

Liquidity Risk Management: A Regulatory Perspective



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THE FEDERAL RESERVE BANK OF RICHMOND

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Supervisory Guidance: Sound Liquidity Risk Management Practices

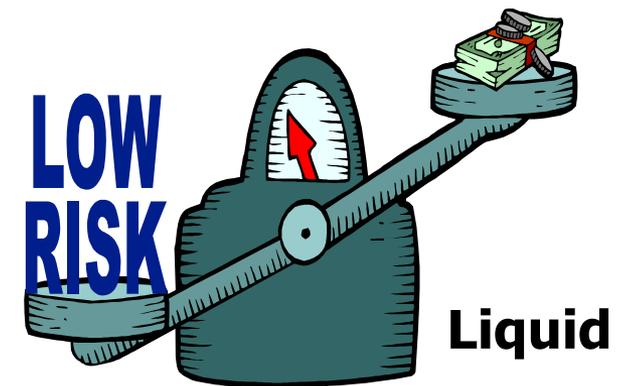
- Elements of Liquidity risk
- Beyond the stated ratio
- Cash Flow Projections
- Scenario Analysis
- Contingency Funding Planning

- **Greater emphasis on liquidity risk management processes**



BEYOND THE STATED RATIO

A Closer Look at Asset Liquidity



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- FFS
- US Treasuries
- US Agency
 - Bullet, MBS, CMO
- Municipal
- Corporate
- 1-4 Family Loans
- CRE/C&I
- Consumer (auto, Heloc, Credit card)
- Agriculture





BEYOND THE STATED RATIO

A Closer Look at Liability Liquidity

Core

Retail

Stable



Non-core

Wholesale

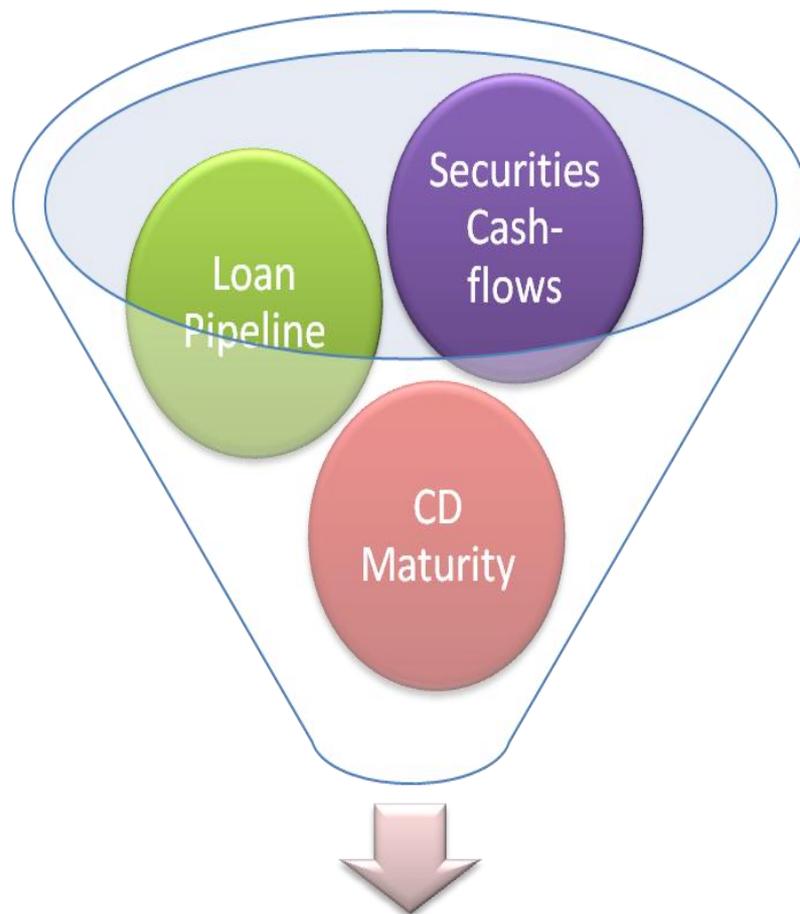
Volatile

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- Core DDA, MMDA, Savings, CDs
- FFP and Repurchase Agreements
- FHLB Borrowings
- Brokered Deposits
- Unsecured/Sub Debt
- Commercial Paper





Pro-Forma Cash-Flow





Comprehensive Contingency Funding Planning

- **Quantitative Assessment / Adverse Scenario Analysis**
- **Narrative Assessment**



Contingency Funding Plan

Quantitative Section / Adverse Scenario Analysis

- Start with “business-as-usual” forward-looking cash flow report
- Identify and incorporate potential adverse events
- Assess levels of severity and timing of events
- Crisis should hit where bank is vulnerable, with scenario severe enough to cause substantial funding disruption
- Evaluate funding sources and needs
- Identify potential alternative funding sources

Scenario Analysis allows for more comprehensive risk measures

Results from scenario analysis should feed into contingency funding plan!



TYPES OF ADVERSE SCENARIOS

- Institution Specific:
 - Asset Quality Concerns
 - Capital levels deteriorate (PCA Guidelines)
 - FHLB Collateral Requirements change
 - Rapid Asset Growth
 - Loss of Large Depositors/Municipalities
 - Correspondent Lines of Credit Terminated
 - Operational Risk/Fraud
 - Reputation Risk Event
- Systemic:
 - Uncertainty in Market
 - Federal Funds Market Disruption
 - Breakdown of Brokered Deposit Market
 - FHLB Funding Difficulties (market disruption)
 - Systemic Credit Crisis





Contingency Funding Planning

Narrative Section / Administrative Matters

- **Establish liquidity-event management processes**
 - Description of stress scenarios / trigger events
 - Delineate levels of stress severity
 - Contact information for critical team members
 - Assignment of responsibility to initiate external communication
 - Required communication flow between lines of business
 - Action plans to execute strategy
 - Detailed risk reporting and frequency





Contingent Liquidity Planning

- **Cushion of Liquid Assets**
- Test ability to sell or pledge loans
- Establish (and test) Federal funds lines of credit
- Drawing down committed facilities
- Understand FHLB capacity
- Lengthening liability maturities
- Diversify funding sources / alternative funding vehicles
- Accessibility to Discount Window and Term Auction Facility
- Retail promotional programs
- Public Relations



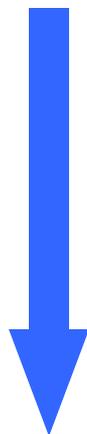


Independent Review

Assess the adequacy of liquidity risk management relative to the risk profile



Verify compliance with policy / procedure for accuracy



Assess reasonableness of assumptions



Identify material risk profile changes





Examination Expectations

- Greater emphasis on liquidity risk management processes (the qualitative aspect)
- Institutions should be looking to diversify funding sources as well as ‘test’ access to sources
- Examiners are encouraging institutions to look at underlying characteristics of assets and liabilities (and beyond regulatory definitions)
- Examiners are encouraging institutions to move towards cash flow modeling over time (to complement static ratio analysis)
- Examiners are encouraging institutions to utilize adverse scenario analysis for liquidity planning and contingency funding purposes
- Lack of appropriate liquidity risk management practices may result in a downgrade of the liquidity rating and/or result in matters requiring attention (or immediate attention)





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