A HOLE IN ONE TWICE AND A CFP CAN BE QUITE NICE

by Steve Brown

A 64-year-old retiree, Ruth Day, from northern England sunk 2 holes in one in the same round last week. In case you were wondering, the feat is very rare indeed. In fact, Golf Digest estimates the odds against a golfer having two holes-in-one in the same round at 67mm to 1. We don't know if Ruth planned to do this or not, but having a good contingency plan in banking is certainly a good idea.

Disruptions in the credit and capital markets have exposed weaknesses in liquidity risk measurement and management systems, so it isn't any wonder that regulators are aggressively telling bankers to prepare a liquidity contingency funding plan (CFP). We get asked more and more what the heck that means, so we thought we would provide some more clarity today.

The basis for the CFP is to have a plan of action to minimize exposure to unplanned liquidity events. These events can include an inability to fund asset growth; difficulty renewing or replacing funding as it matures; the exercise of options by customers to withdraw deposits or to draw down lines of credit; legal or operational risks; the failure of a business line and market disruptions. The CFP, at its base, should be designed as a roadmap to incorporate practical solutions that can be adopted quickly by the bank to address contingencies if they arise.

Each bank is different, so each CFP will be different. As such, banks will have to consider multiple factors when designing and testing it. Some of the most common scenarios to plan for include deterioration in asset quality, becoming less than well capitalized, funding unplanned asset growth, the loss of access to market funding sources, recognizing operating losses, suffering negative press coverage or other events that may call into question an institution's ability to meet its obligations. When working on the CFP, banks should focus on both the direct and indirect effects of a given stress event to be sure it is robust enough to handle actual stress events.

Other key reporting and analysis is also critical when working on your CFP. In particular, analyzing which key metrics to report to the board is critical. Again, these can vary depending on the bank's business model. In general, bankers should build into the CFP defined responsibilities and decision-making authority (so that all personnel understand their role during a problem-funding situation); an assessment of the possible liquidity events that an institution might encounter; details as to how management will monitor for liquidity events (usually stress testing various scenarios); an assessment of the potential for triggering restrictions on to access brokered deposits; identification and analysis of the sufficiency of contingent funding sources. The CFP should also include back-up funding sources and the circumstances where the bank might use such facilities. A strong CFP should address legal, financial or logistical constraints to borrow from each source (notice periods, collateral requirements, capital ratio requirements, marketing, etc.).

Finally, the CFP should set risk limitations, which can include monitoring ratios as simple as loans to deposits, loans to equity capital, percentage of unpledged collateral or purchased funds to total assets. They can also be expanded to include cash flow coverage ratios (cash flow mismatches over specified time horizons); unpledged liquid asset reserves; asset concentrations (for both loans and securities); funding concentrations (on large depositors or sources of borrowed funds); and contingent liability metrics (unfunded loan commitments or lines of credit relative to available funding). Each metric or ratio should be appropriately modeled, stressed, compared to policy limits and regularly reported to ensure compliance.

We don't know if you have ever felt the thrill of sinking a hole in one or not, but we know sinking 2 in the same round probably feels about as good as completing a 100 page CFP in banking (well maybe not that good).

BANK NEWS

M&A

Vision Bankcard will acquire a controlling interest in ailing Centennial Bank ($239mm, UT). The terms were not disclosed.

SBA

At the beginning of next month, the SBA will raise the cap on goodwill financing from $250k to $500k.

Branch Activity

PNC said it will close 12 branches around the Pittsburgh area. Midwest Bank will sell 5 branches in the St. Louis area.

FDIC Reserves

The DIF balance may have been fallen to $10.4B at the end of 2Q. However, the FDIC actually has $42.4B in reserves, up from $41.5B in the 1Q. Due to the drop in bank's CAMELS ratings, the agency has increased contingent loss reserves to $32B, $3.5B more than the 1Q.

Foreclosures

Research by RealtyTrac finds foreclosure filings in Aug. exceeded 300k for the 6th straight month. NV was the highest at 1 in 62 households, followed by FL (1:140), CA (1:144) and AZ (1:150).

Credit Cards

New analysis finds credit card companies cut limits on an estimated 58mm people in the past year. The average credit limit reduction was $5,100 or about 2x more than the 6 month earlier period.

Good News

Analysis by the Boston FRB finds 30% of those who miss 2 mortgage payments eventually become current.

Correction

In yesterday's BID, we incorrectly stated the capital ratio required to be considered "Well Capitalized" was 8% for Tier 1 Risk-Based, when it obviously should have been 6%. Guess we were getting ahead of ourselves, but thanks to all who pointed that out.