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Commercial banks' liquidity within acceptable levels

Use of LDR as a measure has become less relevant in light of developments in the financial system — ABM

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KUALA LUMPUR: The funding and liquidity conditions of the commercial banks in Malaysia are within acceptable levels, the Association of Banks in Malaysia (ABM) said yesterday.

"It is important to note that misleading reporting on asset and liability positions may misrepresent the liquidity situation in the marketplace and may cause concern amongst the business community and the public," ABM said in a statement.

An article in Bloomberg Businessweek last week highlighted a purported lack of deposits at Malaysia's banks. Saying the loan-to-deposit ratio (LDR) is high, the author, Andy Mukherjee, said: "It is unnatural for loan writing to run ahead of deposit taking for so long."

ABM, which represents 27 banking entities in the country, said the rise in LDR among the banks has been driven by the anticipated moderation in deposits growth since 2011. But it said the ratio has remained relatively stable, hovering at between 86.7% and 89.3% over the last three years.

"However, it is noted that the LDR is a simplistic measure which does not take into account the increased sophistication by banks in Malaysia to diversify their sources of funding beyond the deposits and interbank markets to include bond and equity and other financial instruments available to them," ABM added.

"In addition, the inherent limitations in the use of the LDR in today's environment include the assumption that deposits are stable, and that chunky, illiquid loans form the main bulk of the banks' assets," said ABM.

Therefore, the LDR does not accurately reflect the funding and liquidity conditions of banks, it said.

"The use of LDR as a measure of the banks' liquidity has become less relevant in light of the developments in the financial system over the last 10 years or so," it said.

As for deposits, ABM said banks have traditionally and primarily relied on customer deposits as a major source of funding.

"However, since the mid-2000s, the proliferation of alternative investment products available to the average consumer coupled with lower savings and higher consumer activism has reduced the relative stability of customer deposits," it added, noting that "this has resulted in a shift to a broader funding base by the banks".

While deposits remain as the main source of funding for Malaysian banks, ABM said the banking sector continues to raise medium-term funds to better manage maturity and currency mismatches. To address the limitations of the LDR, ABM said the regulators — particularly Bank Negara Malaysia (BNM) — in 2015 introduced the use of other indicators of liquidity risk such as the liquidity coverage ratio (LCR), the loan-to-fund ratio (LTF) and the loan-to-fund-and-equity ratio (LTFE).

According to ABM, the LTF and LTFE are better measurements of liquidity as they reflect the broader-based funding of the banks.

"The LTF includes issuances of debt securities in the denominator and gives a more comprehensive assessment of the banks' funding structure. The LTFE expands on this with the inclusion of equity," it said, noting that these two ratios are available in BNM's Monthly Statistical Bulletin.

As for the LCR, ABM said the ratio ensures that the banks have sufficient high-quality liquid assets that can be used to satisfy liquidity needs in a 30-day severe stress environment and considers a broader range of factors that can affect funding stability, such as the type of counterparty, transaction tenor and redemption features of a specific product.

For commercial banks, ABM said the LCR stood at 142% as at June, which is well above the minimum transitional requirement of 80% in 2017. "It should also be noted that almost all banks maintain LCR levels above the fully phased-in requirement of 100%, which will only take effect in 2019," said ABM.