TIPS FOR BANKERS ON LIQUIDITY MANAGEMENT

by Steve Brown

Despite a tough economy, the average person still leaves a 15.2% tip at restaurants nationwide when they eat out. When it comes to more expensive eateries, generous tippers leave an average of 19.6%. Wherever you go to stuff your belly, tip freely and tip often. After all, it not only stimulates the economy, but it also makes people more dependent on banks (hey, that cash has to go somewhere eventually). In the meantime, we thought our readers might like a few tips of their own during this period of immense industry turmoil and uncertainty.

Tip #1 - The industry has changed drastically and liquidity risk is a very big deal. Each day the news wires are filled with stories about financial entities under significant stress. As a group, bankers should focus additional energy on addressing weaknesses in liquidity that could increase risk to their bank.

Tip #2 - Work to better understand what liquidity management is really all about. To effectively manage liquidity, bankers need to make sure it is embedded into the fabric of the organization. It is an ongoing process focused on ensuring short term obligations can be met at a reasonable cost, while simultaneously ensuring capital is not strained. Keeping tabs on liquidity risk requires banks to have good management information systems, continually analyze liquidity needs under alternate scenarios, diversify funding sources and have contingency plans in place to ensure survival when unexpected consequences surface.

Tip #3 - Appreciate what liquidity risk is and make sure everyone within the bank also understands it. Liquidity risk is an inability to meet daily cash needs as a result of inadequate liquidity capacity or flexibility. Banks should not only make sure there are multiple pools of liquidity that are readily available (e.g. PCBB, FHLB, FRB Discount Window, etc.), but of nearly equal importance, staff should be trained how to respond in a liquidity crisis. Truly understanding funding options in advance of any issue maximizes flexibility.

Tip #4 - Develop key strategy elements and include them as part of the overall liquidity management process. To do that, bankers should make sure they have an agreed upon strategy for handling daily liquidity management, communicated that strategy throughout the bank and approved the strategy at the Board level. In addition, banks should make sure they have policies/procedures that relate to the liquidity strategy and that they have consistent ways to test and monitor things.

Tip #5 - Strengthen reporting and make sure any yellow or red flags that surface are quickly acted upon. One critical component in this regard is the need to ensure both management and the Board are regularly informed about liquidity. If the bank's liquidity situation changes in any material way, it is management's responsibility to immediately inform the Board. In addition, while having quality reports is a key component of any good liquidity management program, these must in turn be supported by regular monitoring and review of limits (on the size of each liquidity pool) and over various time horizons.

As has been seen repeatedly (over the past few weeks in particular), markets can be disrupted and those disruptions can be extreme. When that happens, liquidity can literally dry up overnight (even for very sophisticated and very well recognized companies). As such, now more than ever it is important for banks to constantly measure, monitor, control, report, test and retest liquidity. Controlling liquidity risk to some may seem like a simple and straightforward task. In reality, it is one of the most difficult to manage. Maintaining adequate liquidity and planning for contingencies these days is an ongoing and complex process. While tipping at restaurants is optional and dependent on service, ensuring your bank has a practical and realistic liquidity plan is not. Bankers should take another look at their liquidity plan to be sure it still works, even when access to funding and capital is reduced. Bankers should also take heart this final tip as they prepare for the next regulatory examination visit - examiners will not only evaluate a bank's ability to maintain access to liquidity in a "normalized" situation, but also when market stresses occur. Be prepared and be safe.

BANK NEWS

Goldman Sachs

The Wall Street firm reported 3Q profit fell 70%, the biggest decline in its 9Ys as a public company.

Fed Funds

In an effort to keep Federal funds at lower levels and ensure enough liquidity is in the system, the FRB turned on the spigots and flooded $50B into the system. This action comes after yesterday's $70B flow, which served to eventually push the Fed Fund rate down to 0.25%.