Liquidity Risk Management Program

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EXAMINATION OBJECTIVES

This document and any attachments are superseded by OCC 2012-17.

To determin … k management, strategies, pl …

To determine management's ability to measure, monitor, and control the savings association's liquidity position during normal times and during times of stress, crisis, and even collapse.

To determine if the savings association's officers fully understand the savings association's borrowing programs, including those with the Federal Home Loan Bank (FHLB) System and Federal Reserve System as they relate to critical liquidity needs in times of financial stress.

To determine the adequacy of the savings association's liquidity stress tests and scenario analysis.

To determine if the savings association's officers and employees comply with established policies and procedures regarding liquidity management.

To determine the adequacy of the savings association's liquidity.

To determine the availability of assets readily convertible to cash without undue loss.

To determine access to money markets and other sources of funding.

To determine diversification of funding sources.

To determine reliance on short-term, volatile sources of funds, including borrowings and brokered deposits.

To determine the trend and stability of deposits.

To summarize findings and to initiate corrective action as needed.

Exam Date:	
Prepared By:	
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Docket #:	

Liquidity Risk Management Program

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EXAMINATION PROCEDURES

LEVEL I

1. Review scoping materials applicable to this program. Review liquidity and funding reports, cash flow forecasts, and new borrowing contracts and indentures. Review liquidity ratios and other related metrics.

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2. Determine if the savings association corrected previously identified liquidity-related problems or weaknesses. Review:

   - Prior examination report comments and exceptions.
   - Independent audit exceptions.
   - Internal audit exceptions.
   - Any enforcement or supervisory actions and directives.

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3. Review the Matters Requiring Board Attention and Corrective Actions from the three or four previous ROEs to ensure that the board and management have taken appropriate corrective action where necessary and persistent problems have not recurred.

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4. Obtain and review the adequacy of written plans including the liquidity risk management policies and procedures, contingency funding plan policies, procedures, and business strategies governing liquidity risk management. Determine if the savings association's officers and employees are operating in compliance with these procedures.

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Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

Liquidity Risk Management Program

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5. Assess the adequacy of the association's liquidity risk limits, tolerances, or guidelines. These may include items such as:

- Discrete or cumulative cash flow mismatches or gaps (sources and uses of funds) over specified future short- and long-term time horizons under both expected and adverse business conditions. Often, these are expressed as cash flow coverage ratios or as specific aggregate amounts.
- Target amounts of unpledged liquid asset reserves expressed as aggregate amounts or as ratios.
- Asset concentrations, especially with respect to more complex exposures that are illiquid or difficult to value.
- Funding concentrations that address diversification issues, such as dependency on a few large depositors or sources of borrowed funds.
- Contingent liability metrics, such as amounts of unfunded loan commitments and lines of credit relative to available funding. The association's procedure to appropriately model and compare to policy limits potential funding of contingent liabilities, such as credit card lines and commercial backstop lending agreements.

6. Review the savings association's internal reports applicable to liquidity risk management. Determine whether the reports provide the information needed to effectively measure and control the savings association's liquidity position during normal times and in times of stress. Determine if measurement timeframes (daily, weekly, monthly, quarterly, etc.) are appropriate relative to risks and complexity of operations.

Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

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7. Verify that management conducts liquidity stress testing and scenario analysis on a periodic basis. Review the tests, analysis, and reports to ensure that they are sufficiently robust and incorporate the results into your findings and conclusions. Also, verify that that the association's staff provides senior management and the board of directors the results of the tests and analysis.

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8. Contingency Funding Plan

- Determine the adequacy of the savings association's contingency funding plan. For instance, determine if the contingency funding plan appropriately considers the possibility of no additional borrowing capacity at FHLB and Federal Reserve Banks and no availability of other types of wholesale funding, such as brokered deposits.
- Review the developmental process of the plan as to assumptions, etc. to help determine adequacy.
- Consider how often the association tests the plan and features within the plan, such as contingency borrowing.
- Determine if the plan defines responsibilities and decision-making authority so that all personnel understand their role during a problem-funding situation.

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9. Determine the adequacy of liquidity in relation to current and expected cash flow needs:

- Measure the availability of assets readily convertible to cash without undue loss.
- Determine the extent of unencumbered assets on the balance sheet that might reasonably be available as collateral during times of stress or crisis.
- Determine the level of access to, and diversification of, funding sources under various scenarios.
- Determine the degree of reliance on short-term, volatile sources of funds, including wholesale borrowings and brokered deposits.

Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

WKP. REF.

- Determine the ability of the savings association to fund outstanding commitments and off-balance sheet items.
- For savings associations with mortgage banking operations, determine the ability to fund mortgage loans in the pipeline under various scenarios.
- Determine the impact of higher risk loans on the balance sheet and/or in the mortgage banking pipeline such as nontraditional mortgage loans (interest-only, option ARM, etc) that might become difficult to sell into the secondary markets.
- Determine the degree of reliance on securitizations. Determine if securitization activity is appropriately and sufficiently addressed in liquidity risk planning.

10. Review the level of the savings association's dependence on FHLB System and Federal Reserve System borrowings and determine the amount of its unused borrowing capacity with each. Determine the amount of unpledged eligible collateral that is available to secure FHLB and Federal Reserve borrowings.

11. Discuss with examiners their findings in the other CAMELS areas, especially Capital Adequacy and Asset Quality. If adverse, determine the impact on funding sources and liquidity planning from asset quality deterioration and/or change in Prompt Corrective Action (PCA) capital category.

12. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

Liquidity Risk Management Program

RESCINDED

WKP. REF.

LEVEL II

13. Review the contractual terms of borrowing contracts and indentures to assess any liquidity implications. Determine whether the contracts and indentures contain options and other option-like features that could have adverse liquidity implications.

14. Ensure that management is aware of the terms, triggers, and parameters of borrowing relationships with the FHLB and FRB, especially as they relate to lending curtailments and nonfunding under various scenarios. Verify that management has appropriately considered and incorporated, as applicable, these features into its stress test and scenario analysis and contingent funding plan. Obtain the results of the most recent FHLB and FRB current ratings and onsite loan reviews from bank management and assess the steps taken by management to address concerns and documentation exceptions.

15. Verify that management periodically tests the availability of funds under its various borrowing relationships especially those involving nongovernment entities, such as other banking organizations. Ensure that such testing becomes more frequent when there is evidence or indications of approaching stressful market conditions.

16. Determine the trend and stability of deposits. Ensure that management is aware that the FDIC is unlikely to grant brokered deposit waivers to savings associations falling below well-capitalized status, and has considered this in its contingent funding plan.

17. Determine the ability of the savings association to securitize and sell certain pools of assets including nontraditional mortgage products, less than prime loans, home equity loans, credit card receivables, automobile loans and commerical real estate loans.

Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

RESCINDED

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18. Review the adequacy of the savings association's pipeline report for fixed-rate commitments and assess the adequacy of liquidity.

19. Determine the savings association's contingency funding plans for short-, intermediate-, and long-term liquidity needs. Review whether the savings association has adequate diversification in its potential sources of funds it may use.

20. Ensure that your review meets the Objectives of this Handbook Section. Present on the appropriate work papers and report pages your findings, conclusions, and appropriate recommendations for any necessary corrective measures.

LEVEL III

21. Discuss with the Examiner-in-Charge additional procedures that you are to do when work in Level II is insufficient to draw conclusions on the adequacy of liquidity management performance.

22. Estimate the the amount of cash that the savings association could raise by selling unpledged marketable securities. Estimate the unrealized gain or loss on those securities as a percentage of earnings and capital.

23. Review cash budget projections for the next year under assumptions of stable, declining, and increasing interest rates.

Exam Date:	
Prepared By:	
Reviewed By:	
Docket #:	

Liquidity Risk Management Program

WKP. REF.

24. Consider and estimate the effect of the following stress events on the association's liquidity position:

- A 10.0 percent and a 25.0 percent deposit run on the savings association.
- No additional borrowing capacity at FHLB and Federal Reserve Banks.
- No additional borrowing capacity from other borrowing relationships.
- No new or rollovers of brokered deposits due to PCA category of other than Well Capitalized.
- Inability to sell mortgage loans into the secondary market and inability to sell mortgage-backed securities.
- The loss of access to the repurchase and dollar roll markets.
- A disruption in the capital and credit markets to the extent that financial institutions are no longer lending to other financial institutions (each other).

EXAMINER'S SUMMARY, RECOMMENDATIONS, AND COMMENTS

Exam Date:	
Prepared By:	
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Docket #:	