

The background of the slide is a faded, blue-tinted image of the London skyline, featuring St Paul's Cathedral as the central focus.

O C O R I A N



Mastering liquidity risk management

Top tips from the FCA

Expertise. Trust. Scale.

Before we begin



Ask us anything
on Liquidity

Submit any questions to
our Q&A and comment
using the chat



Share your views

Participate in our live 'ask
the audience' poll questions



Sharing slides

We'll share a copy of the
slides with you following this
session

Our speakers



Jackie Domanska

Principal Consultant (Ocorian)

Jackie is a dedicated expert in prudential regulation and risk, advising investment firms and fund managers of all sizes. She regularly manages prudential projects with a particular focus on IFPR, including ICARA and wind down planning.



Ian Morton

Managing Consultant (Ocorian)

Ian provides specialist advice on prudential aspects of regulation such as authorisations, liquidity, operational, credit and market risks, recovery and resolution, reporting, and operational resilience.



Martin McMillan

Senior Risk and Finance Professional (FCA)

Extensive experience in the prudential space. He reviews, evaluates, and assesses the ICARA submissions of asset and wealth managers as well as broker dealers prudentially supervised by the FCA.



Yuki Kataoka

Prudential Specialist (FCA)

Extensive experience dealing with prudential risks, across multiple business models including sell side, buy side, platforms, payment services, e-money and lending.

Our session today

Overview of liquidity requirements

The big four – Frequent liquidity stresses

What did the FCA do

What did the FCA find

Good and poor practices

Reminder of what was said in the strategy letters

Q&A

Overview of liquidity requirements for investment firms

Set out in MIFIDPRU 6 - Consisting of Basic Liquid Asset Requirement (BLAR) and Liquid Assets Threshold Requirement (LATR)

BLAR

Firms need to hold **1/3rd of Fixed overhead** requirement in core liquid assets called Basic liquid asset requirement

The amount is low- 1/12 of annual fixed overheads

Firms need to hold core liquid assets against this requirement consisting of :

Money held at UK credit institutions

Gilts

MMFs

Some firms can include trade receivables in core liquid assets but restricted to 1/3rd of BLAR

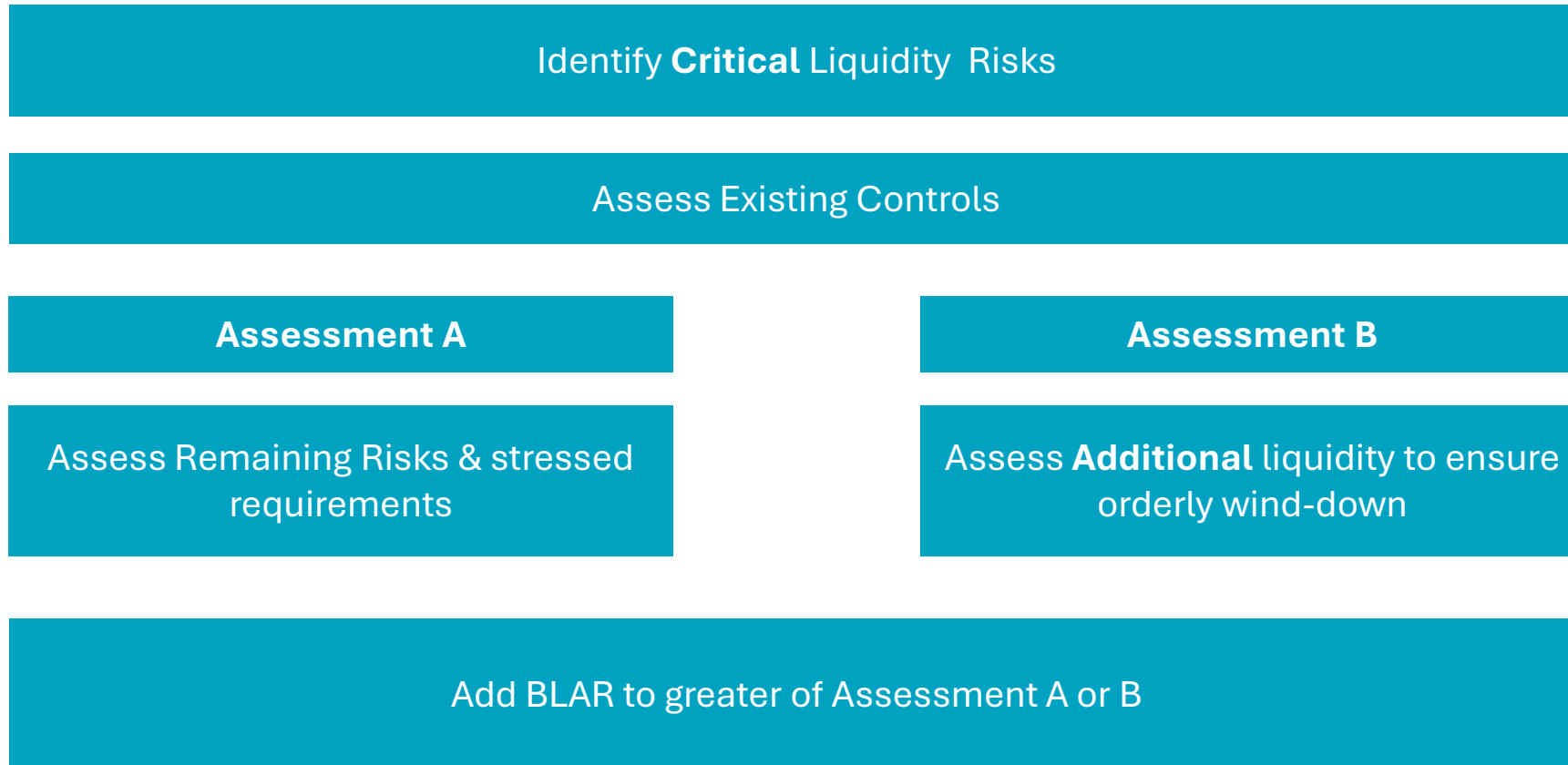
CPMI firms will need to hold full amount of FOR in liquid assets

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Liquid asset threshold requirement (LATR)

Firms need to make assessment for extra liquidity needed for working capital, liquidity stress or wind down. This is more complex and should be a dynamic calculation



The FCA

Wholesale Trading Firms'
Liquidity Risk Management

The big four

During various stress events these are the four most common liquidity stresses firms notified us about

- large cash outflows due to margin-calls
 - The ruin your day, HUGE cleared (CCP) or '*on demand*' bilateral margin call(s)
 - more margin-calls either draining cash or using up facilities across two days before clients pay their first day's margin call at the end of the second day, if at all
- poor management of client relationships
 - unknown concentrations of client risk - not appreciating that two or more counterparties were in fact related
 - underestimate concentration in markets that may have a limited group of buyer and seller types that are likely to react to events in a similar fashion
- buy-ins of large open short settlement positions
- importance of stressing assumptions around liquidity and funding (liabilities)
 - depth available in markets during a stress to accommodate stressed sales without major price impact
 - the speed with which customers or counterparties can withdraw money if terms allow them to do so

What did we do

From a **practical perspective** we checked for gaps and weaknesses in firms' liquidity risk management capabilities

- We analysed, compared, and contrasted (individually, in cohorts, and in totality) the capabilities of twenty-six larger firms including commodity clearing brokers, principal trading firms (PTF) trading in commodities, inter-dealer brokers, and contracts-for-differences firms
- We used information from several sources:
 - the regulatory returns which we already hold
 - a detailed questionnaire
 - meetings with firms to discuss the practical application of their liquidity risk management framework
 - In some instances, we reviewed liquidity risk and ICARA process documentation
- We evaluated the effectiveness of each firm's framework looking at:
 - business model
 - governance arrangements
 - risk identification
 - timing and escalation procedures
 - risk quantification
 - operational arrangements
 - operability of mitigating actions including contingency actions
 - liquid asset threshold requirement (LATR) calculations
 - liquidity stress testing

What did we find

During our reviews when we identified potentially critical weaknesses, we immediately called firms to give them a prompt heads-up

We found:

- Some firms were quite good. We asked them to make a few tweaks
- Some firms weren't too bad. We asked them to make changes and provide an attestation and assurance to confirm remediation
- Some firms had bigger gaps and weaknesses. We asked them to hold incremental liquidity while they made changes and provide an attestation and assurance to confirm remediation

Good and poor practices

The review sets out good and poor practices covering: governance and risk culture, stress preparedness, contingency funding plans (CFP) and wind-down plans (WDP), and liquidity risk management capabilities.

Good practice highlights are:

- a practical approach - at close of business dynamically forecast, T0 next day, T1 the day after that, and thereafter the short-term contractual and potential behavioural and stressed cash inflows and outflows
 - promptly identifying when a stress is likely to crystallise and assessing the likely impact
 - being prepared to take mitigating actions promptly either in advance, or if that is not possible, in a timely manner as soon as a stress event happens – including preapproved planned communications
 - monitoring trade flows and operational processes - what could happen and what has happened
 - being prepared for both market and especially idiosyncratic stresses
 - planning in advance for when liquidity facilities are not available, for whatever reason
- using both financial and non-financial action triggers and limits – CFP and WDP
- teams with up-to-date knowledge of the business, operations processes, and liquidity risks; and, as appropriate a good understanding of outsourcing arrangements especially operations and related support services

Reminder of what we said in our strategy letters

The review summarises what we said to sell-side firms in our Dear CEO letters regarding prudential matters (includes links to each letter).

I draw your attention to the last bullet in this section:

- **good risk management protects profitability**



Q&A

Please use the Q&A chat function at the bottom
to submit your questions

Get in touch



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