Payment throttling: a balancing act for managing intraday liquidity risk

Building a better working world

Payment prioritization strategically regulates outflows to safeguard a bank's intraday liquidity position.

In brief

- Payment throttling is a key strategy financial institutions use to manage intraday liquidity and maintain stability by prioritizing the timing of transactions.
- A well-designed throttling framework balances the dual objectives of protecting a bank's own safety and soundness and minimizing the impact of payment delays on its counterparties.

Introduction

In the financial services industry, the management of intraday liquidity is the cornerstone of a well-functioning payment and settlement system and a key aspect of overall financial stability. Effective intraday liquidity management means that financial institutions can meet their payment obligations at the time expected, such that there are no systemic delays impacting the stability of their customers, counterparties, and the broader financial markets. At the same time, the institution itself should have sufficient liquidity to support its operations throughout the day. The importance of effective intraday liquidity management is only going to increase as FedNow and other global real-time payment mechanisms are quickly changing the nature of "intraday" liquidity management and making it more of 24/7 operational liquidity management requiring more dynamic operational and analytical capabilities than those that exist today.

The formalization of payment-throttling practices is driven by the need to harmonize the flow of transactions and the fluctuations in liquidity. This is particularly important during times of market volatility and high payment volumes. Intraday liquidity management practices, specifically the ability to identify and prioritize time specific obligations and the related operational capabilities continue to be a U.S. supervisory priority per Regulation YY – Enhanced Prudential Standards as well as SR 10-6 Interagency Policy Statement on Funding and Liquidity Risk Management.

Payment throttling allows institutions to prioritize payments so that the most critical transactions are processed first, while others may be delayed pending sufficient liquidity. The main goal is to avoid systemic disruption while preserving the firm's liquidity position.

This article explores essential elements of intraday throttling frameworks; regulatory expectations that govern them; and current industry practices. Additionally, it examines the strategic approaches firms should adopt in implementing these frameworks and the role of artificial intelligence (AI) in optimizing and future-proofing payment operations.

Key components of an intraday throttling framework

Intraday throttling triggers and governance

A robust governance structure is essential to confirming that payment throttling aligns with the institution's risk appetite, regulatory requirements and operational objectives. This structure typically involves a governance committee, clear roles and responsibilities, and escalation procedures for decision-making during periods of stress.

Triggers are predefined conditions or thresholds that when breached initiate a response such as the activation of throttling mechanisms. These triggers should be aligned with the firm's approved risk appetite statement, with linkage to the contingency funding plan (CFP) if stress is severe enough to activate safeguards. In calibrating their intraday risk appetite and limits that initiate throttling, firms should consider factors such as intraday buffer and usage amount, contingent capacity, overdraft limits, and historically stressed payment profiles and volume behaviors.

Effective governance means that triggers are set appropriately, monitored continuously, and adjusted as market conditions or the institution's risk profile changes.

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Payment prioritization methodology

The prioritization methodology is the systematic approach used to determine the order in which payments are processed. This methodology should consider various factors such as counterparty and client relationships, intraday credit arrangements with customers, negative market signaling, and regulatory considerations. High-priority payments, such as those related to market settlements or critical business operations, are processed first to reduce risk and maintain business continuity.

There should be a clear linkage between the prioritization methodology and the throttling triggers. Such a linkage should consider the stress continuum. As an example, a minor deterioration in the firm's liquidity position (trigger level) may not warrant a throttling action and only serves as an alert level for heightened monitoring. However, as the bank moves along the stress continuum, reflecting further decline in its liquidity position, it can initiate throttling of certain non-priority payments to preserve liquidity while continuing to process time-critical payments.

Operational processes, controls and testing

Payment-throttling processes include the mechanisms for monitoring intraday liquidity position and payment flows, initiating throttling and subsequently managing the payment release when the liquidity improves. Automation plays a key role in establishing that these processes are efficient, accurate and scalable. Banks should look to configure their systems to classify payments by their relative priority and execute throttling in line with the prioritization framework approved by the governance committee. Triggers and alerts should be automated such that a breach in approved threshold results in payments being throttled until reviewed and approved for release per the escalation protocol.

Regular testing of the throttling capability is crucial to verify that systematic configuration and controls are effective. In addition to operational tests, banks should test the governance and coordination of payment throttling through tabletop exercises. Results should be documented and made available to the governance committees for their review. Lessons learned should be applied in improving the capability and informing trigger calibrations.

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Reporting and analytics

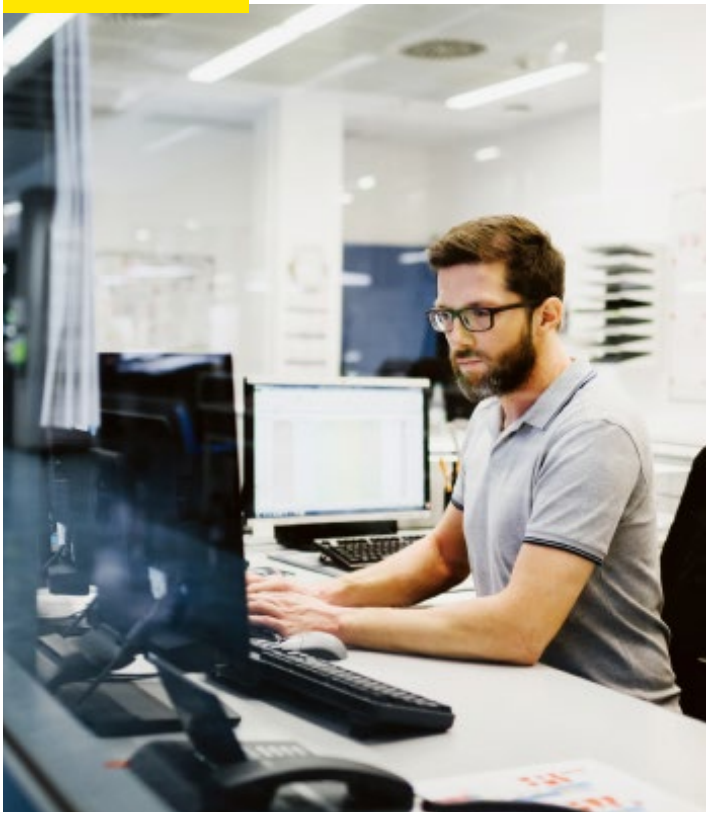
Reporting and analytics are vital to monitoring the performance of the intraday throttling framework and providing insights into payment operations. Reporting mechanisms should deliver timely and accurate information to internal stakeholders and regulators, including data on liquidity usage, payment queue status, and breaches of triggers or limits. Firms should also incorporate ex-post reports to inform senior management with a summary of the day's throttled payments and hold queues.

By leveraging advanced analytics, institutions can gain a deeper understanding of their payment flows, identify trends and forecast future liquidity needs to make more informed decisions regarding payment throttling.

The role of AI in intraday throttling

AI can significantly enhance the capabilities of intraday throttling frameworks. AI-driven systems can analyze vast amounts of data in real time, identifying patterns and predicting liquidity needs with a high degree of accuracy. Machine learning algorithms can be used to identify and prioritize payments for hold and release based on near-real-time data analytics; adaptive modeling and methodology rulesets, including liquidity, regulatory and firm-specific considerations. AI can serve as a copilot for a cash manager who is evaluating several hundred transactions in real-time-payment queues to see which ones are to be released within the guardrails of the firm's prioritization framework.

Moreover, AI can automate complex decision-making processes, reducing the need for manual intervention and allowing for more efficient resource allocation. By leveraging AI, firms can achieve a more proactive approach to risk management, anticipating and mitigating potential issues before they arise.



The way forward:

Firms looking to enhance their intraday throttling capability should adopt a strategic approach that encompasses the following steps:

1. **Assessment of current capabilities:** Evaluate existing intraday liquidity triggers, their linkage to payment prioritization as well as the operational throttling capability to identify gaps and areas for improvement.
2. **Regulatory alignment:** Confirm that the framework is designed to meet current and foreseeable regulatory expectations.
3. **Technology investment:** Invest in technologies that enable real-time monitoring of intraday liquidity position and support throttling in line with changes in liquidity position.
4. **Process optimization:** Streamline processes to reduce latency and improve the speed and accuracy of payment processing. Consider generative AI solutions to support throttling decisions.
5. **Operational processes and governance:** Develop comprehensive operational procedures for staff to execute throttling and establish clear governance structures to oversee payment operations.

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