

# Kasseler Sparkasse

## Liquidity at Risk: liquidity risk under control

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Using the new Liquidity at Risk method, we have succeeded in determining our short-term liquidity on an objective basis. We are particularly pleased with the fact that the project costs for introducing the software were amortised within a short time.

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### A MaRisk-compliant liquidity management structure enables growth in earnings

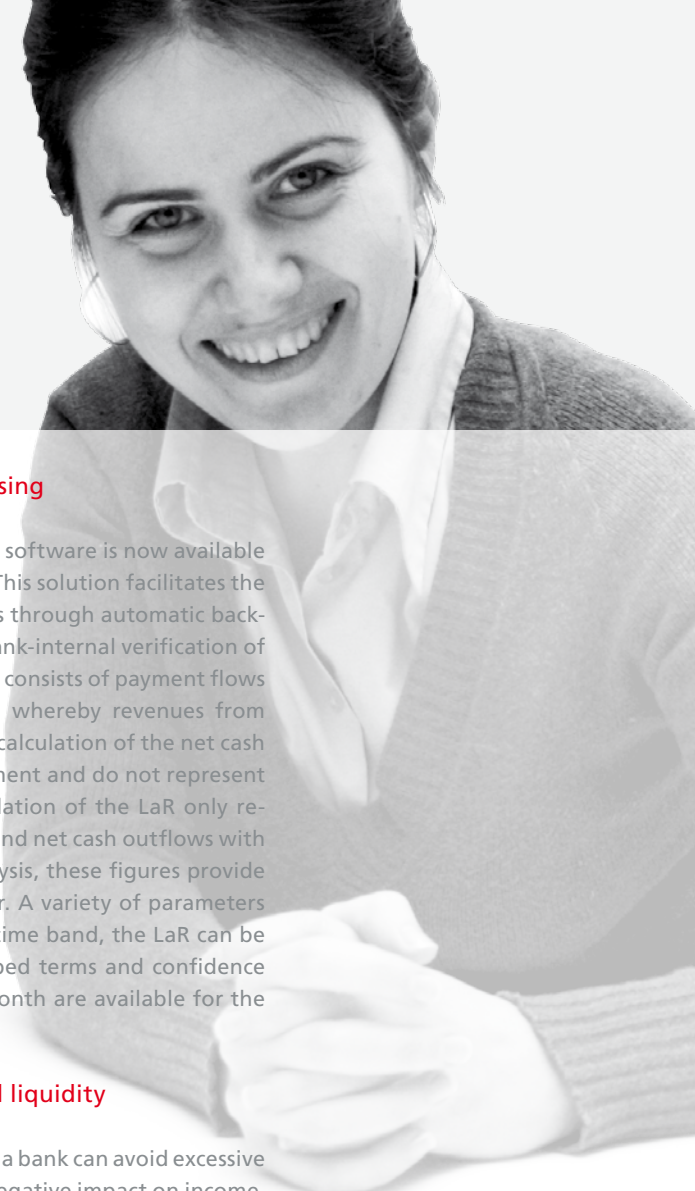
The majority of banks manage their short-term liquidity using current ratios. The new Liquidity at Risk (LaR) concept enables an improved quantification of liquidity risk and can provide liquidity management with controlling impulses that impact on net income. Liquidity management functions are divided into three elements: short-term liquidity management secures the bank's capability to cover net cash outflows affecting liquidity that may occur within days or a few weeks; long-term liquidity management ensures that the bank's refinancing potential remains at an adequate level during periods of structural change so that it can provide sufficient funds at appropriate prices; market liquidity management ultimately ensures that retained assets can be quickly and efficiently transformed into liquid assets. The minimum requirements for risk management (MaRisk) compel all banks to take liquidity risk sufficiently into account within their risk management and control processes.

#### □ Liquidity at Risk (LaR) as a solution for meeting MaRisk requirements

Primarily, MaRisk presents challenges because the anticipated cash inflows and outflows have to be compared in a liquidity profile that also encompasses forecast scenarios. In addition, banks must continuously monitor whether they are in a position to cover actual liquidity requirements at any given time. However, conventional current ratios do not permit reliable statements to be made on the anticipated cash inflows and outflows as client behaviour constitutes an uncertainty factor that cannot be quantified using traditional processes. This problem can be solved using the Liquidity at Risk (LaR) concept: LaR is a calculation of the net cash outflow from all externally directed bank payments that, in all probability, will not be exceeded during a predetermined time horizon. LaR plots a volume ratio that is compared with the liquidity reserves, inclusive of credit lines.



Liquidity risk management requires a flexible and structural scheme.



### □ Simple and practical implementation using ifb-OKULAR® LIQUIRIS

In the form of ifb-OKULAR® LIQUIRIS, a standard software is now available for carrying out the complex calculation of LaR. This solution facilitates the implementation of supervisory law requirements through automatic back-testing and is certified in such a manner that a bank-internal verification of the results is not required. The fundamental data consists of payment flows determined by balancing transaction accounts, whereby revenues from liquidity arrangements are deducted during the calculation of the net cash outflow as they causally serve liquidity management and do not represent externally directed payments. In practice, calculation of the LaR only requires one file that shows both net cash inflows and net cash outflows with the commensurate dates. As a basis for the analysis, these figures provide all the available information on client behaviour. A variety of parameters are now available to the user. Within a specific time band, the LaR can be determined for any combination of the prescribed terms and confidence levels. Terms ranging from a few days to one month are available for the appropriate maturity structures.

### □ Options relating to performance-based liquidity management

Conscious of its short-term liquidity requirement, a bank can avoid excessive levels of highly liquid assets and their resultant negative impact on income. If such assets are refinanced through borrowing on the liabilities side, the corresponding extra charges are frequently higher than those for securities (mortgage bonds, federal) held for the purpose of liquidity management. The effect on income resulting from the reduction of excess liquidity reserves and repayment of refinancing funds constitutes a reduction of the bank's negative spread between refinancing and investment. Calculation of the LaR also offers benefits where a reduction of refinancing funds is not possible on account of refinancing being intensively client-based or where this is undesirable from an accounting policy perspective. Funds that are not immediately required to create liquidity can be redistributed to other securities with lower degrees of liquidity and higher liquidity premiums. As a rule, in the case of both stated procedures for optimising earnings through redistribution to the bank's own security deposit account, a period of two days must be allowed for liquidity to become available. Awareness of the LaR also allows the optimisation of funding credit lines that must be available in less than a day. Secured credit lines at other banks or the pledged account at the Central Bank can be suitably reduced and matured securities redistributed in order to benefit net income. Practical experience shows that using the LaR concept, a short-term reduction of liquidity costs is achievable that, in turn, has a direct impact on the P&L account.

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