Safeguarding Success – Managing Liquidity and Contingency Planning

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In its 2024 Supervisory Priorities, the NCUA set out examination priorities based on activities that pose the highest risk to federally insured credit union members (referred to as "*credit unions*") and that are responsive to the continuous stream of challenges facing credit unions in this current market. It should come as no surprise to anyone that liquidity risk is once again an examination priority for 2024, as the economic environment continues to be uncertain.[1] This all follows on the heels of the *Addendum to the Interagency Policy Statement on Funding and Liquidity Risk Management: Importance of Contingency Funding Plans* issued in July 2023 (the "*Addendum*"), highlighting the importance of contingency funding plans as a crucial component of managing funding and liquidity risk.[2]

NCUA's 2024 Supervisory Priorities

The NCUA areas of supervisory focus for 2024 largely mirrors the prior years, adding Interest Rate Risk (IRR) and dropping Fraud Prevention and Detection. This year's list outlines five (5) areas of examination:

(i) Credit Risk

(ii) Liquidity Risk

(iii) Consumer Financial Protection

(iv) Information Security (Cybersecurity)

(v) IRR

For each area, the NCUA sets forth the parameters of what materials examiners will review in accordance with specific criteria designed to mitigate risk. For liquidity risk, the NCUA once again stresses the importance of contingency funding plans, echoing the July 2023 Addendum. The Addendum emphasized that it is critical for credit unions to be prepared in the face of unpredictable circumstances – identifying the first half of 2023 as a reference point, where the rapid and irrational escalation of deposit outflows adversely affected liquidity and funding, thereby prompting additional guidance. These areas of concern continue to linger and threaten to dampen any optimism over market conditions in 2024.

Liquidity Risk Management

For liquidity risk management, examiners will evaluate:

(i) the effects of changing interest rates on the market value of assets and borrowing capacity;

(ii) scenario analysis for liquidity risk modeling;

(iii) scenario analysis for changes in cash flow projections for an appropriate range of relevant factors;

(iv) the cost of various funding alternatives and their impact on earnings and capital;

(v) the diversity of funding sources under normal and stressed conditions; and

(vi) the appropriateness of contingency funding plans to address any plausible unexpected liquidity shortfalls.[3]

Contingency Funding

For contingency funding plans, the Addendum provides an intelligible checklist: assess current funding stability, maintain diverse funding sources readily available under adverse circumstances, identify operational steps to ensure receipt of contingency funding, verify the readiness of contingency borrowing lines, plan timely movement and posting of collateral (requiring the potential involvement of the Federal Reserve System and the Federal Home Loan Bank System), and continuously evaluate and adapt funding plans as market conditions or strategic initiatives change. The NCUA acknowledges that complying with these contingency funding suggestions may be time-consuming and heeds that credit unions should give this due consideration.

The Addendum provides a timely reminder about utilizing the Federal Reserve Discount Window or the Central Liquidity Facility (which is required for credit unions with assets greater than $250 million) in the face of challenging circumstances.

Points of Performance

As credit unions continue to map their regulatory initiatives and/or audit plans for the year, we emphasize that credit unions should take a close and thoughtful look at their liquidity management program and associated policies and procedures. More specifically, credit unions should consider:

- Planning for adverse events and contingencies, including identifying minimum and maximum liquidity needs and weighing alternative courses of action.
- Define and place limits on certain types of funding sources, e.g. maximum loan-to-deposit ratio or loan-to-asset ratio, individual and aggregate limits on borrowed funds by type and source, minimum level of short-term investment.
- Establishing indicators or triggers that escalate to management when a certain risk threshold is reached.
- Monitoring of:
  - seasonal or cyclical factors that may cause loan and deposit levels to move in opposite directions to anticipate meet loan demand or deposit withdrawals;
  - daily cash as well as long-term liquidity needs through forecasting;
  - the price and availability of credit and the level of liquid assets available to meet funding requirements the incremental cost of liquidity, whether gained through asset management, liability management, or a combination of both.
- Completing a cash flow projection of all significant on- and off-balance sheet flow and related impact.

These factors represent a few examples among more particularized approaches some institutions have taken. We recommend that credit unions give due consideration to how these and any other factors it may find to be relevant all contribute to a robust and comprehensive liquidity management solution.

While all the NCUA's 2024 Supervisory Priorities are important to credit unions, specific considerations around liquidity risk management and contingency funding merit special attention, consistent with the overlapping theme in the Addendum. We encourage our credit union clients to consider communicated supervisory priorities and recent guidance in assessing and planning regulatory activities to address risk and ensure compliance.

For More Information

We are available at any time to answer questions, discuss scenarios, and provide guidance. If you would like further information concerning the matters discussed in this article, please contact the following attorneys or the Chapman attorney with whom you regularly work.

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1 National Credit Union Administration, "NCUA's 2024 Supervisory Priorities," January 2024: https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/ncuas-2024-supervisory-priorities.

2 National Credit Union Administration, "Importance of Contingency Funding Plans," July 2023: https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/importance-contingency-funding-plans.

3 See NCUA's 2024 Supervisory Priorities.