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Roberto Ruozi · Pierpaolo Ferrari

# Liquidity Risk Management in Banks

## Economic and Regulatory Issues



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Economic and Regulatory Issues

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# Liquidity Risk Management in Banks: Economic and Regulatory Issues

**Abstract** At the international level, a wide consensus has emerged over many years on the importance of liquidity monitoring and the need to mitigate the associated risk in order to preserve the stability of individual banks and the soundness of the entire banking system. However, many differences have also emerged regarding how this principle has been transposed into rules or guidelines. Although the changes that have occurred in the international banking system in these last decades have increased the technical solutions available to banks in managing liquidity risk, these changes have also led to an underestimation of the actual exposure to this risk. The crisis has highlighted the need for more efficient liquidity management by banks by involving all governing bodies and corporate management in monitoring and managing liquidity in both normal and stress conditions, integrating better treasury with other functions affecting the liquidity position, and increasing the importance of liquidity risk as a part of risk management. The crisis has also highlighted the weaknesses of self-regulation based on internal models and the need to integrate domestic and international regulations in order to take into account that the search for bank stability and the reduction of competitive inequalities also require defining common rules to limit banks' appetite for liquidity risk. Liquidity risk is difficult to measure and depends on so many factors that a capital requirement is unsuitable to prevent it. Proper management policy requires examining the liquidity risk as a function of the impact area, the time horizon, the origin and the economic scenario where it occurs. After analysing these four aspects, it is necessary to define models of risk measurement, by identifying indicators to monitor, setting appropriate operating limits and related organisational issues. After reviewing the main economic aspects of liquidity risk, this study examines the new international regulations which will introduce, albeit gradually, a common framework for liquidity risk management in banks, and highlights the main economic and managerial consequences that these regulations will produce for bank management.