



The Financial
Services Club

Capital Markets Chamber



Have payments infrastructure risks been largely forgotten?

PJ Di Giammarino, CEO, JWVG

Harry Newman, Managing Director, SWIFT London

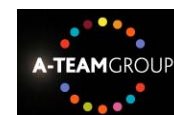
Paul Smee, Chief Executive, UK Payments Council

Simon Bailey, Director, Payments and Transaction Banking, Logica

Chris Dunne, Strategy Director for Transaction Services at VocaLink



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Have payments infrastructure risks been largely forgotten?

*A debate about whether the payments
infrastructure is up to the new risk
management standards*



G20: actively stressing

- ▶ Global
 - G20: The Basel Committee should study the need for, and help develop, firms' stress testing models, as appropriate (56)
 - BCBS: Enhancements to the Basel II framework (Final rules)
 - BCBS: Principles for sound stress testing practices and supervision (Q1 consultation)
 - BCBS: strengthening the resilience of the banking sector (Q2 consultation)
- ▶ EU
 - CEBS CP32 Guidelines on Stress Testing (10 March hearing, responses posted)
- ▶ UK
 - FSA PS09/16: Liquidity risk (12/09)
 - FSA PS09/20: Stress and scenario testing (07/10 plans)
 - FSA CP09/30: Capital planning buffers (Q3 2010)
 - HMT: Resolution arrangements for IBs (Financial Services Act 2010 mandate)
- ▶ US
 - OTS: Interagency policy statement on funding and liquidity risk management
- ▶ AU: DP prudential approach to liquidity risk (1H 2010)
- ▶ JP: Liquidity risk management in financial institutions



New principles to stress about

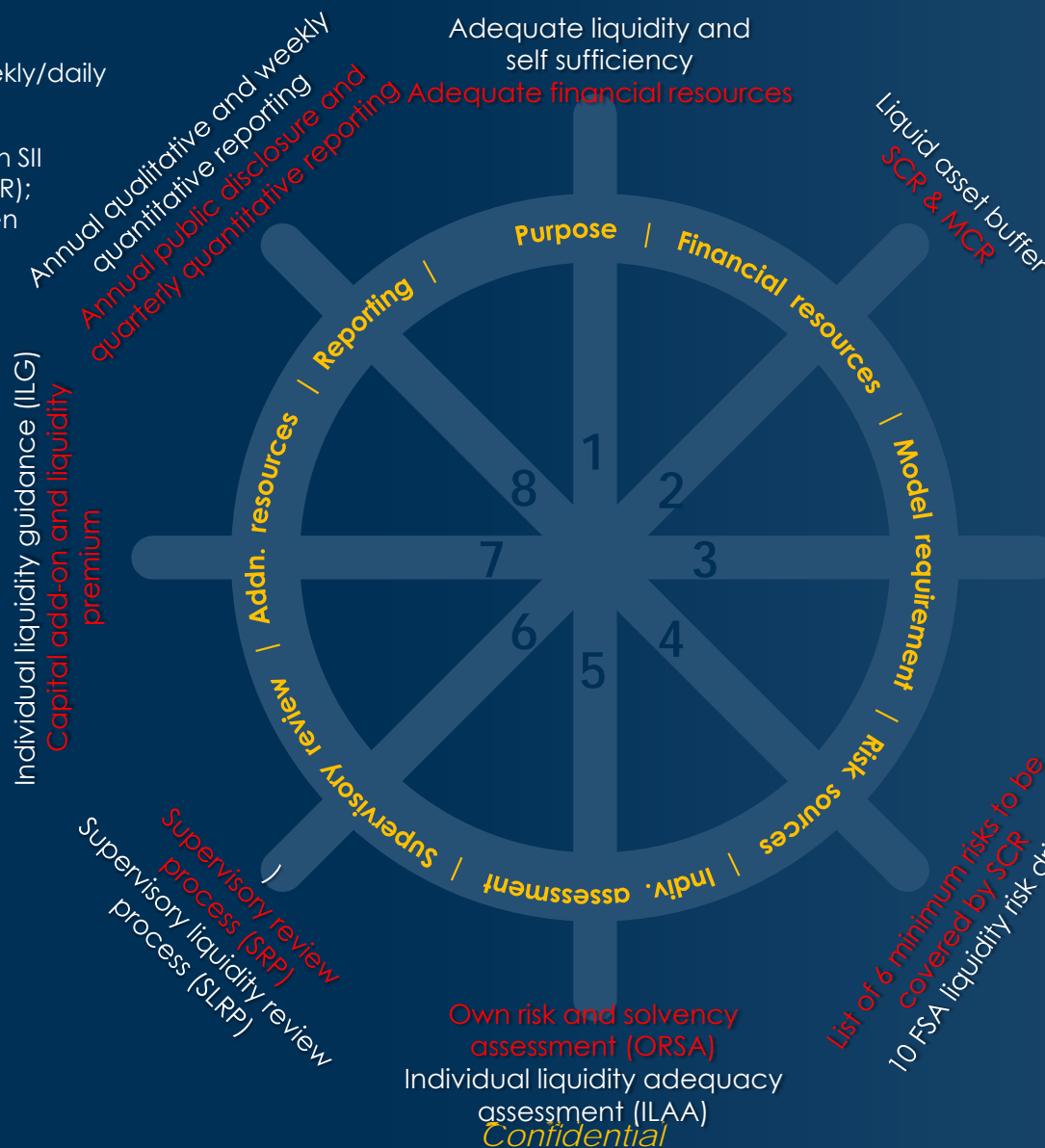
1. Management oversight, governance and documented policies
2. Businesses and economists use results to inform risk appetite and outlook
3. Integration to risk management framework
4. Suitably robust infrastructure: flexible and granular
5. Scenarios: dynamic, forward looking, holistic, specific portfolio, firm-wide risk, taking into account feedback effects, interdependencies and 2nd order effects, reverse stress tests: working back from what damages the bank
6. Ongoing review of appropriateness

Source: BCBS principles for sound stress testing practices and supervision, CEBS CP32, FSA PS09/20



Stress is fundamental to new risk requirements

- ▶ Unable to meet weekly/daily reporting deadlines
- ▶ Duplication between SII reports (RTS and SFCR); unreasonable burden



- Stress testing**
- Standard approach or internal model**
- ▶ Lack of IT infrastructure for stress test model
 - ▶ The standard formula has certain weaknesses, e.g., exclusion of geographic diversification
- Need to ensure assumptions meet business and FSA requirements**
- ▶ Design of certain SII scenarios are pro-cyclical, e.g., for equity volatility stress

Solvency II Liquidity



FSA stress: Dear CEO letter (February 2010)

- ▶ Hundreds of CEOs to confirm by 12 February in writing that they maintain robust liquidity risk management policies, plans, governance, measurement and stress testing procedures.

What are the issues?

- ▶ Inadequate establishment of **liquidity risk tolerance**
- ▶ **In sufficient liquid asset buffer**
- ▶ Inappropriate allocation of **liquidity costs, benefits and risks to all significant business activities**
- ▶ **Failure to identify and measure full range of liquidity risks, including contingent liquidity risks**
- ▶ Inadequate management of **intraday liquidity risk and collateral**
- ▶ Poor quality and robustness of firms' **liquidity stress testing**
- ▶ Ineffectiveness of **contingency plans** put in place to deal with stressed circumstances
- ▶ Inadequate nature and frequency of **supervisory reporting** on bank liquidity position

Source: FSA Dear CEO letter: "FSA requirements on your firms liquidity risk management," January 2010

- ▶ CEOs need to demonstrate that they have taken this seriously and that they are ready, willing and prepared for a spot check at any moment (or not)



BOE stress: CRO stress testing group (February 2010)

- ▶ Group to serve as an informal mechanism for regular industry outreach on stress testing
- ▶ Engage industry at senior levels
- ▶ Group to meet every quarter (or more frequently if needed)
- ▶ Forward agenda:
 - Transparency: Between firms and supervisors and different supervisors
 - Capital planning buffers: FSA to engage with group prior to issuing policy statement on CPB
 - Reverse stress testing: FSA to engage with group regarding implementation of reverse stress testing requirements
 - Capturing dynamic feedback effects: Discussion on importance of considering dynamic feedback effects of stress events and ways these can be captured

Source: 22 February 2010: Reverse stress testing group meeting held at BoE



FSA implementation: April 2010

► Reverse stress testing implementation plan template

- Firms to communicate to the FSA their progress in preparing for the new reverse stress testing requirement
- Areas covered:

1. Current stress testing **framework**
2. Planned **changes** to stress testing framework
3. Key **milestones** in meeting **14 December 2010 deadline**
4. **Resource** implications
5. Qualitative and quantitative analysis in **reverse stress** tests
6. **Requirement** to cover all entities within UK group
7. Requirement to cover **all business lines** within entities

8. Reverse stress test **scenario** construction process
9. Economic **variables** considered
10. **Usage** of results in capital and business planning, strategic decision-making, contingency planning
11. Usage of results to inform **risk appetite**
12. Process for **senior management to review** results, consider and monitor management actions

► Firms to submit their implementation plans by **Friday 16 July**

- **What parts of the payments systems are a problem and for whom (e.g., cash versus securities)?**
- **Are payments infrastructure risks being considered? What are they?**
- **Are the UK standards ahead of other jurisdictions? Are central banks aligned?**
- **How formalised is the management of intraday payment scheduling today? Is it good enough?**
- **What does this mean to the infrastructure resilience and data quality within banks? Are they ready for the new standards?**

Have payments infrastructure risks
been largely forgotten?

What do YOU think?

| Date | Debate |
|-------------|--|
| 19 January | This house believes that stress is a killer for banks operating in the UK. A debate on what it takes to do stress testing right in the capital markets in 2010 |
| 11 February | This house believes that a single customer view will always be fuzzy. A debate on the achievability of FS compensation scheme aims in 2010 |
| 16 March | This house believes that banks' infrastructures are not up for the BIS' new risk controls. A debate on strengthening the resilience of banking |
| 20 April | This house believes that Solvency II and liquidity risk have reinvented the wheel. A debate on the similarity of new risk management standards |
| 11 May | This house believes that payments infrastructure risk has been largely forgotten. A debate about whether the payments infrastructure is up to the new risk management standards |
| 8 June | This house believes that global capital and liquidity buffers standards will never exist. A debate about the achievability of global consistency in risk management approaches |
| 13 July | MiFID II review debate |



Next up

SWIFT'S liquidity risk management survey

Confidential survey on the challenges brought by new regulatory demands of yet more granularity and still greater frequency of reports.

<http://survey.swift.com/sw/surveys/part.asp?S=7047&P=2143525&R=1&H=3D489A69A92FC6690F2B71A341BB775F62DBC0F8>

Check the website for LiRAN and MiFID meetings due to be scheduled soon

<http://jwg-it.eu/events.php>



For more info: email: admin@jwg-it.eu or call PJ +44 (0) 7811 430 503



Thank you

JWG Group Ltd



admin@jwg-it.eu +44 (0)20 7870 8004 www.jwg-it.eu



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