidity, or by assisting firms to stay within internal policy guidelines and alerting them of any breaches.

Global View

Developed to deliver real-time cash and liquidity automation and reporting, SmartStream's TLM Cash and Liquidity Management solution creates a single, global view of balances across all currencies and accounts, allowing accurate understanding of funding, borrowing and lending requirements.

Widely used across the financial services industry, TLM Cash and Liquidity Management is a fully automated solution, providing accurate, high-quality information in an actionable time frame. Importantly, given the potential impact of Covid-19 on staffing levels, it reduces the manual processes and resources needed by banks to meet their monitoring and reporting obligations. In addition, it generates alerts, indicating where limit breaches are due to happen, providing vital protection to businesses. As a result of the high level of automation provided by the solution, should discrepancies arise, they can be investigated rapidly, and without the need for recourse to large teams of staff. This becomes an integral part of a sustainable and reliable business continuity process.

TLM Cash and Liquidity Management supports compliance with BCBS 248 intraday liquidity measures, and also facilitates active management of intraday liquidity, assisting firms to adhere to European Central Bank guidelines on internal capital and liquidity assessment processes.

Greater Visibility

SmartStream is continually investing in new technologies and most recently its innovations team has completed a proof-of-concept for an artificial intelligence (AI) and machine learning module to be embedded within the TLM Cash and Liquidity Management solution. Through the introduction of the new module, cash management teams will gain greater visibility into the complete payment process and be able to manage liquidity risk more efficiently, minimizing the potential of payments being missed.

The advent of the Covid-19 pandemic has had, and will continue to have, a major impact on the global economy. Banks will need to know whether they have sufficient liquidity to ride out the current storm, which in turn, means being able to locate and access liquidity when required, as well as detecting and mitigating any threats. It goes without saying that this will be a tough task, even for the most well-prepared and sophisticated financial institutions.