OPENING REMARKS BY MR. SADA REDDY, GOVERNOR OF THE RESERVE BANK OF FIJI AT THE 2009 AFSPC ANNUAL WORKSHOP AND MEETING ON 26TH OCTOBER 2009, RADISSON RESORT FIJI, DENARAU, NADI

LIQUIDITY RISK IN BANKING ORGANISATIONS

Mr Jason George: **Senior Financial Sector Specialist, BIS;**

Distinguished Resource Persons;

Representatives of the PFTAC Office;

Honoured participants and fellow central bank colleagues;

Bula vinaka, and let me extend to you all a very warm welcome to the Fiji Islands.

I am delighted to be here this morning to address this annual gathering of Bank Supervisors from the Pacific, on the important subject of ***Liquidity Risk in Banking Organisations***. May I commend PFTAC and the AFSPC for choosing this topic for this year's workshop. This is a very appropriate topic for Pacific Supervisors, given what has transpired in the global financial system in the last 12-months.

I note from the programme that we have very distinguished resource persons to guide us in the area of liquidity risk management.

However, at the outset, I would like to share with you some recent developments that have taken place in Fiji with regard to the supervisory role of the Reserve Bank of Fiji. I intend to do this as I presume that one of the greatest benefits of this kind of gathering is the networking and sharing of each other's experiences.

Recent Developments in Fiji

The global financial crisis has had a significant spill-over effect on the liquidity of our financial system. The spill-over effect was brought forth mainly by lower foreign reserve inflows. The floods in January this year also affected most of the businesses especially here in Nadi, and as a result, further strained the liquidity available in the banking system via withdrawals and the need for banks to lend to assist in flood rehabilitation works.

This was a challenging time for our commercial banks as was witnessed by the increased activity observed in the inter-bank money market. To address the threat that our financial system faced, the Reserve Bank responded with a mix of policy measures during the year, including the reduction of the Statutory Reserve Deposits requirement, tightening of exchange controls, devaluation of the Fiji dollar, controls on banks' interest rates and spreads, and re-emphasising the importance of lending to priority sectors for a sustainable future. The Bank also introduced a flood rehabilitation facility to assist in the reconstruction and business resumption due to the flood damages.

Lending rates of our licensed banks were trending down in 2008 but in the first three months of this year, they increased substantially. The RBF was forced to introduce policies in April to bring the lending rates down.

This was important, especially at a time when our economy was being hit by the global downturn and also the effects of severe flooding in early January. The lending rate is now down to about 7.8 percent. I expect it to go down further, because we have told the banks to take their average lending rates down to the levels of December 2008, so there are still some more reductions to be seen.

The weighted average bank deposit rates which were falling last year, have since been on an uptrend. I expect the deposit rates to be positively influenced by the Reserve Bank's policy directive on bank spreads implemented in April, which has been set at 4 percent.

These were very tough decisions, but we had to take them to assist the growth of our economy and I must say that the banks are co-operating well with the Reserve Bank. I know that they are not very happy but in the interest of the country, I am seeking their co-operation to continue to bring lending rates down.

We would like to think that our policy efforts this year have been successful, in the sense that foreign reserves and banking system liquidity have improved to comfortable levels and interest rates have started to drop, thus assisting in economic recovery. I am glad to state that our **financial institutions remain stable and resilient** despite the massive problems globally.

Liquidity Risk Management

I would like to make some specific comments on the topic of this year's annual workshop.

As supervisors, we have been focusing on the maturities/ mismatch of bank's assets and liabilities and requiring our banks to establish their asset-liability management frameworks. Under normal conditions, this risk can be managed relatively easily. However, it is far more difficult to deal with, in periods of unanticipated system-wide demand for liquidity

During times of system-wide stress, such as the one we have just experienced, significant liquidity demands can come from both the asset and the liability side of a bank's balance sheet. On the liability side, banks can face challenges in refinancing short-term debt in the money markets. This is such a significant issue for us in the Pacific given our not-so developed secondary money market. On the asset side, off-balance-sheet exposures can unexpectedly come onto a bank's balance sheet.

Effective liquidity-risk management is therefore important--and especially challenging--during periods of financial stress, when liquidity in the financial system is not adequate and when some of our banks may find it more difficult to fund themselves. Indeed, some of the recent challenges in liquidity-risk management are related to the increased interconnectedness of global markets and the speed with which market prices can change.

International supervisory principles for **Sound Liquidity Risk Management and Supervision** have identified the need for banks to establish a robust liquidity risk management framework that is well integrated into the bank-wide risk management process. A primary objective of the liquidity risk management framework should be to ensure, with a high degree of confidence, that the bank is in a position to both address its daily liquidity obligations and withstand any period of liquidity stress.

I have also read that there have been calls for the assessment of potential liquidity risks to be fully integrated into a bank's capital analysis. Even though strong capital positions reduce the likelihood of liquidity pressure, apparently solvent banks can suffer liquidity problems. Through stress testing and scenario analysis, banks should be able to capture liquidity problems that they may be facing both at institution and systemic levels. With this, banks should still be able to assess the impact that problems in funding-liquidity risk can have on their capital adequacy.

If recent events have taught us anything, it is that, banks need to carefully manage their own exposure to liquidity risks. Because liquidity problems can have significant effects on both sides of banks' balance sheets, liquidity risks should be evaluated and addressed on an enterprise-wide basis, and should be tightly integrated with capital planning.

Supervisory Initiatives

Supervisors are collaborating to understand the causes of the recent turbulence and to identify steps to mitigate future problems. Our gathering here this week is to try to identify those liquidity challenges, and how we as supervisors are positioned to meet these challenges.

I would like to emphasise that the achievement of sound liquidity for banking organisations is an objective that is not isolated. It is thus critical that necessary policies are implemented to ensure that liquidity situations of our licensed financial institutions are sound and stable. I would also wish to highlight that though the global financial meltdown was triggered by poor credit risk management oversight, poor governance practices remained the root cause of the global financial crisis. Liquidity risk oversight by the board and senior management of banks is therefore an important issue which I guess our distinguished resource persons will also be talking to you about in the next few days.

The Annual AFSPC Meeting

Before I conclude, let me congratulate the AFSPC for all the good work that it has been doing for member countries. As with our peer supervisors, the Reserve Bank of Fiji has seen the benefits of training provided to our supervision staff in sessions such as this, and we have also benefited from assistance provided by the Pacific Financial Technical Assistance Centre.

At this juncture, I would also like to acknowledge the assistance of the IMF and PFTAC to the Reserve Bank of Fiji in co-hosting this year's meeting. I would also like to thank the Resource persons for taking time out of your valuable itineraries to travel so far to bring your expertise to the Seminar. We are indeed grateful.

To the Heads of Supervision and representatives of supervisory authorities who will be deliberating in this year's meeting, I wish to highlight to you the importance of your role in making the critical decisions to continue to move forward our supervisory efforts in the region. As supervisors, we are called upon during these challenging times to embrace a path toward economic recovery in the coming years, and our duty is to see that such recovery is not short lived, but one that is sustainable.

Concluding Remarks

The Chinese have a saying, **"may you live in interesting times."** I can hardly disagree. These have been very interesting times for me. I took on the leadership of the Reserve Bank of Fiji in the midst of the global crisis and its significant effects on the Fiji economy. Fiji was also facing one of its most critical moments in terms of balance of payments. Like all Pacific Central Bank Governors, I look forward to the assistance of our financial supervisors to complement our efforts in developing our economies, and continuing to ensure the stability of our financial system.

We are living in a globalised world and for us in the Pacific, the ramifications presented by developed nations have a significant impact on us given the size of our economies. I note from the last guiding principle of **Sound Liquidity Risk Management and Supervision** that supervisors should communicate with other supervisors both within and across national borders, to facilitate effective cooperation regarding the supervision and oversight of liquidity risk management.

Hence our solutions in addressing liquidity risk must be global. On this front, better international relations are critical and with the presence of representatives of international supervisory organisations with us today, I see no better opportunity to strengthen our international relations.

I wish you all a fruitful week.

With these few words, I have much pleasure in declaring the 2009 AFSPC Annual Workshop and meeting open.

Vinaka vakalevu.