



Liquidity Risk

“L” Stands for Liquidity, Losses (Unrealized), Lines (Virtual Instead of Around the Block), and Lightspeed (Withdrawals)

San Francisco Region
Community Bankers Workshop 2024/2025

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Discussion Points

- Board Oversight and Management Responsibilities
- Contingency Funding Plan
 - Overview
 - FRB Discount Window
 - FHLB Borrowings
- Examination Observations and Focus
- Liquidity Case Study
- Resources





Board Oversight & Management Responsibilities

Board Oversight

The board should ensure:

- Understand the nature of liquidity risks and review monitoring reports
- Establish and approve liquidity management strategies
- Establish lines of authority and responsibility for managing liquidity risk

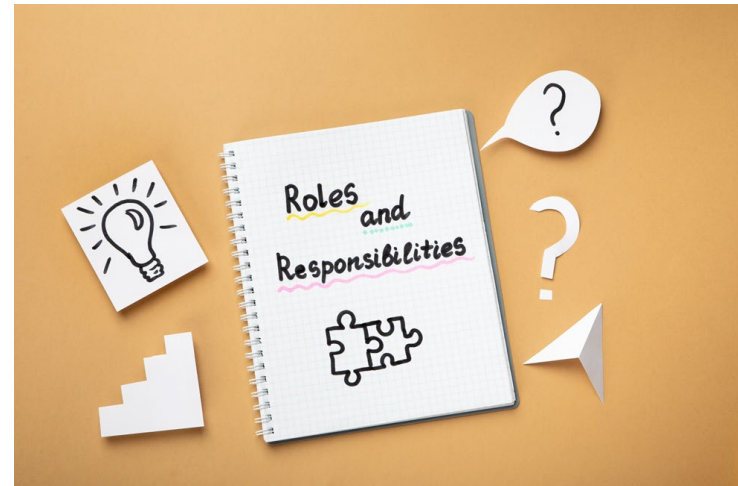




Board Oversight

The board should ensure:

- Enforce management's duties to identify, measure, monitor, and control liquidity risk
- Understand and periodically review the CFP
- Establish and communicate risk tolerances to management



Board Oversight

FDIC Rules and Regulations Part 364 Appendix A.II.F – Asset Growth

An institution's asset growth should be prudent and consider:

- 1. The source, volatility and use of the funds that support asset growth;**
2. Any increase in credit risk or interest rate risk as a result of growth; and
3. The effect of growth on the institution's capital



Management Responsibilities

Risk measures and reporting systems

Independent control infrastructure

**Liquid asset buffers
(cash, unencumbered marketable securities,
and market instruments)**

Regular reporting to the Board

Contingency Funding Plans

Management Responsibilities: Independent Review

Assesses the adequacy of risk identification, risk measurement and reporting

Checks the adherence to policies and procedures

Fosters compliance with rules and regulations

Reports instances of noncompliance

The Board, or committee thereof, should receive the final report from the independent reviewer.



Contingency Funding Plan



Contingency Funding Plan – Overview

Roles and
Responsibilities

Communication
Plan

Early Warning
Indicators

Low Probability
High Impact
Liquidity Events

Funding Plans

Operational
Testing Plan

Stress Testing
Schedule &
Frequency

CFP – Overview: Traditional Stress Scenario

**Macroeconomic events
supplemented by
institution-specific
information**

**Front loaded impacts
with feasible funding
plans**

**Sufficiently severe
impacts**

**Model of entire event
timeframe**

**Measure liquidity
level at each period**



CFP – Overview: Current Stress Scenario

Accelerate assumed runoff events to account for technological advancements:

- Management should recognize that technology has impacted potential **speed** of withdrawals
- Scenarios should reflect stressful assumptions for the **timing** of outflows
- **Granular** time buckets should be used to capture impact of potential immediate withdrawals
- Assumptions on contingent funds availability should reflect time to **settle** the transaction

Source: Ask The Regulators: Supervisory Update on Funding and Liquidity Risk Management, Q&A, May 2023

CFP – Overview: Stress Scenario

Common weaknesses in severe stress scenarios:

- Deposits “walk” rather than “run,” especially considering uninsured deposit levels
- Deposit growth offsets runoff
- Loans not funded or renewed
- Unsecured funding lines fully available
- Funding lines lend immediately to full availability
- Brokered deposits utilized

CFP – Overview: AOCI

Accumulated other comprehensive income (AOCI) impact on CFPs:

- If an institution opts-out of AOCI treatment, unrealized losses on AFS securities will not impact regulatory capital ratios, but will reduce GAAP equity capital
- Funds providers will look at the market value of pledged securities
- Funds providers may consider GAAP capital in assessing a bank's creditworthiness

CFP – Overview: AOCI

Accumulated other comprehensive income impact on CFPs:

- Funds providers may be restricted by law or policy from lending to banks with low or negative GAAP equity or tangible capital
- Contingency funding plans and liquidity scenario analyses should consider these impacts, if applicable

CFP – FRB Discount Window

Strong Contingency Funding Plans:

- Test borrowing arrangements periodically
- Account for time to move securities to safekeeping and for test trades
- Note the differences between primary, secondary, and emergency credit

Securities are pledged through an approved safekeeping agent

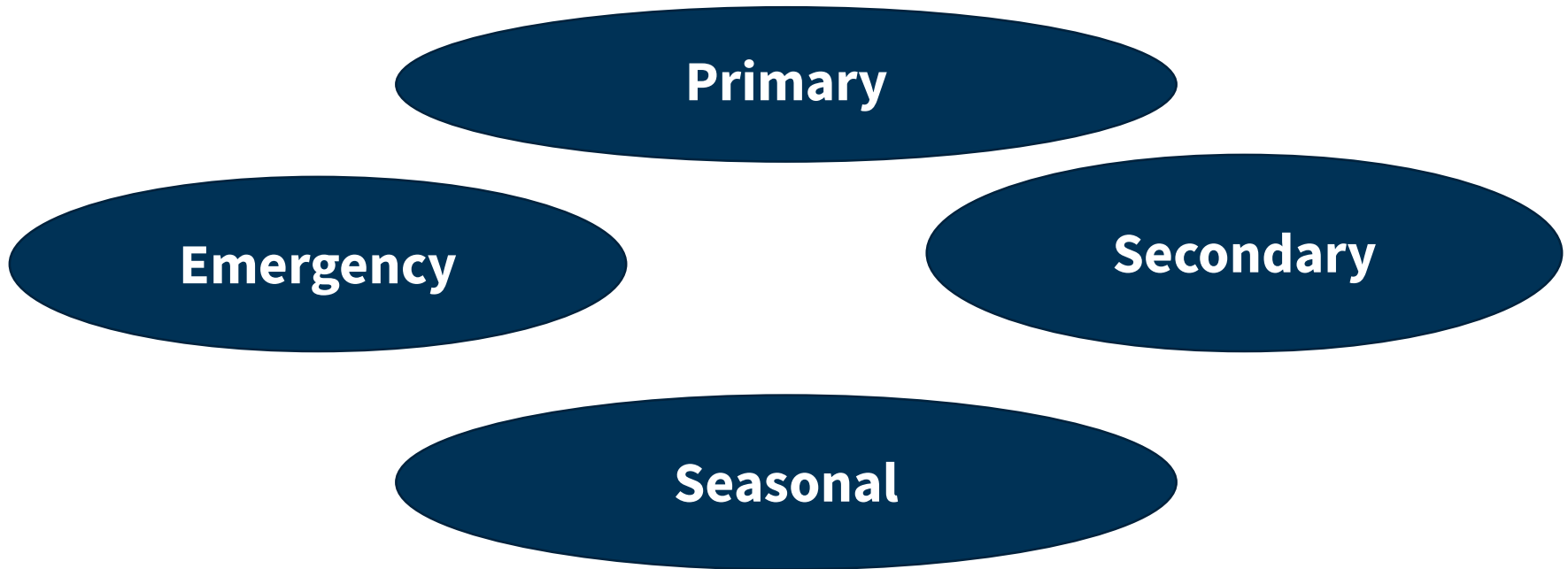
Potentially Eligible Collateral*

- Municipal Bonds
- Corporate Bonds
- Asset-Backed Securities (ABS)
- Collateralized Debt Obligations (CDOs)
- Collateralized Loan Obligations (CLOs)
- Agency-Backed Mortgage Securities
- Non-Agency Residential Mortgage-Backed Securities (RMBS)
- Commercial Mortgage-Backed Securities (CMBS)
- Trust Preferred Securities (TPS)
- Loans

**Collateral acceptance is contingent on conditions, visit frbdiscountwindow.org for a full listing*

CFP – FRB Discount Window

Four types of lending facilities:



CFP – FRB Discount Window

Potential Limitations:

- There are conditions to collateral acceptance
- Securities must be pledged through an approved safekeeping agent
- Portfolio review and/or testing requirements may delay finalizing the line



CFP – FHLB Borrowings

Advances:

- Fully collateralized
- Credit available between 20% and 60% of total assets
- Fixed, variable, hybrid, or convertible rate terms
- Maturities range from overnight to 30 years
- Advance terms can include call options



CFP – FHLB Borrowings

Potentially Eligible Collateral:

- UST/US Agency Bonds
- Mortgage-Backed Securities
- Single-Family Mortgages
- Commercial Real Estate Loans
- Collateralized Mortgage Obligations
- Real Estate-Based Loans

Potential Limitations*:

- Positive Tangible Capital (Includes AOCI)
- Safety and Soundness
- CRA
- Lendable Collateral Value
- Collateral Inspections
- Timing of Advance
- Size of Advance

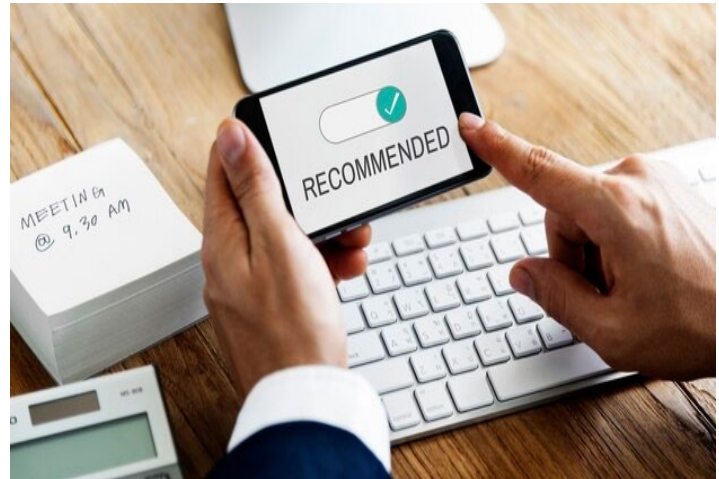
***Not a full listing. Refer to your FHLB's Membership Guidelines for full eligibility requirements.**



Examination Observations and Focus

Exam Observations and Focus

- Management oversight
- Stress testing
- Contingency funding plan
- Liquidity levels
- Policies and procedures



Exam Observations and Focus

Some things change...some stay the same...

Industry guidance remains the same, but examination focus will look at updated assumptions:

- Stress testing
- Contingency funding plans
- Cash flow projections

Exam Observations and Focus

Some things change...some stay the same...

Industry guidance remains the same, but examination focus will also emphasize:

- Testing of borrowing lines
- Funding diversification
- Board and management oversight

Exam Observations and Focus

Some things change...some stay the same...

There have been changes in the Report of Examination and Examination Manual:

- Concentrations page updated for uninsured deposits
- Examination manual updated to focus attention on uninsured deposit risks

Exam Observations and Focus

Not every “core” deposit is core...

Despite a UBPR definition as “core,” some categories of deposits have characteristics that are less stable:

- Out of area, less than \$250,000
- Fiduciary accounts
- Uninsured transaction accounts
- Listing service accounts, less than \$250,000
- Accounts with high interest rates

Exam Observations and Focus

Not every “core” deposit is core...

Despite a UBPR definition as “core”, some categories of deposits have characteristics that are less stable:

- Reciprocal deposits
- Primary purpose exception accounts

Liquidity Risk





Case Study

Liquidity Risk – Case Study

What would you rate Liquidity? And, why?



Liquidity Case Study

Liquidity Definition – 2 Rating

A rating of 2 indicates **satisfactory** liquidity **levels** and funds management **practices**. The institution has access to sufficient sources of funds **on acceptable terms** to meet present and anticipated liquidity needs. **Modest weaknesses** may be evident in funds management **practices**.

Liquidity Case Study

Liquidity Definition – 3 Rating

A rating of 3 indicates liquidity **levels or funds management practices in need of improvement**. Institutions rated 3 may lack ready access to funds **on reasonable terms or** may evidence **significant weaknesses** in funds management practices.

Liquidity – Case Study:





Resources

Resources

- [Interagency Policy Statement on Funding & Liquidity Risk Management \(FIL-13-2010\)](#)
- [FDIC's Supervisory Insights Journal, Summer 2017, "Community Bank Liquidity Risk"](#)
- [FDIC Risk Management Manual of Examination Policies – Section 6.1](#)
- [Capital Markets Resource Center](#)
- [Banker Resource Center](#)
- [Federal Reserve Discount Window](#)
- [Bank Term Funding Program](#)
- [FHLB San Francisco Resource Center](#)

