DCU BULLETIN

Division of Credit Unions
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Focus on Liquidity

In 2001, credit unions experienced a large influx of deposits due to a variety of economic factors. These deposits have caused many credit unions to carry a great deal of liquidity on the balance sheet without adequate plans for use of the funds. As economic conditions change credit unions may experience an outflow of funds. Because of these conditions, the examiners will analyze each credit union's ability to meet the challenges. The NCUA Letter to Credit Unions # 02-CU-05, Examination Program Liquidity Questionnaire, provides a copy of the questionnaire the examiner may use to evaluate your credit union's liquidity. It can also be a thought provoking document to guide your liquidity and funds management. Your CAMEL rating for this component will, in part, be determined based on your ability to plan for and meet potential liquidity needs without adversely affecting daily operations.

The credit union liquidity management tools the examiners review will include, but are not limited to, the following:

- Budget
- Business (Strategic) Plan
- Liquidity Policies and Plans
- Cash Flow Forecast

Budget and Business Plan

Your budget and business plan must reflect your assumptions about the movement of funds in and out of the credit union, both on the asset and liability side of the balance sheet. This will require a pro forma (forecasted) balance sheet in addition to the income statement budget. Since the budget is a working document within the business plan, your liquidity concerns, goals, and strategies must be addressed in writing.

Liquidity Policies and Plans

Credit unions should develop policies and plans that address liquidity beyond simply the acquisition of lines of credit. The policies and plans should also, when appropriate, develop procedures and criteria for balancing the credit union's liability funding costs relative to its yield on assets. Additionally, the credit union should develop controls that will ensure this activity falls within the stated goals identified in the business plan.

In addition to the acquisition of funds, the policies and plans need to address what to do with excess funds. Simply placing money in overnight accounts may not be the most effective use for those funds and has created situations in which a number of credit unions are paying more for deposits than they are earning on the resulting assets.

Credit unions should periodically analyze, document, and report their liquidity positions as part of a sound funds management program. Proper forecasting and planning help anticipate needs before they arise and provide for timely consideration of potential solutions.

Cash Flow Forecast

The examiners will review your forecasts of expected inflows and outflows of funds. Many times examiners find cash flow forecasts consists only of balancing the bank account at the beginning of the day. Your analysis needs be based on your detailed knowledge of anticipated changes in cash flow for the credit union. As an example, successful forecasting includes but is not limited to the following:

- Investment maturities and purchases
- Expected loan and investment payments
- Expected funding or sale of loans
- Expected acquisition of deposits
- Members' deposit patterns (primarily in share draft portfolios and payroll deposits)
- Upcoming capital projects
- Contingent liabilities

Depending on the size and complexity of your operations you may need to forecast the cash flows daily, weekly, or monthly.

For additional information please call either Jane Johnson at (360) 902-0508 or Mike Delimont at (360) 902-8790.