DATE: June 23, 2017

TO: Chief Executive Officer of the Institution Addressed

FROM: Candace Franks, Bank Commissioner

SUBJECT: Liquidity and Funds Management

Recently, members of my staff and I have been in engaged in multiple levels of discussions regarding the current trends in liquidity and funds management affecting the banking industry nationwide and, here in Arkansas. For many years, as a result of the recent financial industry crisis, banks experienced an influx of cash and liquid funds from customers and investors seeking a safe and stable alternative to uninsured, potentially volatile investment products. However, we are now seeing a shift, in some markets and sectors, in the availability of core deposits and traditional funding sources. This shift is resulting in a resurgence of banks utilizing non-core funding and alternative funding sources to obtain and maintain reliable sources of on-balance sheet liquidity. The changing funding environment coupled with continued asset growth, specifically in certain high loan demand markets, creates a level of heightened concern and the need for enhanced monitoring and oversight by both regulators and bank management; specifically, at the board level.

Although the vast majority of Arkansas state chartered banks are operating in a safe and sound condition, when a bank's overall condition becomes less than satisfactory or its capital position is significantly impacted, the availability and utilization of secondary funding sources is often one of the first areas that may be negatively affected. Therefore, a bank operating with a heavy reliance on non-core funding may have notable liquidity exposure which can result in even further regulatory scrutiny.

Banks that operate with a large or concentrated level of brokered deposits or deposits obtained through a listing service should be particularly mindful of how changes in their financial condition or regulatory status could potentially result in the loss of these types of deposits or an increased cost associated with these types of accounts. Management and the board should be aware of any concentrations on the liability side of the balance sheet, specifically in the deposit portfolio, and should actively manage any concentration risk. Additionally, we expect management to monitor the level, if any, of uninsured deposit activity in your institutions as this number has also increased in recent months.

My staff and I are closely monitoring the liquidity environment of Arkansas state chartered banks and the following are a few statistics that you may find noteworthy. Aggregated data from the March 31, 2017, self-examination program indicates that approximately 14 percent of banks have a net non-core dependency ratio of greater than 20 percent and approximately 15 percent of banks have a reliance on wholesale funding of greater than 15 percent. Additionally, 21 percent of our banks are operating with less than 10 percent on-balance sheet liquidity and 23 percent of banks have loan to deposit ratios in excess of 90 percent.

As you and your bank's board more closely monitor your liquidity and funds management positions, please remain mindful of existing guidance. On April 5, 2010, the Federal Deposit Insurance Corporation issued Financial Institution Letter 13-2010 titled, "*Funding and Liquidity Risk Management*" and on March 17, 2010, the Federal Reserve issued Supervision and Regulation Letter 10-6 titled, "*Interagency Policy Statement on Funding and Liquidity Risk Management*." Both of these documents refer to an interagency regulatory document which provides guidance on sound practices for managing funding and liquidity risks and strengthening liquidity risk management in depository institutions. This policy statement emphasizes the importance of cash-flow projections, diversified funding sources, stress testing, a cushion of liquid assets and a formal, well-developed contingency funding plan for measuring and managing liquidity risk. The document links are below:

https://www.fdic.gov/news/news/financial/2010/fil10013.html

https://www.federalreserve.gov/boarddocs/srletters/2010/sr1006.htm

We encourage you and your board to take some time to fully review and re-evaluate your bank's asset/liability management program, policies and risk limits. Now is the time to ensure that the bank's deposit portfolio and the utilized and planned secondary sources of liquidity are aligned with the board approved funding strategy.

If my staff and I can be of any assistance as you engage in this process, please do not hesitate to contact us.

Sincerely,

Candace A. Franks
Bank Commissioner

CAF/SM/bm