



Risk-Managed Internal Audit and Credit Review Expertise

NEWS

AuditOne Advisory: Liquidity Risk Management Analysis 2020

AuditOne, LLC

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AuditOne Advisory

From Bud Genovese, Chairman

This Advisory presents data that we have compiled to help in your institution's Liquidity Risk Management (LRM) process. AuditOne performs many remote-based LRM audits every year at institutions in the Western US and around the nation. One of our ALM audit specialists, Kruskal Hewitt, has developed the following presentation of liquidity metrics and limits from a range of financial institutions. Mr. Hewitt has been a risk manager, portfolio manager and trader at international and regional banks. I hope you find this information useful, and please share with your colleagues having responsibilities related to Liquidity Risk Management and Liquidity Policy. Thank you, — Bud

AUDITONE LLC'S ANALYSIS OF LIQUIDITY LIMITS 2017 – 2019

AuditOne LLC is a leading provider of outsourced internal audits for community banks and other small/midsized financial institutions (FIs), predominantly in the western US. Please refer to our website (www.auditonellc.com) for further information. Asset/Liability Management (ALM) is among AuditOne's practice areas, and within that we perform many audits of Liquidity Risk Management (LRM) every year. US FIs are expected to have regular internal audits of their monitoring and control of LRM, which requires a variety of tools.

AuditOne has compiled (anonymously) data from 70 of our LRM clients on liquidity limits. These are institutions where we have used data from the most recent AuditOne LRM audit, no further back than 2017. AuditOne believes this database is relevant to AuditOne clients because it covers a relatively narrow range of asset size, geography and business lines. AuditOne updates this analysis annually.

WHICH LIMITS?

Regulators have not created rules or detailed guidance on how liquidity risk should be modeled, measured or limited, as there are with interest rate risk. Nor are liquidity risks similar from one FI to another, as in investments risk (where all FIs invest in a relatively narrow range of financial instruments). As a result, there is a broad proliferation of metrics (and limits), differing widely across institutions. As shows below, there are only two measures that are used by more than half of our clients and only seven that are used by more than 30%. As a result, our analysis of FI liquidity risk limits is inconclusive; rather, those limits are customized to each FI's individual needs.

AuditOne has analyzed the limits on liquidity and funding sources of 70 regulated FIs over the period 2017 through 2019. In this group there is one FI with only two liquidity policy limit measures, and two with as many as 18 measures; the average is nine. There is no correlation between balance sheet size and the number of policy measurements; the second smallest balance sheet (\$70 million) has 14 policy measures and the largest (\$11 billion) only two limits. The 70 FIs have in total 109 different measures of liquidity. Of these, 71 are used by only one or two FIs. However, 58 out of 70 FIs have at least one of the two most prevalent limits:

- Net Non-Core Funding Dependence, used by 51 (73%) of the 70 clients
- Loans / Deposits, used by 37 (51%)

Brokered deposits are also a common limit variable; 45 (64%) of the institutions covered have a limit on brokered deposits expressed as a percentage of either total deposits or total assets.

Overall, we believe that our clients are satisfactorily monitoring their liquidity positions, and that the common points of liquidity risk exposure across institutions generally get appropriate attention. We do not suggest an "ideal" set of liquidity measures.

Please note: The difference between "less than" and "less than or equal to" (or "greater than" and "greater than or equal to,"), is minimal (in ratio terms). In the following presentation we have made no distinction between the two. For ease of notation, only "less than" (<) and "greater than" (>) are used.

DEFINITIONS

Brokered Deposits / Total Deposits: In the numerator, all brokered deposits (per regulatory definition) and all deposits > \$250,000 (unless the institution has designated specific large depositors as core).

FHLB Advances / Total Assets: In the numerator, all collateralized borrowings from the FHLB.

Liquid Assets / Total Assets: In the numerator, all assets that mature within one year plus all Available for Sale securities (all maturities).

Liquid Assets / Total Deposits: Ditto.

Net Non-Core Funding Dependence: Calculated as noncore liabilities less short-term investments divided by long term assets. Noncore liabilities are total time deposits > \$250,000 plus other borrowed money plus foreign office deposits plus securities sold under agreements to repurchase plus Federal Funds purchased plus insured brokered deposits. Long term assets are net loans and leases, plus all securities less debt securities with a remaining maturity of one year or less, plus other real estate owned (non-investment).

Wholesale Funding / Assets: The numerator is brokered deposits (including CDARS) plus listing service deposits plus security repurchase agreements plus net Fed Funds purchased.

2017 – 2019 DATABASE ANALYSIS

This analysis presents results across our entire database of 70 LRM audit clients. We would be happy to recalculate any of the results for subsets of institutions based on asset size, primary regulator, and/or a specific limit that is not listed below; please contact our CEO Jeremy Taylor at 562-802-3581.

Note that “< %” implies a limit expressed as a maximum (i.e., the highest that ratio can go), and vice versa. This is in contrast, in the tables below, with “Maximum” which indicates the highest limit amount across the database and “Minimum”, the lowest limit amount, whether the limit itself represents the highest or lowest the ratio in question, allowed.

Net Non-Core Funding Dependence: <%

Clients	Average	Median	Minimum	Maximum
51	26%	25%	7%	60%

Loans / Deposits: <%

Clients	Average	Median	Minimum	Maximum
37	103%	100%	75%	135%

On Balance Sheet Liquidity / Deposits: >%

Clients	Average	Median	Minimum	Maximum
31	15%	15%	7%	40%

On Balance Sheet Liquidity / Assets: >%

Clients	Average	Median	Minimum	Maximum
31	12%	10%	3%	20%

Brokered Deposits / Total Deposits: <%

Clients	Average	Median	Minimum	Maximum
30	16%	13%	5%	75%

FHLB Advances / Assets: <%

Clients	Average	Median	Minimum	Maximum
26	24%	25%	10%	40%

Wholesale Funding / Assets: <%

Clients	Average	Median	Minimum	Maximum
22	30%	30%	10%	50%

DATABASE MIX SUMMARY**Database mix by asset size (all dollar figures in millions):**

Clients	Average	Median	Minimum	Maximum
70	\$1,018	\$371	\$24	\$11,400

Database mix by primary regulator (all dollar figures in millions):

Clients	Average	Median	Minimum	Maximum	Regulator
51	\$1,153	\$378	\$70	\$11,400	FDIC
9	\$316	\$235	\$24	\$1,069	OCC
8	\$721	\$497	\$209	\$2,000	FRB
1	na	na	na	na	FISCU
1	na	na	na	na	NACU

AuditOne LLC – Company Overview

AuditOne LLC is a leading provider of risk management services to financial institutions in the Western US and nationally. Our sole focus enables us to deliver effective and efficient internal audit and credit review services. This exclusive focus translates into exceptional benefits to our financial institution clients. We have experience with all regulatory authorities and offer a full selection of audit services comprising BSA/Anti-Money Laundering Program, Automated AML System Validation, Asset/Liability Management (ALM) and IRR Audits, ADA Website Compliance Reviews, IT/Information

Security/Cybersecurity, Network Penetration Tests, Credit Review/ALLL, ACH Rules Compliance, Operations, Trust Audits, SOX/FDICIA Testing, and many specialty areas within each of these.

Our deep expertise is your edge. For more information on this article, or to receive a proposal for Liquidity Risk or other Asset/Liability Management Audits, please contact David Kellerman, ALM Practice Director, AuditOne LLC, at: [Contact Us](#)

For information on how our services can help reduce risk at your institution, contact Jeremy Taylor, CEO, at: [Contact Us](#). Also, for more information about AuditOne LLC and all our audit services see www.AuditOneLLC.com.

AuditOne has been [audited for compliance](#) with the QAR requirements of the Institute for Internal Auditors (IIA).

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