



September 15, 2015

Budget Planning: New Challenges and Solutions

Dear Clients

OCC recently asked THC if variance analysis can be conducted with the bank's budget plan, as THC is a recognized OCC Interest Rate Risk model vendor. This question underlies multiple new challenges to your current budget planning.

Your budget plan should not only be based on a growth plan, customer behavior, projected market rates and operating expenses that you consider reasonable. The budget plan should be compared with the actual outcome monthly ("variance analysis"), where significant variance should be explained and the budget plan should be revised, when need be.

Risk management should be part of the budget planning process

Challenge

Budget planning process involves multiple stakeholders' inputs to agree upon (1) an optimal strategic plan, (2) the level of risk exposures, (3) continual monthly monitoring and review the performance. Therefore, your ALM model assumptions of loan prepayment, deposit account withdrawal, ALLL provision, and many other items that are validated and audited should be incorporated in your budget plan, not just what you consider reasonable. These are your new challenges

- How to iteratively formulate the budget plan effectively while leveraging the robustness of the ALM model assumptions?
- How to conduct variance analysis operationally that can enhance your performance by adjusting the budget plan when appropriate?
- How to gain regulatory approval for the budget plan?

Solutions

THC has developed a budgeting system that makes your budget planning simple and effective, with negligible upfront implementation work enabling you to focus your time on business planning. These are the simple steps:

Step 1. One simple step in uploading your current budget plan to Fin Sim, an excel interface financial simulation model. Fin Sim combine your ALM models and your budget planning assumptions. You can formulate your budget plan effectively working with your team.



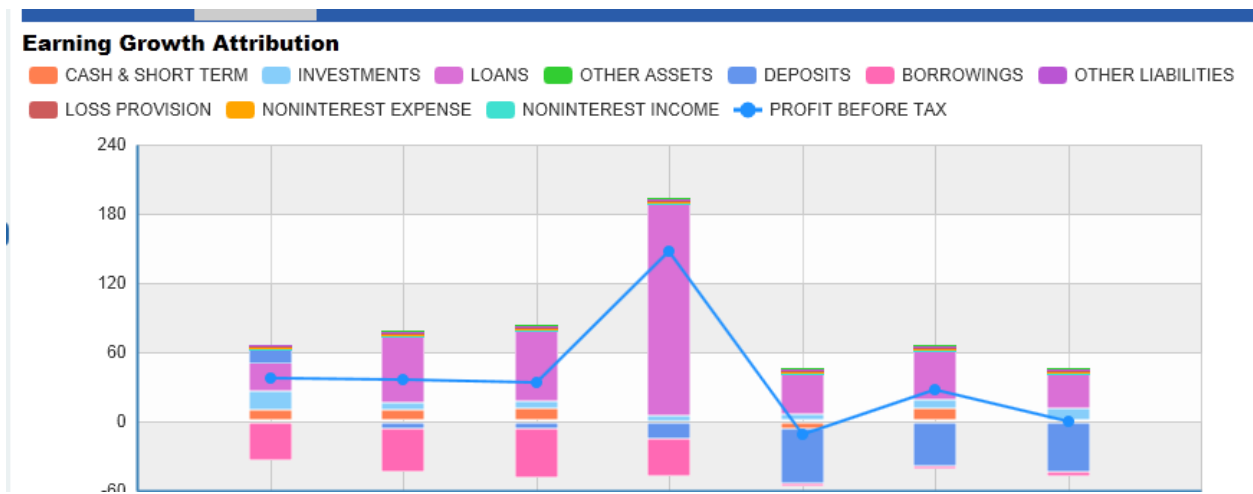
Step 2. Upload Fin Sim to Risk Officer, the ALM solution. In Risk Officer, you can edit and maintain your budget plan, generate reports, and conduct what-if analysis with Trade Simulations and Financial Simulations

Step 3. Upload your GL results to Fin Sim monthly (with one click) and generate the variance analysis

This implementation involves minimal cost while meeting all the new budgeting challenges

Numerical Example

Based on a hypothetical bank’s budget plan assumptions, alternative growth plan and market assumptions can be applied to evaluate their impact on earnings and capital ratios, consistent with the ALM model assumptions. For example, earnings attribution (figure below) enables you to identify the key performance and risk drivers.



The budget plan is maintained in your Risk Officer database, so that you can upload relevant GL numbers to generate your variance analysis, a sample is given below. Since the models are consistent between the budget plans and the ALM model, any large variance can be explained to the Board and to the regulators. Adjustment to your strategic plan can be made accordingly. This process should enhance your performance, beyond just meeting the regulator’s expectation.

Interest Rate Base Case	Jun-15	Jul-15	Actual Variance(%)	Aug-15	Actual Variance(%)
Balance Sheet(\$000)					
ASSETS					
Total Cash & Short Term	15,996	16,038		16,088	
Securities					
Total U.S. Government agency obli	2,314	2,314		2,314	
Securities issued by states and pol	8,140	8,140		8,140	
Total Mortgage-backed securities	48,963	48,963		48,963	
Total Asset-backed securities and	434	434		434	
Total Other debt securities	1,534	1,534		1,534	



Conclusion

The new challenges to budget planning gives rise to new solutions: maintain consistency in budget assumptions and ALM model assumptions to provide what-if analysis and variance analysis. The process enables you to

- iteratively formulate the budget plan effectively while leveraging the robustness of the ALM model assumptions;
- conduct variance analysis operationally that can enhance your performance by adjusting the budget plan when appropriate; and
- gain regulatory approval for the budget plan

Please do not hesitate to contact THC staff if you have any questions on regarding the budget planning

Regards

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