An ALM Program Refresher

hedging risk management ALM

Summary: Seven things you can do to help ensure your bank meets regulatory expectations for your ALM program.

A CNBC survey asked people what they would do with an unexpected $5,000 bonus. The most popular answers were: pay off debt (34%), save it for short-term expenditures or emergencies and (22%) and invest it for long-term goals like college or retirement (15%). Now that you know, maybe it can help focus some of your marketing messages to customers and prospects.

Community banks are always trying to improve their performance and risk profile too, so today we take a look at asset liability management (ALM) programs. Here are 7 things you can do to help ensure your bank meets regulatory expectations. Most likely you are doing some or all of these, but it is a good refresher.

First, involve your board of directors or asset liability committee in taking a proactive approach toward ALM. These groups should fully understand the risks the bank runs with its products and activities. Once they do, they can then communicate an acceptable risk tolerance throughout the bank.

Next, be sure the ALM team is properly staffed and trained. ALM is a complex process that changes over time, so bank boards should hire managers who have training in handling and managing risk from the outset. Then, boards should receive detailed, quarterly reports about the bank's risk level.

Third, continue to educate board members at least annually (or as key changes occur) to better understand ALM. They don't need to be experts, but they do need to understand it well enough to meet their fiduciary duties and responsibilities for oversight.

Fourth, be sure to choose the right model. It used to be that call report driven reports were good enough. These days, almost every single deposit and loan on the books have structural components that make call reporting so blunt that you have to wonder if this is now running afoul of fiduciary responsibilities. While regulators in some instances may still allow this, the model must be an adequate fit for your bank's complexity and risk profile and meet your fiduciary responsibility as a director.

Fifth, be sure simplicity isn't too simple and masking other potentially significant risks. For banks with simple balance sheets, it used to be ok to just do a maturity gap analysis. Today, nothing on the balance sheet goes to maturity (given prepayments), so this is weak analysis, at best. It ignores critical things like embedded prepayment options on both single-maturity and amortizing securities or loans, deposit decay rates, puts or calls, interest rate caps, rate floors, and the right to convert a fixed rate to variable, for example.

Sixth, choose vendors carefully. Banks can choose from a variety of ALM vendors, but this can also come with substantial variation in data management, complexity, and expense. Get a good idea of vendor capacity to capture your bank's risks before you take them on. Take particular notice of the product's ability to model your bank's present and planned products, both on and off balance sheet; its transparency; and the adequacy and breadth of its model validations and internal control reviews.

Seventh, it is important to document, test and validate. Examiners expect to see that you've documented key assumptions used by your ALM model.

If you have any questions on ALM, feel free to contact us. We have over 15Ys of experience; we are here for you.

OUTSOURCED ALM SERVICES FOR COMMUNITY BANKS

Managing interest rate risk is both art and science. Regulators have raised the bar and community bankers have more to do than there are hours in a day. To see how easy it is to outsource & get expert help, contact us today.