



## Supervisory Update on Funding and Liquidity Risk Management

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- ▶ Chris Dietz, Indiana Department of Financial Institutions and CSBS
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- ▶ Suzanne Clair, Federal Deposit Insurance Corporation
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## Welcome everyone

- Today's session
- Questions:
  - Email your question to: [asktheregulators@stls.frb.org](mailto:asktheregulators@stls.frb.org)
  - or
  - Use the “Ask Question” button in the webinar tool
- This call is being recorded and will be available immediately following the session.
  - Archived recording can be accessed using the same link as today's webinar.
- A survey will be delivered via email following the call. Let us know your thoughts or ideas for future sessions.



## Goals of Today's Session

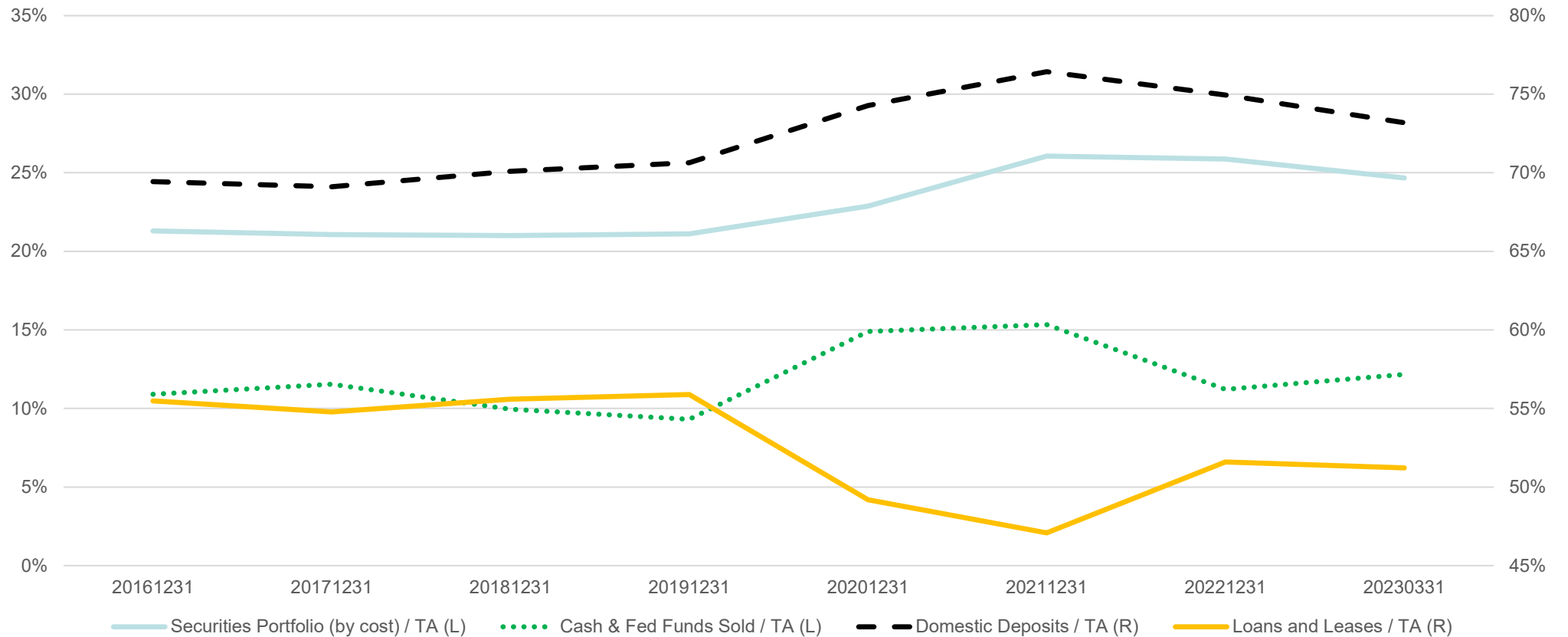
Communicate to bankers the following key points:

- How the rising interest rate environment and recent stress has impacted banks' balance sheet strategies and liquidity.
- Principles for sound funding and liquidity risk management practices that are outlined in the 2010 interagency policy statement.
- The importance of liquidity stress testing and the use of appropriate assumptions and effective contingency funding plans.
- Supervisory focus on funding and liquidity risk management, including what to expect during upcoming safety and soundness examinations.



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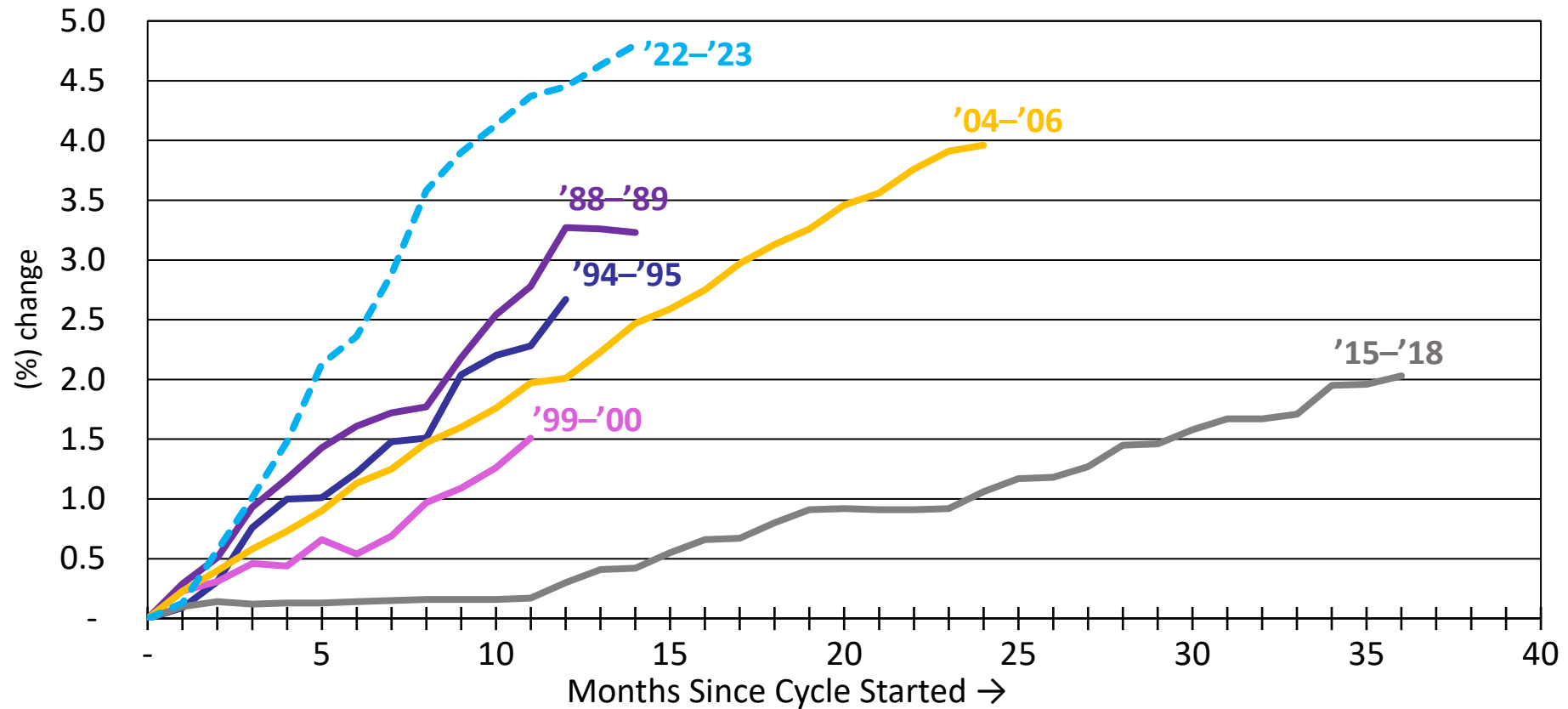
## The Effect of Rising Interest Rates on Banks' Balance Sheets and Liquidity



Source: Call Report filings



## Change in Effective Federal Funds Rate

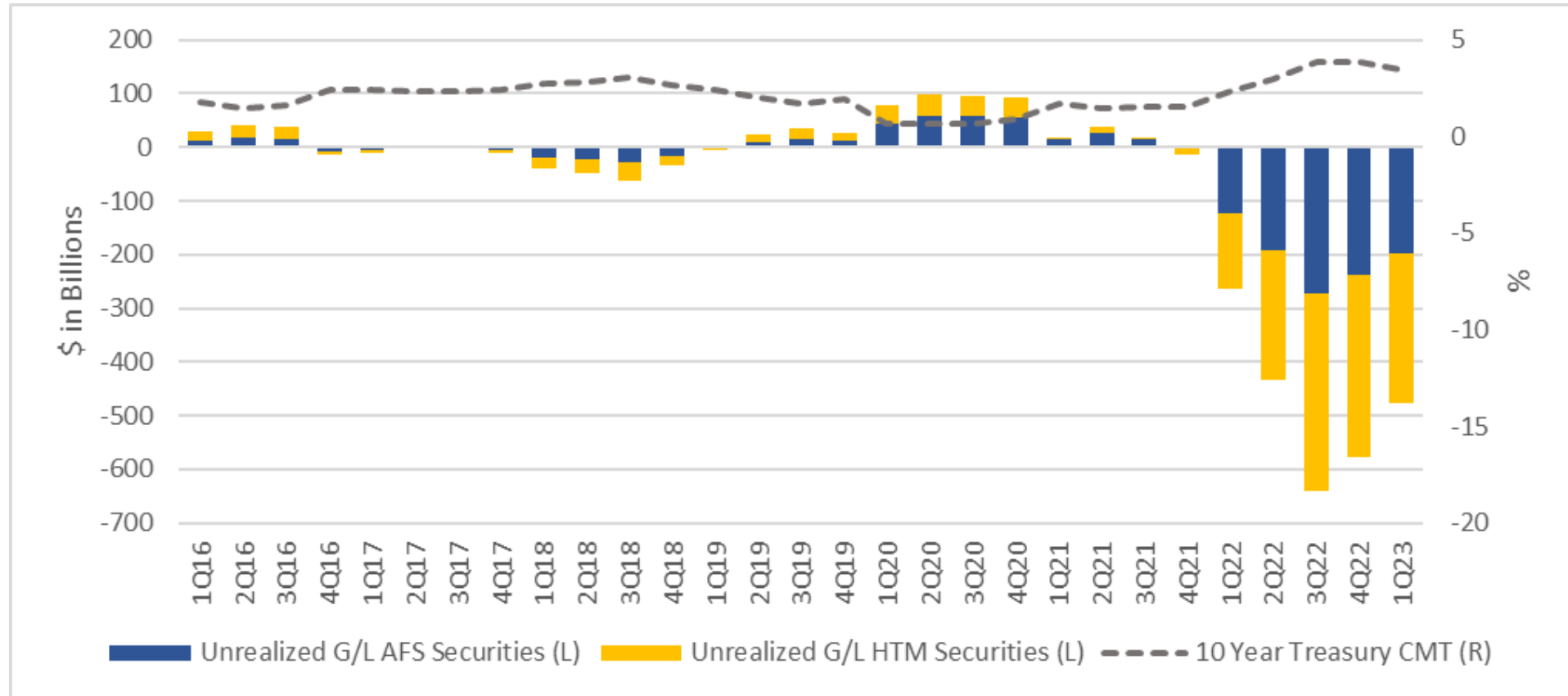


Source: Board of Governors of the Federal Reserve System (H.15 Selected Interest Rates, downloaded using the Federal Reserve Bank of Saint Louis's FRED Tools). Change is calculated as the monthly average level.



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## Unrealized Losses on Debt Securities



Source: Call Report filings for Unrealized G/L and Federal Reserve Bank of Saint Louis's FRED Tools for 10 year Treasury CMT



## Interagency Policy Statement on Funding and Liquidity Risk Management (2010)

- The Policy Statement provides:
  - Recommended governance and risk management practices.
  - The principle expectation that banks manage funding and liquidity risk using processes and systems that are commensurate with their complexity, risk profile, and scope of operations.
  - Critical elements of sound liquidity risk management.



## Critical Elements of Sound Liquidity Risk Management

- Effective corporate governance by board of directors and management
- Appropriate strategies, policies, procedures, and limits
- Comprehensive liquidity risk measurement and monitoring systems
- Active management of intraday liquidity and collateral
- A diverse mix of existing and potential future funding sources
- Adequate levels of highly liquid marketable securities
- Comprehensive contingency funding plans (CFP)
- Internal controls and internal audit processes





## Strategies, Policies, Procedures, and Limits

- Appropriate strategies, policies, procedures, and limits help to manage and mitigate liquidity risk. They should:
  - Identify primary funding sources to meet daily cash outflows and plans/actions for dealing with potential and actual liquidity disruptions.
  - Articulate the approved liquidity risk tolerance.
  - Document and periodically review assumptions used in projections.
  - Employ quantitative targets and qualitative guidelines that include measurements, limits, and guidelines addressing:
    - Cash flow projections under expected and adverse conditions / Target amounts of unencumbered liquid asset reserves / Measures used to identify less stable liabilities and liquid asset coverage ratios / Asset concentrations / Funding concentrations / Funding risks / Contingent liability exposures



## Risk Measurement, Monitoring, and Reporting

- Comprehensive liquidity risk measurement, monitoring, and reporting systems:
  - Liquidity risk reports should provide sufficient supporting detail to assess the institution's sensitivity to changes in market conditions, the bank's financial condition, and other risk factors.
  - Provide senior management and the board timely reports on liquidity risk exposure and compliance with approved risk limits and risk tolerance.
  - Implement robust methods for comprehensively projecting cash flows over appropriate time horizons.



## Intraday Liquidity and Collateral Management

- Institutions should actively manage their intraday liquidity positions and risks to ensure they meet obligations on a timely basis under both normal and stressed conditions.
- Effective intraday liquidity and collateral management teams:
  - Monitor and measure expected daily gross liquidity inflows and outflows.
  - Manage and mobilize collateral when necessary to obtain intraday credit.
  - Calculate collateral positions for pledged and unencumbered exposures in a timely manner, and understand operational and timing requirements associated with accessing the collateral.



## Diversified Funding Sources

- Institutions should establish a funding strategy that provides effective diversification in both the sources and tenor of funding. An appropriately diverse funding strategy should:
  - Include a diverse mix of existing and potential future funding sources across varying time frames.
  - Maintain an ongoing presence in its chosen funding markets and strong relationships.
  - Regularly confirm and test its capacity to raise funds quickly from each source.
  - Identify and monitor the main factors that affect its ability to raise funds.



## Unencumbered Liquid Assets

- Institutions should maintain adequate levels of highly liquid marketable securities/liquid assets to be used to meet liquidity needs in stressful situations by:
  - Maintaining a buffer of liquid assets that can be easily and immediately converted into cash.
  - Estimating liquidity needs during periods of stress that incorporate contractual and noncontractual cash flows and the possibility of funds being withdrawn.
  - Ensuring that unencumbered, highly liquid assets are readily available, of high quality, and are able to be operationally monetized.



## Scenario and Stress Testing

- Informs funding and liquidity risk profile and are critical for effective risk measurement.
- Should include sensitivity analysis for a range of institution-specific and market-wide systemic shocks across varying time horizons.
- Provides support and information that shapes contingency funding plans.
- Provides support and insights for liquid asset needs.



## Scenario and Stress Testing Assumptions – Supervisory Observations

- Assumptions for cash flow projections should be reasonable, documented, and regularly reviewed.
- Detailed deposit stability analysis and runoff assumptions are especially important in the current environment.
- Investment portfolio assumptions (liquidity, duration, sensitivity)
- Funding Access: Secondary market borrowings including FHLB, discount window, federal funds, secured lines, etc.



## Contingency Funding Plans (CFP) – Supervisory Observations

- Policies, procedures, results from stress tests, and action plans are all essential components of CFP.
- CFP should address elevated levels of unrealized losses as well as potential further losses on liquidity value of investment securities.
- Operational readiness to tap contingent funding sources is key.
  - Bank management is encouraged to establish discount window or Bank Term Funding Program access.
  - Institutions will not be criticized for establishing/testing these lines.





## Supervisory Focus – What to Expect

- Open dialogue regarding proactive Asset Liability Management.
  - Evaluate liquidity modeling results and assumptions.
  - Closely review deposit and outflow monitoring capabilities, including uninsured and other less stable funding sources and intraday exposures.
  - Focus on effective contingency funding planning and execution.
  - Review operational capabilities to tap contingent funding channels, including the preparations for placing collateral.



## Supervisory Focus – What to Expect (cont.)

- Uniform Financial Institutions Rating System (UFIRS) liquidity rating.
- Ongoing contacts outside the examination process may occur.
- Encourage bank managers to reach out to reach out to their field, regional, or district supervisory staff.



## Liquidity Resources

- [Ask the Fed® Discount Window Mechanics](#)
- [Ask the Fed® The Bank Term Funding Program - Overview and Program Details for Depository Institutions](#)
- [2010 Interagency Policy Statement on Funding and Liquidity Risk Management \(Federal Register-govinfo.gov\)](#)
  - [OCC Bulletin 2010-13 Interagency Policy Statement on Funding and Liquidity Risk Management](#)
  - [FDIC FIL-13-2010 - Funding and Liquidity Risk Management Interagency Guidance](#)
  - [Federal Reserve Board - SR Letter 10-6: Interagency Policy Statement on Funding and Liquidity Risk Management](#)
- [OCC Liquidity Handbook Version 1.1 updated August 16, 2021](#)
- [Federal Reserve - Supervisory Policy and Guidance on Liquidity Risk Management](#)
- [FDIC Liquidity and Funds Management Manual \(section 6.1\)](#)
- [Federal Reserve Banks - Operating Circular No. 10](#)
- [CSBS website](#)



## To Ask a Question:

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**Thanks for joining us.**