

## LIQUIDTY MANAGEMENT

### Meaning

Liquidity can be defined as the ability of a bank to meet demand for funds on account of maturity of liabilities exactly when they fall due or when depositors want their money back. The bank's liquidity stems from the following:

**If in need of short-term liquidity, a bank can have recourse to any of the below sources.**

- Cash in excess of CRR;
- Investments in SLR securities over and above the mandatory requirements.
- Prime assets – investments in T-bills, top-rated short-term paper and loans to top-rated companies
- Swapping forex funds to INR

**In a situation of surplus liquidity, the bank would look at the following options:**

- Money market lending
- REPO
- Buying T-bills, CP or securities, depending upon the tenors of surplus liquidity
- Repaying refinance (if any)

## **FUNDING THE BALANCE SHEET**

The bank's balance sheet is **funded not only by deposits but also by market borrowing – call / notice / term money, inter-bank deposits, reverse repos and refinance**. Forex funding is also resorted to when the USD / INR exchange rate is expected to be stable

## **(A) Cash Reserve Ratio (CRR)**

A scheduled bank (SCB) is under obligation to keep a cash reserve called the Statutory Cash Reserve, with the Reserve Bank as per provisions of **section 42 of the Reserve Bank of India Act, 1934**. Accordingly, every scheduled bank is required to maintain with the Reserve Bank an average daily balance equal to at least 4% of its net demand and time liabilities.

## **Liabilities not to be included for NDTL**

- Paid up capital, reserves, any credit balance in the Profit & Loss Account of the bank.
- Net income tax provision;
- Amount received from insurance company on ad-hoc settlement of claims pending judgement of the Court;
- Amount received from the Court Receiver
- The liabilities arising on account of utilization of limits under Bankers' Acceptance Facility (BAF);
- Subsidy released by NABARD under Investment Subsidy Scheme for Construction / Renovation / Expansion of Rural Godowns;

- Net unrealized gain / loss arising from derivatives transaction under trading portfolio;
- Income flows received in advance such as annual fees and other charges which are not refundable
- Bill rediscounted by a bank with eligible financial institutions as approved by RBI.

## **Demand Liabilities**

Demand Liabilities include **Current Deposits, Demand Liabilities portion of Saving Bank Deposits Margin held against LC, Balances in overdue FD, Cash Certificate and RD, Outstanding TTs, MTs and DDs, Unclaimed deposits, Credit Balances in CC accounts and Deposits held as security for advances which are repayable on demand.**

## **Time Liabilities**

Time Liabilities include **Fixed Deposits, Cash Certificates, Cumulative and Recurring Deposits, Time Liabilities portion of Saving Bank Deposits, Staff Security Deposits, margins against LC not payable on demand, deposits held as securities for advances which are not payable on demand and gold deposits.**

## **Other Demand and Time Liabilities**

Other Demand and Time Liabilities include **interest accrued on deposits, Bills Payable, Unpaid Dividends etc.**

## **Assets with the Banking System**



Assets with the banking system include **balances with banks in current account, balances with banks and notified financial institutions in other accounts**, funds made available to banking system by way of notice made available to the banking system.

## **Arrangements with Correspondent Banks for Remittance Facilities**

When a bank accepts funds from a client under its remittance facilities scheme, it becomes a liability (liability to others) in its books. The liability of the bank accepting funds **will extinguish only when the correspondent bank honours the drafts issued by the accepting bank to its customers**. Remaining unpaid balance should be reflected in the bank's books as liability under the head 'Liability to others in India' and the **same should also be taken into account for computation of DTL for CRR / SLR purpose**.

## **Penalties for CRR Shortfall**

In case of default in maintenance of CRR requirement on a daily basis penal interest will be recovered for that **day at the rate of 3% p.a. above the Bank Rate on the amount by which the amount actually maintained falls short of the prescribed minimum on that day**, and if the shortfall continues on the next succeeding day/s, penal interest will be recovered at a rate of 5% p.a. above the Bank Rate.

## **Statutory liquidity ratio**

Statutory Liquidity Ratio (SLR) Section 24(2A) of Banking Regulation Act, 1949, requires every banking company in India to maintain such percentage not exceeding 40 per cent of its total Demand and Time Liabilities. The stipulated levels of Statutory Liquidity Ratio had reached

a very high level of 38.5% during 1991–92. The present stipulated SLR is 19.50% which came into effect from the fortnight commencing October 14, 2017.

## **Penalty for not maintaining SLR ratio by bank**

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## **Monetary Control by RBI**

- **Open market operations**

Open Market Operations is when the RBI involves itself directly and buys or sells short-term securities in the open market. This is a direct and effective way to increase or decrease the supply of money in the market.

- **Bank Rate**

A bank rate is essentially the rate at which the RBI lends money to commercial banks without any security or collateral. So now if the RBI were to increase the bank rate, the commercial banks would also have to increase their lending rates. And this will help control the supply of [money](#) in the market.

- **Variable reserve requirement**



There are two components to this instrument of monetary policy, namely – The Cash Reserve Ratio (CLR) and the Statutory Liquidity Ratio (SLR).

- **Liquidity adjustment facility**

The Liquidity Adjustment Facility (LAF) is an indirect instrument for monetary control. It controls the flow of money through repo rates and reverse repo rates.

## **CLEARING CORPORATION OF INDIA LIMITED (CCIL—NETTING / ELIMINATION OF EXPOSURES)**

CCIL is an institution set up to clear outright and repo trades among market players on a guaranteed basis. Negotiated Dealing System (NDS) is a online trading platform while CCIL is a Clearing House settling trades.

Products handled by CCIL are

(a) Domestic

- G-Secs / State Governments / T-Bills
- Repos / CBLOs

(b) Forex

- USD / INR

CCIL has also introduced a dealing and trading platform for forex called FX Clear to deal in forex swaps.

### **FX CLEAR**



FX Clear enables trading to be done through Order Matching Mode and Negotiation Mode. Order Matching Mode **automatically matches the best bids and offers in the system. In the Order Matching Mode, the dealer can specify his parameters: minimum selling price, maximum buying price, stop loss and take profit levels.** These can be time / date-constrained.

### **FX-SWAP-**

A foreign exchange swap (also known as an FX swap) is an agreement to **simultaneously borrow one currency and lend another at an initial date**, then exchanging the amounts at maturity.

### **Forex**

Forex (FX) refers to **the global electronic marketplace for trading international currencies and currency derivatives.** It has no central physical location, yet the forex market is the largest, most liquid market in the world by trading volume, with trillions of dollars changing hands every day.

## **COLLATERALIZED BORROWING AND LENDING OBLIGATION (CBLO)**

A collateralized borrowing and lending obligation (CBLO) is a [money market](#) instrument that represents an **obligation between a borrower and a lender concerning the terms and conditions of a loan.** CBLOs allow those restricted from using the [interbank call money market](#) in India to participate in the short-term money markets.

## **REAL TIME GROSS SETTLEMENT (RTGS)**

The term real-time gross settlement (RTGS) refers to a funds [transfer](#) system that allows for the instantaneous transfer of



money and/or securities without **netting debits** with credits across the books of a central bank. Once completed, real-time gross settlement payments are final and irrevocable.

## **IDRBT as Certifying Authority (CA)**

The Institute for Development and Research in Banking Technology (IDRBT) at Hyderabad has **become the Certifying Authority for the banking and financial sector for all the applications implemented over the INFINET (Indian financial network)**. The INFINET provides for the communications backbone for all the Systemically Important Payment System Applications. It is clear that banks will have to take urgent steps to ensure that all banks' branches, including those in the countryside, are networked.

## **PUBLIC KEY INFRASTRUCTURE (PKI)**

In the physical world the signature of a person is used and associated to establish identity and credibility of the individual.

**PKI is an online infrastructure using encryption digital signatures and digital certificates. The paper-based concepts of identification, declaration and proof are carried through the use of digital signatures in electronic environment.** Digital signatures are created and verified using Public Key Cryptography.