

# Question 1 of 6

P2.T8.25.3.1

You are the Treasurer of Midwest Global Bank, a systemically important financial institution (SIFI) with significant cross-border payment operations. Your bank processes billions of dollars in payments daily across multiple payment, clearing, and settlement (PCS) systems.

One morning, an unexpected liquidity crunch arises:

- A major counterparty bank defaults, causing a delay in expected inflows.
- The central bank's real-time gross settlement (RTGS) system experiences a temporary outage, preventing transactions from clearing.
- Several corporate clients initiate large outgoing wire transfers early in the day, consuming a significant portion of your available liquidity.
- Your bank has pledged most of its high-quality liquid assets (HQLA) as collateral, leaving limited immediate funding options.

Which of the following actions would be the **least effective** in mitigating intraday liquidity stress?

- A. Prioritize critical payments and temporarily delay non-essential outgoing transactions while monitoring the liquidity impact in real time.
- B. Request emergency intraday credit from the central bank or correspondent banks to bridge the liquidity shortfall.
- C. Sell long-term illiquid assets immediately at market prices to raise liquidity for same-day transactions.
- D. Tap uncommitted intraday credit lines with counterparties while monitoring overall exposure and funding gaps.

## Explanation

C is CORRECT.

### 25.3.1. C. Sell long-term illiquid assets immediately at market prices to raise liquidity for same-day transactions.

Selling long-term illiquid assets (like loans, real estate, or structured products) in a crisis usually means selling at fire-sale prices. When markets are stressed, nobody wants to buy, and selling these assets quickly will result in large losses.

Why this is a bad move:

1. It takes too long: Liquidation isn't immediate—finding buyers takes time.
2. Value destruction: The bank may lose money by selling at distressed prices.
3. Signals distress: If markets see a bank dumping assets, it could cause a panic.

#### **Incorrect options:**

**Regarding A**, prioritizing critical payments and delaying non-essential transactions while monitoring liquidity is wise. Banks employ payment throttling to process essential transactions first, delaying less urgent ones. Many major financial institutions automate this queuing process.

Advantages:

- Prevents cash drain during the day.
- Ensures that time-sensitive obligations are met first.
- Reduces operational risk without relying on external funding.

**Regarding B**, requesting emergency intraday credit from central banks or correspondents is a good backup, not the first choice. They provide secured or unsecured intraday credit, but excessive borrowing can signal financial distress to regulators and the market.

Advantages:

- Provides immediate cash to cover obligations.
- Prevents systemic risk from spreading to other institutions.

Potential downside:

- Borrowing costs: Unsecured credit can come with high penalty fees.
- Regulatory scrutiny: Heavy reliance on emergency credit may be seen as poor liquidity management.

**Regarding D**, using uncommitted credit lines from banks offers flexible liquidity without central bank regulations. However, over-reliance on counterparties is risky if market conditions worsen.

Why this works:

- Quick access to liquidity without needing to sell assets.
- Diversifies funding sources beyond central banks.

Potential downside:

- If markets are unstable, lenders could cut credit lines.
- Too much reliance on short-term borrowing can increase future refinancing risk.



## Question 2 of 6

P2.T8.25.3.2

A large international bank is experiencing a surge in outgoing payments due to heightened market volatility. The bank's three lines of defense are structured as follows:

Line of Defense	Department	Responsibility
1st	Treasury	Manages intraday funding and ensures liquidity is available for payments.
2nd	Corporate Risk Management	Establishes policies and monitors intraday credit exposure.
3rd	Internal Audit	Independently assesses the effectiveness of the bank's risk management framework.

### Scenario:

During a sudden liquidity squeeze, the bank's net debit cap at the central bank is nearly exceeded, and daylight overdrafts are rising. The treasury team considers delaying some payments to conserve liquidity, but corporate risk management warns that delayed settlements could create reputational and counterparty risks. Internal audit has raised concerns that prior stress test scenarios did not account for such an extreme event.

In this scenario, which department should ensure that any deviations from standard liquidity procedures are within risk limits and approved by senior management?

- A. Treasury Department
- B. Corporate Risk Management
- C. Internal Audit
- D. Treasury Department & Internal Audit

### Explanation

**B is CORRECT.**

### **25.3.2. B. Corporate Risk Management (Second Line of Defense)**

Primary Responsibility: Ensure risk policies and regulatory compliance are upheld while mitigating reputational and counterparty risks.

#### **Plan of Action:**

- Assess the impact of delayed payments on the bank's counterparties and financial market utilities (FMUs).
- Ensure any deviations from standard liquidity procedures are within risk limits and approved by senior management.
- Advise Treasury on potential regulatory or reputational implications of payment delays.
- Begin stress-testing alternative funding strategies to anticipate how the crisis might evolve.

#### **Treasury (First Line of Defense)**

Primary Responsibility: Actively manage intraday liquidity to ensure essential payments are processed while preventing the net debit cap from being breached.

#### **Plan of Action:**

- Prioritize critical payments (e.g., margin calls, clearinghouse settlements) while delaying non-essential transfers.
- Communicate with counterparties about potential delays to mitigate reputational risk.
- Explore temporary funding options such as intraday credit facilities, repo transactions, or interbank borrowing.
- Provide real-time liquidity updates to Corporate Risk Management.

#### **Internal Audit (Third Line of Defense)**

Primary Responsibility: Ensure the bank's intraday liquidity risk management framework is effective and aligned with best practices.

#### **Action Plan:**

- Monitor Treasury and Corporate Risk Management's response to ensure it adheres to internal policies.
- Identify whether governance failures or data limitations contributed to the crisis.
- Ensure risk oversight committees are fully informed to maintain transparency.
- Recommend a formal post-event review to identify gaps in stress testing and policy enforcement.

## Question 3 of 6

P2.T8.25.3.3

A multinational bank relies on real-time liquidity tracking systems to manage daily cash flows and comply with regulatory requirements. During a market-wide liquidity crunch, the bank faces:

- Spikes in intraday overdrafts due to delayed incoming payments.
- Increased time-sensitive obligations (e.g., margin calls, repo settlements).
- Rising reliance on intraday credit lines, raising liquidity risk concerns.
- Payment throughput slowdowns, delaying settlements across key systems.

Which approach best stabilizes liquidity immediately while improving long-term intraday liquidity risk management?

- A.** Enhance real-time tracking of settlement positions and payment throughput while monitoring peak overdrafts and reliance on unsecured credit.
- B.** Expand short-term borrowing and rely on overnight funding, postponing risk assessment.
- C.** Delay all non-essential payments, regardless of counterparty risks.
- D.** Focus only on credit line usage and counterparty risks, assuming liquidity issues will resolve when markets stabilize.

### Explanation

**A is CORRECT.**

**25.3.3. A. Prioritizing real-time tracking of payment flows, ensuring sufficient collateral, and coordinating with counterparties to accelerate incoming payments.**

- Real-time tracking allows the bank to quickly identify liquidity shortfalls and take action before overdrafts escalate.
- Ensuring sufficient collateral helps meet urgent liquidity needs, reducing reliance on costly intraday credit.
- Coordinating with counterparties can accelerate incoming payments, minimizing payment delays and stabilizing cash flow.
- This approach immediately stabilizes liquidity while building long-term resilience by improving tracking mechanisms.

## **Incorrect Options:**

**Regarding B**, reducing reliance on intraday credit by delaying outgoing payments and rationing liquidity across settlement systems.

Why it's wrong:

- Delaying payments could damage the bank's reputation and increase counterparty risk, potentially triggering systemic liquidity issues.
- Rationing liquidity may disrupt key settlements, creating cascading defaults in payment systems.
- While reducing reliance on intraday credit is ideal, it must be done strategically—not by delaying critical payments.

**Regarding C**, focusing on stress testing and revising risk models to improve future liquidity risk forecasts.

Why it's wrong:

- Stress testing is a long-term solution—it does not immediately stabilize liquidity during a crisis.
- While improving risk models is important for future liquidity management, it does not address urgent intraday funding gaps.
- Short-term fixes are needed first before long-term improvements can be implemented.

**Regarding D**, increasing reliance on intraday credit lines and securing additional short-term funding from external sources.

Why it's wrong:

- Borrowing more intraday credit only kicks the can down the road, increasing future obligations and reliance on volatile funding.
- Securing external short-term funding may not be feasible in a market-wide liquidity crunch, as other institutions could also be struggling.
- While liquidity lines provide a temporary buffer, they should not be the primary strategy—a more sustainable solution is needed.

## Question 4 of 6

P2.T8.20.8.1

Which of the following is a USE of intraday liquidity?

- A. Income funds flow
- B. Term repo (as the repo seller)
- C. Funding of nostro accounts (at correspondent bank outside home market)
- D. Intraday credit (Federal Reserve unsecured committed line of credit, LOC)

### Explanation

**C is CORRECT.**

**Funding of nostro accounts (at correspondent bank outside home market) is a USE of intraday liquidity**

In regard to (A), (B) and (D), each is a SOURCE of intraday liquidity.

## Question 5 of 6

P2.T8.20.8.2

Venkat explains that “all risk management frameworks start with a governance structure that defines the roles and responsibilities of various bank employees and committees in overseeing risk-related activities,”<sup>1</sup> and effective governance includes the oversight of intraday liquidity risk. In regard to the governance structure of intraday liquidity risk management which of the following statements is **TRUE**?

- A. Intraday liquidity risk should be accepted as a cost of doing business
- B. Roles and responsibilities should be defined within the eight lines (i.e., two times four) of defense model
- C. PCS Systems should only be a source of funds; if PCS becomes a use of funds, then a yellow flag should be triggered
- D. Intraday liquidity risk should be incorporated in the risk taxonomy and is a component of risk self-assessment including settlement risks

### Explanation

**D is CORRECT.**

In regard to (A), (B) and (C), each is FALSE.

- **Venkat explains that Active Risk Management is characteristic of the governance of intraday LRM:** "Active risk management. In many institutions, intraday liquidity risk is accepted as a cost of doing business and is not as actively managed with the same level of rigor as other types of enterprise risk or even other liquidity risks. The leading banks with large volumes of PCS activities recognize the criticality of understanding and working to reduce their intraday liquidity risks. These institutions classify settlement and systemic risks as components of their risk taxonomy, and critically, incorporate them into the firm's risk appetite framework"<sup>1</sup>
- **Integration with risk governance includes the THREE lines of defense model:** Treasury, Corporate Risk Management, and Internal Audit. Says Venkat, "The intraday liquidity risk management framework follows the industry's three lines of defense model, with particular emphasis on expertise in the second line of defense to coordinate across the institution ... Corporate Risk Management is the second line of defense, responsible for overseeing funding-related policy and procedures: advising in the development of risk

management programs, monitoring the ongoing risk-taking activities across all of a bank's funding desks, aggregating reporting across the bank, and providing an independent view of the effectiveness of the bank's overall intraday liquidity risk management programs."<sup>1</sup>

- **Payment, clearing, and settlement (PCS) Systems can be either a source or use of funds:** "Settlements at PCS systems. Most PCS systems have one settlement per day, with many occurring in the late afternoon timeframe. This may serve as either a source or use of funds depending on the net position of a participant on any given day."<sup>1</sup>

<sup>1</sup> Shyam Venkat, Stephen Baird, Liquidity Risk Management (Hoboken, NJ: John Wiley & Sons, 2016)

## Question 6 of 6

P2.T8.20.8.3

Each of the following is a measure for quantifying and/or monitoring risk levels **EXCEPT** which is a measure for understanding intraday flows?

- A. Total payments
- B. Client intraday credit usage
- C. Intraday credit relative to tier 1 capital
- D. Daily maximum intraday liquidity usage

### Explanation

**A is CORRECT.**

**Total payments is a measure for understanding intraday flows**

In regard to (B), (C) and (D), each is a measure for quantifying and/or monitoring risk levels.