

Results of the white label survey on liquidity risk governance

ECB Money Market Contact Group, 1st Quarter 2011

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Survey objective

“To establish the extent to which European financial institutions have resolved the issue of the conflict of interest between managing liquidity risk in a prudential manner and targeting this activity as a potential profit centre”

This issue is highlighted in CEBS 147 in articles 18, 83, 85 and 86

SUMMARY FINDINGS

19 RESPONSES FROM 23 SURVEYS SENT OUT TO MMCG MEMBERS

Findings

Oversight of liquidity risk management

- The ultimate responsibility for liquidity risk is usually (12 out of 19 respondents) delegated to ALCO (slide 15)

- Liquidity risk oversight/reporting is the responsibility of risk management in half the cases with Corporate Treasury and Finance/control making up the balance (slide 16)

- With respect to the CRO
 - The CRO is active (>16 out of 19 respondents) in monitoring risk utilisations and developing risk methodologies (slides 17 and 18)
 - The CRO's role has changed in more than half the cases in the last year (slide 19)
 - Where it has changed, this has been due to:
 - Increasing the robustness of the reporting framework
 - Increasing responsibilities to comment on risk rather than merely reporting
 - There are few plans to change to role of CRO from the current status quo (slide 21)

Findings

Oversight of liquidity risk management (cont.)

- With respect to the CFO
 - The CFO has an active role in monitoring liquidity risk utilisations in a little more than half (11/19) the respondents (slide 22)
 - In only half the respondents does the CFO or finance have an active role in developing liquidity risk methodologies (slide 23)
 - The role of the CFO or Finance with respect to monitoring or developing risk methodologies has not changed in the last year and there are few plans to do so (slide 24 and 25)
- With respect to MM trading
 - MM trading is actively involved in developing liquidity risk methodologies in about half the respondents (slide 26)
 - Where it is involved, this is attributed to its market knowledge
 - There are few plans to change the status quo (slide 28)

Findings

MM trading responsibilities and performance measurement

- The reporting lines for MM trading and risk reporting are in most instances separated (slide 31)

- With respect to prudential Vs P&L responsibilities
 - Most (15/19) MM trading desks have responsibility for meeting regulatory liquidity reporting ratios (slide 32)
 - Where respondents are responsible for meeting regulatory reporting ratios, most (12/15) are judged primarily on their prudential role rather than ability to generate P&L (slide 34)
 - Notwithstanding that, most respondents (17/19) have a budget (slide 35)

- With respect to factors contributing to remuneration, the responses are varied (slide 36) and include
 - P&L
 - Meeting regulatory reporting requirements
 - Establishing a fair FTP
 - Diversifying funding sources from market/ECB

Findings

MM trading responsibilities and performance measurement (cont.)

- With respect to organisation
 - It is evenly split as to whether MM trading is part of a larger trading unit or as a standalone (slide 37)
 - A number of other products are included but this is by no means consistent (slide 38)
 - In most instances (17/19), MM trading is responsible for financing the Central bank accounts (slide 39)

- With respect to reporting lines
 - In most instances (15/19), MM trading resides within the commercial activities of the bank (Corporate and Investment Bank) (slide 40)
 - Where it does not, it reports directly to a board member
 - There appear to be few plans to change this (slides 41 and 43)

Findings

FTP framework

- With respect to FTP infra structure
 - Most respondents (17/19) have a FTP framework in place (slide 45)
 - For the majority (12/17), this was established before 2007 (slide 46)
 - The FTP usually (11/17) applies to all assets and liabilities (slide 47)
 - Where it does not, OBS commitments and trading assets are the common exceptions
 - For most (16/17) it applies to both short and long term assets and liabilities (slides 48 and 49)
- With respect to FTP pricing
 - In most cases (14/17) it is either market based or market based plus add-ons (slide 50)
 - Common costs included are for CC (14/17) and IRS (11/17) basis swaps and liquidity buffers (9/17) (slide 51)
 - Half (8/17) of the FTP frameworks contain a bid/offer spread (slide 52)
 - The majority adjust the maturity of retail deposits (12/17) for behaviour (slide 54) but in most cases (11/17) assets are not behaviourally adjusted (slide 55)
 - For most FTP frameworks, trading assets are funded on a short-term basis (slide 56) and not according to maturity
 - In (10/17) cases, OBS commitments are charged a liquidity fee (slide 58)
 - *(This is not consistent with most regulatory directives e.g. Directive 2009/111/EC of the European Parliament, Basel sound practices for managing liquidity risk , CEBS guidelines on liquidity cost benefit allocation)*

Findings

FTP framework (cont.)

- With respect to FTP conflict resolution and P&L
 - ALCO/ CFO/Finance most commonly resolve FTP disputes (slide 59)
 - Most respondents indicated a central function as the beneficiary of the net result of the ftp policy (slide 60)
 - Half have a target for the result of the FTP policy (slide 61)

Findings

Governance of resource allocation

- In both the allocation of Balance sheet limits and liquidity risk limits, there are more than 19 respondents for each section. This implies either that:
 - There is a lack of co-ordination about how such limits are allocated
 - And/or different business get delegated authority to allocate limits
- The most common bodies responsible for allocating balance sheet and liquidity limits in both cases are ALCO and the board of directors (slide 63)

Observations

- Has the issue concerning the conflict of interest between managing liquidity risk been resolved?
 - The responses suggest otherwise
 - MM trading is responsible for prudential ratios (slide 32)
 - MM trading is primarily judged on its prudential role (slide 33,34)
 - Yet MM trading has a P&L target (slide 35) and largely reports to commercial (profit focused) activities (slide 40)

How is this inherent conflict managed?

- There is a very inconsistent approach to FTP
 - Approach to bid/offer spreads
 - Approach to what factors are included with FTP
 - Arbitrary nature as to how it is derived

Does this make a level playing field impossible?

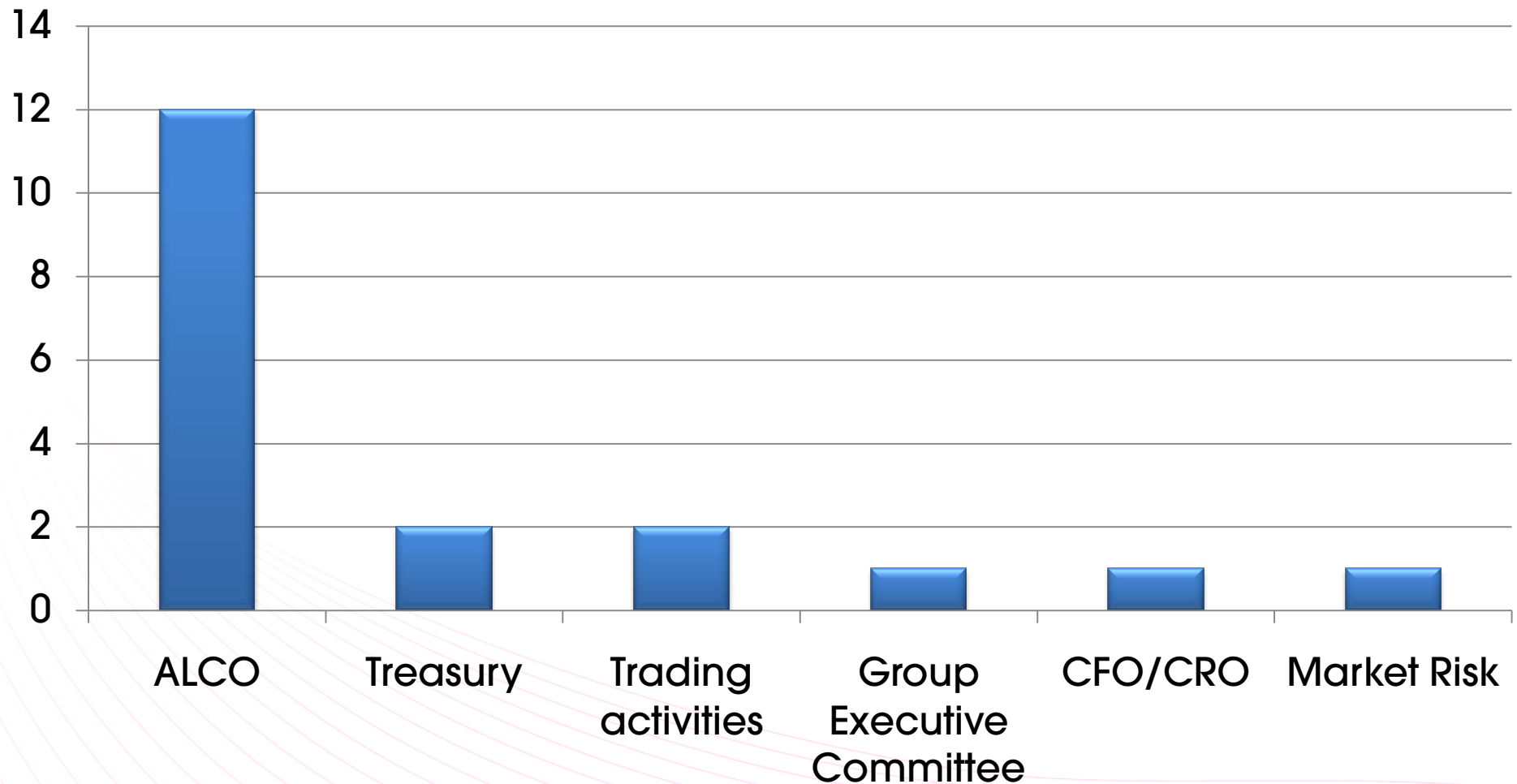
Observations

- The governance of liquidity as a resource (slide 63) is very confused. We believe a comparable slide concerning capital/RWA would be much clearer

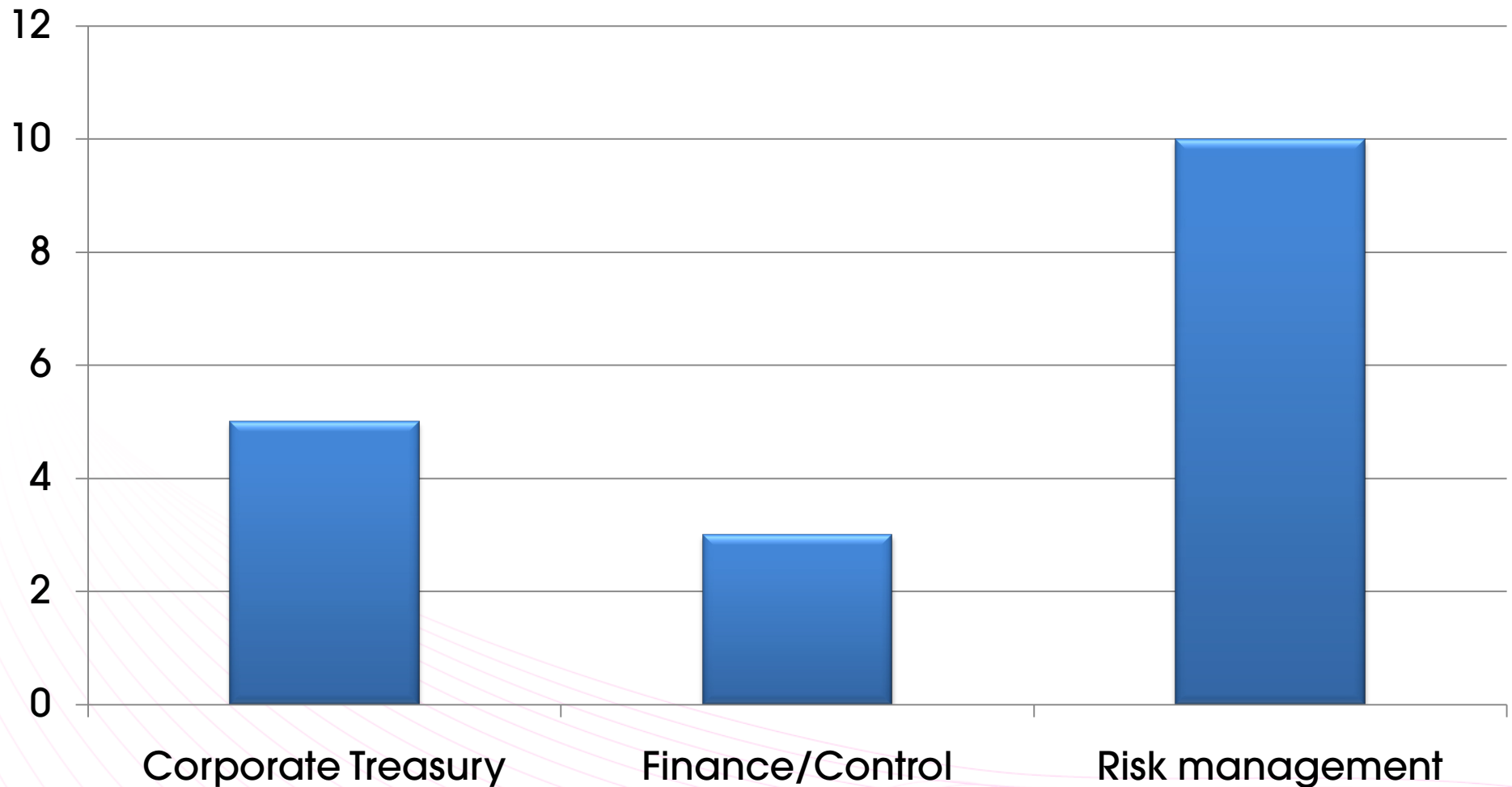
Is this a reflection of the inherent conflict within the management of liquidity risk and its reporting lines or a reflection of the infancy of the recognition of liquidity as a scarce resource?

OVERSIGHT OF LIQUIDITY RISK MANAGEMENT

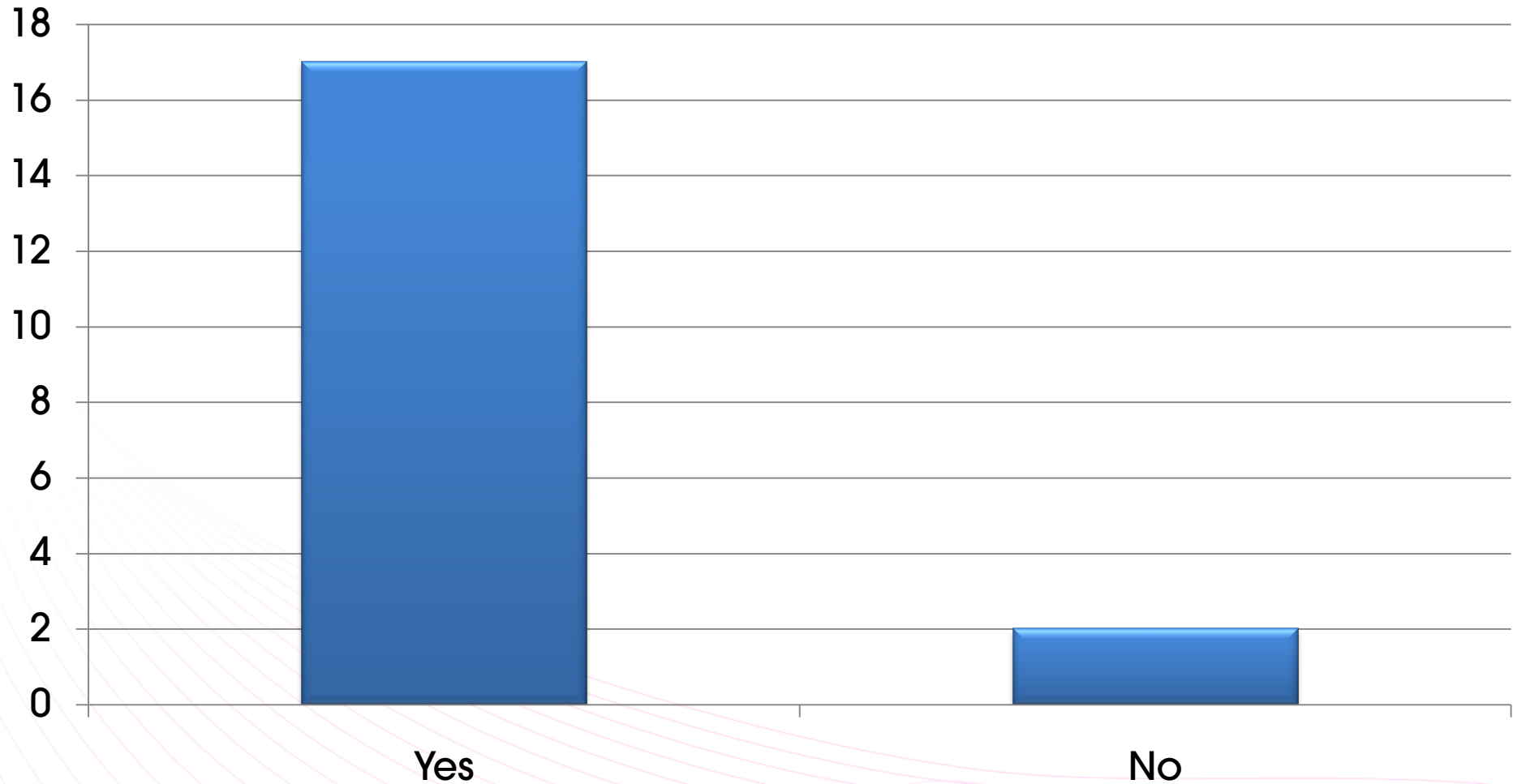
Q1: To whom does the board delegate the ultimate responsibility for the liquidity risk profile of the balance sheet?



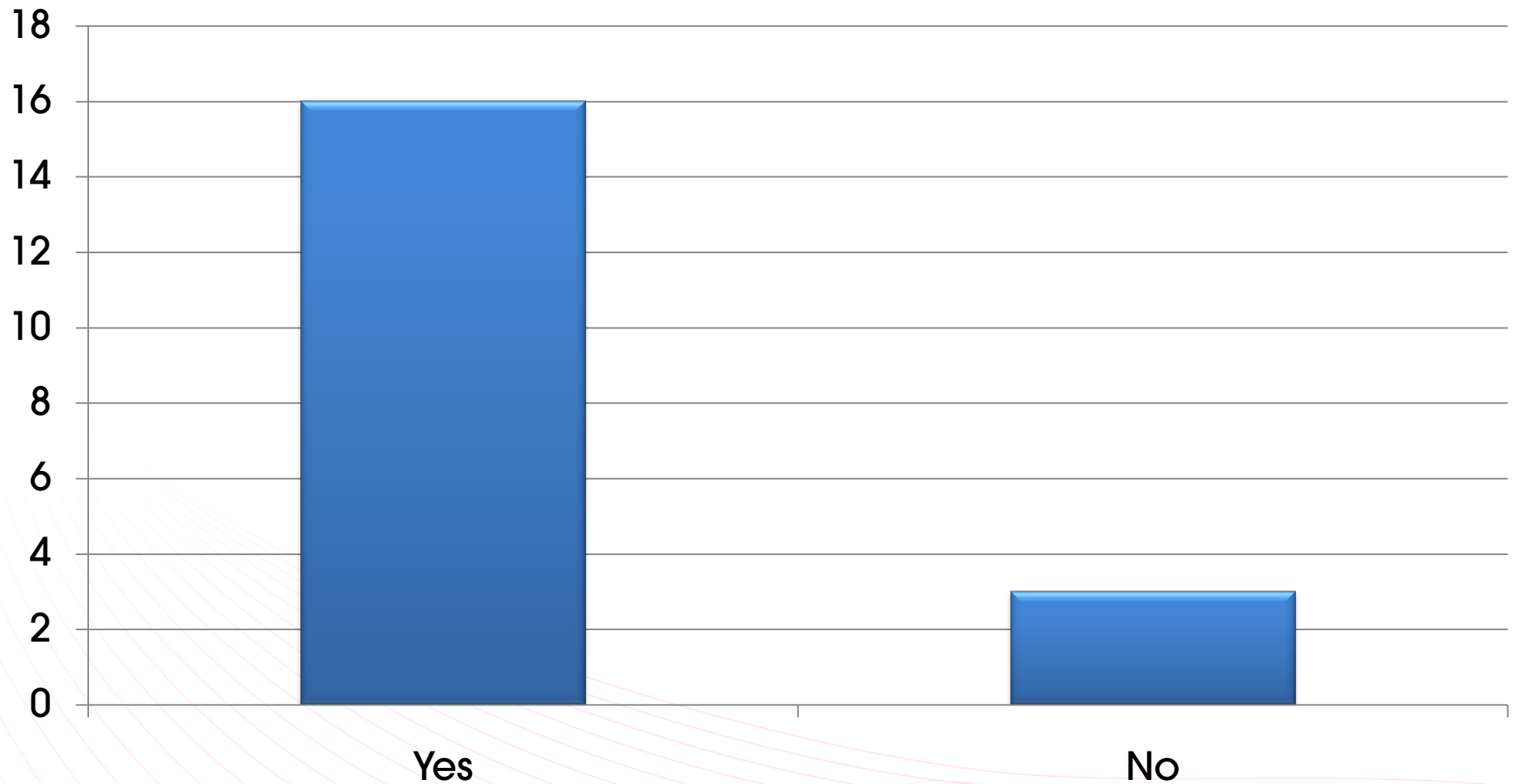
Q2: Which corporate body or department has oversight of the liquidity risk management reporting within your bank?



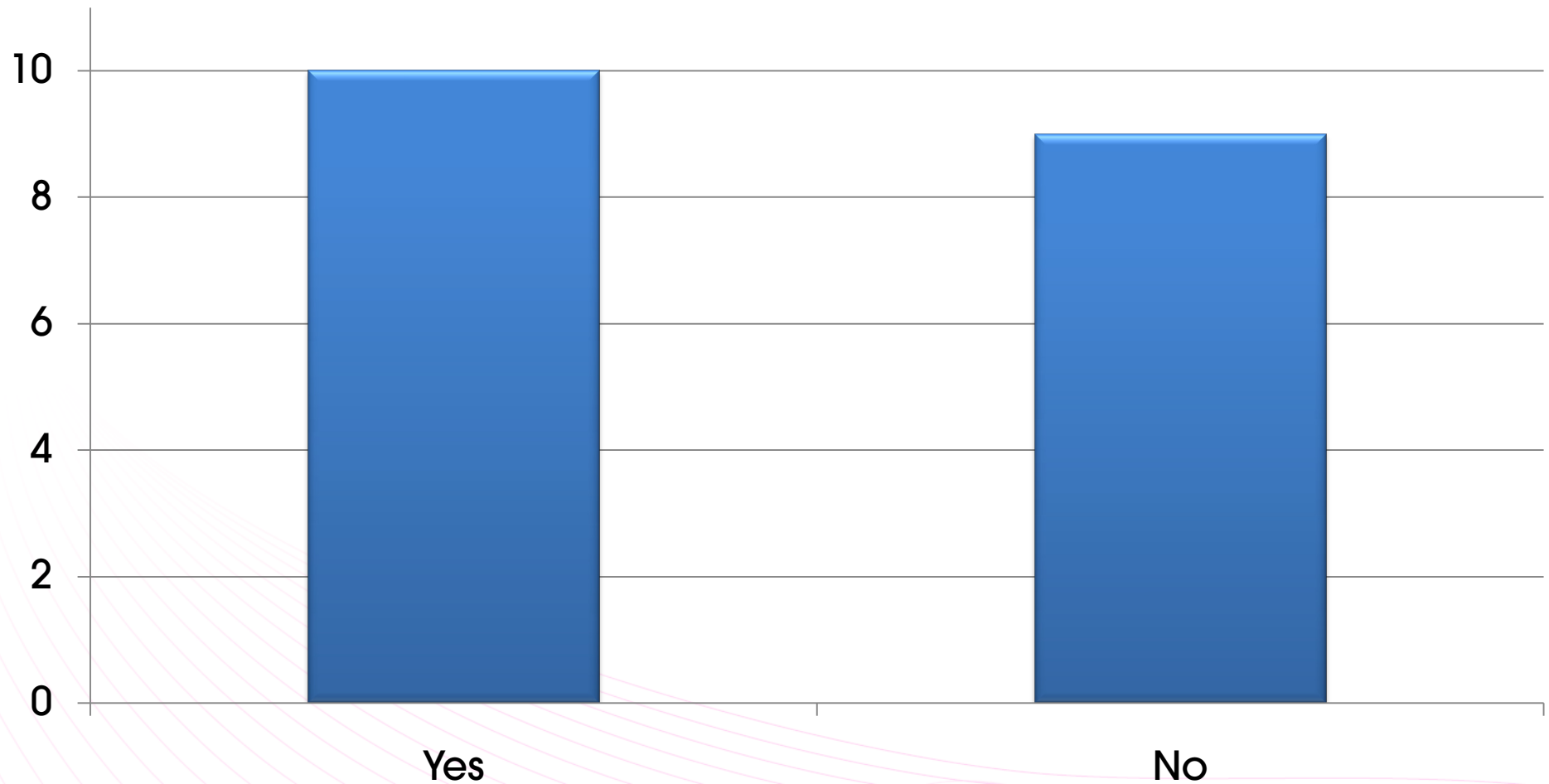
Q3: Does Risk Management (or the CRO) have an active role in monitoring risk utilisations?



Q4: Does Risk Management (or the CRO) have an active role in developing liquidity risk methodologies?



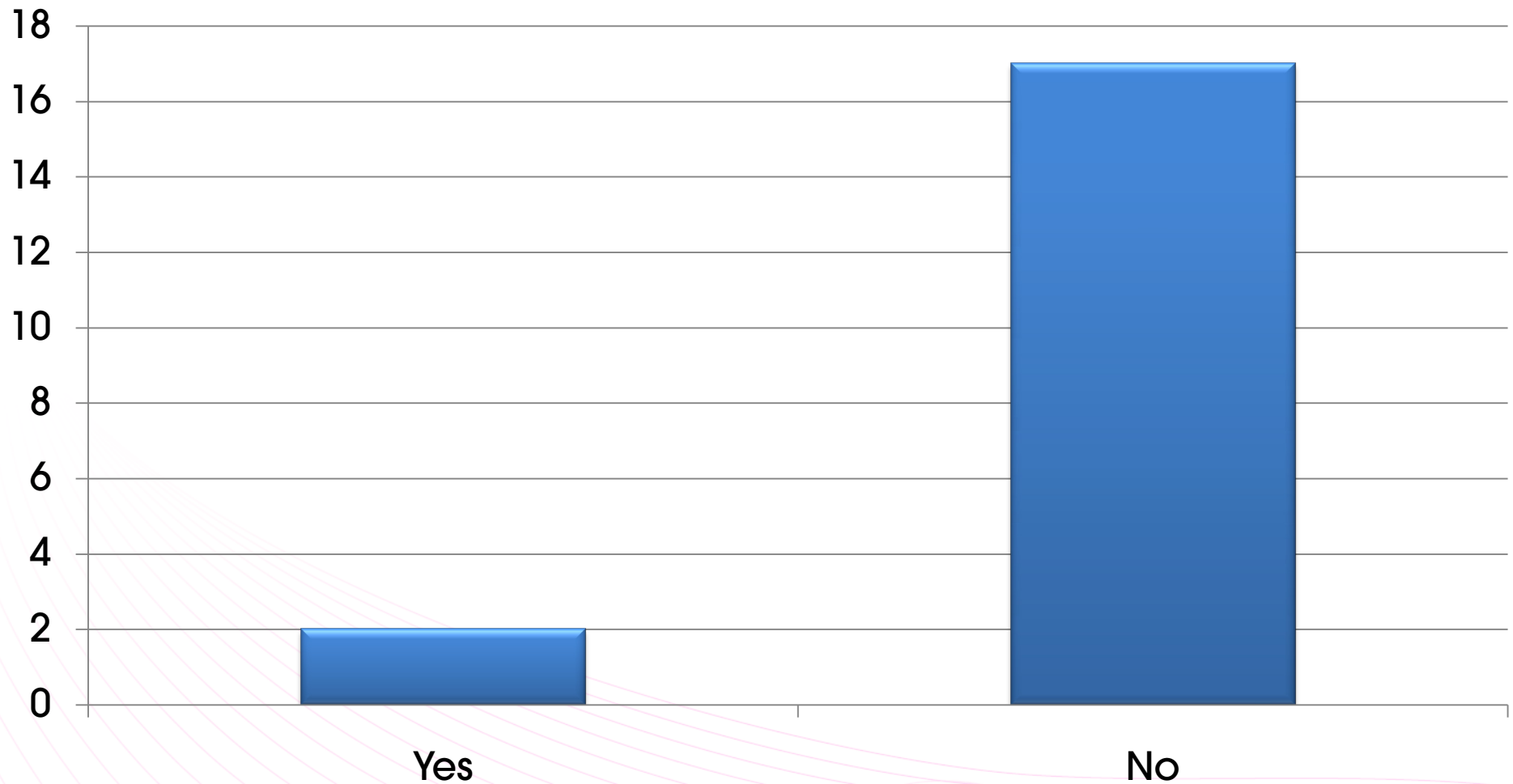
Q5: Has the role of the CRO with respect to monitoring or developing liquidity risk methodologies changed in the last year?



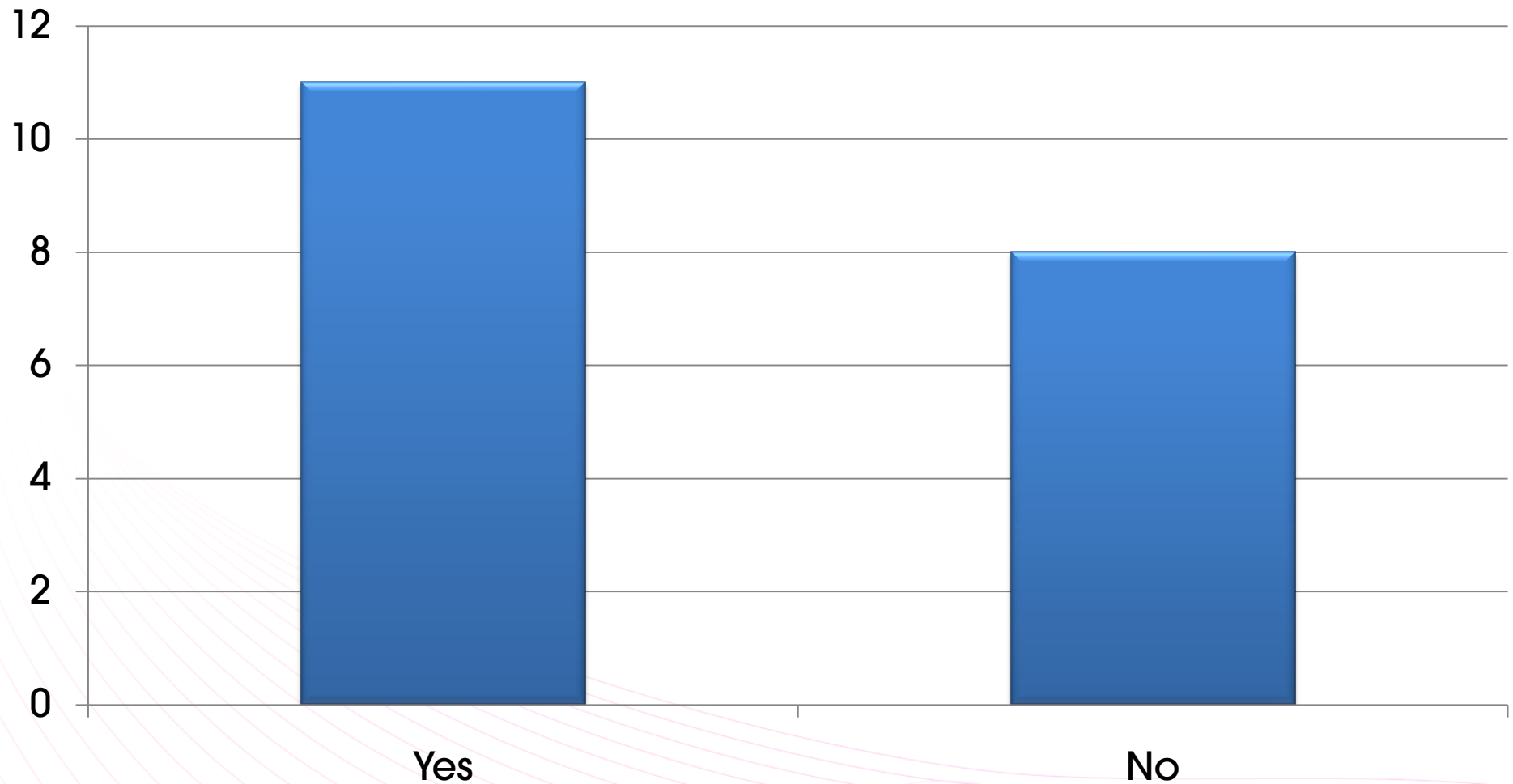
Where the role of the CRO has changed, the changes are attributed to...

- Risk management more involved in robustness of liquidity risk models
- Until 2007, CRO did not monitor liquidity risk at all
- Creation of specific liquidity risk reports
- More resources (fte's and investment in technology) are being assigned to liquidity risk within risk management
- Increased attention from risk management due to regulatory developments and local regulatory pressure
- Involvement in developing stress tests and contingency plans
- CRO mandate has moved from a purely monitoring to advisory role

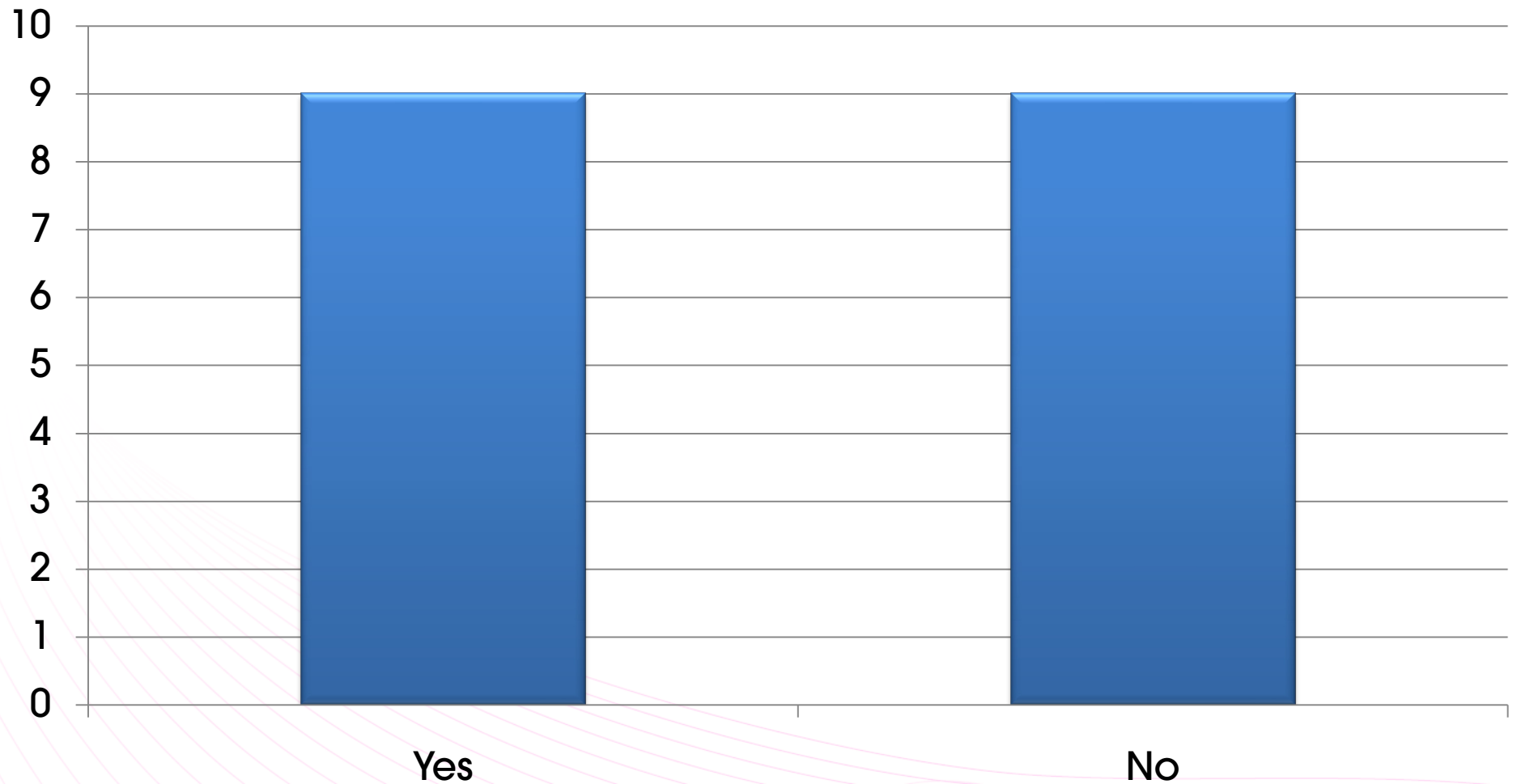
Q6: Are there plans or discussions to change the role of the CRO with respect to monitoring or developing liquidity risk methodologies?



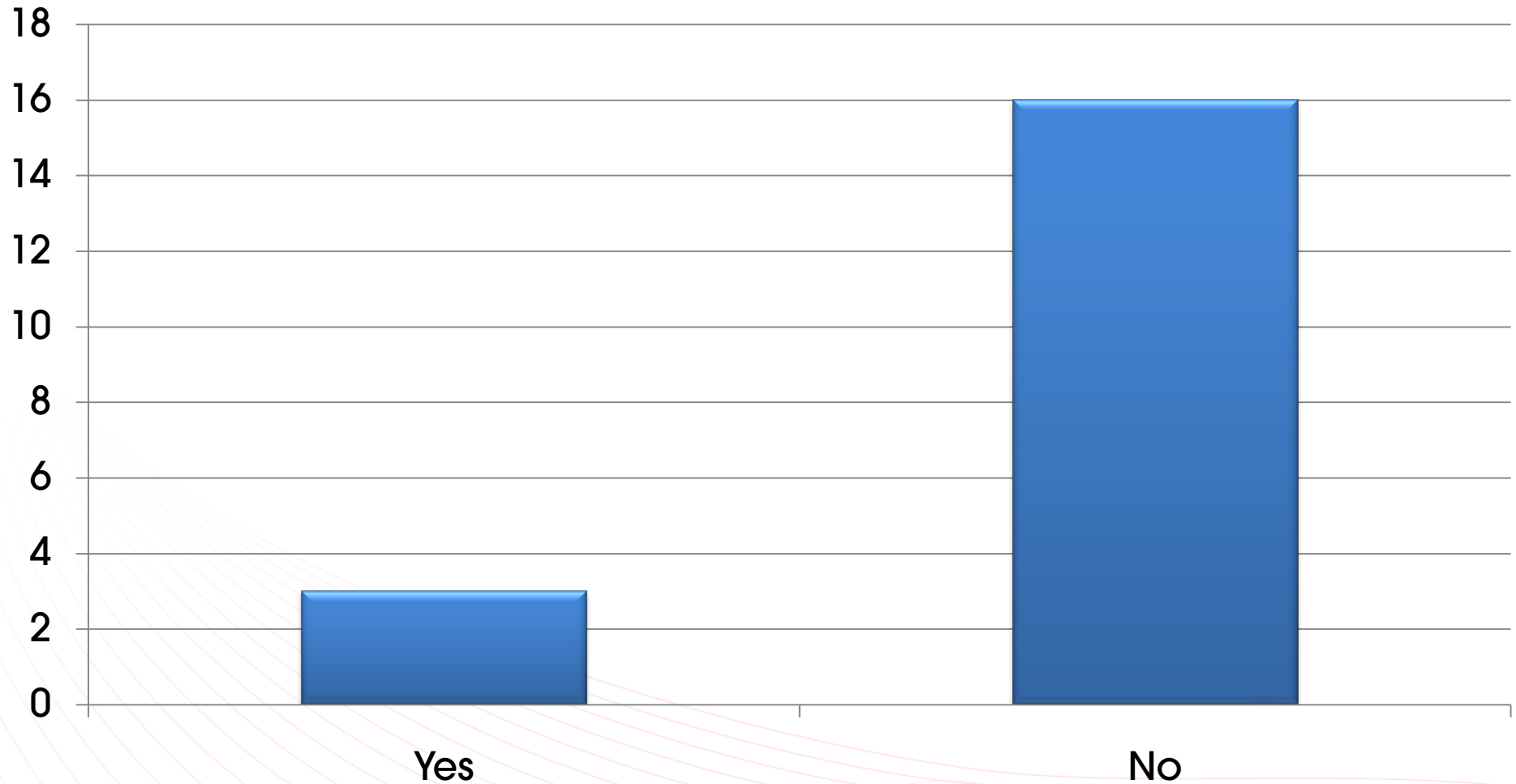
Q7: Does Finance (or the CFO) have an active role in monitoring liquidity risk utilisations?



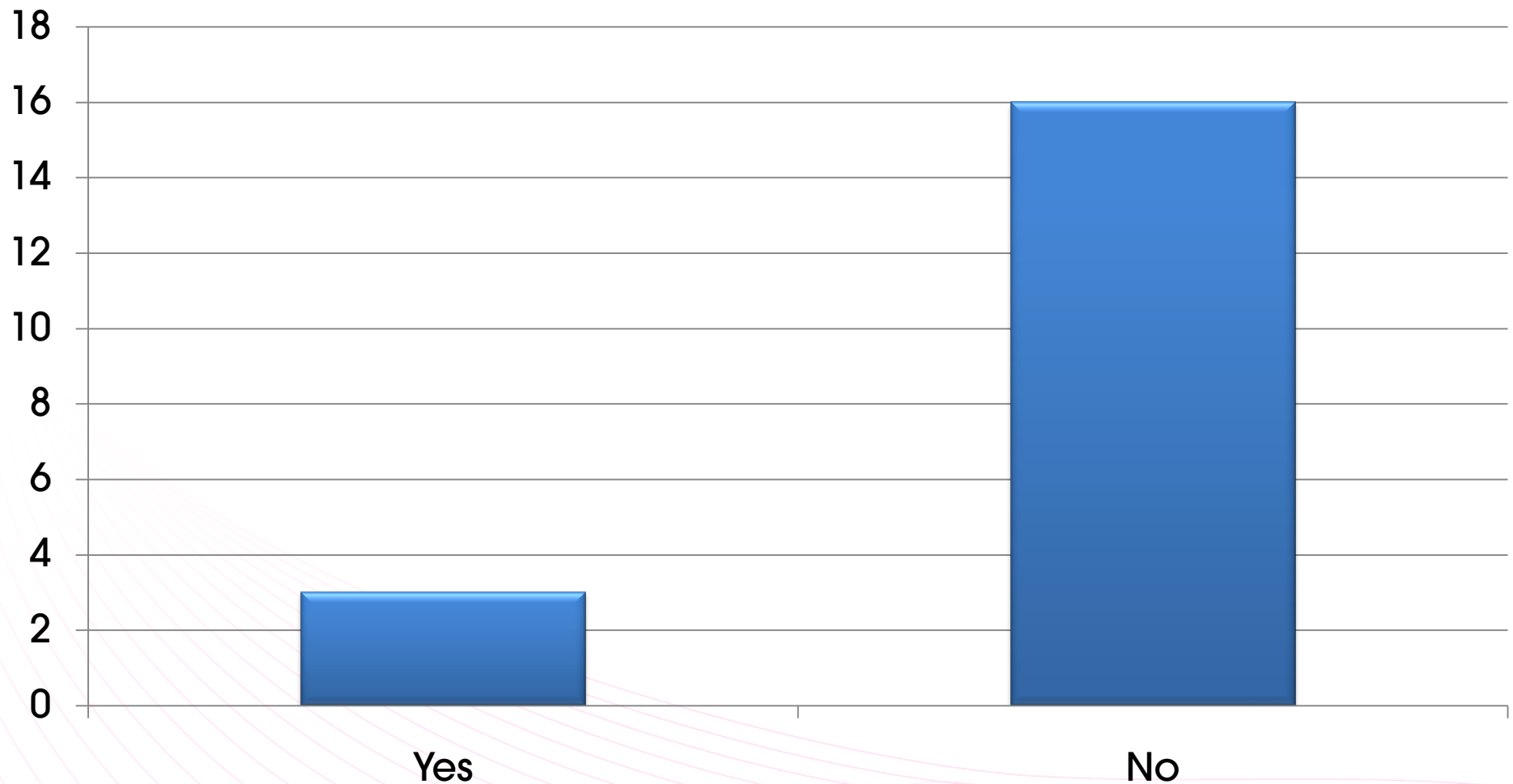
Q8: Does Finance (or the CFO) have an active role in developing liquidity risk methodologies?



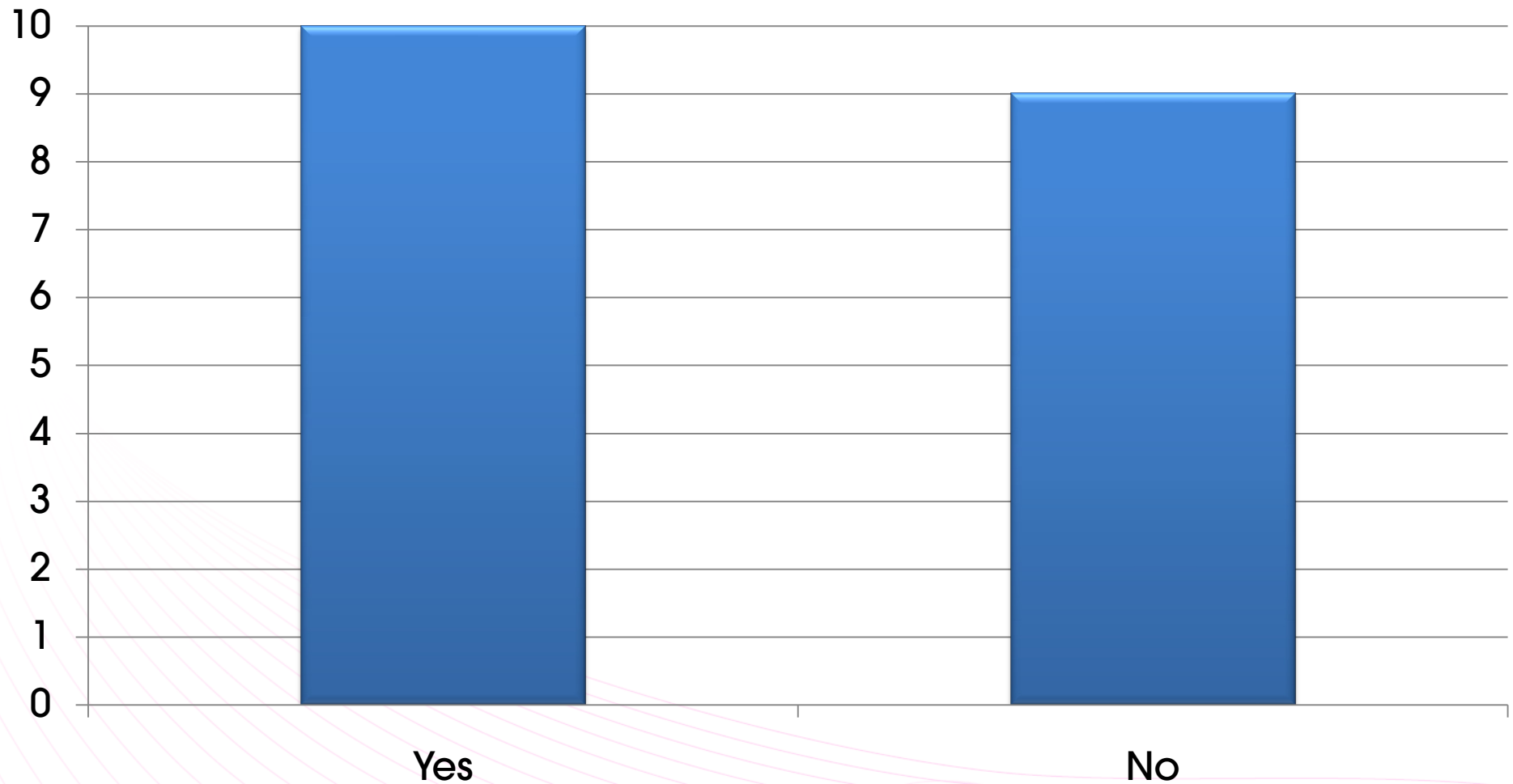
Q9: Has the role of Finance (or the CFO) with respect to monitoring or developing liquidity risk methodologies changed in the last year?



Q10: Are there plans or discussions to change the role of Finance (or the CFO) with respect to monitoring or developing liquidity risk methodologies?



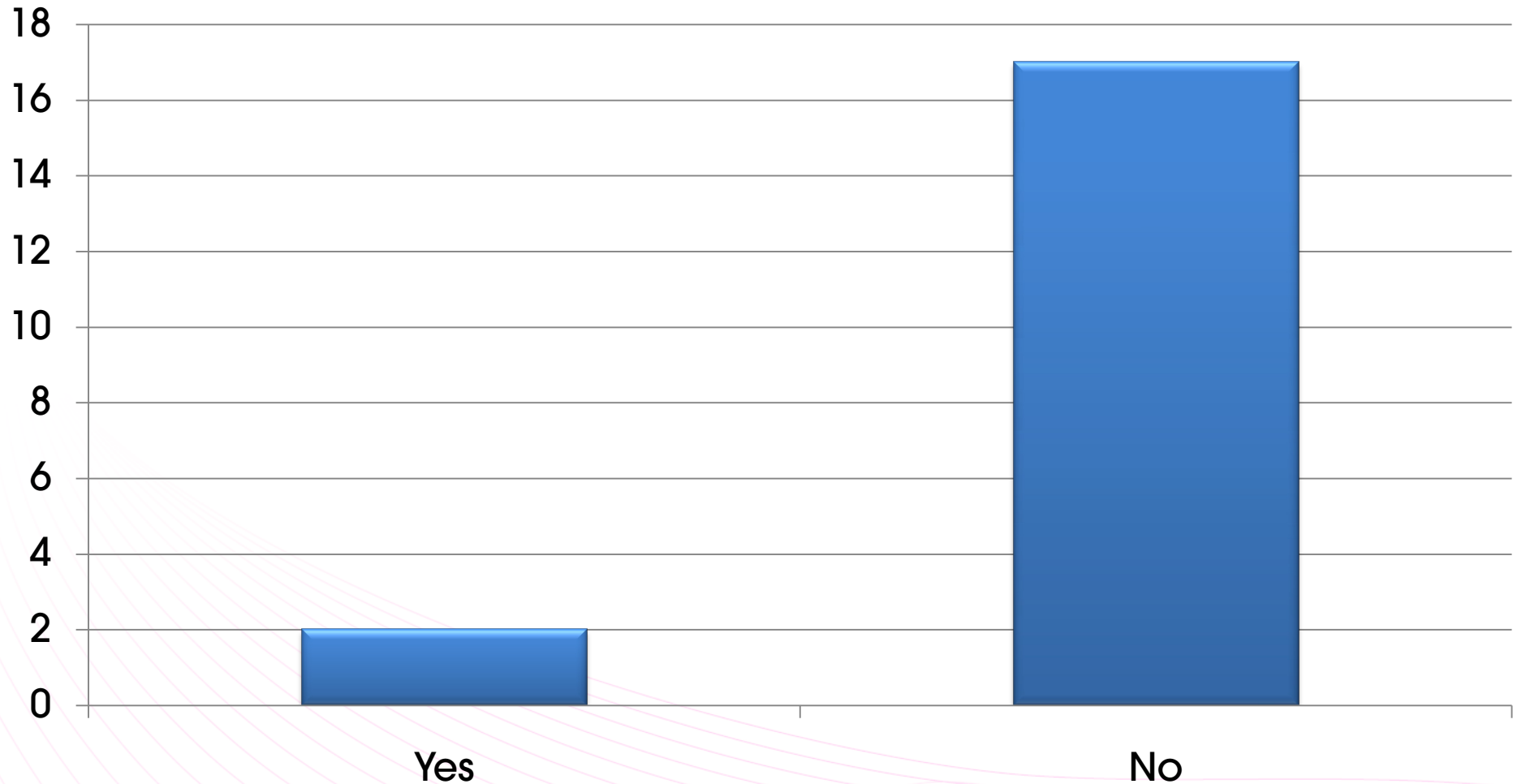
Q11: Does MM trading have an active role in developing liquidity risk methodologies?



Where money markets has influence...

- MM Trading is separate from dealing room activities and part of finance
- MM trading re-assesses due to its market access/knowledge
- MM has significant input due to its market knowledge (majority)

Q12: Are there plans to change the role of MM trading in developing liquidity risk methodologies?

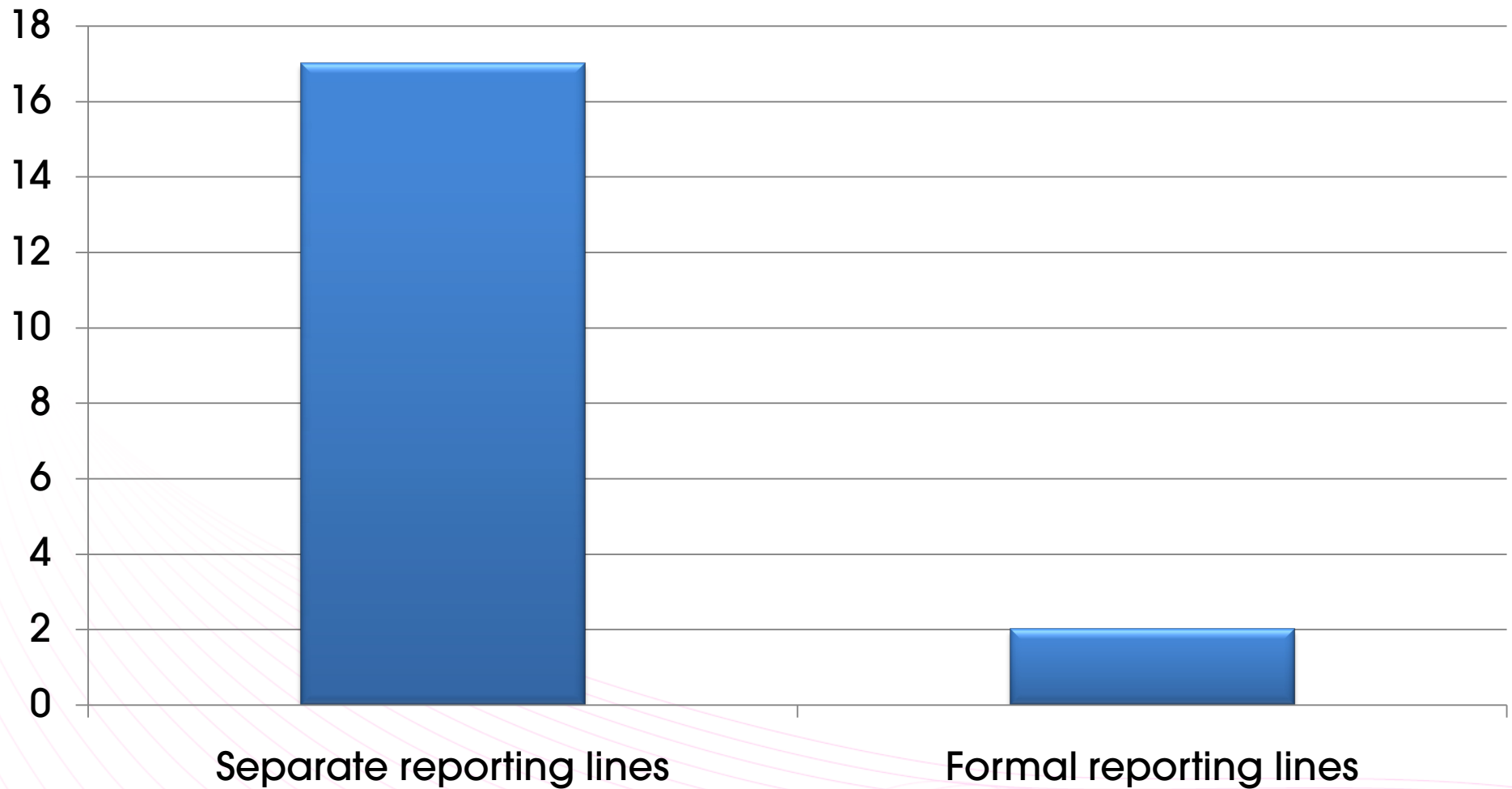


Where there are plans to change the involvement of mm trading...

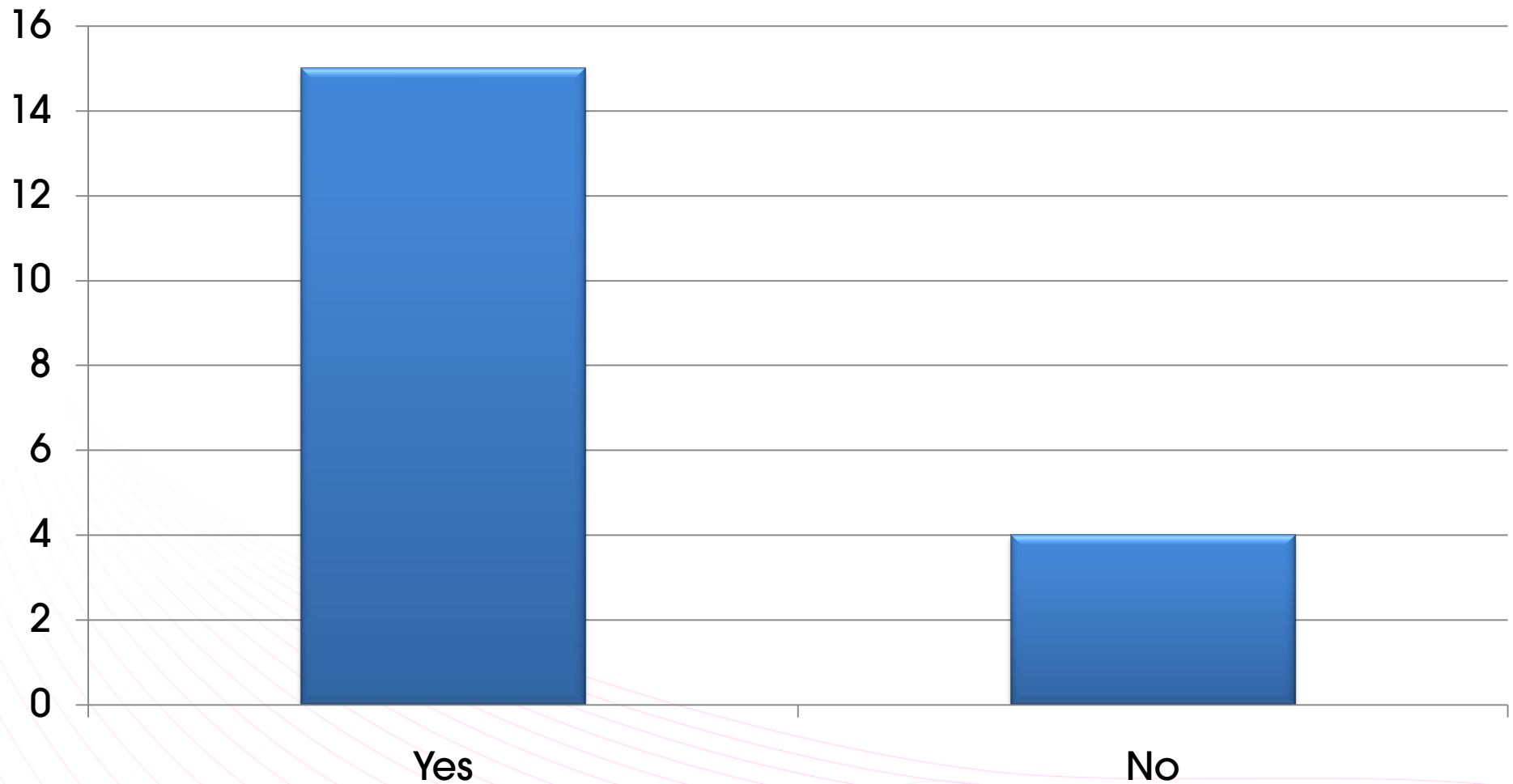
- The whole risk governance from Group ALCO down is being reviewed
- MM trading is becoming more involved in designing methodologies

MM RESPONSIBILITIES AND PERFORMANCE MEASUREMENT

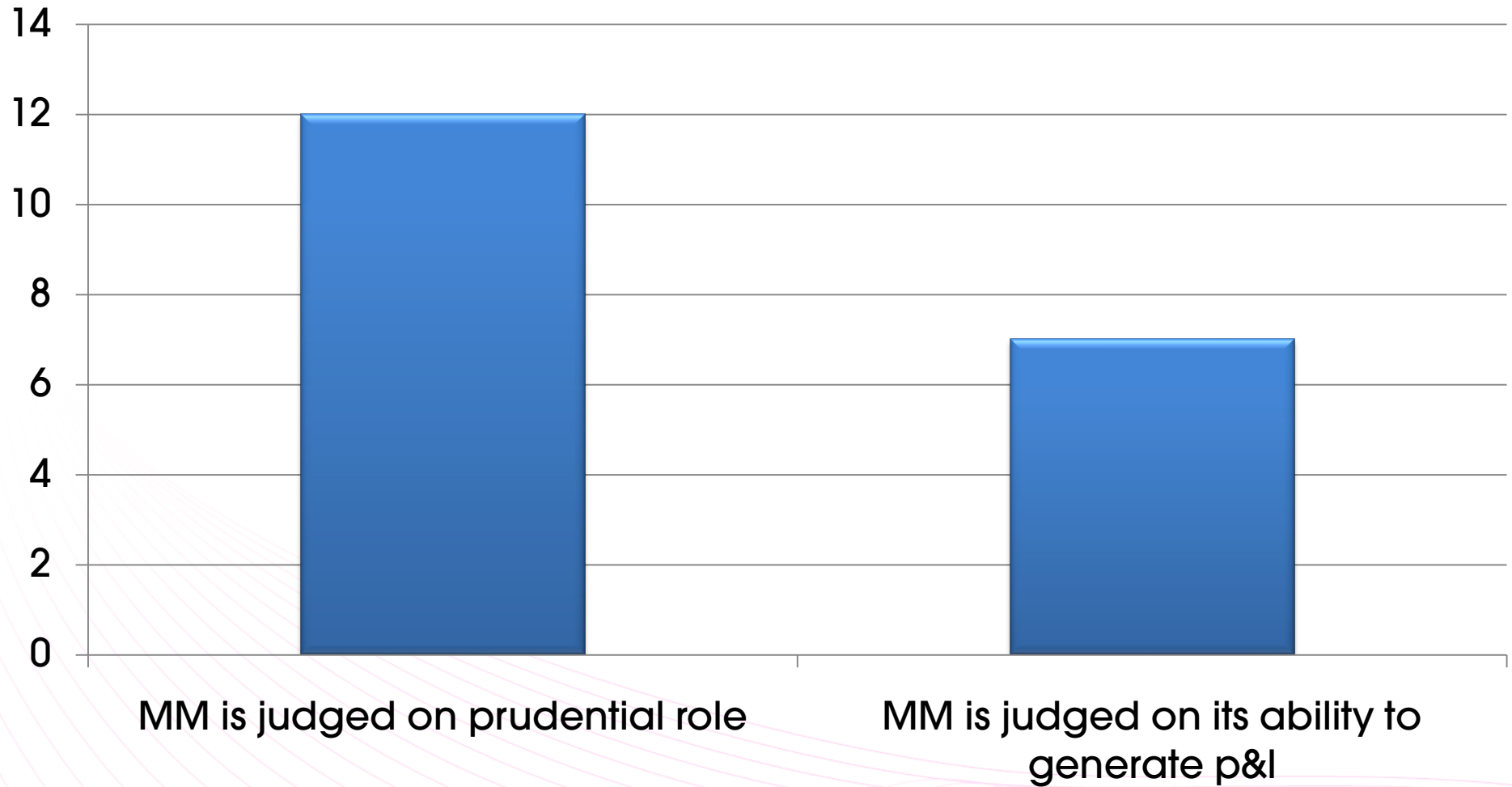
Q1: What is the reporting relationship between the Liquidity Risk responsible body and MM?



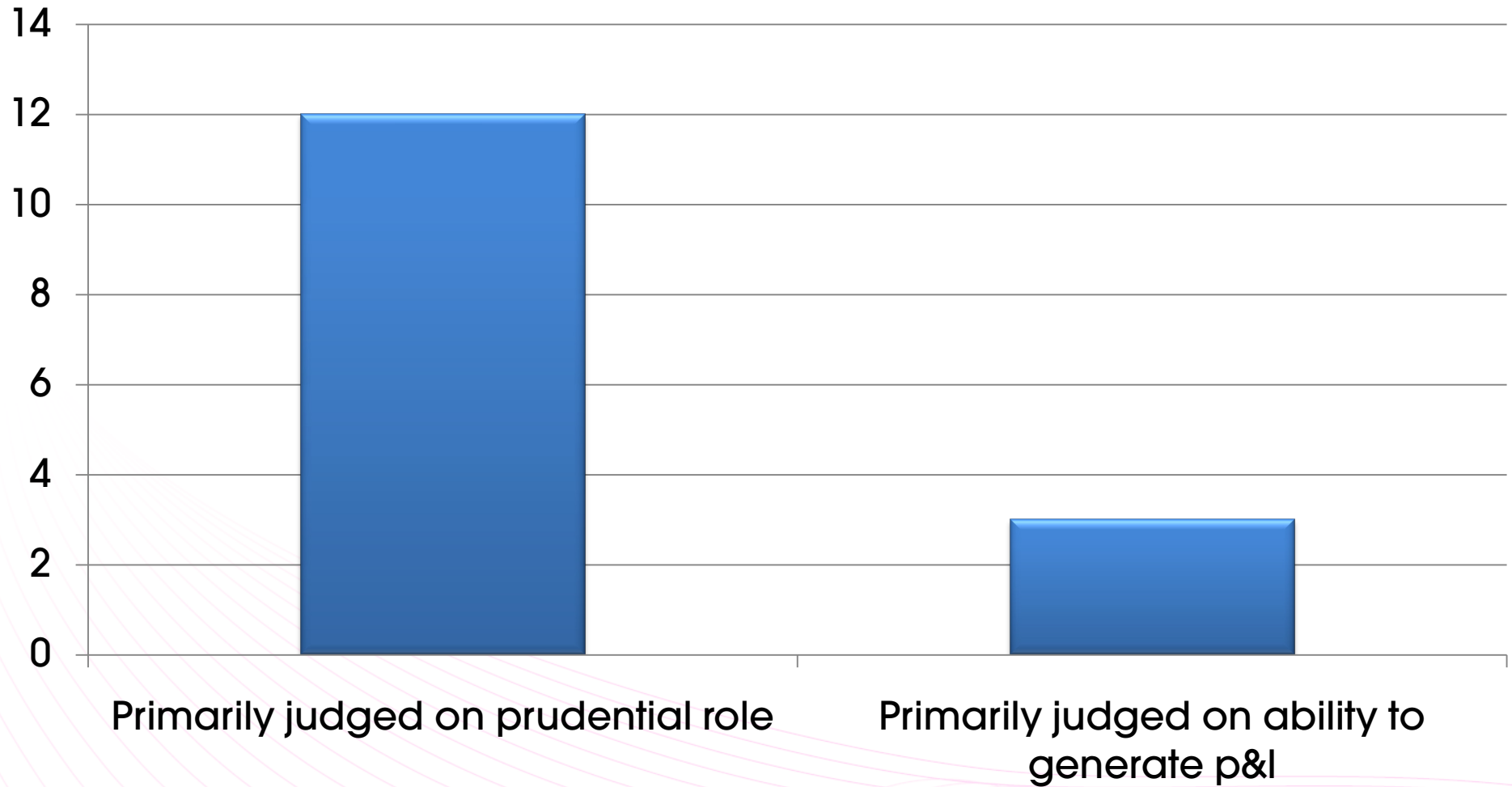
Q2(i) : Does MM have responsibility for meeting any regulatory liquidity reporting ratios?



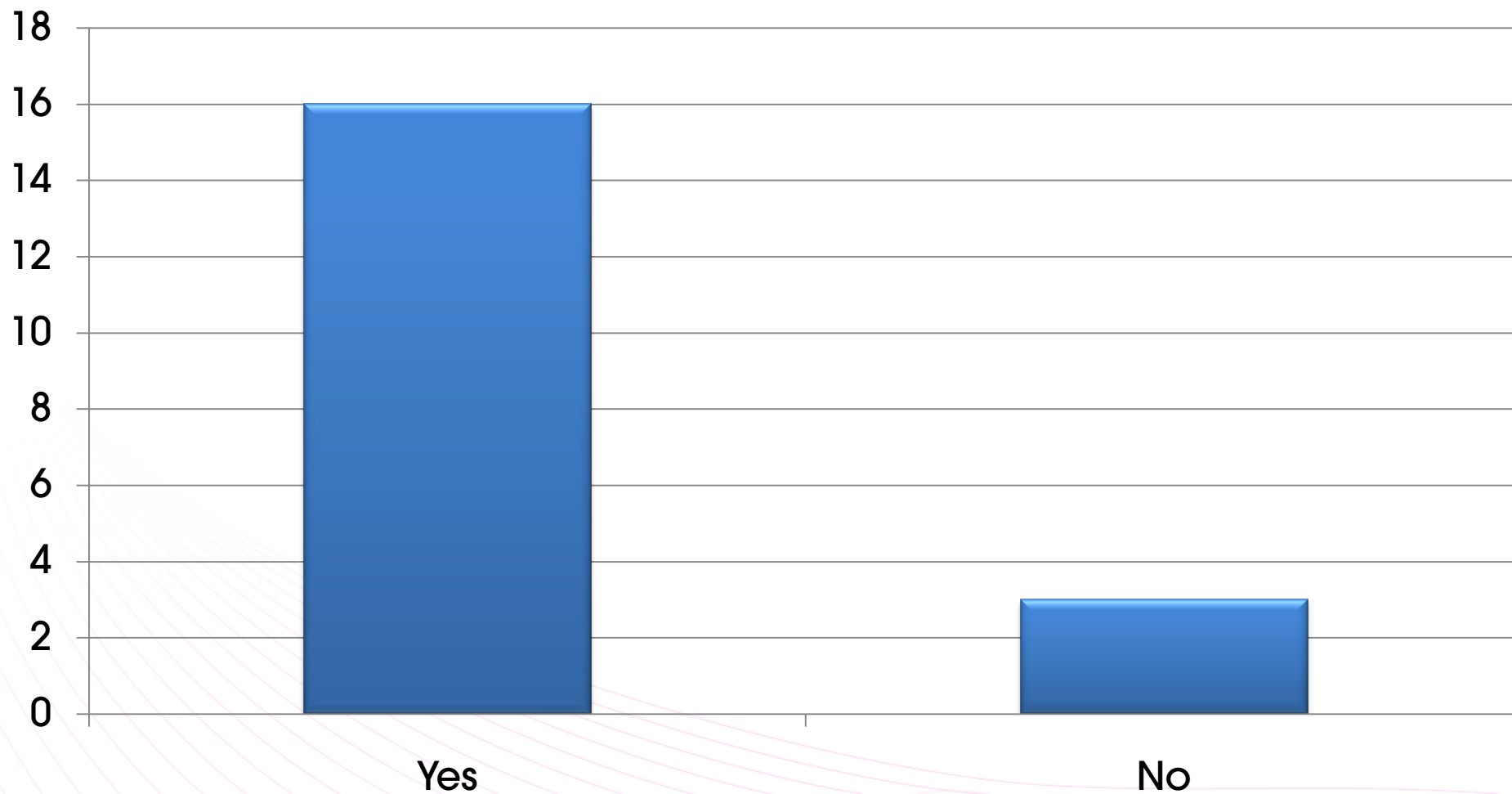
Q2(ii) : Which statement is more true?



Q2(iii) : Of the 15 banks which have responsibility for meeting regulatory ratios, which statement is more true?



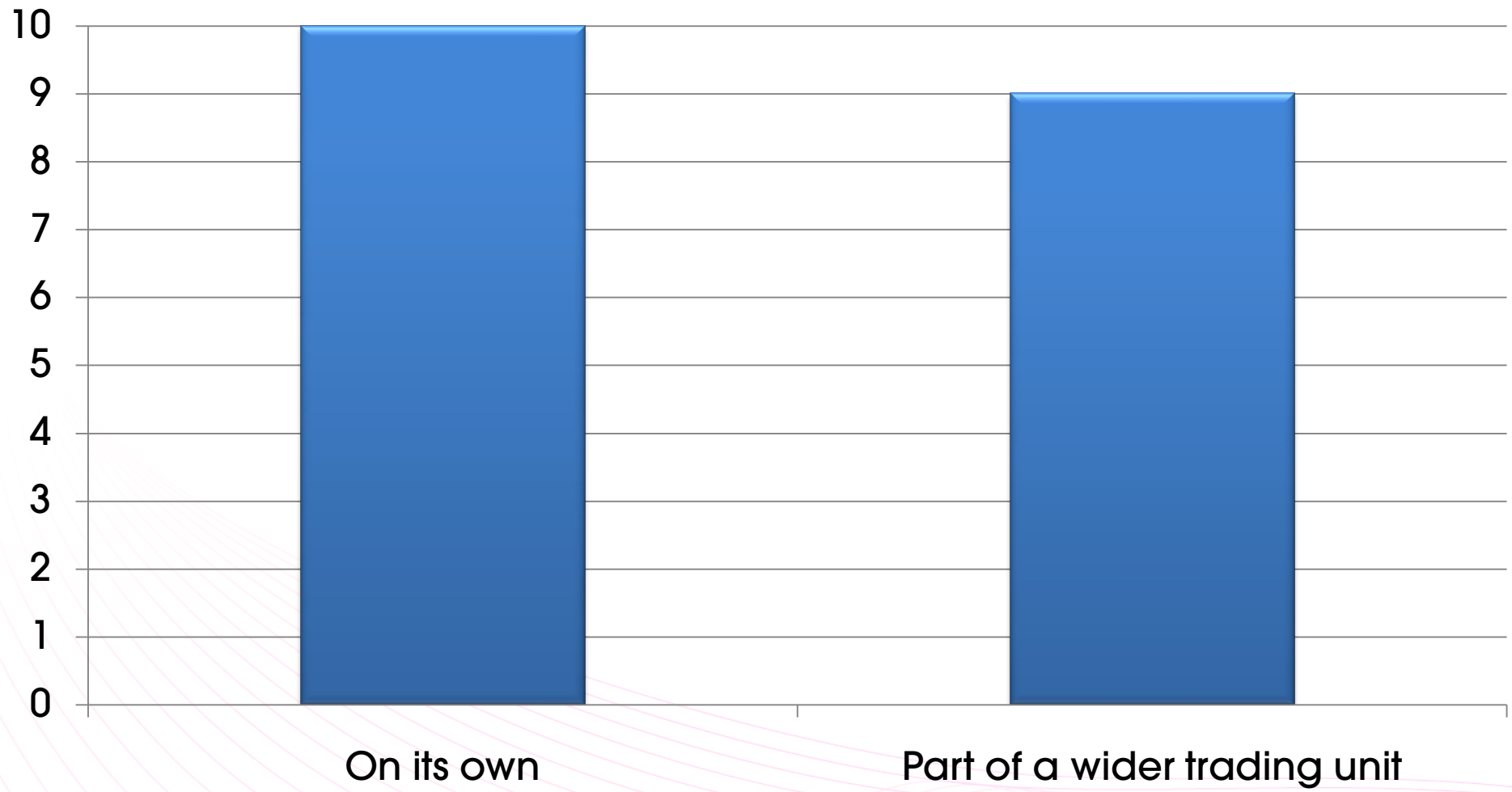
Q3: Does MM have a P&L budget?



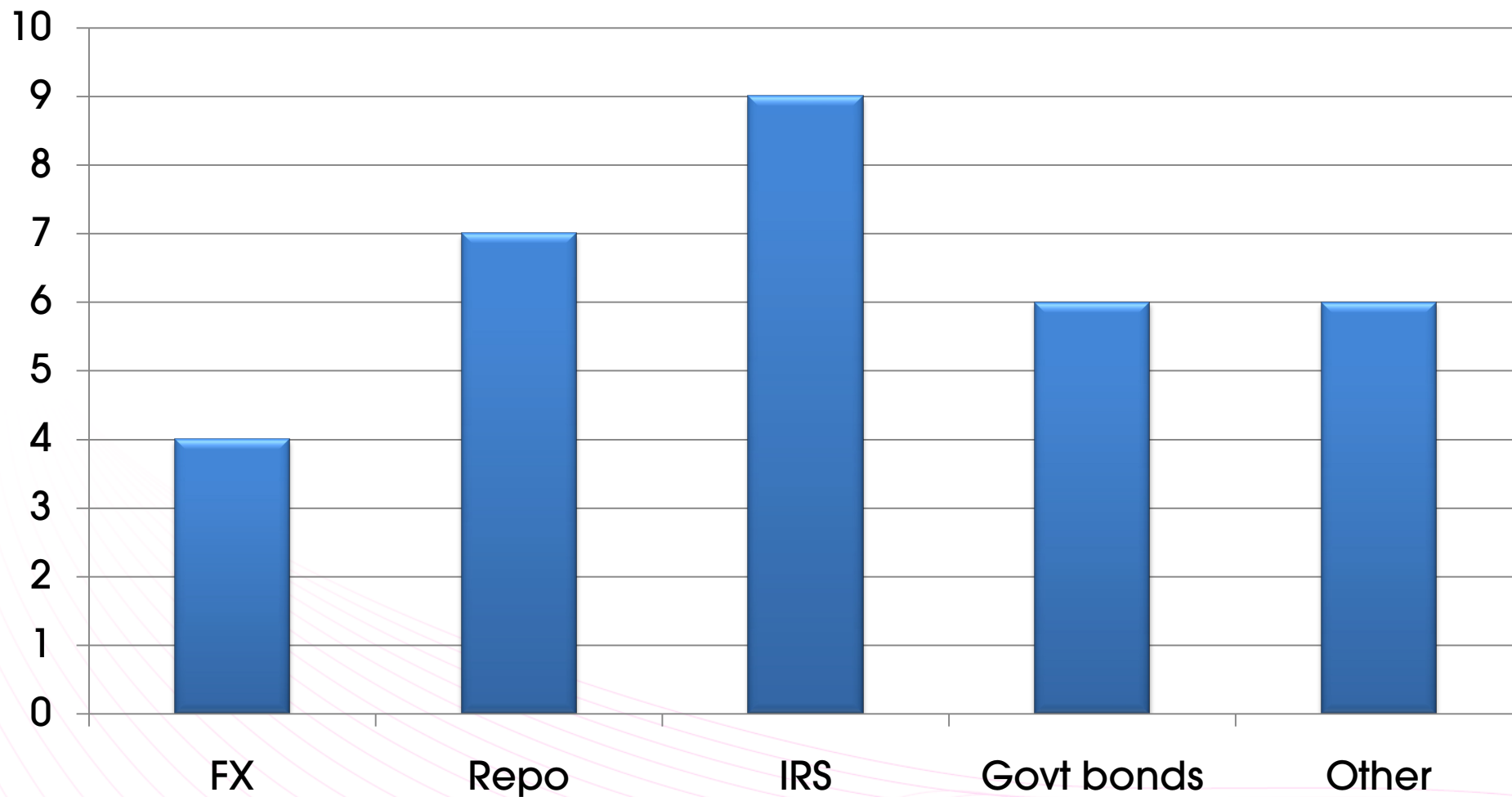
Q4: What factors are taken into account in deciding MM trading remuneration?

- Protection of firm franchise
- Fulfilling budgetary targets
- Maintaining prudent liability profile, accurate internal transfer pricing and managing liquidity pool costs
- Liquidity FTP methods
- Meeting internal/external requirements
- Compliance with limits
- Group/ divisional/ business unit/ individual performance (qualitative and quantitative targets)
- Servicing customers, revenue targets, liquidity management
- P&L, meeting regulatory requirements,
- Individual and team performance against specific targets
- Developing market funding rather than ECB reliance
- P&L as well as developing funding sources
- Liquidity profile, regulatory ratios and diversified funding mix
- P&L

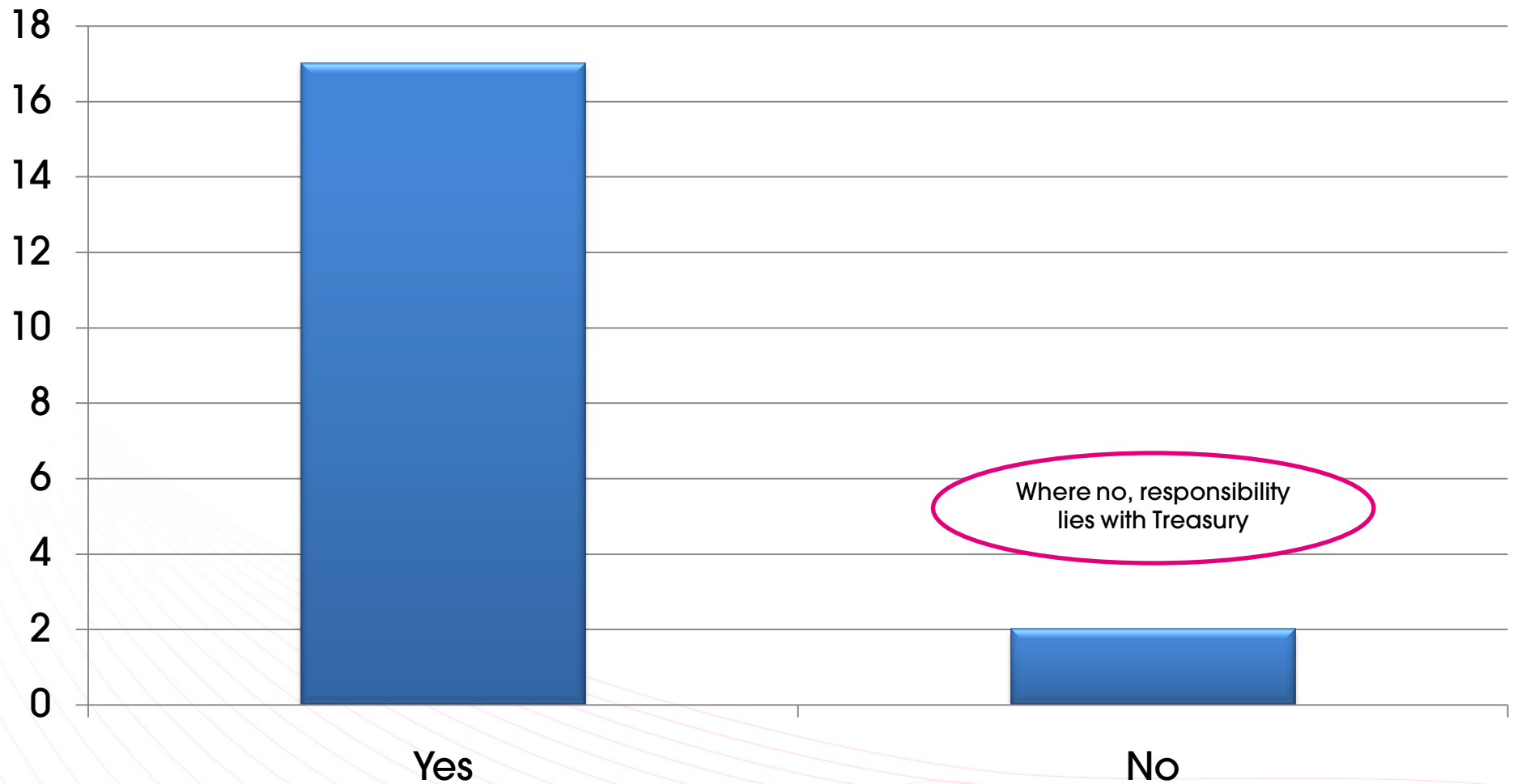
Q5 (i): Does MM exist as a trading unit on its own or as part of a wider trading group?



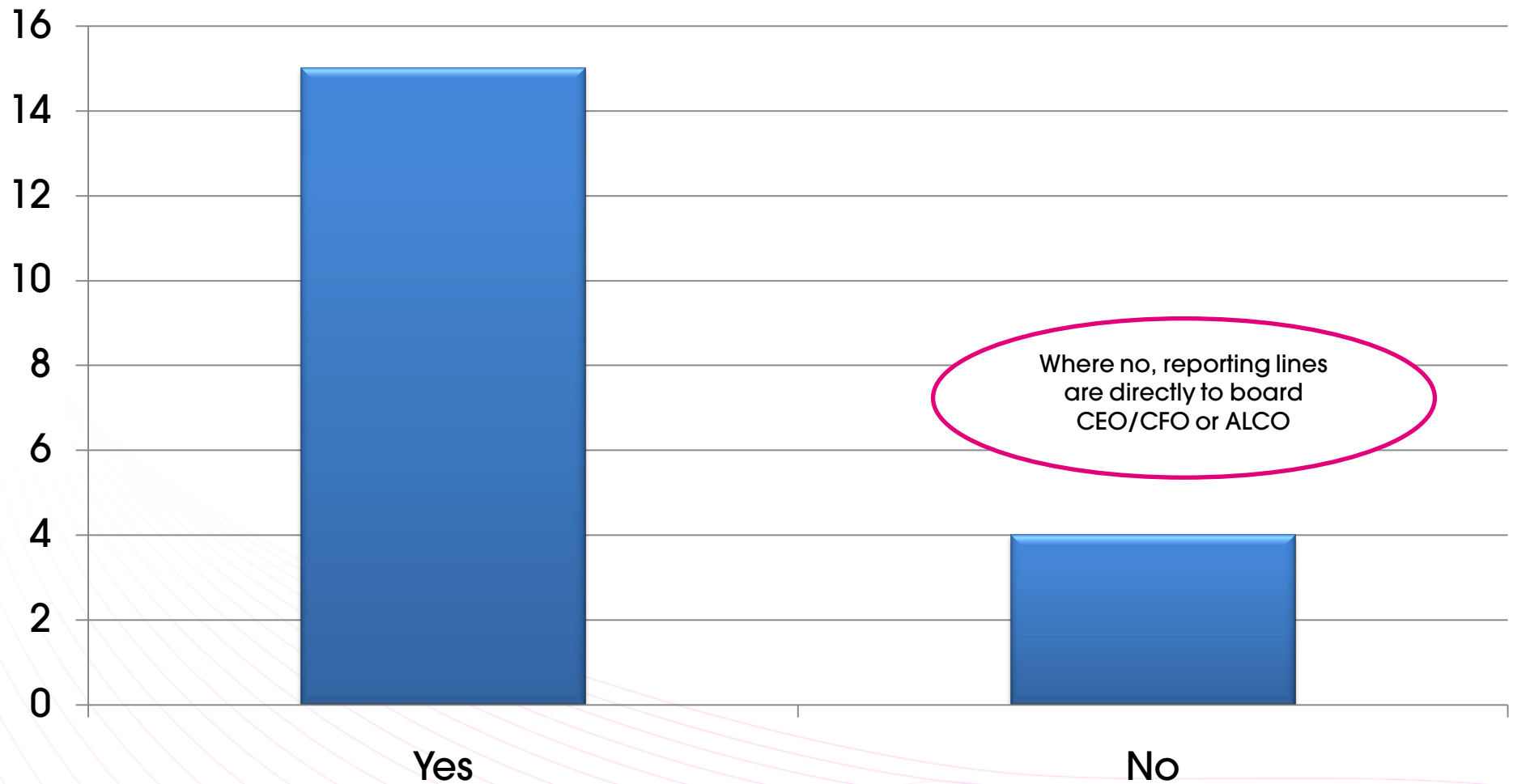
Q5 (ii): What other products are included in MM?



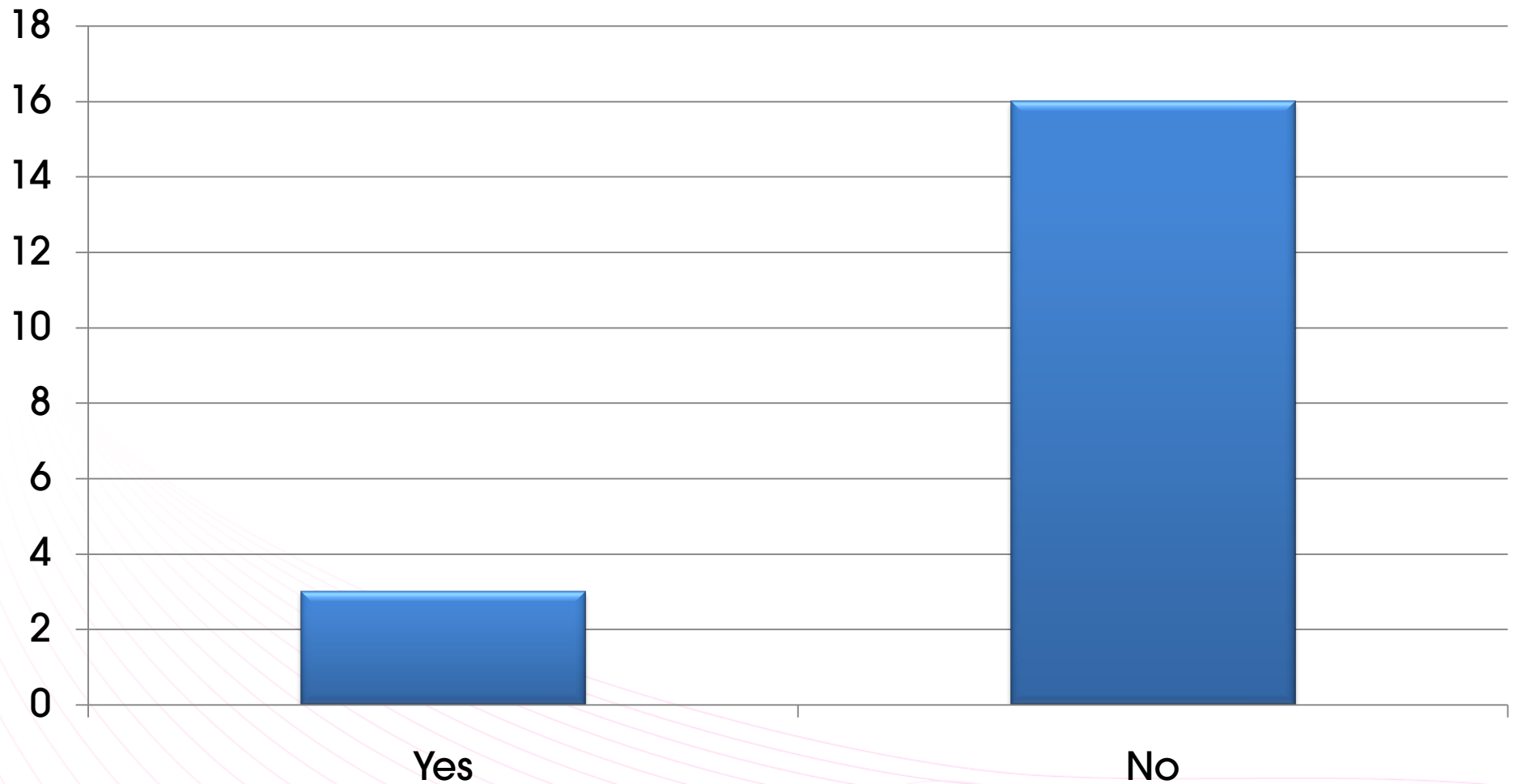
Q6 : Is MM trading responsible for funding the central banks accounts?



Q7+ Q8 : The reporting line and revenue for MM lies within the commercial banking activities (Corporate Bank, Investment Bank)



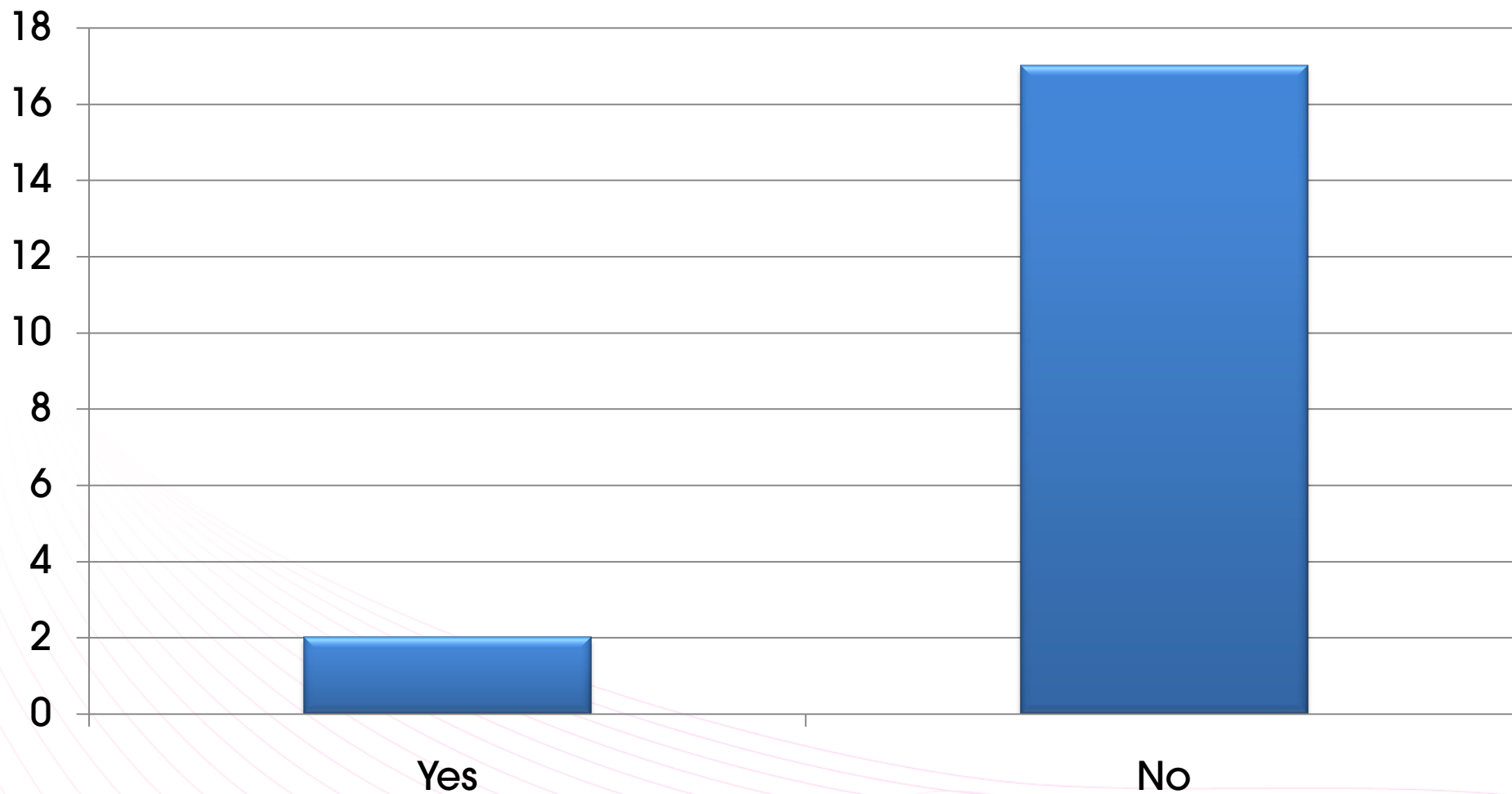
Q9 : Has the reporting line for Money Markets changed in the last year?



Q9 : Has the reporting line for Money Markets changed in the last year?

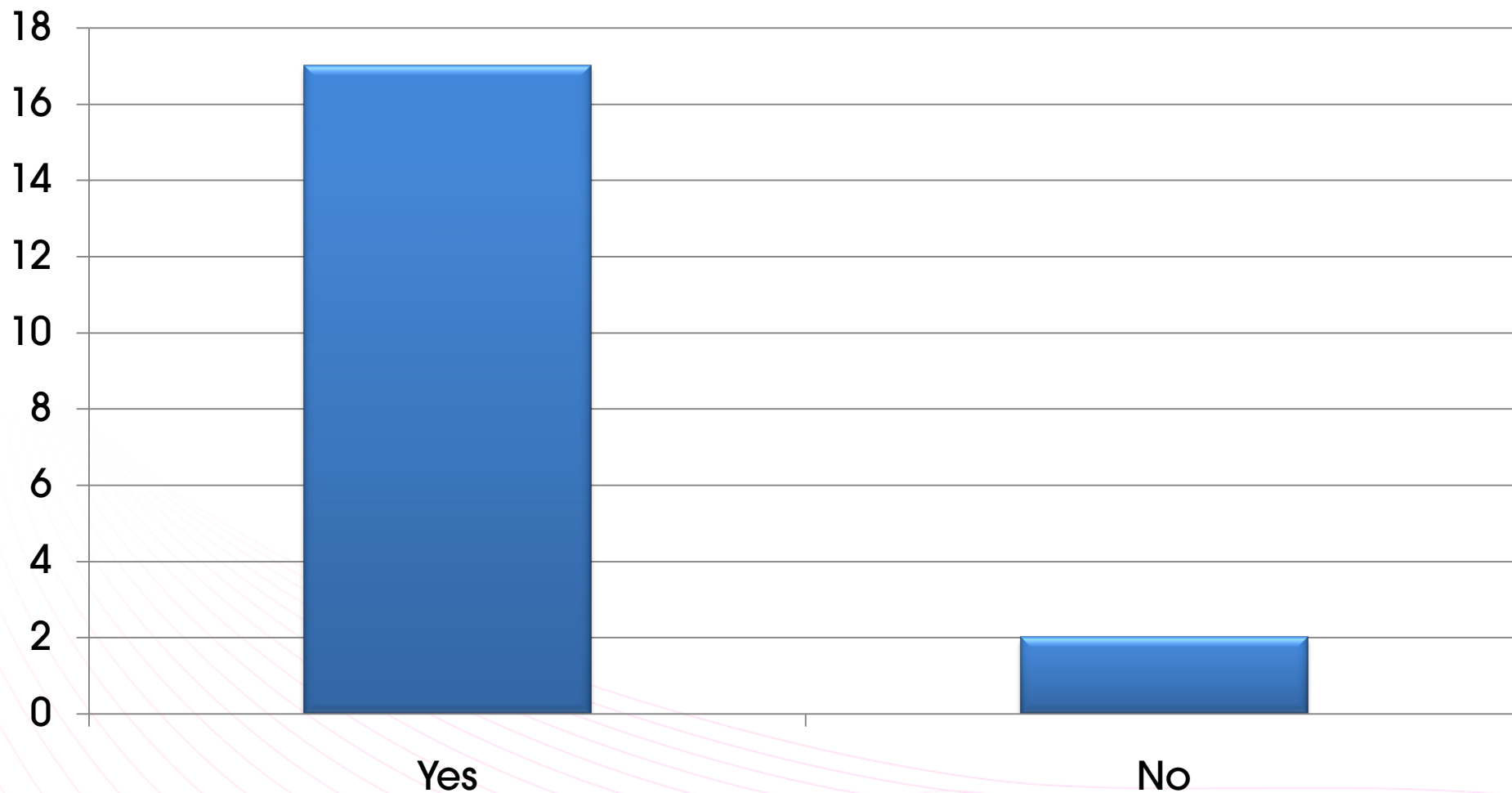
- Where yes,
 - In one instance been changed to a board member directly
 - From a single reporting line to head of finance to a split line to head of finance and head of markets

Q10 : Are there plans or discussions to change the reporting lines?

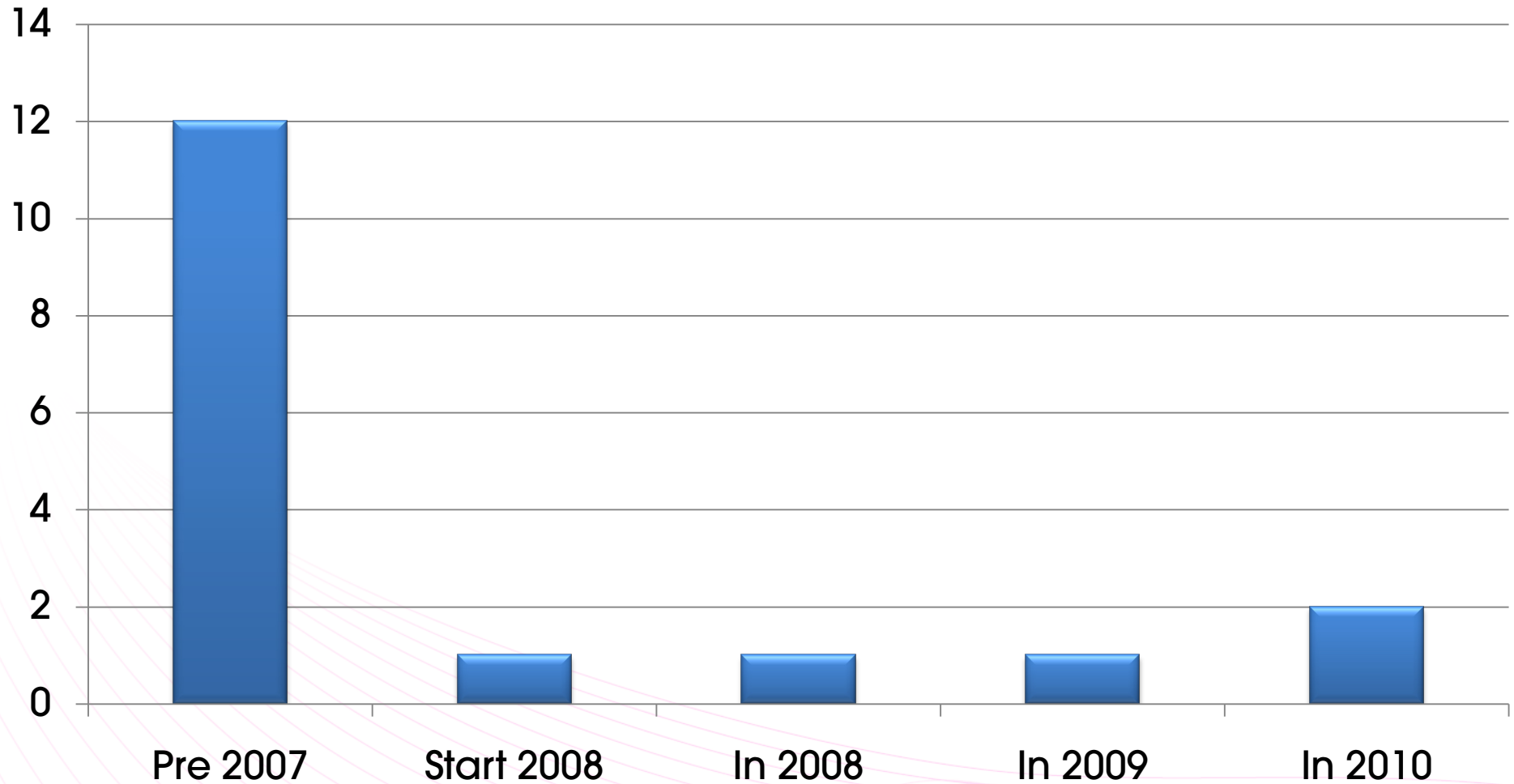


FTP FRAMEWORK

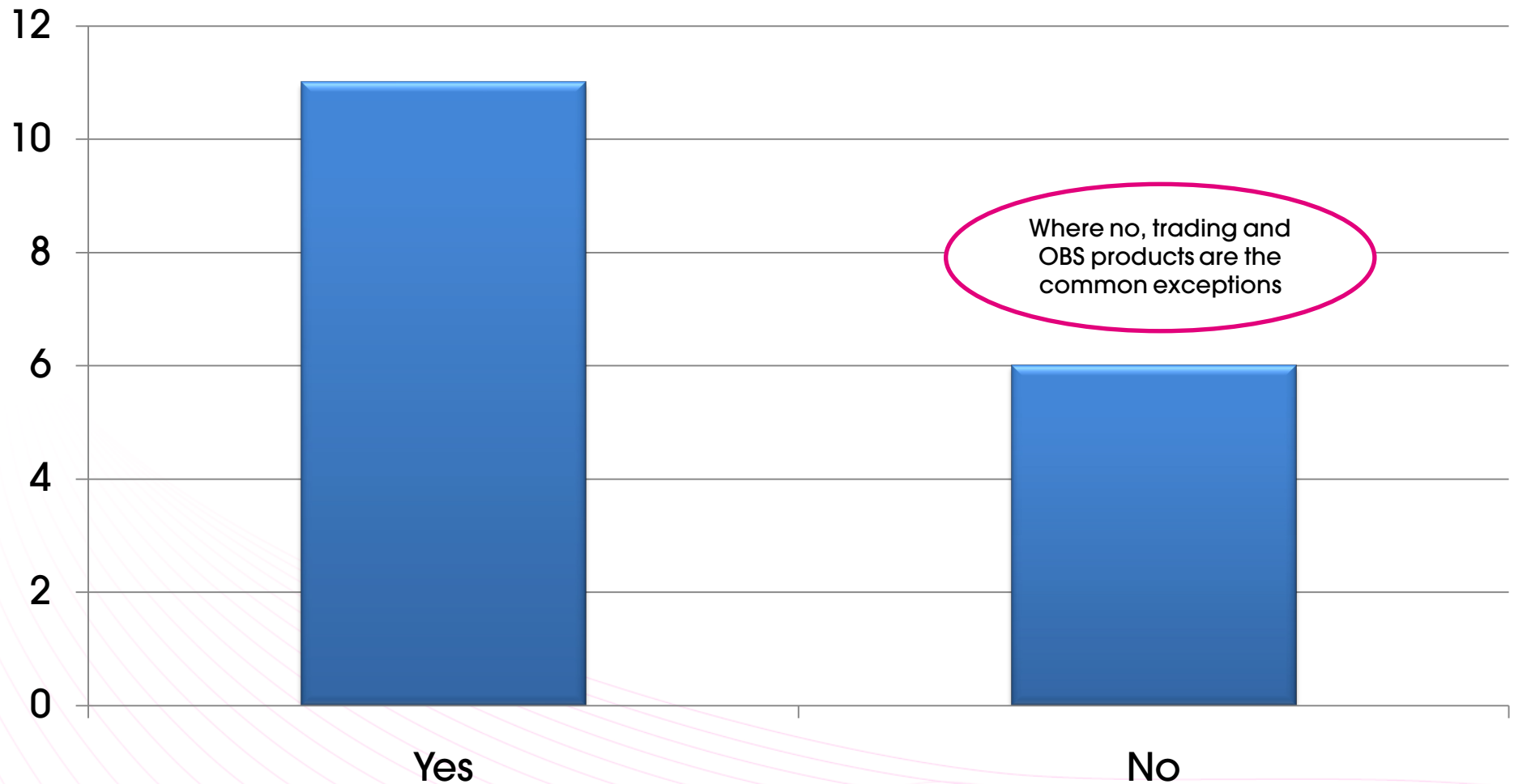
Q1: Does your bank have a FTP framework for liquidity in place?



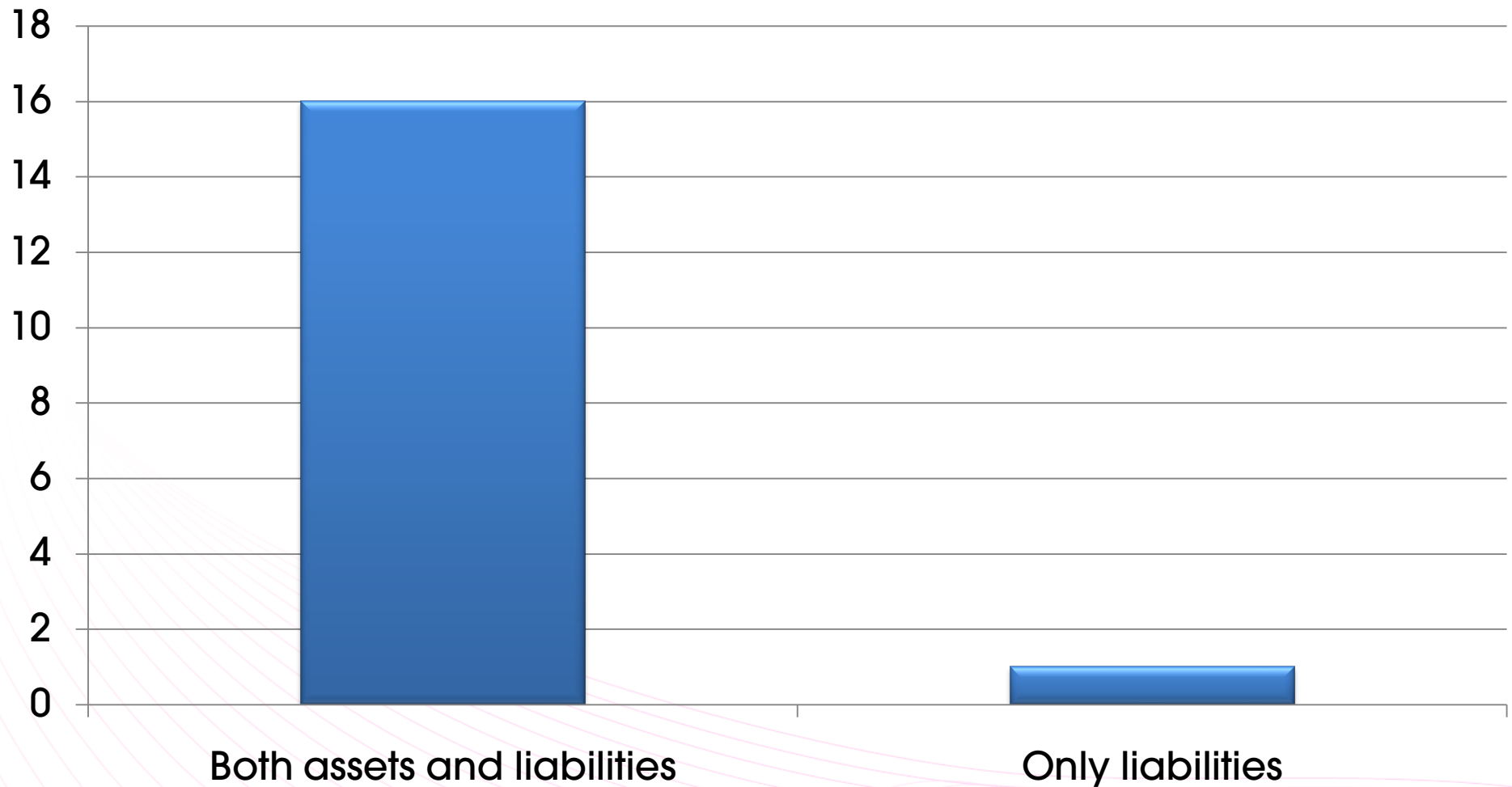
Q2: When was this FTP framework established ?



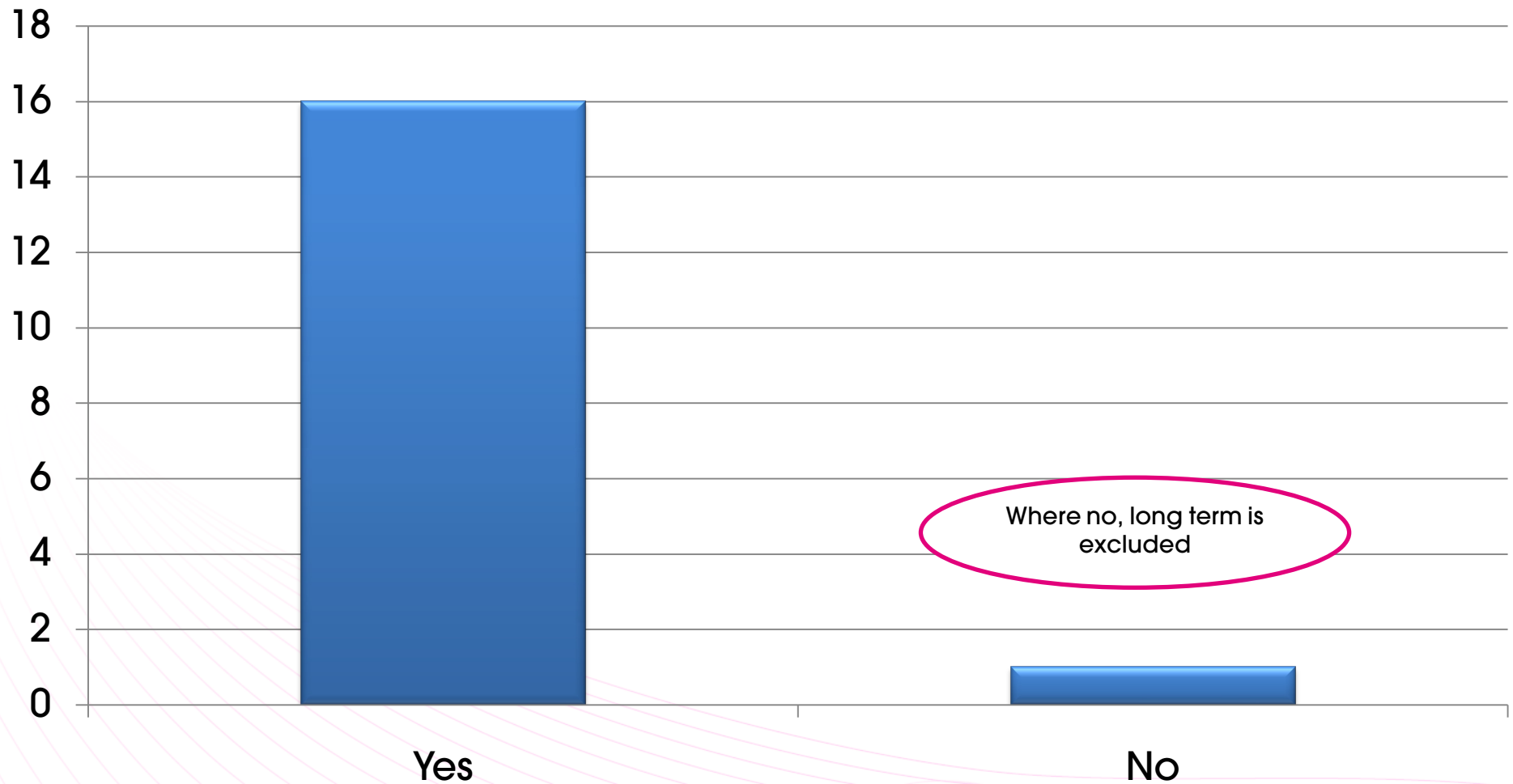
Q3: Does your FTP framework apply to all assets and liability originating activities (including e.g. trading and/or off-balance products)?



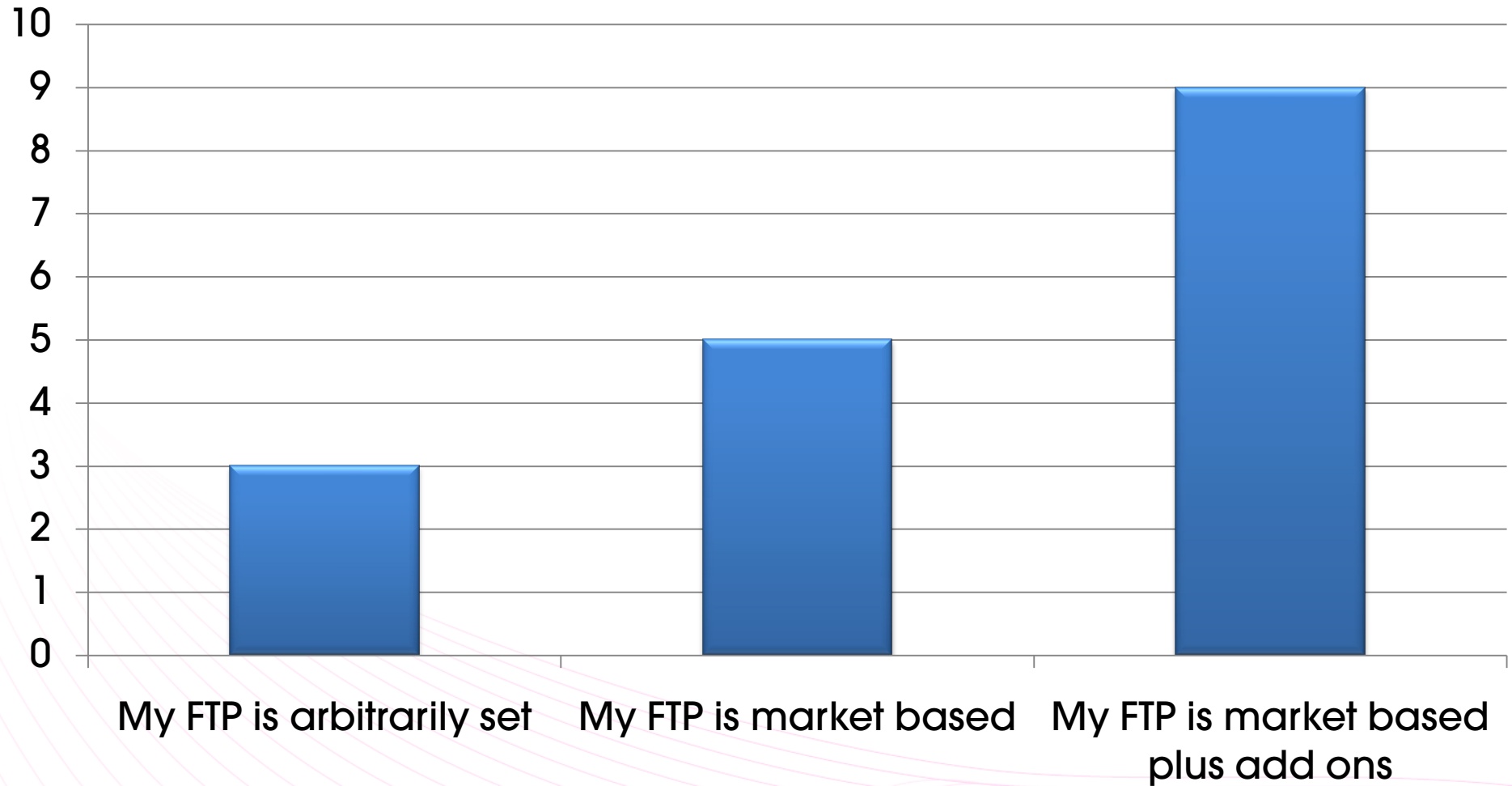
Q4: Which side(s) of the balance sheet does your transfer pricing framework apply to?



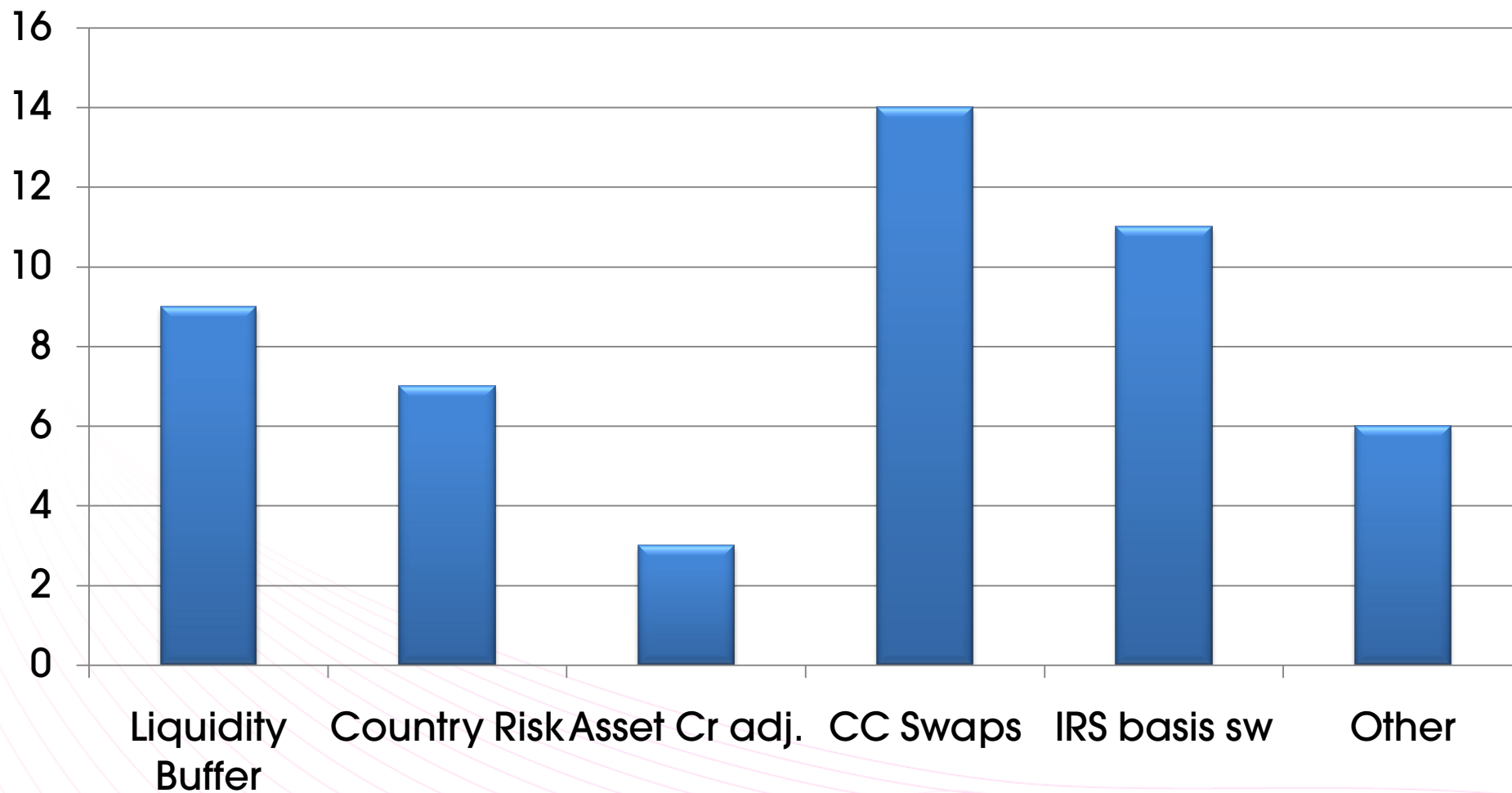
Q5: Does the FTP policy apply to both short (out to 2 years) and long term (>2 year) balance sheet items?



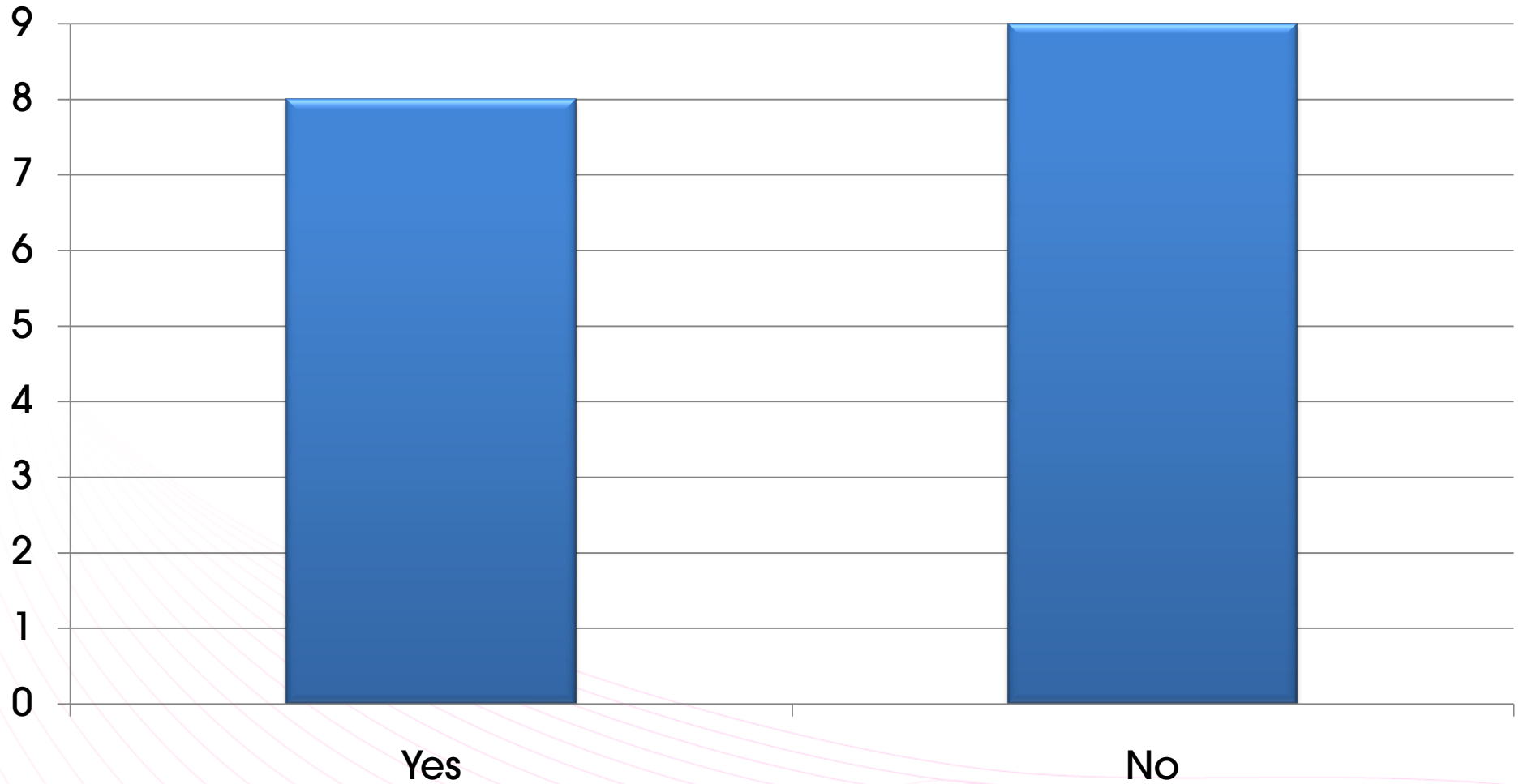
Q6: Which is most true?



Q7: Does your FTP include costs for?



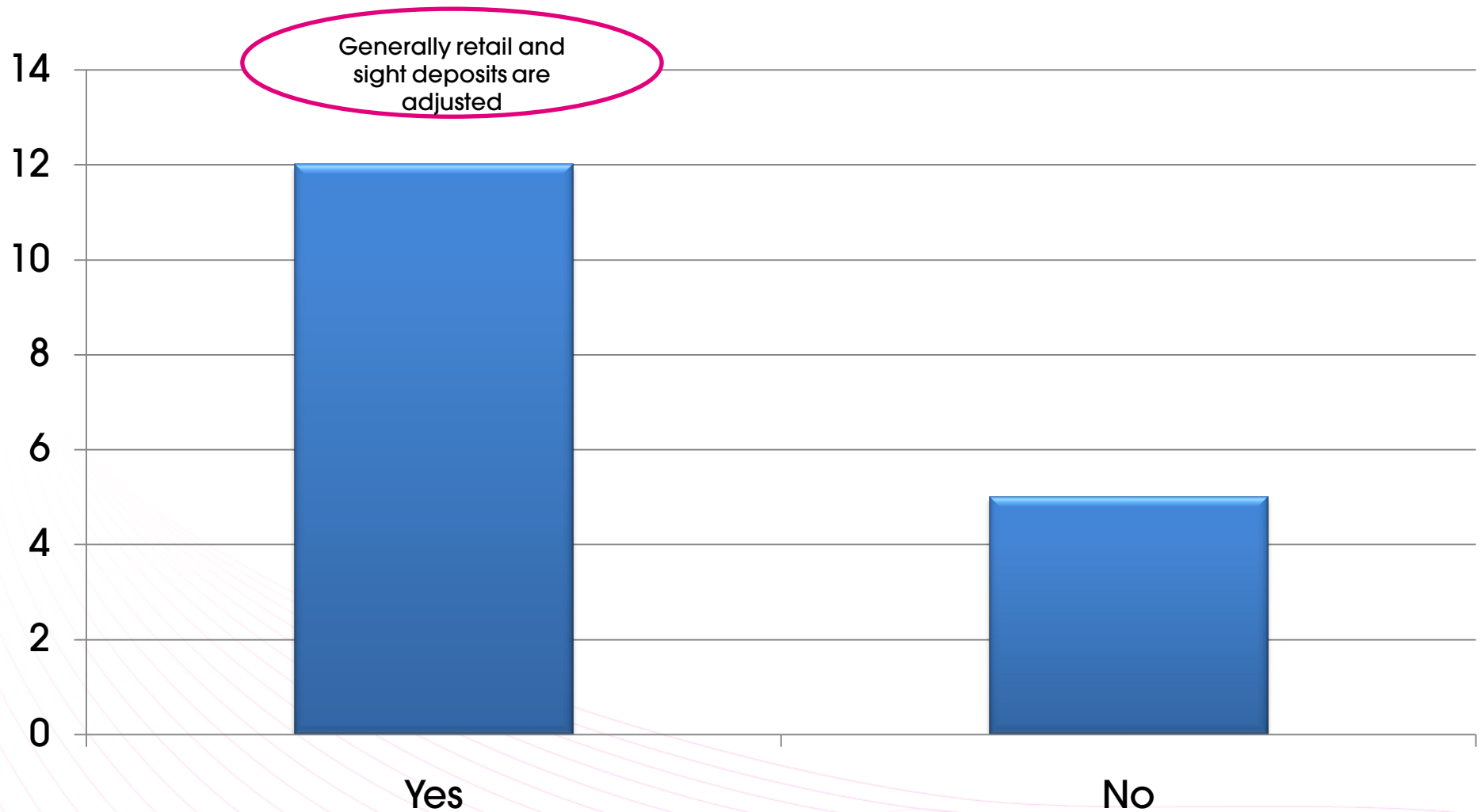
Q8: Does your FTP have a bid/offer spread?



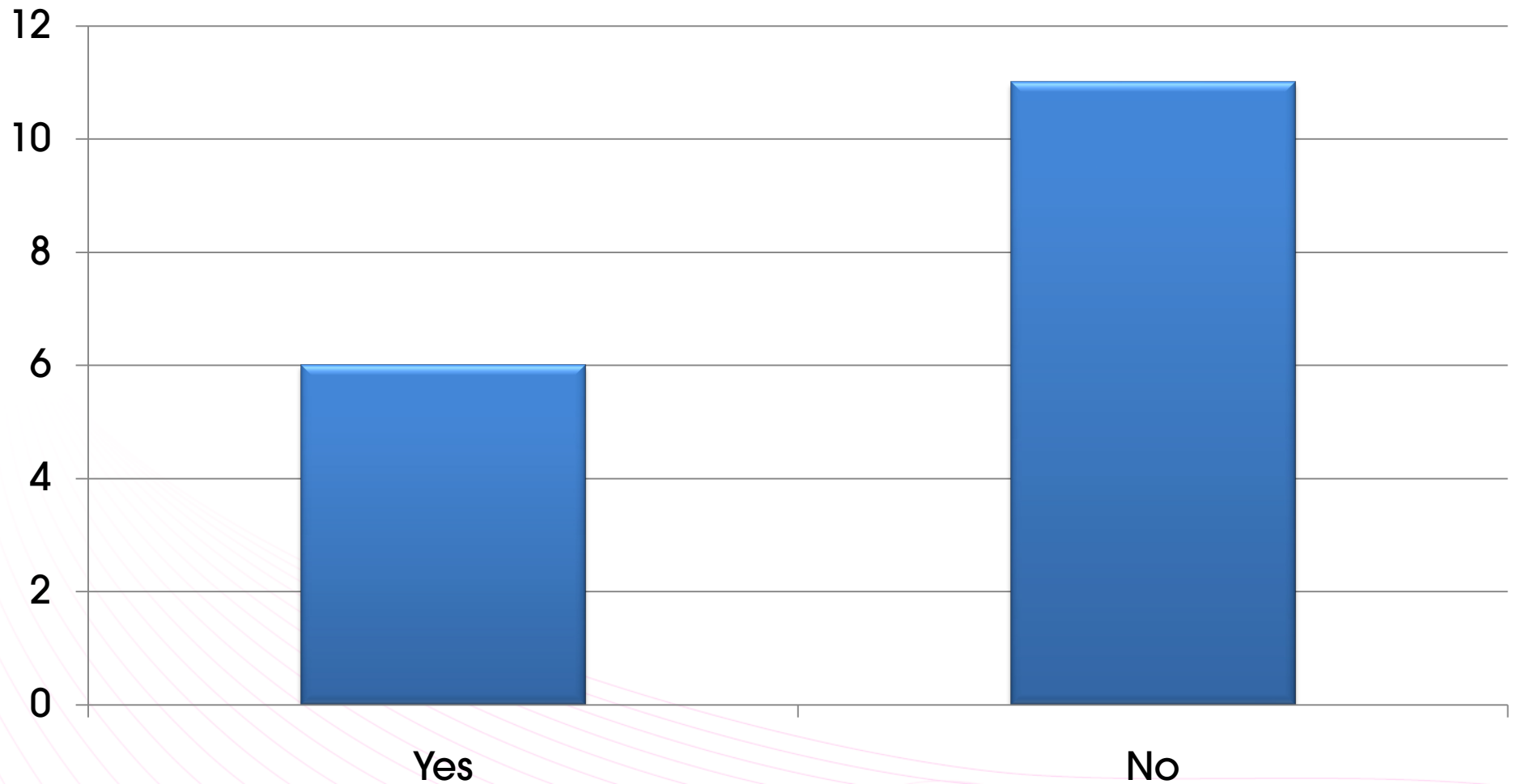
Q8: Does your FTP have a bid/offer spread?

- Where yes,
 - Only for short-term FTP and not all currencies
 - Market based
 - <12 month is market based, > 12 month is 10bp
 - < 12 month no, > 12 month is 3-5 bp depending upon maturity

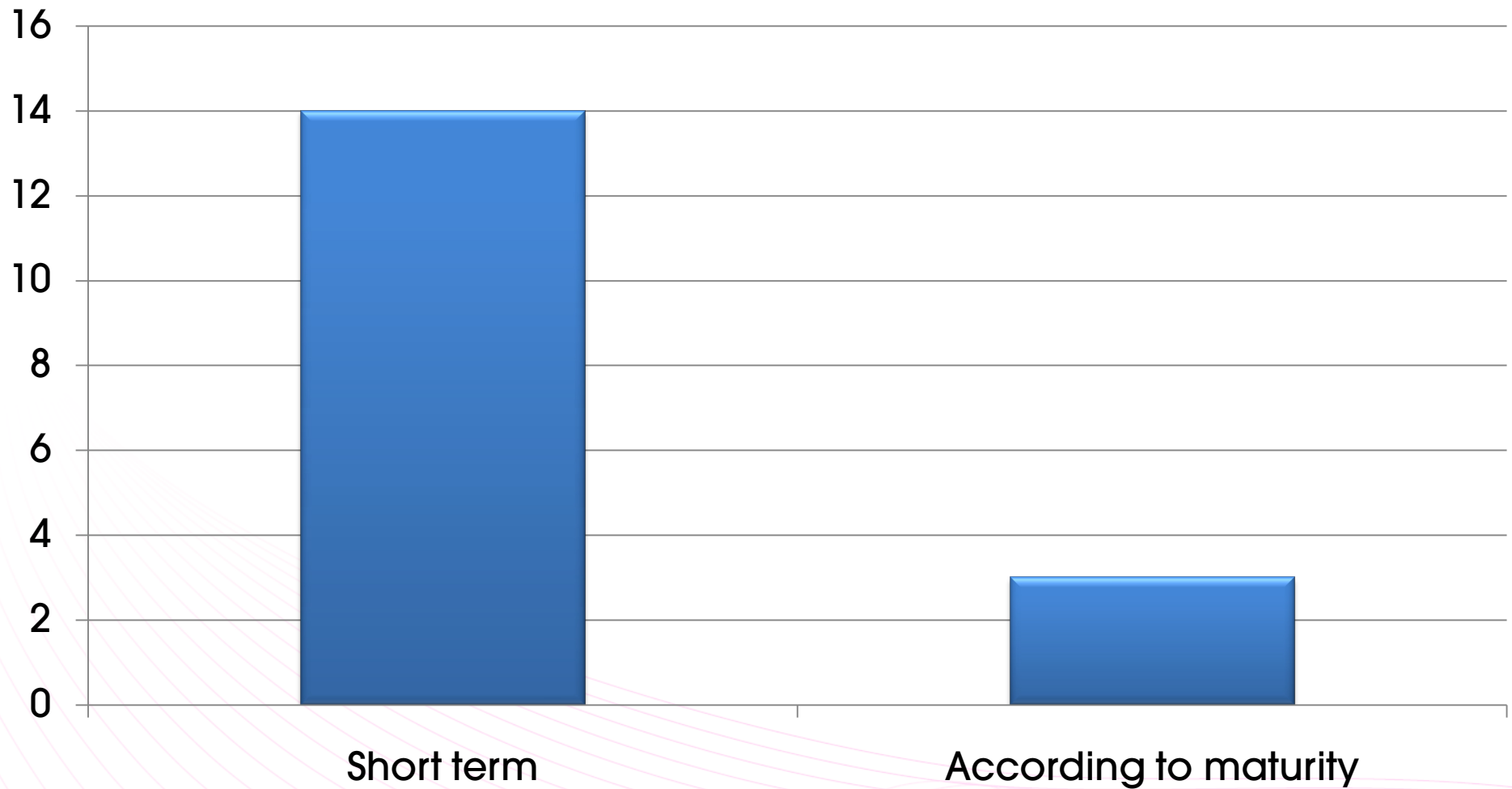
Q9: Does your FTP adjust maturity of liabilities for expected behaviour?



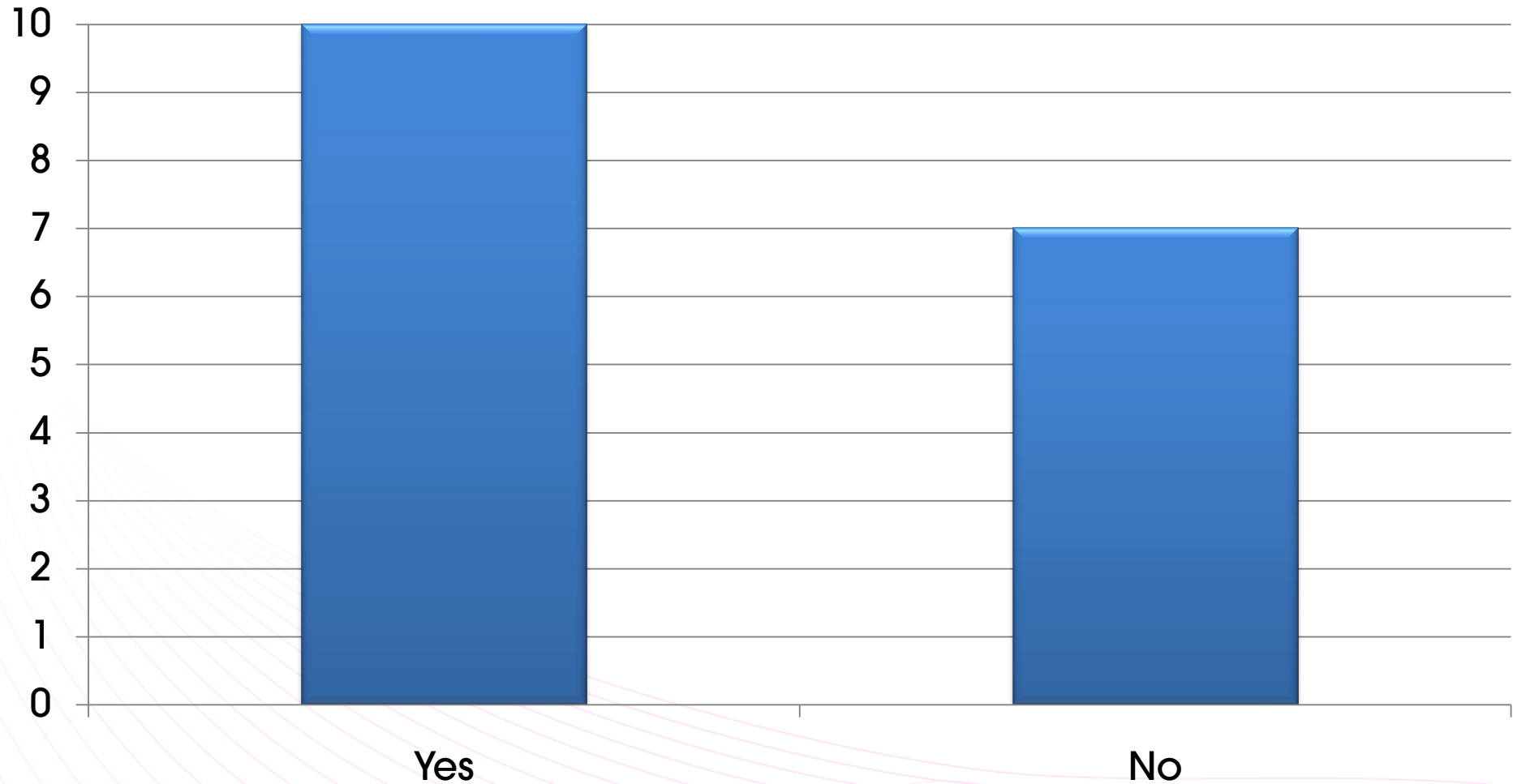
Q10: Are assets behaviourally adjusted before applying the ftp?



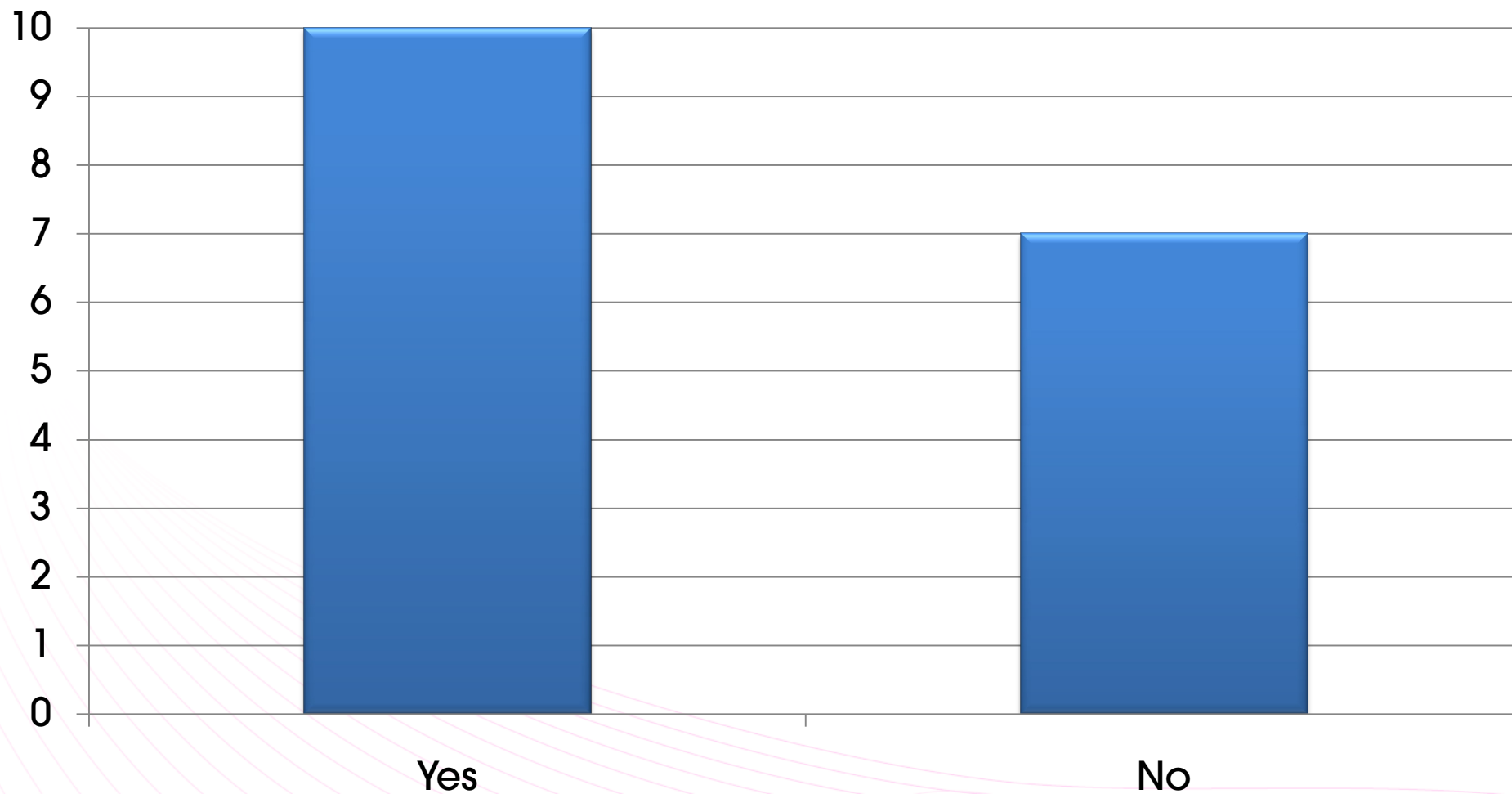
Q11: Are trading assets funded on a short term basis or according to their maturity?



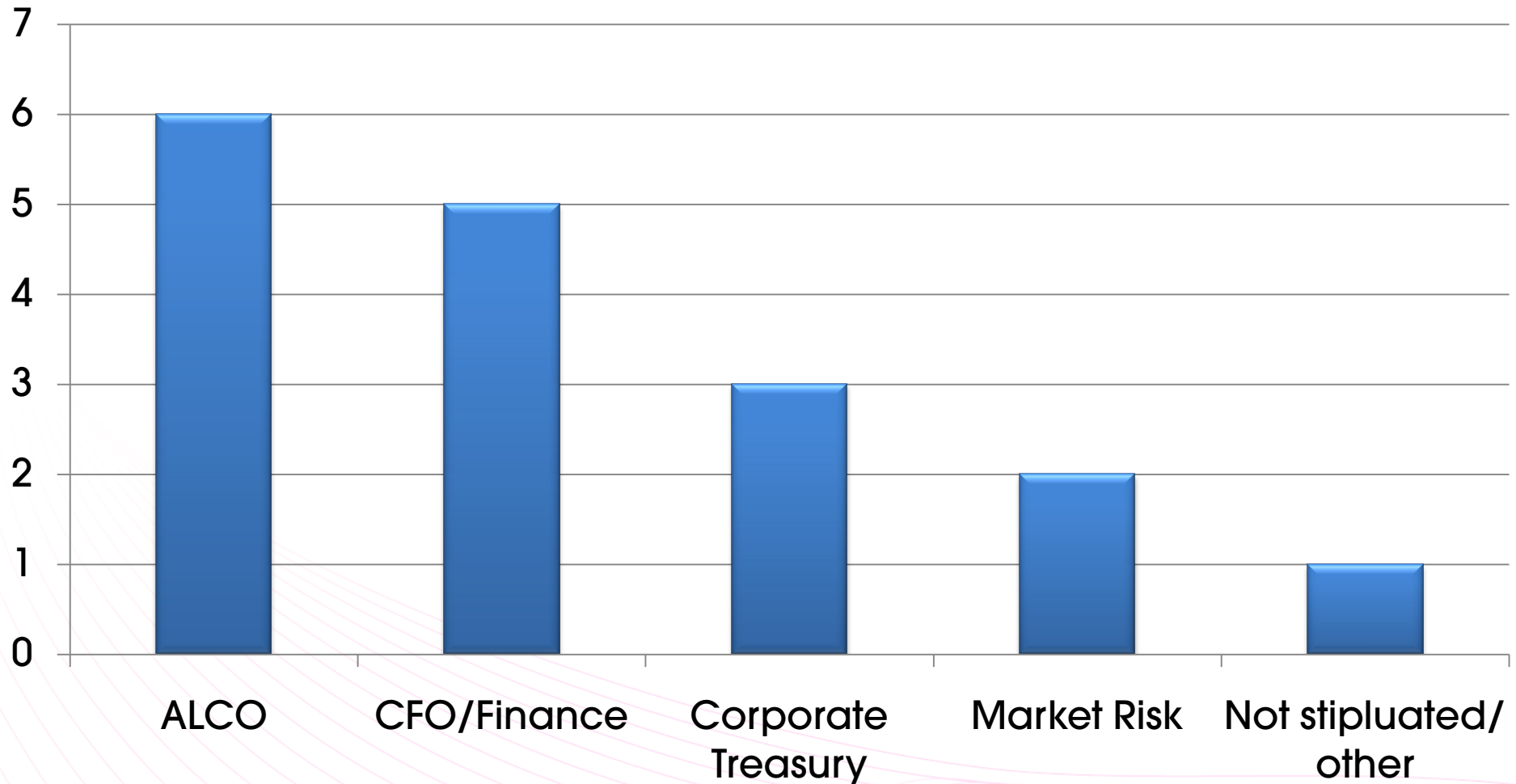
Q12: Is your FTP based in your reporting currency and basis swapped?



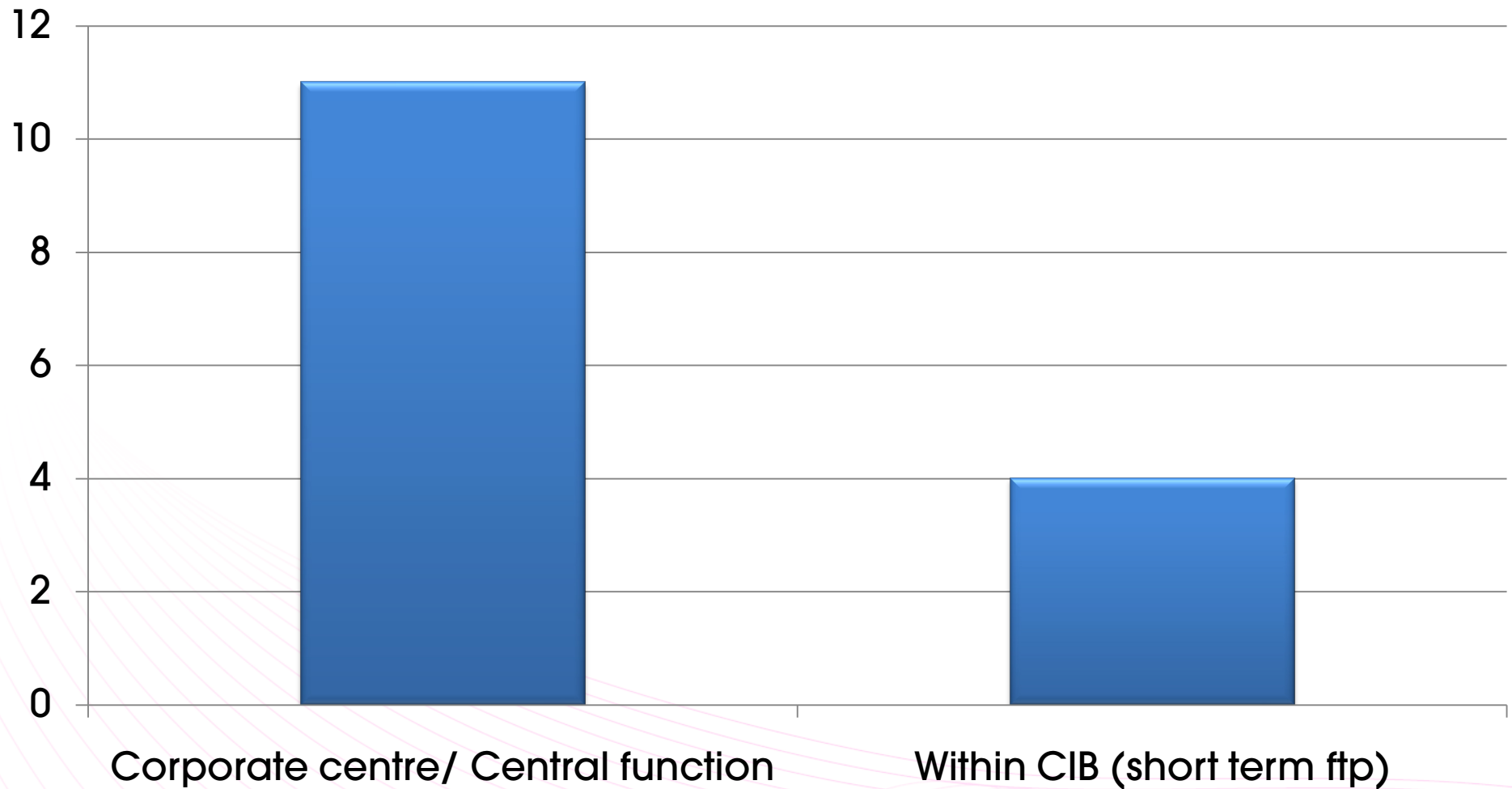
Q13: Do OBS commitments get charged a liquidity fee?



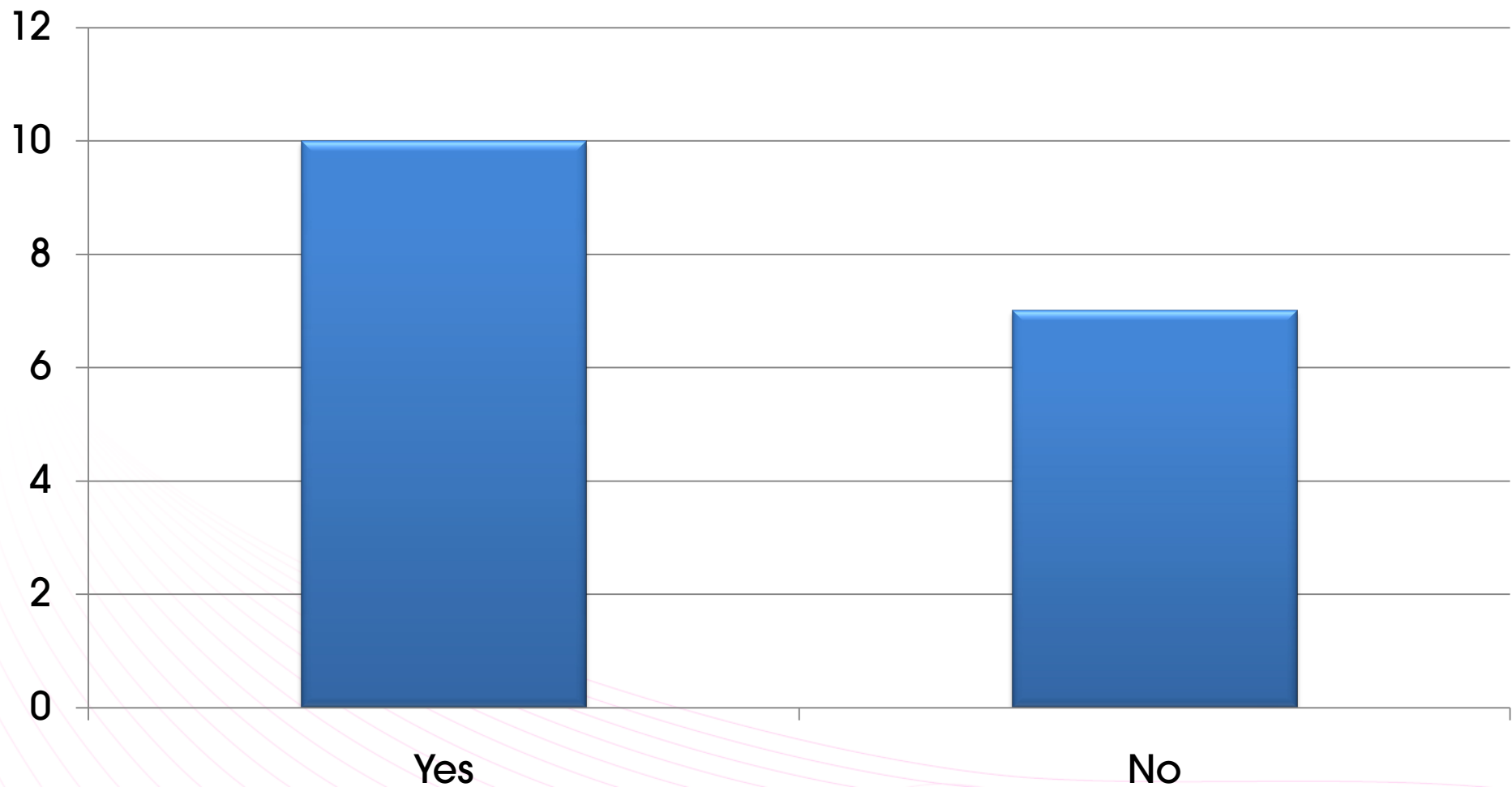
Q14: Which corporate body or department decides and resolves conflicts in respect of FTP issues?



Q15: Who receives the net result of your FTP policy (profit centre, cost centre or corporate centre or similar)?



Q16: Does the beneficiary of the net result of FTP policy have a P&L target?



GOVERNANCE OF RESOURCE ALLOCATION

