# Module: Finance
# Section: Liquidity
# EM-420

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## Introduction

Liquidity represents the ability to meet all liability obligations and fund increases in assets and/or decreases in capital. Funds must be available at reasonable prices and in maturities required to support the asset structure. Sufficient liquidity is essential to accommodate expected and/or unexpected balance sheet fluctuations and to provide funds for growth.

The primary sources of liquidity within the Farm Credit System (System) include: access to funding, marketable investments, loan sales, supplemental lines of credit, and cash. The following provides a brief description of each.

<u>Access to Funding/Financial Markets</u>--Ongoing access to funding is by far the predominant source of liquidity within the System. System banks obtain funding through the marketing of consolidated Systemwide bonds and discount notes to the investing public via the Federal Farm Credit Banks Funding Corporation (Funding Corporation). System associations do not have similar access to the financial markets, but instead rely on their affiliated district banks as an ongoing source of funding under a defined debtor-creditor relationship.

<u>Marketable Investments</u>--System banks maintain a reserve of high-quality marketable investments which may be liquidated to meet cash flow needs during periods of temporary disruptions in the financial markets. Although associations may also hold marketable investments, subject to their district bank's approval, most do not due to their accessibility to funds from the district bank.

<u>Loan Sales</u>--The sale of loans via participations or the secondary market provides an alternative source of liquidity for both System banks and associations.

<u>Supplemental Lines of Credit</u>--Lines of credit with other financial institutions are occasionally established to supplement the traditional source of funding for System banks and associations as described above. These lines of credit would typically be used for supplemental, emergency, or temporary funding needs.

<u>Cash</u>--Cash is the result of the net cash flow from various sources including net cash income and any net paydown on the loan portfolio. Cash provides immediate liquidity, but is typically maintained at a very low level by investing in earning assets and/or paying down debt so as to minimize the opportunity cost of carrying noninterest-bearing cash balances. Refer to the Other Assets section of the Assets module for further discussion on cash.

The primary uses of liquidity within the System include: debt payments, loan demand, contingent liabilities, near-term capital expenditures, operating expenses, and cash dividends and stock retirement. The following provides a brief description of each.

<u>Debt Payments</u>--Due to the large volume and generally wide array of Systemwide securities utilized for funding purposes, System banks typically have significant debt obligations coming due on a routine basis. Association debt payments are primarily limited to interest payments on the direct loan from the funding district bank, in addition to discretionary principal payments.

<u>Loan Demand</u>--An expansion in loan demand creates a corresponding demand for funding. An increase in loan demand may result in heightened demand for new loans, and/or additional draws on already existing loan commitments.

Contingent Liabilities--Although the most prominent contingent liability is typically the above-mentioned outstanding loan commitments, litigation can also be significant. While usually infrequent in nature, litigation losses can be substantial when incurred.

Capital Expenditures--Capital expenditures planned for the near-term must be provided for out of liquid funds. Examples of such expenditures would include building projects, computer-related purchases, office furniture and equipment, etc.

Operating Expenses--While operating expenses should routinely be covered by operating income for all institutions operating at a profit, income and expense timing differences typically create modest liquidity needs in the interim. Additionally, the operating expenses of unprofitable institutions create an ongoing use of institution liquidity.

Cash Dividends and Stock Retirement--Cash dividends represent a direct outflow of liquid funds, as do stock retirements when paid in cash.

The adequacy of each institution's liquidity must be evaluated on a case-by-case basis in light of the projected sources and uses of liquidity. This evaluation includes the assessment of several variables including: access to ongoing funding, secondary sources of liquidity, funding stability, anticipated and potential demands on liquidity, and the quality of liquidity management.

## Examination Objectives

The fundamental examination objective in the liquidity area is to determine the overall adequacy of the institution's present and projected liquidity. This is accomplished through the following principal objectives:

Assess the sufficiency of the institution's liquidity position in light of present and anticipated liquidity needs;

Determine compliance with applicable liquidity-related requirements, specifically the liquidity reserve requirement for System banks and the General Financing Agreement for associations; and

Conclude as to the effectiveness of management in planning for, executing, and monitoring the overall liquidity function.

## Criteria and Guidance

The liquidity evaluation process involves the analysis of numerous factors, both quantitative and qualitative. In general, evaluative factors should be quantified to the extent possible and appropriate. Some factors, however, are qualitative by nature and all factors whether quantifiable or not must ultimately be interpreted subjectively. Consequently, the following discussion of evaluative factors integrates both quantitative and qualitative considerations, including qualitative factors designed to provide the examiner a prospective view of the institution's liquidity strength. The five key evaluative factors discussed below are:

- Access to funding;
- Secondary sources;
- Funding stability;
- Demands on liquidity; and
- Liquidity management.

Access to Funding

As a result of the unique and structured funding mechanism within the System, continued access to funding/financial markets is the predominant source, and determinant, of a System institution's liquidity. For System banks, this entails continued access to funds in the financial markets via the Funding Corporation. For associations, this means continued available funding from the district bank. In both cases, however, continued access to funding at a reasonable cost is ultimately dependent upon overall institutional strength, i.e., the other CAMEL factors--Capital, Asset Quality, Management, and Earnings. Consequently, a System institution's performance in each of the other CAMEL areas, and the resulting overall condition, bears directly on the institution's liquidity position.

In evaluating bank access to funding, appropriate consideration should also be given to the condition of other System institutions. System bank funding is derived from consolidated Systemwide securities, for which all System banks are jointly and severally liable. Consequently, the aggregate condition of System banks and the entire System, in general, is a fundamental determinant in the Funding Corporation's ability to market System securities, which in turn generate liquidity for the System banks.

From a slightly different perspective, consideration to other System institutions is also relevant in assessing an association's liquidity position. Specifically, when an association is reliant on a district bank for essentially all of its funding needs, the bank's liquidity position becomes a relevant consideration, i.e., the end user is impacted by the stability of the pipeline. To the extent an association's overall condition can command alternative sources of funding, the impact of the bank's liquidity position is mitigated.

Associations cannot directly access the financial markets as System banks do, but rather rely on the district banks as their primary source of funding. As such, each association operates under a General Financing Agreement (GFA) with its respective district bank to provide the necessary funding for its lending operations. The GFA (including any attached, referenced, and/or related documents) outlines specific conditions with which the association must comply to ensure its continued access to funding from the district bank.

The System, from time to time, utilizes various self-discipline mechanisms to monitor its own condition and performance and, hence, creditworthiness, such as the Contractual Interbank Performance Agreement. Specific measures or indicators of institutional strength and liquidity include the Contractual Interbank Performance Agreement, loanable funds, and collateral. Each is briefly discussed below.

<u>Contractual Interbank Performance Agreement (CIPA)</u>--The CIPA is an agreement between all System banks and the Funding Corporation (as scorekeeper) which measures and monitors each bank's/district's quarterly financial condition and performance. A quantitative model is used to score performance in several key categories related to capital adequacy, asset quality, earnings performance, interest rate risk management, and liquidity reserves. The resulting score is translated into an alphabetical rating similar to those used by industry firms such as Moody's or Standard and Poors. The agreement provides for economic penalties against individual banks if specified minimum thresholds of performance are not met.

<u>Loanable Funds</u>--The level of an institution's loanable funds (earning assets less interest-bearing liabilities) provides an indicator of organization strength in general, and of external funding needs in particular. An institution's loanable funds position is directly affected by asset quality, earnings performance, and capital accretion, and, as a result, provides a basic indicator of overall financial strength and creditworthiness. Additionally, loanable funds represent internally generated funding, thereby reducing the need for debt funding and external liquidity.

<u>Collateral</u>--The existence of a sufficient quantity and quality of collateral is reflective of organizational strength and creditworthiness. Each System bank is required to hold an amount of collateral at least equal to its total outstanding debt obligations. Collateral for this purpose includes eligible loans, marketable investments, other property owned, cash, and other assets approved by FCA. Refer to FCA Regulation 12 CFR § 615.5050 for further System bank collateral details. Similarly, the GFA between a district bank and association outlines the collateralization requirements for the association's direct loan from the bank. Adequate collateralization of direct loans is particularly important as these loans constitute asset-based lending, i.e., inventory loans.

The quality of an institution's collateral will necessarily mirror the quality of its assets, particularly the loan portfolio. Thus, an institution's asset quality can provide particular insight into the stability of its collateral position. A deteriorating asset quality trend and/or significant level of marginal quality assets likely signals future collateral problems.

Considerations in evaluating an institution's continuing access to funding include:

- What are FCA's conclusion's regarding the strength of the institution's capital, asset quality, management, and earnings? These are the key foundational factors that determine the institution's creditworthiness and its ability to command continued access to funding.

- In assessing bank access to funding, what is the aggregate condition of all System banks and the overall System in general? How is this impacting the marketability and cost of consolidated Systemwide securities?

- For associations, how strong is the liquidity position of the district bank? If weaknesses in the bank's liquidity position exist, to what extent is the association reliant on the bank as its sole source of funding? Consider the association's loanable funds position, any existing secondary sources of funding (as discussed below), and the financial capability of obtaining an alternative source of funding, if the need were to arise.

- Has the association's GFA and any modifications been approved by FCA? Has the district bank noted any violations of GFA requirements? If so, what is the resolution, e.g., have the violations been corrected, has the bank formally waived the requirement, etc.? Do association or bank personnel anticipate any future violations of the GFA? Has FCA's examination work identified any violations of the GFA?

- How much borrowing margin is currently available on an association's direct loan from the district bank? What is the trend?

- Assuming an institution has continuing access to funding, at what cost is the funding available? Liquidity entails more than just the ability to obtain fundsavailable funding must also be at a reasonable cost. For an association, is a risk differential/premium being paid on its funding from the district bank? For a bank, is an economic penalty being incurred under the terms of the CIPA? In either case, is the total effective cost of funding reasonable so as to allow the institution to be profitable and remain viable?

- What is the level of performance under any currently operative System self-discipline mechanisms, e.g., the CIPA for System banks? Consider any trend in the performance, as well as peer group comparisons.

- What is the institution's level and trend of loanable funds? What are the underlying causes of any change in the level of loanable funds, e.g., earnings, change in the level of capital stock, change in the level of nonearning assets (noncash basis nonaccrual loans, other property owned, accrued interest receivable, other assets), etc.? Due to the potential seasonal fluctuation of certain items (e.g., accrued interest receivable), trend comparisons should typically be made using the same point in time each year.

- How strong is the institution's collateral position, from both a quantity and quality perspective? For example, how does the net collateral margin compare to a peer group of similar institutions? What is the trend? How strong are the institution's underlying asset quality and collateral quality? Are there existing or emerging adverse asset quality trends? Consider the relationship between the direct loan balance and various asset quality indicators such as the level of accrual loans, nonadverse loans, Acceptable loans, etc.

- For System banks, does the institution's collateral calculation and function comply with FCA regulatory requirements? Refer to FCA Regulations 12 CFR Part 615, Subpart B, and complete workpaper FCA 4015, as needed.

<u>Secondary Sources</u>

Although continued access to funding is certainly the primary source of System liquidity, other sources of liquidity do exist. These secondary sources provide alternative sources of funds to meet emergency or short-term liquidity needs. Secondary sources of liquidity for System institutions include marketable investments, loan sales, and supplemental lines of credit.

Marketable Investments--System banks are required to maintain a liquidity reserve of high-quality, marketable investments as an emergency source of liquidity in the event of disruptions in the financial markets. These investments are not intended to constitute the institution's primary liquidity source, but rather provide temporary funding in the event access to the market is interrupted. The liquidity reserve requirement is outlined in FCA Regulation 12 CFR § 615.5134(a), which requires each bank to hold cash and eligible investments sufficient to fund 50 percent of the bank's bonds, notes, Farm Credit investment bonds, and interest due within the next 90 days divided by 3, plus 50 percent of the bank's discount notes and commercial bank borrowings due within the next 30 days. This requirement equates to approximately 15 days of funding needs, providing a period of time to allow the banks to pursue alternative sources of funding.

All investments held for the purpose of meeting the liquidity reserve requirement must be separately identified and free of any liens (FCA Regulation 12 CFR § 615.5134(b)). Additionally, the liquidity reserve requirement is to be calculated as of the last day of each month using monthend data (FCA Regulation 12 CFR § 615.5134(c)). The size of the liquidity reserve requirement will fluctuate from one month to the next. As such, FCA examiners should exercise discretion in determining compliance with this requirement, giving consideration to the reasons for, and magnitude of, any variations from the prescribed liquidity reserve amount.

In addition to the liquidity reserve requirement, System banks are allowed to hold investments for managing short-term cash flows and interest rate risk (FCA Regulation 12 CFR § 615.5132 and § 615.5135). In no case, however, shall total investments (excluding any Federal Agricultural Mortgage Corporation securities) exceed 30 percent of total outstanding loan volume (FCA Regulation 12 CFR § 615.5132 and § 615.5131(i)).

Associations are authorized by regulation to hold eligible investments, but only as approved by their affiliated district bank. In practice, most associations do not maintain marketable investments due to their accessibility to funding from the district bank via the GFA. Additionally, the cost of funding association investments is generally greater than the available return.

Note: Refer to the Investments section of the Assets module for a more complete discussion on System investments. The investment-related discussion in this section is only from a liquidity perspective.

Loan Sales--The sale of loans can also provide a secondary source of liquidity. While loan participations are commonly sold due to lending limit constraints and/or capital and risk management purposes, participations may also be sold to generate liquidity. Similarly, loans may be sold on the secondary market for liquidity purposes. For example, agricultural loans may be pooled and sold through the Federal Agricultural Mortgage Corporation (Farmer Mac) and conforming rural home loans through the Federal National Mortgage Association (Fannie Mae). As a prerequisite to loan assets providing meaningful liquidity, however, such assets must be of the type and quality necessary to ensure ready marketability.

Other assets may also provide a limited source of funding particularly in a time of crisis, e.g., the sale and leaseback of a building. This source of funding, however, is very limited in nature and generally less than readily available.

Supplemental Lines of Credit--System institutions may also choose to maintain an additional line(s) of credit with commercial banks or other financial institutions to supplement their primary funding source. These lines of credit would typically be used for supplemental, emergency, or temporary funding needs. Lines of credit generally carry a cost in the form of commitment fees and/or compensating balances. Additionally, associations may not obtain funding from institutions other than the affiliated district bank without the district bank's approval.

Considerations in evaluating secondary sources of liquidity include:

- For System banks, has the institution maintained appropriate compliance with the regulatory liquidity reserve requirement (FCA Regulation 12 CFR § 615.5134)? Specifically, are any variations from the prescribed liquidity reserve amount reasonable and appropriately managed? Also, are liquidity reserve investments separately identified and free of any liens, and is the reserve requirement calculated as of the end of each month?

- For associations, has the holding of any marketable investments been approved by the affiliated district bank (FCA Regulation 12 CFR § 615.5141)?

- Are all investments held for liquidity purposes high-quality, readily marketable securities meeting the eligibility criteria outlined in FCA Regulation 12 CFR § 615.5140? (Specific guidance on investment regulatory compliance, investment quality, and investment management is contained in the Investments section of the Assets module.)

- To what extent does the institution have high-quality, readily marketable loan assets that could be sold to generate liquid funds without disrupting operations?

- Does the institution have any supplemental lines of credit in place as additional or backup sources of funding? If so, are such lines of credit irrevocable and evidenced by a written contract? Lines of credit which contain "adverse change" clauses are frequently of no value due to the escape clause being triggered prior to the need for supplemental credit arising. Similarly, lines of credit with short-term maturities are of correspondingly limited value.

- Are the costs of any supplemental lines of credit reasonable in light of the benefits received?

<u>Funding Stability</u>

Given the System's reliance on access to funding as the primary source of liquidity, the stability of the funding source becomes a relevant evaluative factor. System banks are reliant on access to stable financial markets on a continuing basis. Similarly, associations depend on their district bank as a stable, secure source of funding. Having a stable, reliable source of liquid funding is critical to meeting the immediate and ongoing cash flow needs of a lending institution.

Considerations in evaluating funding stability include:

- For System banks, are there currently any significant disruptions in the financial markets which impede the System banks' continued access to funds in the marketplace? Is there significant potential for market disruptions in the foreseeable future? Although infrequent in nature, financial, economic, agricultural, and/or national defense crises can create significant chaos in the financial markets, potentially impeding the System banks' normal access to funding. Note: Whenever the FCA Board determines such an emergency exists, it may increase the authorized maximum level of investments and/or modify or waive the liquidity reserve requirement.

- For System banks, what is the current interest rate spread and trend between consolidated Systemwide securities and similar-term U.S. Treasury securities? A wide or widening spread may signal weakening confidence in the System, general market unrest, instability, etc.

- For associations, what is the financial condition of the district bank in general, and the strength of its liquidity position in particular? To the extent an association relies on its district bank for funding, the strength of the bank and the bank's liquidity position impacts the association's funding stability.

<u>Demands on Liquidity</u>

While the above evaluative factors relate to sources of liquidity, an examiner must also assess the anticipated and potential demands on an institution's liquidity. As outlined in the Introduction discussion above, the primary uses of liquidity include: debt payments, loan demand, contingent liabilities, near-term capital expenditures, operating expenses, and cash dividends and stock retirement. The specific nature and magnitude of these items will vary from one institution to another and from one timeframe to another, requiring a case-by-case assessment.

Considerations in evaluating an institution's demands on liquidity include:

- Does the institution have ample sources of liquidity to ensure the payment of all debt obligations? System banks generally issue new debt securities and/or accumulate cash from operations just prior to the maturity of debt obligations, as necessary, to generate sufficient liquid funds. Associations typically rely on ongoing access to funding to meet specific debt obligations.

- Is an increase in loan demand/volume anticipated, and if so, to what magnitude? Whether in the form of increased demand for new loans, additional draws on already existing loan commitments, or both, an increase in overall loan demand necessarily creates a demand for liquid funds. Assuming continued creditworthiness and collateral sufficiency, System banks should be able to raise the necessary funding in the financial markets via the Funding Corporation. The funding of association loan growth, however, is also constrained by the terms of each association's GFA and the remaining borrowing margin on its direct loan. In all cases, the anticipated loan growth needs to be managed in such a way as to maintain continued creditworthiness.

- Regarding loan commitments specifically, how does the current borrowing margin on an association's direct loan from the district bank compare to the total amount of outstanding loan commitments? What portion of outstanding loan commitments are likely to be drawn upon? Consideration should be given to seasonal fluctuations in loan volume, and the anticipated peak loan demand.

- Does the institution have a history of frequent and/or substantial litigation issues? How significant are historic litigation losses? What is the level and materiality of currently existing and potential litigation? Although typically infrequent in nature, litigation losses and related expenses can be substantial when incurred. Possible information sources include the institution's annual report, management reporting, and the response to FCA's advance letter request for a litigation assessment.

- Do any other significant contingent liabilities exist? Consider joint and several liability (for System banks), repurchase liability on loans sold on thesecondary market, potential tax liabilities assessments of any kind, environmental risk on other property owned, etc.

- Are significant near-term capital expenditures planned, e.g., building-related projects, major computer-related purchases, etc.? These expenditures will draw upon the institution's sources of liquidity.

- Does the institution have readily available sources of liquidity sufficient to bridge any timing differences between the inflows of operating income and the outflows of operating expenses? For unprofitable institutions, what portion of operating expenses are not being covered by operating income? How long can the institution generate sufficient liquid funds necessary to make up the difference?

- Does the institution have sufficient liquidity to accommodate anticipated cash dividends, if any, as well as any stock retirements paid in cash?

<u>Liquidity Management</u>

As in almost every area, management effectiveness is a key evaluative factor. Effective liquidity management starts with a solid understanding of the role of liquidity and the underlying variables that impact its adequacy. Additionally, management needs to ensure effective execution of the liquidity function, implement appropriate internal controls and monitoring and reporting processes, and take appropriate corrective action when necessary.

Considerations in evaluating liquidity management include:

- Does institution management (board and executive management) reflect a sufficient understanding of the role of liquidity and the evaluative factors that impact the adequacy of liquidity in its institution?

- For System banks, has the board provided sufficient policy guidance on liquidity in compliance with applicable investment and liquidity regulations, specifically FCA Regulation 12 CFR § 615.5133(b)?

- How effective is institution management in building and maintaining a strong, creditworthy organization that can continue to command ready access to funding?

- Does institution management appropriately manage the maturity relationship between assets and liabilities to facilitate effective cash flow management? Are noninterest-bearing cash balances appropriately minimized to reduce the associated nonearning asset burden?

- Are internal controls and monitoring processes sufficient to reasonably ensure compliance with the liquidity reserve requirement for System banks and GFA requirements for associations? Are adequate internal controls in place to safeguard and monitor the collateral function?

- Does the institution's board receive appropriate liquidity-related reporting? For example, a bank board should be kept fully informed as to compliance with the regulatory liquidity reserve and collateral requirements, and an association board should be kept apprised of its borrowing margin and compliance with the GFA.

- When and if liquidity weaknesses arise, does institution management take appropriate corrective action?

## Examination Procedures

The following provides model examination procedures for conducting a liquidity evaluation. Consistent with risk-based examination principles, examiners should add, delete, or modify procedures as needed based on the particular circumstances of the institution.

1. Coordinate liquidity evaluation activities with other members of the examination team and the examiner-in-charge (EIC). Emphasis should be on identifying how examination results in other areas impact the liquidity analysis, and ensuring sufficient work is completed to conclude on the sufficiency of liquidity while avoiding duplication of examination effort. Examples of key areas that will likely require coordination with the liquidity evaluation include:

    - Capital;
    - Asset quality;
    - Management;
    - Earnings;
    - Investments;
    - Asset/liability management; and
    - Regulatory compliance.

2. For System banks, obtain and evaluate liquidity policy (this will normally be part of the investments policy). Determine if policy guidance complies with FCA Regulation 12 CFR § 615.5133(b) and is appropriate to the institution's needs.

3. For associations, obtain and review the GFA. Ensure the GFA complies with FCA Regulations, i.e., determine if the GFA and any modifications have been approved by FCA (association compliance with GFA requirements is addressed under procedure 6 below).

4. Obtain liquidity-related information (as applicable to the institution) as of the current date, and for prior

dates when necessary to establish a trend. Information sources may include the CIPA report, loanable funds position, collateral position, GFA and any related monitoring, investments report, outstanding loan commitments report, and litigation summary.

5. Utilize discussions with institution managers as needed throughout the evaluation process to gather information, provide clarification, and discuss trends, projections, goals, etc.

6. Evaluate the institution's access to continuing funding. Considerations include:

   a. FCA's conclusions regarding capital, asset quality, management, and earnings as they relate to the institution's creditworthiness.

   b. Aggregate condition of all System banks and the overall System in general as it relates to the marketability of consolidated Systemwide securities (banks only; impacts associations only via the bank's liquidity position).

   c. Liquidity strength of the affiliated district bank (associations only).

   d. Current and projected compliance with GFA requirements (associations only). Consider any violations noted by the district bank or during FCA examination work, as well as the likelihood of any violations in the foreseeable future.

   e. Amount and trend of borrowing margin on the direct loan (associations only).

   f. Cost of available funding. Is funding available at a reasonable cost so as to allow the institution to remain profitable and viable?

   g. Level of performance under any System self-discipline mechanisms, e.g., the CIPA for System banks.

   h. Strength of loanable funds position in terms of level and trend.

   i. Sufficiency of collateral in terms of quantity, quality, trend, and peer comparisons. Association collateral is governed by each association's respective GFA, while bank collateral is governed by FCA Regulations 12 CFR Part 615, Subpart B. To determine if a bank's collateral calculation and function meet regulatory requirements, complete workpaper FCA 4015 as needed.

7. Evaluate any secondary sources of liquidity available to meet emergency or short-term liquidity needs. Considerations include:

   - Appropriate compliance with the liquidity reserve requirement (banks only). Refer to FCA Regulation 12 CFR § 615.5134.

   - Approval from the affiliated district bank for the holding of marketable investments (associations only). Refer to FCA Regulation 12 CFR § 615.5141. Consider the need and purpose for such investments.

   - Compliance with regulatory requirements regarding quality and type of marketable investments held (this assessment is normally done as part of the overall investments evaluation--see the Investments section of the Assets module for further guidance). Refer to FCA Regulation 12 CFR § 615.5140.

   - Existence of high-quality, readily marketable loans that could be sold to generate cash.

   - Any supplemental lines of credit that could realistically be drawn upon when and if needed.

8. Evaluate the stability of the institution's primary source of funding. Considerations include:

- Current or foreseeable disruptions in the financial markets (banks only; impacts associations only via the bank's liquidity position).

- Interest rate spread between System securities and similar-term U.S. Treasury securities as it relates to potentially weak confidence in the System, market instability, etc. (banks only; impacts associations only via the bank's liquidity position).

- Strength of the affiliated district bank's liquidity position (associations only).

9. Evaluate the nature and magnitude of demands on the institution's liquidity. Considerations include:

   - Existence of ample sources of liquidity to ensure timely payment of all debt obligations.

   - Magnitude of any anticipated increase in loan demand/volume. Consider continuing creditworthiness and collateral sufficiency to support additional debt. For associations, also consider the terms of the GFA, and the remaining margin available on the direct loan.

   - The volume of outstanding loan commitments, giving consideration to the amount of commitments likely to be drawn upon in light of seasonal loan volume fluctuations and projected peak loan demand.

   - Frequency and materiality of litigation issues.

   - Other potential contingent liabilities, e.g., joint and several liability (for System banks), repurchase liability on loans sold on the secondary market, tax liabilities, assessments, environmental risk, etc.

   - Significance of planned near-term capital expenditures.

   - Liquidity needed to cover timing differences and/or any shortfall between operating income and expense.

   - Significance of any anticipated cash dividends and/or cash stock retirements.

10. Evaluate the effectiveness of the institution's liquidity management. Considerations include:

    a. Institution management's (i.e., board and executive management) understanding of liquidity and the factors that impact its adequacy.

    b. Sufficient liquidity policy guidance in compliance with FCA Regulation 12 CFR § 615.5133(b) (requirement for banks).

    c. Effectiveness of institution management in building and maintaining the creditworthiness of the institution.

    d. Management of the maturity relationship between assets and liabilities, including the minimization of noninterest-bearing cash balances.

    e. Internal controls and monitoring processes to reasonably ensure compliance with liquidity-related requirements, e.g., liquidity reserve requirement (banks only), GFA requirements (associations only), and the collateral function.

    f. Sufficiency of liquidity-related reporting to the board.

    g. Appropriate corrective action taken when and if needed.

11. Weigh the results of all liquidity examination work and formulate tentative conclusions giving consideration to cause, effect, materiality, and results of other related examination areas.

12. Discuss examination results and tentative conclusions with examiners responsible for the investments, asset/liability management, and overall management evaluations.

13. Discuss items of concern, scope of work performed, and conclusions with the EIC and appropriate institution management. Obtain management's response as to the underlying cause(s) of deficiencies or weaknesses, as well as management's planned corrective actions.

14. Prepare a leadsheet or other summary document which summarizes work performed and conclusions reached.