**Policy 5205: Small Asset Liquidity Risk Management**

***This model policy is intended for credit unions that are under $50 million in assets. The requirements for credit unions above this asset size are found within CU PolicyPro Model Policy 5200,***

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

**General Policy Statement:**

The Board adopts the following liquidity management policy to better accommodate decreases in [[CUname]]'s (Credit Union) deposits and fund increases in loans. 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 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.

**Guidelines:**

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 (7)).
   4. Active management of intraday liquidity and collateral (See Sections (9) and (10)).
   5. An appropriate diverse mix of existing and potential future funding sources (See Section (11)).
   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 limits and loan types (See Section (3) and applicable lending policies).
   7. A Contingency Funding Plan that sufficiently addresses potential adverse liquidity events and emergency cash flow requirements (See Section (8)).
   8. Internal controls and audit processes sufficient to determine the adequacy of the Credit Union’s liquidity risk management process (see Section (12)).
2. **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 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:  
         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 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 Credit Union will primarily rely on liquid assets to fund increases in loan demand and concentrate on adjusting the price and availability of credit, establishing pricing and loan limits and the level of liquid assets held in response to changes in member asset and liability preferences.
   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.
   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.
4. **ASSET MARKETABILITY.** When determining asset marketability the Credit Union Management will determine how salable the Credit Union's assets are in terms of both time and cost. To maximize profitability the full return on liquid assets (readily marketable assets) against the higher return associated with less liquid assets will be carefully weighed. 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.** Management will ensure that assets are properly valued according to relevant financial reporting and supervisory standards. Because valuations may deteriorate under market stress, this will be taken into account in assessing the feasibility and impact of asset sales on the Credit Union's liquidity position during stress events.
5. **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.
6. **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.
7. **LIQUIDITY MEASURES.** Management 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.
   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.
8. **STRESS TESTING.** The Credit Union will conduct stress tests on a periodic 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.
   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.
9. **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.
10. **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.
11. **DIVERSIFIED FUNDING.**The Credit Union will diversify its funding sources in the short-, medium- and long-term, and will periodically 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.
12. **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 try to separate the risk measurement and risk-taking duties to provide a more objective assessment of liquidity.