



STATE OF ALABAMA
ALABAMA CREDIT UNION ADMINISTRATION

100 N. UNION STREET, SUITE 650, MONTGOMERY, ALABAMA 36104
TELEPHONE: (334) 353-5770 • FAX (334) 353-5795
www.acua.alabama.gov



KAY IVEY
GOVERNOR

TO: Alabama Credit Unions

FROM: H. Greg McClellan

H. GREG MCCLELLAN
ADMINISTRATOR

RE: Liquidity Concerns

Date: November 28, 2023

During 2023, the importance of liquidity management and contingency funding planning has been highly elevated. Loan demand has increased significantly for some credit unions while deposit levels have been seen as decreasing generally since the year 2020. The Alabama Credit Union Administration (ACUA) has placed a high priority on examining the level of liquidity in state-chartered credit unions and consider this issue as a high level of risk at the present time. The June 2023 (quarter-end financials) revealed slightly over 30% of state-chartered credit unions had NCUA defined liquidity ratios (Cash + Short-term Investments / Assets) of less than 10%. A lack of liquidity could be the fastest path to failure for a credit union.

Liquidity is the amount of available cash or cash-like assets a credit union reflects in its financial statement. It must be sufficient to allow for withdrawals from deposit accounts, cash outflows to fund loans, pay the expenses incurred in the credit union's operations, repayment of their own debt, and cash outflows to meet investment, debt, and other contractual obligations not included elsewhere. In addressing liquidity levels and the ability to respond to required cash flows, credit unions must constantly review available cash and the nature of any investments considered as additional cash flow sources. Be aware that some investments may not be easily converted to cash during times of economic crisis and may be subject to a discount from face value.

Credit unions must have a plan to address Liquidity and Contingency Funding (NCUA Regulations Section 741.12 and ACUA Regulations Section 19). This includes a credit union board approved written liquidity policy and contingency funding plan. More than one source for contingency funding should be identified and engaged. Evaluate corporate credit unions, Central Liquidity Fund, Fed Discount Window, Federal Home Loan Bank, and banks. The ability of these entities to serve as a source of contingency funding should be evaluated as to the effects of an economic crisis and resulting increased demand on the entities. ACUA has noticed an increase in borrowings by credit unions during 2022-2023 which is concerning. For all federally insured credit unions (per NCUA data), the number of borrowers increased from 336 at December 2021 to 1,237 at June 2023. Of total borrowings at June 2023, the FHLB had the highest percentage of total borrowings at 69.7% of all borrowings. Corporates represented 1.1% and the Federal Reserve Bank had 25.4%.

Credit unions should monitor all their sources of contingent funding to ascertain if the contingent funding source has an overall limit on funding availability and stay abreast of policy for any changes being considered by funding sources. For example, the FHLB is in the process of evaluating their operations, part of which would require at least 10 percent of certain members' assets remain in residential mortgage loans or equivalent FHLB mission assets and preserving the benefits of FHLB debt issuance for all members by limiting debt issuances that unduly raise debt

clearing costs or debt issuance activity, just to highlight a few of their considerations. This review by FHLB will also evaluate decreasing the number FHLBanks from 11 down to 8.

Credit unions may wish to conduct a more complex examination of liquidity by a high-level review of the cash flow of the credit union. A review of a 30-day total of all withdrawals from deposit accounts, cash outflows to fund loans, cash expenses arising from the credit union's operations (including interest paid on borrowed money), and the cash it needs to comply with investment, debt, and other contractual obligations which are not included elsewhere will provide a picture of the credit union's cash outflow. That outflow would then be netted by all various sources of cash that come into the credit union over the 30-day period, including but not limited to deposits, loan payments, maturity of investments, etc. When the two numbers are divided (cash flow in / cash flow out), you have a good picture of the credit union's liquidity position. The higher the ratio is above 100%, the stronger the credit union's liquidity position.

In 2023, many credit unions have seen high loan demand. Meeting this demand has had an impact which has led to a decrease in liquidity. Areas which could be managed to help reduce the loan demand include increasing loan rates, revision and tightening of lending requirements, and/or simply halting lending for a period until liquidity returns to a safe level. While loan demand has weakened since the first of 2023, credit unions should be aware that banks reported tightened lending standards across many lending segments. The reasoning provided for changing standards across the lending segments are related to an uncertain economic outlook, reduced tolerance for risk, deterioration in credit quality and collateral values, and concerns about funding costs (See Fed October 2023 Senior Loan Officer Opinion Survey on Bank Lending Practices, available on Fed Reserve site). Evaluate lending, especially business loans, in relation to the credit union being a last resort lender due to the borrower being a higher risk category which other lending sources wish to avoid. Auto loan defaults and credit care debt are now at extremely high levels.

The deposit side of the balance sheet should also be managed. You may examine the terms and rates offered on the deposits, especially if rates begin to fall. Longer terms on deposits may increase the interest expense for a longer period of time and not provide repricing opportunities of deposit accounts in an appropriate manner. It is also noted that deposit flight risk is a possible scenario, whether this is for deposit insurance coverage, wealth transfer to family members, or for better rates. It is recommended that credit unions monitor the amount of uninsured deposit amounts as well as unfunded contingencies as they monitor and manage liquidity. Be cautious in relying on non-member deposits at above normal interest rates.

ACUA reviews the NCUA defined liquidity ratio regularly. Credit unions with less than a 10% liquidity ratio will be cited in an examination as to higher liquidity risk, especially if the ratio has been decreasing over a period of time. Such credit unions will be required to report to ACUA the liquidity ratios and plans to improve liquidity on a monthly basis. Credit unions with a 5% or less liquidity ratio will be required to report to ACUA on a weekly basis the credit union's liquidity ratio and the credit union's plan for increasing the liquidity ratio. ACUA may randomly evaluate various credit unions' liquidity position at various and unannounced intervals. Credit unions with consistently low liquidity may be deemed to be unsafe and unsound which may cause the ACUA to undertake more drastic Administrative Actions.