

The background of the entire page is a nighttime photograph of a city skyline, likely Dubai, with numerous skyscrapers illuminated. In the foreground, there is a body of water, possibly a canal or marina, with many boats docked. Long-exposure light trails from cars and boats create vibrant streaks of yellow, red, and blue across the water and sky.

ALM TODAY GROWTH TOMORROW

Proactive risk management
in uncertain times for credit unions

THE RECENT RISE OF RISK

From bank runs to unrealized losses, financial institutions in 2023 are facing growing risks to their deposit books and investment portfolios. And at the root of their problems are rising interest rates, driven by central banks' efforts to curb inflation.

Over the past year alone, the U.S. Federal Reserve has raised its funds rate by 500 basis points and counting. Many think that interest rates are nearing their peak. But a year ago, many thought inflation was transitory.

With higher rates looking like they're here to stay, credit unions must now reeducate themselves on how to manage their exposure to interest rate risk. But we live in unpredictable times – and the more uncertainties you face, the more certainty you need from risk management.

When anything can happen, it's critical to know how every possible scenario could affect the balance sheet in the future – and that your firm could take the hit. So, in the wake of recent financial institutions closures and takeovers, new approaches to both managing current risks and testing the effects of further stresses will be key to the survival and growth of credit unions.

We are reluctant to declare 'all clear' on recent regional banking stress.¹

Candace Browning, Head of Global Research, Bank of America

ALM matters more than ever

Asset-liability management (ALM) plays a key role in reducing the impact of interest rate, liquidity, market and other risks on the balance sheet.

As part of a compliance framework, effective ALM also helps credit unions meet their regulatory obligations for maintaining adequate levels of liquidity and capital.

But ALM has another essential function: it allows risk managers to be proactive and plan for change, evaluate options and really understand the balance sheet.

So, there's no better time than now to redefine your organization's approach to ALM, backed by the balance sheet management tools you need to build strategies for growth.

The more uncertainties you face, the more certainty you need from risk management.



A new age of proactive ALM

Even in the grip of ever-tightening liquidity and capital regulations, ALM for credit unions has always been about more than check-box compliance. But in today's precarious financial environment, it's even more vital for risk managers to look beyond the rules and consider every possibility the future of banking could hold.

By being proactive about ALM in this way, credit unions can continually assess where problems can surface before they actually become real or take effect on the balance sheet.

Unlimited possibilities

Whether your problems are affecting your deposit books, bond portfolios or commercial real estate, it pays to know your potential exposure under different scenarios – whatever happens in the future. And because the future's looking so uncertain, you'll need to use your imagination to cover all conceivable bases.

In early 2022, very few risk managers were testing the impact of a 500-point rate rise on their balance sheet; now, nothing can be taken for granted. Inflation likely won't get worse from here, but we certainly can't rule out the possibility.

So, for optimal ALM, it makes sense to keep analyzing the effects of both hikes and falls in interest rates, along with a wide range of other potential stresses.

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How to proactively manage today's balance sheet risks

Whatever risks your balance sheet faces, you can get a handle on your exposure in seven pre-emptive steps:

1. KNOW YOUR MEMBERS

Deposit runs can shut down financial institutions, as recent events have shown. But beyond these headline-hitting closures is a less immediate problem that many firms currently face – the slow but steady leakage of deposits. And as interest rates rise, who can blame savers for chasing yield elsewhere?

To stop the leak, you first need a 360-degree view of your members and their deposits. Who do you need to keep most happy? Who is most likely to leave? Which accounts would you be comfortable losing? Only with this knowledge can you start building a deposit strategy that ensures a more stable source of funding.

2. ADD BRAND VALUE

To make sure your savers stick with you, you need to put your strengths as a brand to work. Traditional banking values still count for credit union members in the always-on age, giving you valuable opportunities to drive engagement and loyalty through closer relationships and meaningful support.

Communication is key, so make sure it's easy for members to find you, whether on social media or in a branch. In the present cost of living crisis, when people need to both save and spend more efficiently, you could be helping members on both sides of the balance sheet. But you can't if they don't know who or where you are.



3. RETHINK DEPOSIT STRATEGIES

Today's members want security, liquidity and yield from their deposits, in that order. So, as well as reinforcing their trust in your services, it's crucial to provide a mix of products that meets – and keeps on meeting – their individual needs, whether through sight, term or tiered deposits.

You don't have to chase huge deposits; a well-diversified, sticky base of small deposits in high volumes can be healthier in the long run. But with deposit betas still relatively low, you'll likely have to raise your rates. Above all, be innovative: offer teaser deals; link savings products with credit cards; box clever to shore up liquidity.

4. TEST YOUR LIMITS

Whatever strategies you devise, are you sure they'll survive a significant risk event? Carrying out a broad range of stress tests across multiple scenarios will show you what losses you could incur or whether you should redefine your risk appetite. Plus, with reverse stress tests, you can pinpoint vulnerabilities in your business models.

By digitally processing and analyzing all your risk data, a liquidity dashboard will help you quickly understand your liquidity profile and survival horizon at portfolio and enterprise level – in normal times and in a crisis. At preset trigger points, you'll also see when contingent funding plans should kick in or your ALCO needs to rethink its strategies.

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5. ASSESS INTEREST RATE EXPOSURE

In increasing interest rate environments, it's more important than ever to measure exposure to unrealized losses. Like many financial institutions, you may be aiming to improve your yield and offset liquidity premiums by investing in agency mortgage-backed securities. If so, you face a dangerous combination of duration and extension risks.

Whether rates go up or down, regulators and auditors alike are bound to start asking more questions about your exposure. Be ready to meet their demands with more disclosures, especially on held-to-market securities, which look set to attract new regulatory attention.

6. EXPAND YOUR HORIZONS

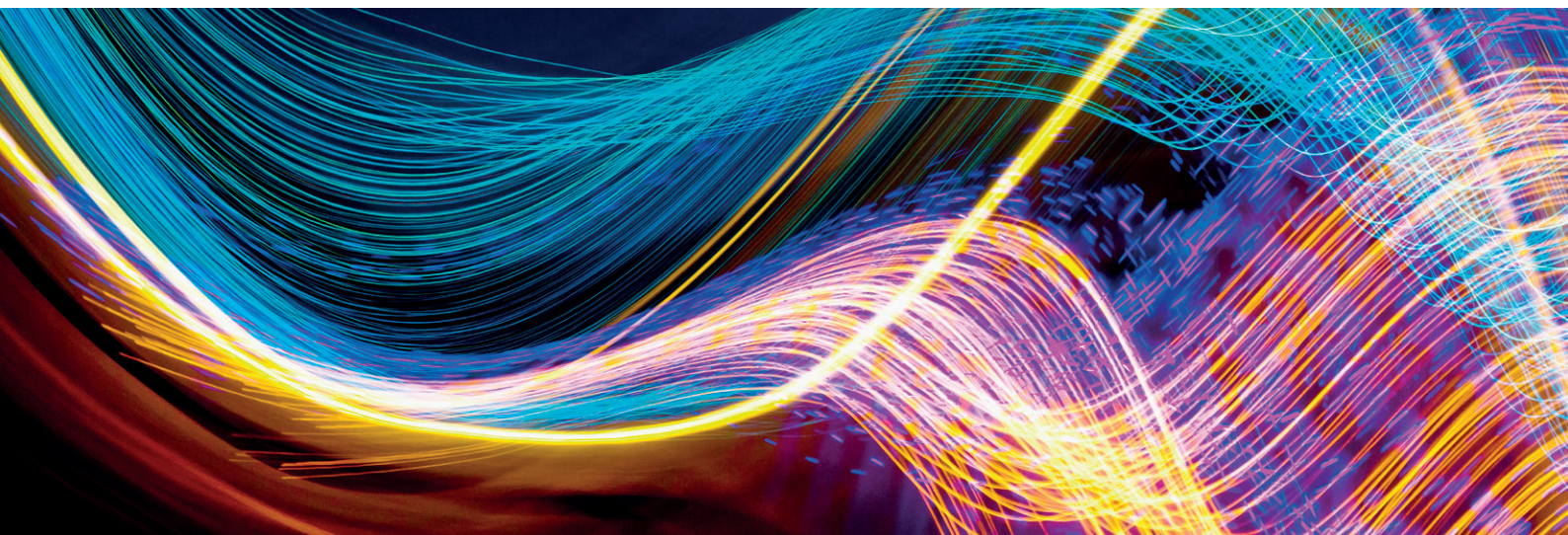
Interest income measures may traditionally be the main focus of your executives and ALCO, but the time has come to start analyzing and valuing the balance sheet as a whole. Measuring your credit union's market present value or direction of equity can give you early warning of risks that lurk beyond the net interest income horizon.

These kinds of analytics will surface any problems with slow-moving earnings caused by mortgage extensions, prepayments and the like. By using your imagination and forecasting the impact of rate changes or other shocks on the entire balance sheet, you can clarify which of your products are the most sensitive and why.

7. ANALYZE MORE OFTEN

ALCO analysis usually takes place monthly or even quarterly, but in a crisis, it makes sense to step up the monitoring cycle. Running daily or weekly ad hoc stress tests on liquidity and contingency funding plans keeps you on top of not only downside but also upside risks to your business, such as from buying mortgage or loan books.

The latest, most state-of-the-art balance sheet management systems give you a single place to gather data, analyze your risks and drive all sorts of insights beyond ALM. With highly automated workflow and powerful analytics, you can spend less time crunching the numbers and more time on what they mean for your business.



What about third-party technology risks?

Since the collapse of Silicon Valley Bank (SVB), which lent primarily to small technology companies, there's been growing anxiety about the stability and reliability of fintech providers.

That makes it all the more important to invest in risk management technology from larger, more established firms with years of industry experience and partnerships behind them and a wide range of complementary, easily scalable financial systems and services.

The time has come to start analyzing and valuing the balance sheet as a whole. Measuring your credit union's direction of equity can give you early warning of risks beyond the net interest income horizon.

“While the failure of Silicon Valley Bank has raised concerns over banking industry health and the impact on technology investments and growth in the IT sector, IDC believes that spending on technology will not be impacted overall. Rather, banks will shift their investment priorities to defend/grow revenues in traditional products and services, and possibly shift away from smaller fintechs to larger incumbent partners.”²

Drive growth in the face of uncertainty with FIS

If you're concerned about risks to your balance sheet, we've got you covered. Get in touch to find out more about our advanced ALM and other risk management solutions for credit unions.

²Source: IDC, IDC Blink: Tech Supplier Fallout from the Silicon Valley Bank Failure Could Be Good News for Larger Incumbent Vendors, March 28, 2023

TO LEARN HOW FIS CAN HELP CONSULT YOUR ACCOUNT MANAGER OR CLICK HERE.



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 www.fisglobal.com

 getinfo@fisglobal.com

 twitter.com/fisglobal

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