Creating a Contingency Funding Plan: Common Problems and How to Avoid Them

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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..

Problem #1: The risk analysis is not specific enough – the CFP should identify potential crisis events and detail both the early warning signs and required responsive actions

The contingency funding plan (CFP) should consider possible scenarios or events that could impact the credit union'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 credit union'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 credit union not being able to tap its normal funding options because of credit or capital constraints.

The CFP should identify the early warning signs or triggers that the credit union will monitor to expose the possibility of a particular liquidity stress event. The plan also needs to include details regarding how often triggers will be evaluated and what response or action the credit union 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 credit union 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 credit union's PCA category.

Problem #2: The CFP is too "static" — it needs to be reevaluated 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 credit union's balance sheet and risk position.

It's important to have an ongoing process for monitoring events that could impact the credit union'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 credit union's actual funds availability and communicate, among the group, any potential concerns. This ensures business decisions are coordinated to reduce any impact to the credit union'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 actual funding capacity available from each of your resources at any point in time. Your credit union should regularly calculate the funding capacity from each funding source considering policy limitations, current amounts outstanding and the institution'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.

Problem #3: The funding sources mentioned in the CFP are not readily available — you should only include sources that you know you can access without delay.

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 situation, your time and resources will be strapped. It's extremely unlikely that you'll be in a position to invest the necessary capital to establish a relationship with a corporate credit union, or to directly borrow funds that require extensive evaluation and review before they're available (i.e., Central Liquidity Facility (CLF)). 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 credit unions that reference the Central Liquidity Facility without being established with the program. Understand that an approval process is required before obtaining a CLF advance. If you want to tap this source of funding, your credit union must either be a direct member of the CLF or have access to the program through a membership with a corporate credit union. You don't want to attempt to establish these memberships in a crisis situation. Be proactive. The CLF 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 obligate you to use it, but it will be available if needed.

Problem #4: The CFP ignores reliable sources of funding — consider listing service deposits as a potential funding strategy.

A listing service can provide a reliable source of supplemental funding that may be utilized in a crisis environment. According to NCUA Regulations, Section 701.32, a credit union may take in nonmember deposits from other credit unions in an amount up to 20% of its total shares or $3 million, whichever is greater. A listing service such as QwickRate can provide inherent controls to help federally insured credit unions comply with this regulation, since QwickRate ensures that only its investing credit union subscribers will have access to view your posted rates.

The QwickRate Marketplace provides you with an abundance of opportunities to establish relationships with other credit unions. You'll find that QwickRate investors are less rate sensitive than most, due to the fact that they're primarily motivated by insurance coverage. Also, you should note that in a crisis situation, your credit union's ability to raise funds locally may be hindered. Because the QwickRate Marketplace extends beyond your local market, potentially negative local press should not affect your ability to successfully attract deposits.

Your QwickRate Marketplace subscription allows you to utilize both the issuing and investing components of the non-brokered CD Marketplace. It's important to note that if you plan to incorporate QwickRate deposits into your contingency funding plan, you'll need to contact us for additional training on the issuing side of the Marketplace. And, as with any source, you'll also want to perform operational testing – 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. If you're not already a QwickRate subscriber, it's easy to get started. Just contact us to establish a relationship

Problem #5: The CFP relies too heavily on corporate credit union funding — think about additional funding resources beyond the corporate framework.

Relying solely on a corporate credit union for supplemental funding minimizes your organization's options and increases risk of becoming too dependent on one source. What happens if your corporate credit union becomes stressed? It's not unthinkable, as the historical meltdown of US Central has proven. Guard against concentrating a large portion of your contingency funding with one correspondent. Diversify your sources, as well as your funding types.

Problem #6: The credit union makes vague and general assumptions that can't be quantified — prepare for atypical events and back up your plan with hard facts.

Our review of contingency funding plans uncovers many examples of institutions incorporating 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 is never typical. It generally places the credit union in a situation that people "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 assume the best when planning for a potential crisis.

In summary…

The financial world has changed – a dynamic and proactive contingency funding plan is now essential for assuring ongoing liquidity and risk management. Putting a customized plan in place can help you better manage your institution and its funding and protect the credit union moving forward. Furthermore, your CFP enables you to uncover potential issues early and provides examiners with confidence that your institution is prepared for any unforeseen event. Your credit union should continually evaluate the capacity and availability of its funding sources to meet future requirements. QwickRate's Marketplace is a valuable primary and contingent liquidity source for financial institutions. If we can help your credit union 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.