Deposit Guarantee Corporation of Manitoba
La Société d'assurance-dépôts du Manitoba

Guideline

Subject: Liquidity Risk Management Principles

Effective Date: July 1, 2022

Table of Contents

1.0 Overview

These Liquidity Risk Management Principles provide guidance on how credit unions and the Caisse (cu/caisse) should manage their liquidity risk. These Principles should be read together with DGCM's **Asset Liability Management (ALM) Guidelines**.

1.1 Made in Manitoba Principles

The Liquidity Risk Management Principles are a made in Manitoba version of international and Canadian principles. DGCM's document draws on several sources including:

- Basel Committee on Banking Supervision – *Principles for Sound Liquidity Risk Management and Supervision (http://www.bis.org/publ/bcbs144.htm)*
- Office of the Superintendent of Financial Institutions (OSFI) – *Liquidity Principles* (https://www.osfi-bsif.gc.ca/Eng/fi-if/rg-ro/gdn-ort/gl-ld/Pages/b6-2020.aspx)
- Credit Union Prudential Supervisors Association (CUPSA) – *Liquidity Risk Management Guiding Principles (http://cupsa-aspc.ca/pdf/publications/16-COM-001.pdf)*

Both the Basel Committee and OSFI papers were designed for large banks with diverse liquidity sources, secondary market activity, and complex investment and liquidity needs.

The CUPSA paper was geared towards the provincial cu/caisse sector. However, Manitoba's framework is unique in that cu/caisse place considerable reliance on Credit Union Central of Manitoba (CUCM) to manage cu/caisse liquidity investments. In addition, Manitoba cu/caisse continue to invest the majority of their excess liquidity with CUCM. DGCM's Liquidity Risk Management Principles take into account these unique features of our Systems.

Notwithstanding reliance on CUCM, each cu/caisse should adopt appropriate liquidity risk management practices that follow the ALM Guidelines with variance for size and complexity. Complexity may depend on the sources of liquidity such as online, out of province, broker, or wholesale deposits and securitizations.

Additionally, DGCM's Intervention Policy lists the following liquidity risk indicators:

- Liquidity, over a 12 month average, is less than 10% of the cu/caisse's deposits. Despite the benefits of liquidity pooling, DGCM's position is that each cu/caisse should be self-sufficient and able to fund its own growth.
- Reliance on borrowing from CUCM, or frequent reporting of low liquidity, are causes for increased concern.

2.0 Liquidity Risk Management Principles

As indicated in DGCM's ALM Guidelines, a cu/caisse's board, with support and advice from senior management, is responsible for approving all ALM policies, targets, and risk tolerances. The board is also responsible for overseeing senior management compliance with the policies and targets. To do so, the board must follow an appropriate governance framework.

The daily management of liquidity risks is senior management's responsibility. As a cu/caisse gets larger and more complex, this responsibility may be delegated to a management committee often referred to as an Asset Liability Committee (ALCO).

The Risk Management Principles listed in this document expand on board and senior management responsibilities and sets out the parameters for a liquidity risk management framework. The establishment of a robust risk management framework that complies with the following principles will minimize liquidity risks to a cu/caisse.

Principle 1 – Risk Management Framework

A cu/caisse should establish a robust liquidity risk management framework. Such a framework allows a cu/caisse to manage its daily liquidity obligations and withstand periods of liquidity stress. A framework may include:

- board-approved tolerance for liquidity risk which is defined in the cu/caisse's Liquidity or ALM Policy, and reflected in budgets, board reporting, and controls
- board-approved liquidity targets that consider statutory requirements and DGCM's Intervention Policy; and include a liquidity cushion in excess of regulatory minimums
- a governance model that allows for regular risk assessment: see DGCM's Enterprise Risk Management (ERM) Guidelines
- understanding of CUCM investments of statutory and excess liquidity
- understanding of funding requirements including loan demand, deposit redemptions, and alternative sources of liquidity (e.g. securitizations)

- analysis of funding requirements under various scenarios and a funding strategy in cases of stress
- timely and reliable information systems to manage ongoing liquidity

Principle 2 – Board Governance

The board of a cu/caisse is responsible for overseeing the management of liquidity risk. This includes setting a liquidity risk tolerance which is appropriate for its business strategy. It should reflect a cu/caisse's financial condition and funding capacity, and ensure that it is able to withstand prolonged periods of stress.

The board should:

- understand the nature of a cu/caisse's liquidity risk
- receive appropriate and timely management reports
- establish accountability for managing liquidity risk
- oversee the identification, measurement, monitoring, and control of liquidity risk by senior management to ensure that the cu/caisse's liquidity position is within established policy and regulatory requirements
- review and approve ALM/liquidity policies
- understand and periodically review plans for dealing with adverse liquidity events

Principle 3 – Management Practices

As noted in the ALM Guidelines, senior management is responsible for the development and maintenance of liquidity policies and for the daily management of liquidity. Sound management practices include:

- managing cash flow on a daily basis: understanding operating liquidity risks including matching and funds flow analysis
- diversifying funding sources, reviewing concentration risk, and understanding borrowing capacity
- understanding short and long term liquidity needs in normal and stressed times
- managing the purchase of derivatives or products designed to hedge interest rate, foreign exchange, or liquidity risks

Principle 4 – Understanding the Role of CUCM

Manitoba cu/caisse rely on CUCM for management of all statutory and the majority of excess liquidity and as a lender. Each cu/caisse should understand CUCM's ongoing role and practices in the management of liquidity risk.

To achieve this, a cu/caisse should:

- understand CUCM's investment strategy, liquidity risk exposures, and funding capacity including liquidity constraints
- understand CUCM's requirements for participating in the settlements system including requirements for appropriate collateral
- establish ongoing controls and lines of communication with CUCM to understand the processes that may be established in adverse liquidity events
- understand the results of any CUCM liquidity analysis or stress testing for liquidity scenarios, including cu/caisse specific scenarios or system-wide scenarios

A cu/caisse, in reviewing CUCM's funding capacity, should consider whether it is appropriate to identify other sources of funding to mitigate stressed events.

Principle 5 – Advanced Risk Management Practices

DGCM's liquidity risk management expectations are described in the ALM Guidelines. These guidelines include differential expectations based on size, complexity, and level of risk. The liquidity risk management framework described under this Principle should be read in light of those differential expectations.

In addition to the items listed under Principle 1, a liquidity risk management framework may include advanced management practices such as:

- a reliable process for measuring and reporting funding requirements through the projection of cash flows
- an understanding of the availability of unencumbered liquid assets at CUCM that can be accessed under stress conditions without incurring undue losses
- liquidity stress testing
- a crisis funding plan to address liquidity shortfall scenarios
- information systems and personnel (or ALCO) that monitor and report liquidity positions to senior management and the board as required

Principle 6 – Liquidity Stress Testing

DGCM's ALM Guidelines require large cu/caisse (assets > $1 billion) to perform liquidity stress testing. The ALM Guidelines also require cu/caisse with material concentrations of non-traditional liquidity sources (e.g. broker, online deposits, or securitizations) to stress test those sources.

A robust liquidity stress testing framework may include:

- regular stress tests for a variety of short-term and protracted cu/caisse specific or market-wide stress scenarios that identify impacts on future cash flows and overall liquidity position
- a reporting process that includes stress test findings in the strategic planning process, in the establishment of a cu/caisse's liquidity cushion, and if required, in mitigating actions or changes to a crisis funding plan
- a review by senior management of stress test findings with reporting to the board

The extent and frequency of testing should be commensurate with the nature, scope, complexity, and risk profile of the cu/caisse and its liquidity risk exposures.

Principle 7 – Crisis Funding Plan

A large cu/caisse (assets > $1 billion), should develop a crisis funding plan as part of its liquidity risk management framework. The plan would be driven by stress test findings and would set out strategies for addressing liquidity shortfalls in emergency situations.

An effective crisis funding plan may include:

- a set of early warning indicators that identify liquidity risks or potential funding needs that may be based on stress test results
- a communication plan to ensure timely communication with senior management, board, cu/caisse members, CUCM, and regulators; the communication plan should include escalation measures
- assigned roles and responsibilities
- action plans for altering on-balance sheet assets and liabilities (e.g. market more aggressively, sell assets that were intended to be held, lengthen maturities of liabilities, raise interest rates on deposits, and other pricing strategies) and use of off-balance sheet sources
- identification of sources of liquidity demand or run-off and alternative sources of funds

3.0 Future Considerations – Excess Liquidity

CUPSA Liquidity Principles 7 and 8 are currently not applicable in the Manitoba context due to regulatory constraints in Manitoba that require the majority of excess liquidity to be invested in CUCM's liquidity pool.

These non-applicable principles include requirements around the maintenance of robust liquidity buffers in excess of statutory minimums and establishment of a framework around collateral positions (e.g. to access the settlements system) that does not unduly impair the liquidity position.

If, in the future, changes are made to the excess liquidity framework in Manitoba, DGCM would require a cu/caisse to implement additional risk management controls including the development of a comprehensive investment policy. At that time, DGCM will consider the adoption of further regulatory measures such as the Internal Capital Adequacy Assessment Process (ICAAP) and Basel liquidity tests.