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Building Your Liquidity Stress Test

By Kris Muller, CFA, Senior Portfolio Manager, Balance Sheet Solutions, LLC

In 2013, the NCUA implemented a ruling on Liquidity and Contingency Funding plans that reinforced liquidity planning guidelines based on credit union asset size. One of the components of this guidance was for credit unions to conduct a regular liquidity “stress test” to assess how well they would handle various liquidity events.

For many institutions, a liquidity stress event has never occurred, so projecting member behavior in unknown situations may be difficult. However, with some consideration, every credit union should be able to show examples of how their cash flow may be impacted under certain scenarios.

Making Projections

This stress test is driven by understanding the volatility of your cash flows. Are your cash flow projections based on national averages, or historical experience? Do you have a high core percentage of share deposits that may stay during a stress event, or a large amount of hot money that will move quickly? The more accurately your projections match your actual member behavior, the more realistic your assumptions will be. Studying your historical data, especially some of your tightest liquidity periods, may provide some good data for your analysis.

Getting Started

Begin with your base case scenario – what are your budgeted numbers for the upcoming year? From there, build three scenarios that you would consider a plausible worsening liquidity situation at your credit union. For example, a moderate liquidity crisis could be share growth rising by 2% instead of the projected 4%. A worsening crisis may show an outflow of shares, while an extreme crisis may show double digit share declines:

Growth Rate Assumptions				
	Budget	**Moderate**	**Severe**	**Crisis**
Sources of Funds				
Non-Maturity Share Growth	4%	2%	0%	0%
Uses of Funds				
Share Outflows	0%	0%	5%	10%

These will only be starting points, but from there, your credit union should consider other cash flow items, such as:

- How will you handle loan growth in a liquidity crisis? Will you slow demand through higher rates or choose to borrow?
- In addition to low or negative share growth, how would you handle maturing certificates? Would you let the money leave, or offer higher rates?
- If the liquidity crisis is a systemic event, such as a market collapse, will investments be sold at their full value?
- How will your credit union's equity be impacted?

The complexity of the stress test will depend on the size of your institution with larger credit unions expected to have a more detailed analysis. Your starting cash flow projections could come from either a *Sources and Uses* report, or the *Gap Cash Flow* report generated from your Asset Liability Modeling reports. The key question for every scenario: Do you have enough cash flow, either through primary or secondary sources, to meet your liquidity targets?

It is impossible to project exactly what will happen if a liquidity event occurs at your credit union. However, this exercise in considering what *may* happen should help staff see the warning signs of potential problems and enact planning where needed.

For more information, please contact your Balance Sheet Solutions representative or email Kristina Muller *at kristina.muller@balancesheetsolutions.org.*