



# LIQUIDITY RISK MANAGEMENT

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PRESENTED BY: LISA M. THOUIN, CPA, CGMA

JOINT FMS NY/NJ & NJ BANKERS ASSOCIATION  
HALF DAY CFO CONFERENCE

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# Your Presenter

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# The Agenda

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- Key Happenings Past Decade
- May 2010 Regulatory Guidance
- Recent Regulatory Comments
- Keys to Success

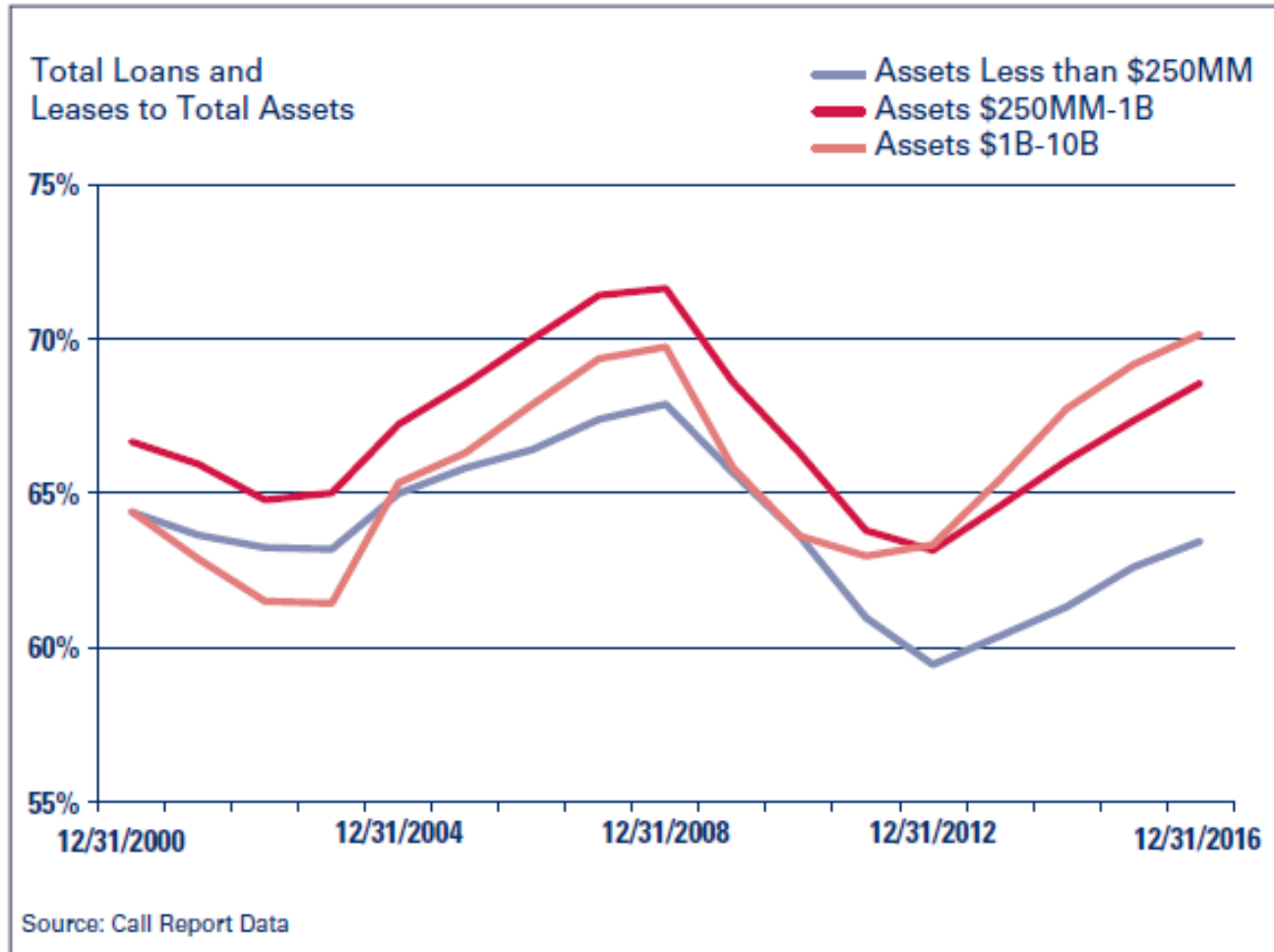
# Key Happenings of Past Decade

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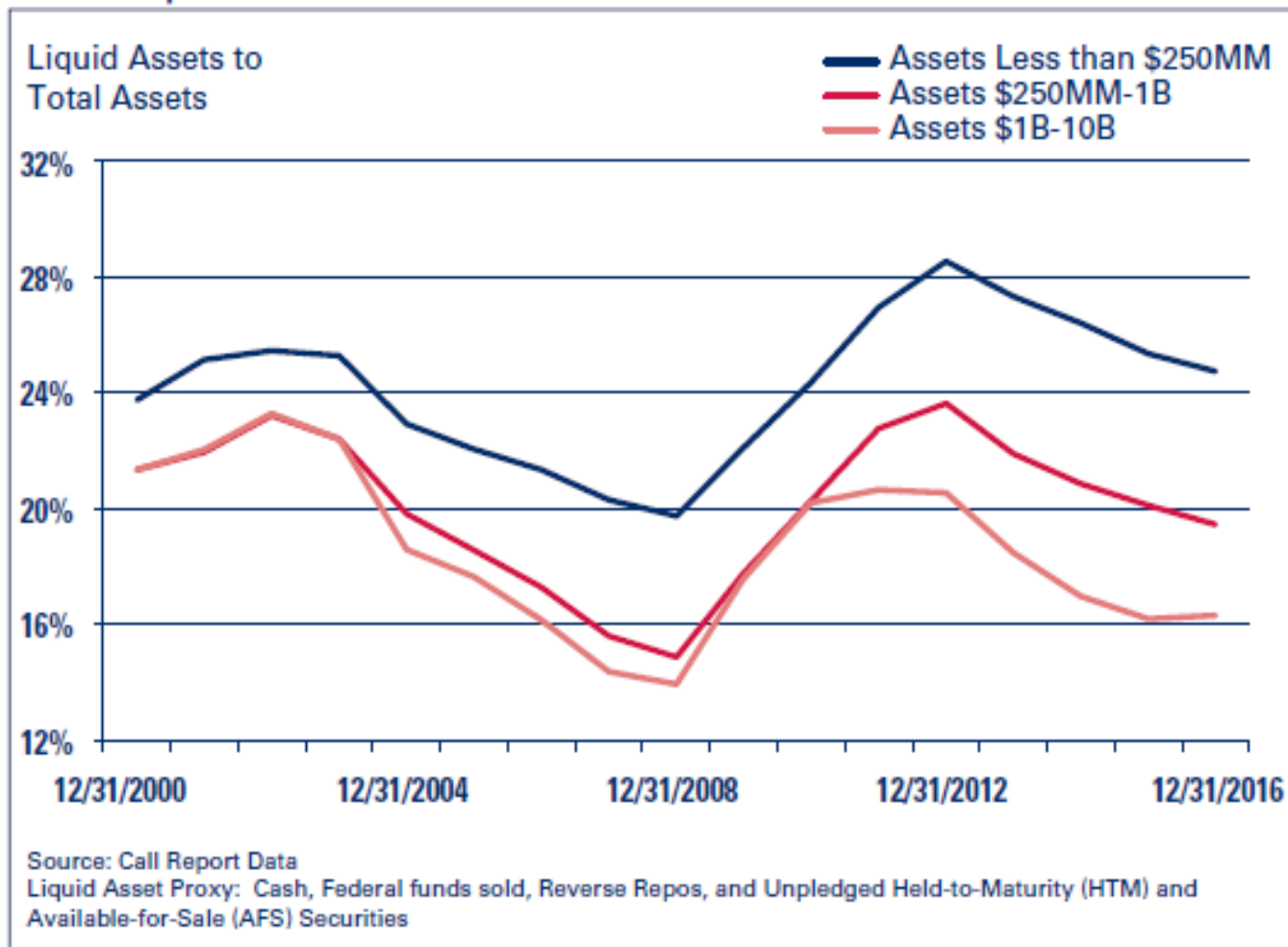
- Extended period of historically low interest rates
- Notable build up of non-maturity deposits
- New channels with quick access for customers to shop
- Expanding economy and rising rates
- Heightened regulatory concerns



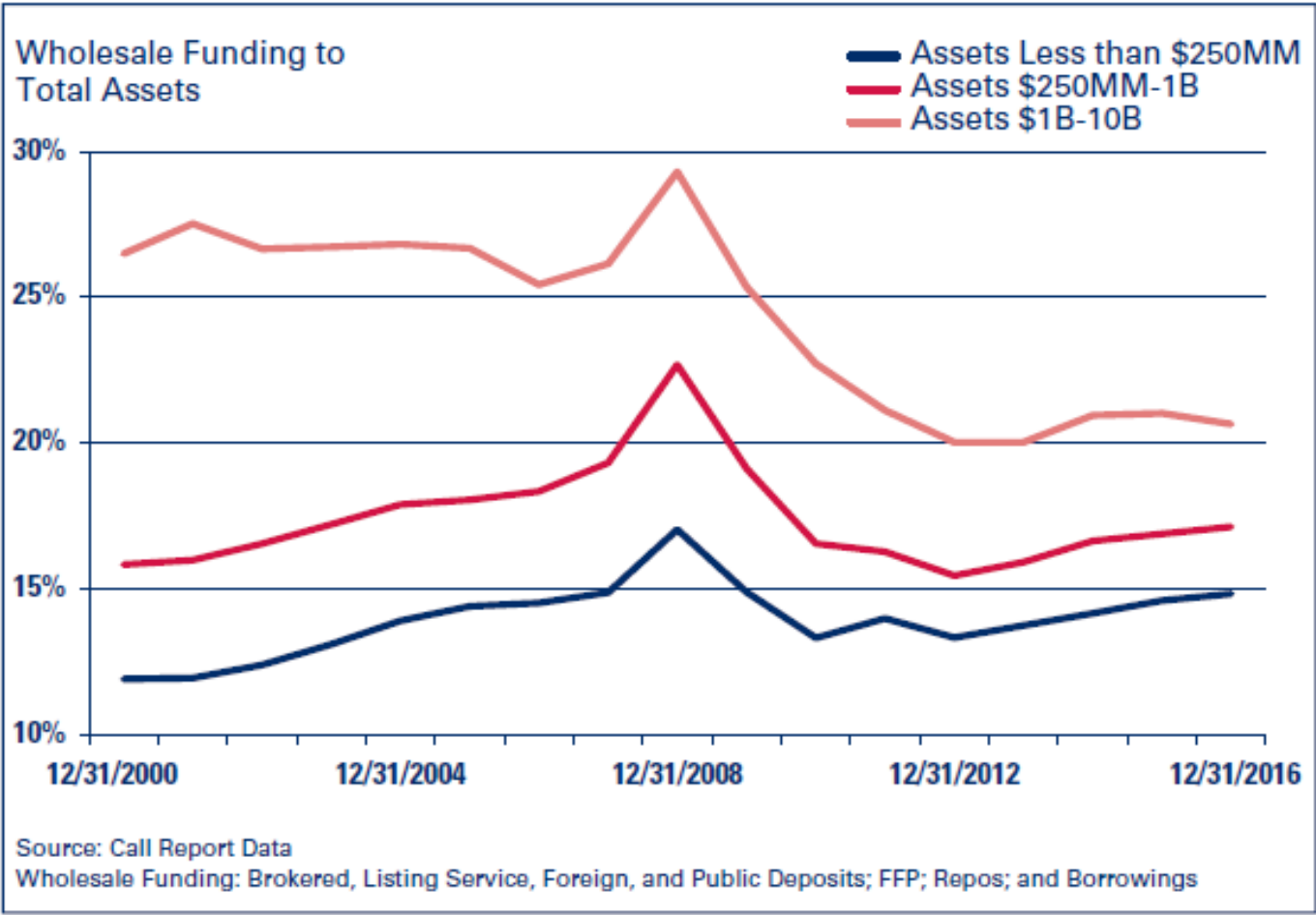
# Loans and Leases on the Rise After Retreating Post-Crisis



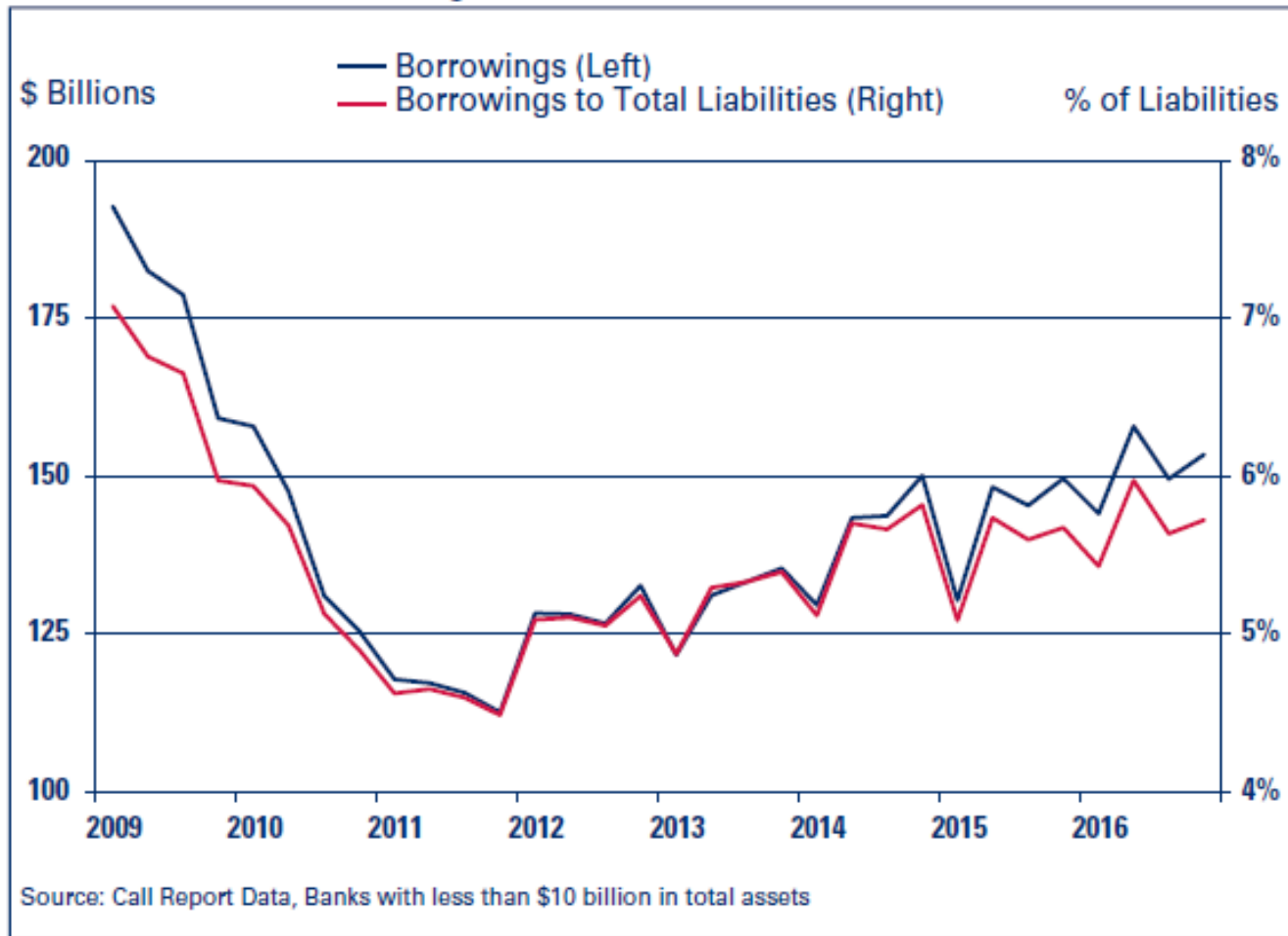
# Liquid Assets Rebound Then Retreat Post-Crisis



# Wholesale Funding Reverses Post-Crisis



# Reliance On Borrowings Has Reversed From Post-Crisis Lows





# May 2010 Regulatory Guidance



# Emphasis on Tools for Monitoring

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- Cash flow projections – current and prospective
- Stress testing
- Diversified funding sources
- Cushion of liquid assets
- Well-developed CFP (Contingency Funding Plan)

# Additional Points of Guidance

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- Integration with other risk management activities
- Effective Corporate Governance
  - Oversight of board
  - Active management involvement in control of liquidity risk
- October 2017 Interagency Community Bank Teleconference
  - 2010 guidance reinforced



# Recent Regulatory Comments

# Regulator Comments

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- **Policies**

- Bank has not implemented liquidity and CFP policies and procedures ***that are appropriate*** for risk profile of bank.
- Policies lack limits for potentially volatile funds
  - <25% of total assets
- Changes in policy limits not substantiated

- **Reporting**

- Provide executive summary section of liquidity report
  - Explain results of stress tests

- **Assumptions**

- Define and support all stress test assumptions

# Management Should Re-Evaluate / Expand Stress Scenarios

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- Require different corrective actions such as negative reputation risk causing significant deposit run off

- Include asset financial deterioration erosion scenarios



quality and performance and capital

- Incorporate deposit rate restrictions

# Management Should Re-Evaluate / Expand Stress Scenarios *(cont'd)*

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- Segment various loan portfolios as each portfolio offers different degrees and types of risk
- Consider exposure large depositors and accounts and volatility of high-rate deposit
- Conduct on severe and crisis scenarios at same time





# Recent Regulator Comments

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- **Potentially volatile funding sources**

- Monitoring large depositor accounts
- Analyze deposit rates offered and other sources

- **Off balance sheet commitments**

- Establish limits and implement monitoring procedures

- **Cash flow projections**

- Expand to include medium and long-term horizons



# Current Events – Fed Hikes Interest Rates

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- Federal Reserve raised target range for federal funds rate by quarter point to range of 1.5 - 1.75% during March 2018 meeting, in line with market expectations, saying the economic outlook has strengthened in recent months.
- Fed raised growth forecasts for 2018 and 2019; projections point to an extra rate increase in 2019.



# Looking Ahead

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- Fed expected to raise rates 3 more times this year
- Increased competition could put further pressure on loan spreads
- Deposit migration likely but the level uncertain
- Timing and degree of deposit rate increases are a question
- Alternative funding use and capacity will be challenged

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# Keys to Success



# Elements For a Successful Program

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## 1. Effective policy limits

- Minimum and maximum



## 2. Solid measuring and monitoring process

- Appropriately detailed
- Asset-based liquidity position and needs
- Forecast of cash flows

# Elements For a Successful Program

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3. Implement a stress testing process with defined scenarios appropriate for your bank



4. Document and maintain a liquidity contingency plan that can be relied on in event of various liquidity events or crisis

# ALCO Strategies

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- Focus on managed balance sheet growth / use of leverage
- Use scenario analysis and stress testing to inspire strategic ideas and decision making
- Cover both
  - Short-term operational liquidity needs
  - Longer-term operational and contingency needs
- Increase understanding of retail deposits and deposits at risk



# Deposit Assumptions

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- **Challenges:**

- Traditional deposit studies provide limited insight for liquidity management
- Most institutions did not (are not) experience(ing) liquidity issues
- Merger and acquisition clouds the picture

- **Consider**

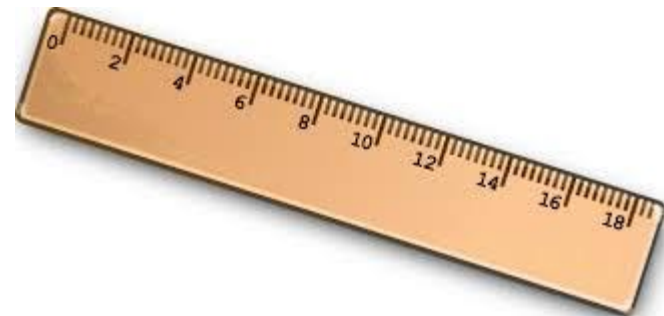
- Segmentation analysis and strategies
  - Pay up for rate sensitive funds
  - Don't pay up for non-rate sensitive funds
- Monitor deposit activities during next rate cycle

# Key Measures & Ratios

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- **Traditional measures not so reliable**

- Loans/deposits
- Non-core funding dependency ratios
- Liquid assets



- **Today's approach**

- On-balance sheet liquidity
  - Liquidity sources (cash, due from banks, accrued interest receivables, unpledged securities AFS) / Liabilities (total deposits and ST borrowings)
- Wholesale funding alternatives/diversification
- Stress testing and contingency funding planning



# Developing Stress Assumptions

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- Look at your institution's history/worse experiences
- Perform studies /leverage business initiatives
  - Deposit behaviors
  - Concentrations – large depositor, business/industry dependence
  - Research events of other institutions



# Build a Scenario

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- Cover general and unique risks your institution faces
- Make them plausible and impactful
- Consider low probability/high impact scenarios too
- Define the events that would cause those factors to occur or matter



# Liquidity Sensitivity Factors

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- Large deposit run off
- Loss of wholesale / non-core funding
- Reduction in loan repayments
- Devaluation of investment portfolio
- Freezing of markets (loan sales)
- Loan growth > deposit growth



# Contingency Funding Plan Success

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- Identify scenarios – what would happen if
- Narrative – tell the story
  - Document assumptions
  - Simulate impact on net cash flows
  - Document remediation strategies
- Document step-by-step crisis management execution, including roles and responsibilities, contact information



# *The Take-Away?* Be Proactive!

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- Expand stress-testing practices
- Improve liquidity-monitoring processes
- Enhance CFP
- Dive deeper into deposit analysis
- Update policies and governance practices
- Leverage liquidity stress testing at ALCO





# *Questions?*



# Contact

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