Classification: EBA members only

Webcast: “Achieving liquidity efficiency in an imperfect storm"

EBA Liquidity Management Working Group

Tuesday, 24 October, 11:00 CET
or
Monday, 30 October, 15:00 CET

Thank you for joining
the webinar will start shortly

Presented by

Daniel Szmukler, EBA Director

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During this webcast, the following topics will be covered:

1. Summary of the EBA Liquidity Management Working Group activities
2. The liquidity management ecosystem
3. The shift to a high-interest rate paradigm
4. Reassessing corporate treasury priorities in today's environment
5. Strategies and tools for banks and corporates to optimise cash more effectively
6. Considerations for the ecosystem over the medium term
7. Key takeaways

Background on the EBA Liquidity Management WG (LMWG)

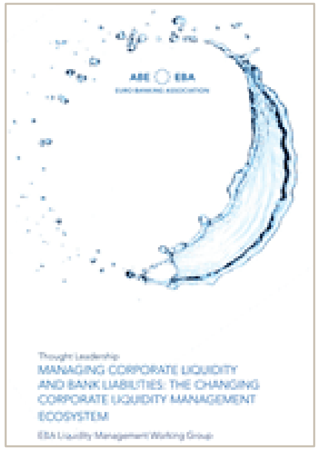
- The Euro Banking Association (EBA) launched a Liquidity Management Working Group (LMWG) in 2017

- With the objective to support liquidity management professionals in better understanding and dealing with ongoing market developments as well as related technical, operational, regulatory, and organisational questions

- Since then, the group has generated insights for the EBA community on several relevant topics:
  - ✓ impact of Basel III on banks' LCR ratios and funding strategies
  - ✓ use cases for notional pooling and virtual accounts
  - ✓ impact of instant payment and intraday liquidity on the corporate liquidity management ecosystem
  - ✓ how real-time data is valued by liquidity management practitioners
  - ✓ the impact of the COVID-19 pandemic on liquidity management practices
  - ✓ guidance on how banks and corporates should respond to the recent shift to a high-interest rate paradigm

The journey so far

Launch of the LMWG



Phase 1

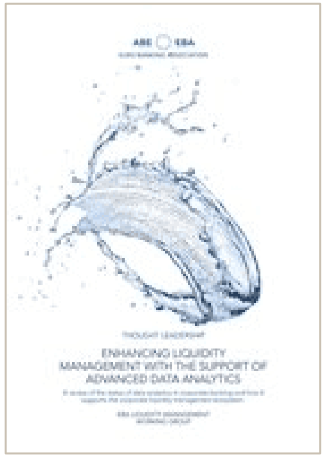
Managing Corporate Liquidity and Bank Liabilities: The Changing Corporate Liquidity Management Ecosystem

Phase 2

How banks can harness technology for the benefit of the corporate liquidity management ecosystem

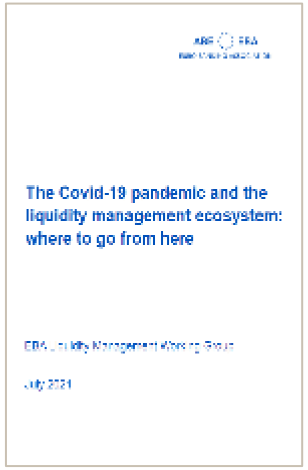
Phase 3

Impact of instant payment and intraday liquidity on the corporate liquidity management ecosystem



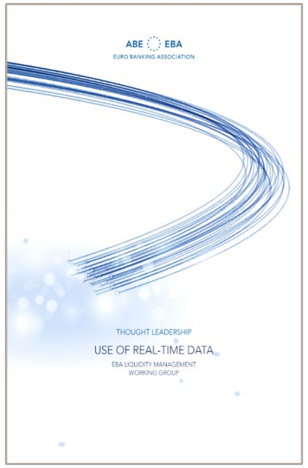
Phase 4

Identifying uses cases in data analytics in the context of liquidity management and Liquidity risk in a multi-currency environment



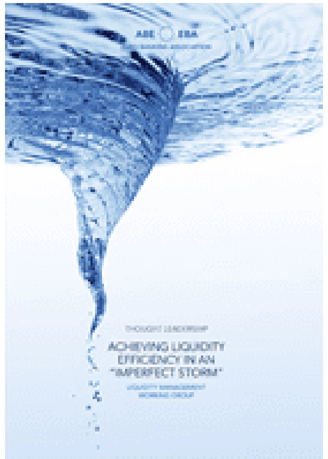
Phase 5

The impact of the pandemic on the liquidity management ecosystem



Phase 6

The use of real-time data by corporates to manage their liquidity



Phase 7

Achieving liquidity efficiency in an imperfect storm

2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023

Liquidity Management Working Group (LMWG)

Current members of the LWMG

ABN·AMRO
Bank of America Merrill Lynch
Bank of Ireland
BARCLAYS
BNP PARIBAS
citi
CRÉDIT AGRICOLE
Danske Bank
Deutsche Bank
Handelsbanken
HSBC
ING
J.P.Morgan
MUFG
Nordea
SEB
SOCIETE GENERALE
standard chartered
Santander
INTESA SANPAOLO
UniCredit

Corporates the LMWG has engaged which since its inception

Deutsche Post DHL Group
ERICSSON
ENDEMOL SHINE GROUP
Munters Your Perfect Climate
here
SCANIA
Fidelity INTERNATIONAL
CooperStandard
worldpay
CBRE
Telefónica
TRELLEBORG
NH | HOTEL GROUP
RECORDATI
iZettle
WARNER MEDIA
CAME
Sano Rice
rötra
INTESA SANPAOLO VITA
damartex GROUP
xerox
سابك sabic
SAFRAN
Spotify
RÉMY COINTREAU
BOSCH
ARROW
DAIKIN
Honeywell
Baker Hughes
VEOLIA
RYANAIR
AVERY DENNISON
BUREAU VERITAS
FedEx
Nilfisk
RTGS.global
south pole

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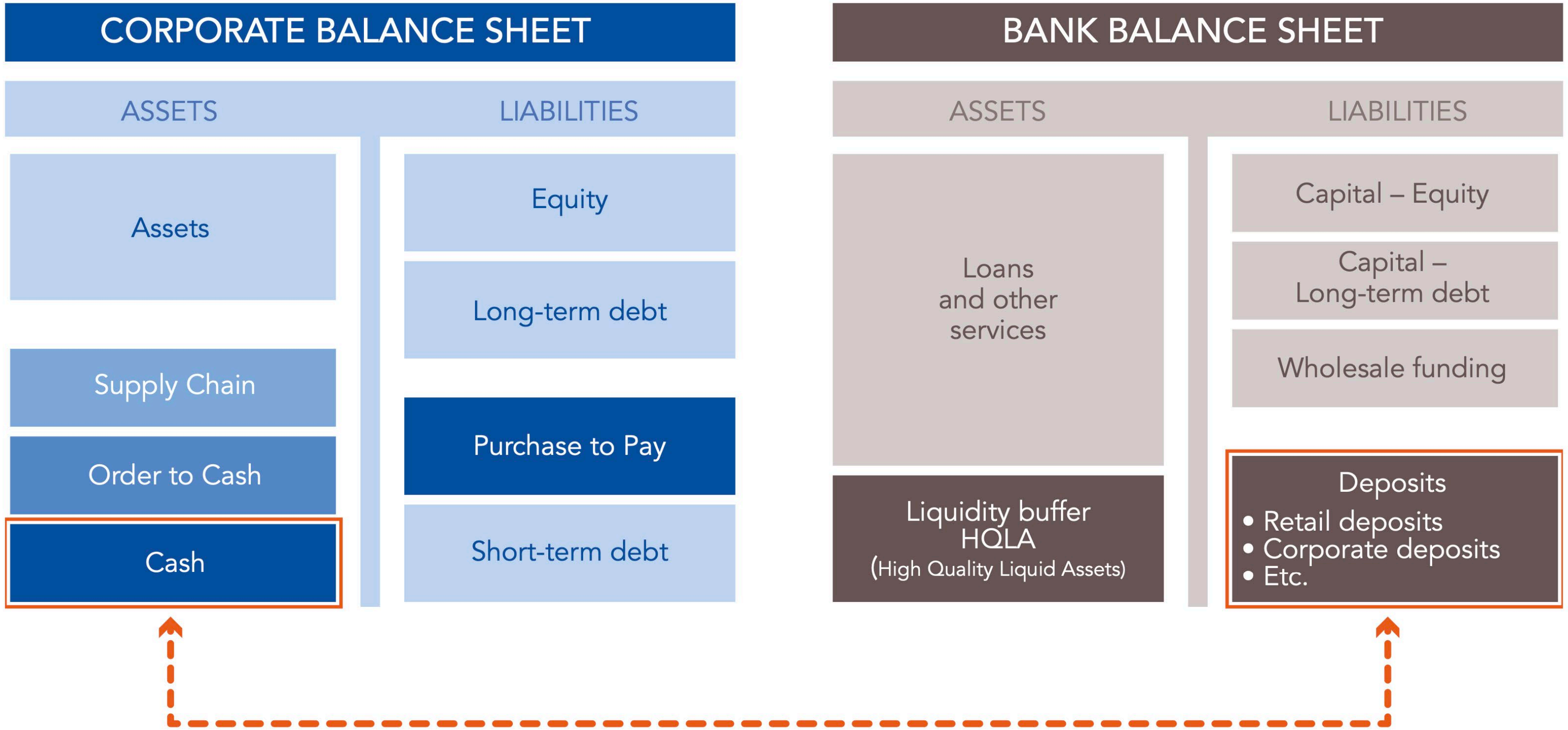
2. **The liquidity management ecosystem**
3. The shift to a high-interest rate paradigm
4. Reassessing corporate treasury priorities in today’s environment
5. Strategies and tools for banks and corporates to optimise cash more effectively
6. Considerations for the ecosystem over the medium term
7. Key takeaways

Corporate liquidity management: where corporates and banks are interdependent



Corporates rely on banks to provide a range of services, technology solutions, payment infrastructure, balance and transaction reporting, and cash pooling solutions. Most importantly, banks provide a trustworthy and well-managed balance sheet with access to central bank money.

Banks need deposits from their client base, both retail and corporate, to help them achieve their funding/ lending objectives, while managing their balance sheets within the framework set by the authorities.

Liquidity management: different perspectives between corporates and banks

For **non-financial corporates** liquidity is an enabler of the productive cycle

WORKING CAPITAL

For **banks** “liquidity” is not just an enabler of the productive process: it is the raw material itself of the productive cycle

FUNDING

TECHNOLOGY

DATA

HUMAN BEHAVIOUR

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ABE EBA
EURO BANKING ASSOCIATION

WE ARE CURRENTLY WITNESSING UNPRECEDENTED CHANGES GLOBALLY

Inflation 10%+

Energy crises

Supply chain crises

Labour market crises

Geopolitical crises de-globalisation

Increased cyber attacks

Volatility in capital markets, interest, FX, commodities

Central bank hikes

Rapid collapse of banks

Increasing perception of risk

Increasing cost of capital

Increasing cost of operations

Refinancing risk increase

More volatile capital markets

Possibly discontinue operations

Consumers are getting worried

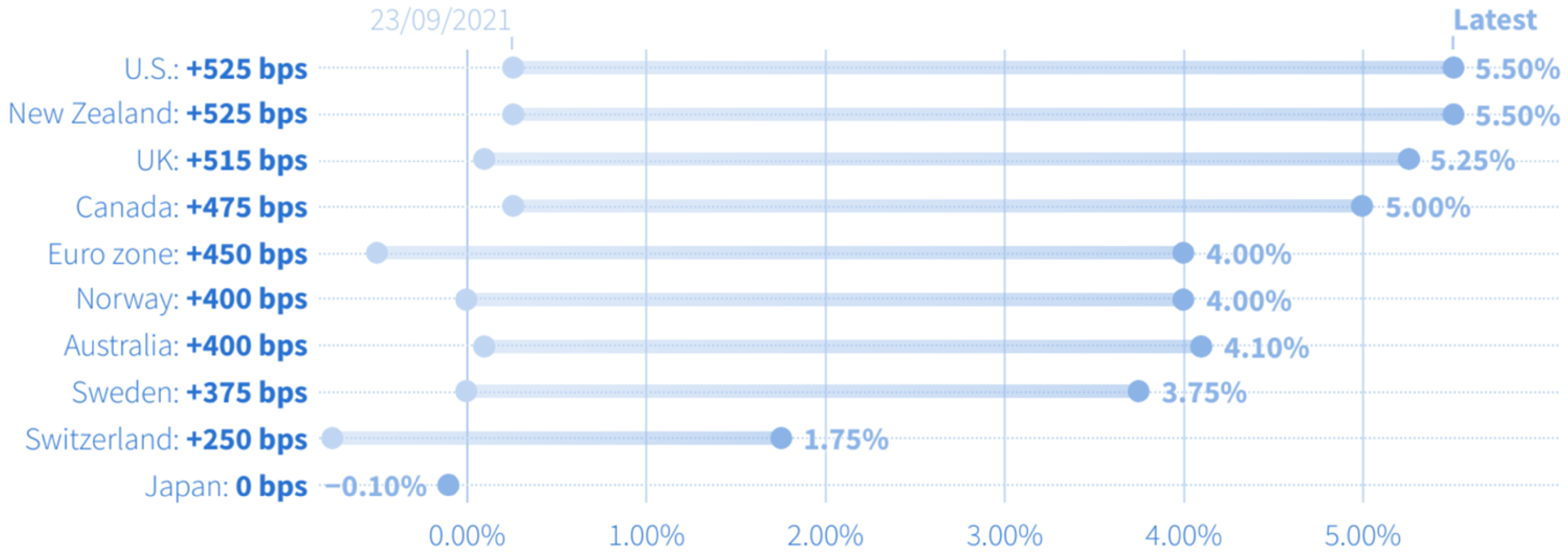
Less confidence in the economy

Job security and financial independence

How to prepare for future black swan events in the future?

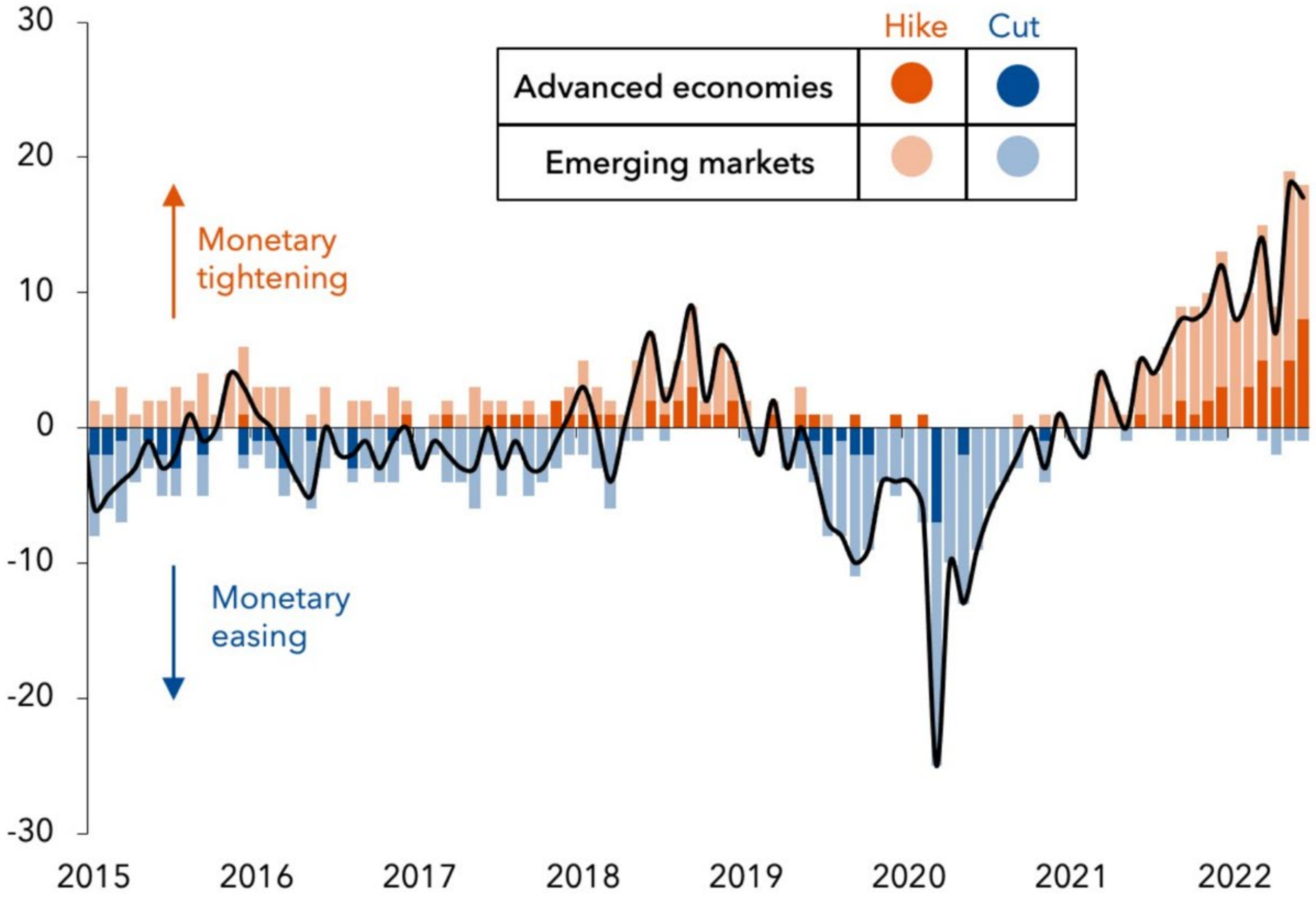
The race to raise rates

Change in policy rates by central banks overseeing the 10 most traded currencies since the start of the interest rate tightening cycle in September 2021.

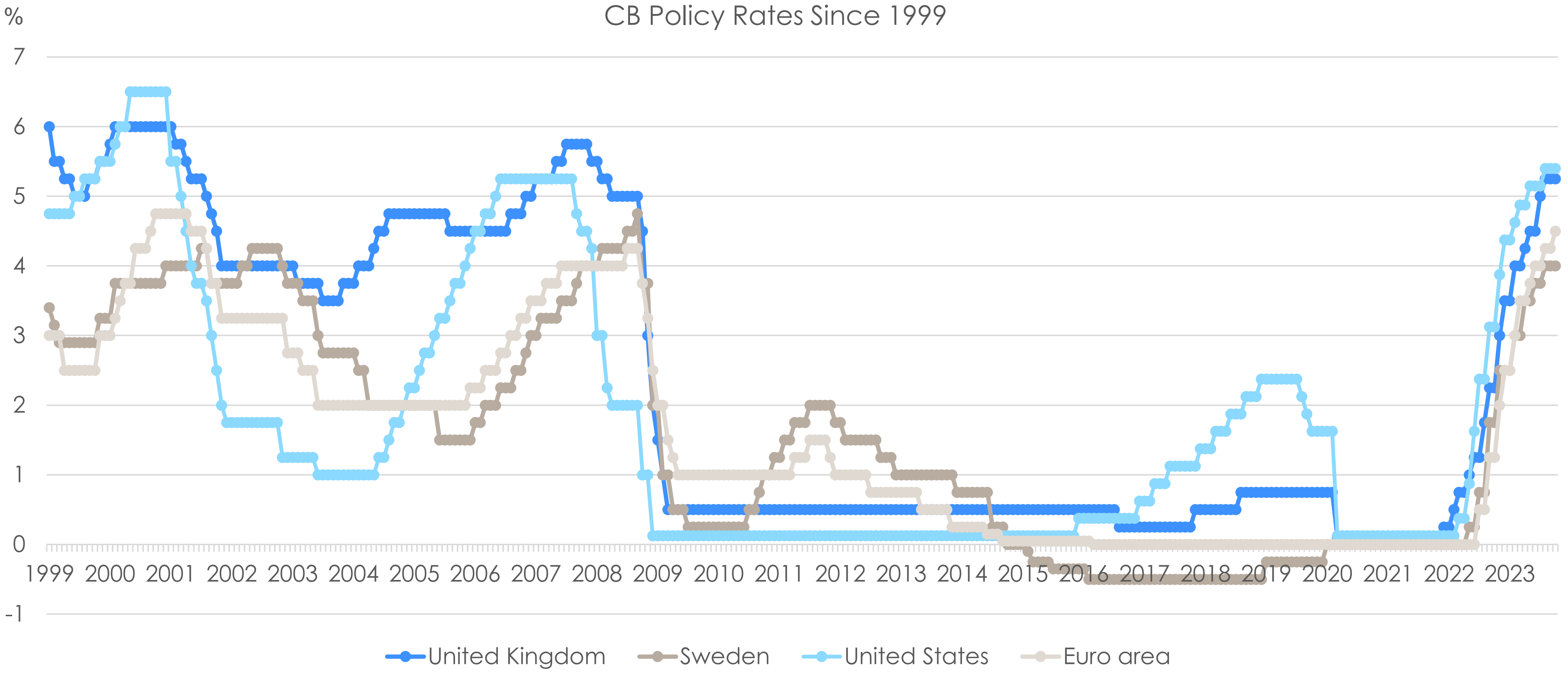


Source: Refinitiv Datastream | Reuters, September 14, 2023 | By Vincent Flasseur

Advanced and emerging market hiking cycles now synchronized

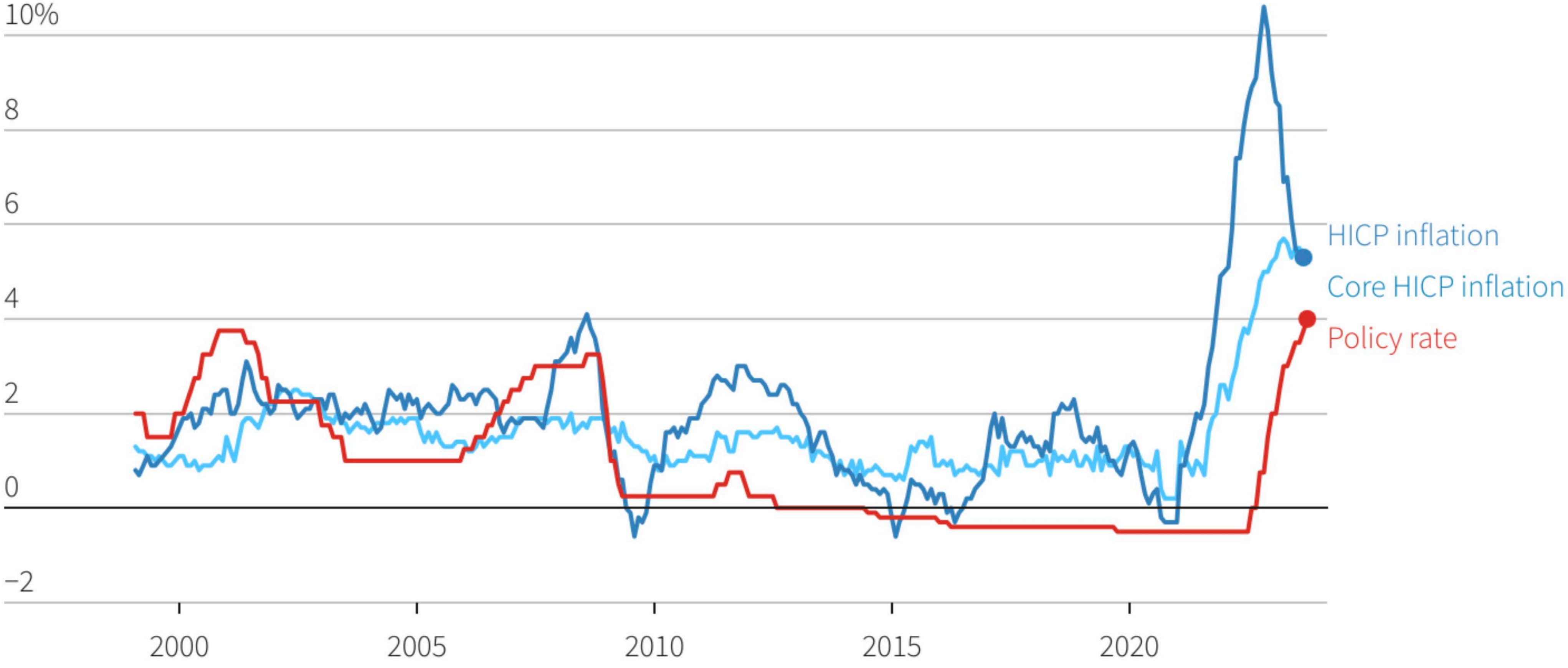


Comparison of Central Bank rate hikes over the last two years



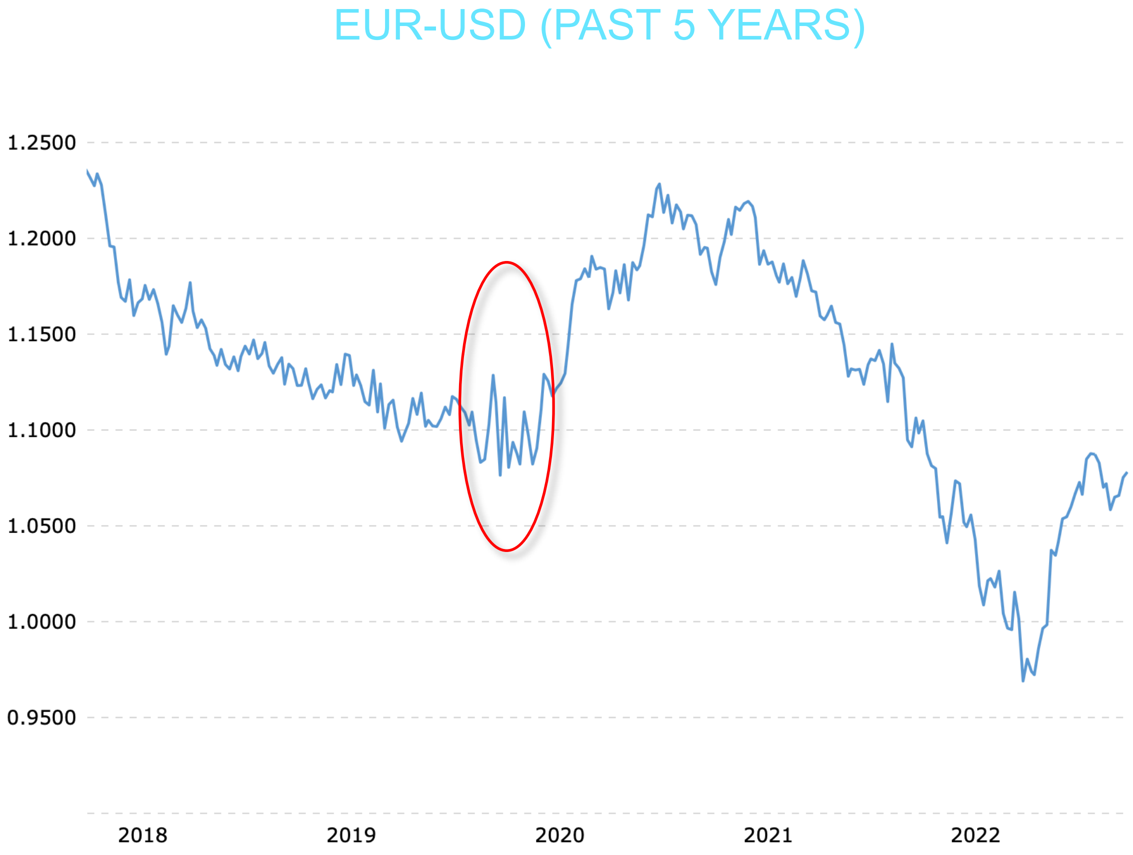
ECB hikes policy rate to record high

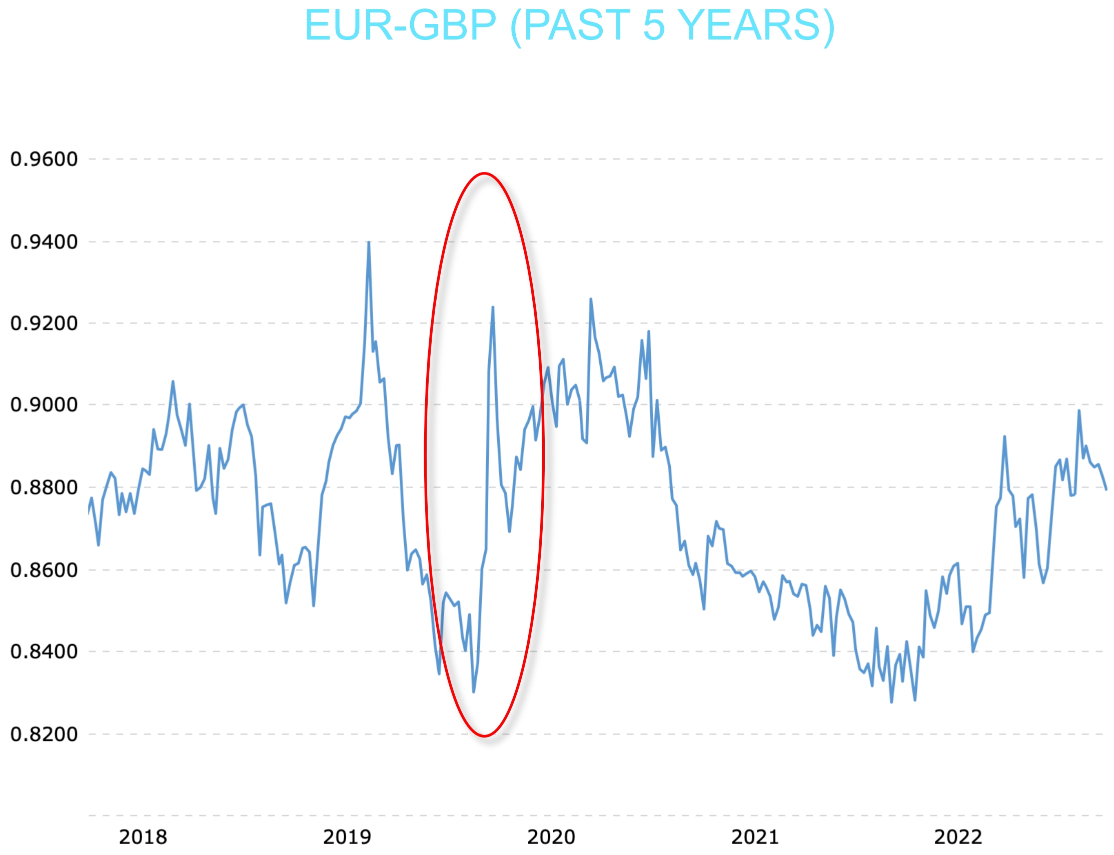
The European Central Bank raised its policy rate by 25 bps to 4%, the tenth consecutive hike since the start of the tightening cycle.



Source: Refinitiv Datastream | Reuters, September 14, 2023 | Vincent Flasseur

FX volatility

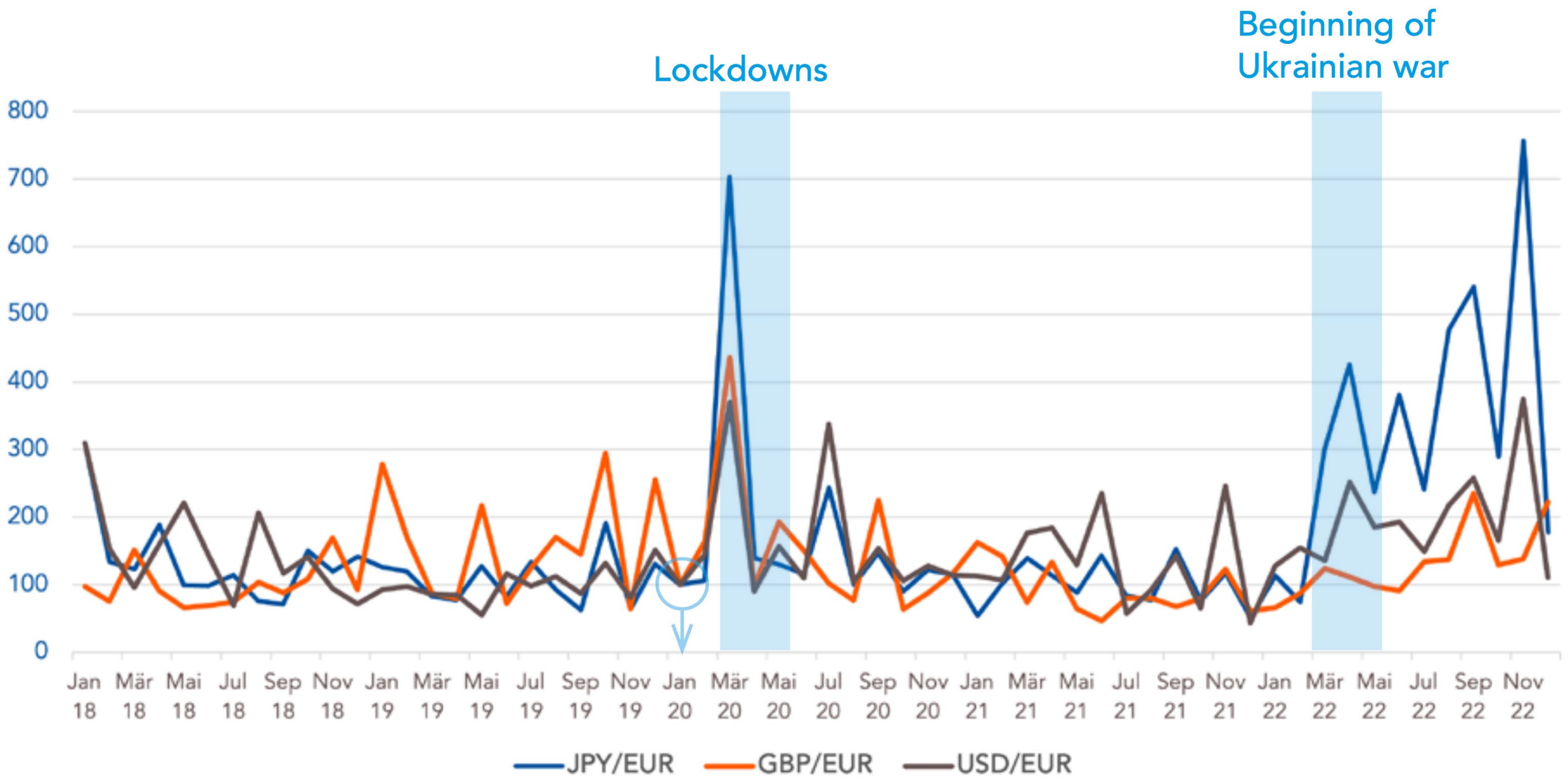




Monthly exchange rate volatility of major currency pairs

(Jan 2020 = 100)

Note: Exchange rate volatility computed using monthly standard deviations.
Source: EBA analysis (using FRED exchange rate data)



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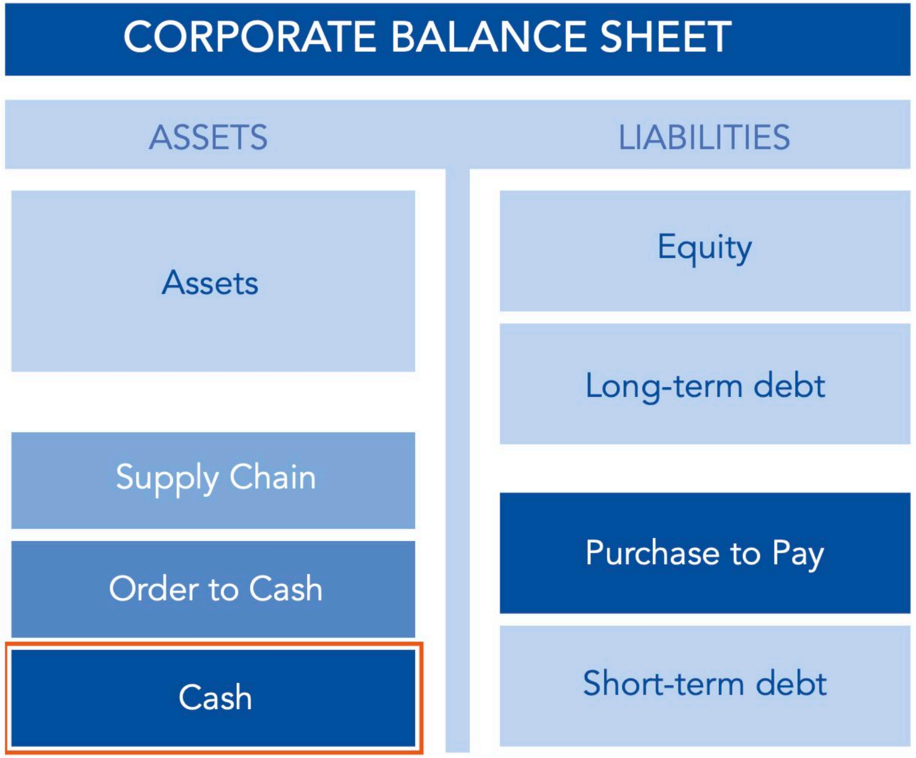
The liquidity ecosystem



Companies need liquidity to support their financial obligations

- Need to manage the asset cash to
  - Manage repayment of debt
  - Manage supplier payments in the different currencies in a timely manner
  - Manage the incoming flows in the different currencies in a timely manner

On the basis of a robust treasury model for the different responsibilities.

Treasury responsibilities

Liquidity

Simplified accounts, better visibility and control

- Rationalise accounts and automate recon
- Real-time cash visibility
- Actively manage WC / DSO across regions
- Standardise service/ processes

Funding

Maximise self-funding through own operations

- Drive consolidated, accurate cash flow forecasts
- Automate domestic x-border structures
- Increase interest income and reduce interest expense
- Reduce re-financing risk

Bank Providers

Reduced complexity, lower bank cost

- Diversify counterparty exposures and wallet shares
- Centralise transactions/ Economics of Scale
- Standardised documentation
- STP processing/ reduce operational and cyber risk

FX Positions

Consolidated positions, lower exposure and costs

- Able to identify and manage risks across regions; rigorous risk main framework
- Centralise FX to reduce spreads
- Leverage technology to reduce operational risks

Treasury Automation

Operational efficiency via STP automation and control

- Efficient payment collections, e.g. STP
- Standard processes
- Tight integration between ERP, TMS, and banking systems

Corporate Treasury Steering Model

Corporate treasurers need to comply with very strict…

- Treasury mandates
- Treasury policies

…for senior management to stay in control of the treasury operations within the pre-defined risk parameters, pre-authorisation levels, and objectives.

Corporate Treasury Steering Model – Treasury Mandate – Example 1

Steering Model

- **Business Units**' financial performance is measured at **EBITDA** level – excluding financial income and expenses
- Financial income, expenses, and related risks are managed at the **treasury level**
- The company has a centralised approach to finance, treasury, liquidity and insurance

Corporate Treasury Steering Model – Treasury Mandate – Example 2

Our Treasury/ Liquidity goals

- To support business needs, starting with liquidity, ensure that every **one of our 300+ legal entities** has sufficient cash available to cover local disbursement obligations.
- Improve our **cash efficiency** through leaner cash balances in our bank accounts. Like the concept of just-in-time inventory, we seek to arrange **just-in-time cash**.
- Work on **borrowing efficiency** by optimising the terms and conditions as well as the **mix of our credit facilities**.
- **Support the business** regarding the management of various economic risks (often through insurance products) and financial market risks (through hedging strategies).

Corporate Treasury Steering Model – Treasury Mandate – Example 3

Liquidity and Cash Management

- **All cash held by Operations are Group funds**. Group funds must be held with known/**approved counterparties** and must not be placed at risk through inappropriate banking, deposit or investment arrangements.
- Details of all bank accounts held by Operations must be provided to treasury and changes thereto to be **approved by Treasury**.
- Treasury ensures that Operations have **access to liquidity to adequately** fund their **working capital**.
- **Treasury coordinates** liquidity and deposit arrangements for surplus cash or investments.
- All Operations must participate in **Group liquidity** arrangements and cash pools (at arms-length interest terms), where it is legally and fiscally possible.
- The main banking activities of Operations must be with **Treasury-approved banks**.

Corporate Treasury Steering Model – Treasury Mandate – Example 4

Group cash position

- "…Company's previous target in terms of cash management was to maintain a **cash position** equivalent to at least 30% of net sales. Going forward the company will target to maintain a cash position in the range of 10-15% of net sales.

Changes in the external environment have forced a reassessment of treasurers' priorities

A higher perceived impact of 'black swan' events…	…underscores the need for higher liquidity buffers as an absorption cushion…	…reinforces the benefits derived from a greater understanding of the underlying cash flow dynamics…	…and requires putting in place more robust policies and contingencies for making and receiving funds.
Elevated geopolitical uncertainty…	…increases the perceived risk of exposures in certain markets…	…leading to a need to reassess relationships in those markets…	….with the potential loss of assets and EBITDA needing to be offset using liquidity buffers.
Greater perceived counterparty risk due to rising interest rates…	…leads to a higher perceived risk of late or non-payments…	…which requires more active monitoring of exposures by credit management…	…and greater diversification as well as the possibility to absorb these losses with liquidity buffers.
The increased cost of interest expense…	…generates a need to reduce external funding…	…through more effectively recycling cash	…and achieving greater efficiencies in managing working capital and risk.

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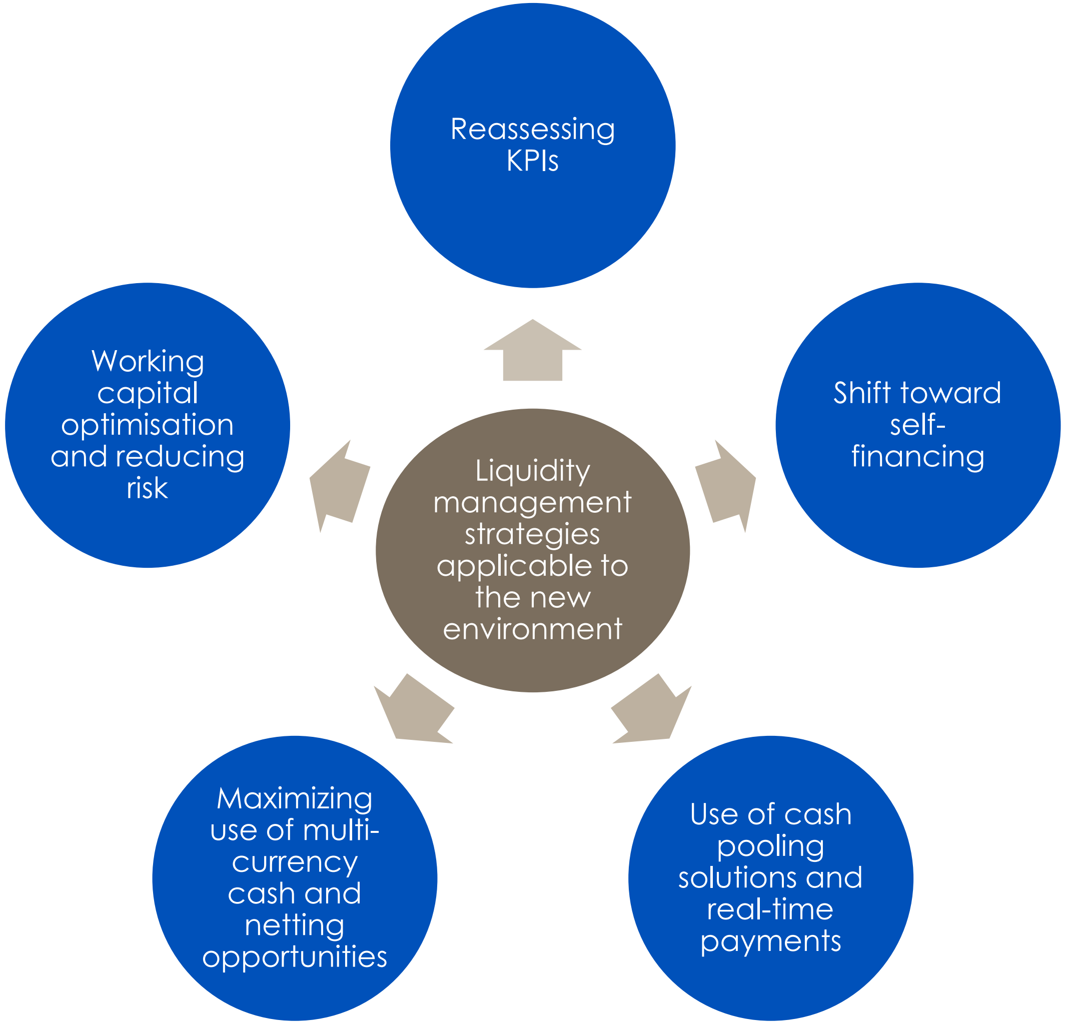
Liquidity management strategies applicable to new liquidity environment

Treasurers are currently confronted with an urgent imperative: they must enhance the efficient allocation of liquidity upstream.

This is essential for bolstering the organisation's overall liquidity position, enabling the release of additional funds, and expediting the repayment of debts and reduction of interest expenses.



Benefits of various strategies and tools for banks and corporates to optimise cash more effectivity

Objective	Strategies and tools	Benefits
Achieve greater working capital efficiencies	• Greater reliance on self-financing • Driving broader conversations about the use and awareness of cash across the organisation • Reassessing terms of trade and KPIs	• Greater liquidity efficiency • Faster debt repayment and interest expense reduction • Reduced dependence on external funding sources
Enhance cash visibility, automation, and control	• Set up treasury function as an in-house bank • Cash flow forecasting • Use of cash pooling solutions • Real-time payments	• Understand dynamics of the firms future cash flows and netting opportunities • Achieving consolidated liquidity positions • Reduced costs of overdraft facilities and borrowing • Lowering operational costs in treasury operations • Facilitating "just-in-time" liquidity
Maximise the use of multi-currency cash	• Multi-currency cash pools • Reducing short-term debt facility usage • Reassessment of FX hedging strategies • Trapped cash solutions • Leveraging FX swaps for multi-currency liquidity	• Improved multi-currency liquidity efficiency • More efficient repatriation of unused cash • Reduced FX hedging costs • Enhanced visibility across the organisation
Generate yield on excess cash	• Money market funds/ investments • Other alternative short-term investments	• Opportunity to generate yield on excess cash without increasing the risk • Greater diversification • Quick and easy access to liquidity • Ensures security of principal

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Medium-term strategic considerations for banks

Reassessing the remuneration of client balances
- Characteristics of balances that require remuneration
- Use of alternative benchmarks for pricing

More active use of intraday liquidity and the regulatory/cost implications
- How to achieve continued BCBS 248 compliance
- More active monitoring of liquidity and collateral positions from a LCR, RWA, and interest perspective

Improving governance around cash management and investment policies
- Implementing dynamic policies that can adapt to different environments
- Establishing clearer decision-making around changes to these policies

ESG disclosure impact
- Impact on future balance sheet composition
- Disclosure compliance and product development

The increased rates boosted the overall NII of banks as witnessed in the recent financial disclosers of banks

And now we found ourselves in a “Imperfect Storm”

- Inflation 10% +
- Energy crises
- Supply chain crises
- Labour market crises
- Geopolitical crises
- Increased cyber attacks
- Volatility in capital markets, interest, FX, commodities
- Central Bank hikes

- Increasing cost of Debt
- Increasing cost of operations
- Refinancing Risk Increase
- Focus to consolidate cash quicker
- Recycling cash – how much cash do we have
- Focus on volatile markets and possibly discontinue operations

How to prepared for future black swan events with liquidity

The current interest rate and macro-economic environment represent a significant paradigm shift for the liquidity management ecosystem

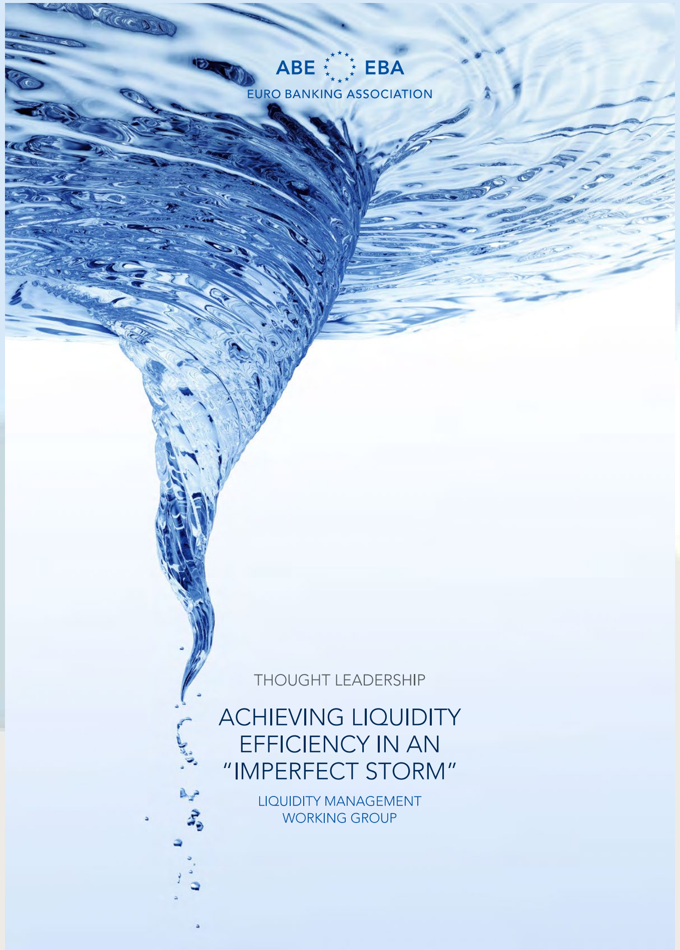
It requires:

- Developing an effective treasury strategy that is suited for a low-interest rate environment or a rising rate environment but any rate environment
- Repositioning of available solutions such as real-time payments and cash pooling solutions to gain greater cash visibility, automation, control and the adoption of innovative tools and technologies to maximise working capital efficiency to effectively “recycle” cash.
- In the future, the practice of holding liquidity for payments and extending credit lines is expected to incur greater costs, necessitating a more meticulous approach by banks in managing these aspects.
- Recent bank failures may lead to stricter liquidity requirements by US and European regulators
- In the current climate of increasing interest rates, the heightened liquidity expenses faced by banks may be passed on to their corporate clientele, potentially leading to an elevated cost of capital for these businesses
- Going forward, not getting used to the status quo and remaining agile to adapt swiftly to the constantly shifting conditions will be paramount for banks

Any Questions

How to find the report?

The report is available for download for all EBA member organisations



Achieving liquidity efficiency in an imperfect storm

Download the full report (access to EBA members only):

https://www.abe-eba.eu/publications/