

BANKERS SERVICE CORPORATION

Regulatory and
Risk Management
Expertise



**Back to the Basics:
Liquidity and Asset/Liability
Management
August 21, 2023**

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A discussion of current events related to Liquidity Management and Asset/Liability Management (ALM)

Liquidity Issues

- **For years, most community banks had few liquidity concerns; instead, many had too much liquidity and needed loans;**
- **Business cycle switched and many need liquidity;**
- **Liquidity issues can lead to bank failures**

Year-over-Year Bank Growth Trends

Source: Bank Trends

	2016	2017	2018	2019	2020	2021	2022
Deposit growth	7.31%	4.75%	4.63%	7.95%	24.38%	12.16%	-0.55%
Brokered deposit	-5.4%	11.28%	14.36%	7.43%	2.36%	-45.33%	55.70%
FHLB advances	16.25%	5.25%	-0.73%	-13.34%	-50.78%	-30.14%	284.20%
Securities	7.43%	2.28%	3.02%	9.20%	29.38%	23.92%	-4.06%

Percent of Securities

	2018	2019	2020	2021	2022
Securities > 3 years	70.81%	70.90%	73.03%	77.56%	75.18%
Loans	4.5%	4.4%	3.5%	2.0%	11.7%

CONSEQUENCES

- **Bank failures – although not community banks - Silicon Valley Bank, Signature Bank, First Republic Bank**
- **Caused by liquidity failures, not by asset quality.**
- **But are equally asset/liability management failures.**

Regulatory Reactions

- **Regulators admitted to dropping the ball with Silicon Valley Bank.**
- **Every action has an equal and opposite reaction, but in some cases overreaction:**
 - **Regulators have made liquidity a much larger focus;**
 - **This increased focus has included being much harder on community banks.**

Regulatory Reaction or Overreaction?

- **Most of what they are discussing or requiring is necessary;**
- **Most are best practices.**
- **There have been some outliers.**
- **I have heard from a few clients that they are moving the goalposts.**

Liquidity Best Practices

- **Step up liquidity monitoring**
- **Frequency?**
 - **Monthly, weekly, daily?**
- **Also need to monitor contingency funding triggers.**

Liquidity Best Practices

- **Review your pro-forma cash flow analysis:**
 - **It's not enough to just look at what you have now, but also what you are going to have in the future.**
- **Regulatory guidance requires this.**

Liquidity Best Practices

- **Regulators also want you to stress test your pro-forma cash flow analysis.**
- **You should be stress testing for both bank specific and market-wide factors.**

Liquidity Best Practices

- **You have calculated your liquidity ratios and performed stress tests - what if you fail the test?**
- **Management should develop plans to address any shortfalls.**

Liquidity Best Practices

- **Monitor funding concentrations for levels and trends:**
 - **Large depositors**
 - **Uninsured depositors**
 - **Brokered deposits**
 - **Internet CD's**
 - **FHLB**

Liquidity Best Practices

- **Review your Contingency Funding Plan (CFP) before you have a funding problem.**
- **A CFP is a crisis management plan.**
- **Interagency Policy Statement**
- **Test contingency funding sources.**

Asset/Liability Management

- **Silicon Valley Bank had a liquidity crisis, but why?**
 - **The mismatch between long term bonds and short term uninsured deposits; and**
 - **The fastest 500 basis point rise in rates since the 1970's.**

Asset/Liability Management

- **Good news for community banks is that most of your deposits are insured and are consequently not as big an immediate liquidity threat.**
- **Bad news is that most of you are carrying long-term bonds that are underwater.**

Asset/Liability Management

- **Current Issues**
- **Most models have performed as they should during this period of rapidly rising rates.**
- **However, some have failed or issues have been revealed.**
- **Static versus Dynamic**

Asset/Liability Management

- **In several cases, the rising rates have revealed issues within various products.**
- **In at least two cases that I know of, clients are switching vendors as rising rates revealed weaknesses with their models.**

Asset/Liability Management

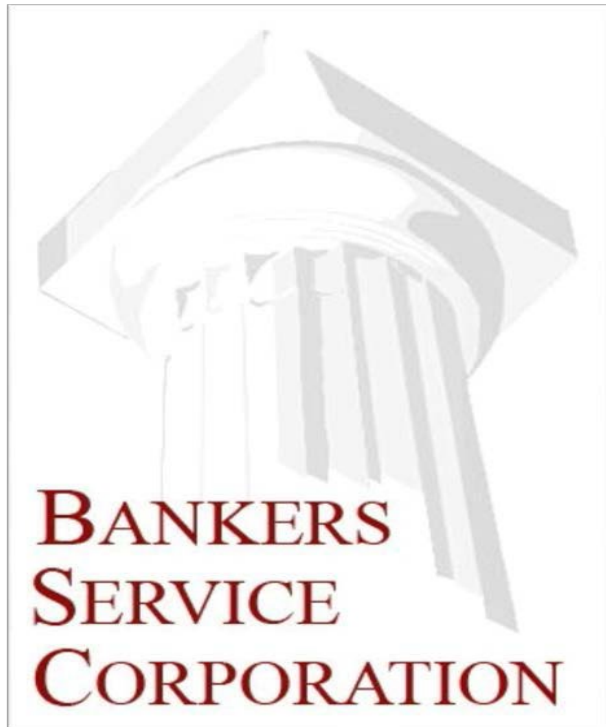
•Best Practices:

- Review policies and policy limits.
- Review primary assumptions including betas and decay rates
- Stress Test, stress test, stress test assumptions.
- Document discussions in minutes.
- Approve all policy exceptions
- Discuss corrective actions for exceptions.

Resources

- 1. Interagency Policy Statement on Funding and Liquidity Risk Management, Federal Reserve SR 10-6 (March 17, 2010), FDIC FIL-13-2010 (April 10, 2010), and OCC Bulletin 2010-13 (March 22, 2010)**
- 2. Addendum dated 7/28/2023**
- 3. Joint Agency Policy Statement on Interest Rate Risk, FIL-52-1996**
- 4. FFIEC Advisory on Interest Rate Risk Management, FIL-2-2010**

QUESTIONS?



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- 23 Years with KDFI including 7 as Banking Division Director;
- 14 Years with Bankers Service Corporation performing ALM Audits, Backtesting, Loan Review and Strategic Planning;
- 25 Years as an Instructor at Graduate School of Banking at LSU