

BANKING INDUSTRY INSIGHTS

Reprioritizing the Margin in 2024:

How to Reinvent the ALCO Meeting to Improve Your Profits



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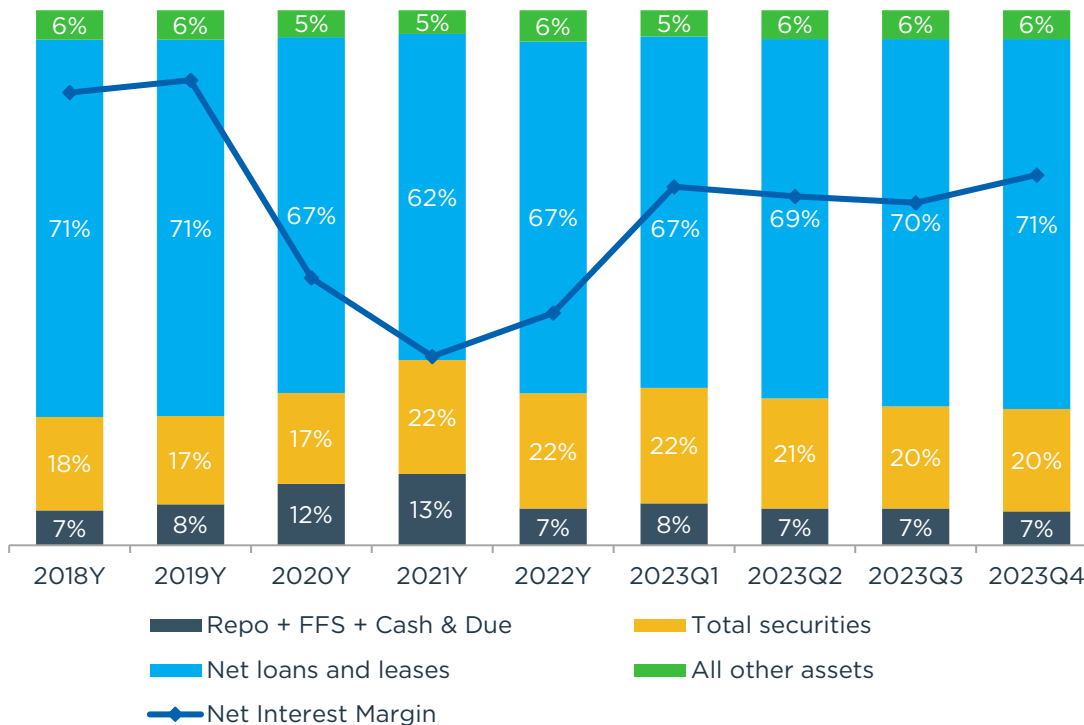
Uncertain interest rates, shifting monetary policies and a volatile global economic environment have resulted in market uncertainty and profit instability. Learn how reprioritizing net interest margin and rethinking your ALCO approach — making it an asset for strategic risk and to assess opportunities — can help keep your institution in the black.

As the yield curve remains inverted and the Federal Reserve indicates potential monetary policy adjustments, financial institutions will face challenges throughout 2024.

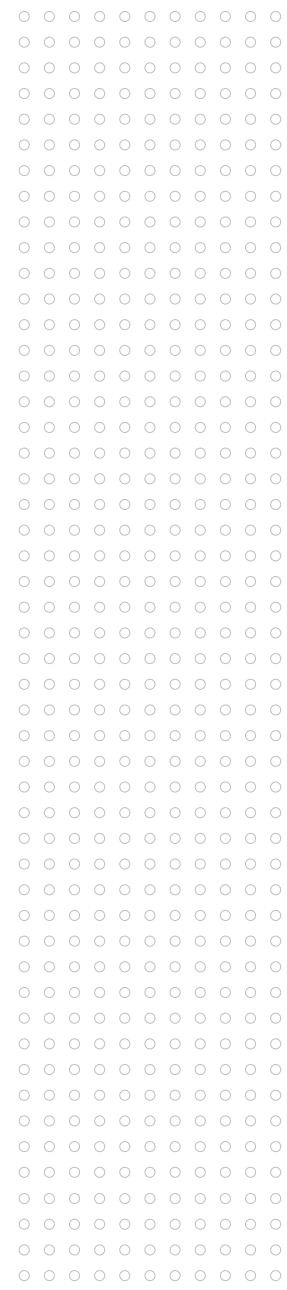
Net interest margin (NIM) has been highly volatile over the past five years, mainly due to a rapidly shifting interest rate environment (see chart). With rate cuts penciled in for 2024 and potential yield curve volatility, a fresh approach to asset-liability committee (ALCO) meetings can help stabilize NIM and profits.

Why reprioritize NIM?

Most institutions are heavily dependent on net interest income to drive profits. In fact, net interest income accounts for 88% of aggregate revenue at the median community bank. Since 2018, there has been significant NIM volatility related to asset-liability mix changes, interest rate cycles and the use of options. Institutions with the greatest dependency on net interest income have seen the greatest volatility in profitability.



Over the past five years, net interest margin for community banks with less than \$10B in assets has fluctuated as much as 50 basis points. Source: S&P Capital IQ.



Reimagining ALCO

The ALCO process has evolved as interest rate risk modeling has become more complex and regulatory expectations have increased. However, ALCO is often an exercise in regulatory appeasement, entailing report reviews, regurgitating ratios and checking regulatory boxes. ALCOs may overweigh certain areas, including the economy, loan and deposit pricing, interest rate risk reports and investments.

But what's often missed is the idea that ALCO meetings can improve profits. For instance, effective strategies could theoretically increase NIM 10 basis points. And for an institution with \$500 million in loans, that improvement can translate to \$500,000 in pre-tax income.

Net interest margin is the ultimate scorecard for ALCO meetings, and there are strong correlations between highly effective ALCO processes and higher, stable NIM over time. In fact, the ALCO meeting may be an expensive proposition — not just from the personnel expense, but also from the strategies that can make or lose money.

Balance sheet management and ALCO

Balance sheet management varies greatly from other approaches to ALCO. Interest rate risk management and asset liability management are often used interchangeably with balance sheet management, but these approaches produce far different outcomes. Balance sheet management is the most comprehensive and represents *the nexus of position assessment and strategy execution*. Assessing risks and opportunities through the lens of the entire balance sheet helps to craft unique strategies to improve NIM.

For example, consider the following questions:

- Is the loan pricing strategy helping grow market share?
- Is there a loan strategy?
- How do loan structure and pricing decisions affect interest rate risk and liquidity?
- What effect do deposit pricing strategies have on the marginal cost of funds?
- How can you leverage the investment portfolio to manage liquidity, interest rate risk and expand income?
- How does robust capital stress testing affect contingency funding planning?

These topics are often ignored at ALCO meetings, but doing so can cost a financial institution basis points at a time when it desperately needs the income. Institutions with effective ALCO meetings are having these discussions and executing strategies that come from each session.

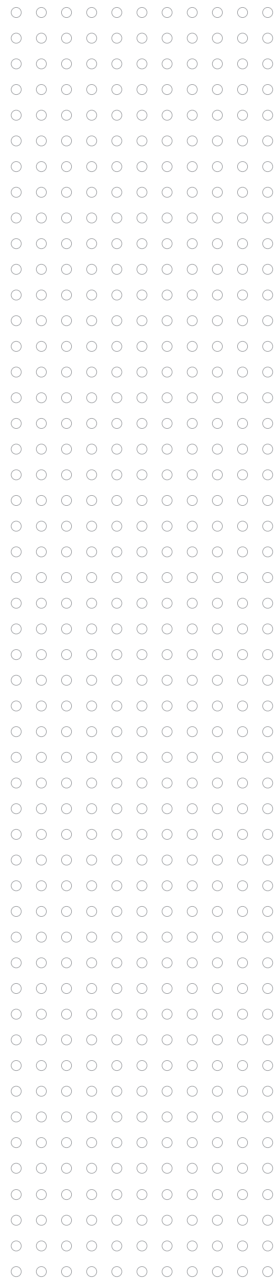
Peering into a volatile future

Interest rate volatility in 2024 will lead to greater NIM volatility. As such, the approach to and process for ALCO will be critical to ensure that budgets and stretch goals are met. Many institutions may have the talent internally to run reports and aggregate an ALCO packet; however, an independent facilitator can bring new perspectives, best practices and strategies to squeeze basis points out of the balance sheet.

The ALCO packet is not just a document that the Board of Directors approves, but rather a challenge deserving of custom crafted strategies for risk management and profitability to optimize the balance sheet.

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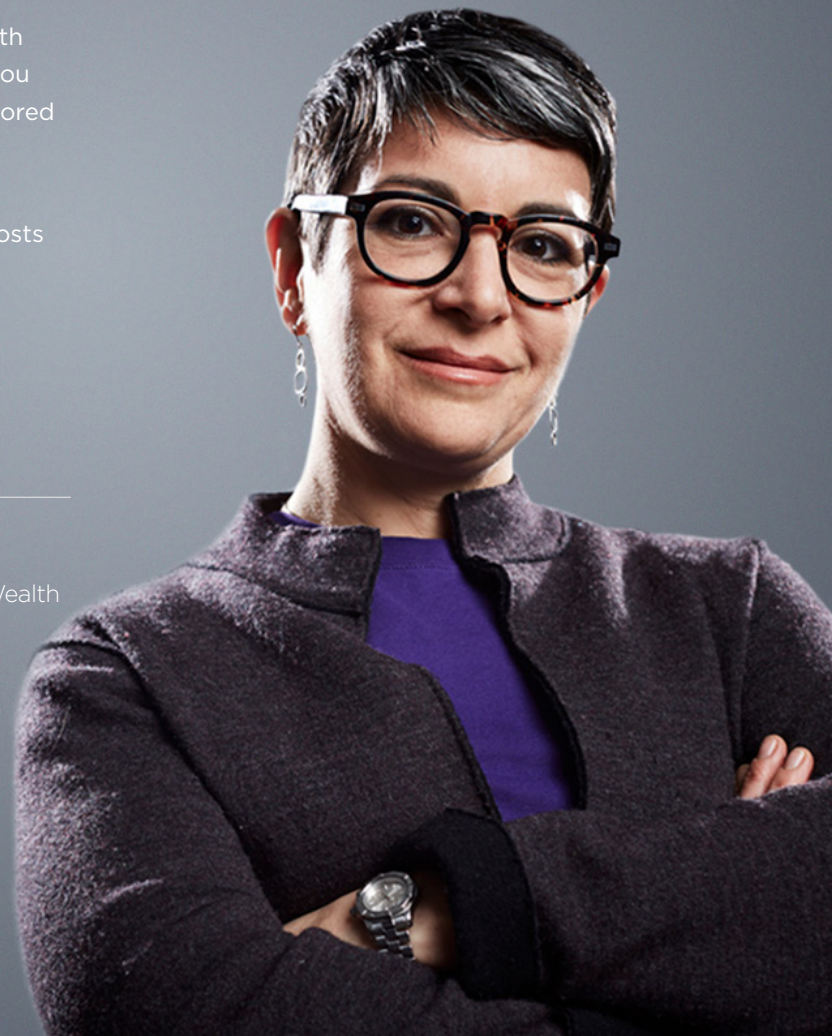
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