

# Improving Risk Control Processes

By Robert (Trey) Rudder, VP of Interest Rate Risk Assessment



As credit unions grow and develop, their Asset Liability Management (ALM) solution must keep up with the demands of the balance sheet. Our current economic cycle has severely tested our balance sheets. As we look to improve our risk control processes, all risk measurement systems are drawing interest. ALM is going to be a point of interest for examiners as we go forward.

ALM systems come in all shapes and sizes but they must be appropriate for your institution. In today's world, the model must be capable of modeling the optionality that is inherent in today's balance sheets. One doesn't need Collateralized Mortgage Obligations (CMOs) or Mortgage-Backed Securities (MBSs) to have a great deal of optionality, you simply need to make mortgage loans and hold them on your books.

Southeast Corporate FCU uses Bancware's ALM4 software as its ALM solution and now member credit unions can also. Our new service, ALM+, is designed to address the ALM needs of larger, more complex credit unions that are ready for a higher level of modeling. Coupled with our current offerings of corpAnalytics and ALMonitor, Southeast Corporate now offers solutions to solve almost any credit union's ALM need.

Bancware is one of the industry leaders in risk management systems. BancWare ALM4 allows modeling of customer behavior, economic valuation, interest rate scenarios and a wide range of other variables.

## Features

- Provides scenario-dependent evolution of various results, including interest income/expense, balances, market values, net interest income and net economic value sensitivity, cash-flows and gap profiles
- Allows quantification of the market value changes of assets, liabilities, and economic value of capital resulting from interest rate movements
- Allows flexible definitions of business assumptions

## Benefits

- Understand the impact of market changes on the balance sheet more clearly to make more informed business decisions
- Fully quantify potential impacts of interest rate fluctuations on future earnings and cash flow streams
- Measure interest rate risk inherent in the balance sheet from the economic value perspective

The ALM+ solution is a cost effective way to access upper tier ALM modeling as well as high caliber expertise. By utilizing ALM+ and its Bancware platform, members with more complex balance sheets can benefit from Southeast Corporate's expertise, experience and a high powered, industry leading ALM model. ALM+ also allows members the option of receiving fully customizable model assumptions and ALM reports without the headache of in-house setup and continuous model management.

Through Bancware, ALM+ uses a stochastic modeling process with a trinomial lattice for market value modeling which adds a tremendous amount of accuracy over a static model. In a static term structure model, rates are flat through the planning horizon. A trinomial lattice allows rates to change in one of three directions at each point in time. In other words, at each point in time rates can go up, down, or stay the same. For balance sheets with path dependent options such as mortgages, stochastic modeling is a much better process as each point or "node" on the lattice will dictate a different behavior. This type of modeling is a much more real world evaluation technique.

If your credit union has an investment portfolio that includes MBS or CMO fixed income products, stochastic modeling could greatly benefit your institution. Bancware includes an option adjusted spread calculation in the market valuation process of fixed income investments. The option adjusted spread (OAS) is basically a discount rate that takes optionality into consideration. The result is a more realistic pricing structure determined by both rates and imbedded options.

Most interest rate risk reports will display plenty of information. However, does the data give you actionable intelligent information? Our goal is not to give you an overwhelming amount of data to sift through but rather to give you applicable information in order to make better decisions about balance sheet management. Our staff will work with you so that you clearly understand the data and know how to apply it to your situation and decision making process. Members will also be able to customize the reporting parameters to address the uniqueness of their institution. Bancware uses Excel as the report writer so all model output is Excel based and can be used just like any other Excel spreadsheet.

ALM+ is designed to leverage existing systems to benefit our members. If a complete interest rate risk service is not what you are looking for, members can use ALM+ to create a customized product. Through this new customized channel, Southeast Corporate can help members with mortgage servicing rights, portfolio valuation, and ALM validations. To learn more contact your Member Relationship Manager.

