**Policy 5200: Liquidity Risk Management**

**Model Policy Revised Date: 05/13/2024**

**General Policy Statement:**

The Board adopts the following liquidity management policy to better accommodate [[CUname]]'s (Credit Union) capacity to meet its cash and collateral obligations at a reasonable cost. The Board realizes that the Credit Union must remain resilient in times of economic stress and funds must be available at reasonable prices relative to competitors, and in maturities required to prudently support medium to longer term assets. Further, the Board acknowledges that liquidity is essential to compensate for expected and unexpected balance sheet fluctuations, member share migrations, and to provide funds for growth.

Liquidity is the Credit Union's capacity to meet its cash and collateral obligations at a reasonable cost. Maintaining an adequate level of liquidity depends on the Credit Union's ability to efficiently meet both expected and unexpected cash flows and collateral needs without adversely affecting either daily operations or the financial condition of the Credit Union.

Liquidity risk is the risk that the Credit Union's financial condition or overall safety and soundness is adversely affected by an inability (or perceived inability) to meet its obligations.

1. **LIQUIDITY RISK MANAGEMENT.** The Credit Union’s liquidity risk management will be sufficient to meet its daily funding needs, and cover both expected and unexpected deviations from normal operations. The critical elements of the Credit Union’s liquidity risk management include the following:

	1. Effective governance consisting of Board oversight and active involvement by management (See Section (2)).
	2. Appropriate management and mitigation of liquidity risk.
	3. Comprehensive liquidity risk measurement and monitoring systems (including assessments of the current and prospective cash flows or sources and uses of funds), that are in line with the Credit Union’s complexity and business activities (See Section (8)).
	4. Active management of intraday liquidity and collateral (See Sections (10) and (11)).
	5. An appropriate diverse mix of existing and potential future funding sources (See Section (12)).
	6. Adequate levels of highly liquid marketable securities free of legal, regulatory or operational impediments that can be used to meet liquidity needs in stressful situations and controlling asset composition (lending quality and volume), including pricing and loan type limits (See Section (4) and applicable lending policies).
	7. Comprehensive Contingency Funding Plans (CFPs) that sufficiently address potential adverse liquidity events and emergency cash flow requirements (See Sections (9) and (13)).
	8. Internal controls and internal audit processes sufficient to determine the adequacy of the Credit Union’s liquidity risk management process (see Section (15)).

1. **RESPONSIBILITIES.**

	1. **Board of Directors.**The Board is ultimately responsible for the liquidity risk assumed by the Credit Union. As a result, the Board will ensure the Credit Union's liquidity risk tolerance is established and communicated in such a manner that all levels of Management clearly understand the Credit Union's approach to managing the trade-offs between liquidity risk and short-term profits. The evaluation of determining liquidity risk will include the identification of appropriate ratios that can signal changing liquidity conditions, preparation of cash flow projections, and the establishment of available cash that is managed. The Board is also responsible for the following duties:

		1. Understanding the nature of the Credit Union's liquidity risks and periodically reviewing information necessary to maintain this understanding;
		2. Establishing executive-level lines of authority and responsibility for managing the Credit Union's liquidity risk;
		3. Enforcing management's duties to identify, measure, monitor and control liquidity risk;
		4. Understanding and periodically reviewing the Credit Union's contingency funding plans (CFPs) for handling potential adverse liquidity events; and
		5. Understanding the liquidity risk profiles of important affiliates as appropriate.
	2. **Management.**Management is responsible for the following duties:

		1. Ensuring that Board-approved strategies, policies, and procedures for managing liquidity (on both a long-term and day-to-day basis) are appropriately executed within the lines of authority and responsibly delegated for managing and controlling liquidity risk. This includes the following:

			1. Overseeing the development and implementation of appropriate risk measurement and reporting systems, liquid buffers (e.g., cash, unencumbered market securities and market instruments), CFPs, and an adequate internal control structure; and
			2. Regularly reporting the Credit Union's liquidity risk profile to the Board.
		2. Determining the structure, responsibilities and controls for managing liquidity risk and overseeing the Credit Union's liquidity positions;
		3. Coordinating the Credit Union's liquidity risk management with its disaster recovery, contingency and strategic planning efforts, as well as with business line and risk management objectives, strategies, and tactics;
		4. Considering the liquidity costs, benefits and risks in the strategic planning and budgeting processes. Management will evaluate significant business activities for both liquidity risk exposure and profitability; and
		5. Developing and managing the Credit Union’s intraday liquidity strategy.
	3. **Asset/Liability Management Committee (ALCO).** The ALCO is responsible for the following:

		1. Actively monitoring the Credit Union's liquidity profile;
		2. Ensuring that the risk measurement system adequately identifies and quantifies risk exposure; and
		3. Regularly reporting accurate, timely and relevant information about the level and sources of risk exposure to the Board. These reports will be provided on at least a quarterly basis (but will be more frequent when the need arises).

			1. These reports will provide the Board and management with an understanding of the Credit Union's liquidity risk exposure, compliance with risk limits, consistently between management's strategies and tactics, and consistency between these strategies and the Board's expressed risk tolerance.
2. **IMPLEMENTATION AND POLICY REVIEW.** With the assistance of the ALCO the [[5200-5]] is responsible for implementing and reviewing this policy.
3. **ASSET MANAGEMENT AND COMPOSITION.** Liquidity needs will be met by managing the Credit Union's asset structure through the sale or planned runoff of readily marketable assets. Because the Credit Union tends to have little influence over the size of total deposits, the ALCO will primarily rely on liquid assets to fund increases in loan demand. The ALCO will concentrate on adjusting the price and availability of credit, establishing pricing loan type limits and the level of liquid assets held in response to changes in member asset and liability preferences. The ALCO will also determine a target amount of cash-on-hand.

	1. **Liquidity Requirements.**The amount of liquid assets the Credit Union will hold depends on the stability of its deposit structure and the potential for rapid loan portfolio expansion. Generally, where the Credit Union's deposit accounts are composed primarily of small stable accounts, a relatively low allowance of liquidity will be required. A higher allowance for liquidity is required when:

		1. Recent trends show substantial reduction in large accounts;
		2. A substantial portion of the loan portfolio consists of large static loans with little likelihood of reduction;
		3. Large unused lines of credit or commitments to lend are expected to be used immediately;
		4. Concentration of credits have been extended to an industry with present or anticipated financial problems; and
		5. Strong relationships exist between member share and draft accounts and principal employers in the trade area who have financial problems.
	2. **Liquidity Cushion.**

		1. Management will ensure that it has a cushion of highly liquid assets without legal, regulatory, or operational impediments (i.e., unencumbered) that can be sold or pledged to obtain funds in a range of stress scenarios. These assets will be held as insurance against a range of liquidity stress scenarios, including those that involve the loss or impairment of typically available unsecured and/or secured funding sources.
		2. The size of the cushion of such high-quality liquid assets will be supported by estimates of liquidity needs performed under the Credit Union’s stress testing, as well as aligned with the Credit Union’s risk tolerance and risk profile.

			1. Estimates of liquidity needs during periods of stress will incorporate both contractual and non-contractual cash flows, including the possibility of funds being withdrawn. The estimates will also assume the inability to obtain secured funding as well as the loss or impairment of access to funds secured by assets other than the safest, most liquid assets.
	3. **Controlling Asset Composition.**
		1. Management will utilize lending quality and volume to assist with potential liquidity pressure. This may also include adjustments to loan pricing, loan limits, and originating loans for future sales.

1. **ASSET MARKETABILITY.** The ALCO will determine how salable the Credit Union's assets are in terms of both time and cost. To maximize profitability, the ALCO must carefully weigh the full return on liquid assets (readily marketable assets) against the higher return associated with less liquid assets. Income derived from higher yielding assets may be offset if a forced sale is necessary because of adverse balance sheet fluctuations.

	1. **Proper Valuation of Assets.** The ALCO will ensure that assets are properly valued according to relevant financial reporting and supervisory standards. Because valuations may deteriorate under market stress, the ALCO will take this into account in assessing the feasibility and impact of asset sales on the Credit Union's liquidity position during stress events.
2. **LIABILITY MANAGEMENT.** From time to time, liquidity needs may be met by managing the Credit Union's liability structure by attracting rate sensitive borrowers and accessing approved lines of credit.

	1. The Credit Union will periodically report, document, and analyze its liquidity position in order to anticipate needs and provide considerations for potential solutions.
	2. The Credit Union will manage its rate-sensitive and volatile funding sources carefully, avoiding excessive reliance on funds that may be only temporarily available on which may require premium rates to retain.
3. **BUDGETED LIQUIDITY RATIO.** The Board sets a budgeted liquidity ratio. This ratio is subject to change depending on the following:

	1. Present and anticipated asset quality;
	2. Present and future earnings capacity;
	3. Historical funding requirements;
	4. Current liquidity position;
	5. Sources of funds.
	6. Anticipated future funding needs; and
	7. Options for reducing funding needs or attracting additional funds.
4. **LIQUIDITY MEASURES.** The ALCO will measure liquidity trends based on the indicators below. These indicators will be periodically reviewed and formally approved. These assessments will include vulnerabilities to events, activities and strategies that can significantly strain the capability to generate internal cash. Assessments should be done more frequently during periods of uncertainty.

	1. **Cash Flow Projections.** Cash flow projections that include discrete and cumulative cash flow mismatches or gaps over specified future time horizons (i.e., weekly, monthly, quarterly) under both expected and adverse business conditions. Assumptions will include member behavior, balances of shares and loans, interest rate changes, changes to prepayment speed on loans.
	2. **Short-Term Borrowings to Total Funding.**This ratio looks at the total short-term borrowing as a percentage of total funding.
	3. **Short-Term Investments to Total Assets.** The ratio shows how much of the Credit Union's assets can be readily converted into cash. Short-term investments are securities with remaining maturities of 1-year or less.
	4. **Short-Term Investments to Volatile Liabilities.** The ratio indicates how much of the Credit Union's volatile liabilities such as CD's of $100,000 or more are matched by short-term assets.
	5. **Net Loans to Core Deposits.** The ratio shows how much of the loan portfolio is funded by stable deposits. Core deposits are share and passbook deposits and CD's less than $100,000.
	6. **Volatile Liability Dependence.** The ratio shows the degree to which volatile liabilities fund long-term assets. This figure is the result of dividing the difference between volatile liabilities and temporary investments by loans and longer term investments.
	7. **Net Loans to Deposits.** The ratio shows how much of the Credit Union's deposits are lent and the Credit Union's ability to fund additional loan volume with these deposits.
	8. **Asset Concentrations.** Certain asset concentrations that could increase liquidity risk through a limited ability to convert to cash (e.g., less marketable loan portfolios).
	9. **Funding Concentrations.**

		1. Funding concentrations that address diversification of funding sources and types, such as large liability and borrowed funds dependency, secured vs. unsecured funding sources, exposures to single providers of funds, exposures to funds providers by market segments, and different types of brokered deposits and wholesale funding.
		2. Funding concentrations that address the term, re-pricing and market characteristics of funding sources, with consideration given to the nature of the assets they fund. This will include diversification targets for short-, medium- and long-term funding, instrument type and securitization vehicles.
5. **STRESS TESTING.** The Credit Union will conduct stress tests on a regular basis for a variety of institution-specific and market-wide events across multiple time horizons.

	1. **Sources of Potential Liquidity Strain.**Stress test results will be used to identify and quantify sources of potential liquidity strain and to analyze possible impacts on the Credit Union’s cash flows, liquidity position, profitability and solvency.
	2. **Exposures.** Stress test results will also be used to ensure that current exposures are consistent with the Credit Union’s established liquidity risk tolerance.
	3. **Remedial/Mitigating Actions.**Management will take remedial and/or mitigating actions to limit the Credit Union’s exposures, build up a liquidity cushion, and adjust its liquidity profile to fit the Credit Union’s liquidity risk tolerance. The Credit Union will use the guidelines outlined within policy (see section 15).
	4. **Contingency Funding.** The results of these tests will play a key role in shaping the Credit Union’s contingency planning. The Credit Union’s CFP will be regularly tested and updated to ensure that it is operationally sound. Specifically, these tests will ensure the following:

		1. Roles and responsibilities are up-to-date and appropriate;
		2. Legal and operational documents are up-to-date;
		3. Cash and collateral can be moved where and when needed; and
		4. Contingent liquidity lines can be drawn when needed.
6. **COLLATERAL POSITION MANAGEMENT.**The Credit Union will calculate all of its collateral positions in a timely manner, including the value of assets currently pledged relative to the amount of security required and unencumbered assets available to be pledged. Management will maintain an understanding of the potential demand on required and available collateral arising from various types of contractual contingencies during periods of both market-wide and Credit Union-specific stress.
7. **INTRADAY LIQUIDITY POSITION MANAGEMENT.** The Credit Union will monitor intraday liquidity to ensure that it is able to meet payment and settlement obligations in a timely manner, under both normal and stressed conditions. Management will develop and monitor the Credit Union’s intraday liquidity strategy that allows the Credit Union to do the following:

	1. Monitor and measure expected daily gross liquidity inflows and outflows;
	2. Manage and mobilize collateral when necessary to obtain intraday credit;
	3. Identify and prioritize time-specific and other critical obligations in order to meet them when expected;
	4. Settle other less critical obligations as soon as possible;
	5. Control credit to consumers when necessary; and
	6. Ensure that liquidity planners understand the amounts of collateral and liquidity needed to perform payment systems obligations when assessing the organization’s overall liquidity needs.
8. **DIVERSIFIED FUNDING.**The Credit Union will diversify its funding sources in the short-, medium- and long-term, and will regularly gauge its capacity to raise funds quickly from each source.

	1. **Market Access.** Management will ensure that it maintains market access, as it affects the ability to raise new funds and liquidate assets. Management will also ensure that market access is being actively managed, monitored and tested by the appropriate staff in a way that is consistent with the Credit Union’s liquidity risk profile and sources of funding.
	2. **Types of Funding.** The Credit Union will ensure that it is not overly-concentrated on any one source of funding. Depending on the nature, severity and duration of a liquidity shock, potential sources of funding include, but are not limited to, the following:

		1. Deposit growth.
		2. Lengthening maturities of liabilities.
		3. Issuance of debt instruments.
		4. Sale of subsidiaries or lines of business.
		5. Asset securitization.
		6. Sale (either outright or through repurchase agreements) or pledging of liquid assets.
		7. Drawing-down committed facilities.
		8. Borrowing.
9. **CONTINGENCY FUNDING PLAN (CFP).**
	1. **Liquidity Management**. Management will maintain liquidity sources sufficient to meet normal operating requirements as well as contingent events. The Credit Union will work through sources of liquidity in the order indicated below:
		1. **On-balance-sheet liquidity.** The credit union will maintain [[5200-2]] percentage of liquid assets such as cash or cash equivalents (short-term deposits and short-term maturity Treasuries). This percentage should be measured against the largest liquidity outflow the credit union has experienced and over a corresponding period.
		2. **Market Funding Sources.** The credit union will have the capacity to borrow from relationships established with a corporate credit union, correspondent bank, Federal Home Loan Bank (FHLB), etc.
		3. **Backup Liquidity.** In the event that the credit union’s on-balance-sheet liquidity and market funding sources are inadequate, the credit union will have a third line of protection with a contingent liquidity provider such as the Central Liquidity Facility or the Federal Reserve Discount Window.
	2. **Triggering Events.** Management will monitor potential liquidity stress events that could trigger the need for contingency funding, which may include the following:

		1. Loss of access to unsecured borrowings;
		2. Material change in terms and collateral requirements for secured borrowings;
		3. Deterioration in asset quality;
		4. Significant operating losses and declining net worth;
		5. High or unexpected loan growth;
		6. Higher deposit run-off than expected;
		7. Severe draws against open-end lines of credit;
		8. Slowdown in cash flows from a change in prepayments;
		9. The Credit Union's inability to renew or replace maturing funding liabilities;
		10. Members unexpectedly exercising options to withdraw deposits or exercise off-balance-sheet commitments;
		11. Changes in market value and price volatility of various asset types;
		12. Changes in economic conditions, market perception, or dislocations in the financial markets; and/or
		13. Disturbances in payment and settlement systems due to operational or local disasters.
	3. **Managing Stress Events**. Management will employ contingency planning to:

		1. Identify stress events that could affect the Credit Union (i.e., no new shares or borrowings, largest intramonth share runoff over last 10 years sustained for 12 months, random risk scenario aligned with member concentration, etc.) and level of security;
		2. Design early-warning indicators;
		3. Identify the likely liquidity responses to such events; and
		4. Plan for the management of stress events.
	4. **Sources of Contingency Funds.**
		1. The Board may access any of the following sources of funds whenever prudent:
			1. Regular membership with the Central Liquidity Facility or documented borrowing access to the Federal Discount Window (required if the credit union has assets of $250 million or more);
			2. Established Lines of Credit. The Board has approved borrowing amounts at the following institution(s): [[5200-1]] for [[5200-3]];
			3. Secondary Market Loan Sales;
			4. Short-term Investment Sales up to [[5200-4]];
			5. Loan Participation Agreements;
			6. Federal Home Loan Bank Advances (limited to 20% of assets);
			7. Non-member share certificates (limited to 50% of net amount of paid-in and unimpaired capital and surplus, less any public unit and non-member shares or $3 million, whichever is greater); and/or
			8. Supplemental capital exploration.
		2. The Credit Union may also consider tertiary plans at its discretion, such as lengthening the term of share certificates with high early withdrawal penalties and/or suspending certain lending activities in areas that have the lowest level of disruption to the membership.
	5. **Procedures.**Management will develop sound procedures for liquidity crisis management to include the following:

		1. Designating who executes the CFP;
		2. Designating who determines the amount to borrow;
		3. Designating who contacts large depositors and assures them that the situation is under control;
		4. Making the distinction between a minor liquidity crunch from an actual liquidity crisis;
		5. Outlining the various stages and levels of severity (i.e., temporary vs. intermediate and long-term disruptions), and designing action plans for each state and level of severity; and
		6. Ensuring frequent communication and reporting among the designated crisis team members.
	6. **Transaction Authority.** The Credit Union designates [[5200-6]] with the authority to transact on behalf of the credit union in accordance with the guidelines outlined within this policy.
	7. **Capital Considerations.** The Credit Union will prepare itself for the specific contingencies that would be applicable in the event the Credit Union becomes less than “well capitalized” pursuant to Prompt Corrective Action (PCA), such as restricted rates paid for deposits, the need to seek approval from NCUA to accept brokered deposits, and/or the inability to accept any brokered deposits.
	8. **Communication Plan.**

		1. **Marketing.** When liquidity approaches risk limits, the Credit Union will consider updating its marketing program to initiate appropriate changes to share and loan programs (i.e., pricing, terms, products, etc.).
		2. **Media.** The Credit Union will have a media plan for how to manage press inquiries that may arise during a liquidity event.
10. **PRE-EMPTIVE LIQUIDITY RISK MONITORING.** Management will also consider potential early warning indicators by observing macroeconomic news and trends that could lead to a potential deterioration in economic conditions and changes in borrowing capacity or secondary market for loan/security sales. Credit union procedures will identify proactive steps to obtain liquidity, secondary capital, and funding when observation of a potential impending liquidity crisis (short- and long- term indicators will be considered).
11. **INTERNAL CONTROLS.** Management will ensure that an independent party regularly reviews and evaluates the various components of the Credit Union’s liquidity risk management process and Contingency Funding Plan. These reviews will be designed to assess the extent to which the Credit Union’s liquidity risk management complies with both supervisory guidance and industry sound practices. Management will provide a report of the key issues requiring attention including instances of noncompliance and address the issues for prompt corrective action consistent with approved policy. When possible, the credit union will also separate the risk measurement and risk-taking duties to provide a more objective assessment of liquidity.
12. **LIQUIDITY PARAMETERS.** Below are guidelines for the Credit Union to assist in determining when remedial action may need to occur.

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| **Liquidity Policy Parameters** | **Within Guidelines** | **Within Guidelines, Approaching Limit**  | **Over Limit**  |
| A | Loan to Asset Ratio | < or = 85% | > 85%, < 90% | 90% or > |
| B | Loan to Share Ratio | < or = 105% | > 105%, < 110% | 110% or > |
| C | Borrowings /Total Shares and Liabilities | < or = 20% | > 20%, < 25% | 25% or > |
| D | Cash and Short-Term Investments/Total Assets | > or = 6% | > or = 5%, < 6% | < 5% |
| E | Regular Shares and Share Drafts/Total Shares and Borrowings | > or = 25% | > or = 22%, < 25% | < 22% |
| F | Total Secondary Sources/Total Assets | > or = 15% | > or = 12%, < 15% | < 12% |
| G | Unpledged Investments/Total Assets | > or = 6% | > or = 5%, < 6% | < 5% |
| H | Total Mortgage Related Concentration/PCA Capital | < or = 780% | > 780%, < 800% | 800% or > |
| I | Borrowings from each lender/Total Lender Credit Line | < or = 70% | > 70%, < 75% | 75% or > |
| J | Eligible collateral X advance rate/Total Lender Credit line | > or = 101% | > or = 100%, < 101% | < 100% |

1. **EXCEPTIONS TO POLICY.** The CFO will have the latitude in exercising judgement based on expertise in certain situations, as outlined in procedure. When approaching or exceeding policy limits, the CFO will document and present remediation plans to the Board of Directors.