

Abstract

The client – a global custody bank – had to determine the excess/core part of operational deposits held by its clients in the context of the Liquidity Coverage Ratio (LCR) reporting.

The challenge was to design and implement, for all entities in scope, a model and reporting tools that would meet this requirement within short regulatory timeframes and clients' business objective.

As part of this delivery, Avantage Reply consultants validated the model and put in place processes that supported reporting tools.

In addition, the client benefited from process automation, thus reducing manual intervention and therefore operational errors and gain better understanding of key model drivers through knowledge transfer.



LCR Operational Deposits Model

THE CLIENT

The client is a Eurozone subsidiary of a North America-headquartered global custody bank providing investment services to the European market including global custody (settlement and safekeeping), portfolio and fund accounting, corporate trust services, global collateral services, depositary receipts services and broker-dealer services.

THE CHALLENGE

In the context of the reporting of the Liquidity Coverage Ratio (LCR) under the EU Delegated Act, the client required a tool that aimed at determining the excess/core part of operational deposits held by its clients. Given their nature, operational deposits are deemed as a relatively permanent funding source and therefore benefit from a favourable stress outflow rate in the computation of the Net Liquidity Outflows (denominator of the LCR ratio).

The challenge was to design and implement, for all entities in scope, a model and reporting tools within short timeframes that are in line with regulatory and business requirements, meet data architecture constraints and comply with internal validation process. Given very aggressive timelines, the biggest challenge was with the selection, testing and validation of data.

APPROACH AND SOLUTION

An Avantage Reply team composed of a project manager, business analysts, quantitative analysts and IT developers, was deployed on client site and supported by client's Risk, Finance and IT functions. The project governance included Steering Committee composed of representatives from multiple locations.

The project was composed of three phases: the definition of the model and the collection of data, the development of the tool and the documentation.

Taking into account the fact that Group had already developed a model at US level, for group consistency and comparability, the selected approach was to perform in-depth analysis of the compatibility and differences between US and EU methodologies. The existing Group model was then compared with peer companies in Europe and challenged on a conceptual basis by reviewing alternative models.

Based on the interim findings, Avantage Reply collected the data on an ad hoc basis (before automation). The collection of data and the computation of the results for each entity was key in allowing the stakeholders to correctly assess the model and to make an operational test of data accuracy and completeness. This analysis offered a unique opportunity to communicate key drivers used in the model and explain the rationale behind each in-scope criterion (see below) and each assumption of the model.

The identification of data and the selection of model methodologies allowed the team to design the dataflow and build databases. During this second phase, the team paid particular attention to development of a tool that met internal control requirements and offered a sufficient audit trail.

The last steps – documentation and validation - were conducted in parallel to the previous step taking into account the short timescales, and the time required for internal approval of IT, Model Validation and other relevant stakeholders. The early involvement of model Validation and IT developers permitted successful implementation of the model by quickly identifying, mitigating and addressing any material hurdle or risk.

As a result, a model composed of two main stages has been developed. The first stage of the model (scope in) was to select deposits eligible for operational treatment, by excluding deposits that did not meet the regulatory eligibility criteria. The second stage was to estimate the portion of the core deposits based on a statistical model that included clients' transaction. Reporting build allowed not only to meet regulatory reporting requirement, but also to inform business about the key drivers and their changes.

RESULTS AND BENEFITS

Early sponsor identification and stakeholder engagement, along with regular communications allowed Avantage Reply to design, build and implement a model that met all business objectives and complied with regulatory requirements.

Automation of the process reduced manual interventions and therefore limited operational errors. A set of controls were designed and put in place in order to validate and explain the result in detail.

Regular workshops with client stakeholders based in multiple locations allowed the client to be aware of the progress of model development and helped smooth implementation of the model.

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