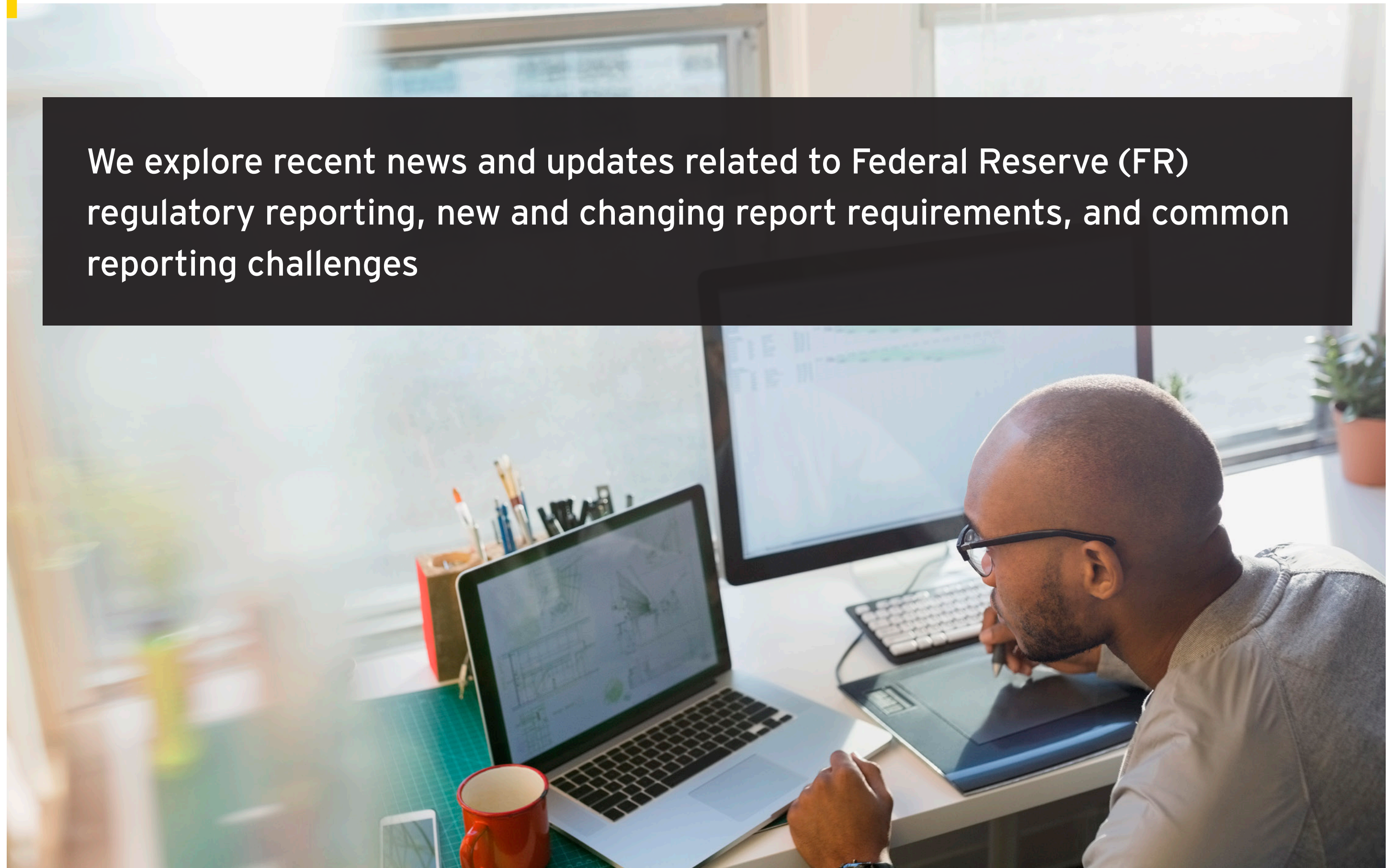
Liquidity reporting challenges and trends

Emerging trends and challenges with FR 2052a and LCR reporting

Brief summary



Following the 2008-09 Global Financial Crisis, regulators released guidance and focused their supervisory efforts across three core pillars: capital adequacy, soundness of internal controls and timely monitoring of emerging liquidity risks. The FR finalized the Liquidity Coverage Ratio (LCR) rule in early 2014, shortly followed by the establishment of FR 2052a daily reporting, to complement advanced supervision of financial institutions' liquidity risk management practices. Liquidity reporting expectations are evolving to align with standards of capital and other regulatory reporting. As part of this briefing, we discuss:

- The evolution of liquidity reporting
- COVID-19 liquidity reporting impacts
- Today's regulatory focus areas and the challenges that firms face in meeting evolving supervisory expectations for liquidity reporting
- Emerging trends for liquidity reporting and quality assurance
- Targeted actions that firms can take to address liquidity reporting challenges and expectations

Firms have matured their methods to implement reporting and to conform with rules. In tandem, regulators have a heightened focus on liquidity data quality and governance, adherence to regulations, sustainability of the overall process and the role of liquidity reporting in business decision-making.

A rapid history and recent news

The 2008-09 Global Financial Crisis highlighted the need for granular, timely liquidity data and reporting to monitor liquidity risks across the financial services industry. This need was initially addressed through the LCR stress test. However, regulators soon recognized that a single, consolidated report was insufficient to understand a firm's potential drivers of liquidity depletion.

FR 2052a is aimed to capture intracompany flows and exposures, particularly of large, systemically important, globally active US banking institutions. It represents an evolution of regulatory reporting, moving from the prior "static liquidity report" format to a dynamic data structure of trade-level detail, aggregated by common data characteristics, including product, currency, counterparty and maturity date. This enables FR to better monitor liquidity risk and proactively identify potential funding vulnerabilities.

COVID-19 liquidity reporting impacts

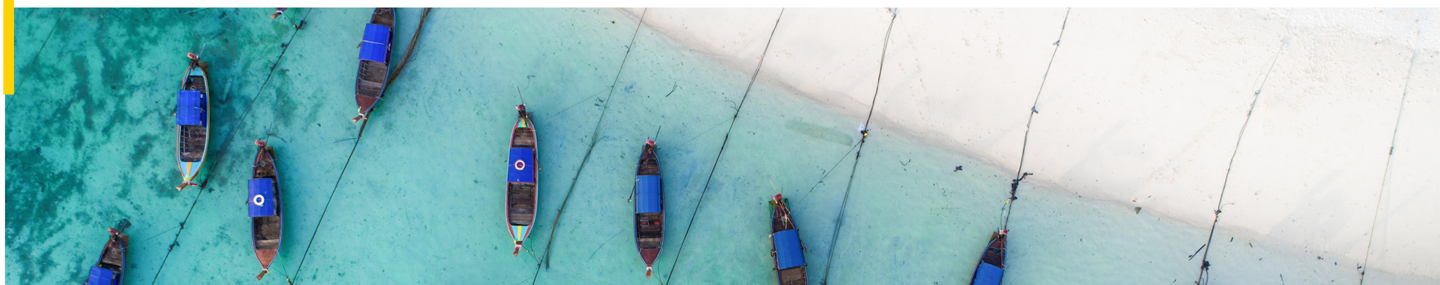
The benefits of liquidity reporting are live in action through the COVID-19 global pandemic. Liquidity reporting has been of critical importance during this pandemic because of its ability to inform daily changes across sources and uses of liquidity, in addition to draws on commitments across counterparty segments. The transparency of contractual cash flows evidenced in FR 2052a has allowed regulators to model client behavioral impacts of the pandemic.

Along with other current industry challenges described further throughout this brief, the COVID-19 global pandemic has revealed several areas where improvements to liquidity reporting can be made:

- Report latency should be expedited to T+1 to facilitate timely analysis of contractual cash flow data and inform management decision-making.
- Certain processes should be automated through robotics, machine learning or other innovative technologies in order to reduce the reliance on human resources to deliver required reporting, and to do so in a timely matter.

The pandemic has increased the potential for regulators to delay or revise rules on capital and liquidity, delay or relax supervisory expectations to promote lending to households and businesses, and potentially reduce the frequency and intensity of supervisory exams. Some initial relief has been provided already; the situation continues to evolve day by day .

Current industry challenges



Regulatory expectations of liquidity reporting have shifted to better align with those of traditional regulatory reports, including FR Y-14Q/M, FR Y-9C and FFIEC 009. There is increased emphasis on data infrastructure stability, data accuracy, and robust governance and control frameworks. Firms are engaging in the following activities to address heightened regulatory expectations:

- Improvements to data and controls at the source of origination
- Development of sustainable quality assurance programs
- Execution of formal regulatory reporting training programs
- Enhancement of cross-report validation and reconciliation

Data quality and governance

Regulatory expectations continue to evolve from basic data quality profiling and scorecard capabilities, to demonstration of end-to-end completeness and accuracy of reporting. Firms are focused on establishing a control environment that ensures that data is correctly originated, aggregated and transformed.

Banks are conducting comprehensive reviews of reported data and establishing ongoing data quality review programs. Many firms have established data governance activities, including liquidity reporting committees, policies, procedures, standards, accountability policies, data attestation processes and materiality standards.

Data infrastructure/acquisition

Data acquisition is a frequent challenge for liquidity reporting. Data must be enriched with processing and allocation logic during transformation to allow for repeatable, daily data retrieval.

Data elements are frequently not entered correctly at the point of data capture, since those responsible are not aware of the downstream impacts of overlooked data fields. This can be solved through training trade-capture team members on the purpose of each data field in liquidity reporting.

Controls and validations need to give confidence that the liquidity risk data are representative of an institution's position. The sophistication of controls must be commensurate with balance sheet volume and volatility. Measures may range from basic trade counts to broader valuation controls.

Current industry challenges

Have you considered ...

Creating a current-state, end-to-end process timeline to identify and mitigate drivers of daily liquidity reporting roadblocks?

Issue identification can enable development of a data acquisition strategy, prioritized based on the liquidity

Cash flow and assumptions

An institution's cash flow methodologies and assumptions must be clearly documented and consistently applied. The data architecture requires the ability to support integration of base cash flows from origination systems into the liquidity analytics and reporting layer, which can be a complex process. Some capital market product cash flows may be generated within only source systems.

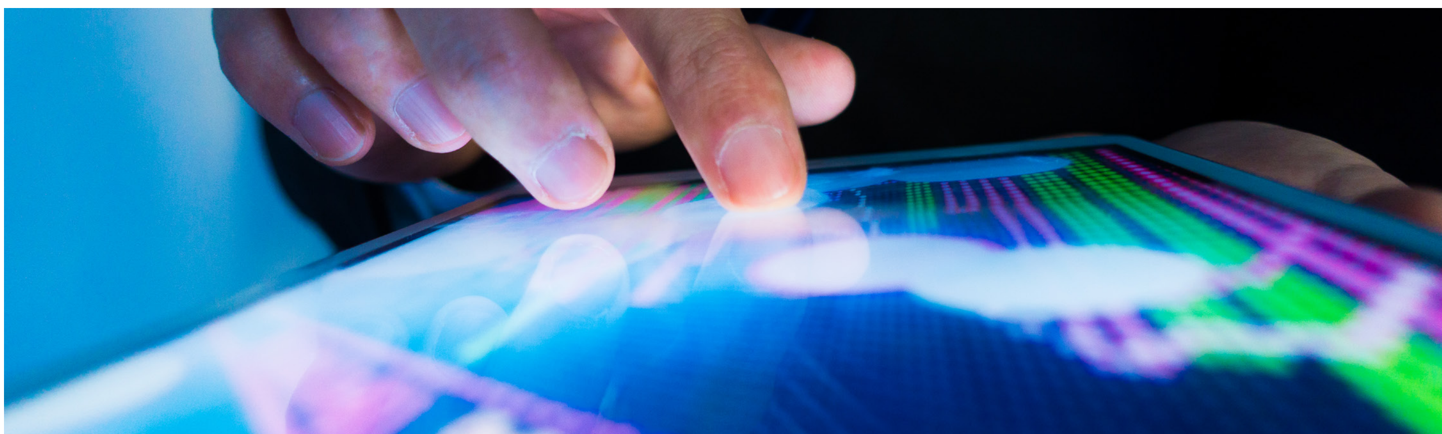
Aggregation criteria and logic must clearly define rules for all reporting and cash flow generation attributes. General ledger balancing control structures should incorporate business unit combinations that roll up to legal entity, management hierarchy and product hierarchy levels to support segmentation for both regulatory and management reports.

Finally, sourcing of undrawn commitments and off-balance-sheet exposures typically requires coordination with risk management and line of business (LOB) teams, since not all liquidity parameters are calculated in one place.

Reporting operating model

Daily liquidity reporting is a complex process. Often, the best processes require manual adjustments and coordination across various functions (e.g., regulatory reporting, data providers, data governance, risk management, LOBs).

A reporting operating model can support clearly defined roles and responsibilities, as well as the governance and controls around the process. Treasury typically owns metric results for LCR, while ownership of data accuracy and quality differs between institutions (e.g., it may sit within liquidity risk management, regulatory reporting). Additionally, a change management team can provide critical support to address continuously evolving regulatory requirements and associated reporting logic changes.



Emerging trend – transaction testing

Many institutions are establishing liquidity transaction testing programs, usually designed and implemented by quality assurance functions and internal audit as an extension to the quality review program. Developing a testing framework for liquidity can benefit continuous monitoring of data quality and can support accurate data and reporting.

The first step when implementing a transaction testing program is to define a risk assessment and prioritization methodology to achieve optimal coverage of liquidity reporting over a three-year testing plan. A successful program will require a transaction-sampling approach, defined testing execution principles and methodology, and a distinct approach for reporting and continuous monitoring. Unique liquidity challenges must be considered during each of these activities to support an effective, value-add program.

Risk assessment and prioritization

Risk assessment and prioritization of all products, subproducts and key data elements must be completed to inform the scope of testing. This assessment, and subsequent prioritization, requires liquidity knowledge and subject-matter expert involvement to support identification of unique liquidity considerations.

Design principles for establishing the risk assessment and prioritization framework include considering intercompany and third-party transactions, minimizing the re-creation of models, and incorporating a representative sample of products and data.

Finally, assessing conformance with instructions requires a thorough understanding of liquidity rules and business context and, as such, should be supported by resources with appropriate liquidity subject-matter experience.

Risk-based sampling

An analytical risk-based sampling should be applied to achieve an optimal sampling of transactions. We have observed success in sampling approaches that are risk-based and rule-based, and that to identify exceptions in data set . A risk-based sampling approach allows for selection of a diverse population of transactions to test.

Leveraging analytics to assist the sampling strategy is foundational to the development of a manageable transaction testing program. Business rules should be a mix of both qualitative and quantitative rules and should include regulatory edit checks and coverage of known issues.

Testing methodology

Testing mechanisms can drive testing program efficiency gains and process improvements. Considerations can include:

- Test for multiple purposes (e.g., element vs. classification) across multiple reports
- Leverage the same transactions to reduce documentation requested and number of samples
- Improve visibility into data transformations between the System of Origin and the report to enhance data lineage documentation

Execution of testing is time- and resource-dependent. Transaction testing involves tracing a reported value back to its source document. In liquidity reporting, this can be a challenge because the data source may be difficult to locate, or appropriate documentation may be challenging to acquire.

Program operationalization

Testing program ownership can influence program success. Assigning ownership can depend on the complexity of reporting and the data being tested. Liquidity expertise, the ability to scale testing (e.g., offshore capabilities) and technology availability will benefit a liquidity testing program. Once ownership is assigned, resources must be trained on the test approaches and methodologies, and liquidity education must be provided, as applicable.

Transaction testing programs can substantially benefit from continuous monitoring and reporting, and serving as a strategic business partner to frontline businesses. This enables firms to better identify areas of emerging risk and to communicate results at an executive level, both internally and with regulatory bodies. Along with detecting risks, monitoring allows for the identification of improvement opportunities through automation and efficiency as the enterprise and its tools, technologies and testing evolve.

Institutions are starting to revamp testing execution that leverages emerging technology, and further automation for testing and associated reporting, since it can provide a significant uplift. Technologies can include workflows, additional data and analytics, and Optical Character Recognition.

A well-designed and executed transaction testing program adds business value to financial institutions. It strengthens front-to-back controls, including the testing and governance process at the data source, and it enables monitoring and escalation of large data variances.

Conclusions

Given the pandemic that the world is currently experiencing, there is significant focus on liquidity reporting, both externally by regulators and internally with escalated pandemic response decision-making. In the upcoming months, as society and the economy begin to heal, there will be many significant lessons learned, many of which may have an impact on future liquidity reporting decisions. If you have any questions on the subsequent brief, please reach out, but we will continue to keep you updated on liquidity reporting and any other regulatory reporting requirement updates.

For more information and continuous COVID-19 coverage, please refer to the following link:

EY regulatory reporting homepage

Latest thinking

COVID-19 related impacts on regulatory reporting

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