Arab Monetary Fund

General Guidelines

For

Central Banks to deal with COVID-19 implications on Financial Stability

Arab Monetary Fund

May 2020

Background

The world is witnessing the effects of corona virus (COVID-19) on economies and financial markets around the world, through the impact on several economic sectors, including Energy, tourism, foreign and domestic trade, transport, health and education, which poses a great challenges for policymakers to pursuing their developments' efforts at their countries.

The COVID-19 also posed challenges on financial stability, as the cash flows of the banking and financial sector were negatively affected, through the possibility of defaulting clients of banks and financial institutions across different sectors which requires immediate action by central banks to maintain the soundness, robustness and continuity of the financial sector in accordance with proper banking and financial business rules, and preserving the sustainability of corporates, especially Small and medium-sized enterprises (SMEs). In addition to protect individuals from the risk of default and their ability to pay, in order to maintain their credit rating.

Based on the above, many central banks have taken stimulus and preventive measures in their respective jurisdictions, including injecting liquidity into the banking sector by reducing costs of monetary policy instruments and compulsory cash reserves. It has also strengthened the loan guarantee system in support of the productive sectors, which has helped the banking sector to postpone loans to individuals and corporates. Moreover, central banks have adopted support programs for productive sectors with a view to sustaining them. As for macroprudential policy instruments, the number of central banks has released or reduced some of them. At the capital instrument level, Countercyclical Capital Buffer (CcyB) has been released as well as reduced risk weights within the capital adequacy in some sectors. As for liquidity instruments, several countries have reduced liquidity coverage ratio (LCR) from the required ratio of (100%), and some countries have set caps on the debt-to-income ratio (DTI) or loan-to-value ratio (LTV). In addition, other measures were taken to prevent the distribution of annual dividend and bonuses. As for fiscal policy, the finance ministries have taken several measures to support the real economy.

In this context, the Basel Committee on Banking Supervision has postponed the implementation of Basel III requirements. Some international institutions have also aimed to issue general guidelines on how central banks are handling the COVID-19, as the Bank of International Settlements has developed three basic principles as follows:

- **Principle 1**: The adjustments should be effective in supporting economic activity. That should apply at least to the crisis period, and preferably even beyond, when establishing the basis for a solid recovery.
- **Principle 2**: The adjustments should preserve the health of the banking (financial) system. Banks should remain sufficiently well capitalized, liquid and profitable to underpin sustainable growth.
- **Principle 3**: The adjustments should not undermine the long-run credibility of financial policies. Credibility is hard to gain and easy to lose. Compromising the policies excessively in the short run can create serious long-term damage. From this perspective, adjustments should be, and seen to be, temporary. Transparency is key in meeting this principle.

The Arab Monetary Fund's is keen to provide support to its member countries in the field of economic, financial and monetary reforms that aim to enhance financial stability in the Arab region, and in light of the discussions that took place in numerous consultative meetings organized by the Fund at the level of Arab Central Banks and Monetary Authorities' Governors as well as within the subcommittees and task forces, such as Arab Banking Supervision Committee, Financial Stability Task Force, Financial Inclusion Task Force, the Arab Committee on Payment and Settlement Systems and the Regional Fintech Working Group, the following general guidelines have been issued for Central Banks to deal with COVID-19 implications on Financial Stability.

AMF General Guidelines for Central Banks to deal with COVID-19 implications on Financial Stability

Principle (1)

The Central Bank policy seeks to support economic activity while preserving the integrity of the financial system and ensuring transparency.

Principle (2)

Establishment of a crisis management or a financial stability committee under the leadership of the central bank and includes representatives from the Ministry of Finance and Securities Commission, to ensure coordination, cooperation and support between monetary policy, fiscal policy, and macro and micro prudential policy.

Principle (3)

Gradual usage of the macroprudential policy tools, by applying the appropriate tool at the right time, and not to overstate in reducing regulatory and prudential requirements.

Principle (4)

It is possible at the current stage if required to release the countercyclical capital buffer (CCyB) tool, however it is better not to release other tools at the current stage such as the conservation capital buffer (CCoB), the capital buffer for banks of domestic systemically important banks (DSIBs), and Leverage Ratio, due to its important role in enhancing the ability of financial system to absorb losses.

Principle (5)

Support productive sectors with greater impact, for example, central banks can allow, for a temporary period, reducing the risk weights of these sectors within capital requirements.

Principle (6)

Gradual and careful reduction of the capital buffers instruments if the crisis extends till the end of this year.

Principle (7)

It is possible to consider reducing liquidity requirements or LCR (liquidity coverage ratio) from the required ratio (100%) in a measured manner, if the current crisis extends for more than another three months.

Principle (8)

Under any situations, allowing the use of the capital and liquidity buffers must coincide with implementing restrictions on dividends and bonuses distribution.

Principle (9)

Consider developing guidance on using the Expected Credit Loss model (ECL) and building provisions also classifying customers and coordinating with the external auditor in this regard, according to the International Financial Reporting Standards (IFRS9). However, these countries that have not applied as yet the standard may consider postponing the application of (IFRS 9) until the end of the crisis.

Principle (10)

Central banks must balance when promoting financial stability. on one hand actions needed to protect the financial sector, and those actions needed to protect the private sector, especially small and medium-sized enterprises.

Principle (11)

Postponing the collection of fines imposed on banks at the current stage, pending recovery from the end of the crisis.

Principle (12)

Strengthening the regulatory systems that support the development of technical performance, communications and working remotely, in addition to the implementation of digital financial transformation processes and the use of Financial Technologies by commercial banks. Ensuring that procedures and frameworks are clear to enhance cyber-security, providing adequate infrastructure, appropriate technical support, and alternative plans in the event of an Internet break, to address disruption impact on operations.

Principle (13)

Continuing the attention of central banks to enhancing clients' data and the financial consumer protection, considering the increased usage of Financial Technologies.

Principle (14)

Strengthening the compliance management, risk management and anti-money laundering and counter-terrorist financing (AMF-CFT) and developing the needed methodologies to meet the challenges associated with the use of fintech in banking operations, especially that operations are carried out without communicating with clients face to face. The importance of developing principles emerges as significant for the safe use of Financial Technologies at this stage. It is also important to continue the efforts related to the use of the digital identity, eKYC and electronic signature[1].

Principle (15)

Enhancing digital financial inclusion and digital financial literacy, and launching large-scale campaigns remotely, in light of the increased reliance on Financial

[1] In this regard, the guidelines principles issued by the Arab Monetary Fund in the context of the fintech working group could be considered: https://www.amf.org.ae/sites/default/files/Digital%20ID%20and%20eKYC-Dec-2019.pdf.

Technologies in the current crisis. Furthermore, developing ways and means to enhance financial literacy in coordination with educational institutions.

Principle (16)

Consider directing legislation and regulation to focus on the priorities of the epidemic's challenges to reduce the negative impact on the banking and economic sectors.

Principle (17)

Consider at this stage the possibility of reducing on-site control on banks as the current situation may necessitate their reduction, with the aim of focusing at the current stage on limiting the impact of COVID-19, bearing in mind that the central banks are currently working remotely to prevent transmission

Principle (18)

Protecting the integrity and credibility of credit reporting systems, where the full and accurate participation of credit information must be promoted on an ongoing basis, including reporting negative credit data resulting from the crisis, and taking all means that limit the negative impact on the credit history of good customers who have outstanding payments that cannot be paid due to circumstances beyond their control, and they were caused by the current crisis. In this context, it is possible to direct good customers to review their banks (within the methods of communication permitted during the crisis) and negotiate with them to reschedule the facilities, or it is possible to make a note in the credit report of the reasons for the failure of a good customer.

Principle (19)

Guide the credit information companies to implement measures to monitor negative credit information that was reported during the crisis which may include using credit symbols or codes related to this crisis to facilitate the preparation of the required credit reports.

Principle (20)

Strengthen the capacity of regulatory authorities to deal with complaints and disputes during the crisis, this is in light of the potential increase in complaints and disputes, in addition to promote the application of information technology to receive complaints and resolve disputes.

Principle (21)

Encourage digital access to the credit reports, to ensure that the right to access credit reports will not be affected during the crisis.

Principle (22)

Review business continuity plans for central and commercial banks, as well as review the effectiveness of risk management, early warning systems and recovery plans used by central and commercial banks.

Principle (23)

To examine the need of banking supervision and financial stability departments to develop micro and macro stress tests considering the current crisis.

Principle (24)

Enhance public awareness of the role of both Deposit Insurance Corporations and loan guarantee institutions in the protection of deposits and guaranteed loans.

Principle (25)

Consider issuing continuous assurance messages to depositors and investors, provided that these messages have credibility and transparency, thereby enhancing public confidence in the central bank and the formal financial sector considering the current crisis.

Principle (26)

Consider instruments and procedures considering the requirements of Islamic banks. It would also be desirable for the procedures to include all Non-banking financial institutions subject to central bank supervision.

Principle (27)

Assess on an ongoing basis, the impact of the instruments and actions taken in terms of their effectiveness, longer-term impact and any negative effects related to these.

Principle (28)

Work actively to prepare for the post-crisis period in terms of the timing and progression of the suspension of the tools that were used to mitigate the impact of this suspension, the speed of the return of the economic cycle to its status and the maximization of the recovery effect.