

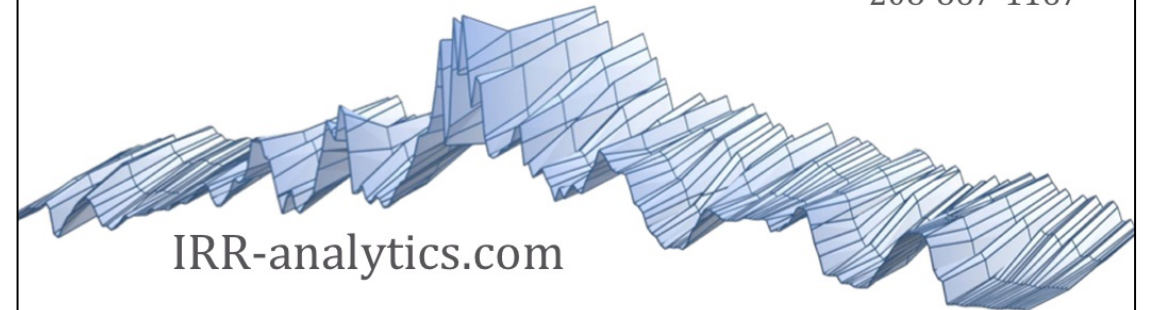
Streamlined ALCO: Best Practices for Allocating Time & Resources

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Overview

- Typical ALCO structure and format
- Technical and strategic components of ALCO
 - Specific ideas to streamline technical activities
 - Focal points of strategic activities
- Peer comparisons



Typical ALCO Responsibilities

- Investments
- Liquidity
- Interest Rate Risk
- Capital Planning
- Earnings/Performance
- Budget/Planning

Typical ALCO Structure

- Responsibilities
 - ALCO charter with general board-delegated responsibilities
 - Additional responsibilities assigned in various policies
- Membership
 - Executive management (CEO, CFO, CCO, etc.)
 - Representation from key managers that can influence and provide input on investments, loans, retail funding, and wholesale funding
 - Board members

Board-level vs. Management-level ALCO

- Board-level can represent full board for certain functions with reporting to full board
 - i.e. review model validation report, policy exception waivers, etc.
- Management-level tends to be more flexible for meeting times, frequency, and agendas



Board-level vs. Management-level ALCO

- Many institutions effectively have both
 - Executive committee
 - Investment committee
 - Pricing committee
- Some small banks do not have ALCO and board satisfies both responsibilities

Technical and Strategic ALCO Components

- Technical ALCO activities – STREAMLINE
 - Policies/risk limits/compliance
 - Models and tools
 - Budgets
 - Reporting
 - Minutes
- Strategic ALCO components
 - Planning
 - Performance
 - ALM/risk management
 - Decision making

Technical ALCO Components

- Policies and risk limits
 - Policies should be clear and concise
 - Low page count encourages more thorough review and understanding
 - \approx 2-3 pages for each IRR, liquidity, CFP and investments
 - Include responsibilities, risk limits, exception requirements
 - Remove unnecessary or impractical requirements
 - Simplify (start from scratch?)

Technical ALCO Components

- Policies and risk limits (continued)
 - Limit the number of policy limit measurements
 - IRR – 12M EaR, 24M EaR, and EVE (+/-400bp)
 - Liquidity – Up to five
 - Investments – Less than three
 - Include early warning indicators?
 - Include performance targets (i.e. ROA, ROE, NIM, etc.)?

Technical ALCO Components

- Models and tools
 - Important to right-size ALM model/vendor
 - In-house, outsourced reporting, or full-service outsourced
 - IRR... Liquidity? Budgeting? CECL?
 - Cost vs. benefits
 - Used for decision making?



Technical ALCO Components

- Budgets
 - 1x per year vs. more frequent
 - Rolling budgets/forecasts



Technical ALCO Components

- Reporting
 - 5-minute test (current results, trends, policy compliance)
 - Dashboard policy monitoring reports
 - Include all policy requirements for ALCO
 - Summary reports and visual tools (examples to follow)
 - Detail provided, but not necessarily reviewed line by line

Dashboard Report Example

Sample Dashboard Report (Section)

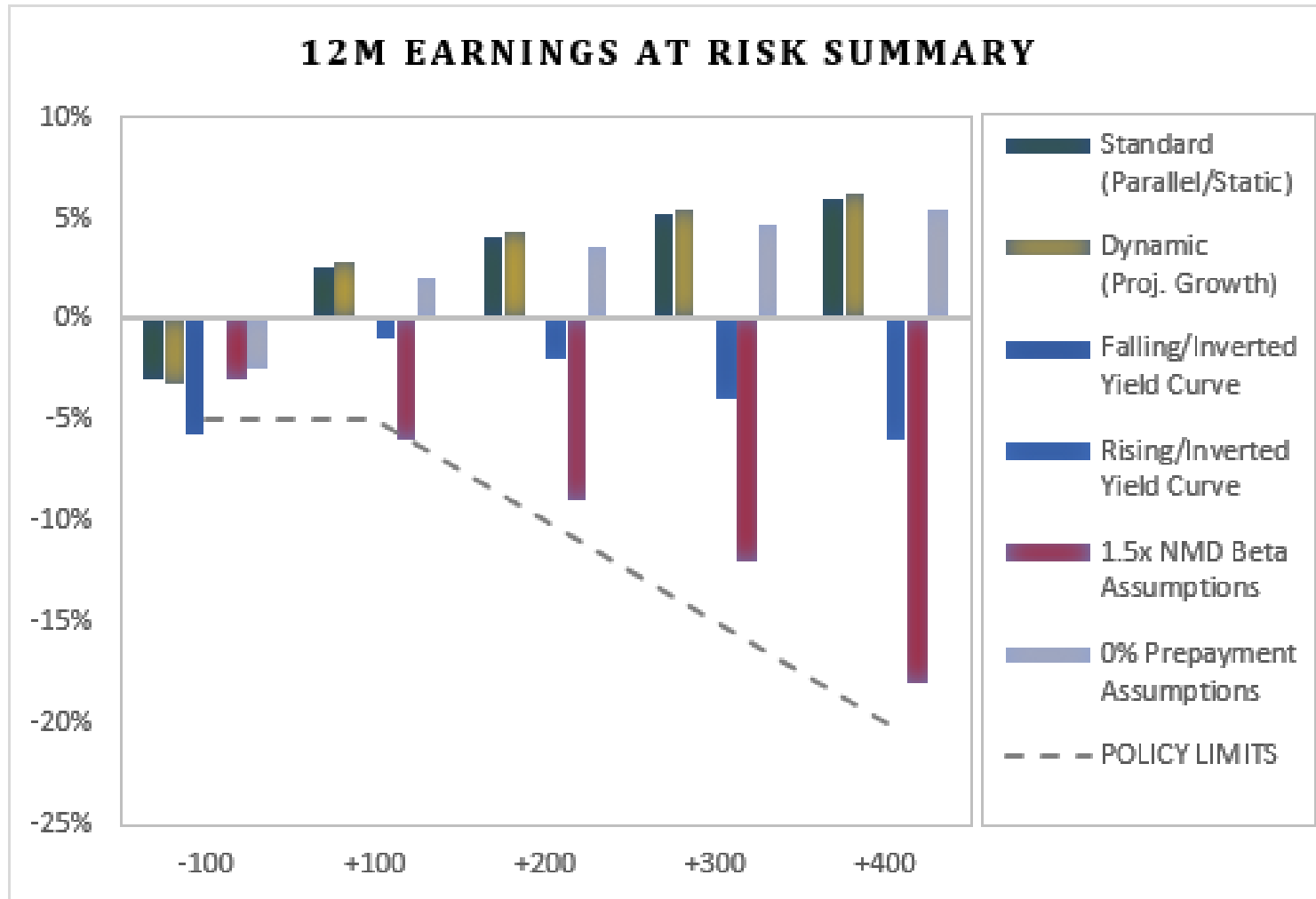
	Historical				Current	Policy
	4Q18	1Q19	2Q19	3Q19	4Q19	Limit
EaR Year 1						
-200bp	-14.2%	-10.2%	-8.8%	-6.2%	-7.0%	-15%
-100 bp	-10.1%	-8.1%	-6.7%	-4.0%	-4.3%	-10%
+100 bp	2.0%	1.9%	1.8%	1.9%	2.1%	-10%
+200 bp	3.8%	3.5%	3.2%	3.4%	3.5%	-15%
+300 bp	5.3%	4.2%	4.6%	4.7%	4.9%	-20%
+400bp	5.5%	4.8%	4.9%	5.0%	5.2%	-25%

Dashboard Report Example

Sample Dashboard Report (Section)

	Historical				Current	Policy	Max/
	4Q18	1Q19	2Q19	3Q19	4Q19	Limit	Min
<u>Liquidity</u>							
<u>Primary Liquidity Ratio</u>	12%	11%	13%	13%	14%	12%	Min
<u>Total Liquidity Ratio</u>	42%	39%	42%	42%	39%	20%	Min
<u>Wholesale Funding Ratio</u>	6%	8%	7%	7%	9%	20%	Max

Summary IRR Chart Example



Summary Cash Flow Table

	Beginning	Policy Min.	End of 12M CF Projection		
			Base Case	Significant Stress	Extreme Stress
Liquid Assets (000s)	396,000		364,020	366,000	348,000
Primary Liquidity Ratio	14%	12%	13%	12%	12%
Available Funding (000s)	747,500		752,500	253,030	207,658
Total Liquidity Ratio	41%	25%	39%	20%	16%

Stress Assumptions:

Loan Payment Defaults	-	10%
Runoff of NMDs	5%	10%
CD Renewal Rate	50%	35%
Borrowing Lines Revoked	No	Yes

Technical ALCO Components

- Minutes
 - Include summary of meeting activities and decisions
 - Assign action items for reference and accountability
 - Memos can be used to document certain activities
 - Include short written description
 - Example: Assumption review/updates for ALM model

Strategic ALCO Components

- Planning
- Performance
- Adjustments
- ALM/risk management
- Decision making

Strategic ALCO Components

- Make plenty of time for strategic discussion
- Identify specific strategic/tactical adjustments
- Constant evaluation of tradeoffs
 - cost/benefit
 - risk/reward
- Case study: CSO presents one new initiative each quarter for consideration (but rarely implemented)

Strategic ALCO Components

- Strategic discussion results in action or deliberate inaction
 - Are we meeting appropriate performance targets?
 - Are performance targets sustainable over the long term?
 - Are we managing risks appropriately?
 - Do we need to make a change?

Characteristics of a Strong ALCO

- Very good at technical activities
- No/few administrative exam issues
 - Most ALM guidance is not new
- Focus on big picture
- Interprets results appropriately
 - Q: Is 0.80% ROA is good or bad
 - A: It depends!

Characteristics of a Strong ALCO

- Members understand the moving parts
 - Operational activities and trade-offs
 - Bank's role in the marketplace
 - Economic and interest rate cycles
- Committee leadership keeps meetings on track
- Consistent strategic direction
 - Moving quickly between strategies may result in not realizing the benefits of any strategy

Characteristics of a Strong ALCO

- Strong risk management culture
 - Will we survive the next crisis?
 - What might the next crisis look like?
 - Plan for expected scenario(s); prepare for crisis scenarios
- Demonstrated track record
 - Or, why do we expect different results with the same approach?

Takeaways

- Streamline technical activities (policies, reporting, etc.)
- Make time for strategic discussion
 - Identify specific strategic/tactical adjustments
 - Evaluate tradeoffs
 - Make decisions (including deliberate inaction)

Questions?

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