**Fact Sheet**

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November 18, 2011

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# Fact Sheet on Liquidity Management Proposed Rule

Financial institutions experienced varying degrees of difficulty in their ability to access funding in the credit markets when the global financial turmoil erupted in 2008. At the same time, financial institutions faced the dilemma of being unable to easily convert investments held for liquidity into cash to help mitigate the effects of the difficulty in accessing the credit markets.

In response, the banking regulators issued guidance to their regulated institutions to address liquidity risk management. Although Farm Credit System (FCS) institutions were able to continually access short-term funding during that crisis, the Farm Credit Administration (FCA) recognized the need to strengthen its liquidity reserve regulation. The proposed liquidity and funding rule provides for that by meeting the following six objectives:

- Improving the capacity of FCS banks to pay their obligations when they fall due
- Strengthening liquidity management
- Enhancing the marketability of assets relied upon for liquidity
- Requiring cash and highly liquid assets solely to compose the first 30 days of the 90-day liquidity reserve as well as even more stringent requirements for the first 15 days
- Establishing a supplemental liquidity buffer for longer-term market disruption and contingency planning purposes
- Strengthening contingency funding plans

The proposed regulation implements these objectives as follows:

**615.5134(a) Liquidity Policy:** The proposed rule would require FCS bank boards, for the first time, to address specific issues pertaining to liquidity risk management in their policies. Under the proposed rule, board policies must establish appropriate strategies, policies, procedures, and limits that will enable the bank to monitor, measure, manage, and mitigate liquidity risk. Additionally, proposed § 615.5134(a) would strengthen internal controls at FCS banks by bolstering board direction to, and oversight of, management.

**615.5134(b) Liquidity Reserve Requirement:** The purpose of this paragraph is to better prepare FCS banks so they can withstand future liquidity crises. This paragraph addresses vulnerabilities identified during recent crises by building upon and strengthening existing core

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concepts, principles, and requirements governing the liquidity reserve and supplemental liquidity buffer. In addition, proposed § 615.5134(b) would repeal the provisions in existing § 615.5134(a) that impose specific credit ratings on investments that FCS banks hold in their liquidity reserves.

**615.5134(c) Unencumbered:** The proposed rule would expand upon a provision in the existing regulation that requires all investments that an FCS bank holds in its liquidity reserve to be free of lien. The proposed rule, for the first time, would expressly prohibit FCS banks from holding assets in their liquidity reserve that are explicitly or implicitly pledged to secure, collateralize, or enhance the credit of any transaction.

**615.5134(d) Marketable:** This proposal would require FCS banks to hold only marketable investments in their liquidity reserve. Proposed § 615.5134(d) specifies additional criteria and attributes that determine whether investments are marketable for the purposes of this regulation.

**615.5134(e) Composition of Liquidity Reserve:** The existing regulation already requires every FCS bank to maintain a sufficient stock of liquid assets to fund its maturing obligations and other borrowings for at least 90 days. The proposed rule would divide the liquidity reserve into two levels. FCA's proposal would require each FCS bank to maintain a sufficient quantity of highly liquid assets in the first level of its liquidity reserve so it could continue normal operations for 30 days if System access to the markets is impeded. Cash and securities that mature in three years or less must compose 15 days of the first level of the liquidity reserve. The second level of the liquidity reserve would consist of liquid assets that are sufficient to fund the banks' operations for the next 60 days during a prolonged stress scenario.

**615.5134(f) Supplemental Liquidity Buffer:** The proposed rule introduces a new concept into FCA's liquidity regulation by requiring all FCS banks to establish and maintain a supplemental liquidity buffer that would provide a longer-term, stable source of funding beyond the 90-day minimum liquidity reserve. During a significant stress event, FCS banks could also draw upon the supplemental liquidity buffer to meet potential short-term liquidity needs.

**615.5134(g) Discounts:** This paragraph of the proposed rule would amend the provision in the existing rule that pertains to the discounts that FCS banks must apply to assets in their liquidity reserves. The revised provision on discounts is more appropriate to the new regulatory structure, which splits the liquidity reserve into two levels, establishes a supplemental liquidity buffer, and greatly strengthens contingency funding planning at FCS banks.

**615.5134(h) Contingency Funding Plan:** The proposed rule would strengthen contingency planning at FCS banks by amending the applicable provisions of the liquidity regulation. These amendments should reinforce the wherewithal of FCS banks to withstand future crises.

**615.5134(i) Reservation of Authority:** This paragraph of the proposed rule would strengthen FCA's supervisory and regulatory oversight of liquidity management at FCS banks. Under this reservation of authority, FCA expressly reaffirms its authority to require FCS banks, either individually or jointly, to adjust their treatment of instruments (assets) in their liquidity reserves so they have liquidity that is sufficient and commensurate with the risks they face.

The proposed rule asks a number of questions and solicits input from the public about unfunded commitments and the best way to measure the creditworthiness of investments.

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