



Mark H. Smith
I N C O R P O R A T E D

ORGANIZING AND UTILIZING AN EFFECTIVE ALCO

**PRESENTED BY:
CYNTHIA R. WALKER, CEO**

(Webinar will begin on the hour)

FOR CPE CREDIT YOU MUST PARTICIPATE IN ALL THE QUESTIONS



TOPICS TO COVER TODAY

- Organizing the Asset Liability Management Committee (ALCO)
- Define the ALCO Function
- Explore information and reports needed
- Ways to increase ALCO effectiveness

ORGANIZE ASSET LIABILITY MANAGEMENT COMMITTEE (ALCO)

Committee (or individuals) designated by the Board
Bring key decision makers together

- CEO
- CFO
- Lending
- Marketing
- Board of Director representative
- Others as needed



OVERSIGHT

Credit unions are required to have policy and process in place

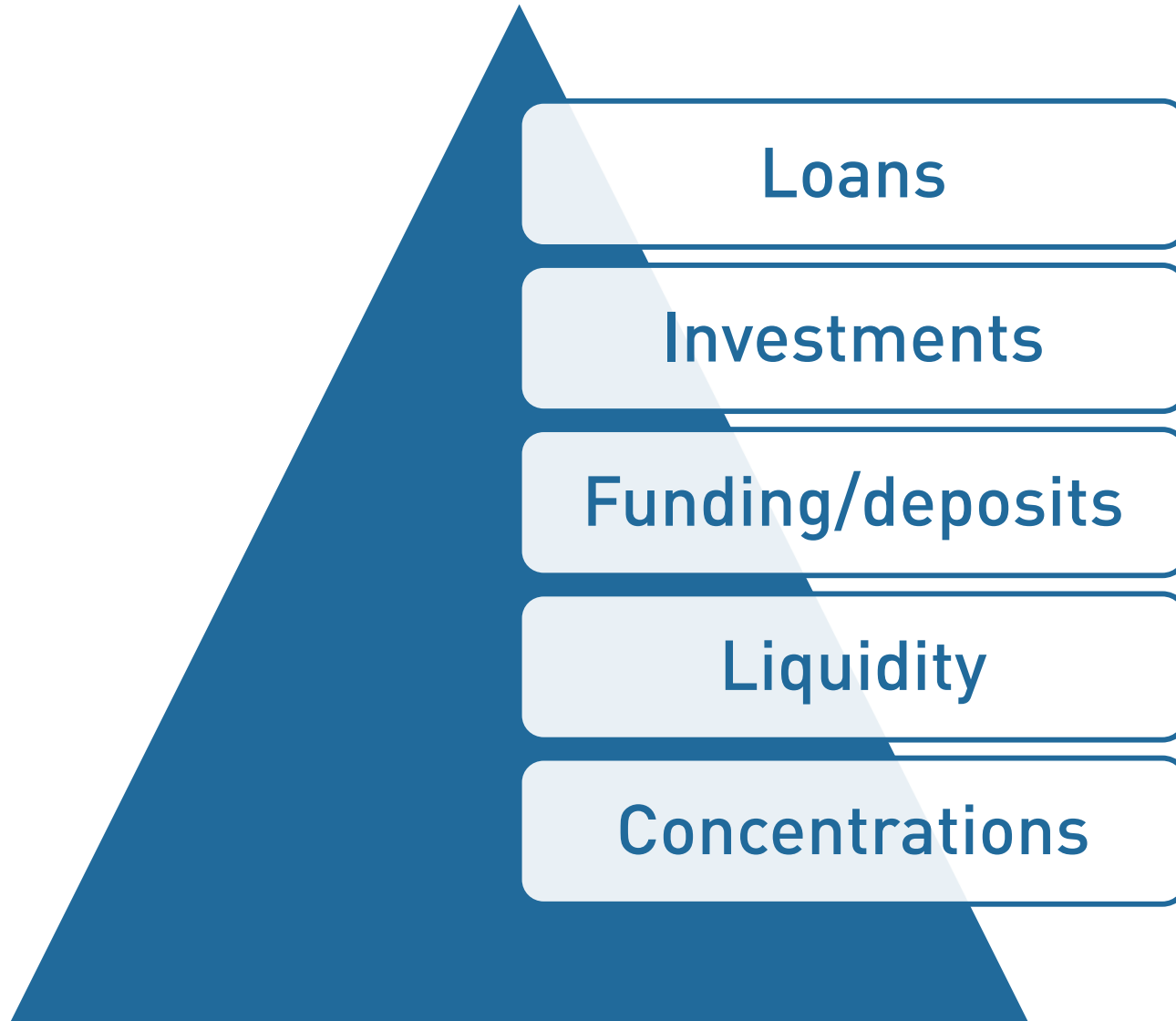
- identify
- measure
- monitor
- manage
- control interest rate risk.

Board of Directors are responsible for the policies

Policies defines limits/appetite for risk.

Board can delegate the process

OVERSIGHT INCLUDES



STRONG DECISION MAKERS

Understand CU exposure to changing interest rates

- Anticipate and mitigate earnings fluctuations
- Know the impact to the economic value of the balance sheet

Anticipate pressures on loan and deposit rates

- Real vs Phantom
- Deposit changes and needs

Monitor liquidity positions

- What we have now
- What do we need? Today, this month, this quarter.....

Other considerations

- Credit/delinquency

Strategic focused

Identify
exposures

Develop responses
to exposures

Oversee
implementation
of plans

Track risk to
policy limits

POLL QUESTION #1

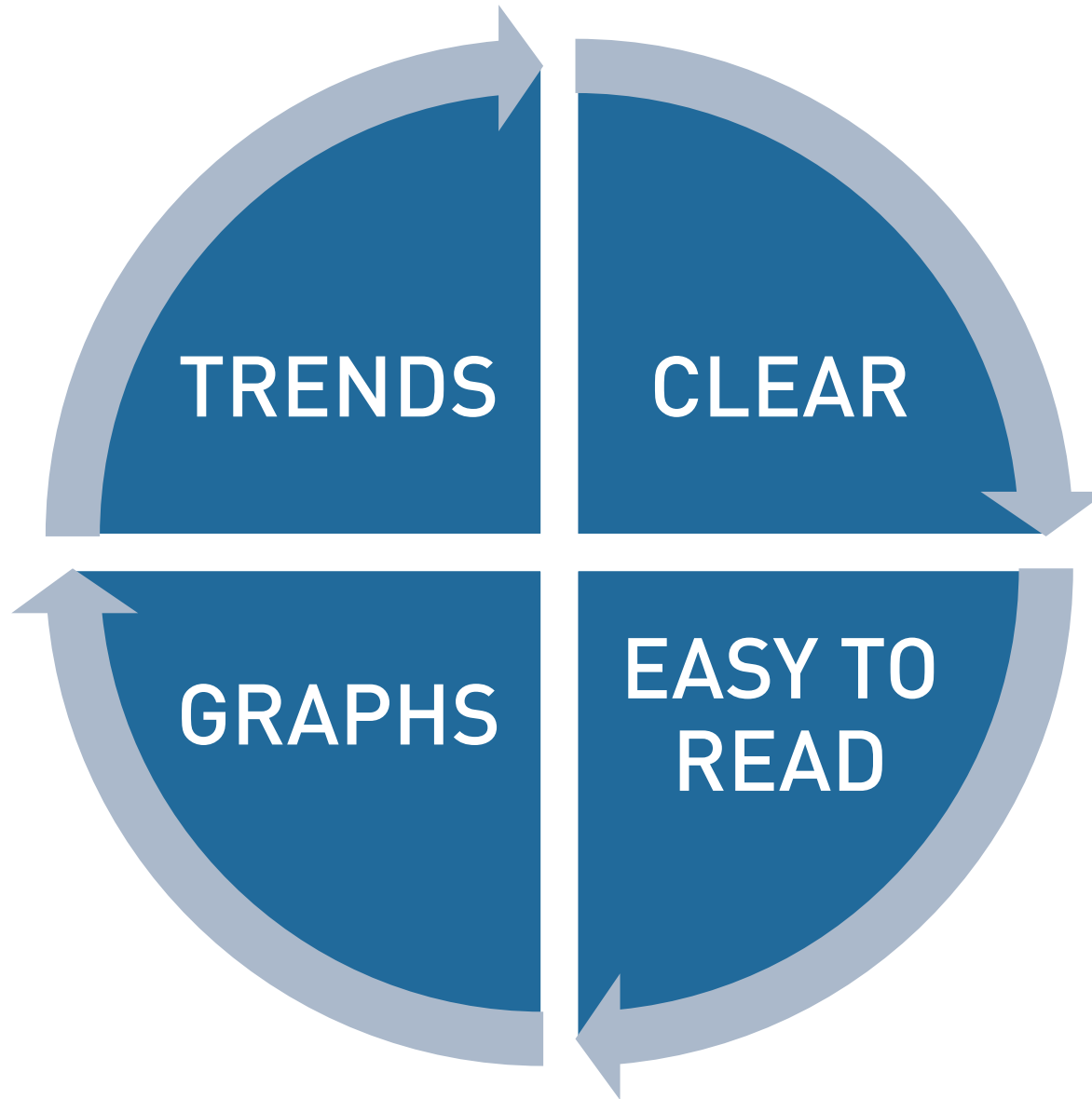
REPORTS

INFORM AND PROMOTE DISCUSSION

Key ratios and statistics - example

- Average loan yields
- Average cost of funds
- Net interest margin
- ROA
- Loans to total assets
- Growth
- Net worth ratio

REPORT CONTENTS



FUNDING (DEPOSITS) DISCUSSION

CORE DEPOSITS	Define and understand
RATE SENSITIVITIES	Understand how earnings will be impacted as interest rates change
STRATEGIES	How to control or manage cost of funds
CASH FLOW	Anticipate loans and deposits inflow and out flow Likely scenario and stress events



MONITOR LIQUIDITY POSITION

- Static liquidity ratios
- Economic conditions that may impact liquidity
- Develop options and responses
- Compare results to policy
- Recommend corrective action when necessary



COMPETITIVE POSITION

- Rates charged and paid in marketplace
- CU rates ensure profitability
- Do the CU goals match ability
- Evaluate credit union philosophy
- Loan rates and deposit rates are equitable to both borrower and saver

POLL QUESTION #2

IMPORTANCE OF UNDERSTANDING MODEL ASSUMPTIONS

- Can be manipulated to provide desired outcome
- IRR results relied on by ALCO and Board
- Balance sheets are larger, more complex, and leveraged
- Some CUs are taking on new risks
- Will be reviewed by regulators

IMPORTANT IRR MODEL ASSUMPTIONS

LOANS – FOCUS LARGER BALANCE ACCOUNTS FIRST

Classifications

Type
Terms
Rates

Prepayments

Cash flow
Different than loan
terms

Extension/refinance risk

As interest rates
change payment
behaviors change

IMPORTANT IRR MODEL ASSUMPTIONS

INVESTMENTS – FOCUS LARGER BALANCE ACCOUNTS
FIRST

Classification

- Types
- terms

Options— Calls/steps

Complex
mortgage-backed
securities
Cash flows change
as interest rates
change

IMPORTANT IRR MODEL ASSUMPTIONS

SHARES – FOCUS REGULAR SHARES AND SHARE DRAFTS

Betas

- Rate sensitivity

Lags

- Time to raise rates

Decays

- How long deposits stay

ALM MODEL ASSUMPTIONS – ALCO MUST UNDERSTAND

Key elements to managing the assumptions

- Assumptions are supportable and documented.
- Discuss in ALCO and documented in minutes
- Review assumptions annually by ALCO and document
- Consider external data comparisons
- Take a fresh look at assumptions



CONSEQUENCES OF ASSUMPTION ERRORS

Underestimating risk

- Decline in earnings
- Negative earnings
- Decline in capital
- Missed opportunities in the future

Overestimating risk

- Lost income
- Lost opportunities

INTEREST RATE RISK ANALYSIS

NII and NI at risk

Net Economic Value
(NEV)

Summary Report

Trends

INTEREST RATE RISK ANALYSIS CONSIDER ALTERNATIVE SCENARIOS

But don't overwhelm

- Increased rate sensitivities
- Shorter decay
- Alternative rate shock scenarios
- Change deposit composition - less sensitive to more rate sensitive
- NCUA supervisory test

INTEREST RATE RISK ANALYSIS

- Model new business
- Compare results to policy
- Recommend corrective action when necessary

CONFIDENCE IN RESULTS

- Back-testing NII simulation
- Account for variances/document
 - Rate/Volume
- Sensitivity analysis
- Validation/third party review

GOOD ASSUMPTIONS MUST BE USED IN ESTIMATING INTEREST RATE RISK

- Perfect assumptions do not exist
- Most important—share and loan behavior
- Consequence of material errors—serious
- Backtesting—improves process
- Sensitivity analysis helpful
 - Understand which assumptions have the most impact

POLL QUESTION #3

ALCO REPORTS TO THE BOARD

Essential the Board is kept informed of the ALM position with defined reporting procedures

- Define who is responsible to report to the board
- Establish frequency
- High level reports with comparison to policy limits
 - » Income simulation current results and trends
 - » NEV current results and trends
 - » Liquidity historical and forecasted

FINAL THOUGHTS

**PERIODICALLY EVALUATE POLICY LIMITS
FOR REASONABLENESS AND MAKE
RECOMMENDATIONS**

BE PREPARED AND BE EMPOWERED

**CREDIT UNION MANAGEMENT OBJECTIVES
MAY NOT ALWAYS COINCIDE WITH
REGULATORY OBJECTIVES**

SUMMARY

ALCO is the place to pull it all together

ALCO effectively utilizes information to make decisions and aid in the management of the credit union.

Strategize, plan and prepare for multiple situations

Review new products, and balance sheet shifts for potential exposures.

Document, document, document the process.

MHSI EASY AND AFFORDABLE SOLUTIONS

CECL THIRD PARTY REVIEW (NON-CLIENT)

By using MHSI you

- Save time
- Delegate to the experts
- Have access to extensive experience
- Receive help with exams and responses
- Have a reliable resource
- From a friendly and reputable company





THANK YOU

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