SANA'A
CENTER FOR STRATEGIC STUDIES
مركز صنعاء للدراسات الاستراتيجية

# REVITALIZING YEMEN'S BANKING SECTOR:

# NECESSARY STEPS FOR RESTARTING FORMAL FINANCIAL CYCLES AND BASIC ECONOMIC STABILIZATION

**By:**

**Farea al-Muslimi**

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The Sana’a Center for Strategic Studies is an independent think-tank that seeks to foster change through knowledge production with a focus on Yemen and the surrounding region. The Center’s publications and programs, offered in both Arabic and English, cover political, social, economic and security related developments, aiming to impact policy locally, regionally, and internationally.

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# EXECUTIVE SUMMARY

Yemen's banking sector faces a litany of challenges stemming from the county's ongoing economic collapse and the warring parties' competition for financial control. The most critical challenge is the division of the central bank between Sana'a and Aden and the fierce competition between these two branches over the administration and regulation of the country's commercial and Islamic banks. In February, this has seen Houthi authorities arrest senior officials from several banks in the capital for supposedly complying with policies set by the central bank in Aden and the Yemeni government's Economic Committee.

Other obstacles facing the banking sector are a prolonged liquidity crisis, the deteriorating local currency exchange rate, the loss of revenue from freezes on assets and public debt repayments, obstacles to moving money within Yemen and internationally, and the general deterioration in private sector confidence in the banking sector that has spurred the migration of the financial cycle from the formal economy to informal markets and networks.

The weakening of Yemen's commercial and Islamic banks has had wide-ranging consequences. Among the implications are a dramatic rise in black market activity, exchange rate destabilization, and increased difficulty for traders to finance imports. These in turn have undermined attempts to establish social and political stability, exacerbated the humanitarian crisis, and ultimately prolonged the conflict.

Since mid-2018 the Sana'a Center has been meeting with the heads of Yemen's banking sector, current and former senior central bank officials on either side of the frontlines, financial authorities across the country, as well as prominent economists, business leaders and currency traders from Yemen and around the region.[1] The following policy brief is an outcome of these discussions. In synthesizing the opinions of these experts, this paper lays out recommendations for revitalizing the Yemeni banking sector and offers a background on the challenges it has faced.

1) In researching this paper, the author conducted a focus group with CEOs from Yemen's commercial and Islamic banks at the Yemeni Banking Association in Sana'a in mid-2018. Banks represented at the meeting were: al-Amal Microfinance Bank, Arab Bank Limited, Cooperative and Agricultural Credit Bank (CAC Bank), International Bank of Yemen, Islamic Bank of Yemen for Finance and Investment, al-Kuraimi Islamic Microfinance Bank, Qatar National Bank, Rafidain Bank, Saba Islamic Bank, Shamil Bank Of Yemen And Bahrain, Tadhamon International Islamic Bank, Yemen Bank for Reconstruction and Development, and Yemen Commercial Bank.

**These recommendations are:**

- Reunify the administration for the Central Bank of Yemen; this must be a top priority of all stakeholders and the international community must pressure all parties to the conflict to facilitate this development.
- Reactivate Yemen's anti-money laundering and counterterrorism financing mechanisms.
- Release Yemeni bank balances frozen in central bank accounts through re-activating the central bank's payment clearing house functions.
- Facilitate the secure transfers of cash holdings of foreign and domestic currency both within the country and internationally.
- Ease import financing requirements to allow banks to utilize their frozen non-cash balances to underwrite letters of credit for the importation of basic commodities.
- Establish a cash clearing system to swap cash payments between banks, money exchange networks and businesses.
- Replace damaged banknotes currently stockpiled by the banking sector.
- Restart partial servicing on the accrued interest of outstanding public debt.

# BACKGROUND: CHALLENGES FACING YEMENI BANKS

## Prolonged Liquidity Crisis Spurs Loss of Public Confidence

The Yemeni banking sector has faced a liquidity crisis since 2016. Following the escalation of the conflict in early 2015 the country entered a precipitous decline in economic activity. Of primary concern for state spending was the cessation of oil exports, which had until 2015 been the largest source of government revenues and the country's primary source of foreign currency. Consequently, the central bank was forced to begin drawing down on its reserves of domestic currency to fund public expenditures and deploy its reserves of foreign currency to finance imports.

Throughout 2015, the central bank took action to shore up foreign currency supplies in the country through limiting local market access, while commercial banks began limiting customer withdrawals.[2] These actions, together with a financial blockade of the country that severely curtailed commercial banks' ability to carry out international financial transactions, led traders and wealthy Yemenis to be hesitant to let banks hold their money. Cash withdrawals from the banking sector thus increased; in the first six months of 2016 alone, customers withdrew some 300 billion Yemeni rials (YR) from their accounts, amounting to a mass migration of financial flows from the formal to the informal economy.

With little cash liquidity themselves, commercial banks could not make deposits at the central bank. Concurrently, the Yemeni government denied the central bank, based in Houthi-controlled Sana'a, access to the foreign printers necessary to print new banknotes, and thus the CBY's cash reserves of Yemeni rials began to decline. In attempting to address this, the central bank leadership began to reissue damaged banknotes that had been removed from circulation. Many businesses refused to accept them, however, leaving many commercial banks with vast stockpiles of unusable currency notes for which they have since born the costs of storing.

By September 2016, the central bank was forced to cease salary payments to most of the 1.2 million Yemenis on the public payroll, due to a lack of physical cash with which to pay them. Simultaneously, the central bank's foreign reserves were almost entirely depleted.

2) In 2015, the central bank took actions to reduce transactions in foreign currency. For example, the central bank asked commercial banks to allocate part of their received remittances from Yemeni expats working abroad to cover imports and facilitate country's external needs of foreign currency payments. Also, in July 2015 the CBY limited its lines of credit for fuel imports to avoid depleting foreign currency reserves.

## A Divided Central Bank

In September 2016, Yemeni President Abdo Rabbu Mansour Hadi issued a decree to relocate the Central Bank of Yemen headquarters from Sana'a to Aden. This brought new, interrelated challenges and risks to commercial banks. Hadi had announced the move without first securing the institutional expertise and staff, information archives or financial reserves necessary for the new location to carry out central bank functions. While the central bank in Aden has gradually developed greater capacities and has the privileges associated with being internationally recognized, it still lacks the institutional and technical capacity to supervise domestic banking operations or evaluate banks' liquidity needs, among other deficiencies. Meanwhile, the central bank in Sana'a has maintained most of its staff and information archives, and much of its leverage with the country's largest financial institutions, given that their headquarters are mostly located in the capital. However, it has minimal reserves and is unable to carry out international transactions.

Thus, since September 2016 there have been two central banks in Yemen – in Sana'a and Aden – claiming national jurisdiction yet neither has the capacity to fulfill the role. With the two central banks operating independently of and often in opposition to each other, the country has suffered from divergent fiscal and monetary policies. Efforts to implement mechanisms to relieve the liquidity crisis have also been hampered by disputes between the rival central bank branches, with the country's banking sector caught in the middle (see below 'Aden and Sana'a Compete for Financial and Monetary Control').

## Banking Sector's Asset and Revenue Squeeze

### *Frozen Assets*

The commercial bank deposits held at the central bank prior to September 2016 have since then become divided between Sana'a and Aden. In general, the Sana'a-based authorities have allowed commercial banks to transfer balances held at the Sana'a-based CBY to the central bank in Aden, but not cash. Since the division of the CBY, its branches in Sana'a and Aden have applied similar mechanisms to handle the balances of commercial banks in their accounting systems and to restrict cash withdrawals. The central bank in Aden allows cash withdrawals only on the net balance of cash deposits made since September 2016. Deposits made before September 2016 that were moved from Sana'a to Aden can only be transferred or mobilized to swap payments within accounts at the central bank and the banking system, and not for any other purpose (such as customer cash withdrawals).[3]

The central bank in Sana'a has operated a similar mechanism since early 2017; it does not allow commercial banks to use cash balances accumulated prior to 2017, which represent the bulk of most banks' financial assets. Meanwhile, the separation of cash transactions from non-cash transactions has undermined the use of non-cash payment instruments, like checks, and has discouraged the public from conducting financial transactions within the banking sector.

The central bank in Aden has mandated that for banks to make partial cash withdrawals on non-cash deposits they must transfer assets – including treasury bills – from the central bank in Sana'a to Aden, something the Sana'a central bank has yet to allow.

## *Frozen Public Debt Repayments*

Commercial banks have come under further strain due to the central bank's suspension of payments on domestic debt. Prior to the conflict, commercial and Islamic banks were large investors in domestic debt instruments issued by the CBY on behalf of the Ministry of Finance. Commercial banks hold 72 percent of all treasury bills. Meanwhile, Islamic banks have invested heavily in Islamic sukuk bonds.[4] The Public Debt Department, under the leadership of the central bank in Sana'a, has continued to reissue treasury bills on maturation, and has transferred their generated interest into uncashable accounts. With regard to the sukuks, upon maturation the debt department has transferred the original amounts invested in the sukuks and their generated returns to uncashable accounts, while disallowing the re-issuance of this debt instrument. Thus, Islamic banks have lost alternative channels to relocate their investments.

In September 2018, the central bank in Aden raised interest rates on domestic debt instruments and introduced new ones in an attempt to attract the assets of commercial and Islamic banks. As of November, it had sold YR100 billion in debt to a group of commercial and Islamic banks. However, the central bank in Aden required that these debt instruments be purchased in cash, preventing Yemeni banks from shifting existing investments in public debt into the new instruments to take advantage of the increased interest rates.

3) The central bank in Aden opened two accounts for each commercial bank: The first account holds cash and non-cash deposits made since the division of the central banks in September 2016; cash withdrawals from this account are restricted to the net balance of cash deposits. The second account holds deposits made before September 2016 that were transferred from Sana'a to Aden; commercial banks can only transfer or mobilize balances from this account to swap payments across their accounts in the central bank. The balances in this account cannot be used beyond this scope, for example to conduct cash transactions including customer cash withdrawals.

4) Sukuks are a form of Islamic debt instrument issued by the central bank in behalf of the Ministry of Finance to attract the investment of Islamic banks. These public debt assets are used to fund government projects under agreed Islamic Sharia models.

## Deterioration of the Yemeni rial

The instability of the Yemeni rial has aggravated the liquidity crisis in the banking sector. As of this writing the Yemeni rial had lost, relative to the US$, almost two thirds of its purchasing power since March 2015, when it was trading at YR215 per US$1. The rial reached a record low of more than YR800 per US$1 in October 2018, before rebounding to YR525 per US$1 by the end of the year. The decline and rapid fluctuations in value of the local currency have led Yemenis to withdraw their rial savings from banks and convert them in the informal markets to foreign currencies, particularly US dollars and Saudi rials, to preserve their value and to benefit from the growing purchasing power of foreign currencies.

The depreciation of the rial caused some commercial banks losses of currency assets, particularly banks whose foreign currency obligations were greater than their assets. Meanwhile, those banks with available funds have speculated on the exchange rates.

## Aden and Sana'a Compete for Financial and Monetary Control

The CBY leadership in Aden and the Yemeni government-appointed Economic Committee have recently stepped up efforts to resume a functioning importation system, restore confidence in the banking sector and return financial flows to the formal economy. However, these efforts remain difficult to implement in the absence of a unified central bank and due to disputes between the central banks in Sana'a and Aden, which have competed for control over banking and import regulations.

The CBY in Aden drafted a procedural framework in June 2018 to support the import of five essential commodities – rice, wheat, milk, sugar and cooking oil – from a US$2 billion deposit provided by Riyadh. In September, the Yemeni government issued Decree 75 to regulate fuel and basic commodity imports, although a month later the regulation of food imports was suspended indefinitely due to concerns that tighter controls would reduce food imports and worsen Yemen's already dire food security crisis. Due to the divisions and rivalry between the central banks in Sana'a and Aden, Yemeni banks were unable to fully benefit from this new framework.

The Aden-based CBY instructed traders in June 2018 that letters of credit (LCs) to guarantee imports must be opened with commercial banks operating in Aden and that equivalent funds in Yemeni rials should be deposited at accounts held by the CBY in Aden, among other conditions. In November 2018, Houthi authorities issued orders for commercial banks to use checks to cover LCs, seeking to prevent the transfer of rial banknotes outside their territory. Houthi authorities threatened reprisals – including the imprisonment of senior staff – against banks that complied with directives issued in Aden,[5] while the CBY in Aden has threatened commercial banks with fines for not providing cash to cover imports.

5) The Houthi-run National Security Bureau detained the Deputy Director of Shamil Bank of Yemen and Bahrain Abbas Nasser in January 2019 for several days in response to the bank's dealings with the central bank in Aden.

The Yemen Banks Association (YBA) sent a letter to the CBY governor in Aden, Mohammed Zammam, in November 2018, outlining the difficulties commercial banks faced in underwriting LCs for food and fuel importers using cash. Due to the liquidity crisis, banks did not have sufficient cash to underwrite LCs for importers. In the letter, the YBA said that to satisfy the Aden-based CBY and the Economic Committee's demand, the commercial banks would need to use checks to purchase Yemeni rial banknotes from informal economic institutions – such as money exchangers. Due to the liquidity crisis, commercial banks have turned to informal networks to obtain cash drawn on non-cash frozen assets. In this scenario, rial banknotes are overpriced relative to checks, and commercial banks absorb the cost of exchanging checks into cash.

Fears have been raised that the absorption of these financial burdens would reduce the impact of the Aden-based CBY's privileged exchange rate given to fund imports on basic foodstuffs. Commercial banks would also be left with little option but to deal with the same informal networks the Aden-based CBY and the Economic Committee are looking to disempower.

### *Houthi Authorities Obstruct New Liquidity Circulation*

In response to the Aden-based imports financing mechanism requiring importers to deposit cash at the central bank in Aden to underwrite LCs, in December 2018 Houthi authorities imposed new restrictions to prevent the transfer of cash out of their territory. Houthi authorities banned banks from transferring amounts exceeding YR450,000 (equivalent to roughly US$900 in December 2018) from Sana'a to Aden without prior approval from the Sana'a-based central bank. Although sources in the banking sector report that rial banknotes are being transferred via informal networks, this process is associated with high costs and risks due to the conflict-driven instability in Yemen. Bankers have complained that banknotes transported by truck are vulnerable to confiscation and robbery over road networks, and that the cost of transferring rial banknotes to Aden has become untenable.

Houthi authorities have also tried to prevent new banknotes printed in Aden from circulating in their territories, thereby obstructing efforts to address the liquidity shortage faced by commercial banks. Houthi authorities have been motivated by the assumption that the new banknotes would increase the local currency supply and thus create inflationary pressures. They also seek to prevent these rial banknotes from being used to purchase foreign currency out of the market in Houthi-controlled areas. While these restrictions have eased somewhat, and new currency printed in Aden is being used in restaurants and shops in Sana'a, Houthi authorities have focused on preventing commercial banks from handling or using these banknotes.

When the central bank was relocated to Aden in 2016 the amount of physical money in circulation was estimated at YR 1.3 trillion; of these banknotes, which are still largely in circulation, at least 90 percent are currently considered damaged, according to banking sector sources that spoke with the Sana'a Center. The Aden-based central bank has since printed more than YR1 trillion to replace damaged rial banknotes in circulation, but Houthi restrictions against the use of this new currency has limited its impact on the liquidity crisis faced by commercial bank.

This further diminished public confidence in formal banking operations and reduced cash deposits in commercial banks, as Yemenis have been reluctant to deposit their savings in banks that were unable to accept new banknotes. Houthi authorities have regularly carried out inspections of bank treasuries and cash boxes to check if they were accepting the rials printed in Aden and have at times taken measures to confiscate new banknotes they found.

An October 2018 World Bank report estimated that currency circulation outside the formal banking sector more than doubled between 2014 and 2017, from YR810.9 billion to YR1.67 trillion. This number has likely risen since the report, as more than YR1 trillion in banknotes printed in Aden have not been allowed to enter the commercial banks operating in densely populated Houthi areas, where some 70 percent of the population live, with corresponding high consumption and economic activity.

## *Houthi Security Detaining Senior Bank Staff*

Since the beginning of this year, the Houthi authorities, through their affiliated national security agency and central bank in Sana'a, have intensified measures to punish commercial banks intending to relocate their headquarters to Aden, or those caught implementing financial transactions to open letters of credits under the Aden-based central bank's import financing mechanism. These actions have increased fears and shaken confidence of the banking sector, forcing both banks and their customers to search for safer ways to transfer funds and relocate investments.

While Houthi authorities lack the international financial legitimacy and monetary tools essential to influence the banking sector activities directly, they have applied physically coercive tactics to try and force the banking sector to abide by their decrees and, more often, to prohibit them from following directives issued from Aden.

On February 10, Houthi security personnel raided the headquarters of Tadhamon International Islamic Bank (TIIB) and arrested the treasury director and another two employees. TIIB is Yemen's largest bank in terms of total assets. Houthi security also arrested several executives from al-Kuraimi Microfinance Bank, and Saba Islamic Bank.

Banking sources told the Sana'a Center that such actions were a punishment for TIIB management's interaction with the central bank in Aden – in particular opening letters of credit – and the bank's refusal to sell 20 million Saudi rials to the central bank in Sana'a to fund the imports of a basic commodities importer loyal to the armed Houthi movement. On February 11, the bank management organized a demonstration of its staff in front of the bank headquarters to call for the release of its detained employees.

The Sana'a Center also learned that there had been a dispute between the authorities in Sana'a and Aden related to the Cooperative and Agricultural Credit (CAC) Bank. In February this led to central bank officials in Aden successfully petitioning the Society for Worldwide Interbank Financial Telecommunication (SWIFT) headquarters in Belgium to have the CAC Bank's SWIFT access removed from Sana'a and placed in Aden.

## Restrictions on Cross-Border Banking and Compliance Challenges

In 2018, the Aden-based central bank attempted to have certain restrictions on Yemeni banks' international financial transactions lifted. As of this writing, most American and European banks continue to refuse to interact with Yemeni banks. However, the central bank in Aden has resumed the full functions of the SWIFT network.(6)

The SWIFT network had been deactivated in September 2016, when the central bank headquarters was moved to Aden. President Hadi's decision to nullify the authority of the staff handling SWIFT payments at the Sana'a-based CBY before arrangements had been made to relocate the network to Aden led to a freeze in the balances of commercial banks held by the central bank. This meant that Yemeni banks were unable to open food import credits, worsening the humanitarian situation in the country.

The SWIFT system was reinstalled at the central bank in Aden in April 2017, but limited transactions were made on the network because the central bank's foreign currency reserves had not been replenished and restrictions on Yemeni banks by the international financial system remained. By the time the central bank in Aden resumed full operations on the SWIFT network, it had been disconnected from the global transaction system for more than a year.

Due to the withdrawal of international recognition of the Sana'a-based Financial Information Unit (FIU), moreover, foreign agencies have stopped sharing information with Yemen about money laundering. The FIU and the national anti-money laundering committee in Yemen have since been largely disconnected from global anti-money laundering agencies, such as the Financial Action Task Force and the Middle East and North Africa Financial Action Task Force. This leaves Yemen vulnerable to money-laundering and terrorism-financing risks. The current lack of cohesion over definitions, rules and regulations also makes it difficult for commercial and Islamic banks to abide by anti-money laundering and counter-terrorism financing standards.

The central bank in Aden is unable to fully ease the restrictions imposed on Yemeni banks by regional and international entities due to the failure of Yemen to comply with the requirements and procedures of these international parties. The existence of multiple

6) The SWIFT network is the linchpin of international finance, used to transmit payments and letters of credit; without a functioning connection to the SWIFT system, no money could enter or leave Yemen through formal channels, hindering foreign trade and access to international support funds, and increasing money laundering and terrorism financing risks in Yemen.


*CEOs from Yemen's commercial and Islamic banks join the Sana'a Center for a focus group at the Yemeni Banking Association in Sana'a, May 28, 2018. Banks represented at the meeting were: al-Amal Microfinance Bank, Arab Bank Limited, Cooperative and Agricultural Credit Bank (CAC Bank), International Bank of Yemen, Islamic Bank of Yemen for Finance and Investment, al-Kuraimi Islamic Microfinance Bank, Qatar National Bank, Rafidain Bank, Saba Islamic Bank, Shamil Bank Of Yemen And Bahrain, Tadhamon International Islamic Bank, Yemen Bank for Reconstruction and Development, and Yemen Commercial Bank.*

authorities also precludes effective work to prevent money laundering, as well as making banks vulnerable to arbitrary decisions by the judicial, security, tax and zakat authorities of various parties to the conflict.

Furthermore, the Saudi-led military coalition imposed restrictions preventing Yemeni banks from transferring their surplus foreign currency to feed their accounts held abroad; previously, Yemeni banks had moved their cash holdings of foreign currencies to accounts in correspondent banks in other countries. Due to the coalition's restrictions on transfers, Yemeni banks were unable to use their foreign currency holdings to finance imports of goods to meet the population's needs. In November 2018, the Aden-based CBY informed commercial banks that it had reached an agreement with the Saudi Arabian Monetary Agency to facilitate the transfer of foreign cash holdings. As of this writing, however, this has not been implemented.[7]

7) The impact of restrictions on the transfer of foreign currency has been mitigated by the use of smugglers to move cash across borders, although this workaround entails high risks and costs.

# RECOMMENDATIONS FOR REVITALIZING THE YEMENI BANKING SECTOR

- ***Reunify the Central Bank of Yemen***

The absence of a single unified authority to implement coherent monetary policy and regulate the financial sector nation-wide is the most serious challenge facing Yemen's commercial and Islamic banks.8[(8)] The international community must pressure all parties to the conflict to facilitate a reunified administration for the Central Bank of Yemen (CBY), which is currently divided between Houthi-controlled Sana'a and the internationally recognized Yemeni government's temporary capital of Aden. The central bank's reunification should be on the top of the agenda at the United Nations-led consultations between the warring parties in the next round of negotiations. The UN Security Council should adopt a resolution mandating that the UN Special Envoy for Yemen prioritize the reunification of the central bank, and include the threat of international sanctions against any party that attempts to impede the central bank's reunification.

*In the meantime, the following recommendations should also be pursued:*

- ***Reactivate Anti-Money Laundering and Counterterrorism Financing Mechanisms***

The central bank's Financial Information Unit (FIU) and the national anti-money laundering committee should be reactivated to resume anti-money laundering activities, while ensuring their neutrality and the exchange of information globally in accordance with international law and agreements.

Yemen's classification as a high-risk country has led to Yemeni banks being unable to carry out normal financial transactions with foreign banks. This has curtailed their ability to finance international trade, most importantly the importation of basic commodities. Customers needing international financial transfer services have thus been forced to withdraw their funds from the formal economy and utilize informal networks to do so. The increased financial flows through these largely unregulated and unmonitored networks has in turn empowered the very same nefarious financial activities international anti-money laundering and counterterrorism financing policies are meant to prevent.

8) In almost every interview or meeting the author conducted for this research, of all economic matters facing the country the reunification of the central bank was the most salient issue. As a CEO of one of the major private banks in Sana'a said in an interview with the author in May 2018: "If we have a unified central bank, 80 percent of our issues will be solved. Even when the war was ongoing in the first year, we still were able to work because we only had one central bank."

The reactivation of the FIU and the national anti-money laundering committee would begin the process of lowering Yemen's risk category, which would allow banks to reconnect internationally and draw funds back into the formal economy. This is crucial for both Yemeni and international efforts to curb money laundering and terrorism financing.

- ***Release Banks' Retained Balances***

Efforts should be made to fully re-activate the central bank's payment clearing house functions, through which Yemeni banks should be allowed to utilize their currently-frozen balances to meet the urgent demands of customers and pay government dues. Restoring clearing house functions would entail the central bank reapplying a former system in which banks could swap payments over the banking system through utilizing their accumulated balances held by the central bank. This allows banks to avoid cash payments or transfering rial banknotes between Yemeni cities to swap such payments.

In light of the banking sector's need for foreign currency, the central bank in Aden should also work to release banks' foreign currency balances and facilitate banks' requests to transfer these balances abroad to enable international financial transactions and trade.

- ***Facilitate Secure Transfers of Cash Holdings***

The central bank in Aden should establish secure means for commercial banks to transfer their holdings of foreign and domestic currency both within the country and internationally.

Regarding domestic currency holdings: the central bank in Aden should arrange means for commercial banks to transfer Yemeni rial banknotes from Aden to Sana'a to help ease the liquidity crisis banks face in Houthi-controlled areas. Among the options the central bank should consider, at least initially, is arranging deliveries using UN aircraft.

Regarding foreign currency holdings: the agreement, announced in November 2018, with the Saudi Arabian Monetary Agency to facilitate the transfer of Yemeni banks' foreign currency holdings through Saudi Arabia should be implemented as soon as possible. This would enable banks to increase their balances in correspondent banks and strengthen their ability to finance imports of basic commodities and medicines.

- ***Ease Import Financing Requirements, Establish Cash Clearing System***

The central bank in Aden and the Yemeni government's Economic Committee should immediately alter their import financing regulations to allow banks to utilize a defined percentage of their frozen balances, besides cash, to underwrite letters of credit for the importation of basic commodities.

As well, the central bank in Aden should establish a cash clearing system to swap cash payments between banks, money exchange networks and businesses.[9] This should also be set up to handle remittances and international aid funding, and to facilitate the delivery of salary payments made by the Yemeni government to public servants working in Houthi-controlled areas.

The above two actions would accelerate the entire importation process, reduce the risks associated with transferring physical banknotes between Houthi-controlled areas and Aden, and assist the banking sector in mitigating its liquidity crisis.

- ***Replace Damaged Banknotes***

The central bank in Aden should prioritize the replacement of damaged banknotes currently stockpiled by the banking sector. A mechanism should be developed to mediate between the Aden and Sana'a central bank branches to facilitate the safe delivery of replacement banknotes to all Yemeni governorates. This could be included among the UN Special Envoy for Yemen's economic deescalation measures. All efforts must be made to pressure the Houthi authorities to reverse their current policy of refusing to recognize as official currency newly printed banknotes issued from Aden.

- ***Restart Partial Public Debt Servicing***

As commercial and Islamic banks have been large investors in domestic debt instruments, the central bank in Aden should take steps to repay these investments. Initially, this should involve cash payments on accrued interest, while the central bank should endeavor to pay down the principal on matured debt once the government budget deficit improves. Importantly, the central bank should make cash payments, rather than use checks, in order to increase liquidity in the banking sector. This would allow banks to meet customers' cash needs and attract financial flows back into the formal economy.

9) The cash clearing system is a mechanism to reduce the financial burdens and risks commercial banks incur in transferring Yemeni rial banknotes from Houthi-controlled areas to Aden to open letters of credits (LCs). These LCs were made available under the import financing mechanism established by the central bank in Aden and the associated Economic Committee in June 2018 to regulate the importation of five basic food commodities.

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