RBI/2008-09/174

UBD. PCB. Cir. No12/12.05.001/2008-09

September 17, 2008

The Chief Executive Officers,
All Primary (Urban) Co-operative Banks

Dear Sir/Madam,

Liquidity Risk Management System in Tier I UCBs- Guidelines

As you may be aware a comprehensive Asset Liability Management (ALM) including Liquidity Risk Management guidelines have been prescribed for scheduled UCBs. These guidelines have been extended to other Tier II as well.

2. Liquidity is the ability of a bank to fund increase in assets and meet obligations as and when they come due, without incurring unacceptable losses. Virtually every financial transaction or commitment has implications for a bank's liquidity. Effective liquidity risk management helps ensure a bank's ability to meet cash flow obligations, which are uncertain as they are affected by external events. Liquidity risk management is of paramount importance because a liquidity shortfall at a single institution can have system-wide repercussions. At the same time, imprudent liquidity management can put banks' earnings and reputation at great risk. Some of the recent failures that occurred especially in the urban co-operative banking sector have been on account of liquidity problems.

3. In view of the above, and keeping in view the level of computerisation and the current level of MIS in Tier I UCBs it has been decided that basic liquidity risk management guidelines may also be issued to Tier I UCBs. Accordingly, guidelines on Liquidity Risk Management are enclosed.

4. Banks are advised to prepare Liquidity Statement Returns (Annex I, II) as on the last reporting Friday of March / June / September / December and submit to the Board within a month from the last reporting Friday. **The first such set of returns may be put to the Board as on the last reporting Friday of December 2008.**

5. As regards submission of returns to RBI under Off Site Surveilance(OSS), separate communication will follow .

6. It may be noted that RBI attaches utmost importance to Risk Management in banks and expects banks to submit the Liquidity Statement Returns correctly and within the prescribed time to their Board . To this end, banks may designate and authorize one or two senior official/s who would be responsible for the correct compilation and timely submission of these returns and who would be fully responsible for the information furnished therein.

7. Please acknowledge receipt of this circular, to the Regional Office concerned and also place it before your Board of Directors in its next meeting.

Yours faithfully,

(A.K Khound)
Chief General Manager-in-Charge

Guidelines on Liquidity Risk Management-Tier I UCBs

1. Measuring and managing liquidity needs are vital for effective operation of UCBs. By assuring an UCB's ability to meet its liabilities as they become due, liquidity management can reduce the probability of an adverse situation developing. The impact of liquidity problem of an UCB need not necessarily be confine to itself but it may be felt on other UCBs / banks as well. UCBs should measure not only the liquidity positions on an ongoing basis but also examine how liquidity requirements are likely to evolve under different assumptions / scenarios. Liquidity measurement can be made through stock or cash flow approaches. The stock approach uses certain liquidity ratios viz. credit deposit ratio, loans to total assets, loans to core deposits, etc. While the liquidity ratios are the ideal indicators of liquidity of banks operating in developed financial markets, the ratios do not reveal the real liquidity profile of Indian banks including UCBs, which are operating generally in an illiquid market. Experience shows that assets commonly considered as liquid like Government securities, other money market instruments, etc. have limited liquidity when the market and players move in one direction. Under the cash flow approach analysis of liquidity involves tracking of cash flow mismatches (flow approach). The maturity ladder is generally used as a standard tool for measuring the liquidity profile under the flow approach, at selected maturity bands. The format of the Statement of Structural Liquidity under static scenario without reckoning future business growth is given in Annex I.

2. The Maturity Profile as given in Appendix could be used for measuring the future cash flows of UCBs in different time bands. The time bands, given the Statutory Reserve cycle of 14 days may be distributed as under:

i) 1 to 14 days
ii) 15 to 28 days
iii) 29 days and upto 3 months
iv) Over 3 months and upto 6 months
v) Over 6 months and upto 1 year
vi) Over 1 year and upto 3 years
vii) Over 3 years and upto 5 years
viii) Over 5 years

3 The investments in SLR securities and other investments are generally assumed as illiquid due to lack of depth in the secondary market and are therefore required to be shown under respective residual maturity bands corresponding to the residual maturity. However, some of the UCBs may be maintaining a few securities in the trading book, which are kept distinct from other investments made for complying with the Statutory Reserve requirements and for retaining relationship with customers. Securities held in the trading book are subject to certain preconditions such as :

i) The composition and volume are clearly defined;

ii) Maximum maturity / duration of the portfolio is restricted;

iii) The holding period not exceeding 90 days;

iv) Cut-loss limit prescribed; (The level up to which loss could be ascribed by liquidating an asset. Illustratingly, if a security bought at Rs. 100 is quoted in the market on a given day at Rs. 98 and the board of management fixed the maximum loss which may be incurred on this particular transaction at not more than Rs.2.00, the cut loss limit is placed at Rs.2.00 for this particular security. The cut loss limit varies from security to security based on bank's loss / risk bearing capacity).

v) Defeasance periods (product-wise) i.e. time taken to liquidate the position on the basis of liquidity in the secondary market are prescribed. The defeasance period is dynamic and in volatile environments, such period also undergo changes on account of product-specific or general market conditions;

vi) Marking to market on a weekly basis and the revaluation gain / loss absorbed in the profit and loss account; etc.

UCBs which maintain such **trading books** and complying with the above requirements are permitted to show the trading securities under 1-14 days, 15-28 days and 29-90 days time bands on the basis of the defeasance periods. The Board of the UCBs should approve the volume, composition, holding / defeasance period, cut loss, etc. of the **trading book**.

4 Within each time band there could be mismatches depending on cash inflows and outflows. While the mismatches up to one year would be relevant since these provide early warning signals of impending liquidity problems, the main focus should be on the short-term mismatches viz., 1-14 and 15-28 days time bands. UCBs, however, are expected to monitor their cumulative mismatches (running total) across all time bands by establishing internal prudential limits with the approval of the Board. The mismatches (negative gap between cash Inflows and outflows) during 1-14 and 15-28 days time bands in normal course should not exceed 20% of the cash outflows in each time band. If an UCB, in view of its current asset-liability profile and the consequential structural mismatches needs higher tolerance level, it could operate with higher limit sanctioned by RBI for a limited period.

5 The Statement of Structural Liquidity (Annex I) may be prepared by placing all cash inflows and outflows in the maturity ladder according to the expected timing of cash flows. A maturing liability will be a cash outflow while a maturing asset will be a cash inflow. While determining the probable cash inflows / outflows, UCBs have to make a number of assumptions according to their asset-liability profiles. While determining the tolerance levels, the UCBs may take into account all relevant factors based on their asset-liability base, nature of business, future strategy, etc.

6. In order to enable the banks to monitor their short-term liquidity on a dynamic basis over a time horizon spanning from 1-90 days, UCBs may estimate their short-term liquidity profiles on the basis of business projections and other commitments for planning purposes. An indicative format (Annex II) for estimating Short-term Dynamic Liquidity is enclosed.

Annex – I
to circular UBD.PCB.cir.No.12 /12.05.001/2008-09 dated September 17, 2008

Name of the bank : ____________________

Statement of Structural Liquidity as on : ______

(Amounts in Crores of Rupees)

	Residual Maturity								
Outflows	**1 to 14 days**	**15 to 28 days**	**29 days and upto 3 months**	**Over 3 months and upto 6 months**	**Over 6 Months and upto 1 year**	**Over 1 year and upto 3 years**	**Over 3 years and upto 5 years**	**Over 5 years**	**Total**
1. Capital									
2. Reserves & Surplus									
3. Deposits	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
i) Current Deposits									
ii) Savings Bank Deposits									
iii) Term Deposits, Long Term Deposits (Tier II).									
iv) Certificates of Deposit									
4. Borrowings	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
i) Call and Short Notice									
ii) Inter-Bank (Term)									
iii) Refinances									
iv) Others (specify)									
5. Other Liabilities & Provisions	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
i) Bills Payable									
ii) Branch Adjustments									
iii) Provisions									
iv) Others									
6. Unavailed portion of Cash Credit / Overdraft / Demand Loan component of Working Capital									
7. Letters of Credit / Guarantees									
8. Repos									
9. Bills Rediscounted (DUPN)									
10. Swaps (Sell / Buy /									

maturing forwards									
11. Interest payable									
12. Others (specify)									
A. Total Outflows									
Inflows									
1. Cash									
2. Balances with RBI									
3. Balances with other Banks	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
i) Current Account									
ii) Money at Call and Short Notice, Term Deposits, Long Term Deposits (Tier II) and other placements and balances with other banks including DCCBs and SCBs									
4. Investments (including those under Repos but excluding Reverse Repos)									
5. Advances (Performing)	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
i) Bills Purchased and Discounted (including bills under DUPN)									
ii) Cash Credits, Over-drafts and Loans repayable on demand									
iii) Term Loans									
6. NPAs (Advances and Investments)*									
7. Fixed Assets									
8. Other Assets	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX	XXX
i) Branch Adjustments									
ii) Leased Assets									
iii) Others									
9. Reverse Repos									
10. Swaps (Buy / Sell) / maturing forwards									
11. Bills Rediscounted (DUPN)									
12. Interest receivable									
13. Export Refinance from RBI									

14. Others (specify)									
B. Total Inflows									
C. Mismatch (B-A)									
D. Cumulative Mismatch									
E. C as % to A									
* Net of provisions, interest suspense and claims received from ECGC / DICGC.									

Annex - II

Enclosed to circular UBD.PCB.cir.No12/12.05.001/2008-09 dated September 17 ,2008

Name of the Bank : _____________________________

Statement of Short-term Dynamic Liquidity as on _______

(Amounts in Crores of Rupees)

		1-14 days	**15.28 days**	**29-90 days**
A.	**Outflows**			
1.	Net increase in loans and advances			
2.	Net increase in investments :			
	i) Approved securities			
	ii) Money market instruments (other than Treasury bills)			
	iii) Bonds / Debentures / Shares			
	iv) Others			
3.	Inter-bank commitments			
4.	Off-balance sheet items (Repos, Swaps, Bills Discounted, etc.)			
5.	Others			
	Total Outflows			
B.	**Inflows**			
1.	Net cash position			
2.	Net increase in deposits (less CRR obligations)			
3.	Interest on investments			
4.	Inter-bank claims			
5.	Refinance eligibility (Export credit)			
6.	Off-balance sheet items (Reverse Repos, Swaps, Bills discounted, etc.)			
7.	Others			
	Total Inflows			
C.	Mismatch (B-A)			
D.	Cumulative mismatch			
E.	C as a % to total outflow			

Appendix

Enclosed to circular UBD.PCB.cir.No.12 /12.05.001/2008-09 dated September 17, 2008

Maturity Profile - Liquidity

Heads of Accounts				**Classification into time bands**
A.	**Outflows**			
1.	Capital, Reserves and Surplus			Over 5 years band.
2.	Demand Deposits (Current and Savings Bank Deposits			Savings Bank and Current Deposits may be classified into volatile and core portions. Generally 10 % of Savings Bank and 15 % of Current Deposits are withdrawable on demand. This portion may therefore be treated as volatile. While volatile portion can be placed in the first time band i.e., 1-14 days, the core portion may be placed in over 1-3 years time band.
				The above classification of Savings Bank and Current Deposits is only a benchmark. Banks which are better equipped to estimate the behavioural pattern on renewals, premature closures; etc. on the basis of past data / empirical studies could classify them in the appropriate time bands, i.e. behavioural maturity instead of contractual maturity, subject to the approval of the Board / ALCO.
3.	Term Deposits including Long Term Deposits (Tier II)			Respective residual (remaining period to maturity) time bands. Banks which are better equipped to estimate the behavioural pattern on renewals, premature closures, etc. on the basis of past data / empirical studies could classify the retail deposits in the appropriate time bands on the basis of behavioural maturity rather than residual maturity. However, the wholesale deposits (deposits over Rs.15 lakhs and inter-bank deposits) should be shown under respective residual time bands.
4.	Certificates of Deposit, Borrowings and Bonds (including Sub-ordinated Debt)			Respective residual time bands.
5.	**Other Liabilities and Provisions**			
	i.	Bills Payable		1-14 days time band.
	ii.	Branch Adjustments		The net credit balance may be shown in 1-14 days time band.
	iii.	Provisions other than for loan loss and depreciation in investments		Respective time bands depending on the purpose.
	iv	Other Liabilities		Respective time bands. Items not representing cash

				payables (i.e. guarantee fee received in advance, etc.) may be placed in over 5 years time bands.
6.	Export Refinance - Availed			Respective time bands of underlying assets i.e. depending upon the residual maturity of export credit.
B.	**Inflows**			
1.	Cash			1-14 days time bands.
2.	Balances with RBI / Public Sector Banks and SCBs and DCCBs for CRR / SLR purpose.			While the excess balance over the required CRR / SLR may be shown under 1-14 days time bands, the Statutory Balances may be distributed amongst various time bands corresponding to the maturity profile of DTL with a time-lag of 28 days.
3.	**Balances with other Banks**			
	(i)	Current Account	(i)	Non-withdrawable portion on account of stipulations of minimum balances may be shown under over 1-3 years time band and the remaining balances may be shown under 1-14 days time band.
	(ii)	Money at Call and Short Notice, Term Deposits , Long Term Deposits (Tier II) and other placements	(ii)	Respective residual maturity time bands.
4.	**Investments (Net of provisions)**			
	(i)	Approved securities	(i)	Respective residual maturity time bands excluding the amount required to be reinvested to maintain SLR corresponding to the DTL profile in various time bands.
	(ii)	PSU bonds, CDs and CPs. Units of eligible categories of mutual funds (close ended), etc.	(ii)	Respective residual time bands. Investments classified as NPIs should be shown under over 3-5 years time bands (sub-standard) or over 5 years time band (doubtful).
	(iii)	Equity of All India FIs and co-operatives, Units of eligible categories of mutual funds (open ended)	(iii)	Listed shares in 1-14 days bucket, with a haircut of 50%. Other shares in 'Over 5 years' bucket.. Units of eligible categories of mutual funds (open ended) may be kept under 1-14 days bucket.
	(iv)	Securities in the Trading Book	(v)	1-14, 15-28 and 29-90 time bands corresponding to defeasance periods.
5.	**Advances (Performing)**			
	i)	Bills Purchased and Discounted (including bills under DUPN)	(i)	Respective residual maturity time bands.
	ii)	Cash Credit / Overdraft (including TOD) and Demand	(ii)	Banks should undertake a study of behavioural and seasonal pattern of availments based on

		Loan component of Working Capital.			outstandings and the core and volatile portion should be identified. While the volatile portion could be shown in the near-term maturity time bands, the core portion may be shown under over 1-3 year time band.
	iii)	Term Loans		(iii)	Interim cash flows (instalments) should be shown under respective maturity time bands.
6.	**NPAs (Net of provisions, Overdue Interest Reserves and claims received from ECGC / DICGC**				
	i)	Sub-standard		i)	Over 3-5 years time band.
	ii)	Doubtful and Loss		ii)	Over 5 years time band.
7.	Fixed Assets			Over 5 years time bands.	
8.	**Other Assets**				
	i)	Branch Adjustments		The net debit balance may be shown in 1-14 days time band. Intangible assets and assets not representing cash receivables may be shown in over 5 years time band.	
	ii)	Leased Assets		Interim cash flows may be shown under respective residual maturity time bands.	
C.	**Contingent Liabilities / Lines of Credit committed / available and other inflows / Outflows**				
1.	(i)	Unavailed portion of Cash Credit / Overdraft / Demand loan component of Working Capital limits (outflow)		(i)	Banks should undertake a study of the behavioural and seasonal pattern of potential availments in the accounts and the amounts so arrived at may be shown under relevant residual maturity-time bands within 12 months.
	(ii)	Export Refinance - Unavailed (inflow)		(ii)	1-14 days time band.
2.	Letters of Credit / Guarantees devolvement (outflow)			Based on past history, these should be distributed across time bands.	
3.	Repos / Bills Rediscounted (DUPN) / Swaps INR / USD, maturing forex forward contracts etc. (outflow / inflow)			Respective residual maturity time bands.	
4.	Interest payable / receivable (outflow / inflow) - Accrued interest which are appearing in the books on the reporting day			Respective time bands.	
	Note :				
	(i) Liability on account of event cash flows i.e. short fall in CRR / SLR balance on reporting Fridays, wage settlement, capital expenditure, etc. which are known to the banks and any other				

	contingency may be shown under respective maturity bands.
	(ii) All overdue liabilities should be placed in the 1-14 days time band.
	(iii) Interest and instalments from advances and investments, which are overdue for less than one month may be placed in over 3-6 months, time band. Further, interest and instalments due (before classification as NPAs) may be placed in over 6-12 months time band if the earlier receivables remain uncollected.

D.	**Financing of Gap**		In case the negative gap exceeds the prudential limit of 20% of outflows. (1-14 and 15-28 days time bands) the bank may show by way of a foot note as to how it proposes to finance the gap to bring the mismatch within the prescribed limits. The gap can be financed from market borrowings (call / term), Bills Rediscounting, Repos and deployment of foreign currency resources after conversion into rupees (unswapped foreign currency funds), etc.