OPINION

Managing liquidity risk in today's environment

After several years of abundant and cheap liquidity, banks are facing new liquidity risk management challenges in today's rapidly changing environment. Between June 2022 and May 2023, the Philippine benchmark interest rate moved from 2.5% to 6.25%. Similar interest rate trends have been noted across the Asean markets, impacting bank balance sheets and creating tougher economic conditions for customers. Borrowers are dealing with increased loan payments on variable-rate loans, decreased savings rates due to inflation, and general uncertainty about economic conditions.

The recent data are tracking significant growth in bank fixed-income securities investments, which are susceptible to unrealized losses in a rising interest rate environment. Securities growth was 60% from April 2020 to April 2023. Banks hold these securities to collect cash flows from interest and principal, but long-term securities with large unrealized losses are not typically sold to avoid realizing a loss. Thus, these investments do not represent true access to liquidity, unless banks undertake repurchase agreements at market value.

Another factor driving up liquidity risk was demonstrated in the recent overnight failure of certain US banks. The sudden collapses show how, in the age of instant communication and social media, a financial panic can go into hyperdrive, facilitated by the ability to make instantaneous bank transfers and withdrawals.

SUITS THE C-SUITE
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Although underlying problems caused the failure, banks need to recognize the additional liquidity risks now that social media has become interwoven into our social and financial lives. In an analog, bricks-and-mortar world, the US banks in question could arguably have had time to reach out to (and be propped up by) the Federal Reserve. But the speed at which social media fanned the flames of customer panic meant that, by the time banks opened the next morning, it was already too late to save them.

Conditions can change quickly. Banks must stay on top of their liquidity management.

TRADITIONAL STRESS-TESTING ASSUMPTIONS

Banks need to take another look at their liquidity stress testing assumptions in light of:

• The new speed of bank runs given the evolving role of technology in banking, including the ability of social media to turn a drama into a crisis. All the evidence suggests that a bank run precipitated by social media has the potential to cause even a healthy bank to fail in a matter of days.

• The inflationary environment, with some observers predicting interest rates could climb into the low — or even the high — teens.

• The potential need to support entities or funds, such as money market funds or unit investment trust funds (UITF), even though banks are not contractually obligated to do so.

The new reality in which banks find themselves operating means current estimates of their contingency funding requirement may be significantly too low. They may also be underestimating the need to deal with intense media coverage or to incorporate reputation risk considerations into funding decisions. At its core, a contingency funding plan (CFP) is a crisis management tool. The plan should set out strategies management expects to use to address liquidity shortfalls. In this environment, now is a good time for banks to review their CFP and test its operational components.

When updating stress testing, it's vital not to ignore the worst-case stress tests. Monitoring and reporting functions are normally performed routinely, by the numbers on hypothetical, forward-looking scenarios. Management should look beneath the surface to highlight potential problems. Banks can no longer afford to "play it safe" with liquidity.

The point is stress tests are not predictions. These are not events we think will likely eventuate. They are tools for revealing vulnerabilities — which means we must base them on worst-case scenarios. For example, what would the balance sheet look like if 80% of depositors pulled out their funds in a short period of time? It's important to assess the impact of extreme but plausible scenarios like this on an institution's earnings, liquidity, and solvency positions.

SOLVENCY AND LIQUIDITY ARE TIGHTLY INTERTWINED

Banks also need to think more deeply about the link between their solvency and liquidity, which affects their liquidity buffer. The liquidity buffer is a pool of ear-marked, high-quality, and liquid assets used to meet immediate liquidity needs when faced with adverse conditions.

Capital is not a substitute for liquidity. But the two are very closely intertwined. The more solvent a bank is, the less likely will a run ensue. Therefore, the weaker a bank's solvency position, the more careful the bank has to be about maintaining a higher capital buffer.

Apart from solvency concerns, the size of the liquidity buffer is also affected by a bank's survivability horizon and risk appetite. The board should have a view on how long the bank is intended to survive a stressful environment when there is no access to new wholesale funding. Discussing these types of conditions will help to determine the size of the liquid asset buffer the bank needs.

BUILDING LIQUIDITY RISK INTO DECISIONS

In tackling this issue, bankers should ensure liquidity risk strategies are clearly articulated and understood throughout the institution, especially in business units that generate and consume liquidity. This will help to drive corporate strategy that addresses liquidity risk and prudent business decisions. Otherwise, there may be gaps between business and financial plans, which can greatly weaken liquidity positions in the current environment.

For example, institutions may not adequately prepare for the implications on the liquidity of actions taken in normal business activities, like focusing on a new customer segment, or strategic initiatives, like acquisitions or entering new markets. Liquidity costs must also be taken into account to more accurately reflect the true costs of products and services, leading to more appropriate deposit pricing.

For banks looking to embed liquidity risk into day-to-day business decision-making, incentives can play an important role. Are targets sufficiently designed to achieve an appropriate balance between risk appetite and risk controls? Between short-run and longer-run performance? Or between individual or local business unit goals and firm-wide objectives?

UNDERSTANDING BANK FUNDING RISK

An important piece of managing liquidity risk is to understand how the bank is funding its balance sheet. Normally, this involves a mix of core deposits, noncore deposits, wholesale funds and equity. Management should understand concentration risks, including large fund providers or large depositors, concentrations to certain industries, concentrations of non-insured deposits or concentrations in certain types of wholesale funding. Part of the CFP should be potential responses to those concentration and funding risks. Deeply knowing your customers and a study of historic deposit behaviors can also help the bank understand the expected maturities on its deposits.

DATA QUALITY MAY NEED TO BE ADDRESSED

The experience of helping banks to assess liquidity risk in institutions around the region highlights the need to address data problems. Accurate risk assessment depends on aggregating data across multiple systems to develop a group-wide view of liquidity risk exposures and identify constraints on the transfer of liquidity within the entire banking group.

If banks are adjusting their stress-testing scenarios and assumptions, this is also an opportunity to check the validity and accuracy of data used in all reports feeding into liquidity risk management. Improving the accuracy of liquidity metrics and liquidity positions can identify significant liquidity opportunities.

INDEPENDENT REVIEW OF LIQUIDITY RISK MANAGEMENT

Finally, in a rapidly changing environment, an independent review can be helpful to evaluate liquidity risk management processes for their alignment with regulators' guidance and industry sound practices.

All these efforts will deliver strong returns on their investment. The better banks manage liquidity, the less it will cost — an increasingly important differentiator in today's market.

This article is for general information only and is not a substitute for professional advice where the facts and circumstances warrant. The views and opinions expressed above are those of the author and do not necessarily represent the views of SGV & Co.

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CORRECTION

DUE TO A MISTAKE in attribution, a story on the use of cash transfers as emergency aid published on Friday, June 30 has been withdrawn. The story was duly removed from the online edition. *BusinessWorld* regrets the error.

NEDA considering longer NAIA concession period

By Justine Irish D. Tabile
Reporter

THE Department of Transportation (DoTr) expects the government's economic planning agency to complete its review of the unsolicited and solicited proposals for redeveloping the Ninoy Aquino International Airport (NAIA) by July, and is currently studying whether to grant a longer concession period to allow proponents more time to recover their investment.

In chance remarks, Undersecretary for Aviation and Airports Roberto C.O. Lim told *BusinessWorld* that the National Economic and Development Authority (NEDA) is expediting the review.

"*Siguro* by July *matatapos ang review ng* NEDA. *Minamadali din nila 'yan para magkaroon tayo ng* clear direction *kung ano ba 'yung* proposal *at syempre ang* private sector *kasi naghihintay rin* (Maybe NEDA will complete its review by July. NEDA wants it done quickly to give us clear direction on what the proposal should be and also because the private sector is also waiting on it)," Mr. Lim said on Saturday.

He added that the decision to alter the concession period will be up to NEDA. The new concession period will be known when it reports its review findings, he said.

On April 27, the Manila International Airport Consortium, composed of Aboitiz Infracapital, Inc., AC Infrastructure Holdings Corp., Alliance Global–Infracorp Development, Inc., Filinvest Developments, JG Summit Infrastructure Holdings Corp., and Global Infrastructure Partners, submitted an unsolicited proposal for the rehabilitation of NAIA.

This unsolicited proposal involves P267 billion worth of investment, which includes a P57-billion upfront payment and around P211 billion in development costs over a 25-year concession period.

In June, the DoTr and the Manila International Airport Authority submitted to NEDA a P141-billion solicited proposal which gives the private concessionaire 15 years to operate the airport and recover its investment.

"*Pag-uusapan 'yan sa* NEDA *kung i-e-*extend *nga itong* proposed concession period (NEDA is studying the extension of the concession period)," Mr. Lim said.

"*'Yung* proposal *ng* DoTr *binigay sa* NEDA *para i-*consider *nila. Kung* okay *ba sa kanila 'yung* plan *at kung dapat ba natin dagdagan* or *bawasan*, under evaluation *ngayon 'yan* (DoTr's proposal was submitted to NEDA for its consideration. If the plan is all right and if the concession period needs to be extended or reduced, that is still under evaluation)," he said.

Mr. Lim said the DoTr is open to the idea of extending the concession period if NEDA approves it.

"*Kung sa palagay ng* NEDA *na dagdagan, e di dadagdagan natin* okay *lang sa amin. Kung* they want to make it 20, okay *lang*, if they want to make it 25, okay *lang rin samin* (If the NEDA thinks that it should be extended, then we will extend it. If they want to make it 20 or 25 years, that's okay with us too)," he said.

WB studying 2nd extension for Cebu BRT facility to accommodate restructuring plan

THE World Bank (WB) is looking to further extend the expiration date for the financing package supporting Cebu City's bus rapid transit (Cebu BRT) project, to allow time for the submission of a proposal to restructure the facility.

"It is proposed to extend the closing date by three months from June 30, 2023 to Sept. 30, 2023, to allow time for the government to submit a request for restructuring of the project with necessary changes," the World Bank said in a document uploaded on its website.

"Upon receiving such request, the project could be duly restructured to facilitate completion of activities under the current scope/design agreed during the mid-term review and thereby satisfactorily achieve the project development objective," it added.

The $228.5-million Cebu BRT project was approved on Sept. 26, 2014. Its closing date was originally set on June 30, 2021, before being granted a two-year extension.

The facility consists of $116 million from the World Bank Group unit International Bank for Reconstruction and Development (IBRD), $25 million from the Clean Technology Fund (CTF), and 50.89 million euros from the Agence Française de Développement (AFD). The Philippine government will supply $30 million in counterpart financing.

FULL STORY

Read the full story by scanning the QR code with your smartphone or by typing the link <bit.ly/CebuBRT070323>

The World Bank said that $23.9 million or about 17% of the $141-million total loan commitment from IBRD and CTF has been disbursed.

The bank said that the current progress on the project's development objective is "moderately unsatisfactory."

The project aims to "improve the overall performance of the urban passenger transport system in the project corridor in Cebu City in terms of the quality and level of service, safety, and environmental efficiency." — **Luisa Maria Jacinta C. Jocson**

In the photo (L-R): Patricia Poco-Palacios (Global Dominion president & COO), Riza Mantaring (Sun Life Financial Philippines former CEO & country head), and Stephanie Chung (eCompareMo CEO)

Filipino finance chiefs speak on women leadership

The Philippines is generally doing fine when it comes to gender equality — females are more likely to enter college and be in higher-paying positions in companies, and women occupying high government positions is not an unusual scene. Compared to other nations, women in the country have high levels of access to economic opportunities (David et al., 2017 & 2018). This is far from its historical gender equality stature when there were much fewer women than men enter colleges and only a handful become professionals (Sobritchea, 1989).

Specific to finance, studies support the benefits of allowing women to take due leadership roles in firms. Having female executive officers is positively related to having good financial performance (Shrader et al., 1997; Smith et al., 2006; Francoeur et al., 2008; and Strom et al., 2014).

However, the count of female leaders in senior management roles dipped from 48 percent in 2021 to 39 percent in 2022 according to a report from P&A Grant Thornton.

The challenge is in cultivating a culture and promoting an environment that's more supportive of career growth for women. Three finance industry leaders share their insights.

"I have found that often, when females do not assume senior leadership roles, it is because they don't want to," said the former CEO and country head of Sun Life Financial Philippines, Riza Mantaring. "Many women still feel that they are primarily responsible for the home and for caring for their children. This makes them hesitate to take on more responsibility for fear that it could impact their ability to care for their families," she added. To these, Mantaring suggested some actions such as providing child-care facilities for emergency situations and holding training sessions during working hours rather than after hours.

Aside from being a result of personal choices, what society has to say as a whole seems to be driving the inequality, as well. "The cooperation of society in consciously accepting that women are marginalized and need support in order to thrive," is critical in addressing the issue according to eCompareMo CEO Stephanie Chung. She also shared a story about women needing to call their families immediately when working overtime to designate or check on their tasks at home while the men simply continue with their work, as if house chores automatically belong to women.

Finance under more women leaders was described by Chung as, "more robust" and that in firms more opinions will be heard, more discussions will be opened.

"More than just having women in leadership roles for the sake of it, the more important issue that must be addressed is equitable representation of all genders in the workplace," said Global Dominion President & COO Patricia Poco-Palacios. "This allows for a more connected and psychologically safe environment, cognizant of the needs and issues of the workforce," she added. More than half of the officers in Global Dominion are females and the company has been led by two women out of a total of three presidents in its 20 years in the industry.

Final Statements:

"We have to remember, too, that gender-inclusiveness doesn't just mean women, but providing a welcoming and nurturing environment for LGBTQA+ too." — Riza Mantaring

"The industry will be all the better for it since men and women both can contribute equally but differently." — Stephanie Chung

"As leaders we want to make sure that as many perspectives are heard, and we can support each other in the best way we can. This makes it easier for collaboration and productivity, especially when we are pushing for ambitious goals together." — Patricia Poco-Palacios

— **By: Aian Guanzon**