Excess Liquidity Challenges and Opportunities

Kirk M Da Silva

FAIA, FIPA, FFA, CFE, Cr.FA, DABFA, ACIB, Acc.Dir. MCMI

Reasons for holding liquid assets

To ensure that

* commercial banks and credit unions can meet the day to day demands from depositors.
  * they have sufficient funds to meet commitments for approved loans.
  * they meet regulatory requirements.

Reasons for holding liquid assets (cont'd)

- The ability therefore, of financial institutions such as banks and credit unions to meet the demands for withdrawals and other cash outflows is a clear indicator of its viability. If a financial institution is not able to meet its member's withdrawal requirements, general credit expenses or if it is forced into a situation of having to significantly limit new lending, a serious lack of confidence can develop.

Reasons for holding liquid assets (cont’d)

- Liquidity is therefore of paramount importance not just for the individual financial institution but for the stability of the financial system as a whole.

Adopting , liquidity management philosophy

* Adopting a liquidity management philosophy is an important step in managing liquidity.

* The philosophy however, needs to be enshrined in a policy document outlining the broad goals and objectives of the financial institution with regards to liquidity.

Important principles of liquidity management

* In the case of credit unions ensuring enough liquidity to guarantee the orderly funding of member's needs;
* providing a prudent cushion for unforeseen liquidity needs;
* Investing liquid funds in a manner which emphasizes the need for security and liquidity.

Important principles of liquidity management (cont'd)

* Part of this process includes having a comprehensive understanding of the nature of the credit union's assets and liabilities, and the cash flows these represent.

Important principles of liquidity management (cont’d)

* This type of information can be obtained from the Statement of Cash flows.
* The Statement of Cash Flows are now primary financial statements.
* The financial viability and survival prospects of any organisation rest on the ability to generate positive operating cash flows.

Liquidity challenges facing Financial Institutions

- Many of the Commercial banks and Credit Unions are faced with the challenge of carrying too much cash
- The problems of lower credit demand.
- These large amounts of unused lending capacity in the sub region of the OECS can be attributed to a large extent to various factors.

Liquidity challenges facing Financial Institutions (cont’d) - Factors

* A weak or low demand for credit by both individuals and businesses deemed to be credit worthy by commercial banks and credit unions alike.

Liquidity challenges facing Financial Institutions (cont’d) - Factors

* This lack or insufficiency of the demand for credit is as a result of:
* Anaemic economic growth.
* the many business closures.
* The great unemployment situation and job redundancies which have plagued and continues to plague not only OECS countries but countries in the wider Caribbean region.

Liquidity challenges facing Financial Institutions (cont'd)

- The global economic and financial crisis which commenced around 2008 as a result of the collapse of ***Lehmans Brothers***.

- This impacted on the region by a significant increase in loan delinquencies.

Liquidity challenges facing Financial Institutions (cont’d)

- In 2015, non-performing loans in the Eastern Caribbean Currency Union (ECCU) averaged 18.8%.

Liquidity challenges facing Financial Institutions (cont’d)

- **“Faced with substantial increases in the proportion of delinquent loans, commercial banks have raised their credit assessment standards and have become more risk averse. As a consequence of these factors commercial loans have either declined or expanded less rapidly.”**

(Professor Compton Bourne)

Liquidity challenges facing Financial Institutions (cont'd)

* In 2015, commercial banks' lending to the private sector declined by 4.5%.

Strategies to deal with Excessive Liquidity

The very obvious choices or strategies that the credit unions may wish to deploy:

- Invest the excessive funds
- Limit the deposit inflow
- Adopt an aggressive lending approach
- Monitor deposits rates.

Strategies to deal with Excessive Liquidity (cont'd)

* Basel iii - is a comprehensive set of global measures intended to strengthen global capital and liquidity rules with the goal of promoting a more resilient banking sector.
* Under Basel iii funds from credit unions will most likely be classified as non-bank financial institutions (NBFIs').

Strategies to deal with Excessive Liquidity (cont'd)

* The serious implication of lower deposit rates result in significant reduction in investment income for the credit union.
* Can the credit unions seek to limit or turn away their members with their deposits? As the commercial banks are doing?

Strategies to deal with Excessive Liquidity (cont'd)

* Credit Unions exist to help people; they are not in business of making a profit.

* The fundamental objective of credit unions is to serve their members.

Strategies to deal with Excessive Liquidity (cont'd)

- How do credit unions reject member's deposits?
- Unless credit unions are to change their people-first philosophy.

Strategies to deal with Excessive Liquidity (cont'd)

- Has the time come for credit unions to change their fundamental or basic philosophy and model to suit a rapidly changing financial business environment?

Strategies to deal with Excessive Liquidity (cont’d)

- **Don’t the credit unions have sufficiently large capital cushions and high enough rates of returns on equity to accommodate higher levels of credit risks?**

Strategies to deal with Excessive Liquidity (cont'd)

- Credit unions must continue to attempt to expand their loan portfolio through highly targeted lending programs.

Strategies to deal with Excessive Liquidity (cont'd)

- Credit unions may need to look at:
- recruitment policies imparting more training to employees
- examining interest rate spread
- looking into areas and sectors where current excess liquidity will be utilised.

Thank You.