Why the Liquidity Policy is Important

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Since we have passed the March 31 deadline for the NCUA's Emergency Liquidity Rule, credit unions should now have in place a liquidity policy reflecting their specific preferences for monitoring liquidity levels and steps to take in a crisis. During recent discussions with credit unions working on this policy, many felt this exercise was a waste of time as they never had a liquidity crisis and don't foresee one happening. In recent years, the combination of high share growth and low loan demand left many credit unions with substantial liquidity levels. Therefore, the NCUA requirement for a detailed liquidity policy and contingency funding plan (for credit unions over $50 million in assets) seemed to be an irrelevant exercise.

However, the importance of the liquidity policy should not be overlooked. Like an insurance policy that we hope to never use, the liquidity policy does serve as a useful tool for management and staff to guide them through a potential crisis.

Set Your Preferences

The liquidity policy is your opportunity to set the thresholds for the liquidity levels which your credit union prefers to operate. Some credit unions like the comfort of a large liquidity cushion, while others prefer to maintain a lower level. Many credit unions have also differed on their preferences of emergency liquidity options – some credit unions have no issues with borrowing funds, while others only see borrowing as an opportunity of last resort. Take some time to establish your preferences, and share them in an approved document with staff, so they understand the philosophy of your credit union.

Schedule Testing

The greater argument for the creation of a liquidity policy is that unforeseen situations do happen and all institutions need to be prepared. Circumstances such as bad publicity or the downsizing of a local employer could result in negative share growth that quickly develops into a liquidity crisis. That is why the NCUA is also looking for credit unions to stress test their sources and uses of funds analysis. By creating hypothetical scenarios such as negative share growth or an early redemption of certificates, the credit unions can determine how their liquidity levels would be impacted if such crisis events occurred. They are also encouraging credit unions to test liquidity sources on an annual basis. While you may think you have access to a line of credit, you should have the appropriate staff run through the scenario once a year to make sure that the process runs smoothly.

Final Thought

A guideline to consider when establishing your policy standard is to *write your policy so that a complete stranger would know how you want things done.* Could a stranger walk into your credit union and know how to manage your liquidity levels, or get through a liquidity crisis? While we may not think that a liquidity crisis is on the horizon, creation of the liquidity policy is your opportunity to guide staff through the proper channels to ensure the future health of your credit union.