

## Built for Stress: Rethinking Liquidity Management in a New Era of Risk



### The new climate: persistent volatility

The post-pandemic era has been defined by persistent interest rate volatility, following central banks' aggressive monetary tightening regimes in response to inflationary pressures. This shift is driving new behaviors among depositors, while affecting funding sources and introducing risks in asset performance. In response, banks are investing in more advanced interest rate simulation and enhanced scenario analysis, recognizing that old assumptions about rate sensitivity and customer behavior need to be revisited.

Yet new sources of volatility continue to test institutional resilience. In the US, banks are now reporting a sharp rise in unrecoverable credit card debt, suggesting that consumer financial stress is intensifying. Consumer stress is not limited to the US, as a **German bank** significantly increased its consumer credit risk provision in 2024, citing 'overstretched borrowers'. This added to existing concerns over the state of commercial real estate and corporate borrowing. Credit spreads are an important component of interest rate risk. Erosion in credit quality fuels further uncertainty around future cash flow projections, complicating liquidity planning and emphasizing the importance of forward-looking, integrated risk analytics.

As the macroeconomic climate grows more unpredictable, the ability to link interest rate exposure, asset quality and funding behavior into a coherent liquidity strategy is a defining marker of institutions' strategic capability.

Funding liquidity risk management – both operational and financial – is a central pillar of the asset and liability management (ALM) function, acting as a real-time stress test of balance sheet assumptions. The process exposes whether institutional expectations around funding, credit and capital can hold up under pressure. Funding liquidity can be a dynamic balancing act, as the same asset can be mobilized for a variety of functions, including capital buffers, collateralized short-term funding and support for trading activities. Its effect on risk, recovery, resolution and profitability can vary significantly, depending on how the asset is deployed.

Recent events have shown, repeatedly, that even well-capitalized institutions can falter when liquidity strains emerge. As market volatility appears set to continue, and is increasingly mirrored in rising consumer stress, hidden vulnerabilities in liquidity positions are likely to emerge.

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## From ratios to real-time: evolving liquidity strategies

A bank's ability to raise money under stress or replace maturing obligations, known as funding liquidity management, has been a focus for regulators' reforms following the global financial crisis. Ample liquidity ratios and buffers, which often sit above minimum requirements, signal a bank's ability to withstand a crisis. Yet in 2023, despite previously strong liquidity ratios, Credit Suisse's liquidity position deteriorated as confidence waned, and deposit outflows accelerated. The events at Credit Suisse highlighted the importance of considering not just the size of liquidity buffers but also how quickly and effectively they can be mobilized. Liquidity resilience can depend as much on operational execution as it does on structural metrics.

## Operationalizing liquidity

Operational liquidity management refers to a bank's day-to-day ability to meet short-term obligations, including customer withdrawals, trade settlements and margin calls. While funding metrics provide a strategic view of medium-to-long-term stability, they may be insufficient during fast-moving, real-time stress events. In moments of acute market disruption, the ability to access, deploy and operationalize liquidity at speed becomes critical to survival.

The collapse of Silicon Valley Bank, Signature Bank and First Republic Bank in 2023 demonstrated how rapidly liquidity can become scarce, fueled by concentrated deposit bases, delayed recognition of stress and inadequate access to emergency funding. These institutions met liquidity requirements prior to their collapse, yet lacked the intraday capabilities and contingency mechanisms to stop or slow mass withdrawals.

## A structural shift for smaller institutions: the flight to safety

While funding concentration risk has become a focus for supervisory scrutiny, the broader impacts of the 2023 banking crisis are shaping liquidity management well beyond regulatory compliance. The US crisis had broader structural impacts on the industry, triggering a widespread 'flight to safety'. Depositors moved funds from regional and community banks to systemically important institutions, which were perceived to be more stable. The largest US banks were able to absorb these inflows due to significant liquidity buffers and robust internal controls that were often well above regulatory requirements.

For smaller banks, this marked a critical turning point. As well as depleting deposit bases, they are also facing intensifying competition from FinTechs offering streamlined, digital-first banking experiences. In this new risk environment, operational liquidity management has become a strategic imperative for these institutions. On the funding side, maintaining liquidity coverage ratios (LCRs) above regulatory minimums is no longer considered conservative policy, but has become part of prudent liquidity governance. US regulators, including the Federal Deposit Insurance Corporation (FDIC), have emphasized the importance of ensuring that contingent liquidity arrangements are reliable and executable.

## Regional context: institutions adapt

In Europe, banks continue to hold strong regulatory liquidity profiles. However, European supervisors have reinforced expectations around intraday liquidity management, the usability of buffers and cross-border liquidity transfer mechanisms. Essentially, institutions are expected to plan for how their LCR can be operationally executed during a crisis. Key considerations include how quickly high-quality liquid assets (HQLA) can be monetized, the seriousness of early stress indicators and the deployment of liquidity buffers.

Meanwhile, in Asia, liquidity risk has remained largely contained, but new pressures are emerging. Interest rate risk may have a substantial impact on Japanese regional banks with large holdings of low-yielding government bonds. Singapore and Hong Kong have seen their largest institutions bolster LCRs, as regulators push firms to invest in advanced liquidity monitoring as part of broader efforts to align with Basel III and manage dollar funding risk.

Prudential requirements in the banking business may shape commercial approaches and can impact profitability dynamics. But banks can also strategically manage these costs, aligning them to their balance-sheet objectives and risk appetites.

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## From intraday oversight to liquidity optimization: a blueprint for operational liquidity management

To manage today's complex liquidity environment, institutions are looking to adopt best practices and the necessary supporting infrastructure and systems to enable agility, resilience and transparency:

### Intraday monitoring and execution

- Monitoring of cash flow positions and collateral movements across entities and currencies.
- Integrated systems that track liquidity usage across business lines, legal entities and jurisdictions.
- Granular time-sensitive data on asset liquidity characteristics and settlement timing.

### System coordination and cross-functional collaboration

- Adoption of a 'real-time treasury mindset', moving from static daily reports to continuous liquidity positioning.
- Integration of treasury and risk functions to support collateral optimization, encumbrance management and funding decisions.
- Deployment of tools (such as shared dashboards, early-warning indicators and contingency planning) that align key stakeholders, including the Chief Financial Officer (CFO), the Chief Risk Officer (CRO) and the Asset-Liability Committee (ALCO).
- Expansion of stress testing from regulatory compliance to a strategic planning function used by treasury, ALCO and business lines.
- Progressive integration of business risks, funding and profitability management.

### Integrated analytics

- Incorporation of macroeconomic data and behavioral inputs to simulate multiple liquidity trajectories.
- Implementation of reverse stress testing to identify liquidity gaps and their causes.
- Progressive integration of business risks, funding and profitability management.

Liquidity risk management is evolving into a strategic capability that ties together all the elements of the balance sheet. Operational liquidity is increasingly a dynamic and data-driven practice, as institutions respond to market volatility and depositors' changing behavior. In this new era of financial stress, liquidity can no longer be viewed solely as a regulatory compliance metric. It must be embedded in both funding and operational strategies, enabling institutions to respond quickly and navigate shifting industry dynamics.

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