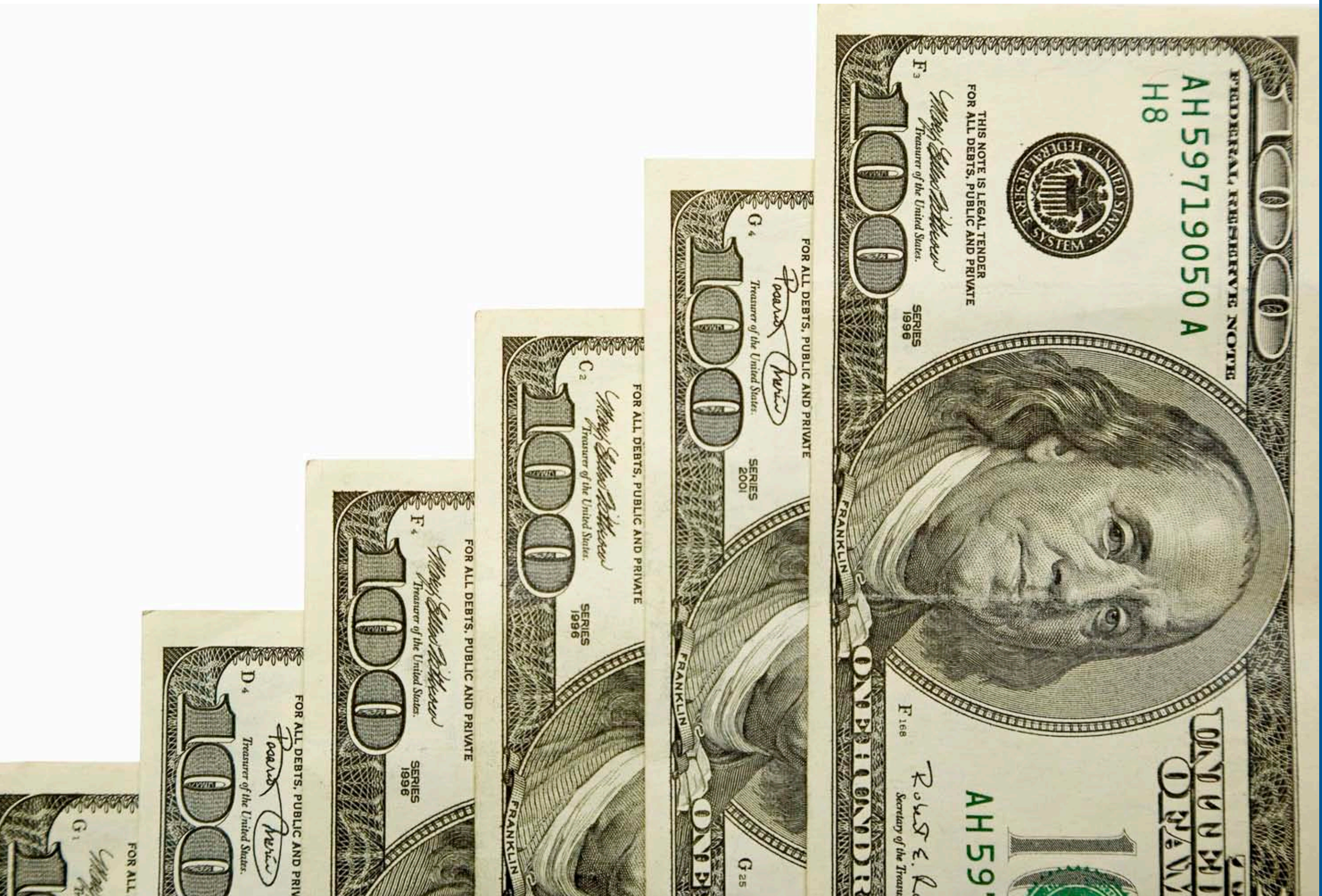
American Bankers Association

ABA Toolbox on Liquidity

ABA Members Only

Tool 3:

Integrating Near-Core and Non-Core Sources Into Bank Funding



Dear Reader,

Welcome to Tool 3 of the ABA Toolbox on Liquidity, which focuses on the development of a strategy for Near-Core and Non-Core Funding. The Interagency Policy on Liquidity and Funds Management (Guidance) spells out expectations in this area in general terms. However, the Guidance does not identify sources of Non-Core and Near-Core Funding, nor does it identify the roles they might play in liquidity policy and contingency funding plans (CFP). We thought it would be helpful to address these topics in Tool 3.

Tool 3 contains the detailed review of many Near-Core and Non-Core Funding sources and continues the development of the XYZ case study, as XYZ management chooses funding sources and fills out funding worksheets to use as XYZ develops its liquidity policy.

Karl Nelson was the lead author of Tool 3 and served as either as an executive with, or consultant for, institutions that have used virtually all of the Near-Core and Non-Core sources in this Tool. We thank him for all the insight he provided in developing this Tool and the role he played in developing some of the material in Tool 5.

Tom Farin, FARIN & Associates, Lead Author

Mr. Farin is the author of three separate books on financial institution asset-liability management, as well as a popular asset-liability newsletter. FARIN & Associates is best known for using technology and education to help community banks develop and implement retail strategies.

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Mr. Nelson is the President and CEO of KPN Consulting, an organization engaged in the asset/liability committee (ALCO), funding, and liquidity arena. His career has included executive positions with Silverton Bank, Institutional Deposits Corp, FHLB of Atlanta and Promontory Interfinancial Network, LLC (to learn more about Karl, visit www.kpnconsulting.net/6152.html).

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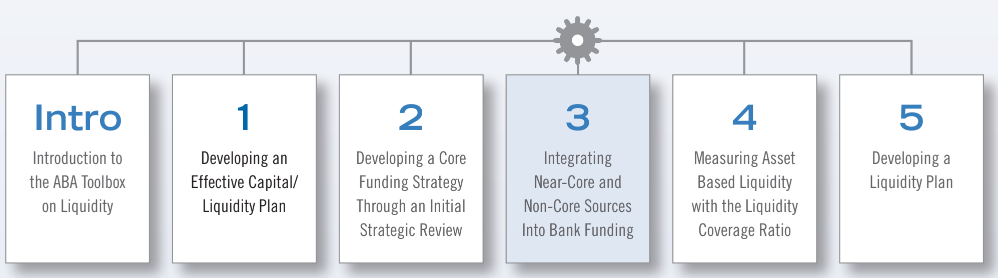
3

Integrating Near-Core and Non-Core Sources Into Bank Funding



Glossary

Base funding – Levels of Near-Core and Non-Core Funding normally carried as part of an institution's business plan or strategy

Brokered Deposit - Deposits are considered to be brokered when the party facilitating the transaction receives a commission for connecting the depositor and the institution receiving the deposit

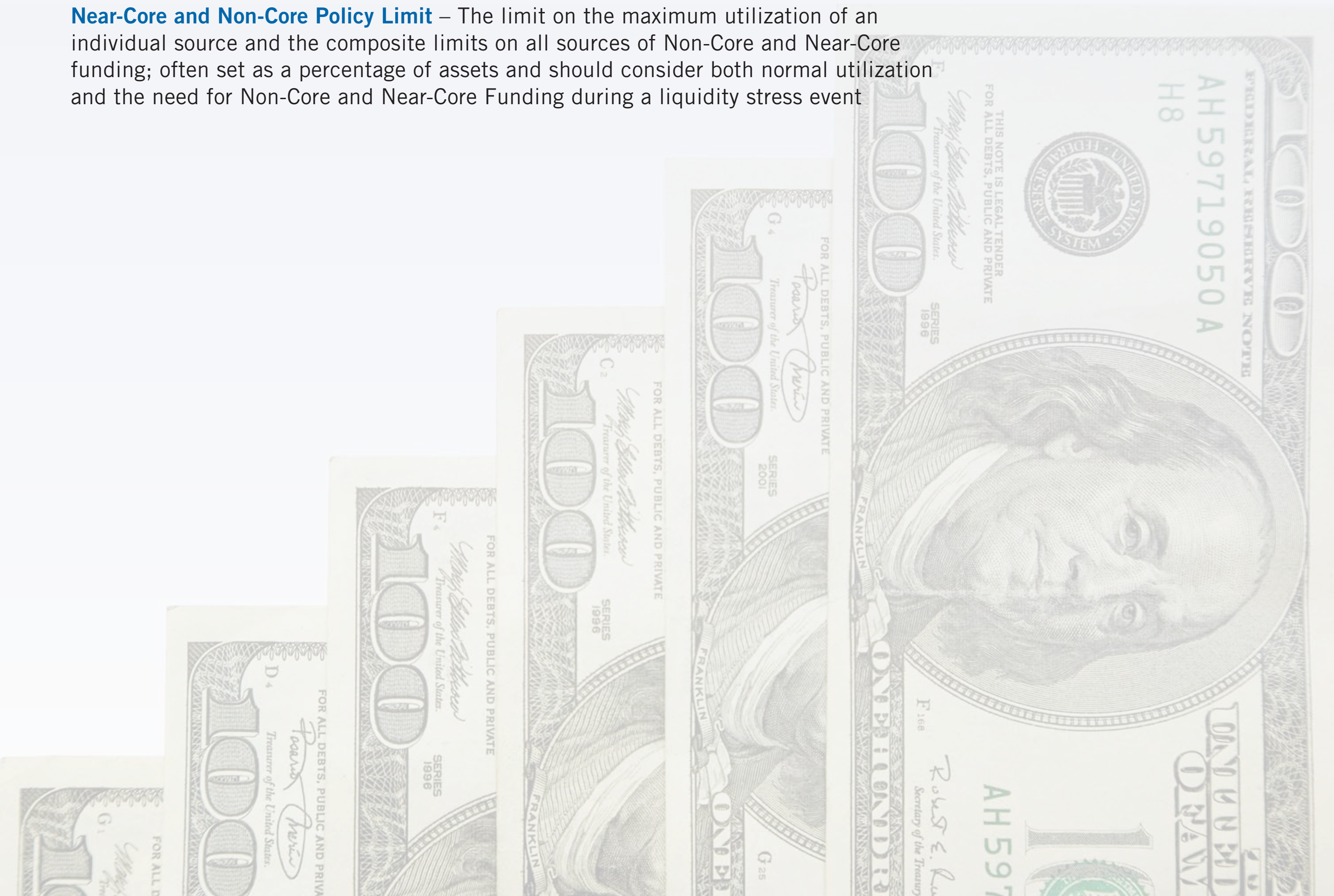
Contingent funding – Utilization of Near-Core and Non-Core Funding to deal with liquidity stress events

Facility Testing – The act of testing availability of funding from a source, the results of which should include notes on when and how the test was run, the actions required to take down the funding, and the time it took for the funding to come on line

Funding Diversification – The act of diversifying Near-Core and Non-Core Funding sources to provide flexibility in dealing with liquidity stress events and to avoid over-concentration in a single source

Near-Core and Non-Core goal – The target for the level of Near-Core and Non-Core Funding to be carried on a bank balance sheet during normal times

Near-Core and Non-Core Policy Limit – The limit on the maximum utilization of an individual source and the composite limits on all sources of Non-Core and Near-Core funding; often set as a percentage of assets and should consider both normal utilization and the need for Non-Core and Near-Core Funding during a liquidity stress event



Near-Core and Non-Core Funding Sources Should Be Carefully Managed

The use of Near-Core and Non-Core Funding has been part of our industry for over twenty years. In fact, the level of Non-Core Funding has been holding relatively steady for the past ten years. At the end of 2008, Non-Core Funding exceeded $2.6 trillion. It is clearly a dominant factor in funding financial institution balance sheets today.

Near-Core and Non-Core Funding choices have multiplied over the past 25 years and offer our industry significant advantages, including resources for supporting balance sheet growth and needed funding at a reasonable cost. However, as we saw in Tool 2, Near-Core Funding at times grows of its own accord in response to strategies implemented to grow Core Funds. However, the overuse of Near-Core and Non-Core Funding has led to unwise asset growth and consequently many of the failures we are seeing in the current economic environment. That is why it is important for institutions to consider Near-Core and Non-Core sources of funds separately and create plans specifically around these funding sources.

Resources to Manage Near-Core and Non-Core Funding

The goal of this tool is to supply resources that will help institutions develop and implement an approach to managing Near-Core and Non-Core Funding. At the same time, this tool will support the the Near-Core and Non-Core Funding components of your bank's liquidity policy. There are three activities banks should engage in to manage Near-Core and Non-Core Funding effectively. Banks should ***diversify*** the types of Near-Core and Non-Core Funding sources they use, ***support*** the use of the sources they use, and ***balance*** the use of Near-Core and Non-Core Funding sources to a level appropriate to meet their needs.

Diversify Sources of Near-Core and Non-Core Funds: The Interagency Guidance addresses this issue directly, commenting that over-reliance on any one source of funding is considered unsafe and unsound. Therefore, it is important to seek out new sources that match up with the funding goals of the institution.

Support the Sources that are Used: Institutions should match sources of funds to particular situations – contingency funding, for example.

Balance the Use of Near-Core and Non-Core Funds: Overall use of Near-Core and Non-Core funds and the use of individual sources of Near-Core and Non-Core funds should be limited based on the type of institution and its funding goals.

Tool 3 provides a number of resources to help banks accomplish these goals:

- Detailed information on a number of different Near-Core and Non-Core Funding sources
- Continued review of the XYZ case study
- Worksheets and example spreadsheets to enable institutions to lay out the foundation for their Liquidity Policy Statement

Banks must consider two questions:

- Should we use Non-Core Funding at all?
- Should we use brokered deposits?

Diversify Sources of Funds

The task of choosing sources of funds can be a daunting one for banks. But before an institution can begin the task of choosing specific sources, it must first consider two questions:

- Should we use Non-Core sources of funds at all, or just stay with the Near-Core Sources?
- Should we use brokered deposits?

Near-Core or Non-Core?

Near-Core Funding is a familiar source of funding for banks. It is normally gathered as part of a Core Funding strategy, because the majority of Near-Core Funding employs the same marketing and acquisition techniques. For example, the promotion of a CD special is likely to bring in CDs both below and above the regulatory distinction between Jumbo and non-Jumbo deposits. Near-Core Funding is a known entity for banks, and both banks and boards of directors are comfortable with these sources of funds.

Once acquired, Near-Core Funding is used in much the same way as Core Funding: a primary source of funding for loans and investments carried on the asset side of an institution's balance sheet. However, some Near-Core sources are among the most rate sensitive of an institution's portfolio. An institution in a market where competitors are paying well above the regulatory caps may see a significant outflow of Near-Core Funding, leading to increased liquidity stress. Also, Near-Core sources may react more strongly to negative publicity because many of these sources of funds are not covered by FDIC insurance.

Non-Core Funding can provide access to new maturities and structures while taking advantage of lower funding costs than may be available with Core Funding. However, this funding is less familiar to some bank directors and boards, and it takes some planning to obtain. Facilities have to be arranged and applied for. Also, some uses of Non-Core Funding led to problems that were part of the financial crisis. Therefore, although most community banks do use Non-Core Funding, there are still some that see this source of funding as inappropriate. Should regulatory sanctions restrict a bank's access to Non-Core Funding, it is possible this will lead to interest rate risk issues as access is removed to long-term Non-Core funding.

Non-Core Funding can provide access to new maturities and structures while taking advantage of lower funding costs than may be available with Core Funding.

Using Near-Core and Non-Core Funding can offer several benefits:

- Near-Core and Non-Core sources can be more cost-effective than Core Funding.
- Near-Core and Non-Core sources may provide a term structure not readily available from depositors, which can effectively hedge interest rate risk in certain assets like fixed-rate mortgages.
- An institution may find itself in a situation where it is nearly impossible to match deposit growth rates to loan growth rates. In those cases, a portion of loan growth could be funded with Near-Core or Non-Core Funding, although its strategic goal for loan growth should match its strategic goal for Core Funding growth.

Brokered or Non-Brokered?

Deposits are considered to be brokered when the party facilitating the transaction receives a commission for putting the depositor and the institution receiving the deposit together. The fine line between paying and not paying a commission is not always clear, however, so whether a particular source is considered brokered has often become a point of issue between institutions and their regulators.

Institutions should make a conscious decision about how to use brokered deposits, because during periods of firm-specific financial stress, regulators prohibit institutions from raising or renewing brokered deposits. In addition, institutions should consider the broader landscape when considering brokered or non-brokered. For example, banks may not want to replace funding from a stable reciprocal deposit (considered brokered) with a less stable rate board deposit (considered non-brokered).

Tools for Diversifying Sources of Funds

This tool provides a detailed overview of the following Near-Core and Non-Core sources of funds to help banks identify potential sources that fit their business model:

Near-Core Sources of Funds

- Jumbo CDs
- Public Deposit/Internet Listing Services (can be Non-Core)
- Money Market Deposit Solutions
- CDARS Reciprocal Deposit

Non-Core Sources of Funds

- Private Deposit/Internet Listing Services
- Federal Funds
- Brokered Deposits
- Federal Home Loan Bank (FHLB) Borrowings
- Securities Repurchase Agreements
- Federal Reserve discount window
- Subordinated Debt
- Brokerage Firm Deposit Sweep Arrangements

Support Near-Core and Non-Core Funding

Documentation is another important step in implementing a Non-Core Funding strategy. Regulators have been very open to Near-Core and Non-Core Funding strategies that are well constructed, but they have also been highly critical of those institutions that do not formally describe and document their strategies.

Institutions should monitor each source of funds. The following worksheet has been provided as a tool to help institutions think through some of the pieces that will be needed.

A blank Word document is included with this Toolbox, in which you can record each of your Near-Core and Non-Core Funding sources. In constructing your final policy statement, you could copy and paste from these documents. Or you could reference them in the policy and attach them as exhibits. If you take the latter approach you can modify the original exhibits as needed without finding it necessary to modify the policy statement itself.

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Funding Type Worksheet

Institution:
Date Completed:
Completed by:

Funding Type: ☐ Near-Core ☐ Non-Core ☐ Brokered ☐ Non-Brokered

Information about the funding source.

Funding Mix:

Information about how the funding source fits with other Near-Core and Non-Core sources of funds in the portfolio.

Funding Utilization: ☐ Base Funding ☐ Contingency Funding

Information about the funding source.

Facility Status: ☐ Operational ☐ Under Development

Information about whether the source has been implemented or is still in the planning stages.

Facility Testing:

Information about how the source will be tested.

Funding Type Worksheet is available for download at www.aba.com/LiquidityToolbox.

Constrain Funding

As banks choose new funding sources, they will also need to consider how to limit each funding source individually as well as Non-Core and Near-Core sources of funds as a whole.

Tool 1 walked through an important part of constraining Near-Core and Non-Core Funding – setting goals. A corollary to the goal setting process is choosing a limit. However, while goals can be modified to fit the realities of the business situation, limits should rarely be modified. Therefore, it is critical to take the time to consider limits carefully.

As banks choose new funding sources, they will also need to consider how to limit each funding source individually as well as Non-Core and Near-Core sources of funds as a whole.

Limits should be based on the kind of bank, the results of stress testing, the overall need for contingency funding, and the bank's ability to raise the kinds of Core Funding needed to fund its balance sheet conveniently and cost effectively. In addition, they need to provide the flexibility to deal with unexpected liquidity stress events while staying within the limits. There are several guidelines to follow when setting limits:

1. Limits should be stable. Frequent modifications of limits to accommodate abnormal situations could lead examiners to conclude that you have not carefully diagnosed your true need for Non-Core and Near-Core Funding. However, if capital erodes, limits should be adjusted accordingly.
2. Limits in the aggregate should reflect the industry as a whole. Establishing a limit well above the industry average will require support in the policy for the ceiling.
3. Individual limits for each of the Non-Core and Near-Core Funding sources should reflect standard industry use as well as vulnerability to liquidity stress events.

Beyond setting limits on the overall use of Non-Core and Near-Core Funding and limits on individual categories of Non-Core and Near-Core Funding, it is also important that your policy address how often these facilities will be tested to determine both access and timing in the use of these Non-Core and Near-Core Funding sources. Of course these tests and their results will also need to be documented. Regulations require periodic funding concentration reports that provide information on trends in funding concentration as well as levels of concentration relative to your limits. This will be covered in more detail in Tool 5.

Near-Core and Non-Core Funding Sources

Non-Core and Near-Core Funding choices have multiplied over the past 25 years and offer the banking industry resources for supporting balance sheet growth and needed funding structure at a reasonable cost. The following pages review the principal sources of Non-Core and Near-Core Funding. In addition, the eight sources XYZ elected to use will be reviewed individually through the Funding Source Worksheet that was prepared.

- Brokerage Firm Deposit Sweep Arrangementss
- Brokered Deposits
- CDARS or Certificate of Deposit Account Registry Service®
- Federal Funds Purchased (Fed funds)
- FHLB Borrowings
- Federal Reserve discount window (Fed discount window)
- Jumbo CDs
- Money Market Deposit Solutions
- Public Deposit/Internet Listing Services
- Private Deposit/Internet Listing Services
- Securities Repurchase Agreements
- Subordinated Debt

Other Liquidity Sources

In our discussion of wholesale funding sources, we have attempted to provide a review of the most significant options available. Many bankers also use such techniques as the issuance of Commercial Paper, the Federal Reserve System Treasury Tax and Loan Program, and eurodollar deposits through an offshore International Banking Facility. Many institutions also use government sponsored programs offered through such entities as the Small Business Administration and the USDA. Liquidity for commercial banks that are active in residential mortgage lending is offered through Fannie Mae, Freddie Mac, and the FHLB System, and this has become a significant source of liquidity during the past ten years for many community banks. With the advent of bankers' banks beginning in 1983, the loan participation business has been expanded beyond the traditional correspondent bank network and has been a significant provider of liquidity as well. We encourage readers to examine any liquidity source available today and we hope this discussion will be of value to you as you strengthen your funding and liquidity program.

Jumbo CDs

Description

Generally a Near-Core Funding Source

CDs over $250,000, commonly called "jumbo CDs" are not considered to be Core Funding, because jumbo CDs may not be fully covered with deposit insurance, tend to be more rate-sensitive and are more vulnerable to being withdrawn under liquidity stress events. Yet they should be considered as a Near-Core non-brokered funding source under our definitions as they are generally raised as a byproduct of a Core Funding plan.

Source

These deposits are generally raised from the same market as Core CDs using the same marketing techniques.

Term

Terms offered are generally the same as terms offered for Core CDs. Maturities often range from 30 days or less to as long as 5-7 years. However, in most financial institutions, the largest portion of CD portfolios is concentrated in maturities ranging from 6-24 months.

Pricing

Jumbo CDs are generally priced more aggressively than regular CDs, using tiering strategies, where rates increase as CD balances increase. There are a relatively small number of institutions that offer rates on jumbo CDs below those of regular CDs, a pricing strategy that reflects a desire to avoid funding concentrations in jumbo CDs.

Options

Financial institutions generally participate in the jumbo CD markets using the same approach they use in participating in the Core CD markets. Generally early withdrawal options are offered subject to a penalty. Occasionally, options like add-on capability, rate bumps, and partial early withdrawal without penalty are offered.

Basic Operation

Most institutions have mechanisms in place for marketing and issuing certificates of deposit. The process used is generally the same for Core CDs and jumbo CDs.

Jumbo CDs – continued

Collateral Requirements

Most financial institutions do not provide deposit insurance on CDs issued with balances in excess of FDIC insurance maximums. To the extent the CDs exceed FDIC maximums, the depositor is uninsured. Some institutions post collateral to back up large CDs or purchase private insurance policies to protect depositors.

Ease of Set Up

Most institutions already have a mechanism in place for marketing and issuing CDs.

Ease of Use

CDs are often thought of as rate pumps. Raising jumbo CD funds is a matter of offering rates significantly aggressive to attract customers and using the institution's marketing mechanism to get the word out.

Expected Time to Raise Funds Once Set Up

If rates are sufficiently aggressive, significant quantities of jumbo CDs can be raised within weeks. Note, however, that institutions that are not well capitalized generally may not pay more than 75 basis points above national average rates.

Vulnerability to Liquidity Stress Events

Balances in jumbo CDs are considered to be significantly more vulnerable to withdrawal during liquidity stress events than Core CDs, especially when there is publicity that questions the present or future viability of the institution, because balances in these CDs exceed the amount covered by FDIC insurance. Historically, jumbo CD customers have shown a willingness to pay early withdrawal penalties necessary to redeem jumbo CDs early if customers are concerned that a portion of their principal is at risk.

Capital Treatment

Not applicable.

Unique Advantages

Institutions can raise jumbo CDs as part of their normal Core Funding marketing and issuance process. Periodic testing of this facility is ongoing, as almost all institutions have sufficient quantities of jumbo CDs that are being issued or renewed.

Reciprocal Deposits

Description

Near-Core Funding Source

Reciprocal deposits address the need to attract and retain valuable local customer relationships. Reciprocal deposits are customer funds exchanged among insured depository institutions that are members of a deposit placement service, such as CDARS. Through the exchange, an institution can benefit from large, local customer deposits, while providing the customer with access to FDIC insurance protection beyond the standard maximum deposit insurance amount of $250,000.

Reciprocal deposits provide a stable and cost-effective source of funds for banks serving the credit needs of local communities. Deposit placement services that offer reciprocity also provide a means for banks to better compete with their bigger brethren, including broker-dealers, for larger customer accounts. Although reciprocal deposits are considered “brokered” under existing law, they tend to act more like core deposits and, from our standpoint, can be considered a Near-Core Funding source. Whereas traditional brokered deposits are generally solicited by independent brokers on a nationwide basis from customers who are chasing high interest rates, reciprocal deposits are gathered by banks ***from their own customers and at rates that banks choose to offer*** within the context of each bank’s local markets. Rates on reciprocal deposits are generally lower than traditional brokered deposits and, in the case of Internet-based deposits, can be substantially lower.

Beyond cost, reciprocal deposits offer other advantages over traditional brokered deposits, Internet-based deposits, and FHLB advances. Reciprocal deposits tend to stick with an institution and tend to come from local customers. For example, approximately 80 percent of CDARS deposits are generated from customers residing less than 25 miles from their relationship bank, and the reinvestment rate associated with these deposits is about 80 percent. The franchise value that comes from reciprocal deposits further differentiates reciprocal deposits from traditional brokered deposit services, as well as from wholesale funding sources.

Terms
Available in a range of short- or long-term maturities

Pricing
Usually associated with a transaction fee per placement.

Reciprocal Deposits – continued

Basic Operation

Customers have to sign a placement agreement and a custodial agreement. The agreement invites depositors to list the insured depository institution at which they do not want their funds placed for any reason, and depositors can add or remove a list of institutions on this list later.

Collateral Requirements

None after the placement is made.

Ease of Set Up

Generally quite easy (and with operational and marketing support being provided by the provider for those desiring assistance). Set up time can be as short as 1-2 weeks, depending on the bank's effort.

Ease of Use

Generally straightforward.

Expected Time to Raise Funds Once Set Up

Varies by bank based on the bank's desire, leadership, and resources, but, generally funds can be generated within a one-week period.

Vulnerability to Liquidity Stress Events

Banks must be well-capitalized to participate in a reciprocal deposit network and placement/ funding limits do apply. At a minimum, network members with a deteriorating financial condition are able to maintain their current levels of reciprocal funding – that is, to take on new reciprocal deposits to replace existing deposits that roll off – as long as they remain well capitalized or are adequately capitalized and have an appropriate waiver from the FDIC.

Capital Treatment

Not applicable.

Unique Advantages

- Provide each customer with access to multi-million-dollar FDIC coverage.
- Set the rates offered to customers.
- Generate very large deposits (can be seven figures or more) from local customers.
- Benefit from reinvestment rates than generally far exceed those for funds placed through public deposit/Internet listing services.

Brokerage Firm Deposit Sweep Arrangements

Description

Non-Core Funding Source

Brokerage firm deposit sweep arrangements established using services such as IND or proprietary programs like those offered by Merrill Lynch, can be a cost-effective long-term source of wholesale funding for banks. With these arrangements, banks can secure large blocks of floating-rate funding without collateralization or stock purchase requirements. The cost of funds can be very competitive with other, more traditional wholesale funding options.

Source

Funding comes from cash held in millions of brokerage accounts across the nation and, generally, is considered both geographically diverse and relatively stable.

Structure of Funding

Term

Both short- and long-term funding (e.g., 7 years) is available.

Pricing

Rates are usually based on a set spread over an established rate (e.g., fed funds or LIBOR). Banks utilizing brokerage firm deposit sweep arrangements settle on a daily basis, but do not pay settlement fees.

Basic Operation

After signing a master agreement detailing the amount, rate, and term of the funding it seeks, a participating bank will maintain an interest bearing omnibus MMDA and/or transaction account for each broker-dealer it receives funds from utilizing its standard account opening procedures and documents. Algorithms allocate customer funds in approximately $250K increments (and depositors are given an opportunity to exclude banks where they already have funds on deposit) and result in a bank receiving a single net settlement transaction (deposit or withdrawal) that will be processed via the Fed Wire system each afternoon in order to maintain the pre-designated funding level. All depositor level record keeping and reporting is provided by the broker-dealer with assistance from a service provider.

Brokerage Firm Deposit Sweep Arrangements – continued

Collateral Requirements

Not applicable.

Ease of Set Up

The administrative/accounting burden associated with brokerage deposit sweep arrangements is minimal. Banks open "omnibus" accounts only. Individual account records are maintained by the broker-dealer, and the broker-dealer (not the bank) is responsible for compliance with Bank Secrecy Act (BSA) and anti-money laundering (AML) requirements, and the banks do not need to report on customer-specific know-your-customer (KYC) or customer identification program (CIP) activities for broker-dealer customers.

Expected Time to Set Up

Set-up, training and funding can be accomplished in less than one week once agreements have been executed.

Ease of Use

Straightforward.

Expected Time to Raise Funds Once Set Up

Generally, funding can be provided immediately or can ramp up over periods as long as 12-18 months based upon a depository institution's needs.

Vulnerability to Liquidity Stress Events

Banks must be well capitalized and placement/funding limits do apply.

Capital Treatment

Not applicable.

Unique Advantages

- Funding is available in large blocks.
- Funds can be raised very quickly.
- No collateralization or stock purchase is required.
- A significant majority of funding will be reported as savings deposits and, thus, will not be subject to reserves.

Public Deposit/Internet Listing Services

Description

Either a Near-Core or Non-Core Funding Source

Public Deposit/Internet listing services take various forms in our industry, and can be used to raise CDs and transaction accounts. Many financial institutions have created their own websites for deposit gathering. However, we will confine our discussion to those websites that are created for general use. We will refer to those institutions that are raising funds as "issuers."

Source

There are three main deposit/Internet listing services:

1. BankRate.com
2. MoneyAisle.com
3. Search engines like Google, Bing, and Yahoo

Bankrate.com is a popular public service that provides deposit information for both transaction accounts and CDs. Bankrate.com surveys over 4000 financial institutions on a daily basis and generates information for investors who are then able to interface directly with those institutions offering deposits that day.

MoneyAisle requires that institutions join the network in order to access new depositors. Issuers "program" their process through filters involving geography, maturity, and rate and participate in auctions for either high-yield savings or CD accounts. Investors have open access through the MoneyAisle website; however, issuers must pay fees based on activity. The FDIC has characterized MoneyAisle funds as brokered deposits; however, that view was based on the original pricing model which focused on the success rate as opposed to per click fees. MoneyAisle has changed its pricing model similar to Bankrate.com, which is a non-brokered solution, and anticipates obtaining a non-brokered designation.

Search Engines like Google, Bing, and Yahoo allow institutions to use key word searches such as "high rate money market." The search engines do not facilitate transactions or charge a fee for closed transactions. Consequently, fees charged do not meet the technical definition of brokered transactions. As is true of Bankrate.com and MoneyAisle.com, institutions utilizing search engines can restrict visibility to a defined geographic area. If the defined geographic area is the same as the institution's retail market area it would be reasonable to assume funds raised are Core or Near-Core non-brokered deposits. If the defined geographic area is much broader than the institution's retail market, deposits gathered might be classified as Non-Core non-brokered deposits.

Structure of Funding

Term

Products offered through public deposit/Internet listing services are generally similar to those offered by the institution in its branch network. Internet-only products may have different features and pricing. In some cases, transactions to and from those accounts are limited to the institution's electronic channels.

Pricing

Pricing is generally as aggressive or, in some cases, more aggressive than rates on the same or similar products available through retail branches. Even though rates on these products are higher, marginal cost may be lower as many of the institution's customers may not purchase through these channels.

Options

FDIC-insured institutions may participate in public deposit/Internet listing services without any significant restrictions. All three sources qualify for FDIC insurance.

Basic Operation

To use MoneyAisle, institutions must join the network. That is not the case for either search engine point-and-click marketing or BankRate.com. Placing an ad on the applicable Public Deposit/Internet Listing Service is a matter of filling out a series of dialog boxes online. Once the ad is placed, hyperlinks point to either the institution's Web site or to a product-specific landing page. From that point, the institution uses the same tools and techniques (branch account opening, on-line account opening, call center opening) used in its other retail channels.

Collateral Requirements

Each of these funding sources is supported by FDIC insurance and does not require the use of collateral.

Ease of Set Up

MoneyAisle set up is easily accomplished; however, training on the various "filters" (rate, maturity, product, and geographic preference) may take additional time and effort. The processes for using BankRates.com and the search engines are a matter of becoming familiar with how to place an ad on the network.

Ease of Use

Once ads or promotions are placed, the process of closing the transaction is similar to that used in closing transactions initiated on the financial institution's Web site.

Expected Time to Raise Funds Once Set Up

Time frames to raise funding are similar to that experienced by the institution in marketing through other channels.

Public Deposit/Internet Listing Services – continued

Vulnerability to Liquidity Stress Events

Given that public deposit/Internet listing services are not considered a brokered funding source, there is less vulnerability to liquidity stress than most Non-Core sources. As MoneyAisle is presently considered a brokered source of funding, access could be restricted for those institutions that lose their well capitalized status. As such, MoneyAisle is considered a source of higher-risk liquidity in a stress situation.

Capital Treatment

Not applicable.

Unique Advantages

MoneyAisle offers the industry an ability to attract retail deposits from outside its normal market area and allows issuers the ability to define the geography they wish to develop. Though considered brokered, MoneyAisle does offer the opportunity to cross-sell depositors and establish a relationship that goes beyond a high-yield savings account or CD. In addition it uses an intriguing auction approach to attracting potential depositors.

Both Bankrate.com and the search engines offer institutions the ability to reach out beyond their normal market area and reach customers within their market area they might not otherwise reach. All three offer the potential to raise new funds at a lower marginal cost than through retail channels as there may be less cannibalization of existing funds in relationship to new funds raised.

Federal Funds Purchased (Fed Funds Purchased)

Description

Non-Core Funding Source

Source

Fed funds are the reserve balances that every bank is required to hold on balance at the Federal Reserve. These funds may be borrowed and loaned among banks and their purpose is to maintain bank liquidity. Fed funds are generally used for short-term (less than one week) purposes; however, secured term fed funds may also be in evidence in the marketplace. The fed funds requirement is based on the amount of transaction accounts a bank retains and is generally equal to 10 percent of those balances. For balance amounts of less than $55.2 million, the requirement is lower.

Structure of Funding

Term

The overwhelming dollar volume of the fed funds market is in the form of unsecured, overnight borrowings; however, term fed funds, generally up to one year, may be available, but may require collateral to support these borrowings.

Pricing

The fed funds target rate is determined by the Board of Governors of the Federal Reserve and the market determines the fed effective rate. Fed funds are purchased in very large blocks for larger institutions as well as small blocks for the community bank world. The first marketplace deals in rates very close to the fed effective rate; however, the community bank pricing mechanism generally works off of a spread over fed effective. There can be considerable pricing disparity with fed funds, and banks are well-served to have several sources for their fed funds borrowing activity.

Options

Not applicable.

Basic Operation

The large block marketplace is generally dominated by the largest commercial banks, and New York is the center for fed funds activity. Generally speaking, these very large block trades are conducted at or very near the fed effective rate; however, for the typical community bank dealing in smaller amounts, the distribution system is quite different. Large correspondent banks handle much of the purchase activity; however, a group of some 20 bankers' banks have provided increased competition for community banks and now handle a significant amount of lending volume. Borrowings are noted as Fed Funds Purchased on a bank's balance sheet, and liquidity is the key role for fed funds activity.

Fed Funds Purchased – continued

Collateral Requirements

Generally speaking, purchasing fed funds is an unsecured activity; however, term fed funds facilities may require the pledging of collateral.

Ease of Set Up

Fed funds lines of credit are arranged based on the potential borrower's credit rating and setting up a facility is based on the amount of credit analysis the lending bank undertakes. Setting up the purchase of fed funds should be simple.

Expected Time to Set Up

The amount of time necessary for each lending institution varies but initial set up should not require more than thirty days.

Ease of Use

Once fed funds relationships are established, adjusting an institution's Fed Funds Purchased and sold position is a daily occurrence. It is among the easiest of Non-Core Funding sources to use.

Expected Time to Raise Funds Once Set Up

Once the facility is established, borrowing institutions have immediate (same day) access to borrowings.

Vulnerability to Liquidity Stress Events

The history of risk in the fed funds market is excellent, because there is a careful credit risk assessment in place. As an unsecured funding source, lenders will move quickly to terminate a fed funds line if credit issues arise with a borrower. In some cases, lenders will move to a secured facility.

Capital Treatment

Not applicable.

Unique Advantages

The simplicity of the fed funds market when credit issues are good makes fed funds a very easy facility to use. The pricing in the marketplace is typically very good given the nature of the term (overnight); however, would be a mistake to depend on fed funds for uses that go beyond short-term liquidity.

Federal Home Loan Bank Borrowings

Description

Non-Core Funding Source

Source

The FHLB is comprised of twelve regional banks with assigned territories. These banks are cooperatives owned by members from the commercial bank, thrift, insurance, and credit union industries. To access funding in a particular FHLB, an institution must purchase of stock in that FHLB, which entitles the institution to membership. Though independent, the FHLBs are regulated by the Federal Housing Finance Agency, and each FHLB has its own management and Board of Directors. Chartered by Congress in 1932, the System was created to provide both liquidity and term financing to its members so that homeownership could be expanded through longer-term mortgage finance. The Office of Finance conducts debt-raising activities for the FHLB System through both note and bond issuance and these securities are backed by the "joint and several" guaranty of each of the twelve banks.

Structure of Funding

Terms

Term structure of funding typically varies from overnight to the intermediate term and can be structured with or without amortization as well as options designed to favor either borrower or lender.

Pricing

Pricing of borrowings (referred to as "advances") can be on either a fixed or floating rate basis and is determined by the cost of debt issuance by the System. The spread of FHLB debt to Treasury debt has typically been quite narrow, translating into advantageous funding for its members. The issuance advantage, coupled with very low overhead and modest profitability objectives, has led to advances becoming a principal source of funding for community banks.

Options

Many advance products have embedded options that provide benefits to the borrower. Members that use option-embedded products work with their respective FHLB to make certain the product they use is an appropriate fit for their balance sheet.

Federal Home Loan Bank Borrowings – continued

Basic Operation

Members of the FHLB System have ready access to various funding options, which can be accomplished through automated Internet-based systems or via direct contact with FHLB staff. Each FHLB uses a daily rate sheet that describes both the advance structure as well as the pricing for that day. Members use the information to select appropriate funding.

Members are provided credit limits so that access is made simple within the bounds established for collateral requirements. Unlike many funding sources, advances can be used on a continuing basis, and FHLBs tend to encourage longer-term, more permanent use of their credit facilities. Each member is assigned a specific Credit and Collateral Analyst and contact with the analyst is encouraged to insure no surprises when funding is needed. Relationship managers are a third contact point for members.

Collateral Requirements

The FHLB System does not have a unique standard for allowable collateral; however, each Bank provides its members both the types of collateral allowed as well as haircuts for that collateral. All advances are fully collateralized and all FHLBs allow the pledging of cash, higher grade securities and single family/multi-family residential mortgage loans. Most FHLBs also allow the pledging of commercial real estate loans involving completed real estate projects. As part of the pledging process, the stock owned by each member is also provided as additional collateral in a lending arrangement, and additional activity-based capital purchases are required as advance use increases.

Ease of Set Up

Ease of set up varies according to each specific FHLB. The set up process can be lengthy; however, the credit review is made easier because each FHLB has ready access to call report data. In some cases, an FHLB will also have access to exam information from the primary federal or state regulator.

Expected Time to Set Up

For most FHLBs, set up can be accomplished within 45 days.

Ease of Use

With the addition of commercial banks and credit unions to the membership in the late 1980's, the FHLB system has continued to enhance its lending systems; therefore the FHLB system offers very convenient access to all forms of funding. Typically, access entails same-day or next-day funding for advances. Between the automated processes now in place at many of the Banks and the Funding Desk concept, members find access quite simple, although the process may be different under high stress economic environments.

Expected Time to Raise Funds Once Set Up

Once established with a credit availability or facility, funding generally occurs on a same-day or next-day basis.

Federal Home Loan Bank Borrowings – continued

Vulnerability to Liquidity Stress Events

Credit and collateral risk analysis within the FHLB system is an intensive operation, and members that experience significant declines in CAMELS performance are often restricted in both use (limits) and collateral (type and margin). No FHLB has ever suffered a credit loss on an advance because of full collateralization and the high scrutiny which is a cornerstone of the credit function. Each member has the ability to manage its own credit availability and is encouraged to work closely with FHLB staff when stress occurs. As a result, it is generally believed that FHLB borrowings will be one of the last to terminate in stress conditions, so having FHLB advances should be a key ingredient in a contingency funding plan (CFP).

Capital Treatment

Not Applicable.

Unique Advantages

The FHLB System has become an integral part of many community bank funding strategies, which is due to the funding advantages offered to its members. The unique ability to offer anything from overnight to intermediate maturities on either a fixed or floating rate basis provides a funding source like no other in the marketplace. Based on the System's debt raising capabilities and very low overhead model, pricing is typically very competitive to other wholesale funding sources and, assuming reasonable credit quality, access is a simple and convenient process. Membership in the System also provides access to Community Investment and Affordable Housing Programs that enable members to expand at a reasonable cost their own low income lending activities and many Banks offer Mortgage Partnership Programs that compete very effectively with other Housing Agency models. Finally, the stock of a typical FHLB comes with a dividend that makes ownership attractive in its own right.

Wholesale Brokered Deposits

Description

Non-Core Funding Source

Source

Brokered deposits have become an important funding source for our industry during the past ten years. Created in the 1980s, a third party (broker) sells an institution's CDs as part of a wholesale funding strategy. In a traditional brokered deposit arrangement, brokers generally find investors outside the normal deposit market area, thus expanding an institution's ability to attract deposits. Given the absence of a relationship between the funding institution and the investor, brokered deposits are dependent upon FDIC insurance for its success. The participating institution (issuer) must be well capitalized to use brokered deposits, absent a waiver from the FDIC.

Structure of Funding

Terms

Brokered CDs generally have terms ranging from one week to five years.

Pricing

Institutions that participate in the traditional brokered deposit market generally set the rate they are willing to pay (based on input from the broker) and pay a broker fee. Typically, the rate quoted to the investor includes a broker fee of about 25 basis points, but may be higher or lower depending on the size of the transaction. As a general rule, brokered deposits are more expensive than "organic" CDs (i.e., CDs a bank issues directly without the participation of a deposit broker). However, the pricing of organic CDs in highly competitive markets was higher than the brokered CD marketplace from 2008-2009.

Options

Options embedded in CDs are commonplace and offer the advantage of either offering higher yields with issuer call options or lower yields with investor-put options. Absent these options, early redemption in the brokered marketplace is not allowed except in the case of the death of the investor.

Basic Operation

Participating FDIC-insured institutions have many choices for choosing a broker and once that relationship is established, the process for raising funds is simple. An institution signs a master agreement, which describes the methodology in place for the brokered market and becomes the standard for doing business with that broker. Given variation in suggested yields (by the broker) and fees (to the broker) is part of the market, issuers often have more than one broker to ensure competitiveness in locating investors. The brokerage fee covers the efforts of the broker, including placing the deposits and providing all tax information to both the issuer and investor.

Wholesale Brokered Deposits – continued

Collateral Requirements

Not Applicable.

Ease of Set Up

During the past ten years, additional third parties have entered the brokered deposit marketplace, and many are focused on community banks. With increased competition, brokered deposits have become simple and commonplace.

Expected Time to Set Up

Set up can be accomplished in one week or less.

Ease of Use

Once the process is established, raising brokered deposits is simple and the availability, even in stress periods, has been excellent.

Expected Time to Raise Funds Once Set Up

Time required varies, but can be as little as one day.

Vulnerability to Liquidity Stress Events

The brokered marketplace requires that participating institutions (issuers) be well capitalized. If that status is lost, a waiver must be requested from the FDIC. However, if a waiver is not granted, high concentrations in brokered CDs can cause significant liquidity risk to issuers, as they are required to fund the outflow of maturing deposits.

Capital Treatment

Not Applicable.

Unique Advantages

Raising funds through the brokered deposit marketplace has become commonplace in our industry due to ease of entry and the competitive nature of the market. As a solution that does not require the use of collateral, brokered deposits now represent one of the most used wholesale funding sources and compare in dollar amount to funds generated for our industry by the FHLB System.

Additional Discussion

The growth in wholesale or Non-Core Funding sources through brokered deposits has, in some cases, led to dangerously rapid growth at individual institutions. However, using brokered deposits as part of a well-constructed Non-Core Funding strategy at a well capitalized and well managed institution should not be problematic. An ALCO policy that defines your funding strategy and sets limits on the use of traditional brokered deposits, as well as all other sources, is a must. Additionally, you should measure and monitor the use of these funding sources and we suggest monthly reporting to your Board of Directors. It will always be to your advantage to be able to explain to the board and, upon request, to examiners why the institution elected to use certain funding techniques (e.g., due to pricing or term considerations).

Federal Reserve Discount Window (Fed Discount Window)

Description

Non-Core Funding Source

Source

For most of modern banking history, the discount window was not a preferred funding technique; however, revisions to the discount window programs in 2003 provide institutions in secure financial condition with an additional tool for managing short-term liquidity risks.

Structure of Funding

Terms

The primary credit program is designed for short-term (overnight in most cases) use; however, a temporary term component was added during the financial crisis. Secondary credit is available to institutions not eligible for primary credit to meet backup needs when its use is consistent with a timely return to reliance on market sources of funding. The seasonal credit facility, unchanged in 2003, was designed as a term lending concept for institutions in areas where seasonal issues create unusual deposit outflows. The discount window was designed for institutions with deposits of less than $500 million; terms of up to nine months are offered.

Pricing

The pricing for the primary credit facility initially was priced at 100 basis points over the fed funds target rate. Secondary credit was priced at 50 basis points over the primary rate to reflect the need for a higher level of oversight and administration. The seasonal facility continues to be priced at a floating rate based on the average of fed funds and three-month CD rates and changes every two weeks. With the revision to both primary and secondary credit, the Federal Reserve created the ability to change the spread for borrowings under both facilities in 2003, if economic conditions so warranted. The spread was adjusted downward several times during the 2007-2009 time period, and the Primary Credit borrowing rate is currently fed funds target + 25 basis points (.50%), while secondary credit is priced 50 basis points above that rate (1.00%). Based on available information, the spread will likely return to the initial targets set in 2003 once the Federal Reserve feels economic conditions so warrant.

Options

Not Applicable.

Federal Reserve Discount Window – continued

Basic Operation

Any institution that maintains reserves with the Federal Reserve may apply for a credit facility with its Federal Reserve Bank. Application instructions fare provided on the Federal Reserve website. Access to the primary or secondary credit facility is determined by the creditworthiness of the institution. Generally speaking, an institution rated CAMELS 1, 2, or 3 will be able to access primary credit; however, actual credit analysis results determine access. Accessing the window also requires a pledge of collateral. Generally speaking, those with access to primary credit have the ability to maintain collateral on their own premises. Access to primary credit is generally on a "no questions asked" basis, while secondary credit borrowers will be subject to heightened review.

Collateral Requirements

The types of eligible collateral along with the advance ratios for various forms of collateral are available on the Federal Reserve website. Interestingly, the types of collateral allowed are more generous than one might assume and banks will often pledge less liquid loans. Of course, if speed of borrowing is important, pledging of securities may be a better alternative.

Ease of Set Up

When the Federal Reserve Banks unveiled the new discount window programs in 2003, accessing the window became a simple process. Unfortunately, the true value of the window was not identified until the banking crisis of 2007-2009 unfolded, which resulted in overwhelming demand for credit availability. During the crisis, access was simple or very difficult, depending on the particular Reserve Bank in question. Institutions that have not arranged a facility would be wise to do so, particularly as it relates to a CFP strategy.

Expected Time to Set Up

In normal times, access to the window can be accomplished in less than thirty days.

Ease of Use

Though the Federal Reserve has done all it can to make the process seamless, we have seen variation in performance, depending on which Federal Reserve Bank is used. That said, it is clear that the discount window has been an invaluable tool during the time period between 2007 and 2009. It is expected that future performance, particularly in stressful periods, will improve.

Expected Time to Raise Funds Once Set Up

Once your discount window facility is arranged, raising money is typically a same-day to next-day concept.

Vulnerability to Liquidity Stress Events

The revision to the discount window in 2003 appeared to be an affirmation of the ability and desire of the Federal Reserve to be available as a source of liquidity without the stigma that previously had accompanied the use of the program. As this revision was not tested until 2007-2009, it is difficult to assess the extent to which the Fed will follow through on this promise. However, identifying the Federal Reserve discount window as one of your most valuable funding sources in a stress environment is clearly a good strategy.

Capital Treatment

Not Applicable.

Unique Advantages

Funding from the discount window in normal economic times is, by the nature of its pricing model, not an attractive source. However, during a difficult economic period, the borrowing rate can be very attractive, as it was for the most of the financial crisis of 2008-2009. The discount window facility also became more attractive from a term concept during deteriorating conditions. The discount window is the most viable source for funding in the most difficult economic conditions, which is why discount window has become a key component of a sound CFP.

Private Deposit/Internet Listing Services

Description

Generally a Non-Core Funding Source

Private deposit listing services (often referred to as "rate boards") differ in that information is only provided to those institutions (both funding and investing organizations) that join. This membership fee provides access to a private website that focuses on the funding or investing needs of its members. The premier provider today is QwickRate, whose direct deposits are considered non-brokered, since members pay an annual fee as opposed to a transaction fee, and the process is a direct transaction between funding institution and investor. The rate board concept is designed for institutional players only, with funding provided to FDIC-insured institutions by other institutional investors. Consumers do not have access to rate boards.

Structure of Funding

Term

Rate boards generally offer CD products with a term of one week to five years.

Pricing

Rate boards generally are priced slightly over the national average, and often very competitively in markets where competition is significant. Pricing is also dependent on the kind of strategy a funding institution creates; understanding this strategy is important if pursuing more efficient pricing.

Options

FDIC-insured institutions may participate in rate boards as either issuers (funding) or investors. As rate boards generally operate under FDIC insurance, investors typically stay within that limit; embedding options is generally not of use.

Basic Operation

Funding institutions (issuers) make frequent decisions on which CD maturities to offer as well as what rate to offer, so all investors must deal directly with the issuer to confirm that posted rates are still in effect. Once rates/maturities are posted, information on all issuers is shown to the investor group. Each investor has a unique screen that provides all issuer information, including those institutions with whom the investor has placements, so that the investor can avoid exceeding FDIC limits with any single issuer. Investors then choose which issuers they prefer based on the concept of complete insurance coverage for that deposit. Often, this leads investors to accept less yield as FDIC insurance coverage is the key concept in the rate board environment. Once an investor chooses the institution in which it will invest, a secured communication is initiated directly with the issuer and the transaction is completed.

Private Deposit/Internet Listing Services – continued

Collateral Requirements

Rate boards do not require the use of collateral.

Ease of Set Up

Joining a rate board is a simple process and is normally conducted via the telephone. With the help of the rate board contact person, an institution can be ready to process within a few days.

Ease of Use

Once set up is complete, rate boards do require daily involvement, particularly if the rate environment is volatile. As each transaction must be confirmed by the issuer, protection is afforded against a lapse of attention to the activity. Investors are typically investing up to the FDIC limit ($250,000 at this writing) which makes this an efficient mechanism for raising larger deposits. Once the operation is set up, issuers find that investors tend to re-invest as they become familiar with the process and the institution. Rate boards also involve strategic involvement in that pricing parameters can be adjusted depending on the urgency of the funding. For instance, issuers looking for money the following day will likely post rates near the top of the price structure; however, if funding is not needed in the near-term, posting of rates will occur much lower in the price structure. This often leads to very efficient pricing for those who "pre-fund" activity.

Expected Time to Raise Funds Once Set Up

The services in this section are same-day or next-day funding mechanisms.

Vulnerability to Liquidity Stress Events

Rate boards have less vulnerability to liquidity stress than most Non-Core sources. A rate board issuer must simply be an FDIC-insured institution, so the ability to continue raising funds in stressful economic environments is excellent. However, if an issuer becomes less than well-capitalized, it is limited in its ability to pay top rates.

Capital Treatment

Not applicable.

Unique Advantages

Rate boards have served the industry well. Because FDIC insurance coverage is a central advantage, pricing may become a secondary issue. Once established on a rate board, issuers generally find it easy to access large amounts of funding when necessary. A rate board is particularly attractive to those issuers that use marginal cost analysis when pricing deposits. Institutions not eligible to solicit brokered CDs often switch over to rate boards.

Money Market Deposit Solutions

Description

Near-Core Funding Source

Source

Innovation within the money market deposit arena has provided our industry products that enhance FDIC insurance coverage and allow institutions to attract and retain higher-dollar money market depositors. Through some programs, institutions are able to offer significantly more FDIC coverage to their own depositors that seek both liquidity and safety. The programs exchange coverage within a network of well-capitalized institutions. Because the relationship is maintained with an institution's depositor, these products can be defined as Near-Core.

Structure of Funding

Term

Money market solutions have a stated term of one day. However, the deposits thus far stay with the originating bank for a much longer period.

Pricing

Money market programs typically use a pricing mechanism that is correlated to the fed funds target rate. Institutions in these programs know in advance the rate the networks will pay for new deposits, as well as the price each charges for the reciprocating enhanced insured amount.

Options

Money market instruments do not include embedded options.

Basic Operation

Money market solutions operate in the same manner as money market deposits. The normal account opening procedures are followed. In addition, the depositor must sign an agreement that identifies other institutions with whom they presently have deposits, in order to exclude these institutions from the matching process. Deposits that exceed FDIC limits are sold to the network at a price (buy rate) set by the network. The reciprocating rate (sell rate) is also set by the network, and the spread between the buy and sell rates result in the profit for the network. Thus, the model uses a spread concept as opposed to a transaction fee. Money market solutions are considered to be brokered, so network institutions must be well capitalized to participate in the program.

Collateral Requirements

Money market solutions do not require the use of collateral for the funding institutions.

Money Market Deposit Solutions – continued

Ease of Set Up

Providers typically offer both marketing and operational training for their clients, whichs is typically accomplished via the telephone and Internet.

Expected Time to Set Up

Generally less than one week.

Ease of Use

Money market solutions are best managed by first obtaining a person within the bank who will champion the product. The ability to attract and retain high-dollar liquid funds will typically create additional champions within the bank.

Once established, using money market solutions is as simple as opening a normal money market account, with the exception of redemption. Because redemption activity involves a network, the depositor must usually provide written or telephone instruction for any withdrawals. Withdrawals typically require one-day notice.

Expected Time to Raise Funds Once Set Up

The exchange of coverage occurs on a daily basis and funding is available on a same-day or one-day basis depending on the time of day the deposit is negotiated.

Vulnerability to Liquidity Stress Events

Institutions participating in these programs must be well-capitalized.

Capital Treatment

Not Applicable

Unique Advantages

These solutions are designed to attract and retain high dollar depositors with a need for liquidity and safety. Money market solutions handle both of those investor requirements while retaining pricing control.

Securities Repurchase Agreements

Description

Non-Core Funding Source

Source

A securities repurchase agreement or "repo" involves two simultaneous transactions in which a borrower (seller) of securities sells those securities to a lender (buyer) with an agreement to repurchase the securities at a fixed price on a fixed date. A reverse repo is the same transaction from the perspective of the lender. In effect, a repo is a short-term, collateralized loan.

Structure of Funding

Term

Most repos are done overnight; however, these transactions can occur for a fixed term or on the basis of a continuing contract. Fixed-term repos are usually made for less than 30 days while repos executed under a continuing contract usually contain a clause that adjust rate on a daily basis.

Pricing

The repo market is similar to the fed funds marketplace in that the use generally is for liquidity purposes. Unlike the fed funds market, repos are provided on a secured basis which tends to make pricing more attractive than fed funds. The pricing depends on the term (with overnight less expensive than term in normal cycles) and collateral offered by the borrower.

Options

Repo dealers have been very innovative, creating structures with embedded options, which can benefit either the buyer or seller.

Basic Operation

Repo transactions occur in three forms: specified delivery, tri-party, and held in custody. Tri-party transactions are the dominant form for community bankers and consist of three parties – tri-party agent, seller (borrower), and buyer (lender). The role of the agent is to act as an intermediary between the two parties to the repo and is responsible for the administration of the transaction including collateral allocation, marking to market, and substitution of collateral. This process also includes a collateral management service agreement which includes an "eligible collateral profile". Given the secured nature of this process, risk is highly mitigated; however, there are residual risks associated with the failure of the seller (borrower) to repurchase the securities at the maturity date. In this case, the buyer (lender) has the right to liquidate the securities. Often, risk is mitigated through mark-to-market activities intended to make certain the value of the collateral always provides a safe exit from the transaction. An inability by the seller (borrower) to meet margin calls provides the buyer (lender) the ability to liquidate the collateral.

Securities Repurchase Agreements – continued

Collateral Requirements

The repo market provides for various forms of collateral including securities and whole loans. In times of stress, however, many repo dealers limit eligible collateral to higher quality securities in order to ensure that both liquidity and pricing risks are mitigated. The most common forms of collateral used for repo transactions include U.S. Treasury and federal agency securities.

Ease of Set Up

Institutions desiring to use repos simply contact a repo dealer and establish a relationship. Repos are simple to arrange in normal economic times, but may be more challenging in times of stress.

Expected Time to Set Up

Less than one week in normal times.

Ease of Use

Once a repo relationship is established and the collateral is arranged, execution occurs on a daily basis and is a commonplace transaction.

Expected Time to Raise Funds Once Set Up

Under normal economic conditions, funds can be raised on an overnight basis, but may take additional time during stressful conditions.

Vulnerability to Liquidity Stress Events

The repo marketplace is one that typically works in all environments. However, during the liquidity event of 2008, the repo market was negatively impacted by dealers with concerns over collateral that was not of U.S. Treasury quality, and; activity was negatively impacted, making it difficult for some borrowers to access repos.

Capital Treatment

Not Applicable.

Unique Advantages

Once established, the repo market is easy to use and very price efficient. For those institutions with available collateral, repos are an excellent solution.

Subordinated Debt

Description

Non-Core Funding Source

Source

Subordinated debt is usually issued by bank holding companies; however, it may also be issued at the bank level. Subordinated debt is typically a longer-term and more stable funding source, so it may also qualify for capital treatment. When issued in private placements, subordinated debt is usually not rated; however, publicly-issued subordinated debt must be rated. Convertible subordinated debentures are a hybrid form that add the feature of equity conversion. Subordinated debt falls below senior debt and above equity in liquidation preference.

Structure of Funding

Terms

Subordinated debt is a longer-term funding option with 5-12 year maturities common.

Pricing

Given the liquidation preference for subordinated debt, pricing will generally be more expensive than senior debt and will be highly dependent on whether or not it is rated (and what that rating is). By adding a convertible feature, the cost may be reduced, although this price reduction may have a stockholder dilution impact, if conversion occurs.

Options

A popular option is to have the debt convert to stock of the company.

Basic Operation

Subordinated debt may be issued in any size, but smaller issuances may cause higher costs based on the up-front fees normally associated with issuance. Issues of $5 million or greater are encouraged to create institutional interest. An investment banker and legal counsel will be required for successful issuance, and fees may run to 5 percent of the issuance amount. Smaller issues sold to local investors can sometimes be done without an investment banker but will still require legal counsel.

Collateral Requirements

Subordinated debt transactions are typically unsecured and do not require collateral.

Subordinated Debt – continued

Ease of Set Up

Subordinated debt is a complex issuance, because it requires significant underwriting and legal assistance.

Expected Time to Set Up

Less than 60 days.

Ease of Use

Subordinated debt is fairly easy to use, as long as timely payments are made, unless there are unusual covenants in the debenture.

Expected Time to Raise Funds Once Set Up

Private placements to institutional investors may occur within a few weeks while smaller placements to local investors may take six months.

Vulnerability to Liquidity Stress Events

Subordinated debt is highly vulnerable to stress events due to the nature of the liquidation preference. In severe stress, the ability to issue may completely disappear. Dependence on this source, particularly for community banks, is not recommended.

Capital Treatment

Certain types of subordinated debt may qualify for Tier 2 capital treatment depending on terms, the most important being the average weighted maturity of the issuance.

Unique Advantages

Subordinated debt has characteristics of both debt and equity. Interest paid is a tax deductible expense and, if structured properly, subordinated debt can qualify for Tier 2 capital treatment.

Near-Core and Non-Core Funding Case Studies

On the following pages, XYZ considers its Near-Core and Non-Core Funding strategy, and elects to add 4 additional Near-Core and Non-Core sources of funds. Following the case study are completed funding worksheets.

> While the policy statement addresses the need to diversify an institution's funding sources, there is no requirement to use a particular funding source. The agencies believe that a diversification of funding sources strengthens an institution's ability to withstand idiosyncratic and market wide liquidity shocks.
>
> FDIC Financial Institution Letter FIL-84-2008: Liquidity Risk Management

XYZ Near-Core and Non-Core Funding Strategy

As XYZ began to set goals, management realized there was a relatively heavy reliance on Near-Core and Non-Core Funding. As Figure 3-1 illustrates, as of December, 2009, XYZ was funding 35.9% of its balance sheet from Near-Core and Non-Core Funding sources, well over the industry average of 19%. In addition, XYZ had arranged a relatively short list of facilities to fund its liquidity needs: FHLB advances, jumbo CDs, brokered CDs, and a single Fed Funds Purchased line. (XYZ managment chose to list jumbo CDs as Near-Core Funding, because regulators do not count jumbo CDs as Core Funding. Placing jumbo CDs in Near-Core addresses the issue of concentration that can be volatile, especially during stress events.)

The four facilities XYZ management chose are shown in blue in Figure 3-1. Three of the four facilities were being heavily utilized, limiting severely XYZ's ability to tap into Near-Core and Non-Core Funding sources in a liquidity stress event.

You may wish to create a schedule similar to that in Figure 3-1 to document your Near-Core and Non-Core funding sources, uses, and limits. This schedule will be helpful when it comes time to create your liquidity policy statement in Tool 5.

Figure 3-1 Near-Core and Non-Core Funding Facilities & Limits

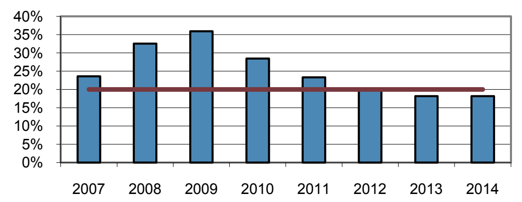
Month/Year	Dec-09			Assets
Near-Core & Non-Core Funding	107,728			300,000
	Balances	PolLim%	Use	% Assets
Near-Core Funding				
CDs > $250K	17,235	30.0%	B	5.7%
CDARS	0	10.0%	BC	0.0%
MoneyAisle	0	10.0%	BC	0.0%
…	0	0.0%		0.0%
…	0	0.0%		0.0%
…	0	0.0%		0.0%
…	0	0.0%		0.0%
Non-Core Funding				
FF Purchased	0	10.0%	B	0.0%
FHLB Advances	43,115	25.0%	BC	14.4%
Brokered CDs	47,378	25.0%	BC	15.8%
Fed Reserve Primary & Secondary	0	20.0%	C	0.0%
Rate Board CDs	0	25.0%	C	0.0%
…	0	0.0%		0.0%
…	0	0.0%		0.0%
…	0	0.0%		0.0%
…	0	0.0%		0.0%
…	0	0.0%		0.0%
…	0	0.0%		0.0%
…	0	0.0%		0.0%
Total	107,728	40.0%		35.9%

XYZ addressed the issue of heavy reliance on Near-Core and Non-Core Funding in its capital/liquidity plan by setting a long-range strategic goal to reduce Near-Core and Non-Core Funding to no more than 20% of total assets. Of course, a sudden reduction could place pressure on earnings as a result of high marginal costs, so management established a series of annual goals to gradually reduce reliance on Near-Core and Non-Core Funding. See Figure 3-2. By the end of Year 3 the targeted level of Near-Core and Non-Core Funding was very close to the 20% goal. In Years 4 and 5, it dropped a bit below the goal.

(e.g., FHLB advances) offer terms, cash flow, and other options not available in the Core and Near-Core markets. These funding options are an important tool in managing the interest rate risk and option risk in XYZ's mortgage portfolio. Also, some Near-Core Funding (e.g., jumbo CDs, rediprocal deposits) is a natural byproduct of execution of its Core Funding strategy.

XYZ divided its limit into base liquidity strategy – 20% – and potential stress events – 20% – for a total policy limit of 40%.

Figure 3-2 Strategic Goal and Annual Targets – Non-Core and Near Core to Assets



Year	NonNr Core Assets	Ending NonNr Fnd
Dec-09	35.91%	107,728
Dec-10	28.40%	76,420
Dec-11	23.28%	60,805
Dec-12	20.10%	53,693
Dec-13	18.15%	51,000
Dec-14	18.12%	54,987
Strat Goal	20.00%	

For a number of years XYZ had used a 40% limit. Management elected to leave the limit in place for two reasons:

- If management lowered the limit much, XYZ would currently be outside its policy limits. Some Near-Core Funding (e.g., jumbo CDs, reciprocal deposits) is a natural byproduct of executionof its Core Funding strategy.
- Lowering the limit much would fail to provide XYZ with any room to use Near-Core and Non-Core Funding as a contingent funding tool during a liquidity stress event.

Management reasoned that a certain level of Near-Core and Non-Core Funding is acceptable. It allows XYZ to manage its cost of funds in an effective manner, especially when competitors are paying rates on deposits significantly above rates on Non-Core Funding. Management also recognized that certain sources of Non-Core Funding

Additionally, management set limits on the use of individual sources. These limits total well above the 40% limit. Doing so offers the flexibility of choosing between Near-Core and Non-Core Funding sources as necessary or appropriate while limiting total Near-Core and Non-Core Funding to 40% of assets.

XYZ chose to add four additional Near-Core and Non-Core sources of funds, expanding its initial potential facilities from four to eight. These sources are highlighted in figure 3-1 in green. Figure 3-1 also shows the limits that have been established for their Non-Core and Near-Core Funding. In addition to the sources, purposes and limits shown in Figure 3-1, management also completed worksheets that discuss each of their near-core and non-core funding sources in detail. A blank worksheet is available at www.aba.com/LiquidityToolbox.

Near-Core and Non-Core Funding Worksheet For: **Jumbo CDs**

Institution: XYZ Bank

Date Completed: 7/30/10 Completed By: Tom Farin

Funding Type: ■ Near-Core ☐ Non-Core ☐ Brokered ■ Non-Brokered

Jumbo CDs are normally raised from the same markets from which XYZ raises its Core Funding as part of strategies aimed at raising Core Funding. They fail to meet the definition of Core because of the size of the deposit. As no commission is paid, they would also be considered to be non-brokered and not vulnerable to restrictions on the use of brokered CDs.

Policy Limit: 30% of assets

Many institutions would argue that policy limits should not be placed on the use of jumbo CDs raised from local customers. XYZ has elected to limit Jumbo CDs to no more than 30% of total assets for the following reasons and include the balances in the overall Near-Core and Non-Core limit because:

- Jumbo CD balances are more rate sensitive and more vulnerable to adverse publicity than other funding sources.
- Jumbo CD balances have the potential to create significant funding concentrations in relatively few retail customers and as such increase the concentration risk in the bank.

The limit was set as high as 30% for the following reasons:

- In the right competitive and economic environments, Jumbo CDs can be a relatively low cost source of funding.
- Jumbo CDs are gathered as a natural byproduct of strategies aimed at raising Core Funding.

Funding Utilization: ■ Base Funding ☐ Contingency Funding

In its base liquidity strategy, XYZ will utilize Jumbo CDs in the following situations:

- The CDs come into the institution as a natural byproduct of efforts aimed at raising Core Funding.
- The cost of Jumbo funding is inexpensive relative to alternative funding sources.
- XYZ needs to preserve collateral to meet asset-based liquidity needs and when alternative funding sources may demand the pledging of collateral.

Facility Status: ■ Operational ☐ Under Development

XYZ has used Jumbo CDs as a funding source ever since the institution has been in operation. Because they renew frequently, there is no need to design a specific program to test this facility.

Facility Testing:

Testing automatically occurs when Jumbo CDs are renewed or opened as part of the XYZ base liquidity strategy.

Near-Core and Non-Core Funding Worksheet For: **CDARS Reciprocal CDs**

Institution: XYZ Bank

Date Completed: 7/30/10 Completed By: Tom Farin

Funding Type: ■ Near-Core ☐ Non-Core ■ Brokered ☐ Non-Brokered

CDs placed through CDARS are typically raised from the same kinds of customers and in the same market area as XYZ's Core customers. The fact that a third party charges a commission to place the monies causes them to be regarded technically as brokered CDs. However, regulatory treatment may be more favorable than for other types of brokered CDs because the funds are raised from local customers.

CDs placed through CDARS have not been an important source of funding in XYZ's base liquidity strategy in the past. However, XYZ recognizes that the ability to provide access to deposit insurance on large CDs has the potential to cause them to become an important part of the XYZ base and contingency liquidity strategies. As compared to FHLB advances and jumbo CDs requiring protection above FDIC insurance maximums, CDs placed through CDARS have the advantage of requiring no collateral on an ongoing basis.

Policy Limit: 10% of assets

XYZ has elected to limit CDARS funding to no more than 10% of total assets for the following reasons:

- Management has no product experience and wishes to gain experience before considering higher limits.
- Under certain kinds of liquidity stresses, the availability of CDs placed through CDARS might be restricted by either the regulator or by the provider.

Funding Utilization: ■ Base Funding ■ Contingency Funding

In its base liquidity strategy, XYZ will utilize CDARS in the following situations:

- CDARS funding is cost-effective.
- XYZ needs to preserve collateral to meet asset-based liquidity needs and when alternative funding sources may demand collateral to be pledged.
- New customers are demanding coverage of their entire principal amount, and available collateral is scarce.
- XYZ has safety-conscious customers it wants to keep.
- XYZ wants to attract large-dollar depositors without raising rates across the board.

In its contingent funding strategy, XYZ will consider use of the CDARS when there are indicators of the potential approach of a liquidity stress event that could cause a run on Jumbo CD funding. At that point, maturing Jumbo CDs might be placed in the CDARS Recriprocal CD Network.

Facility Status: ☐ Operational ■ Under Development

XYZ has applied to join the CDARS Network. It is expected this facility will come on line within the next 30 days.

Facility Testing:

Testing will automatically occur when large CDs are renewed or opened and placed through CDARS as part of the XYZ base liquidity strategy. However, should XYZ go six months without placing a CD through CDARS, one will be placed to test the facility. There is no limit on XYZ's use of CDARS, other than its policy limit.

Near-Core and Non-Core Funding Worksheet For: **MoneyAisle**

Institution: XYZ Bank

Date Completed: 7/30/10 Completed By: Tom Farin

Funding Type: ■ Near-Core □ Non-Core ■ Brokered □ Non-Brokered

MoneyAisle is an online CD Auction resource. Institutions running promotions on this network have the ability to restrict their auctions to a geographic area, which could be inside or outside the market they normally use in raising retail funds. XYZ's use of this facility will be limited to Dane County, Wisconsin, XYZ's defined market area. Because MoneyAisle operates under a click-through model rather than a commission model, it does not meet the technical regulatory definition of a brokered deposit source, although it is currently classified as brokered. XYZ would argue this is clearly a non-brokered Near-Core source as funds are raised in XYZ's market and there is no commission paid based on closing the CD.

MoneyAisle has not been an important source of funding in XYZ's base liquidity strategy. However, XYZ recognizes that the use of MoneyAisle could develop into an important segmentation tool in that it has the potential to reduce cannibalization from existing customers while potentially raising significant new money. In addition, should XYZ need to raise additional Near-Core Funding to replace the loss of a Near-Core or Non-Core Funding source during a stress event, it could develop into an important contingent funding source.

Policy Limit: 10% of assets

XYZ has elected to limit MoneyAisle CDs to no more than 10% of total assets for the following reasons:

- Management has no product experience and wishes to gain experience before considering higher limits.
- Under certain kinds of liquidity stresses, the availability of MoneyAisle CDs might be restricted or interest rate caps enforced as part of a regulatory order.
- Customers may be less loyal, as they often chase rates, generally making the funds less stable.

Funding Utilization: ■ Base Funding ■ Contingency Funding

In its base liquidity strategy, XYZ will utilize MoneyAisle CDs in the following situations:

- The marginal cost of raising CDs through MoneyAisle is below the marginal cost of alternative funding sources.
- XYZ needs to preserve collateral to meet asset-based liquidity needs and when alternative funding sources may demand the pledging of collateral.

In its contingent funding strategy, XYZ will consider use of MoneyAisle when:

- Near-Core funds need to be raised to replace a Near-Core or Non-Core source during a liquidity stress event.

Facility Status: □ Operational ■ Under Development

XYZ has applied join the MoneyAisle Network. It is expected this facility will come on line within the next 60 days.

Facility Testing:

Testing will automatically occur whenever XYZ runs a MoneyAisle promotion, and at least every six months. There is no limit on XYZ's use of MoneyAisle CDs other than its policy limit.

Near-Core and Non-Core Funding Worksheet For: **Fed Funds Purchased**

Institution: XYZ Bank

Date Completed: 7/30/10   Completed By: Tom Farin

Funding Type: ☐ Near-Core ■ Non-Core ☐ Brokered ☐ Non-Brokered

Funds raised from bankers' banks and correspondent banks in the form of Fed Funds Purchased are universally considered to be a Non-Core source of funding. As no commission is paid, they would also be considered to be non-brokered and not vulnerable to regulatory actions restricting the use of brokered CDs. However, because they are often unsecured, a downturn of an institution's financial position may reduce their availability and/or increase their cost.

Policy Limit: 10% of assets

The fed funds market can be an important source of funding for both XYZ's base liquidity strategy and as part of its CFP. Given the nature of XYZs loan portfolio, and the nature of the rest of the asset side of XYZ's balance sheet, management has felt it advisable to limit Fed Funds Purchased to no more than 10% of total assets for the following reasons:

- Management does not wish to become too reliant on a single funding source.
- Under certain kinds of liquidity stresses, this funding source might be restricted or disappear entirely.
- From an interest rate risk standpoint, XYZ does not feel it is advisable to have more than 10% of its funding in immediately repricable fed funds.

Funding Utilization: ■ Base Funding ■ Contingency Funding

In its base liquidity strategy, XYZ will utilize fed funds to provide short-term funding when short-term inflows of funds are exceeded by short-term outflows. This can happen as part of base liquidity strategies and/or when certain kinds of stress events occur (e.g., temporary disruptions in payment systems).

Therefore, it is XYZ's goal to maintain fed funds utilization at no more than 10% of total funding.

Facility Status: ■ Operational ☐ Under Development

XYZ has fed funds facilities available through its bankers' bank and through a correspondent bank. In addition, XYZ can obtain overnight advances when needed from the FHLB, subject to policy and collateral limits.

Facility Testing:

Testing automatically occurs when fed funds are purchased in daily operations, are renewed, or are drawn down as part of the XYZ base liquidity strategy. However, XYZ will insure these facilities are tested from each of the sources at least once every six months.

Near-Core and Non-Core Funding Worksheet For: **FHLB Advances**

Institution: XYZ Bank

Date Completed: 7/30/10 Completed By: Tom Farin

Funding Type: ☐ Near-Core ■ Non-Core ☐ Brokered ■ Non-Brokered

Funds raised from the FHLBs are universally considered to be a Non-Core source of funding. As no commission is paid, they would also be considered to be non-brokered and not vulnerable to regulatory actions restricting the use of brokered CDs.

Policy Limit: 25% of assets

The FHLB is an important source of funding for both XYZ's base liquidity strategy and as part of its CFP. Given the nature of XYZ's loan portfolio, there is far more collateral available than needed to collateralize advances up to and including the 25% policy limit. It could be argued that this limit should be higher. XYZ has elected to limit FHLB advances to no more than 25% of total assets for the following reasons:

- Management does not wish to become too reliant on a single funding source.
- Under certain kinds of liquidity stresses, the FHLB could increase collateral haircuts potentially putting XYZ in a position where there is inadequate collateral to cover outstanding advances.

Funding Utilization: ■ Base Funding ■ Contingency Funding

In its base liquidity strategy, XYZ will utilize FHLB advances to do the following:

- Provide lower cost funding when FHLB advances are inexpensive relative to other funding sources.
- Hedge interest rate risk and option risk in XYZ's loan portfolio.

Because it is a collateralized borrowing source, FHLB advances may be available to fund the balance sheet after other sources of Near-Core and Non-Core Funding have dried up, making advances an important contingency funding source.

Therefore, it is XYZ's goal to maintain FHLB advance utilization at no more than 15% of total funding as part of its base liquidity strategy, keeping the remaining 10% of the policy limit available to fund the balance sheet during stress events.

Facility Status: ■ Operational ☐ Under Development

XYZ has used FHLB advances as a funding source for over a decade. Generally, FHLB advances are always on the XYZ balance sheet.

Facility Testing:

Testing automatically occurs when advances are renewed or drawn down as part of the XYZ base liquidity strategy. Should XYZ go more than six months without taking down a FHLB advance, XYZ will test the facility. Credit availability from the FHLB far exceeds the policy limit on FHLB advances.

Near-Core and Non-Core Funding Worksheet For: **Brokered CDs**

Institution: XYZ Bank

Date Completed: 7/30/10 Completed By: Tom Farin

Funding Type: ■ Near-Core □ Non-Core Brokered □ Brokered ■ Non-Brokered

Brokered CDs are normally raised from the national markets, a geographic area that far exceeds XYZ's normal marketing area of Dane County, Wisconsin. The fact a commission is paid to the broker facilitating the transaction causes them to be regarded as brokered CDs. They fail to meet the definition of Core Funding because of the fact they are obtained from non-customers and because of their status as brokered CDs.

Policy Limit: 25% of assets

Brokered CDs are an important source of funding in XYZ's base liquidity strategy and as part of its CFP. As compared to FHLB advances, brokered CDs have the advantage of requiring no collateral. XYZ has elected to limit brokered CDs to no more than 25% of total assets for the following reasons:

- Management does not wish to become too reliant on a single funding source.
- Under certain kinds of liquidity stresses, XYZ could be unable to raise funds in the brokered CD markets.

Funding Utilization: ■ Base Funding ■ Contingency Funding

In its base liquidity strategy, XYZ will utilize brokered CDs when:

- When the cost of brokered CDs funding is inexpensive relative to alternative funding sources.
- When XYZ needs to preserve collateral to meet asset-based liquidity needs and when alternative funding sources may demand the pledging of collateral.
- When the term structures available in the brokered CD markets provide an effective hedge against the interest rate risk and option risk in the XYZ loan portfolio.

In its CFP, brokered CDs can be an important source of contingency funding when there is a significant deposit outflow as long as financial condition has not deteriorated to the point that XYZ is barred from use of this funding source.

Facility Status: ■ Operational □ Under Development

XYZ has used brokered CDs as a funding source for over five years. Because they renew frequently, under normal circumstances, there is no need to design a specific program to test this facility.

Facility Testing:

Testing automatically occurs when brokered CDs are renewed or opened as part of the XYZ base liquidity strategy, and at least every six months thereafter.

Near-Core and Non-Core Funding Worksheet For: **Federal Reserve**

Institution: XYZ Bank

Date Completed: 7/30/10 Completed By: Tom Farin

Funding Type: ☐ Near-Core ■ Non-Core ☐ Brokered ■ Non-Brokered

The Federal Reserve discount window is a funding source specifically designed to be available in a time of financial stress. It is universally regarded as a Non-Core non-brokered funding source.

The Federal Reserve discount window is a potentially important source of funding as part of XYZ's CFP. The Federal Reserve offers the widest range of options in collateralizing borrowings, more liberal than the FHLBs and other collateralized funding sources.

Policy Limit: 20% of assets

XYZ has elected to limit the Federal Reserve discount Window to no more than 20% of total funding. While this may seem low relative to some other limits, it is important to keep in mind it is being reserved solely as a contingency funding source under XYZ policies. In the contingency funding role, only rate board CDs have a higher limit. Management does not wish to become too reliant on a single funding source.

Funding Utilization: ☐ Base Funding ■ Contingency Funding

In its base liquidity strategy, XYZ will utilize Federal Reserve discount window borrowings when:

- XYZ is short on collateral to fund other forms of collateralized borrowings.
- When other sources of Near-Core and Non-Core Funding dry up making this one of the few viable funding sources.
- When Federal Reserve programs designed to deal with general economic distress fit in nicely with XYZ contingency funding needs.

Facility Status: ☐ Operational ■ Under Development

XYZ has applied for access to Federal Reserve discount window services. It is anticipated this facility will come on line within the next 90 days.

Facility Testing:

As a contingency funding source, XYZ is unlikely to use the discount window on a regular basis. For that reason, this facility will be tested at least every six months.

Near-Core and Non-Core Funding Worksheet For: **Rate Board CDs**

(Public Deposit Internet Listing Services)

Institution: XYZ Bank

Date Completed: 7/30/10 Completed By: Tom Farin

Funding Type: ☐ Near-Core ■ Non-Core ☐ Brokered ■ Non-Brokered

Rate board CDs are normally raised in the national markets from other banks and credit unions in denominations of just under $250,000. They fail to meet the regulatory definition of Core Funding because of the fact they are obtained from non-customers. However, as no commission is paid on the execution of transactions they are not considered to be brokered CDs.

Rate board CDs are a potentially important source of funding in XYZ's CFP. This facility generally continues to be available even if the institution is unable to book brokered CDs. As a result they can be an important source of contingency funding during stress events. As compared to FHLB advances and certain other sources, rate board CDs have the advantage of requiring no collateral.

Policy Limit: 25% of assets

XYZ has elected to match its policy limit on rate board CDs to its brokered CD limit so if brokered CDs are removed as a funding source by regulatory enforcement actions, rate board CDs can fully replace brokered CDs without a policy limit violation.

Funding Utilization: ☐ Base Funding ■ Contingency Funding

In its contingency funding strategies, XYZ will utilize rate board CDs in liquidity stress events:

- When in the midst of a stress event, other sources of Near-Core and Non-Core Funding dry up leaving XYZ in a position where it needs to raise non-brokered term funding.
- When XYZ needs to preserve collateral to meet asset-based liquidity needs and when alternative funding sources may demand the pledging of collateral.
- When the term structures available in the rate board CD markets provide an effective hedge against the interest rate risk and option risk in the XYZ loan portfolio.

Facility Status: ☐ Operational ■ Under Development

XYZ has applied for membership in QwickRate, a provider of rate board CDs. It is anticipated this facility will come on line within 60 days.

Facility Testing:

Testing automatically occurs when rate board CDs are gathered as part of a contingency funding strategy. However, because this is a contingency funding strategy this facility will be tested at least every six months.

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