June 15, 2015

Weekly Post: Dynamic Financial Simulations for Your ALM Strategies

Dear Clients:

Challenge

In the last Weekly Post, I discussed the importance of taking risks into consideration in simulating your ALM strategies,. I discussed how the THC model covers all your regulatory requirements and enables you to manage risk and profitability. However, measuring and managing risk of an ALM strategy is complex.

- How can I compare alternative ALM strategies in funding my loan growth, ensuing that I can meet all the policy limits, including the regulatory EVE % change under multiple shocks, over a 12 month horizon, as opposed to using current date?
- If I use cash to fund loan production, will my EVE % change exceed the policy limits, failing the regulatory EVE% change in taking on too much risk in a rate rising scenario, 12 mo from now?

Solution

THC *Financial Simulation* enables you to measure ALM strategy risks. But, formulating a strategy involves a process, using the ALM model multiple ways. This process and the importance of the simulations can best be explained by Mr. John Gittings, Executive Vice Chairman and CFO, Keystone Bank, in his email to me recently.

Recently while attending a FHLB conference I overheard two bankers discussing ALM Models while they were in the pool. I walked over and introduced myself and asked if they were familiar with THC ALM model. I then told them <u>it is the best ALM model I have ever seen</u>. It is well designed to meet all regulatory requirements but if you use it to just do that then you are missing the best part of the model.

I began in the late eighties working with ALM as a President of a small South Alabama Bank after the S&L Crisis. Back then you needed to know that if you were asset sensitive when rates went up you made more money and if you were liability sensitive you made less money in a rising rate environment. We did have models and even then they worked well. I have used many different models and often run simultaneous models for comparisons. I also installed the in-house Sendero model at one bank.

*Today we upload **ALL** our data and add the assumptions. These are passed thru the model and you get your ALM results. THC offers many different reports in its Dashboard relating to ALM but along with all that you get **Financial Simulation** where you can see in real time what changes you might want to make be it investments, loans, or deposits will do to your model not just individual reports like your investments. You immediately can see the results to EVE, NII, and NI.*

From the Portal you have its Dashboard, Simulation Panel, all Parameter settings at your fingertips. You can make the changes yourself and even look at previous period models. I like to call it my crystal ball. I wish I had this product earlier in my career and could have fully used its power and dynamics. Best of all it is not a static model that you use and never changes. THC is in a constant state of adding modules that will ultimately cover completely all aspects of banking for both the small client and large client. Finally you have access to Tom Ho the creator and designer of the Model and I can assure you he returns all his calls. I would suggest you take some time and let Tom walk you thru the model particularly if you want an arm's length model not being influenced by your Investment partners.

Conclusion

Determining your optimal ALM strategy is a **dynamic** process: analyze performances under multiple scenarios and growth plans, even **interactively**, while incorporating your insights of the regional market conditions and your regulatory constraints.

Feel free to contact me if I can assist you in any way.

Regards,
Tom Ho

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