



Weekly Post:Redefining Asset-Liability Management

October 13, 2016

Dear Clients-

Last week, I spoke at a conference that addressed how technologies have redefined asset-liability management for community banks and credit unions.

I initially spoke about how important ALM models are to banking. ALM Models allow you to measure and monitor your risk capacity. The models metaphorically let you drive on a freeway with well-marked lanes so that you can drive with speed safely. Otherwise, you would drive with caution and fear. But driving is not just following the road.

Driving is about reaching a destination. GPS map technology has changed the way we drive. With full access to information about the route, drivers can now reach their destinations more efficiently. GPS map technology also allows you to reach destinations that they you would not otherwise be able to reach. Furthermore, GPS technology has evolved to a point where it's almost free. As a result, GPS has redefined driving not just for few drivers but for all drivers, changing traffic patterns forever.

Likewise, now ALCOs have access to risk models, risk management processes, valuation, balance sheet transactions, investments, capital planning, budgeting, loan markets, funding facilities and many aspects of asset-liability management at a negligible cost. Today, ALCO can make decisions with a comprehensive and coherent view of market opportunities and within the institution's risk capacity.

I have seen the change in community banking in the past years. The change is real and dramatic with many THC clients becoming profitable. This Post will discuss these changes.

Challenges

- How does financial technologies change our ALM process?
- Can THC models enhance the profitability in your line of business?
- How does measuring risk translate into executions, doing something to your balance sheet?

Solution

In this limited space, I will highlight three aspects of changes. (1) ALM Process, (2) Lines of Business, (3) transactions.

Market Wisdom - Art Hilliard*

Scratch and dent loans are still active. Here is a pool of 18 scratch and dent loans that traded last week.

- All fixed rate
- Performing except for a couple of early payment defaults
- WAC 3.84
- WA LTV 77.28
- WA FICO 728
- WA DTI 35.02
- Geographically diverse

These are pretty much typical scratch and dent loans.

- Disclosure issues
- Appraisal issues
- Early payment defaults
- Flipping

These loans traded all-or-nothing (AON) to a single bidder at 89.75. The market is still healthy.

Recall previous discussions regarding TRID related S&D loans. See attached link. Interesting turn of events with the CFPB. <http://www.bloomberg.com/news/articles/2016-10-11/consumer-finance-bureau-suffers-setback-as-phh-wins-ruling-ju5krh65>

Art Hilliard has been in the mortgage industry for 29 years. He has originated, managed secondary marketing, securitizations and settlements, provided mortgage financial advisory and performed multiple mortgage portfolio sales and acquisitions. He was past president of the Illinois Mortgage Bankers Association.

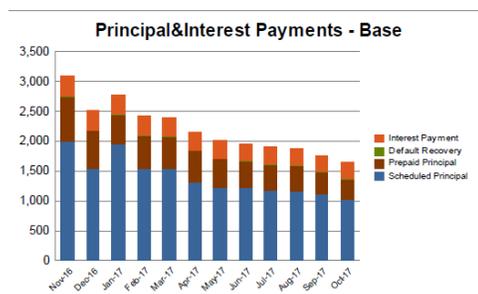


ALM Process After the 2008 financial crisis, risk management is now front and center to ALM. ALM using only financial reporting is retrospective, not prospective, liken to driving without head lights. For example, the Directors Dashboard measures your risk capacity in balance sheet rate sensitivity, capital adequacy, liquidity and profitability using 12 month projections. These measures enable you to identify the leverage of your capital, exploitation of a rising yield curve, and optimal use of cash. These are key drivers to performance.

Performance	Current	Chg from Last Cycle	%Chg
EVE ratio(%)	14.36↓	-0.24	-1.62
Duration	6.50↓	-3.52	-35.12
% EVE chg up 400	-23.80↑	15.81	-39.91
% NII chg up 400	6.51↑	5.56	579.68
Short term/asset(%)	6.76↑	2.88	74.37
Margin(%)	3.70↓	-0.08	-2.14
NII(\$000)	15,579↑	224	1.46
Earnings(\$000)	645↑	71	12.41
ROE(%)	1.08↑	0.10	10.05

THC risk models are cash flow based, not just hypothesizing future possibilities. The Sources and Uses of Funds report is very widely used amongst regulators, ALCO and the Board because the report shows the inflows and outflows of the balance sheet that you can verify. You can target your liquidity coverage ratio to be 2, as a benchmark for your liquidity risk capacity. THC reports enable you to drill down further for your ALM process.

Line of Business Today, loan portfolio management is community banking: originating and pricing loans, introducing loan products, servicing, bidding for and selling loans and working with loan borrowers. These activities are NOT operational processes any more. They are ALM because all the activities are related to your balance sheet risk capacity and optimizing ALM performance. Technologies enable THC model to tie to your core processors; you can now generate your loan portfolio reports by types, performing status, credit, and more, monthly or on demand. Based on timely and accurate reporting, you can take actions managing your loans using loan pricing, funding, investments, and capital management strategies. This change is real and consequential. The cash flow report shows the monthly cashflow projected by THC option-based model, identifying the timing of prepayments and calling of loans.



Numerical Example

Risk management and transacting are inseparable: two wheels of the same vehical. THC Risk Officer enables you to interact with your counterparties, brokers, and stakeholders efficiently. In Bond Monitor App, you can easily upload brokers’ indicative ask prices when selling your securities. In Inventory App, you can upload broker’s bid prices for securities that you consider buying. In Transactional Network, you can upload your FHLB rates and you can submit and search for loan origination partners, loans available for sale and the negotiation facilities.

	ABANumber	Name	Asset(\$000)	District	Distance(...	State	City	Loan/Ass...	Loan/Dep...	ROE(%)	SM
✓	11305202	Millbury Nat...	87,218	1	26.51	Massac...	Millbury	73.05	82.48	4.25	0.14
✓	211371968	Athol-Clinto...	81,129	1	32.02	Massac...	Athol	88.85	108.49	-26.68	0.39
✓	211371340	Methuen C...	87,078	1	33.39	Massac...	Methuen	61.02	68.20	-0.77	0.14
✓	211371670	North Cam...	90,417	1	37.07	Massac...	Cambridge	54.49	70.27	1.47	0.15
✓	211374062	Merrimac S...	75,190	1	44.35	Massac...	Merrimac	50.68	54.41	5.32	0.29
✓	211370451	Canton Co...	107,535	1	44.46	Massac...	Canton	52.42	64.99	3.28	0.21
✓	211370118	Equitable C...	99,906	1	44.54	Massac...	Lynn	64.27	74.88	1.38	0.16
✓	211371793	Stoughton...	108,732	1	47.41	Massac...	Stoughton	64.67	82.41	4.02	0.20

Furthermore, in Know Your Neighborhood, THC database provides detail analysis and data search capabilities of all the banks and credit unions. Further, you can have access to thousands of contacts . You can compare your performance with the appropriate peer group, gain insight into your competitors and seek loan origination partners.



In Peer Group App/Homepage, you can input your search criteria and select banks in groups for your particular purpose. Furthermore, you can generate reports based on the performance measures of each bank in your selected group. THC uses our proprietary data and research to provide risk analytics for the banks.

Conclusion:

Technologies have redefined asset-liability management for community banks and credit unions. ALM is not just about reviewing the institution's overall performance. Today, ALM includes managing loans and risk proactively to enhance performance. You can now manage your balance sheet comprehensively and coherently. You are no longer driving on a dirt road with no headlights, but instead you are now driving on freeway with a GPS. Furthermore, technologies have become widely available. Community banking as a whole will change accordingly.

If you have any questions regarding the Risk Officer Comprehensive ALM solutions, please do not hesitate to contact THC.

Regards,
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THC is NOT a broker-dealer. THC only offers an analytical platform for clients to work together to meet your customers' needs or your balance sheet requirements. THC does not collect any commission.

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