

Weekly Post: Risk-Based Budget Planning

Dear Clients:

Challenge:

Regulatory risk reports assume that the structural balance sheet does not change projecting over a horizon of at least 24 months to prevent growth plans from masking issues. But this flat growth is not a realistic assumption and is not consistent with our need for budgeting or capital planning. This results in the risk reports often being used only for regulatory purposes. This outcome is neither consistent with the regulatory guidelines nor useful for our balance sheet management.

- How can we integrate budget/capital planning to our risk reports?
- How can we identify the risk exposure and profitability under our budget plan?
- How can we update our budgeting plan when we need to adjust the plan?

Solution:

THC Risk Officer™ provides a risk-based budget planning approach. THC can provide you the following quarterly reports with your budget plan (or growth plan):

1. Uses and Sources of Funds Report
2. Executive Summary Report
3. Quantitative assessment of Contingency Funding Plan
4. Proforma Financial Statements (including EaR report)

For monthly reports, you can use our FinSim (excel interface budget planning model) or Financial Simulation. These models enable you to dynamically simulate the results and generate the reports, as mentioned above.

Implementing this Risk-based Budget Planning is simple. You can just provide THC the information for your *Volume Growth Plan* and your *Non-Interest Income/Expenses* in the THC input data file (PATH). The benefits to you are clear, as experienced by some of our clients.

- Your ALM risk reports, which have all the approved models, are consistent with your budgeting resulting in more useful reports for management
- You can monitor your quarterly performance, meeting regulatory and ALCO requirements.

Numerical Example

THC provides our newly released Executive Management Summary to all our clients. This report enables you to evaluate your growth plan and your view on the direction of interest rates in relation to your balance sheet performance. Table 1 below presents the projected financial statements; Table 2 presents your uses and sources of funds; Table 3 presents your current growth plan and



reinvestment/funding assumptions; and Table 4 presents your policy limits and the pro-forma EVE (12 month horizon). The tables enable you to adjust your growth plan to meeting your performance targets. These tables are prepared for a hypothetical bank.

Table 1 Proforma Financial Statements

B/S & IS	Current	3m	6m	9m	1y
Cash	19,118	18,084	15,320	16,067	16,817
Loans	105,383	105,383	105,383	105,383	105,383
Deposits	118,382	116,414	112,917	112,917	112,917
Total Asset	156,719	155,685	152,921	153,668	154,418
Tier 1 Capital	-	-	-	-	-
Interest Income	-	1,490	1,452	1,439	1,437
Interest cost	-	293	267	234	227

Table 2 Sources and Uses of Funds

Uses and Sources of Funds(\$000)	1mo	2mo	3mo	4mo	5mo	6mo
Cash	19,118	18,773	18,427	18,084	17,152	16,230
Investments	660	595	1,180	160	606	151
Loans	5,291	4,617	4,513	3,484	3,107	2,955
Total Sources of Funds	28,358	31,013	34,559	28,371	23,460	24,311
Borrowings	1,585	785	785	498	231	35
Deposits	2,040	6,500	8,007	7,070	2,385	5,850

Table 3 Budgeted Growth Plan

Balance Sheet	Past 6m	Jun15	Dec15	Jun16	Dec16
Cash & Short Term	-	-19.9%	9.8%	8.8%	7.9%
Real Estate	-	0.0%	0.0%	0.0%	0.0%
Non Real Estate	-	0.0%	0.0%	0.0%	0.0%
Investments	-	0.0%	0.0%	0.0%	0.0%
Borrowings	-	0.0%	0.0%	0.0%	0.0%
Deposits	-	-4.6%	0.0%	0.0%	0.0%

Table 4 Proforma Risk Exposure

	Policy	Current	Status	12mo	Status
EVE	N/A	32,827		33,563	
EVE Duration	N/A	1.39		2.35	
EVE ratio	10.00%	20.23%	PASS	21.03%	PASS
EVE (-100) % chg	-10.00%	0.49%	PASS	1.25%	PASS
EVE (+100) % chg	-10.00%	-2.70%	PASS	-3.01%	PASS
EVE (+200) % chg	-15.00%	-6.03%	PASS	-5.57%	PASS

Conclusion

Ensuring your budget planning and risk management to be consistent, by using the same validated models and data, is important for regulatory purpose and for internal management. For our clients, implementation is simple and monitoring Risk-Based Budget Planning should be an integral part of our ALM management processes.

Do not hesitate to contact THC if you want to discuss your Risk-based Budget Planning.

Regards,
Tom Ho

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