

# Sound Liquidity Risk Management

dated June 3, 2009

On May 28, 2009, the CSSF issued a new Circular (09/403<sup>1</sup>) related to the management of liquidity risk. At the end of April, the BCL already issued its own regulation<sup>2</sup> on liquidity supervision.

The new CSSF requirements for liquidity Risk Management are integrated into the Internal Capital Adequacy Assessment Process (ICAAP) and therefore the ICAAP Circular (07/301) is amended.

The CSSF Circular 93/104 regarding the definition of a liquidity ratio to be observed by credit institutions is not modified and still applicable. The only change caused by the amendment is that banks do not need to deduct assets given as a guarantee to central banks against non drawn credit lines. Nevertheless, the CSSF is preparing new quantitative rules which will replace the current table B 1.5 during second semester 2009.

## The challenge

Liquidity risk arises from both assets and liabilities:

- Asset liquidity risk, or market/product liquidity risk, appears when transactions cannot be conducted at quoted market prices;
- Funding liquidity risk, or cash-flow risk, occurs when the institution cannot meet 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 an institution to fail even when it is solvent.

## Key points in the new regulation

The new Circular transposes in our national regulation the eighteen CEBS principles on sound liquidity Risk Management.

Two processes form the core of the new legislation:

- An internal process of identification, measure, management and reporting of liquidity risks to which the institution is exposed. This process enables the institution to control its risks and to assess its needs in terms of available liquidity reserves;
- An internal process of planning and management of available liquidity reserves that enables the institution to permanently guarantee the adequacy of available liquidity reserves.

1 [http://www.cssf.lu/uploads/media/cssf09\\_403.pdf](http://www.cssf.lu/uploads/media/cssf09_403.pdf)

2 [http://www.bcl.lu/fr/publications/R\\_glements\\_de\\_la\\_Banque\\_centrale\\_du\\_Luxembourg/2009\\_4.pdf](http://www.bcl.lu/fr/publications/R_glements_de_la_Banque_centrale_du_Luxembourg/2009_4.pdf)

The new Circular insists on:

- The exhaustive character of the process (all liquidity risk dimensions have to be taken into account, a.o. the concentration risk);
- The methodologies (liquidity status, available liquidity reserves assessment process, stress tests, contingency plan, ...);
- Human capital (the institution should have sufficient well trained staff, adequate resources, proper coordination and overview, and independent internal control and audit functions);
- The appropriateness of IT systems and processes that have to be commensurate with the complexity and materiality of the activities;
- The policies and procedures that provide for the disclosure of adequate and timely information on liquidity Risk Management and liquidity positions, both in normal and stressed times.

For any update on Liquidity Risk Management, please click [here](#) to visit our website.

## Contacts

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