CONVERSATIONS WITH THE ST. LOUIS FED

FEDERAL RESERVE BANK of ST. LOUIS
CENTRAL TO AMERICA'S ECONOMY®

April 18, 2018

10:30AM to 11:15AM CST

The "New Normal" of Liquidity:

Current Environment, Funding Sources and Examination Expectations

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Todays Presenters

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Disclaimer

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Objectives

- Address concerns expressed by bankers with respect to funding and the emphasis of regulators on liquidity risk management
- Discuss regulatory expectations - SR 10-6 - Interagency Policy Statement on Funding and Liquidity Risk Management (March 17, 2010)
- Review recent “Lessons Learned” through day-to-day supervision and bank failures
- Summarize today’s discussion
- Take your questions

What Bankers are Saying

Community Depository Institutions Advisory Council

- 12 executives of various community financial institutions
- Meets twice a year to discuss banking, credit, and economic issues

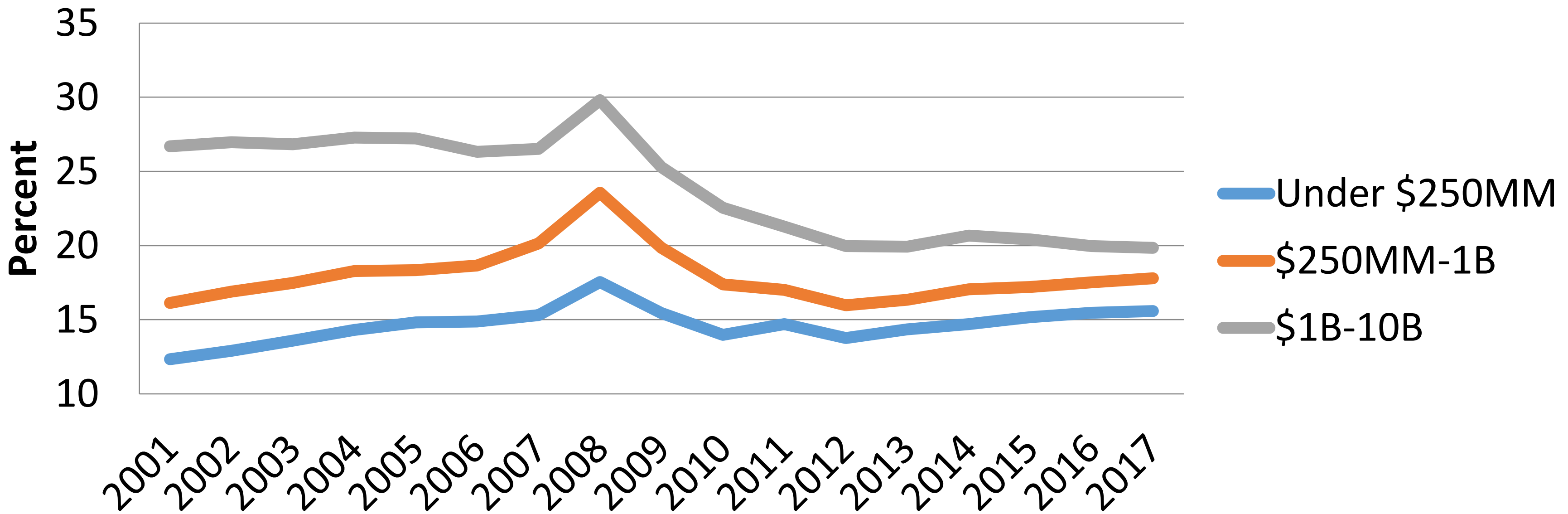
What Bankers are Saying

<u>Comments from our Community Depository Institutions Advisory Council</u>

1. Deposits are the “number one” problem facing community banks.
   - Growing slowly, or contracting, as consumers prefer alternative investments with higher yields
   - Worry that these consumers “are not coming back”
   - Exodus constrains growth, is “not good for small business lending” and constitutes a long-term “strategic” concern
2. Intense rate competition exists in some markets.
3. The struggles of community banks to maintain deposits are not limited to issues with rates.
4. Council members noted that with diminishing core deposits, regulators will need to gain comfort with alternative funding sources as the “new normal.”

Trends -Wholesale Funding to Total Assets

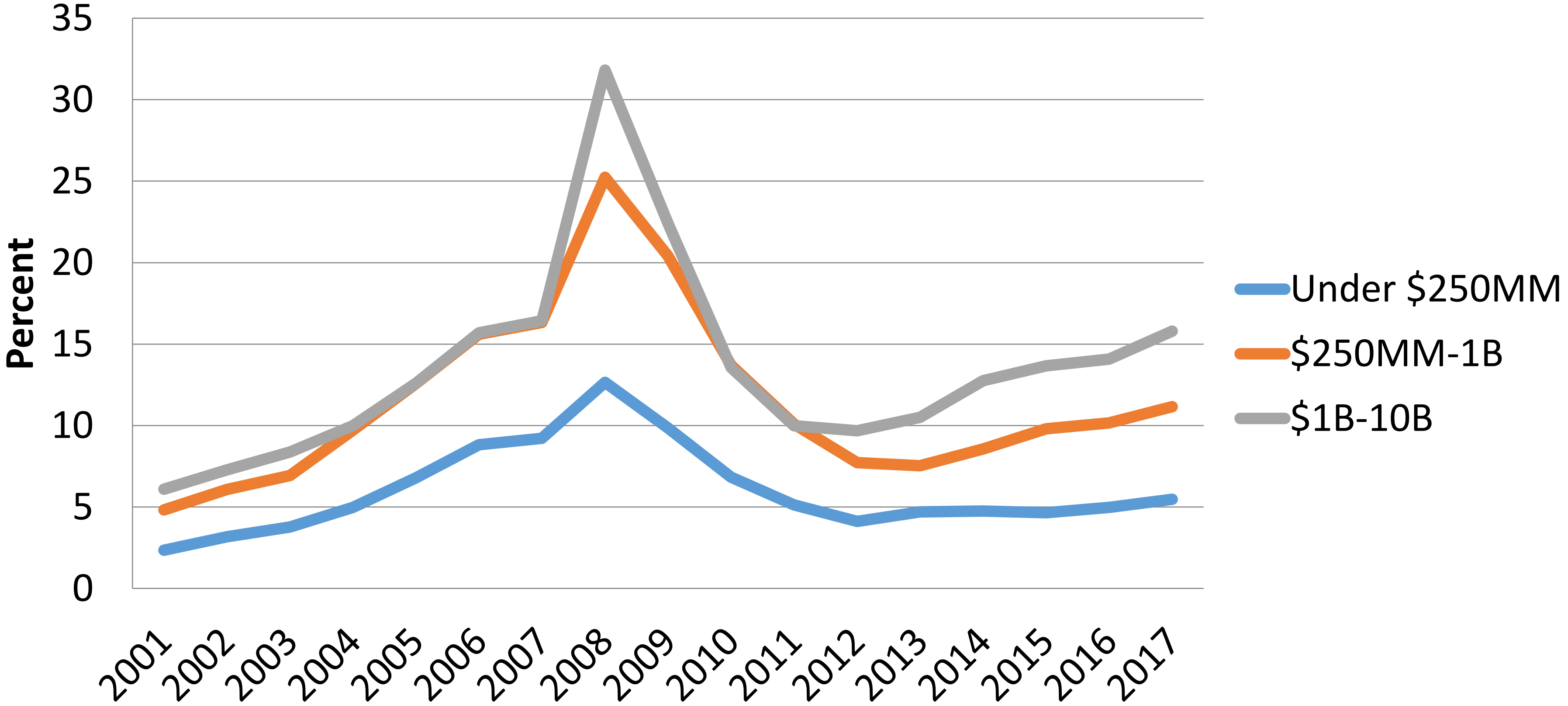
Wholesale funding usage becoming more prevalent at institutions below $1 billion in assets



Source: Call Report Data

Trends - Brokered Deposits > 10% of Assets

Brokered deposit usage increasing as deposit market tightens

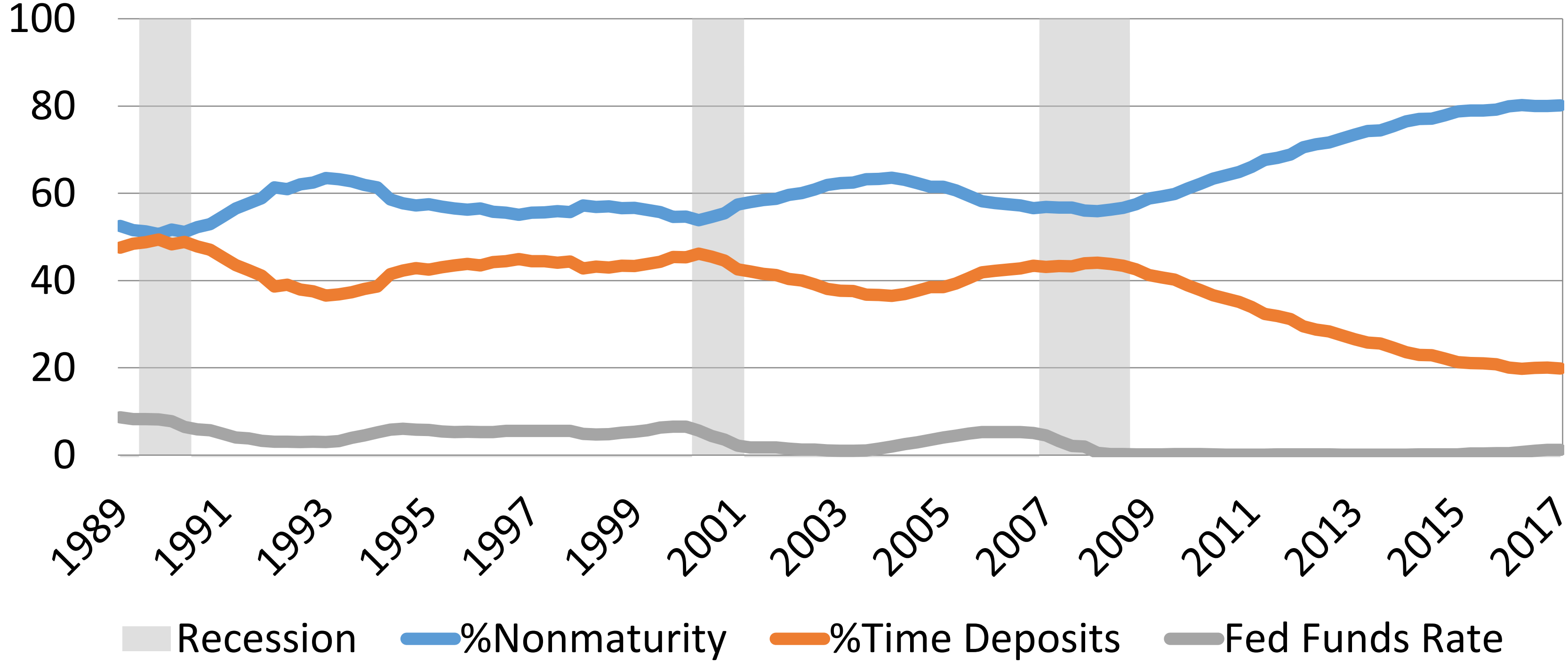


Source: Call Report Data

Spread Between Non-maturity Deposits and Time Deposits is Wider Than Ever

Banks Under $10 Billion in 2017 Dollars

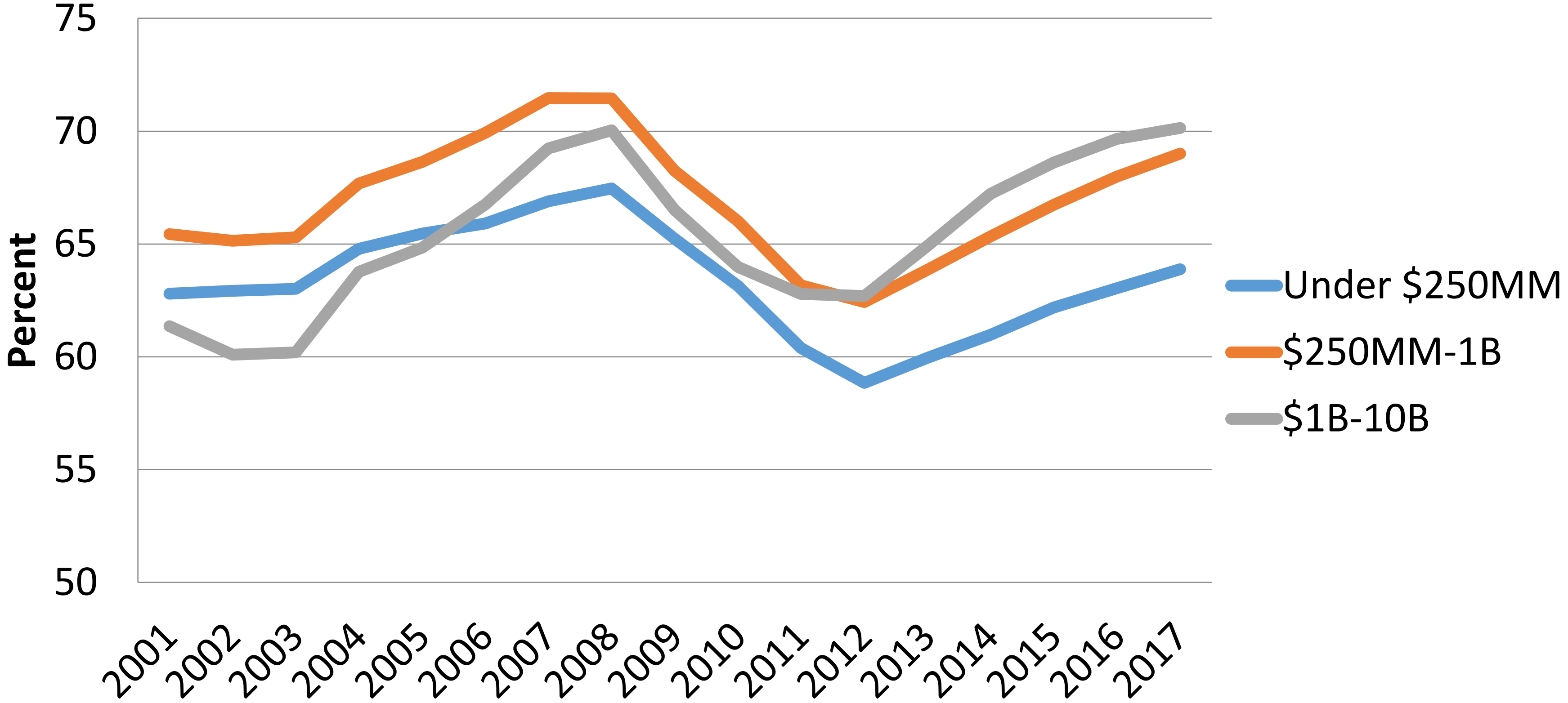
Non-maturity deposits are funding a greater percentage of assets



Source: Call Report Data

Trends - Loans to Assets

Total loans and leases on the rise after retreating post-crisis



Source: Call Report Data

Regulatory Outreach on Liquidity

11/6/17 Interagency Call –

Federal Deposit Insurance Corporation, Comptroller of the Currency, Federal Reserve System, Conference of State Bank Supervisors

- Ongoing emphasis on regulatory outreach
- Not discouraging use of noncore funding, but focusing on regulatory expectations
- Highest concern is when noncore funding is used for rapid loan growth

Regulatory Expectations of Liquidity Risk Management

The Five Pillars

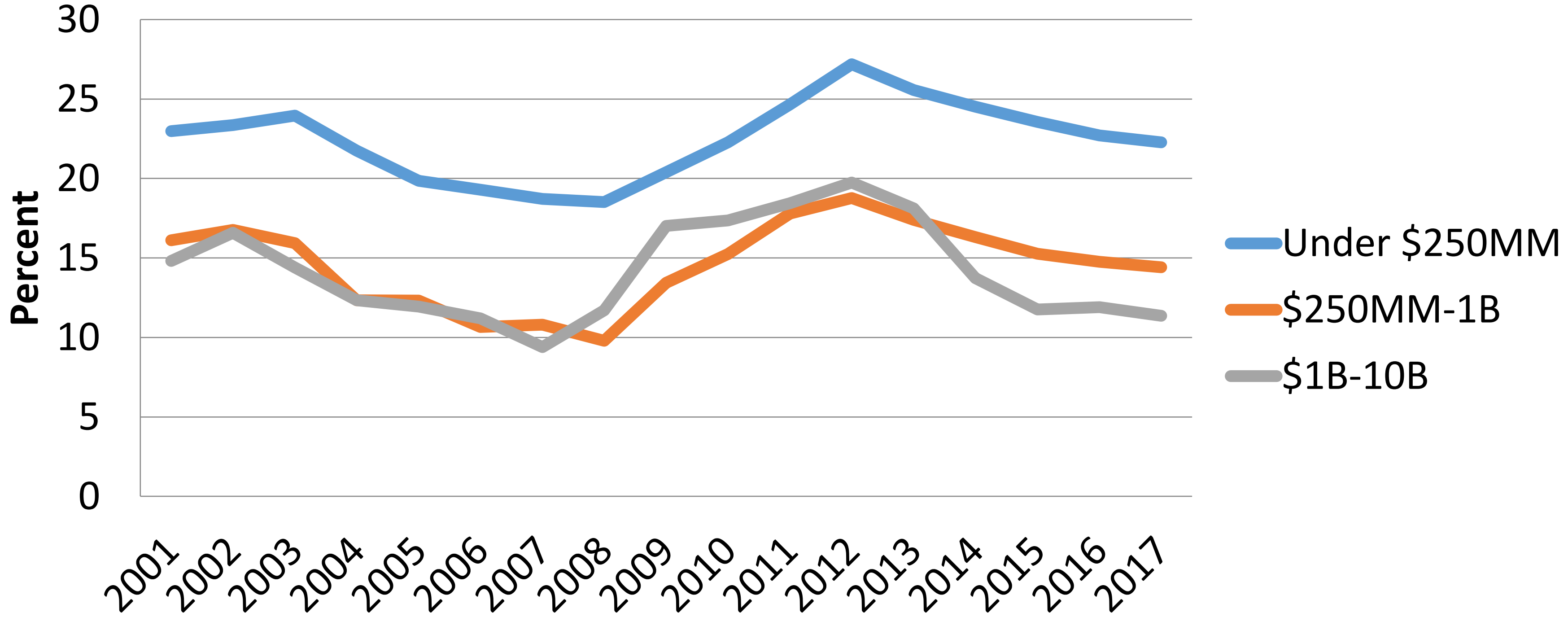
- Cushion of Liquid Assets
- Diversified Funding Sources
- Cash Flow Projections
- Stress Testing
- Contingency Funding Plan

Cushion of Liquid Assets

Eighth District Banks

First line of liquidity defense
No legal, regulatory or operational impediments

Liquid Assets[1] to Total Assets



Source: Call Report Data

[1]Liquid Assets Proxy: Cash and Due Froms + Interest Bearing Bank Balances + Fed Funds Sold + Reverse Repos + Unpledged AFS Securities

Diversified Funding Sources

- Core Deposits
- Stable versus Nonstable
- Brokered /Listing Service/High Interest Accounts
- Laddering Maturities

Cash Flow Projections

- Appropriate Time Horizons
- Realistic and Institution-Specific Assumptions
  - Customer behavior
  - Options
  - Seasonality
  - Growth / funding off-balance sheet

Stress Testing

- High Probability, Low Impact Scenarios

  Examples:
  - Unexpected funding of off-balance sheet items
  - Large depositor run-off

- Low Probability, High Impact Scenarios

  Examples:
  - Capital downgrade
  - Major economic event

Contingency Funding Plan

- Liquidity Event Management Process
  - Roles and responsibilities
  - Early warning indicators or triggers
- Testing
  - Should test all aspects

Funding and Liquidity Impact of PCA Restrictions

Prompt Corrective Action (PCA)

- Main restrictions
  - Brokered deposit restriction
  - Limits on deposit rates that can be offered

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Conclusions

- Interagency guidance covers all banks
- Strongest expectations are for banks using noncore funding for rapid growth or expansion of risky lending segments
- Sets a higher bar both for bankers and for examiners

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References

[Interagency Policy Statement on Funding and Liquidity Risk Management]

[Contingency Funding Plan: Banking Busywork or Essential Management Tool?]

[Navigating the Great Deposit Migration Through Interest Rate Risk Modeling]

[Interagency Liquidity Call November 2017 – Transcript]

[FDIC National Rates and Rate Caps]