

Chapter-7 Basics of Liquidity Risk

Certificate in Risk Management



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Chapter - 7 Basics of Liquidity Risk

Introduction

This chapter helps in understanding the basics of Liquidity risk. This chapter provides framework for Liquidity risk management with examples. It also discusses the measurement methodologies of Liquidity risk.

Learning Objective

After reading this chapter you will:

- To understand the basics of major financial risks i.e. Liquidity risk
- To explain the various management process for Basel III framework under Liquidity risk management.
- To understand the stress testing.



7.1 Liquidity Risk

Liquidity risk is the potential for loss to an institution arising from either its inability to meet obligations as they fall due or to fund increases in assets without incurring unacceptable cost or losses (funding liquidity risk). Sometimes, inadequate market depth where an institution cannot easily unwind or offset specific exposures without significantly lowering market prices causes what is termed as 'market liquidity risk'.

Liquidity is the ability of an institution to transform its assets into cash or its equivalent in a timely manner at a reasonable price to meet its commitments as they fall due. Liquidity risk is considered a major risk for institutions. It arises when the cushion provided by the liquid assets are not sufficient enough to meet its obligation. In such a situation, institutions often meet their liquidity requirements from the market. However, conditions of funding through market depend upon liquidity in the market and borrowing institution's liquidity. Accordingly, an institution short of liquidity may have to undertake transactions at heavy cost resulting in loss of earnings or in worst case scenario, the liquidity risk could result in bankruptcy of the institution if it is unable to undertake transactions even at current market prices.

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Liquidity risk should not be seen in isolation because financial risks are not mutually exclusive and liquidity risk is often triggered by financial risks such as credit risk, market risk, etc. For instance, an institution increasing its credit risk through asset concentration may be increasing its liquidity risk as well. Similarly, a large loan default or changes in interest rate can adversely impact an institution's liquidity position. Further, if management misjudges the impact on liquidity of entering into a new business or product line, the banking institution's strategic risk would increase.

Examples of such internal indicators are:

- a negative trend or significantly increased risk in any area or product line;
- concentrations in either assets or liabilities;
- deterioration in quality of credit portfolio;
- decline in earnings performance or projections;
- rapid asset growth funded by volatile large deposit;
- large size of off-balance sheet exposure;
- deteriorating third party evaluation about the banking institution;

- negative publicity; and
- unwarranted competitive pricing that potentially stresses the banking institution

The formality and sophistication of risk management processes established to manage liquidity risk should reflect the nature, size and complexity of an institution's activities. Sound liquidity risk management employed in measuring, monitoring and controlling liquidity risk is critical to the viability of any institution. Institutions should have a thorough intrinsic understanding of the factors that could give rise to liquidity risk and put in place mitigating controls.

Bank Deposits generally have a much shorter contractual maturity than loans and liquidity management needs to provide a cushion to cover anticipated deposit withdrawals. Liquidity is the ability to efficiently accommodate deposit as also reduction in liabilities and to fund the loan growth and possible funding of the off-balance sheet claims. The cash flows are placed in different time buckets based on future likely behavior of assets, liabilities and off-balance sheet items. Liquidity risk consists of Funding Risk, Time Risk & Call Risk.

Funding Risk: It is risk that firm will not be able to meet efficiently both expected and unexpected current and future cash flow and collateral needs without affecting either daily operations or the financial condition of the firm.

Market Risk: It is the risk that a firm cannot easily offset or eliminate a position at the market price because of inadequate market depth or market disruption.

Management Information System

A bank should have a reliable management information system (MIS) designed to provide timely and forward-looking information on the liquidity position of the bank to the Board and ALCO, both under normal and stress situations. The MIS should cover liquidity positions in all currencies in which the bank conducts its business – both on a subsidiary /branch basis (in all countries in which the bank is active) and on an aggregate group basis. It should capture all sources of liquidity risk, including contingent risks and those arising from new activities, and have the ability to furnish more granular and time sensitive information during stress events.

An effective management information system (MIS) is essential for sound liquidity management decisions. Information should be readily available for day-to-day liquidity management and risk control, as well as during times of stress. Data should be appropriately consolidated, comprehensive yet concise, focused and available in a timely manner. Ideally, the regular reports an institution generates will enable it to monitor liquidity during a crisis; managers would simply have to prepare the reports more frequently. Managers should keep crisis monitoring in mind when developing liquidity MIS. There is usually a trade-off between accuracy and timeliness as liquidity problems can arise very quickly, and effective liquidity management may require daily internal reporting. Since bank liquidity is primarily affected by large, aggregate principal cash flows, detailed information on every transaction may not improve the analysis.

Management should develop systems that can capture significant information. The content and format of reports depend on an institution's liquidity management practices, risks, and other characteristics. Routine reports may include a list of large funds providers, a cash flow or funding gap report, a funding maturity schedule, and a limit monitoring and exception report. Day-to-day management may require more detailed information, depending on the complexity of the banking institution and the risks it undertakes.

Management should regularly consider how best to summarize complex or detailed issues for senior management or the Board. Besides, other types of information important for managing day-to-day activities and for understanding the banking institution's inherent liquidity risk profile include:

- Asset quality and its trends;
- Earnings projections;
- The bank's general reputation in the market and the condition of the market itself;
- The type and composition of the overall balance sheet structure; and
- The type of new deposits being obtained, as well as its source, maturity and price.

Internal Controls

Institutions should have adequate internal controls to ensure the integrity of their liquidity risk management process. These should be an integral part of the institution's overall system of internal control aimed at promoting effective and efficient operations, reliable

financial and regulatory reporting, and compliance with relevant laws, regulations and institutional policies. An effective system of internal control for liquidity risk includes:

- a) a strong control environment;
- b) an adequate process for identifying and evaluating liquidity risk;
- c) the establishment of control activities such as policies and procedures;
- d) adequate management information systems; and,
- e) Continuous review of adherence to established policies and procedures.

With regard to control policies and procedures, attention should be given to appropriate approval processes, limits, reviews and other mechanisms designed to provide a reasonable assurance that the institution's liquidity risk management objectives are achieved. Many attributes of a sound risk management process, including risk measurement, monitoring and control functions, are key aspects of an effective system of internal control. Institutions should ensure that all aspects of the internal control system are effective, including those aspects that are not directly part of the risk management process.

In addition, an important element of an institution's internal control system over its liquidity risk management process is regular evaluation and review. This includes ensuring that personnel are following established policies and procedures, as well as ensuring that the procedures that were established actually accomplish the intended objectives.

Limit breaches should receive prompt attention of appropriate management and should be resolved according to the processes described in approved policies. Periodically, the internal audit function should review the liquidity management process in order to identify any weaknesses or problems which in turn should be addressed by management.

7.2 Basel III Framework for Liquidity Risk

The Basel Committee on Banking Supervision (BCBS) had issued on December 16, 2010 the Basel III rules text on liquidity – “Basel III: International framework for liquidity risk measurement, standards and monitoring” which presents the details of global regulatory standards on liquidity. Two minimum standards viz. Liquidity Coverage Ratio (LCR) and Net

Stable Funding Ratio (NSFR) for funding liquidity have been prescribed by the Basel Committee for achieving two separate but complementary objectives.

The LCR promotes short-term resilience of banks to potential liquidity disruptions by ensuring that they have sufficient high quality liquid assets to survive an acute stress scenario lasting for 30 days.

The NSFR promotes resilience over longer-term time horizons by creating additional incentives for banks to fund their activities with more stable sources of funding on an ongoing structural basis.

The LCR and NSFR would become binding on banks from January 01, 2015 and January 01, 2018, respectively and till then, only reporting is expected from banks. However, banks are expected to scale up their Management Information System (MIS) to meet the Basel III requirements on liquidity standards.

To start with, the Basel III framework (LCR and NSFR and monitoring tools) would be applicable for Indian banks at whole bank level only i.e. on a stand-alone basis including overseas operations through branches. However, banks should endeavor to move over to meeting these standards at consolidated level also. For foreign banks operating as branches in India, the framework would be applicable on stand-alone basis only.

Board and Senior Management Oversight

Board Oversight

The prerequisite of an effective liquidity risk management includes a well-informed Board, capable management and staff having relevant expertise, and efficient systems and procedures. Primarily, it is the duty of the Board of directors to understand the liquidity risk profile of the banking institution and the tools used to manage liquidity risk. The Board has to ensure that the banking institution has necessary liquidity risk management framework and is capable of confronting uneven liquidity scenarios. The Board should approve the strategy and significant policies related to overall management of liquidity. Generally, in this respect the responsibilities of the Board include:

- o Providing guidance on the level of tolerance for liquidity risk;

- Establishing an appropriate structure for the management of liquidity risk and identifying lines of authority and responsibility for managing liquidity risk exposure;
- Appointing senior managers who have the ability to manage liquidity risk and delegate to them the required authority to accomplish the job;
- Continuously monitoring the banking institution's performance and overall liquidity risk profile through reviewing various reports;
- Ensuring that senior management takes necessary steps to identify, measure, monitor and control liquidity risk; and
- Reviewing adequacy of the contingency plans of the banking institutions.

Senior Management Oversight

Senior management is responsible for the implementation of sound policies and procedures keeping in view the strategic direction and risk appetite specified by Board. To effectively oversee the daily and long-term management of liquidity risk, senior managers should:

- develop and implement procedures and practices that translate the Board's goals, objectives, and risk tolerances into operating standards that are well understood by bank personnel and consistent with the banking institution's intent and strategies;
- adhere to the lines of authority and responsibility that the Board has established for managing liquidity risk;
- oversee the implementation and maintenance of management information and other systems that identify, measure, monitor, and control the banking institution's liquidity risk; and
- Establish effective internal controls over the liquidity risk management process and ensure that the same is communicated to all staff.

The responsibility for managing the overall liquidity of the banking institution should be delegated to a specific, identified group within the banking institution. This might be in the form of an Asset Liability Committee (ALCO) comprised of senior management or the treasury function. Since liquidity management is a technical job requiring specialized knowledge and expertise, it is important that responsible officers not only have relevant expertise but also have a good understanding of the nature and level of liquidity risk assumed by the institution and the means to manage that risk. At a minimum, the effective management of assets and liabilities should incorporate the following activities:

- assessing current balance sheet position;
- projecting exogenous factors like the economy, performance of counterparties, competition etc.;
- developing assets and liability strategy;
- simulating strategies;
- determining the most appropriate strategy;
- setting targets;
- communicating targets to appropriate managers and staff; and
- Monitoring and reviewing performance

Liquidity Risk Strategy

Each institution should have an appropriate liquidity strategy for the day-to-day management of liquidity. The strategy should set out the general approach the institution will have to liquidity, including various quantitative and qualitative targets. This strategy should address the institution's goal of protecting financial strength and the ability to withstand stressful events in the marketplace.

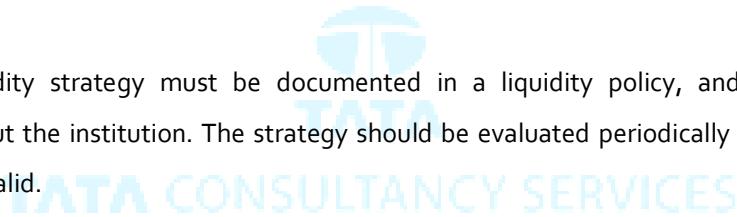
The liquidity risk strategy defined by Board should enunciate specific policies on particular aspects of liquidity risk management, such as:

- **Composition of Assets and Liabilities-** The strategy should outline the mix of assets and liabilities to maintain liquidity. Liquidity risk management and asset/liability management should be integrated to avoid steep costs associated with having to rapidly reconfigure the asset liability profile from maximum profitability due to increased liquidity.
- **Diversification and Stability of Liabilities** - A funding concentration exists when a single decision or a single factor has the potential to result in a significant and sudden withdrawal of funds. Since such a situation could lead to an increased risk, the Board of Directors and senior management should specify guidance relating to funding sources and ensure that the banking institution has diversified sources of funding day-to-day liquidity requirements. An institution would be more resilient to tight market liquidity conditions if its liabilities were derived from more stable sources. To comprehensively

analyze the stability of liabilities/funding sources, the banking institution needs to identify:

- liabilities that would stay with the institution under any circumstances;
 - liabilities that run-off gradually if problems arise; and
 - Liabilities that run-off immediately at the first sign of problems.
- **Managing Liquidity in different currencies-** The institution should have a strategy on how to manage liquidity in different currencies.
 - **Dealing with liquidity disruptions-** The institution should put in place strategies to deal with the potential for both temporary and long-term liquidity disruptions. The strategy should take into account the fact that in crisis situations, access to interbank market could be both difficult and costly.

The liquidity strategy must be documented in a liquidity policy, and communicated throughout the institution. The strategy should be evaluated periodically to ensure that it remains valid.



Liquidity Policies

Board of Directors should ensure that there are adequate policies to govern liquidity risk management process. While specific details vary across institutions according to the nature of their business, key elements of any liquidity policy include:

- General liquidity strategy (short- and long-term), specific goals and objectives in relation to liquidity risk management, process for strategy formulation and the level it is approved within the institution;
- Roles and responsibilities of individuals performing liquidity risk management functions, including structural balance sheet management, pricing, marketing, contingency planning, management reporting, lines of authority and responsibility for liquidity decisions.
- Liquidity risk management structure for identifying, monitoring, reporting and reviewing the liquidity position.

- Liquidity risk management tools for identifying, measuring, monitoring and controlling liquidity risk (including the types of liquidity limits and ratios in place and rationale for establishing limits and ratios).
- Contingency plan for handling liquidity crises.

To be effective, the liquidity policy must be communicated down the line throughout the institution. It is important that the board and senior management ensure that policies are reviewed at least annually and when there are any material changes in the institution's current and prospective liquidity risk profile. Such changes could stem from internal circumstances (e.g. changes in business focus) or external circumstances (e.g. changes in economic conditions).

Reviews provide the opportunity to fine tune the institution's liquidity policies in light of the institution's liquidity management experience and development of its business. Any significant or frequent exception to the policy is an important barometer to gauge.

Monitoring of Liquidity Standards under Basel II

Liquidity Limits

Banks are also required to report compliance on best effort basis the liquidity standards under Basel III. In addition, banks are required to adhere to the following regulatory limits prescribed to reduce the extent of concentration on the liability side of the banks.

- a) **Inter-bank Liability (IBL) Limit-** Currently, the IBL of a bank should not exceed 200% of its net worth as on 31st March of the previous year. However, individual banks may, with the approval of their BODs, fix a lower limit for their inter-bank liabilities, keeping in view their business model. The banks whose Capital to Risk-weighted Assets Ratio (CRAR) is at least 25% more than the minimum CRAR (9%), i.e. 11.25% as on March 31, of the previous year, are allowed to have a higher limit up to 300% of the net worth for IBL. The limit prescribed above will include only fund based IBL within India (including inter-bank liabilities in foreign currency to banks operating within India). In other words, the IBL outside India are excluded. The above limits will not include collateralized borrowings under Collateralized Borrowing and Lending Obligation (CBLO) and refinance from NABARD, SIDBI etc.

- b) **Call Money Borrowing Limit** - The limit on the call money borrowings as prescribed by RBI for Call/Notice Money Market Operations will operate as a sub-limit within the above limits. At present, on a fortnightly average basis, such borrowings should not exceed 100% of bank's capital funds. However, banks are allowed to borrow a maximum of 125% of their capital funds on any day, during a fortnight.
- c) **Call Money Lending Limit**- Banks are also required to ensure adherence to the call money lending limit prescribed by RBI for Call/Notice Money Market Operations, which at present, on a fortnightly average basis, should not exceed 25% of its capital funds. However, banks are allowed to lend a maximum of 50% of their capital funds on any day, during a fortnight.

7.3 Liquidity Risk Management

A bank should have a sound process for identifying, measuring, monitoring and mitigating liquidity risk as enumerated below. Besides the institutional structure discussed earlier, an effective liquidity risk management include systems to identify, measure, monitor and control its liquidity exposures. Key elements of an effective risk management process include an efficient MIS to identify, measure, monitor and control existing as well as future liquidity risks and reporting them to senior management and the board of directors for proactive remedial action.

i. Risk Identification

A bank should define and identify the liquidity risk to which it is exposed for each major on and off-balance sheet position, including the effect of embedded options and other contingent exposures that may affect the bank's sources and uses of funds and for all currencies in which a bank is active. Management should be able to accurately identify and quantify the primary sources of an institution's liquidity risk timeously. To properly identify the sources, management should understand both existing as well as future risk that the institution can be exposed to. Management should always be alert for new sources of liquidity risk at both transaction and portfolio levels.

ii. Liquidity Risk Measurement

An effective measurement and monitoring process is essential for adequately managing liquidity risk. At a very basic level, liquidity measurement involves assessing all of an institution's cash inflows against its outflows to identify the potential for any net shortfalls going forward. This includes funding requirements for off-balance sheet commitments. A number of techniques can be used for measuring liquidity risk, ranging from simple calculations and static simulations based on current holdings to highly sophisticated modeling techniques.

An effective liquidity risk measurement and monitoring system not only helps in managing liquidity in times of crisis but also optimize return through efficient utilization of available funds. Discussed below are some (but not all) commonly used liquidity measurement and monitoring techniques that may be adopted by institutions.

1) Contingency Funding Plans (CFP)

In order to develop a comprehensive liquidity risk management framework, institutions should have way out plans for stress scenarios. Such a plan commonly known as CFP is a set of policies and procedures that serves as a blue print for an institution to meet its funding needs in a timely manner and at a reasonable cost. A CFP is a projection of future cash flows and funding sources of an institution under market scenarios including aggressive asset growth or rapid liability erosion. To be effective, it is important that a CFP should represent management's best estimate of balance sheet changes that may result from a liquidity or credit event. A CFP can provide a useful framework for managing liquidity risk both short term and in the long term. Furthermore, it helps ensure that a banking institution can prudently and efficiently manage routine and extraordinary fluctuations in liquidity. The scope of the CFP is discussed in more detail below.

- **Use of CFP for Routine Liquidity Management**

For day-to-day liquidity risk management integration, liquidity scenarios will ensure that the banking institution is best prepared to respond to an unexpected problem. In this sense, a CFP is an extension of ongoing liquidity management and formalizes the objectives of liquidity management by ensuring:

- a) A reasonable amount of liquid assets are maintained;
- b) Measurement and projection of funding requirements during various scenarios; and

c) Management of access to funding sources.

- **Use of CFP for Emergency and Distress Environments**

It is not always that liquidity crisis shows up gradually. In case of a sudden liquidity stress, it is important for an institution to be seen as organized, candid, and efficient to meet its obligations to the stakeholders. Since such a situation requires a spontaneous action, institutions that already have plans to deal with such situation could address the liquidity problem more efficiently and effectively. A CFP can help ensure that management and key staff are ready to respond to such situations. Bank liquidity is very sensitive to negative trends in credit, capital, or reputation.

2) **Maturity Ladder**

A maturity ladder is a useful device to compare cash inflows and outflows both on a day-to-day basis and over a series of specified time periods. The number of time frames in such maturity ladder is of significant importance and to some extent depends upon nature of banking institution's liability or sources of funds. Institutions, which rely on short term funding, will concentrate primarily on managing liquidity on very short term whereas, other institutions might actively manage their net funding requirement over a slightly longer period. In the short term, institution's flow of funds could be estimated more accurately and also such estimates are of more importance as these provide an indication of actions to be taken immediately. It is suggested that institutions calculate daily gap for next one or two weeks, monthly gap for next six month or a year and quarterly thereafter. While making an estimate of cash flows, the following aspects need attention:

- a) the funding requirement arising out of off- balance sheet commitments also need to be accounted for;
- b) Many cash flows associated with various products are influenced by interest rates or customer behavior. Institutions need to take into account behavioral aspects (anticipated maturity) instead of contractual maturity. In this respect past experiences could give important guidance to make any assumption;
- c) some cash flows may be seasonal or cyclical; and
- d) Management should also consider increases or decreases in liquidity that typically occur during various phases of an economic cycle.

While the institutions should have liquidity sufficient enough to meet fluctuations in loans and deposits, as a safety measure institutions should maintain a margin of excess liquidity. To ensure that this level of liquidity is maintained, management should estimate liquidity needs in a variety of scenarios.

3) Liquidity Ratios and Limits

Institutions may use a variety of ratios to quantify liquidity. These ratios can also be used to create limits for liquidity management. However, such ratios would be meaningless unless used regularly and interpreted taking into account qualitative factors. Ratios should always be used in conjunction with more qualitative information such as borrowing capacity, the likelihood of increased requests for early withdrawals, decreases in credit lines, decreases in transaction size, or shortening of term funds available to the banking institution. To the extent that any asset-liability management decisions are based on financial ratios, an institution's asset-liability function should understand how a ratio is constructed, the range of alternative information that can be placed in the numerator or denominator, and the scope of conclusions that can be drawn from ratios. A fuller appreciation of ratios should recognize uniqueness of individual institutions where comparative data is available and seasonal or time differences of a single institution.

- **Cash Flow Ratios and Limits-** One of the most serious sources of liquidity risk emanates from an institution's failure to "roll over" a maturing liability. Cash flow ratios and limits attempt to measure and quantify the effect of the volume of liabilities maturing during a specified period of time.
- **Liability Concentration Ratios and Limits-** Liability concentration ratios and limits help to prevent an institution from relying on too few providers or funding sources. Limits are usually expressed as either a percentage of liquid assets or an absolute amount. Sometimes they are more indirectly expressed as a percentage of deposits, purchased funds, or total liabilities.
- **Other Balance Sheet Ratios-** Total loans/total deposits, liquid assets/demand liabilities, total loans/total equity capital, borrowed funds/total assets etc. are examples

of common ratios used by banking institutions to monitor current and potential funding levels.

4) **Stress Testing**

Stress testing should form an integral part of the overall governance and liquidity risk management culture in banks. A stress test is commonly described as an evaluation of the financial position of a bank under a severe but plausible scenario to assist in decision making within the bank. Banking institution should conduct regular stress tests by applying various scenarios on their liquidity positions to ensure that they have adequate liquidity to withstand stressed conditions.

The board of directors and senior management should examine stress-testing results and formulate appropriate strategies to address the cash-flow needs revealed by the scenario analysis. For example, there may be a need to reduce liquidity risk by obtaining more long-term funding or restructuring the composition of assets.

It is important for banking institutions to construct reasonable adverse scenarios when stress testing liquidity, and to examine the resultant cash-flow needs. While banking institutions are encouraged to cover stress events of different types and levels of adversity, they should include the following scenarios in their stress testing exercise:

- (i) Institution-specific crisis scenario; and
- (ii) General market crisis scenario.

Institution-specific crisis scenarios cover situations where there are some real or perceived problems at an institution, for example, operational problems, solvency concerns or adverse credit rating changes. A general market crisis scenario is one where liquidity at a large number of institutions in one or more markets, is affected.

An institution should detail the assumptions underlying the behavior of the cash flows of its assets, liabilities and off-balance sheet items under plausible crisis scenarios. The timing and size of the cash flows are important factors to consider.

The assumptions may differ quite sharply from scenario to scenario as cash flow timing and size can behave differently in different situations. Bank institutions should factor in the settlement period or the expected time needed for liquidating assets.

Key assumptions underlying an institution-specific crisis scenario should be that many of the institution's liabilities cannot be rolled-over or replaced, resulting in required repayment at maturity such that the institution would have to wind down its books to some degree. The minimum criteria for using various assumptions when stress testing liquidity risk is as follows:

- The assumptions have to be consistent and reasonable for each scenario;
- The assumptions should be verified and supported by sufficient evidence, experience and performance rather than arbitrarily selected;
- Banking institutions should document the behavioral assumptions in their liquidity management policy statement. The type of analysis performed under each assumption should also be documented to facilitate periodic review;
- Senior management should ensure that key assumptions are evaluated at least annually for reasonableness.

Under a general market crisis scenario, it is assumed that a banking institution may have less control over the level and timing of future cash flows. Characteristics of this scenario may include a liquidity squeeze, counterparty defaults and substantial discounts needed to sell assets and wide differences in funding access among banking institutions due to the occurrence of a severe tiring of their perceived credit quality (i.e. flight to quality).

When performing scenario analysis, institutions may factor in the possibility of intra-group or head office support. This support would be of particular value in a crisis affecting only local operations (because of territorial or jurisdictional limitations) but could prove to be ineffective if the crisis impinged upon the group as a whole. In addition banking institutions should document:

- cash-flow assumptions for the institution specific and general market crisis scenarios; and
- Their own estimate of the minimum number of days needed to arrange emergency funding support from other sources.

Banks should conduct stress tests to assess the level of liquidity they should hold, the extent and frequency of which should be commensurate with the size of the bank and their specific business activities/liquidity for a period over which it is expected to survive a crisis.



Summary

- Liquidity is the ability of an institution to transform its assets into cash or its equivalent in a timely manner at a reasonable price to meet its commitments as they fall due.
- "Basel III: International framework for liquidity risk measurement, standards and monitoring" which presents the details of global regulatory standards on liquidity. Two minimum standards viz. Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) for funding liquidity have been prescribed by the Basel Committee for achieving two separate but complementary objectives.
- It is important for the board to review whether the liquidity risk management system developed is an appropriate one suited to the financial institution's strategic objectives, the scale and nature of its business and its risk profile.
- If the institution's management fails to recognize weaknesses or problems recognized by the Board, it is also necessary to explore in particular the possibility that the Internal Control System is not functioning effectively and review findings.

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