Liquidity Contingency Funding Plan (# 272)

As the competition for retail deposits and their costs continues to increase, more banks have sought to improve their liquidity by reducing the size and liquidity of their investment portfolios and by expanding their wholesale funding sources. While the availability of diverse funding sources can reduce liquidity risk and regulators acknowledge the benefits of wholesale funding, bank managers are expected to be prepared for a more rapid funding erosion during times of stress. Regulatory guidelines call for realistic, written contingency funding plans that are supported by quantified stress testing and new liquidity metrics customized to match the banks' balance sheets. According to the *Interagency Guidance on Funding and Liquidity Risk Management*, all financial institutions, regardless of size and complexity, should have a formal contingency funding plan (CFP) that clearly sets out the procedures for addressing liquidity shortfalls in emergency situations.

The Liquidity Contingency Funding Plan template developed by Young & Associates, Inc. enables you to:

- **Identify stress events**. These are unexpected situations or business conditions that may create liquidity pressures. Stress events may occur for a variety of internal or external reasons, such as unexpected changes in credit risk, operational disruptions, rapid deposit erosion, or inability to access contingent funding facilities.
- **Identify early warning indicators and their monitoring system**. These indicators should signal any negative trends in the bank's internal and external environment and, in case of a potential vulnerability, should trigger a response by the management mitigating the bank's exposure to the emerging risk.
- **Define stress levels**. The various levels of stress severity should trigger different actions and contingency funding strategies.
- **Identify alternative funding sources.** Liquidity pressures may spread from one funding source to another during a stress event, and not all of the existing funding options may be available in all circumstances. Bank management should maintain ongoing communications with alternative funds providers and regularly test its fundraising options to evaluate their effectiveness at providing liquidity in both the short and long term. Concentration tolerances should be set on the usage of alternative funding sources.
- **Define funding strategies**. Funding strategies should outline the available backup facilities under different stress scenarios, the circumstances under which the bank might use them, and the anticipated sequence of use.
- **Establish a crisis management team.** The CFP should identify the individuals who will be responsible for implementing the contingency funding plan. Individual responsibilities and authority should be clearly defined so that all personnel understand their roles during a problem situation.
- **Establish an action plan.** The CFP should outline the specific actions of the crisis management team that would be triggered if the assessment of the warning signals suggests an increased vulnerability in the bank's liquidity position. The plan should ensure a timely, consistent, and coordinated implementation of the contingency funding plan and an effective communication flow between bank management, bank employees, board of directors, the public, and key constituents.
- **Outline the cash flow planning and stress testing process.** The CFP should outline the quantitative tools that will be used to measure, monitor, and control the bank's liquidity position.

A liquidity program, justified by realistic cash flow plans, relevant liquidity metrics, stress testing, and a formal contingency plan, is more likely to withstand regulatory scrutiny and increased liquidity pressures in stressed times. For more information on how Young & Associates, Inc. can help you with your liquidity planning, call Martina Dowidchuk at 1.800.525.9775, or send an e-mail to mdowidchuk@younginc.com.