QwickViews for banks

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Contingency Funding Plans: Common Misconceptions and How to Avoid Them

by Debbie Walker, Director of Regulatory and Compliance, QwickRate

In October of 2009, QwickRate conducted a webinar focused on creating a bank-specific contingency plan. As a courtesy, we offered to review contingency funding plans for any of the participants, and to provide them with comments and recommendations from our Regulatory and Compliance department. It quickly became clear that there were several common misconceptions among the plans reviewed. Because these occurrences were so consistent, we have compiled them in this QwickViews article as a best practice guide for other banks. If you'd like to listen to the webinar, and/or download any of the checklists we provided, please go to www.qwickrate.com/bankreplays.

Creating a plan that is too general in its risk analysis

Your contingency funding plan should be designed to target available funding that the bank can access in a crisis environment. Two types of crisis events are commonly considered. The first type is generally a short-term event that doesn't affect the bank's level of capitalization, but does require it to resort to unused funding resources. The second type of crisis event is usually a worst-case scenario in which the bank can't utilize its normal funding options due to credit or capital constraints. It's important for banks to have documented procedures and resources for addressing both milder, short-term events and also major, longer-term crises. Many of the banks we talked with had used generalized contingency funding plans (CFPs) or templates that didn't speak to specific risks in their local markets. Often their plans defined general indicators that could signal an impending adverse event, but failed to describe specific examples or scenarios of crisis events that could potentially affect the bank's market area and franchise. A much better strategy is to review your bank's potential vulnerabilities, pinpoint any franchise- or market-specific risk exposure, and detail those vulnerabilities in your CFP.

Designing a "static" plan that doesn't reflect changes in current funding availability

We must stress the dynamic nature of the CFP. It is important for an institution to incorporate an ongoing process to monitor and measure the actual funding capacity from each of its resources. Many of the CFPs that we reviewed describe the bank's funding sources and the total amount obtainable from those sources based on available collateral and market potential. However, most plans did not address "actual availability" specific to each funding source. Your bank should continually evaluate its funding capacity considering policy limitations, current amounts outstanding and the bank's ability, if necessary, to secure the additional funding with

About
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Debbie Walker has been with QwickRate since 1988 and leads its ongoing regulatory and compliance efforts. She meets regularly with the FDIC and conducts conferences with various state and national field examiners. Debbie's product and market knowledge, combined with her ongoing regulatory research, provides bankers with a valuable resource to help them successfully implement a national market CD funding plan. Debbie Walker is a graduate of Kennesaw State University with a BS degree in Finance.

available collateral. These steps require you to revisit your CFP frequently, which will mean a little more work, but it will provide a much clearer understanding of the bank's actual contingent funding capacity.

Including funding sources that are not readily available

The purpose of a contingency funding plan is to ensure that you have available funding sources that have been checked, tested and confirmed to be ready when needed. In a crisis environment, your time and resources will be strapped. It's extremely unlikely that you'll have money to purchase additional stock (i.e., from the FHLB), or to borrow funds that require extensive evaluation and review before they're available (i.e., the Federal Reserve Discount Window). If not already established, these types of sources probably won't be available to you in a crisis event, and shouldn't be considered a contingent source of funding. Ask yourself, "In a worst-case crisis scenario, will I actually be able to allocate the time, money and staff to establish this funding resource?" If in doubt, omit it from your CFP. One of the biggest concerns we hear from examiners is about banks that reference the Discount Window without being established with the program. It can take 30-180 days to set up borrowing with a central bank. You don't want to attempt this in a crisis situation. Be proactive. The Discount Window program is less credit sensitive than other resources, and can be a good funding option during crisis situations. Setting up this borrowing capacity doesn't mean you have to use it, but it will be available if needed.

Omitting brokered deposits from the funding strategy

Brokered deposits are still beneficial for most banks to include in a contingency funding strategy. Does your bank have agreements in place to access brokered deposits? It may be good to consider this secondary funding source and establish a brokerage relationship. Just like access to the Discount Window, a brokerage agreement does not obligate the bank to purchase funds; but once in the market, you have a ready source of deposits.

Concentrating too much of your funding in correspondent banks

Federal funds, secured loans and brokered deposits, while they constitute different types of funding, may emanate from the same correspondent bank – increasing the risk that comes with being overly concentrated. What happens if your bank or the correspondent bank becomes stressed? Pay close attention to concentrating a large portion of your contingency funding with one or just a few correspondents. Diversify your sources, as well as your funding types. The federal financial institution regulatory agencies recently proposed guidance on monitoring concentration risk. You can access more information regarding this guidance at http://www.fdic.gov/news/news/financial/2009/fil09055.html.

Overlooking non-brokered institutional deposit funding as an important CFP resource

Non-brokered institutional deposit funding is a beneficial resource in a crisis situation. It can be particularly important if your bank becomes less than well capitalized and is cut off from brokered deposits and other borrowing sources. Are you a member of QwickRate? All FDIC insured banks are welcome in our nationwide marketplace. Because of insurance coverage, you'll find that QwickRate investors are less credit sensitive. Also, since the QwickRate marketplace extends beyond your local market, potentially negative local press should not affect your ability to successfully raise deposits. If you're not well capitalized now, you can still list your bank's rates in QwickRate to generate deposit funding. If your bank is less than well capitalized, you will need to comply with the interest rate restrictions specified in FDIC regulation 337.6 when you set and list your rates. And, as with any source, you'll also want to perform operational testing of our marketplace – so you'll be ready to go if, or when, a funding need occurs. Regulators will look for proof that you have a current subscription agreement, and that you've properly tested your access to the marketplace.

Using generalizations and assumptions that are vague and lack quantification

Our review of contingency funding plans uncovered many examples where institutions incorporated ambiguous, unsubstantiated statements such as "we believe we will always have enough collateral available" and "we typically have an additional $xxx,xxx in securities available if needed." A crisis situation is never typical. It generally places the bank in a situation that you "never believed would happen." Your quantifications regarding available funding, and the security to support that funding, should be as close to absolute as possible. It's never a good idea to speculate or assume when considering a potential crisis.

In summary…

The banking world has changed—a dynamic and proactive contingency funding plan is now an essential resource for ongoing liquidity and risk management. Putting a customized plan in place can help you better manage the institution and its funding and protect the bank moving forward. Furthermore, it enables you to uncover potential issues early and provides examiners with confidence that your institution is in control. There is no such thing as too many funding sources, and your bank should continually evaluate the capacity and availability of its funding sources to meet future requirements. QwickRate's non-brokered marketplace is a valuable primary and contingent liquidity source for community banks. If we can help your bank in any way, just give us a call.

Need additional contingency funding sources? QwickRate can help. Just give us a call at ***800.285.8626****.*

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