

# PwC Liquidity Health Check for Banks

*The financial turmoil during the recent crisis has shown how much the importance of Liquidity Risk Management has been underestimated over the last years. This is why over the course of the last year, there have been significant developments on both local and international levels to put in place a more robust Liquidity Risk Management framework.*

The current liquidity risk regulation in Luxembourg is based on the Circular CSSF 09/403, issued on May 28, 2009, as well as on the BCL règlement N° 4, issued on April 29, 2009. The requirements set forth in this existing regulatory framework are of qualitative nature.

On the international level, complementary quantitative regulation has recently been published, in particular the CEBS “Guidelines on liquidity buffers and survival periods” on December 9, 2009, as well as the BIS consultative document “International framework for liquidity risk measurement, standards and monitoring” on December 17, 2009. The BIS consultative document was leveraged by the European Commission for its working document “Possible further changes to the Capital Requirements Directive”, which will transpose quantitative liquidity risk regulation into European law in the near future.

It is likely that the CSSF will base its future regulation - to be published within the year- on quantitative aspects of Liquidity Risk Management comprised in these documents.

In this context, it is essential for Luxembourg institutions to review their Liquidity (Risk) Management frameworks. Relying on input from an autonomous external expert can prove invaluable in assessing the current state of an institution’s framework and to promptly initiate any potential and necessary corrective actions.



## The Challenge

### Liquidity risk arises from both assets and liabilities:

- Market liquidity risk materialises when transactions cannot be conducted at quoted market prices;
- Funding liquidity risk, or cash-flow risk, occurs when an institution cannot meet its payment obligations.

The fundamental role of banks in the maturity transformation of short-term deposits into longer-term loans makes them inherently vulnerable to liquidity risk, both individually and within the system as a whole.

Recent history proves that lack of liquidity can cause the failure of an institution even when it is solvent.

### The Truth is that...

- The promptness and severity with which liquidity risk can crystallise and funding sources can evaporate was significantly underestimated;
- The size of asset writedowns combined with the longevity of its credit crunch was outside the scope of existing stress tests (if any performed locally);
- A liability-driven balance sheet may be dangerous in terms of liquidity if your reputation is hit (client deposit withdrawals), which is more likely to occur during a financial turmoil;
- Liquidity risk has to be considered within the ICAAP (Pillar II), but that capital is no defence against a liquidity crisis.

As a consequence, the international supervisory bodies mainly aim to focus on further enhancing the resilience of banks to liquidity stress, as well as to increase the international harmonisation of liquidity risk supervision. As such, liquidity will become a focal point in the supervisory review process.

## PricewaterhouseCoopers’ Liquidity Health Check for Banks

**PricewaterhouseCoopers has developed a tailored Liquidity Health Check for Banks targeting 10 key areas:**

1. Risk strategy & profile (objectives, appetite and tolerance)
2. Nature of business and (marketable) asset types
3. Funding strategy and Independence
4. Measuring and modelling (use of maturity mismatch analysis, stress testing, calibration of liquidity buffer)
5. Concentration risks (assets and funding)
6. Quality of reporting and Management Information
7. Skills in Treasury Area and ALM and costs/revenues optimisation
8. Political, economic or geographic factors in relation to the group or parent and the bank’s primary customer base
9. Liquidity Contingency Planning (early warning indicators, management coordination and escalation of issues, scenario planning and testing, etc.)
10. Customer base and Reputation Risk.

## What are the deliverables?

**Our team of experts will meet key representatives of your bank and will review relevant documentation and processes with a view to providing you with:**

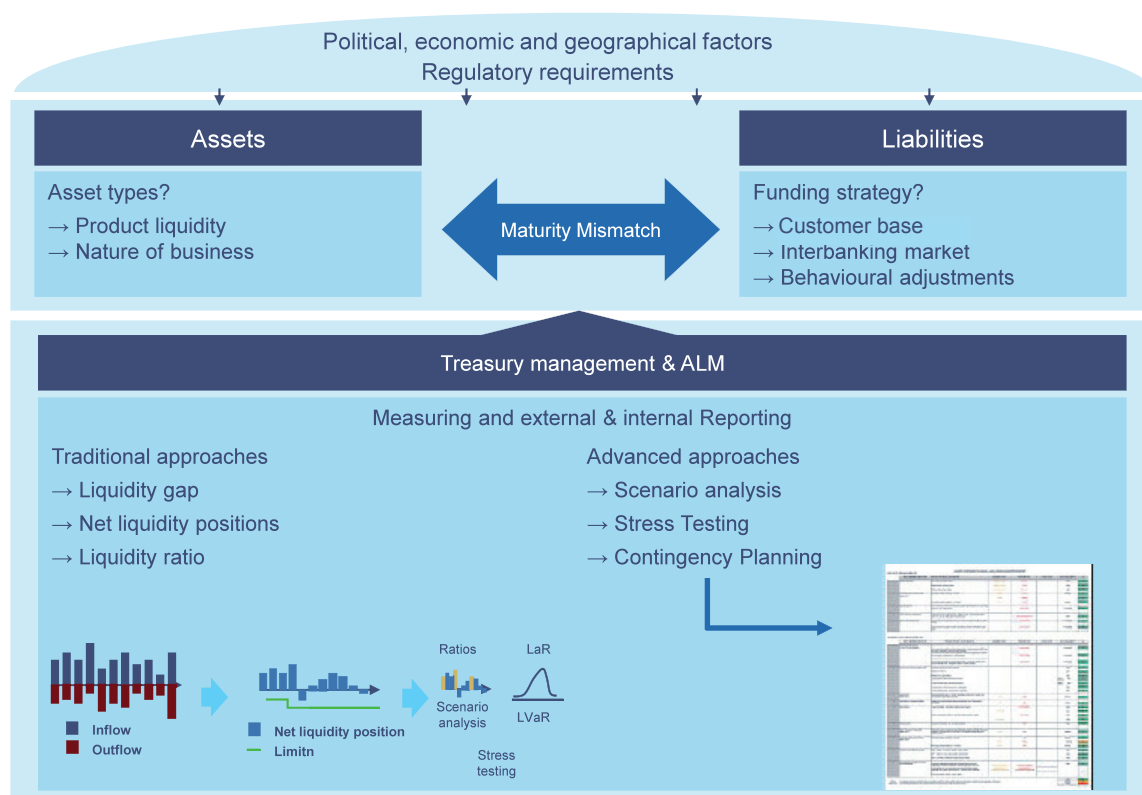
- A multidimensional assessment of your bank’s Liquidity Risk Management framework;
- A list of prioritised management actions.

Those deliverables will help you decide where you want to stand in that spectrum (Satisfy the minimum requirements? Be seen as market leaders? Be somewhere in between those extremes?).

## Luxembourg: a financial place outside the scope?

The new liquidity regulation currently in preparation is likely to have a significant impact on the following key areas:

- The maintenance of an adequate level of liquidity, including an adequate buffer of liquid assets;
- The design and application of plausible but severe stress scenarios;
- The assets eligible for inclusion in the liquidity buffer;
- The identification and measurement of the full range of liquidity risks, including contingent liquidity risks (e.g. due to off-balance sheet positions);
- Treatment of intra-group transactions;
- The maturity and types of funding sources;
- Concentrations in assets and funding sources;
- The implementation of distinct Liquidity Risk Management standards and metrics;
- Public disclosure in promoting market discipline, etc.



Our dedicated team of experts is at your disposal to help you gauge where you stand in the liquidity risk management spectrum.

## Why PricewaterhouseCoopers Luxembourg?

PricewaterhouseCoopers Luxembourg ([www.pwc.com/lu](http://www.pwc.com/lu)) has about 2000 professionals from 53 different countries. PricewaterhouseCoopers ([www.pwc.com](http://www.pwc.com)) provides industry-focused assurance, tax and advisory services to build public trust and enhance value for our clients and their stakeholders. More than 163,000 people in 151 countries across our network share their thinking, experience and solutions to develop fresh perspectives and practical advice.

“PricewaterhouseCoopers” refers to the group of independent firms that are members of PricewaterhouseCoopers International network, each of which is a separate and independent legal entity.

### For further information about the PricewaterhouseCoopers Liquidity Health Check for Banks, please contact:

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