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Traversing the new liquidity landscape

New liquidity risk regulations are driving huge change across the market, with rigorous specifications impacting intraday liquidity availability, reporting and collateral requirements. Colin Robertson, Managing Director, Treasury Services EMEA, BNY Mellon, examines the evolving liquidity space and how banks are adapting in order to comply with the heightened demands.

Colin Robertson
BNY Mellon

The global financial crisis has triggered a complete overhaul of the liquidity market, with regulators introducing new requirements that aim to generate superior levels of transparency and risk mitigation.

Basel III's liquidity monitoring requirements came into effect in 2015 and specify that banks and financial institutions (FIs) have to be able to report balances on an intraday – rather than the traditional 'close of business' (COB) – basis. This shift in focus has had a significant impact on the culture of day-to-day transaction activity.

Previously, intraday credit facilities (effectively a daily overdraft provided free of charge by many banks) were a common means of ensuring funds were readily available in order that payments could be executed as required during each day (with incoming credits covering the intraday position by COB). Indeed, such facilities were viewed as the oil that made the entire market function. Yet with the new requirements scrutinising intraday movements, there is now the necessity for far greater control and management of balances throughout the day.

Managing intraday liquidity

Regulators are concerned with the level of intraday credit facilities being offered by banks to their customers. In the US, for example, a complete reform of the triparty repo market (in which an investor can borrow cash for a short period from another party, using securities as collateral) has taken place. Banks were challenged to reduce the share of triparty repo volumes that were financed by intraday credit to less than 10% of that in 2012. This target has now been reached, with recent figures showing that levels have dropped dramatically to an average of 3-5% of 2012 levels[1].

Liquidity across the market has therefore become much more constrained, creating a challenge for those that rely on this form of 'financing'. It is therefore possible that we may see some form of peer-to-peer (P2P) intraday lending evolving as a new means of meeting demand and filling this gap in the market in the near future.

What has already been seen is that some banks that are offering intraday credit have begun charging for the facility or requesting the credit be collateralised. The type of customer balances that banks are seeking is being driven by another liquidity regulation: the liquidity coverage ratio (LCR). Being phased in between 2015 and 2019, it is designed to ensure banks have sufficient highly-liquid assets to withstand a 30-day period of 'stressed' conditions. Consequently, many banks have had to reassess their business models in order to increase their high-value liquid assets.

New regulation is fuelling the creation of new product features in this respect, with banks aiming to safeguard their access to stable liquidity by implementing a notice period for closure of accounts to a 31-day term or offering interest rates to improve the attractiveness of operational balances. All of this is to minimise the volatility of customer balances and to form a means of obtaining a higher rating in their LCR calculations.

Leveraging technology capabilities

Banks have been required to make substantial changes in a short period of time in order to be able to comply with a range of new, thorough and comprehensive liquidity-based regulations. IT investment is a necessity for many banks, with advances in technology helping to ensure they are equipped to monitor their balances more effectively.

Real-time capabilities are crucial in this respect, and with organisation-wide positions – not just of cash, but securities, assets and liabilities – needing to be taken into consideration, platforms that can provide a real-time holistic view are hugely valuable in terms of improving transparency, understanding exposures, and managing risk across the whole company.

Such systems help to address not only regulatory demands, but evolving client and market demands as well. With the entire financial landscape transforming at such a rapid rate, a key feature of any new technology infrastructure is adaptability; ensuring banks are positioned to meet the needs of a changing market.

While realigning our businesses to adhere to heightened liquidity regulation is no doubt challenging, the requirements, once implemented, will make for a much stronger and robust industry. What's more, over time, the benefits of enhanced platforms – in terms of their transparency, efficiency, robustness and the ability to mitigate possible losses – could offset the initial costs of compliance, allowing banks to reap the wider advantages of a state-of-the-art, future-proof system.

Reference

1. https://www.newyorkfed.org/newsevents/statements/2015/0624_2015.html