

**Irish Financial Regulator
Requirements for Management of
Liquidity Risk
An Industry Perspective**

Objectives:

- **Background**
- **Provide overview of requirement**
 - Qualitative
 - Quantitative
- **Industry View**
- **Implementation Issues**



Background

- **FR engaged in a two year consultative process with the industry.**
- **Genesis - FSA dp24 proposal and international trends**
- **Current Irish regulation seen as falling behind international trends**
- **The Irish Financial Regulator has published its regulatory document on the “Requirements for the Management of Liquidity Risk” with an implementation date of 1st January 2007.**
 - Parallel run with existing reporting requirements January 2007 – June 2007



Current Irish Regulatory Liquidity Requirements

- **Establish appropriate and prudent policies for the management of liquidity.**
- **Ensure existence of adequate internal systems to monitor and control maturity mismatches between assets and liabilities.**
- **Maintain a minimum ratio of liquid assets to total borrowings of twenty five per cent.**
- **Maintain liquid assets that can be realised at short notice without incurring significant loss.**



New Regulatory Reporting Requirements

- **Confirms the importance of qualitative and quantitative requirements for liquidity management.**
- Details the monitoring of liquidity; move from the current stock approach to a maturity mismatch approach
- **Critical time periods (0-8days and 8-31days) and the limits to be applied (100% and 90% cover respectively based on net cumulative cashflow mismatch in each bucket). Limits to be reviewed post 6 month parallel run period**
- Monitoring ratios to be used to observe inflows as a proportion of outflows on a cumulative basis in other time bands
- **Sets out a range of qualitative requirements including:**
 - Review of policy annually by the Board of Directors.
 - MIS capabilities to report, measure, monitor and control liquidity risk
 - Annual review by Internal Audit of compliance with policy.
 - Annual update of scenario analysis and quarterly stress tests



Key Differences Between Current & New Requirements

Requirement for detailed Product Cash Flow Analysis compared to current Aggregate Balance approach.

Opportunity to apply behavioural adjustments to product cash flows.
Necessary to have historic data to support any assumptions.

Management Information suite to provide enhanced reporting, data measurement and monitoring functionality.

More onerous reporting and compliance requirements with increased investment in system infrastructure and the operating framework including an increase in Senior management responsibilities.

- **Qualitative Requirements**

- Recognises systems and procedures dependant on nature, scale and complexity of the business.
- Every institution must have a liquidity policy, reviewed as part of the on-going regulation of credit institutions and incorporating these key components:
 - Role of Board of Directors
 - Role of Senior Management
 - Internal Controls in Managing Liquidity Risk
 - Adequate Management Information Systems for measurement, monitoring, control and reporting.
 - Annual Internal Audit review of compliance with qualitative and quantitative requirements with details of any breaches reported to the regulator.
 - Scenario Analysis, Stress Testing & Assumptions
 - Foreign Exchange – mismatch limits, nonconvertible currency limits, liquidity scenarios, board approval.
 - Market Access procedures; management of relationships, testing of funding sources, stress assessment, funding concentrations
 - Contingency Planning & Disclosure



New Regulatory Reporting Requirements

Details the quantitative measurement methodology to be applied

Definition of Liquid assets – convert to cash within 4 days.

Time periods – 7 in total with specific limits on the 0-8day and 8-31 day periods and observation ratios for other periods.

Behavioural adjustment to cash flows (defined products) assumptions need to be fully documented and supported by historical data).

Setting of limits – formal limits only to time bands 1 (0-8day) – 100% QLA coverage and 2 (8-31day) – 90% QLA coverage. Monitoring ratios for other time bands.

Focus on materiality of cash flows -- benchmark of 1% of gap ratio in each time band. Must be applied consistently to inflows and outflows.



New Regulatory Reporting Requirements

- **Behavioural Adjustments to Cashflows:**

- Overdraft facilities:

- Cannot assume facilities drawn will be repaid on demand
- Funds flow should reflect historical repayment of balances

- Credit Card Balances

- Assumptions permitted on repayment of outstanding balances

- Retail & Corporate Deposits (No Contractual Maturities)

- Assumptions can be made for retail & corporate deposits & must be documented
- Retail deposit threshold €1.5m (ideally for any one individual)
- For Corporate 15% haircut applied to proportion of deposit deemed to be sticky and this amount shown as additional outflow in first timebox



New Regulatory Reporting Requirements

- **Behavioural Adjustments to Cashflows:**

- Retail & Corporate Deposits (Fixed Term)

- Assumptions allowed
 - 10% haircut applies for retail and 15% for corporate as outlined above (applied to residual balances after the institutions own calculations)

- Mortgage Based Products

- Assumptions based on effective rather than contractual dates allowed.

- Derivative Activity

- Both sides of transactions to be shown in relevant timebands
 - Options – show premiums payable/ receivable. When institution becomes aware an option will be or is likely to be exercised, inflows/outflows must be reflected.
 - Futures – show cashflows
 - Swaps – shown on the basis of contractual terms



New Regulatory Reporting Requirements

- **Readily Marketable Assets/Liquid Assets**
 - Quickly (within 4 days and easily convertible to cash without incurring significant loss)
 - Concentration of Holdings; if holding a significant percentage of an issue use judgement in determining whether readily marketable
 - Depth of Market; must be active market to facilitate realisation within 4 days
 - Risk of forced sale loss; apply haircut to assets and deduct from total liquid assets
- **If asset fails to meet above overriding criteria then can't be included as readily marketable asset.**
- **Institutions ensure liquidity framework allows for continuous monitoring of market developments**
- **Encumbered assets not reported as liquid assets**
- **Discounting/Haircuts**
 - Regulator requires application of ECB haircuts (eligible tier 1 &2 assets). Applies to ECB and non-ECB eligible assets

- **Stress Testing**

- Defined by institution
- Alco/Senior Management Overview
- To be completed quarterly for both a bank specific and industry-wide liquidity stress situation.
- Consideration to be given to both a moderate and severe entity-specific stress test
- Requires a related contingency plan

New Regulatory Reporting Requirements

- **Reporting entities:**
 - Licensed Credit Institutions
 - Banking Groups
 - Branches of EEA and non-EEA Banks
 - Exemptions for EEA banks if Financial Regulator satisfied with parents domestic liquidity requirements

- **Implementation**
 - Parallel run with existing requirements for a six-month period commencing January 2007.
 - Parallel run – monthly reporting
 - Quarterly thereafter
 - Limits on mismatch to take effect post six-month parallel run.
 - Earlier move to formal limit
 - Daily internal modelling

Table 1(e) - Ratio Calculations

Liquidity of Credit Institutions							
Maturity Mismatch Calculation - Liquidity Ratios							
Credit Institution:							
Code:							
Reporting Date:							
Amount: Operational Currency 000							
Timebands	Sight to 8 days	Over 8 days to 1 mth	Over 1 mth to 3 mths	Over 3 mths to 6 mths	Over 6 mths to 1 Year	1 to 2 years	2 Years +
Discounted Liquid Assets	-						
Cash Inflows	0	0	0	0	0	0	0
Net Cumulative Cashflow c/Fwd		0	0	0	0	0	0
Total Cash Inflow	0	0	0	0	0	0	0
Cash Outflows	-	0	0	-	0	-	0
Net Cumulative Cashflow c/Fwd		0	0	0	0	0	0
Total Cash Outflow	-	0	0	-	0	-	0
Net Position in the Period	-	-	-	-	-	-	-
Net Cumulative Inflow/Outflow	-	-	-	-	-	-	-
Ratio Analysis							
Liquidity Ratio	100%	100%	-	-	-	-	-
Monitoring Ratio	-	-	100%	100%	100%	100%	100%
Contingent Position							
Facilities Granted							
Undrawn Committed Facilities							
Uncommitted Facilities							
Facilities Received							
Undrawn Committed Facilities							
Uncommitted Facilities							



Industry View

- General principles accepted
- Reasonable engagement by regulator at both industry and institution levels
- Diverse opinions on retail/corporate split and haircuts applied
- Concern at high level of required ratio 8-30 days
- Industry concern that “monitoring” ratios > 1month will become required ratios over time.
- Regulatory consistency in treatment of behavioural assumptions “lowest common denominator”. Feedback only when on-site visit takes place
- Impact on international competitiveness – doesn’t appear to be a major concern at this point.



Implementation Issues

- **Difficulty in matching available cashflow reports to regulatory format.**
- **Practicality of producing regulatory format as a daily internal output.**
- **Building corporate/retail resources split into current reported cashflows**
- **Distinction between wholesale and corporate resources.**
- **Requirement that intra-month Qualifying Liquid Asset coverage at a minimum meets regulatory requirements for that day.**
- **Level of Qualifying Liquid Assets required.**
- **How should the “costs” of this regulation be reflected in pricing/product strategy.**



Conclusion

- **General acceptance of principles**
- **Irish banking industry in throes of implementation at a time when other significant mandatory regulatory deliverables are being rolled out.**
- **Condition of individual banking licenses.**
- **Delivery deadlines are tight**
- **Uncertainty at institution level as to potential QLA holding levels measure will require.**
- **Concern at inconsistencies across the industry around behavioural assumptions and how regulator will deal with these.**
- **How will this reporting requirement “fit” with any future European wide regulatory regime ?**