



Assessing Your ALCO Process

*Questions to consider when seeing
how your institution measures up.*

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It is still surprising to see the range of perspectives among bankers as to what they expect from their asset/liability management process (ALCO). For many banks, ALCO is strictly a financial reporting process focused on regulatory appeasement. At the other end of the spectrum, are those banks that view ALCO as a holistic, integrated risk management process focused on managing all the risk/return aspects of the balance sheet.

See Page 2 for complete article

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Where does your bank fall on this continuum and how does your ALCO stack up? Outlined below are a series of questions that might be considered an ALCO Self-Assessment. Consider the questions and see how your institution measures up.

1. Is your ALCO viewed as a profit center focused upon strategy development and implementation or is it more focused on financial and regulatory reporting?
2. Is the majority of your ALCO meeting spent on the formulation of balance sheet strategies and decision making? Is accountability inherent in your process and are actions assigned and implemented?
3. Do the strategies developed at your ALCO move beyond interest rate risk management and avoid being driven by rate outlooks? Do these strategies include liquidity and capital management?
4. Do you measure and manage liquidity and funding based upon outdated call report type ratios (e.g. loan/deposit, volatile liability dependence, non-core funding dependency, etc.) or do you use measurements more reflective of the current world in which you operate?
5. Does your ALCO have difficulty generating cost-effective funding strategies that actually succeed?
6. Do all ALCO attendees look forward to the meetings? Do board members want to attend and/or participate?
7. Are all the key functional departments of your institution represented at your ALCO meetings? Are all department goals consistent with your institution's goals, issues, risks and opportunities?

8. Are your bank's (ALCO's) investment and/or capital market decisions based upon input or recommendations from a third party that benefits from the transactions they put forward?
9. Is your ALCO package produced by seasoned professionals in asset/liability management utilizing the latest tools and techniques? Do these people continually challenge underlying assumptions (e.g. deposit pricing, customer behavior, prepayment speeds, etc.) that drive your ALCO model and dictate results?
10. Does your ALCO reporting package clearly document the current risk/reward profile of your balance sheet and the risk/reward trade-offs of potential strategies for action? Do ALCO attendees understand and relate to the contents of these reports?

Characteristics of Top Performing ALCO

With the answers to the ten questions above fresh in your mind, it might be of interest as to what we have found to be the key characteristics of top performing ALCO's.

Top performing ALCO's are very focused on managing future net interest income and making decisions that will impact interest rate risk, capital and liquidity on a go-forward basis. For most top performing ALCO's:

- ALCO meetings are considered important to all attendees;
- All key areas of the institution are represented;
- The agenda is focused with clear objectives with emphasis on the future, not the past;
- Decisions are made that influence strategies for: investments; loan products and pricing; deposit products and pricing; wholesale funding; hedging; and, capital management;
- Decisions are made at meetings and responsibilities are assigned;
- The ALCO package is clear and concise, filled with information and not just data;
- Committee members understand and have confidence in the accuracy of the reports; and,
- Policies are designed and documented around business perspectives and not primarily for regulatory appeasement.

In summary, a top performing ALCO process is focused on improving the risk/reward profile of a financial institution through effective decision making and superior strategy development and implementation; it is not focused on regulatory appeasement.

A successful ALCO process will allow decisions to be made by a committee that fully understands the current risk/return profile of the institution and has a complete appreciation for the risk/reward of each potential strategy discussed versus the default risk of “doing nothing.”

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