


Asset/Liability Management – The Importance of Managing Risk




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FEDERAL RESERVE BANK OF KANSAS CITY
SUPERVISION AND RISK MANAGEMENT 


Agenda

- Market risk factors
 - Yield curve
 - Rates, Volumes, Mix
 - Margins
- Liquidity topics
 - Asset growth
 - Noncore funding trends
 - Supervisory initiatives

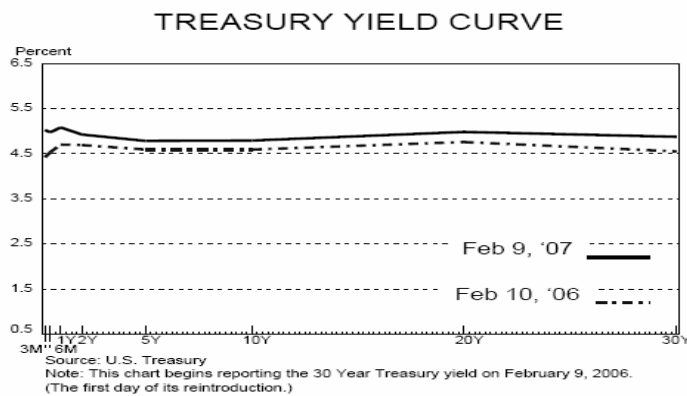
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Macro Conditions and Banking

- 2001–2003
 - Low interest rates, steep yield curve
 - Strong funds volume, weaker loan demand
 - Margin challenges
- 2004–2007
 - Return to growth and higher short term rates
 - Commercial lending
 - Flat yield curve, good margin performance for community banks
 - Liquidity changes

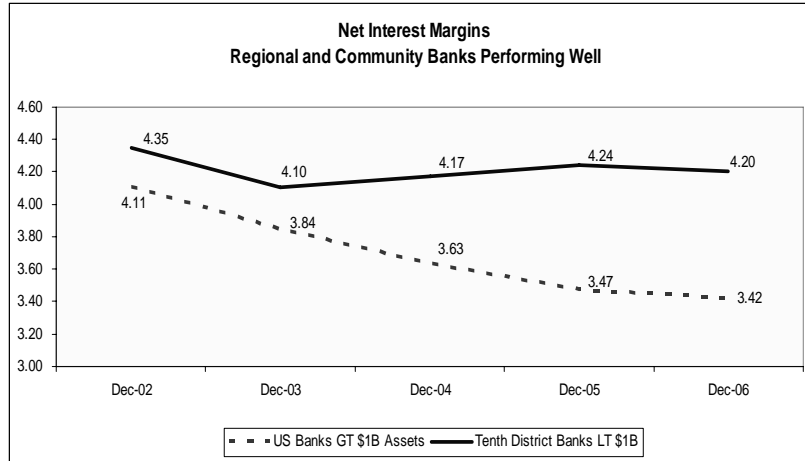
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Continued Flattening



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Net Interest Margins

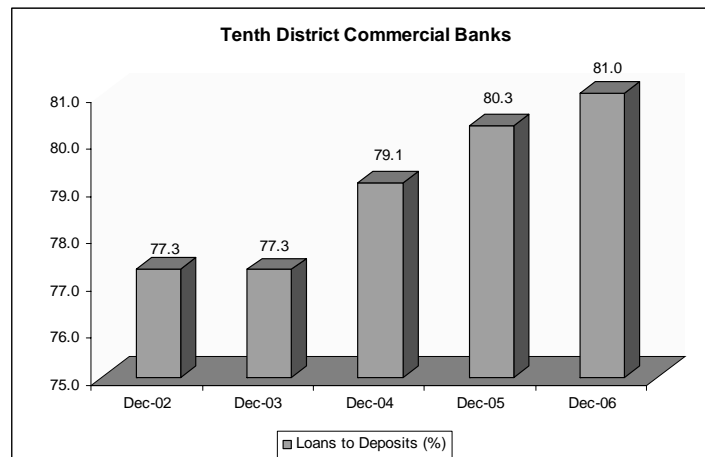


Industry-Wide Margins Continue to Decline

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Changing Asset Mix

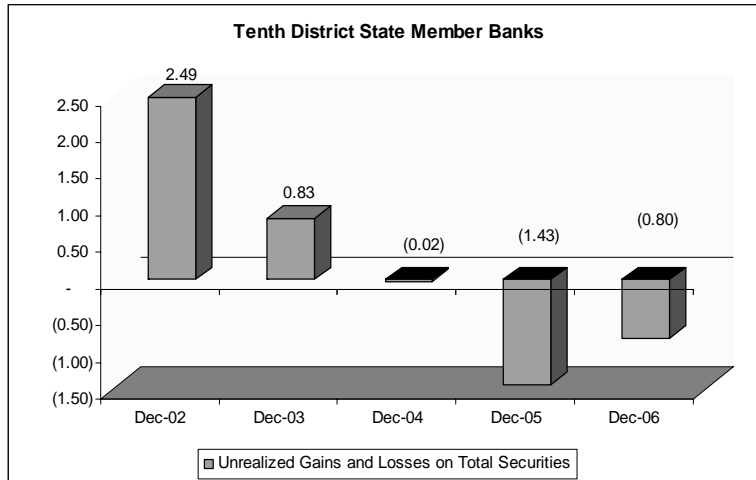


Impact on Earnings? Risk Profile?

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Moderate Depreciation



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Market Risk Summary

- Most banks anticipated rising interest rates
 - Interest rate risk outliers at low level
 - Net margin improvement
 - Flat yield curve hasn't hurt – yet
- Concerns
 - Continued flat curve
 - Banks reliant on wholesale funding/higher securities investments
 - Steepening – increases in long term rates

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Liquidity Issues

Changing fundamentals

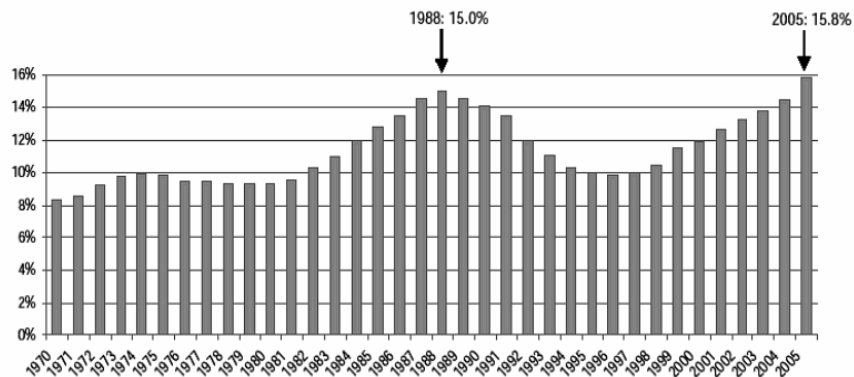
- Loan growth and leverage strategies
- Increased use of noncore funding
- More mismatch risk
- Liquidity on asset side of balance sheet

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Commercial Real Estate Loans

Commercial Mortgages Outstanding as a Percent of GDP



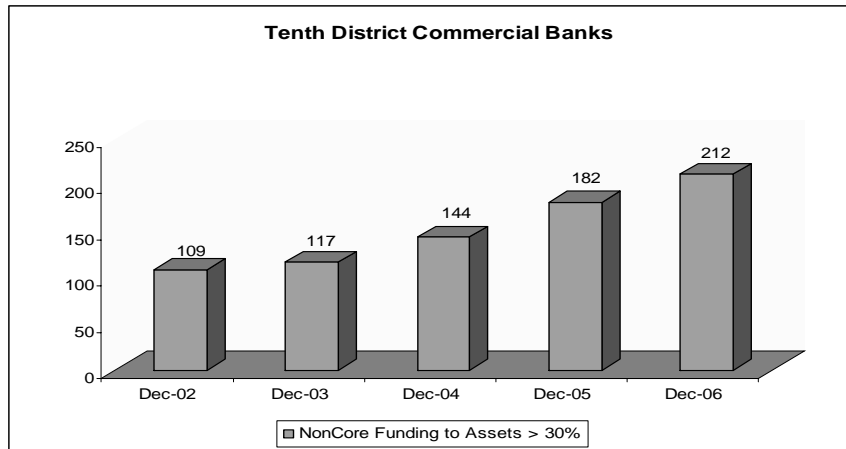
Source: Federal Reserve Flow of Funds


Chart: Moody's Investors Service

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Number of Banks Actively Using Noncore Funding is Increasing



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Liability Liquidity

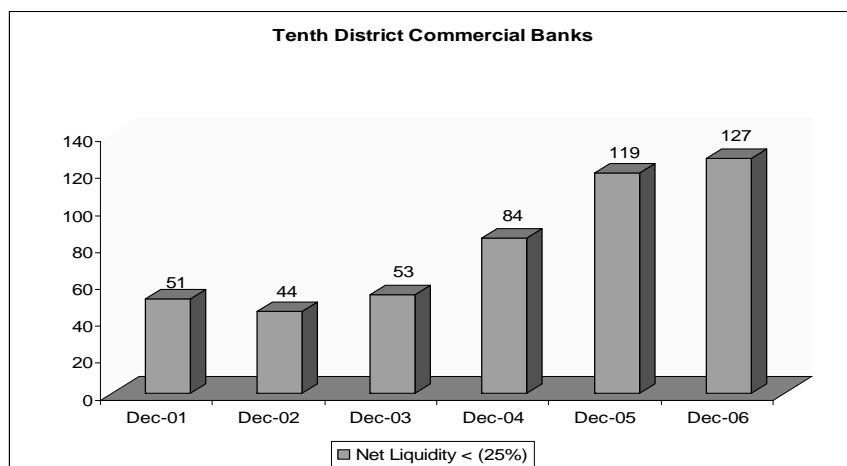
- Brokered deposits
- Internet CDs
- Federal Home Loan Bank Advances
- Certificate of Deposit Account Registry Service (CDARS)
- Discount window
- Other

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Mismatch Risk


- Net liquidity
 - *Indicator* of mismatch risk
 - Liquid assets less noncore funds to total assets
 - Banks with negative net liquidity – noncore funds are greater than liquid assets

Liquidity Mismatch Risk




**Liquidity Indicators – Tenth District Commercial Banks
Median Bank vs. Median Liquidity Outlier
December 31, 2006 Data**

	All Banks	Outliers
Annual Loan Growth Less Core Deposit Growth	2.7%	9.2%
Loans/Deposits	77.1%	94.5%
Noncore Funding/Assets	18.9%	35.3%
Net Liquidity	(4.2%)	(32.6%)

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Contingency Funding Risk/Funding Erosion

- Planning for risk outside normal course of business
- Low probability event
 - “Unwinding”
 - How much
 - How fast
- Amount and timing of runoff
 - Uninsured, Unsecured
 - Term
 - Confidence sensitivity

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Examiner Assessments

- Policy limits, Guidelines
- Monitoring, Reporting
- Cash flow tools to cover
 - Ongoing funding
 - Funding erosion risks
 - Contingency funding sources
 - Timing

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Conclusion

- More liquidity options available
 - More use of sensitive/collateral based funding
 - Securitization, Loan sale options
- Liquidity management not “well standardized”
- Assessment more subjective than other areas
- Examiner guidance

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Questions?