

MUSCAT INTERNATIONAL FORUM FOR RISK MANAGEMENT IN BANKS & FINANCIAL INSTITUTIONS

MANAGING LIQUIDITY RISK AND DIGITALIZATION DYNAMICS

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Views and opinions expressed are solely my own and do not necessarily reflect the official policy or position of the Dubai Financial Services Authority (DFSA).

Basel III Liquidity Framework

Principles for Sound Liquidity Risk Management and Supervision

Liquidity Coverage Ratio (LCR), a short-term measure to ensure banks have sufficient unencumbered HQLA that can be converted easily and immediately in private markets into cash to meet their liquidity needs for the next 30 calendar days.

Net Stable Funding Ratio (NSFR), a longer-term structural metric that requires banks to maintain a stable funding profile in relation to the composition of their assets and OBS activities.

LCR and NSFR are minimum internationally harmonized standards. The standards are complemented by a set of tools to monitor other aspects of liquidity risk as the ratios alone do not provide a comprehensive view of the liquidity profile of banks.

- Contractual Maturity Mismatch,
- Concentration of funding,
- LCR by significant currency,
- Available Unencumbered Assets
- Market-related monitoring tools

Basel III Liquidity Standards

LCR

$$\frac{\text{Stock of HQLA}}{\text{Total net cash outflows over the next 30 days}} \geq 100\%$$

Where Total net cash outflows:
Total expected cash outflows - Min (total expected cash inflows;
75% of total expected cash outflows)

NSFR

$$\frac{\text{Available amount of stable funding}}{\text{Required amount of stable funding}} \geq 100\%$$



Supervisory Tools



Internal Liquidity Adequacy Assessment Process (ILAAP)

ILAAP require firms to identify, measure, manage and monitor their liquidity and funding risks across different time horizons and stress scenarios, consistent with their risk appetite, in a structured and methodological way that can be reviewed and challenged by Supervisors.

Stress testing

Banks must consider in their own stress testing the impact of a range of severe but plausible stress scenarios on their cash flows, liquidity resources, profitability, solvency, asset encumbrance, funding profile and survival horizon. Stress scenarios should be selected to reveal the vulnerabilities of the firm's funding, including for example, a vulnerability to previously liquid markets becoming unexpectedly illiquid.

Supervisory colleges and cross border cooperation agreements

Forums to address risk for international active/cross border banks and coordinate responses between home and host regulators.

Periodic Risk Assessments and Thematic Reviews

Onsite reviews of policies, controls including CFPs, and governance arrangements in addition to offsite supervision.

2023 Banking Turmoil

This time it's different, or is it?



Common themes

SVB, SB, and FRB experienced rapid growth funded by uninsured, concentrated deposit base with issues compounded by poor risk management and weak governance

Common aggravating factor: digitalization

Increase speed and volume of outflows compared to historical experiences and liquidity ratios assumptions

Role of social media in spreading information and rumours which lead to contagion

Key Lessons from the Turmoil

For Banks

- Risk functions must keep pace with growth
- Diversification of funding sources & types
- Must develop, update, and test robust CFPs
- Ensure operational readiness for sourcing collaterals
- Develop communication strategy adapted for digital age

For Supervisors

- Need to understand “outlier” business models
- Must assess bank holistically, look beyond the ratios
- Consider interconnected risks, e.g. unmaterialized losses
- Supervisory concerns and findings to be communicated promptly, followed upon, and acted upon in a timely manner

Assessment of the framework

Liquidity Standards

Design limitations

Behavioural issues

Supervisory responses

Supervisor

Pillar 2

Leverage data

Policy Response BCBS

Focus of full implementation of Basel III

Analytic work to identify ways to strengthen supervisory effectiveness

Final thought

When it comes to supervising liquidity risk, there is no substitute to supervisory judgement.



Thank you