Liquidity risk management for banks – and how Africa is different

ASSA Banking and Finance seminar

24 July 2015

ACTUARIAL SOCIETY OF SOUTH AFRICA

QUANTIFYING RISK, ENABLING OPPORTUNITY

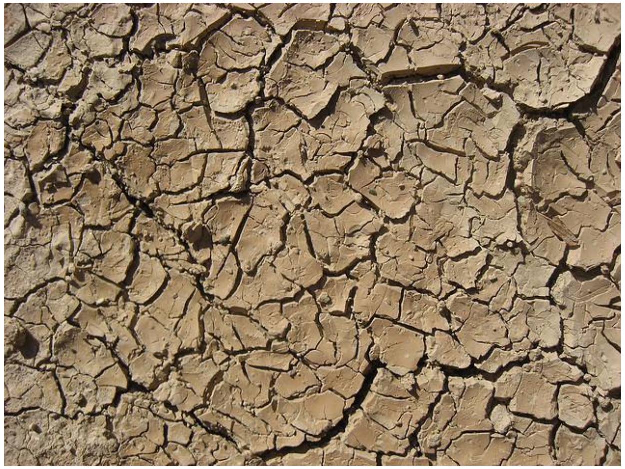
Phillip Olivier

Head: Asset and Liability Management, Barclays Africa Treasury

Contents

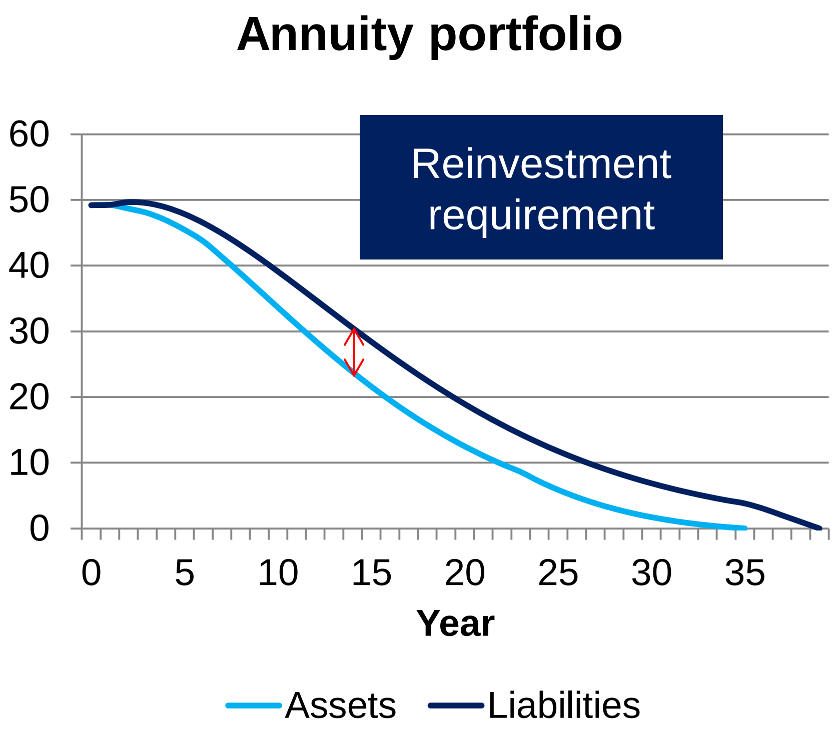
Contents

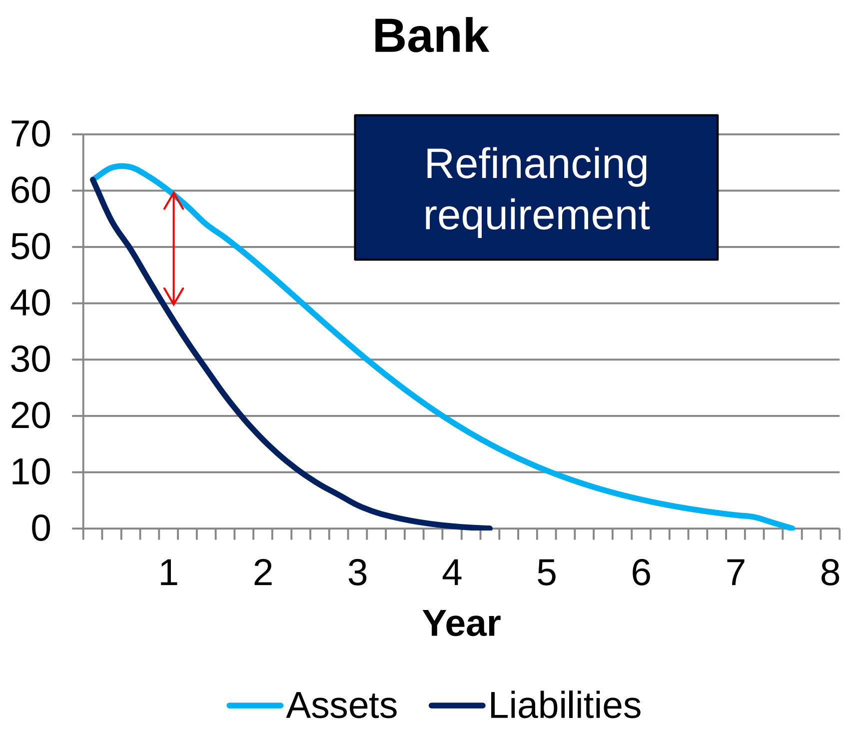
What is liquidity risk?



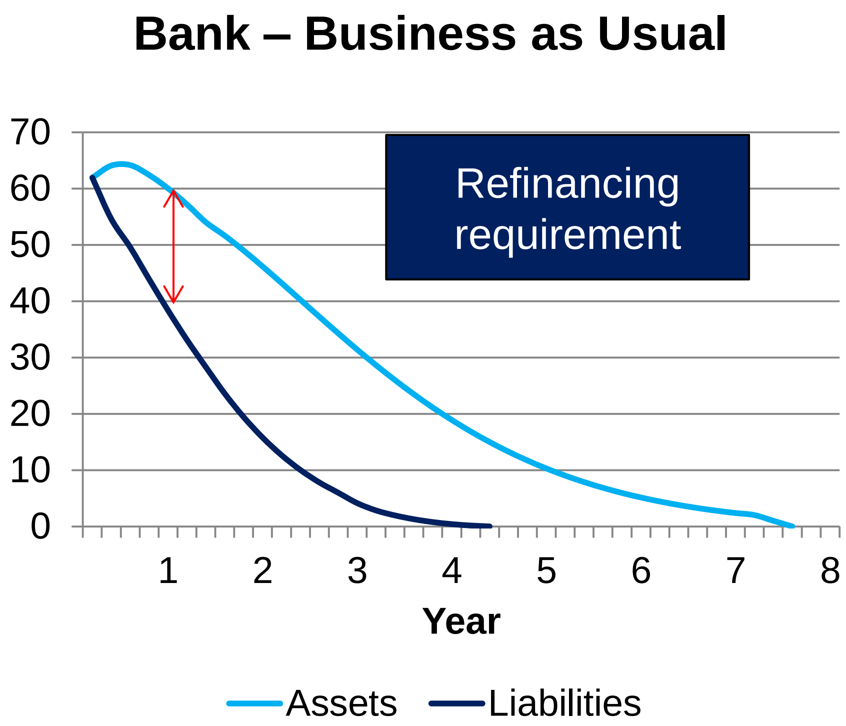
"In banking, liquidity risk is defined as the risk of being unable to meet all the bank's financial obligations when they become due."

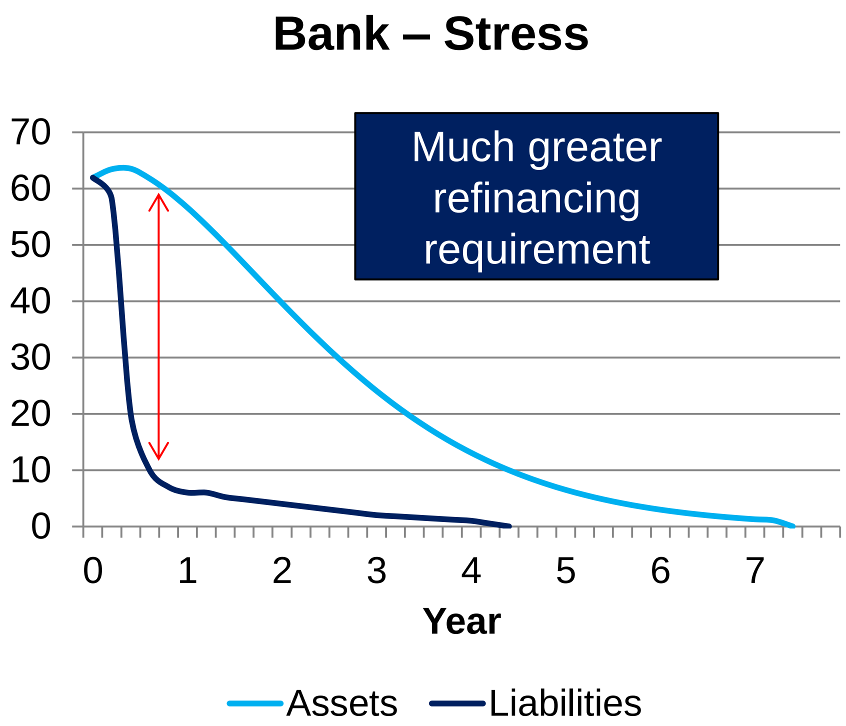
Liquidity risk in banks arises primarily from their role in the economy of maturity transformation.





Under stress, a bank's liabilities become even shorter, further increasing its refinancing requirements.





Contents

What makes liquidity risk special?

- Comes unexpectedly.
- Capital is an inefficient risk mitigant.
- Requires preventative measures and a good response.
- Need to focus on both sides of the balance sheet to manage effectively.

Contents

Preventative measures are far reaching ranging from balance sheet structure to response planning.

- Balance sheet structure (assets and liabilities).
- Liquidity stress testing (internal and regulatory).
- Metrics and dashboards.
- Contingency funding plan / communications strategy.

Various factors need to be considered when determining the optimal balance sheet structure from a liquidity perspective.

- Size and composition of liquidity buffer
- “Liquidity value” of shorter dated customer assets
- Level of encumbrance of balance sheet
- Ability to securitise assets

Assets

- Other assets
- Liquidity buffer
- Short-dated customer loans
- Long-dated customer loans

Liabilities

- Other liabilities
- Capital markets funding
- Institutional / money markets funding
- Corporate / public sector deposits
- Retail / SME deposits
- Equity

- Tenor of funding base
- Composition of funding base (Retail, SME etc.)
- Level of concentration of funding base
- Currency composition
- Secured / unsecured

The Basel liquidity rules have led to a fundamental change in the way liquidity risk is assessed.

Liquidity Coverage Ratio (LCR)

$$\frac{\text{Total qualifying liquid assets}}{\text{Net cash outflow}} > 100\%$$

Time horizon: 30 days

Net Stable Funding Ratio (NSFR)

$$\frac{\text{Available Stable Funding}}{\text{Required Stable Funding}} > 100\%$$

Time horizon: 12 months

Contents

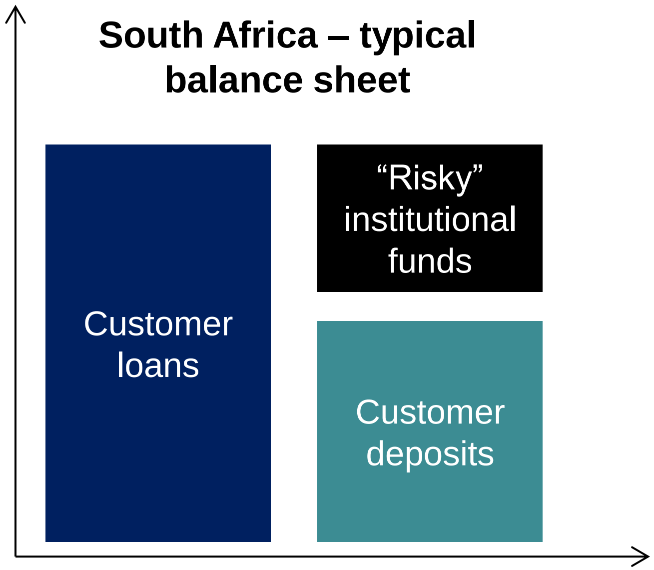
Preventative measures could prove meaningless if a bank responds badly during a liquidity crisis.

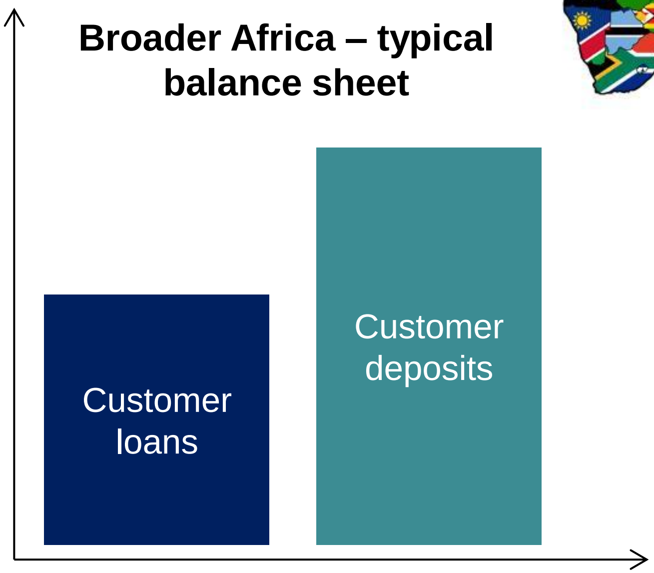
Contents

Liquidity stress events can happen for a vast range of reasons.

Contents

Challenges in South Africa are very different from those generally experienced across the continent.





- Victims of own success?
- Limited availability of liquid assets.
- Tenor limitations – NSFR a challenge.

- Concentrated liability bases.
- Unexpected central bank actions.
- Limited liquidity in gov’t bond market.
- Dynamic balance sheets.

Contents

Some takeaways.

- Liquidity risk has unique features.
- Liquidity risk management for African banks pose unique challenges.
- A "one size fits all" approach does not always work.

Disclaimer

This document contains general information based on my own views only and does not necessarily represent the views of my employer.

It is not intended to provide specific professional advice or services.

This document is not a substitute for professional advice or services, and it should not be relied upon or used as a basis for any decision or action that may affect you or your business.

Whilst every effort has been made to ensure the accuracy of the information contained in this document, this cannot be guaranteed and I shall not have any liability to any person or entity who relies on the information contained in this publication.

Any such reliance is solely at the user's risk.