CRI CARR RIGGS & INGRAM
CPAs and Advisors

LIQUIDITY RISK MANAGEMENT FOR COMMUNITY BANKS

In recent times, regional banks have faced significant liquidity concerns, prompting a renewed emphasis on liquidity risk across the financial sector. This heightened focus has extended to community financial institutions, necessitating the assurance that their processes and controls align with regulatory expectations and industry standards. CRI's recent Quick Hit webinar was conducted to address these pressing issues and provide invaluable insights into the evolving landscape of liquidity risk.

LESSONS FROM RECENT BANK CLOSURES

One need not look far to find yet another article or viewpoint on Silicon Valley Bank (SVB) and the liquidity issues that ultimately resulted in the SVB's demise. Similarly, there is no shortage of opinions as to whether other regional banks are, in fact, at risk of a similar fate. Entwined in those discussions, are a myriad of references to "small banks," as if to say SVB, Signature Bank, and First Republic Bank were actually "small".

A "community bank" is typically considered any bank with less than $10 billion in total assets. For context, Signature Bank was the smallest of the three banks referenced above, with total assets of approximately $110 billion. SVB and First Republic were both in the $200 billion asset range. As such, none of the above were community banks, and their risk profiles and relative complexity were very different from a traditional community bank.

Considering the closures referenced above and the context of size, it is a good time to revisit the fundamentals of liquidity risk management (LRM). Liquidity risk is nothing new to community banks but became a focal point during 2022, as interest rates increased and bond prices declined. Fortunately, the joint regulatory bodies provided community banks with a clear road map for effective liquidity risk management in 2010. In addition, regulators have expected that community banks would have qualified third parties apply audit procedures to LRM periodically.

KEY COMPONENTS OF AN EFFECTIVE LIQUIDITY RISK MANAGEMENT FRAMEWORK

As per the *Interagency Policy Statement on Funding and Liquidity Risk Management*, the following represent the critical elements of a sound liquidity risk management:

- Effective corporate governance consisting of oversight by the board of directors and active involvement by management.
- Appropriate strategies, policies, procedures, and limits.
- Comprehensive liquidity risk measurement and monitoring systems (including assessments of the current and prospective cash flows or sources and uses of funds).
- Active management of intraday liquidity and collateral.
- An appropriately diverse mix of existing and potential future funding sources.
- Adequate levels of highly liquid marketable securities free of legal, regulatory, or operational impediments.
- Comprehensive contingency funding plans.
- Internal controls and internal audit processes sufficient to determine the adequacy of the institution's liquidity risk management process.

While the Federal Reserve Board has changed the dynamics by rapidly increasing interest rates in a short window, the key components of effective liquidity risk management remain unchanged. The disciplined application of these practices provides a clear path for community banks to navigate this short-term challenge successfully.

ENHANCE YOUR LIQUIDITY RISK MANAGEMENT WITH CRI'S EXPERT FINANCIAL INSTITUTION INTERNAL AUDIT TEAM

CRI's financial institution's internal audit team has the requisite skill and knowledge to perform robust timely audit procedures around your bank's liquidity risk management practices. Please contact us today at ***https://cricpa.com/contact/*** to ensure your institution is effectively managing liquidity risk in the current environment.