CONTINGENCY FUNDING PLAN FOR LIQUIDITY

by Steve Brown

Google "CFP" and you will come up with options like Certified Financial Planner; Computers Freedom & Privacy; Conference for Food Protection; Conduit Flow Process and Call for Papers. While interesting, most bankers know CFP as "Contingency Funding Planning." We have covered this before, but given the new policy statement, we highlight items of interest that bankers should incorporate prior to the next exam.

As we have discussed, a CFP for bankers is really just a combination of policies, procedures and action plans in the event of unexpected liquidity issues. These are situations that arise that can increase liquidity risk. Regulatory documentation cites such examples as an inability to fund asset growth; an inability to renew or replace maturing funding liabilities; unexpected deposit withdrawals; off-balance-sheet commitment activity (unfunded commitment draws, etc.); a change in economic conditions or market perception; a change in market value or price volatility of assets; financial market dislocation; and disturbances in payment/settlement systems due to operational or local disasters. The goal of the CFP is to provide a plan that ensures liquidity sources are sufficient to fund normal operating requirements (without incurring undue expense or causing business disruptions).

Beyond just identifying CFP, banks also need to double-check to be sure processes are robust enough to address the latest policy. To do that, the CFP should be designed around a range of stressed environments, have clear lines of responsibility and articulate clear implementation and escalation procedures. Regulators expect banks to take into account events that are high-probability and low-impact, as well as low-probability and high-impact. Then, banks will need to assess variations around expected cashflow projections and make sure there is enough liquidity (both reserves and ways to capture additional funding) to survive the event.

At a minimum, regulators want banks to take into account many different factors when building the CFP. Among some of the most common: 1. Identify stress events that could have a significant impact on the bank's liquidity. These can include asset quality deterioration, changes in PCA capital categories, written agreements, CAMELS ratings downgrades, operating losses, declining equity price and negative press. 2. Take time to delineate various levels of stress severity that can occur so you can understand the different stages for each sort of event. Separate events into buckets to include temporary disruptions, intermediate & longer-term. Then, create early-warning indicators so you can assess funding needs at different points in a crisis and create action plans. 3. Identify external funding sources and uses to understand expected needs and available capacity during a given stress event. Pre-plan the loss of funding sources at various stages of a crisis and identify shortfalls that may occur as a result. In addition, banks need to understand their expected cash flows at various stages in crisis to better measure the bank's ability to internally fund operations. 4. Identify the crisis management team in advance and be sure training has occurred. That way, everyone knows what to do when the crisis hits. Be sure to create action plans for different levels of stress as well. Communication protocols are a key aspect of any crisis management and should include other team members, managers and the board of directors. A good CFP will increase communication requirements as the stress situation intensifies.

No matter the CFP you choose to incorporate or have already built into the fabric of your bank, it is important from time to time to revisit it to see what needs to be tightened up before the next examination team arrives - do that and at a minimum you will at least Certainly Feel Prepared.

BANK NEWS

AMBAC

The monoline insurance co. reported that it may seek a pre-packaged bankruptcy. If true, the event could potentially create an additional OTTI charge to banks that have purchased municipal bonds with AMBAC insurance.

Bank IPO

In a positive sign for bank capital, First Interstate Bancshares was the first bank to conduct an initial public offering since 2007. The successful IPO raised $135mm net of fees and places the Company in a position to purchase troubled banks.

Loan Mod

BofA announced that it will reduce the principal for 45k former Countrywide borrowers where their loan balance exceed home values. The conditions stipulate that the remaining balance must be 120% larger than the home's current value and that 30% of the loan balance will be forgiven only if the homeowner stays current for the next 5Y.

TAG

The FDIC confirmed that as of year-end 2009, more than 86% of institutions had opted in to the Transaction Account Guarantee Program.

Loan Risk

The Supreme Court ruled (United Student Aid Funds v. Espinosa) that if a bank fails to object to a bankruptcy plan, it cannot come back to court later seeking to collect the uncollected portion of the loan.

No De Novo

According to the FDIC, only 31 new charters were added in 2009, the smallest annual total since 1942.

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