Contingency Funding Plans: Common Misconceptions and How to Avoid Them

by Debbie Walker, Director of Regulatory and Compliance, QwickRate

QwickRate has led multiple training sessions on the subject of creating a proper contingency funding plan (CFP). Due to our work in this area, financial institutions sometimes ask us to review their CFPs and offer suggestions for improving their plans. During our evaluations, we often find common problems that minimize the effectiveness of a CFP. Because these issues occur so consistently, we have compiled them in this QwickViews article, along with our comments and recommendations, to serve as a best-practice guide for other institutions.

Creating a plan that is too general in its risk analysis

The contingency funding plan should consider possible scenarios or events that could impact the bank's liquidity and ultimately affect its cash flow, profitability and solvency. It's also important to consider both short- and long-term events. Typically a short-term event doesn't affect the bank's level of capitalization but does require the institution to resort to unused funding resources. A long-term event lasting for an extended period may result in the bank being unable to tap its normal funding options because of credit or capital constraints.

The CFP should identify the early warning signs or triggers that the bank will monitor to expose the possibility of a particular liquidity stress event. It also needs to include details regarding how often triggers will be evaluated and what response or action the bank will take when a potential stress event is identified. A common problem with many CFPs is that they define specific triggers but do not connect those triggers to any specific response or action.

The bank should, to the best of its ability, quantify and understand the impact of the liquidity strain from each individual stress event and make a reasonable determination of the amount of liquidity that could be lost as a result of the various stress events.

Some stress scenarios to consider might include unexpected loan growth or draws on unfunded lines of credit, large deposit outflows, a natural disaster, loss of local industry, deterioration of asset quality or a downgrade in the bank's PCA category.

Not evaluating a "too static" CFP on a regular basis

The CFP should be considered as a living document. Periodically testing and evaluating scenarios, reviewing early warning triggers and estimating funding availability will keep the CFP fresh and relevant to the bank's balance sheet and risk position.

It's important to have an ongoing process for monitoring events that could impact the bank's liquidity position. A crisis management team should be established that will assign roles and responsibilities to specific employees who will be empowered to act in the event of a possible liquidity constraint. The crisis management team should periodically review established triggers, assess the bank's actual funds availability and communicate, among the group, any potential concerns. This ensures business decisions are coordinated to reduce any impact to the bank's liquidity position.

While the scenarios, early warning triggers and crisis management team may require little change over time, the funds availability can be somewhat volatile – as can the actual funding capacity available from each of your resources at any point in time. Your bank should regularly calculate the funding capacity from each funding source, considering policy limitations, current amounts outstanding and the bank's ability, if necessary, to secure additional funding with available collateral. These steps require you to revisit your CFP frequently. That will mean a little more work, but it will provide a much clearer understanding of your 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 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. An interagency guidance has been issued to outline regulatory expectations regarding correspondent concentration risks. You can access this guidance at https://www.fdic.gov/news/news/financial/2010/fil10018a.pdf

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 the QwickRate Marketplace? All FDIC- insured banks, nationwide, are welcome. 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, your CFP 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.

About QwickRate

QwickRate provides the premier Marketplace for non-brokered funding and investing. With more than 3,000 members, QwickRate offers community financial institutions a cost-effective way to gain direct access to a nationwide CD market to help proactively manage their primary and contingency liquidity needs. The company's online QwickAnalytics™ tool offers interactive research on all 6,000 U.S. banks, Bank & Peer Performance analysis and examiner-ready Regulatory Compliance reports. QwickRate, a Preferred Service Provider of The Independent Community Bankers of America (ICBA) is known for its exceptional customer service, which includes unlimited support and valuable on-staff regulatory guidance.