Liquidity Management during the Pandemic

The outbreak of Covid-19 pandemic has brought the global economy to a standstill. With most of the countries in lockdown and macro indicators in the red, the financial world is witnessing an unprecedented liquidity crisis. Governments and Central Banks around the world, including those of the GCC, have announced multiple fiscal and monetary measures to support the economy and are preparing for further action.

Some of the initiatives by Central Banks to support the banking system include introducing repo facility windows for accessing liquidity, change in rules to increase the eligible collateral and relaxation or delay in various regulatory reporting deadlines. Further, to support the economy, multiple Central Banks have drastically cut key benchmark rates that will have an overall effect of increasing liquidity in the market and make it easy for key sectors to continue borrowing. The US Fed has reduced the Fed fund rate by 150 basis points, while SAMA has reduced both the repo and reverse repo rates both by 125 basis points to 1 and 0.5 percent respectively. CBUAE has also reduced the policy rates by 125 basis points. Another relief given by the Central Banks is to allow the deferment of loan instalments for both retail and certain corporate segments by 3 to 6 months without adverse impact of risk classification on such loans.

The actions taken by the Central Banks worldwide evidence the probable impact this pandemic might have on the world economy and thus it warrants a reassessment of liquidity management at the bank level.

The Covid-19 pandemic has impacted the funding, liquidity position and business projections of most banks. While it is difficult to estimate the long-term impact given the dynamic nature of the situation, we believe it will be highly dependent on the balance sheet structure of the individual organisation. Banks need to revisit their funding strategies, asset profile, stress testing scenarios and duration and frequency of stress testing, even as they change their work force structure (read accommodating work from home as a part of their BCP or working with reduced workforce). All these aspects need rethinking at the management level by the banks.

Below are some key recommendations that we believe will prove to be of timely help to the Treasurer and ALCO in navigating these tough times.

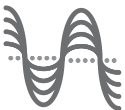
Maintain ability to continue lending at all costs

It is imperative that Banks which are the Financial Intermediaries of the economy retain their key function of providing liquidity and funding to the sectors that require them. The immediate action plan for the Treasurer is to manage the cash position such that the bank is able to maintain a healthy liquidity profile and be able to absorb any requirements of liquidity. The primary focus of the Treasurer should be to manage Customer Franchise and assist the overall goal of the government to support the economy and the most vulnerable sectors. Banks should be able to continue to rollover the credit lines and meet customer loan requests.

Increase HQLA Buffer

Banks should prioritize increasing HQLA levels against other investment plans. It is important that they maintain a large part of their HQLA in cash form to the extent possible. In these tough times it is better to differentiate between liquid assets like Cash and liquidity generating securities, as the valuation of the latter can be subject to volatility. While this will create some drag on the earnings of the Treasury immediately, the last thing a Treasurer would want is to have insufficient liquidity. Banks should convert the HQLA into cash as early as possible, because the longer the crisis persists the more the market levels of liquidity of the HQLA securities will diminish.

Increased Frequency of ALCO Meetings and Reporting



ALCO Meetings should be conducted more frequently to ensure close monitoring of the balance sheet development and timely and appropriate management actions. Treasury should circulate snapshot of key balance sheet metrics to ALCO on a daily basis including LCR, NSFR, top 10/20/30 deposits, deposits maturing in the next 5 days, amount of undisbursed commitments and others.

Cash-flow Forecasting

There should be increased frequency and granularity of cash-flow forecasting taking into account the expected dynamic situation of cash outflow and inflows. This crisis may impact the inflows and outflows in ways which are difficult to estimate. The unexpected credit usage could result into either large prepayments or defaults. Probable changing corporate customer depositors behaviour like an increase in their deposits as a result of liquidating their investments and parking the funds with the bank, or utilisation of their cash in covering their operational expenses like paying salaries, rent, utilities and others, and all such multiple scenarios should be accommodated in cash flow forecasting and monitored on a daily basis with changes made as and when new information comes in.

Testing Contingency Funding Plan

Banks need to review their contingency funding plans to reassess the feasibility and time horizons of various actions in the current crisis. Actions related to enhancing the customer deposit base by increasing cost of funds need to be initiated. Efforts should also be made to repay deposits from risky counterparties which are not of stable nature. Banks should assess the ability and speed with which they can access Central Bank liquidity windows and start accessing facilities that are least punitive.

Recalibrate the Stress Testing Scenarios

ALCO needs to re-calibrate the liquidity stress testing scenarios, factoring in the range of new risk factors and increasing the duration of the crisis and the economic recovery. Scenarios can range from containment of virus within next few weeks leading to slight recession to sustained spread and resulting into deep recession. Consequently, the economic recovery can vary from a V shaped recovery to a U shaped and in the worst scenario an L shaped one. Multiple scenarios will definitely provide a much clearer picture of the potential outcome and severity of the crisis. We strongly believe there will also be a regulatory push to assess the health of banking system once the situation becomes normal. Banks also need to work on their Recovery and Resolution Planning exercise.

Revisiting Early Warning Indicators framework

ALCO needs to redesign and re-calibrate the EWIs to ensure that they fully reflect the unique risks posed by the Covid 19 crisis. It will require a more comprehensive approach rather than simply increasing the severity of the existing risk factors. Needless to say that it also requires an increased frequency of monitoring of EWIs. These EWIs may be linked to the economic factors which are impacted by the virus and in turn has impacted the customers. For example, one EWI can be related to customers who have an exposed supply chain, whose business is too concentrated. EWIs can be more refined in terms of a sector-wise classification of depositors.

FX and IRRBB Management

With the drop in oil price, the FX flows to the country will be lowered as the inward flows will get impacted. If the crisis continues, there might be an increased amount of outward flows which will make the FX situation problematic. Treasurers need to closely monitor the FX risk position and highlight to ALCO as the situation worsens and take appropriate action. For minimizing IRRBB, the best option is to move the balance sheet to as much as floating rate as possible.

Ability to perform Integrated Data Analytics

Banks have to invest in building their data analytics capability to support provision of more real time Treasury Management Information like liquidity outflows and inflows, intraday liquidity, FX position, collateral valuation and cash availability. Analytical capability is also crucial to be able to quickly design and test out more wide-ranging stress scenarios, bring in new risk factors and be able to assess impact of these scenarios on liquidity profile and profitability. The frequency of stress testing should also be increased from the existing half-yearly/quarterly basis to at least on a weekly basis during the crisis and on a monthly basis thereafter so that changing scenarios can be easily accommodated, and swift action taken.

Communication with the Regulatory Bodies

Frequent communication with regulatory bodies is also important so that regulators are aware of the changing situation of the individual banks and the banking sector as a whole. Proactively informing regulators about the bank position and pre-empting the regulators in case of breach of the regulatory ratios becomes a possibility.

It is to be expected that regulators who are currently giving leeway for banks in many areas to support the economy will focus on the well-being and resilience of the banking system once the situation moves towards normalcy. Regulatory bodies will revisit the liquidity, funding and capital adequacy of the banks at the least. While some regulations have been delayed, we are of the view that some new regulations will be born out of this Covid 19 crisis situation. These regulations will surely require a complete review of the liquidity risk management framework including stress testing, funding strategy and contingency management. Needless to say, a well-run Treasury can help the institution in surviving the crisis and thrive once the situation becomes normal.

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