DATE: June 8, 2009

MEMORANDUM TO: Board of Directors

FROM: Sandra L. Thompson, Director
Division of Supervision and Consumer Protection

SUBJECT: Proposed Interagency Guidance – Funding and Liquidity Risk Management

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Proposal: That the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) approves the publication of the attached document titled *Proposed Interagency Guidance – Funding and Liquidity Risk Management* (proposed Guidance) for a 60-day public comment period. The proposed Guidance summarizes the principles of sound liquidity risk management that the agencies have issued in the past and, where appropriate, brings them into conformance with the "Principles for Sound Liquidity Risk Management and Supervision" issued by the Basel Committee on Banking Supervision (BCBS) in September 2008. While the BCBS liquidity document primarily focuses on large internationally active financial institutions, this proposed Guidance emphasizes supervisory expectations for all domestic financial institutions including banks, thrifts and credit unions. The FFIEC's Task Force on Supervision (which has delegated authority from the FFIEC) approved this Guidance on June 3rd, 2009. If approved by the agencies, the proposed Guidance would be published in the *Federal Register* on an interagency basis by the FDIC, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (together, the agencies).

Recommendation: That the Board approves the publication of this proposed Guidance for public comment.

Concur:

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Michael Bradfield
General Counsel

Introduction

The FDIC Board of Directors is being asked to approve for publication in the *Federal Register* the attached proposed Guidance which summarizes the principles of sound liquidity risk management that the agencies have issued in the past and, where appropriate, brings them into conformance with the "Principles for Sound Liquidity Risk Management and Supervision" (Liquidity Principles) issued by the Basel Committee on Banking Supervision (BCBS) in September 2008. This proposed guidance is also consistent, where relevant, with the FIL # 84-2008 Liquidity Risk Management issued by the FDIC on August 26, 2008.[1]

Background

In September 2008, the Basel Committee released their Liquidity Principles, which provided guidance in response to recent events that illustrated liquidity risk management at many financial institutions needed improvement. Deficiencies included insufficient holdings of liquid assets, funding risky or illiquid asset portfolios with potentially volatile short-term liabilities, and a lack of meaningful cash flow projections and liquidity contingency plans. Each country represented on the Basel Committee agreed to implement this guidance domestically. The FFIEC's Task Force on Supervision approved this Guidance on June 3rd, 2009.

The Proposed Guidance

This proposed Guidance defines the process that institutions should follow to appropriately identify, measure, monitor and control their funding and liquidity risk. In particular, the guidance emphasizes the importance of cash flow projections, diversified funding sources, stress testing, a cushion of liquid assets, and a formal well-developed contingency funding plan (CFP) as primary tools for measuring and managing liquidity risk. The agencies expect all financial

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[1] http://www.fdic.gov/news/news/financial/2008/fil08084.html.

institutions[2] to manage liquidity risk using processes and systems that are commensurate with the institution's complexity, risk profile, and scope of operations. Liquidity risk management processes and plans should be well documented and available for supervisory review. Failure to maintain an adequate liquidity risk management process is considered an unsafe and unsound practice.

[2] Unless otherwise indicated, this interagency guidance uses the term "financial institutions" or "institutions" to include banks, saving associations, credit unions, and affiliated holding companies. Federally-insured credit unions (FICUs) do not have holding company affiliations and therefore references to holding companies contained within this guidance are not applicable to FICUs.