



Risk's Role at the ALCO Table

California Bankers Association – 2024 Bankers Summit

October 3, 2024 (2:30 – 3:30PM)

Mark A. Haberland | Managing Director | mhaberland@darlingconsulting.com

Kimberly Jones, Chief Risk Officer



Where should my focus be with regard to ALCO and Risk Management?

Change happens slowly. . .how do I transform ALCO into a “profit center”?

I’m concerned with the quality of my data inputs and how that may impact the results of my models.

How Can Model Risk Management help make this process part of our culture?

I don’t have the resources to keep model assumptions up to date and am fearful I’m not accurately capturing my risk exposures.

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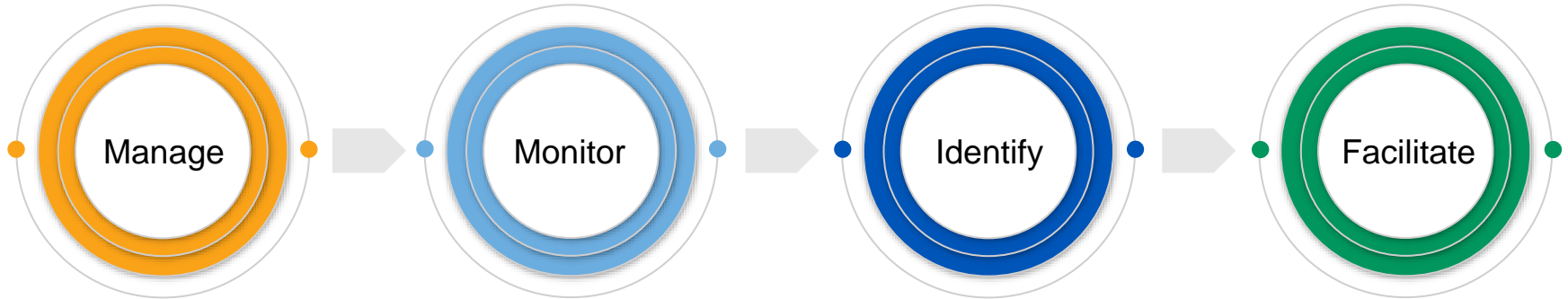
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We Are in the Risk Business



Risk's Primary Objectives at ALCO



Manage performance within acceptable **risk** tolerances

Monitor key risks:
Interest Rate Risk (IRR),
Liquidity, Capital/Credit

Identify secondary risks:
Operational, Market,
Treasury and Emerging
Trends

Facilitate discussions re:
key **risk** areas, **risk**
tolerances, balancing
performance with
exposure

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Common Data Issues

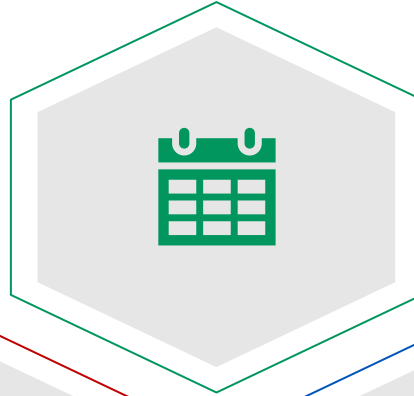
MAPPING & AGGREGATION

Reliability and quality of data; incomplete or inaccurate



SHORTCUTS

During implementation



DOCUMENTATION

Limited / outdated



Best Practices: Data Management

1

- Scrubbing, aggregation
- Testing for new implementations
- Reconciliation, security

DOCUMENTATION

2

- Testing source data
- Periodically test aggregation impact on results

TESTING

3

- Centralized initiatives

STANDARDIZATION

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Assumptions: 5 Key Questions

1

WHAT

What are the **key assumptions**?

2

WHERE

Where are the assumptions **based**: actual experience, peer analysis, and/or expert judgment?

3

HOW

How much can they **vary**?

4

WHO

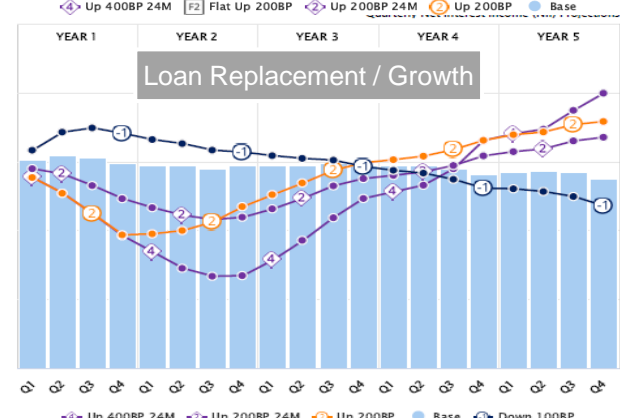
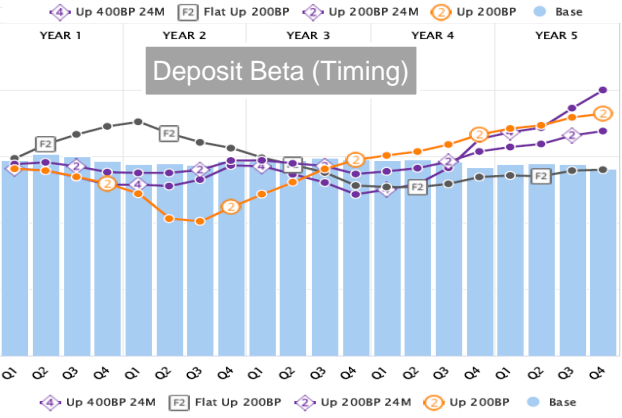
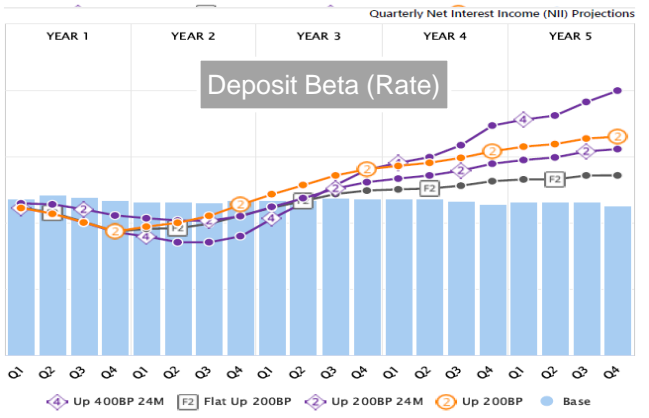
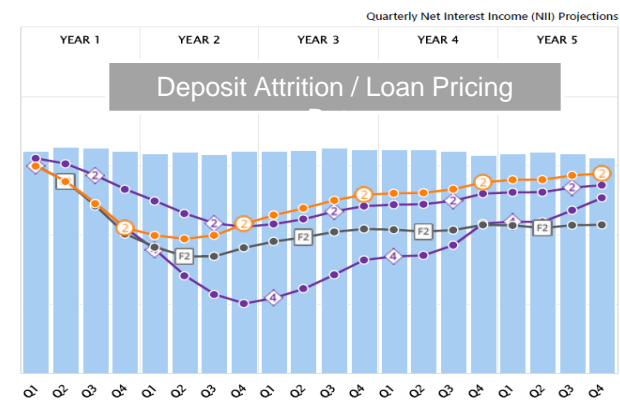
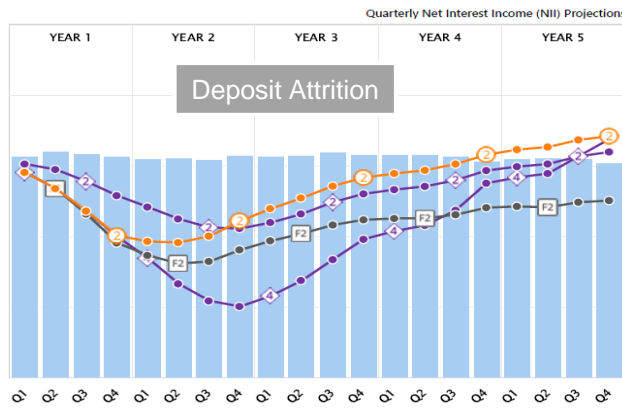
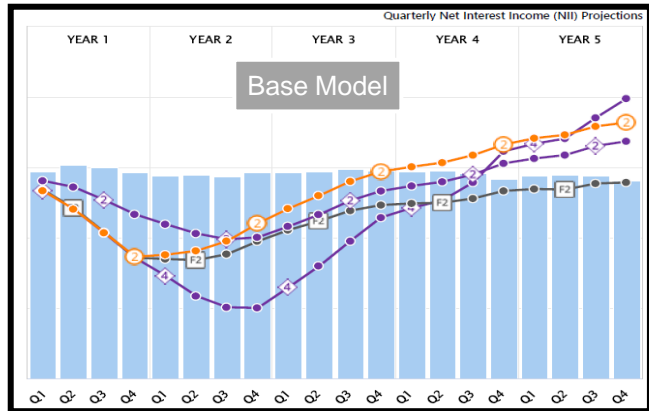
Who **reviews** and **approves**?

5

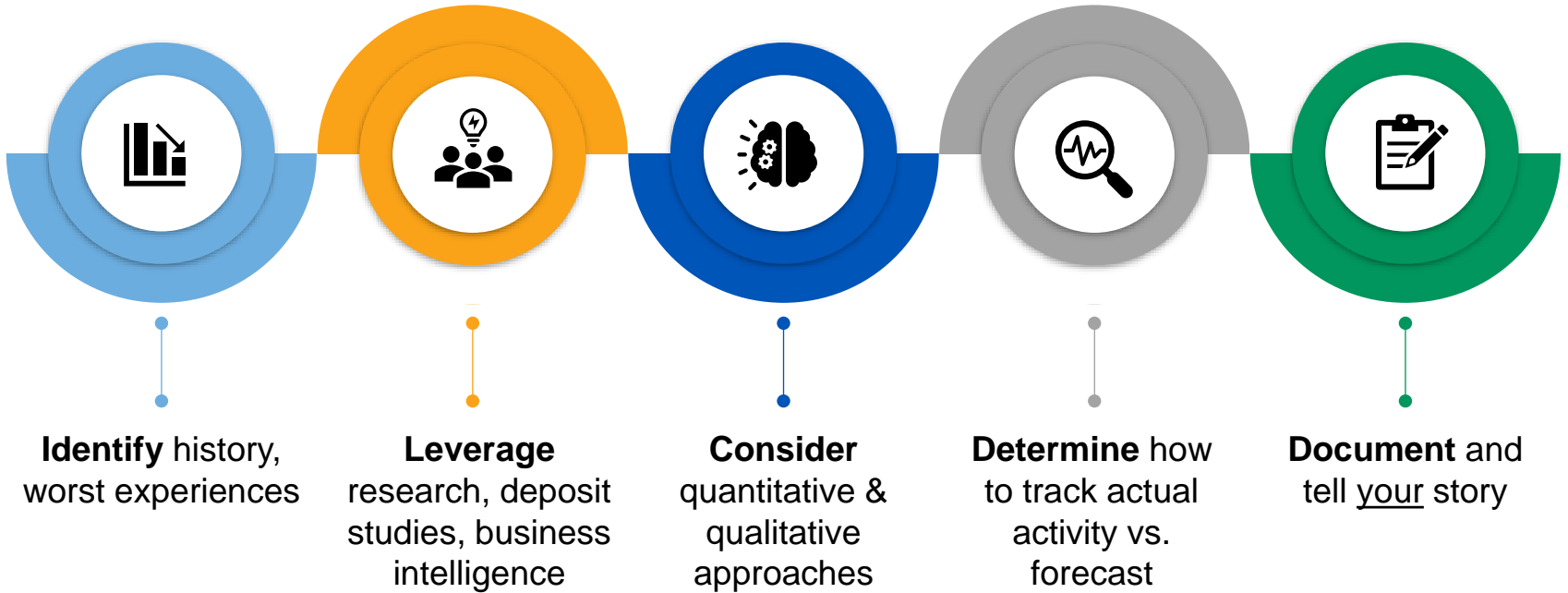
WHEN

When to **recalibrate**?

Examples: Sensitivity / Stress Testing

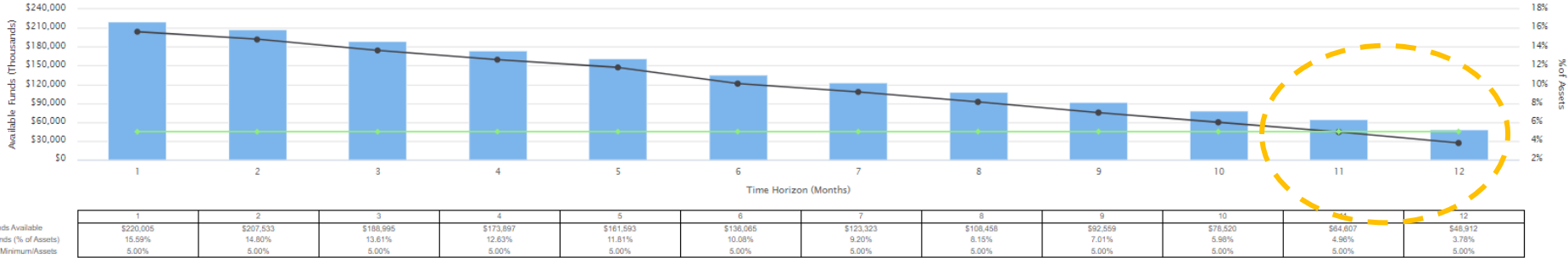


Liquidity Stress Assumption Development

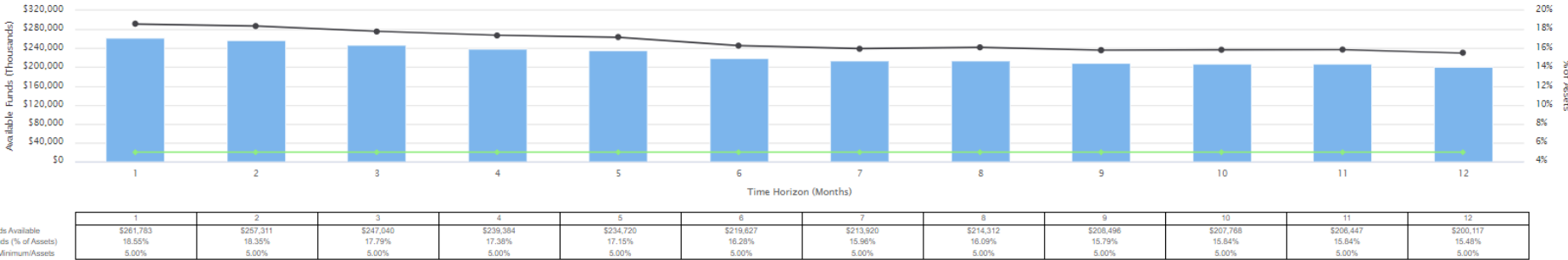


Severe Stress/Relief??? Not So Much Anymore

Severe 2023 Stress - Stress Case - LIQUIDITY FORECAST (TOTAL FUNDS AVAILABLE)

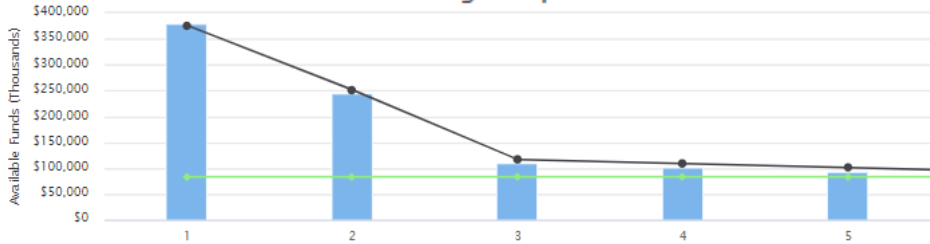


Severe 2023 Stress - Relief Case - LIQUIDITY FORECAST (TOTAL FUNDS AVAILABLE)



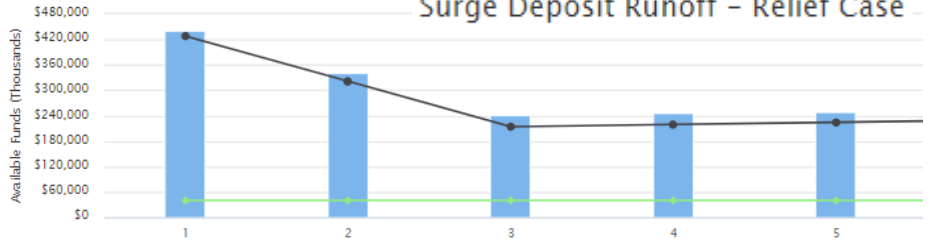
Liquidity Stress: Deposit Runoff – More Impactful Stress

Surge Deposit Runoff – Stress Case



	1	2	3	4	5
Total Funds Available	\$378,622	\$243,913	\$109,204	\$101,670	\$94,136
Avail. Funds (% of Assets)	22.57%	15.09%	7.02%	6.55%	6.07%
Liquidity Minimum/Assets	5.00%	5.00%	5.00%	5.00%	5.00%

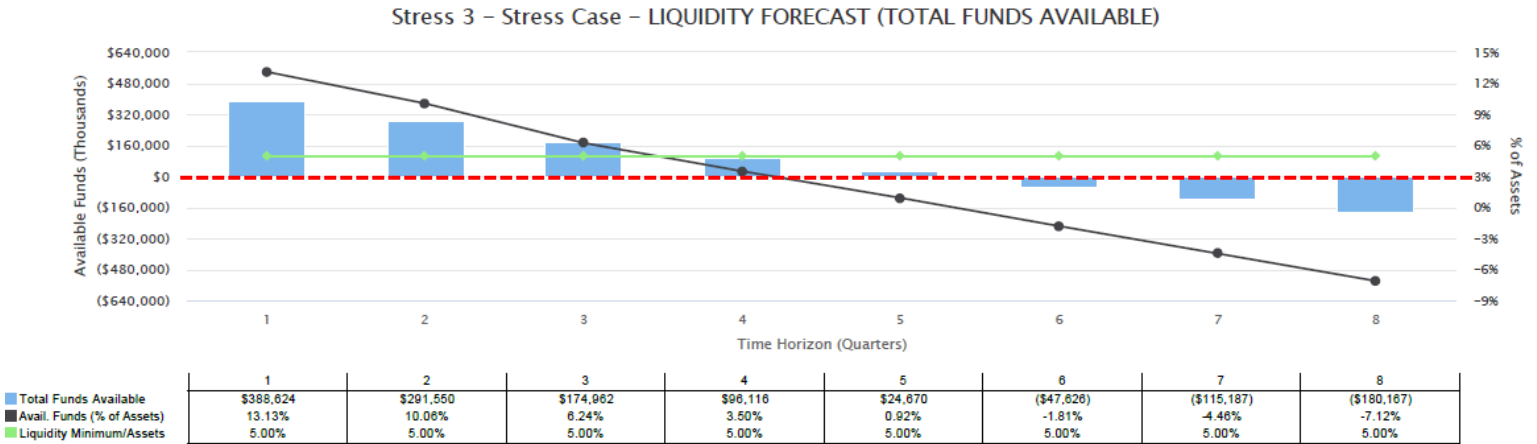
Surge Deposit Runoff – Relief Case



	1	2	3	4	5
Total Funds Available	\$441,249	\$340,423	\$241,778	\$245,087	\$248,165
Avail. Funds (% of Assets)	24.38%	19.05%	13.70%	13.96%	14.22%
Liquidity Minimum/Assets	5.00%	5.00%	5.00%	5.00%	5.00%

Liquidity Ratios	Min / Max	Current	Oct-22	Nov-22
Cash + Unencumbered Coll. / Assets		7.06%	11.25%	10.41%
Net Loans / Deposits	115.00	82.30%	80.71%	84.38%
Brokered Deposits / Assets	25.00	14.96%	20.80%	22.37%
Borrowings / Assets	15.00	1.15%	4.10%	7.19%

Liquidity Stress: Break the “Bank” Scenario



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Critical Questions ALCO Needs to Answer



LIQUIDITY

- How much do we have?
- How much do we need
- How might that change?
- How much do we want to pay?



INTEREST RATE RISK

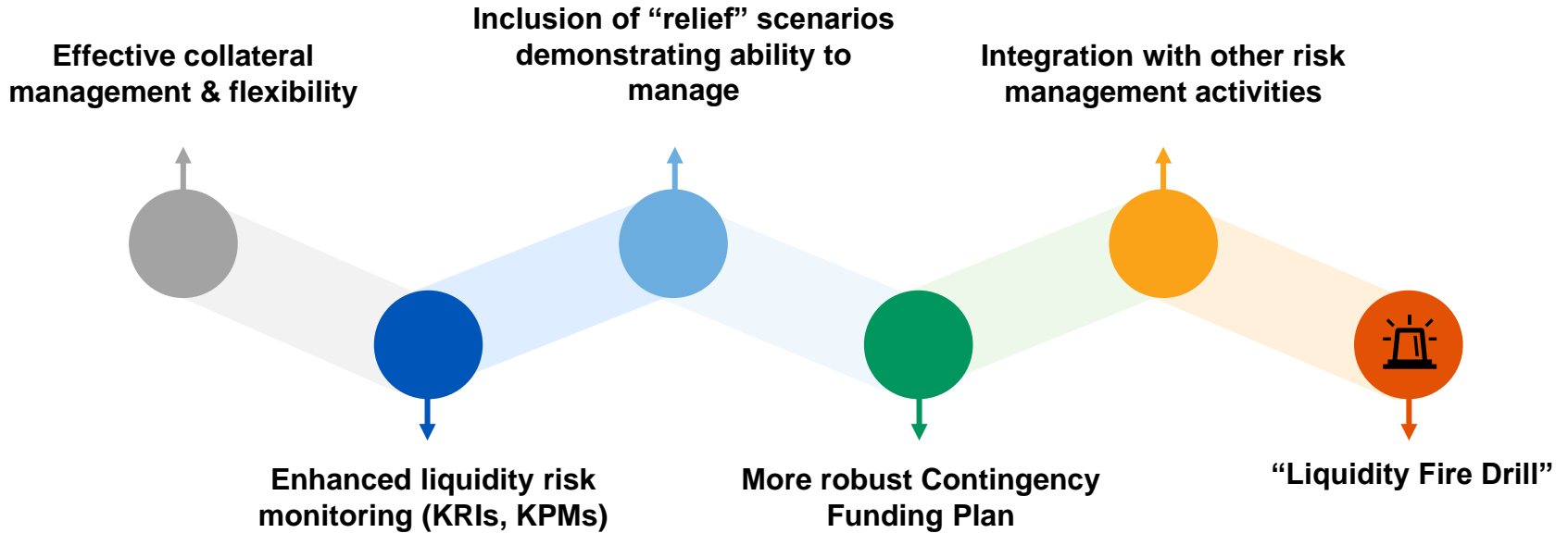
- How much exposure to changes in rates?
- What is cost to mitigate potential risks?
- Are we paid adequately for risks?



CAPITAL

- How much loss can we absorb?
- How much growth capacity do we have?

Liquidity Focus



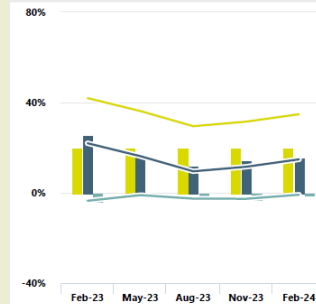
The ALCO Forum – Discussing Liquidity



LIQUIDITY: MODERATE RISK

BASIC SURPLUS	POLICY	FEB24	NOV23	AUG23	MAY23	FEB23	OTHER LIQUIDITY MEASURES	POLICY	FEB24	NOV23	AUG23	MAY23	FEB23
Total Liquid Assets		7.1	5.5	5.4	7.2	7.0	Borrowings / Assets (Max.)		7.4	9.8	12.1	12.1	5.6
Tier 1 Basic Surplus	-5.0	-0.8	-2.6	-2.5	-0.9	-3.4	Brokered Deposits / Assets (Max.)	20.0	0.0	0.0	0.0	0.0	0.0
Tier 2 Basic Surplus	7.0	14.9	11.6	9.6	16.3	22.1	Total Wholesale Funds / Assets (Max.)		7.4	9.8	12.1	12.1	5.6
Tier 3 Basic Surplus		34.9	31.6	29.6	36.3	42.1	Net Loans / Deposits		97.0	100.0	102.5	102.0	94.1
							Net Loans / Assets	85.0	79.4	79.5	79.3	78.5	78.4

	AMOUNT	% OF ASSETS	CUMULATIVE AMOUNT	% OF ASSETS	BASIC SURPLUS	% OF ASSETS
1. TIER 1 LIQUIDITY (LIQUID ASSETS)	214,002	7.1%	214,002	7.1%	-22,640	-0.8%
Cash/Equivalents	32,476					
Free Bond Collateral	155,704					
Other Inv. Cash Flow <30 Days	3,545					
Other Liquid Assets	22,277					
2. TIER 2 LIQUIDITY (FHLB LOAN BASED CAPACITY)	469,257	15.7%	683,259	22.8%	446,617	14.9%
Maximum FHLB Borrowings Capacity	850,757					
Outstanding Advances / LOCs	381,500					
3. TIER 3 LIQUIDITY (BROKERED DEPOSITS CAPACITY)	598,769	20.0%	1,282,027	42.8%	1,045,386	34.9%
Maximum Brokered Deposits Capacity	598,769					
Current Brokered Deposits	0					
4. OTHER LIQUIDITY	222,406	7.4%	1,504,434	50.3%		
Other Investments	157,406					
Secured Borrowing Lines	15,000					
Unsecured Borrowing Lines	50,000					



BASIC SURPLUS CALCULATION

Cumulative Amount
 - Volatile Liabilities Coverage =
Basic Surplus

VOLATILE LIABILITIES COVERAGE

Coverage = \$236,642
 8% of Assets

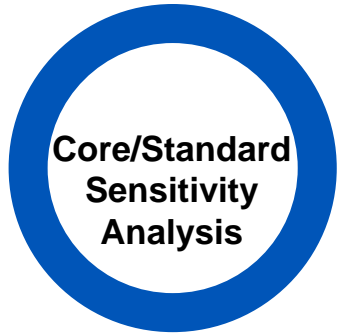
The ALCO Forum – Discussing Liquidity

90 Day Liquidity Forecast					
	TIER 2 BASIC SURPLUS	NET NEW LOAN - FUNDINGS	NET CORE + DEPOSIT FLOWS*	NON-PLEDGABLE + INV CASH FLOWS	PROJECTED = BASIC SURPLUS
CURRENT FORECAST	446,617	0	0	2,733	449,350
11/30/2023 FORECAST	346,459	0	0	2,750	349,209
ACTUAL FORECAST	346,459	11,055	82,851	2,750	421,004
VARIANCE		11,055	82,851		71,795

*Excludes National, Brokered, Brokered One-Way, and Retail Repos

ASSETS	Q1Y1	Q2Y1	Q3Y1	Q4Y1
Overnight Investments	32,476	0	0	0
All Other Investments	20,515	15,521	6,493	11,753
Residential Real Estate & Home Equity Loans	21,454	21,057	18,800	15,680
Commercial & Ag Real Estate Loans	89,775	84,102	97,275	108,646
All Other Loans	91,841	80,323	82,824	74,191
Total Asset Cash Flow	256,061	201,004	205,392	210,269
LIABILITIES				
Retail Time Deposits	63,401	58,856	93,065	81,382
Public Time Deposits	0	0	0	0
National Deposits	0	0	0	0
Brokered Deposits	0	0	0	0
Wholesale Borrowings	0	35,000	25,000	0
Total Liability Cash Flow	63,401	93,856	118,065	81,382
Net Cash Flow	192,661	107,148	87,328	128,888
Cumulative Net Cash Flow	192,661	299,809	387,136	516,024

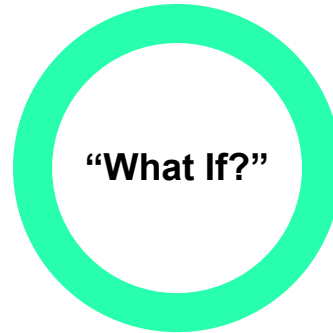
IRR Focus



- Reasonable IRR: +/- 200bps
- “Static” balance sheet
- Simulation horizon: 2-5yrs



- Rate shocks: +/- 300bp in 100bp increments
- Extreme rate scenarios: +/- 400bp? +/-500bp?




- Shifts in asset/liability mix, growth (plan)
- “Abnormal” rate shifts: flattening/steepening



- Isolate meaningful risk variables/assumptions
- Shifts in asset/liability mix, growth
- Yield curve risk
- Option risk
- Basis risk

The ALCO Forum – Discussing IRR

 INTEREST RATE RISK: HIGH RISK													
EARNINGS AT RISK RAMP SCENARIOS													
YEAR 1 NII % Δ FROM YEAR 1 BASE							YEAR 2 NII % Δ FROM YEAR 1 BASE						
POLICY	FEB24	NOV23	AUG23	MAY23	FEB23	POLICY	FEB24	NOV23	AUG23	MAY23	FEB23		
Up 200BP	-10.0	-9.7	-8.8	-7.8	-9.1	-7.7	Up 200BP	-15.0	10.1	10.1	10.7	3.7	2.3
Base (\$ MILLIONS)		\$70	\$73	\$76	\$74	\$80	Base	-15.0	26.6	23.1	21.7	14.7	10.3
Down 100BP	-5.0	4.6	4.1	3.5	4.1	3.7	Down 100BP	-15.0	33.2	28.0	25.2	18.3	12.8
Down 200BP	-10.0	9.0	8.0	6.6	7.7	6.7	Down 200BP	-15.0	38.8	31.2	26.7	20.0	13.6
Steep Down 200BP	-10.0	13.0	12.4	9.6	11.7	9.6	Steep Down 200BP	-15.0	58.8	53.6	42.2	38.8	29.4
Steep Down 400BP		11.1					Steep Down 400BP		61.6				
EARNINGS AT RISK SHOCK SCENARIOS													
YEAR 1 NII % Δ FROM YEAR 1 BASE							YEAR 2 NII % Δ FROM YEAR 1 BASE						
POLICY	FEB24	NOV23	AUG23	MAY23	FEB23	POLICY	FEB24	NOV23	AUG23	MAY23	FEB23		
Shock Up 400BP	-15.0	-32.3	-28.9	-25.5	-30.7	-27.0	Shock Up 400BP	-15.0	6.3	8.4	8.9	2.2	2.3
Shock Up 300BP	-15.0	-24.6	-22.1	-19.5	-23.3	-20.5	Shock Up 300BP	-15.0	10.4	11.3	11.2	4.8	3.9
Shock Up 200BP	-10.0	-17.0	-15.2	-13.6	-15.9	-13.9	Shock Up 200BP	-15.0	14.4	14.1	13.6	7.3	5.5
Shock Up 100BP	-5.0	-8.2	-7.3	-6.5	-7.7	-6.6	Shock Up 100BP	-15.0	21.4	19.4	18.3	11.7	8.5
Shock Down 100BP	-5.0	7.2	6.5	5.6	6.4	5.8	Shock Down 100BP	-15.0	29.9	24.9	22.9	15.6	10.4
Shock Down 200BP	-10.0	13.6	11.5	9.4	11.1	10.0	Shock Down 200BP	-15.0	31.5	24.4	21.4	13.9	8.1
Shock Down 300BP	-15.0	19.2	15.7	12.5	14.8	12.8	Shock Down 300BP	-15.0	31.4	22.4	18.3	10.7	4.0
Shock Down 400BP	-15.0	24.8	19.8	15.4	18.3	15.7	Shock Down 400BP	-15.0	31.1	19.9	15.0	6.8	2.7
ECONOMIC VALUE OF EQUITY SHOCK SCENARIOS													
EVE % Δ FROM 0 SHOCK							POST SHOCK EVE RATIO						
POLICY	FEB24	NOV23	AUG23	MAY23	FEB23	POLICY	FEB24	NOV23	AUG23	MAY23	FEB23		
+400BP	-15.0	-16.1	-11.5	-10.5	-8.0	-7.7	+400BP	8.0	6.9	8.9	10.3	11.3	14.3
+300BP	-15.0	-11.9	-8.7	-7.6	-5.4	-5.3	+300BP	8.0	7.1	9.0	10.4	11.3	14.4
+200BP	-10.0	-8.3	-6.4	-5.1	-3.3	-3.2	+200BP	8.0	7.2	9.0	10.5	11.3	14.3
+100BP	-10.0	-2.3	-1.7	-1.2	-0.2	-0.5	+100BP	8.0	7.5	9.2	10.6	11.4	14.3
0 Shock		0.0	0.0	0.0	0.0	0.0	0 Shock		7.5	9.2	10.5	11.1	14.0
-100BP	-10.0	-2.2	-1.9	-2.6	-3.5	-2.7	-100BP	8.0	7.1	8.8	10.0	10.5	13.3
-200BP	-10.0	-9.6	-9.1	-10.4	-11.9	-10.3	-200BP	8.0	6.5	8.0	9.0	9.3	12.0
-300BP	-15.0	-20.7	-20.2	-21.0	-23.7	-21.6	-300BP	8.0	5.6	6.9	7.7	7.9	10.3
-400BP	-15.0	-38.3	-34.7	-37.3	-45.9	-39.6	-400BP	8.0	4.2	5.5	6.0	5.5	7.8

Capital Focus

Support

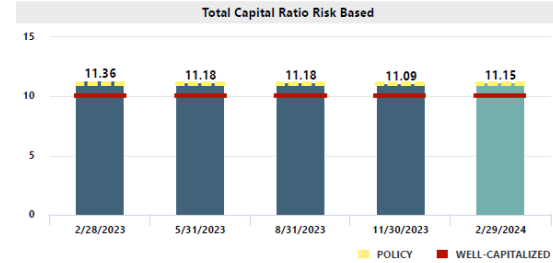
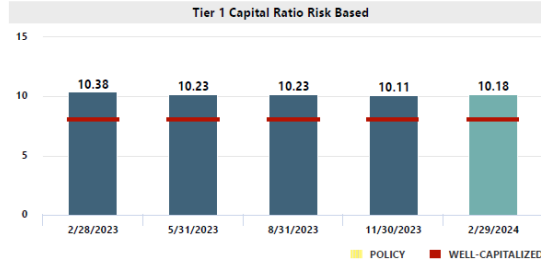
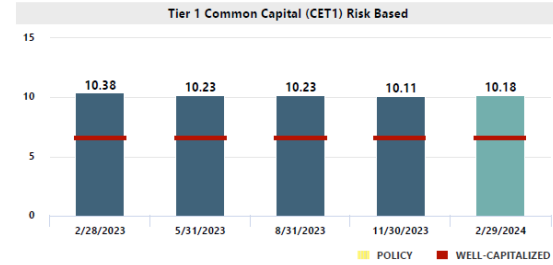
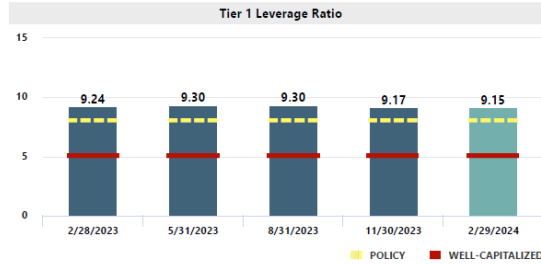
- Operating plan and growth targets
- Dividends/dividend policy
- Cushion needed for unanticipated loss

Provide

- Confidence in depositors/shareholders
- Potential M&A opportunities
- Strategies for pre-emptive actions (should conditions warrant)

... increase capital ratios to address regulatory concerns / orders

The ALCO Forum – Discussing Capital



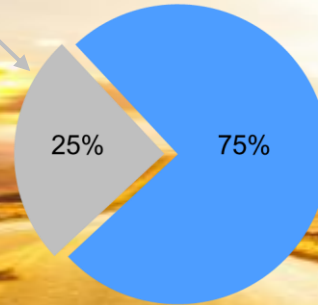
2/29/2024 Capital Summary

	RATIO	AMOUNT	POLICY LIMITS	CUSHION		WELL CAPITALIZED LIMITS	CUSHION	
				CAPITAL	ASSETS		CAPITAL	ASSETS
TIER 1 LEVERAGE	9.15%	270.7	8.00%	-34.1	+425.9	5.00%	-122.8	+2,456.1
TOTAL ASSETS FOR LEVERAGE RATIO		2,957.8						
COMMON EQUITY TIER 1	10.18%	270.7				6.50%	-97.9	+1,506
TIER 1 CAPITAL	10.18%	270.7				8.00%	-58	+725.1
TOTAL CAPITAL	11.15%	296.4	11.00%	-4	+35.9	10.00%	-30.5	+305.4
TOTAL RISK WEIGHTED ASSETS		2,658.5						

All dollar amounts are shown in millions
 *Risk Based asset cushion assumes 100% risk weighting

A More Strategically-Focused ALCO Meeting

Position Update

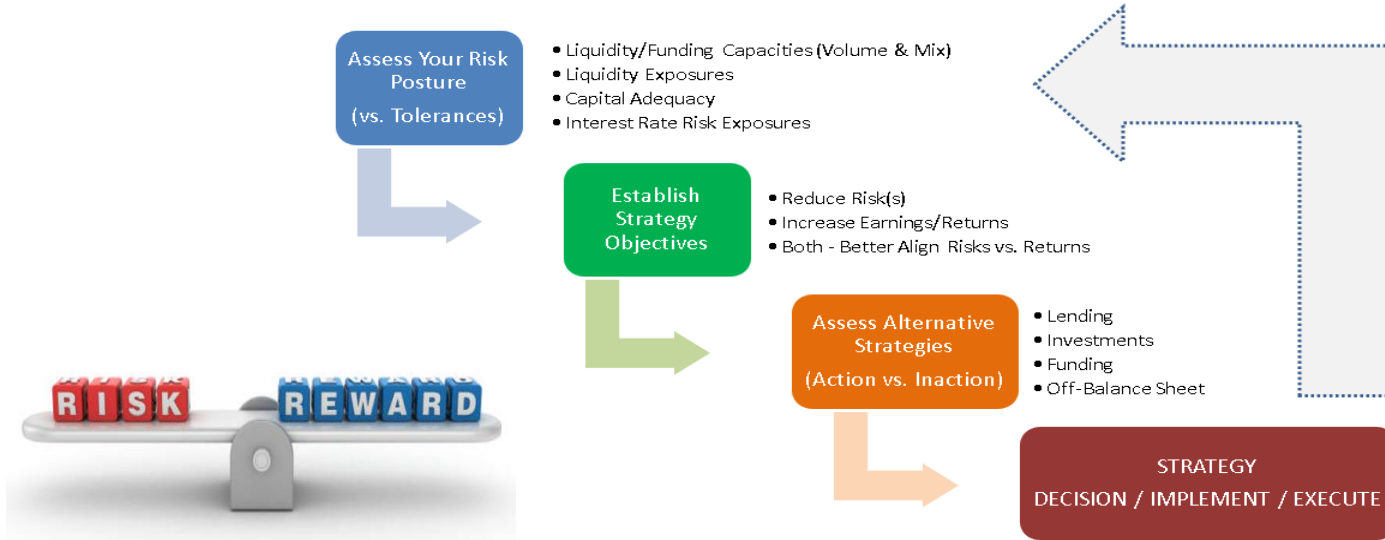


Strategy

- Interest Rate Risk
- Liquidity
- Capital
- Regulatory

Strategy Development

Interest Rate Risk Gets Most of the Attention, but Remember...It's Only One Part of the Risk Assessment



Kimberly Jones, Chief Risk Officer



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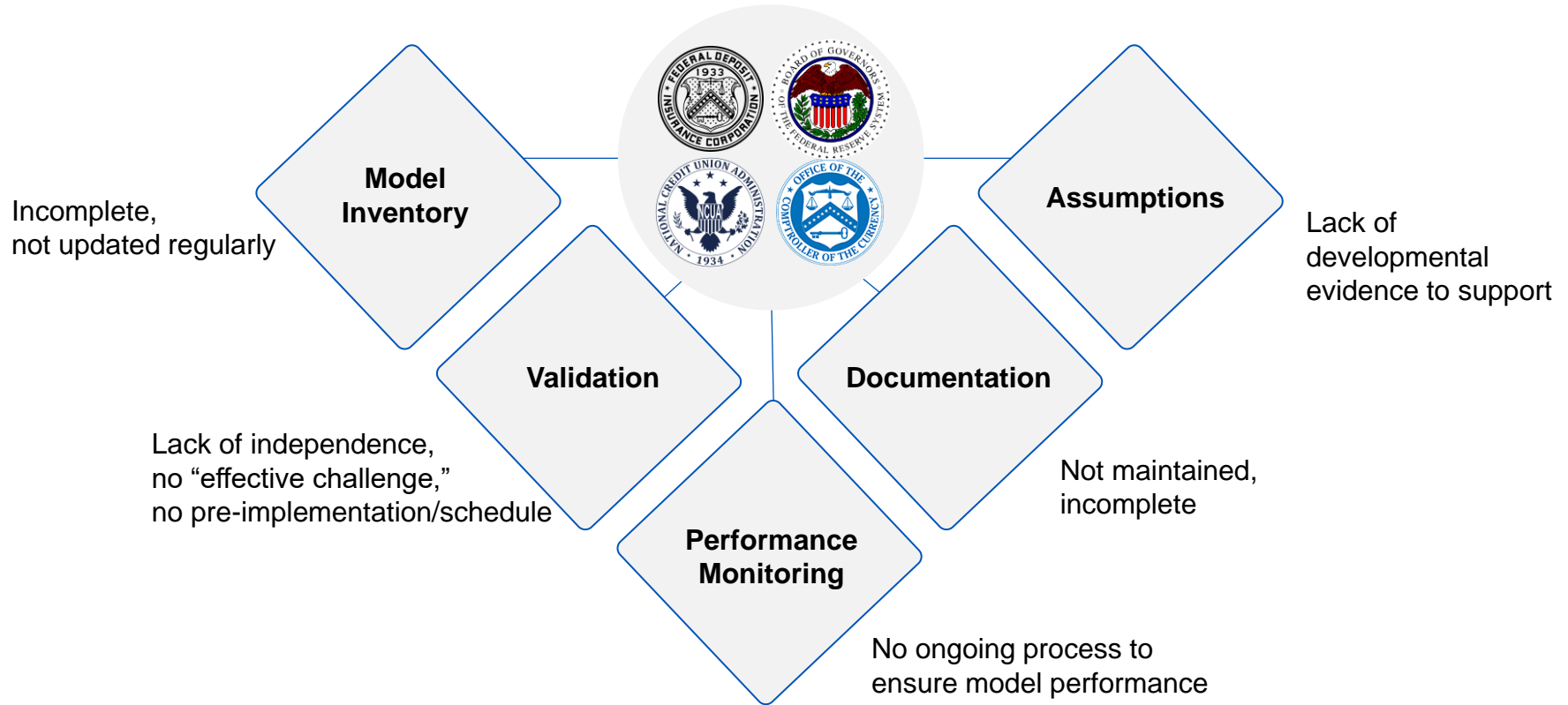
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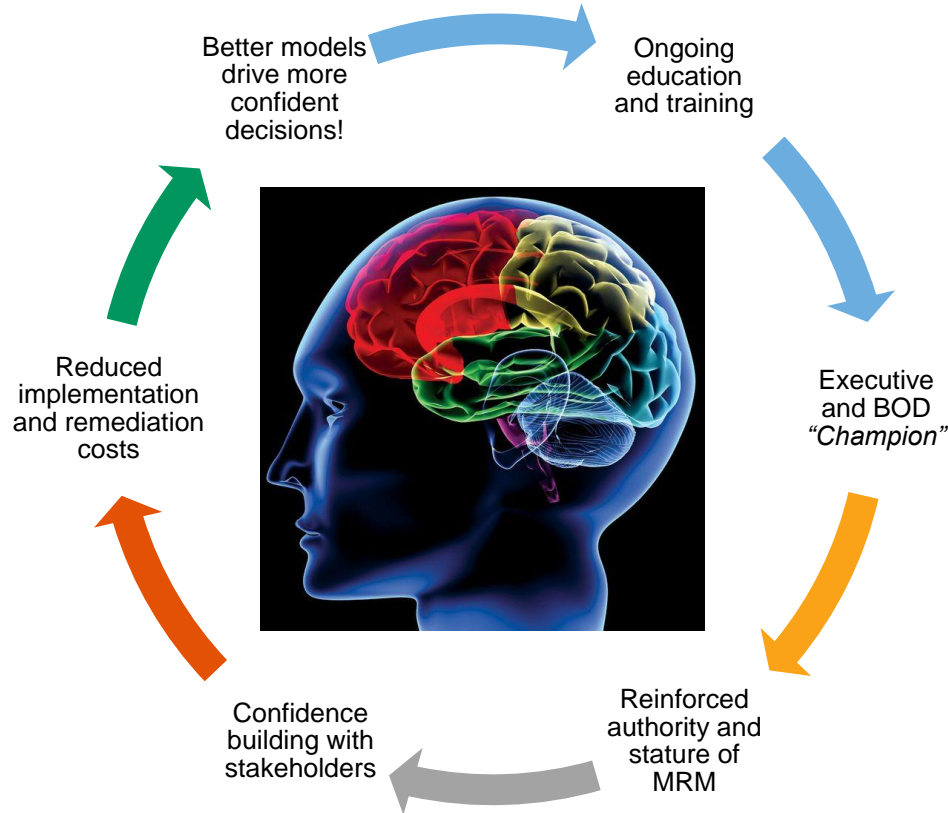
Change happens slowly. . .how do I transform ALCO into a "profit center"?

How Can Model Risk Management help make this process part of our culture?

Regulatory Feedback on Model Risk Management



Changing the Cultural Mindset



Kimberly Jones, Chief Risk Officer



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D·C·G
DARLING CONSULTING GROUP




Questions & Answers

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With nearly 30 years of experience in balance sheet and model risk management, and hands-on experience in audit and leading the operations of DCG's Financial Analytics Department, Mark has unique expertise for optimizing and "right-sizing" risk management in the community, mid-size, and large banking space.

In his current role, Mark facilitates educational programs and collaborative workshops and is a trusted resource for financial institutions, industry, and state trade associations, as well as regulatory agencies on a variety of balance sheet and model risk management/validation topics, including IRR, Liquidity, CECL, BSA/AML, MRM/ERM and ALCO.

Mark is a frequent author and top-rated speaker on a vast array of risk management topics and is Vice Chairman of the Financial Managers Society's Board of Directors and member of California Bankers Association's Enterprise Risk Management Committee. The son of an educator and member of the faculty of Pacific Coast Banking School, Mark's passion for teaching drives his desire to work with bankers to strive for excellence within their organizations.

Mark lives on the North Shore of Boston with his wife, two children, and two dogs. He is a graduate of St. Michael's College in Vermont with a degree in accounting.