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Weekly Post: **Selecting Strategies Meeting Balance Sheet Needs**

Dear Clients-

Strategic planning,budgeting, loan transaction and other balance sheet strategies require evaluating much information including current market data, risk analysis, banking data and more. Furthermore, you need to evaluate possible strategies that meet your balance sheet needs. This Post describes a practical approach to select optimal strategies, in what I call a "Google Search" approach.

My Post last week reviewed three propositions for Strategy Formulation

- Risk and return analysis of a banking strategy must attempt to achieve the highest performance while meeting policy limits and regulatory requirements.
- Every balance sheet has specific needs to adjust the balance sheet risk profile aversion in capital adequacy, interest rate risk, liquidity risk and profitability.
- Every balance sheet strategy impacts the bank's profile differently.

Challenge

However,

- How do you analyze balance sheet strategies in this framework?
- Can there be a more systematic way to explore a broader range of balance sheet strategies?
- Can you avoid using a trials and errors approach in strategic planning?

Solution

Balance sheet strategy can refer to tactical decisions such as buying or swapping securities, originating loans, and leveraging or de-leveraging the balance sheet. This Post also deals with strategic decisions. Over the years, I have used this risk and return analysis to evaluate the impact on

- Acquisition of balance sheets or raising capital
- Multi-year strategic planning of loan growth and leveraging the balance sheet
- Keeping loans on your book instead of selling the loans to agencies

To illustrate the Google Search approach, I will use a hypothetical bank, Bank C, to illustrate the need for a balance sheet risk management.

Suppose Bank C bank has the risk profile below, with margin, leverage, and duration 3.52%, 5.84 and 5.81 respectively. Using the THC percentile table, presented below, the result shows that the margin, leverage and duration of the bank belong to 80%, 10%, 90% percentile among its peers.

Bank	ROE	non-int cost	margin	leverage	duration

Bank C	0.87%	21.70%	3.52%	5.84	5.81
percentile	15%	50%	80%	10%	90%

Ignoring risk aversion level specific to the bank, the result suggests that the bank may wish to

- Lower the balance sheet duration (or equivalently dialing down the liability sensitivity)
- Leverage up the balance sheet

Our next step is to seek balance sheet strategies that best march these requirements while enhancing ROE.

Percentile table of 103 peer group banks

Percentile	ROE	nonnic	margin	leverage	duration
10%	-0.64%	12.89%	2.24%	5.16	0.63
20%	1.16%	16.30%	2.51%	6.17	1.17
50%	3.39%	24.77%	2.92%	8.43	2.71
75%	5.98%	33.11%	3.31%	10.15	3.94
90%	10.14%	44.73%	3.72%	11.90	4.84

Numerical Example

For exposition of clarity, I will show only the tactical decisions, as listed below. The THC model can match over 100 strategies to the bank's needs. This approach enables you to evaluate your strategies in a broader context and manage your risk more effectively. Instead of showing the "optimal" strategies, we show a list of strategies that have the highest score; an approach analogous to a "Google Search."

THC appreciates that there is no "one silver bullet." Instead of one "optimal solution", our models search through our extensive analytical database to provide you insights and clarity into making your decisions. The table below illustrates the "Search Results" along with the score, highlighted in blue.

strategy ID	Strategy Name	Strategy Size (percent of assets)	Strategy Score	Bank Analytics after strategy			
				ROE(%)	Margin(%)	Leverage	Duration
7	buy 1-4 Family Mortgage(Fix 30), fund Deposits(BrokerCD)	5%	10.99	0.97	3.49	6.13	5.69
8	buy 1-4 Family Mortgage(ARM 5/1), fund Deposits(BrokerCD)	5%	9.21	0.92	3.45	6.13	5.59
16	buy 1-4 Family Mortgage(ARM 5/1), fund FHLB Advance(Boston)(Fixed Bullet)	5%	8.12	0.92	3.45	6.13	5.62
15	buy 1-4 Family Mortgage(Fix 30), fund FHLB Advance(Boston)(Fixed Bullet)	5%	8.08	0.97	3.49	6.13	5.73

While the numerical example uses tactical decisions, THC also applies this risk and return analysis to strategic decisions. Of course, analyses of these strategic decisions would require projecting multiple years of financial projection. My Post next week will discuss this topic.

Conclusions

THC Risk and Return Analysis evaluates many strategies that best match the balance sheet needs, involving searching through an extensive analytical data of risk measures, banking data and current market data. This approach providing you a list of best solutions enables you to select strategies most appropriate for you, providing you insights and clarity in your decision making. This "Google Search" approach is practical, intuitive and rigorous at the same time.

If you would like to learn more about THC approach to evaluate your strategies, please do not hesitate to contact my colleagues or me.

Regards,

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