

Contingency funding plans

Satisfying regulators continues to be key challenge

Institutions need to ensure that in today's difficult economy, they have workable contingency funding plans that pass muster with examiners, an industry strategist warns.

Not infrequently, bankers lack the real-world experience necessary for certain aspects of such plans; and regulators don't provide a sample plan to follow. In addition, smaller institutions may lack the adequate staffing, or necessary in-house expertise, to accomplish the task as a top priority.

Among the liquidity-contingency challenges that institutions face, two major items stand out, says Dave Sweeney, managing director, Chatham Financial Corp., Kennett Square, Pa.

Sweeney understands how liquidity stress events can damage an institution. When he was treasurer and chief investment officer at a \$2.5-billion-asset commercial bank based in Naples Fla., it underwent a serious liquidity problem and failed in late 2009.

"It's essential to have documented (liquidity) triggers, and an internal communications plan all figured out," Sweeney said. "The key thing for liquidity contingency funding is to be ahead of the curve."

He explained that to be prepared, it's critically important for an

institution to have "relevant triggers" in place that identify a potential liquidity stress situation before it actually occurs. For example, if the institution's forecast of net income over the next 12 months indicates that it will start losing money, or that its level of income will decrease, that's a "potential trigger for a liquidity event."

In addition, another liquidity trigger is the institution's capital level and whether it is expected to fall. To determine this, it's necessary for management to adopt a forward-looking stance to evaluate the situation.

Such triggers are especially important, because they enable the institution to assess a developing liquidity situation internally before their counterparties will have Call Report data on the same developments. Most counterparties tend to use call reports for doing a credit analysis, Sweeney said.

And if management finds that the institution will be losing money in two quarters, or that capital levels will be reduced, then it needs to take action. "I better start implementing my contingency funding plan today, building up cash reserves—because cash is king," Sweeney said.

A second key item involves communications during a liquidity

event. "Management really needs to build an internal communications plan for when they do get into a contingency funding situation, or a liquidity stress scenario," he said. "Make sure that all of the executive management team is on the same page and communicates consistently—and don't get anxious about it."

"The key thing is that customers come in and ask questions about you—because they get information about you, and they hear stories," he said. The main point is that the institution needs to ensure that it is communicating a "consistent message" during a liquidity event—"you've got to get that down early," he stressed.

"Everyone on the executive management team has to be rowing in the same direction when these things are put in place—or you're going to perhaps cause a minor run on your bank," he said. "But it could be major if you're not 'even-keeled' with everyone rowing in the same direction."

Sweeney also pointed out that when an institution is in a major liquidity stress situation, banking executives are pulled in multiple directions. That's why it's so important to have the communications plan well organized and in place prior to a stress event. **FMU**

Debit interchange fees

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Not surprisingly, concerns about the interchange rule's impact on small institutions intensified after Fed chairman Bernanke told a recent Senate Banking Committee hearing that the planned rule exemption for institutions under \$10 billion assets may not be effective in the marketplace. He acknowledged there may be no way to ensure that smaller issuers are exempt.

Also testifying at the Senate committee, Fed governor Sarah Bloom Raskin noted that the Fed would delay its rule-making process if Congress directs it to do so. She acknowledged that certain sections of

the Dodd-Frank Act that instruct the Fed to ensure that interchange fees are "reasonable and proportional" to the costs of maintaining a debit card system were difficult for the Fed to interpret.

The ABA's Kemper emphasized that the small-bank exemption will not work in practice. "Every community banker that I speak with strongly believes they will be severely impacted by the interchange price controls imposed on larger banks," he said.

The economics involved suggest that market share will flow to the lowest-priced product, even if those

lower prices are mandated, he said. "The result for small banks is either a loss of market share, a loss of revenue that supports low-cost accounts and other valuable services, or both."

He pointed out that if the current proposal is implemented, banks will likely see a 70% to 85% cut in debit-card revenues. "This means that the income earned on the service will be significantly less than it costs a bank to provide," he added.

"The proposed rule dictates that my bank—and financial institutions throughout the country—must lose money on every debit card transaction we process unless we charge consumers more," Kemper said. His

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