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LIQUIDITY MANAGEMENT IN A SUSTAINABLE BANKING MODEL

Abstract:

Following the devastating 2008 financial crisis, many banks seem to be displaying renewed appreciation for fundamental ethics that must underpin banking as a business: focus on essential services in an effective, honest and transparent manner. Despite ongoing abuses, many large global banks, who now trade at a fraction of their previous value, now appear more attentive to needs of customers and changing preferences of investors. Yet more needs to be done in banking and finance to build trust, as public perception surveys, particularly in the US and UK, suggest. Even if big banks remain slow to adapt, they will be forced to change by the growing threat of upcoming ‘challenger’ banks. Many of these have a competitive advantage in a more responsible, sustainable and innovative business model, which is winning over customers and investors. Sustainability in the sense of institutions’ ability to weather crises effectively comes down to better risk management and greater customer focus, based on models proposed by the Bank for International Settlements (BIS) and central banks.

Given the scope for improvement among many large banks, the aim of this paper is to identify and articulate basic principles which banks ought to follow, to adapt to a paradigm of sustainability and responsibility, and explore how these can be implemented. Through this examination a contribution can be made to thinking around best practice and positive influence on policies of financial institutions.

This exposition focuses on real life examples of poor liquidity management, including Royal Bank of Scotland and Northern Rock in the UK. This permits identification of what was missing in the liquidity framework, which then points up need for reform. In this context and drawing upon theory, the crucial role of the board of directors is explored, in taking responsibility for policy formulation and oversight on an ongoing basis, including defining the bank’s risk appetite and articulating a liquidity policy statement.

A number of basic principles are presented which banks should be following consistently, around business model and the critical aspect of liquidity management. The latter can be briefly summarised as: matching assets with liabilities; maintaining liquidity and contingency plans; cognizance of central bank liquidity; awareness of bank liability exposures; use of appropriate metrics to monitor liquidity; robust internal funds transfer pricing policy; and ‘ownership’ of the liquidity risk framework by the management board.

Keywords:

banking, liquidity, governance, sustainability, regulation

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