

Fundamentals of the ALM Audit

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Agenda

- Overview
- Regulatory Guidance
- Audit Scope
- Common Findings



Overview

- ALM
 - Asset Liability Management
 - ALM Committee (ALCO)
 - Interest Rate Risk (IRR)
 - Net Interest Income (NII)
 - Net Economic Value (NEV)
 - ALM Model



Overview

- Liquidity
 - Liquidity Risk Management
 - Contingency Funding Plan



Overview

- ALCO
 - How Board Handles ALM Oversight
 - Made up of Senior Mgmt & (sometimes) BOD



Overview

- Interest Rate Risk (IRR)
 - The exposure of CU's financial condition to adverse movements in interest rates
 - IRR results from differences in the maturity or timing of adjustments of assets, liabilities & off-balance sheet instruments
 - Changes in interest rates affect Net Interest Income & Economic Value

Overview

- Net Interest Income (NII)
 - The difference between revenue generated from CU's assets and the expenses associated with paying out liabilities
 - Used to quantify IRR
 - NII simulations:
 - Generate insight into the impact of changes in market rates on earnings and guide RM decisions
 - Provide a comprehensive way to stress plausible near-term earnings results.

Polling Question #1

- Audits of ALM include review of:
 - A. Liquidity
 - B. Currency Transaction Reports
 - C. Interest Rate Risk
 - D. Both A & C

Overview

- Net Economic Value (NEV)
 - The present value of assets - the present value of liabilities +/- the present value of expected CF's on off-balance sheet items
 - Quantifies the economic value of the entire balance sheet expressed as a single amount
 - Simulates impacts for different rate scenarios



Overview

- ALM Model
 - Used for ALM Assumptions
 - Model can include:
 - Projected B/S volumes
 - Prepayment rates for loans
 - Repricing sensitivity
 - Non-maturity deposit decay rates
 - Projected interest rates



Overview

- ALM Model Validation
 - Conceptual/Methodological Soundness
 - Ongoing Process Verification
 - Back-testing of Key Assumptions

Overview

- Liquidity Risk Management (LRM)
 - LRM should:
 - Be sufficient to meet CU's daily funding needs
 - Cover expected & unexpected deviations from the norm
 - Process should identify, measure, monitor and control liquidity risk

Overview

- Contingency Funding Plan (CFP)
 - Can be part of ALM Policy, or separate
 - Provides BOD-approved framework for managing liquidity
 - Lists liquidity sources for adverse circumstances



Regulatory Guidance

- 1996 Joint Statement on IRR
- 2010 Interagency Statement on Funding & LRM
- 2021 Interagency Advisory on IRR Management
- 2022 NCUA Supervisory Priorities
- NCUA Examiner's Guide "Interest Rate Risk"

Regulatory Guidance

- 1996 Joint Statement on IRR
 - Provides guidance on prudent IRR management principles
 - BOD & Mgmt Oversight Responsibilities
 - RM Process



Regulatory Guidance

- 2010 Interagency Statement on Funding & LRM
 - Provides guidance on sound practices for managing funding and liquidity risk



Regulatory Guidance

- 2021 Interagency Advisory on IRR Management
 - FAQs on 2010 Advisory



Regulatory Guidance

- 2022 NCUA Supervisory Priorities
 - Deals with CU high share growth past 2 years
 - Surplus funds invested in longer duration assets = increased IRR.
 - If kept short-term, current period earnings are impacted.

Regulatory Guidance

- NCUA Examiner's Guide
 - References many guidance docs
 - Also NCUA related LCUs
 - Exam procedures

Polling Question #2

- ALM Models typically include:
 - A. Safe deposit box listings
 - B. Projected interest rates
 - C. Potential suspicious transactions
 - D. New hire listings



Audit Scope

- ALM Policy Should Include:
 - Responsibilities
 - ALM Identification System
 - System for monitoring & reporting risk exposures
 - Risk Limitations in:
 - Up and Down Rate Scenarios
 - Minimum EVE/NVP ratio



Audit Scope

- ALCO Structure/Policy
 - Appropriate Personnel
 - IRR Measurement Techniques
 - Meeting Frequency
 - Assumptions

Audit Scope

- Input Validation
 - Agree key figures from model to G/L, etc
 - Appropriate sources?



Audit Scope

- Assumptions
 - Appropriate & Reasonable?
 - Properly Documented?
 - Periodically Updated as Needed?
 - Stress Tested?

Polling Question #3

- Audit Review of ALCO includes:
 - A. Review of ALCO meeting schedule
 - B. Review of Committee personnel
 - C. Snacks served at ALCO meetings
 - D. Both A & B



Audit Scope

- Model Validation
 - Obtain Independent Validation Certificate
 - Review Summary
 - Recent?

Audit Scope

- Model Reports
 - Review for Clarity & Adequacy
 - Provided to Sr. Mgmt/ALCO/BOD?
 - Determine Back-testing Adequacy
 - Model Estimates to Actual Results
 - Quarterly
 - 90 & 360 day lookbacks



Audit Scope

- Liquidity Policy
 - LRM Guidance
 - LRM Measures
 - Funding Concentrations
 - CFP
 - Liquidity Crisis
 - Early Warning Signs



Audit Scope

- Liquidity Reporting
 - Review of Measurement Monitoring
 - Liquidity Position Stress Test
 - Annual Testing/Usage of Contingency Lines

Polling Question #4

- Audit Review of Model Reports includes:
 - A. Ensuring proper distribution
 - B. Review of accuracy
 - C. Adequacy of back-testing
 - D. All of the above

Common Findings

- Policy lacking required elements
- Non-comprehensive CFP
- Limited Back-testing
- Back test results not reported
- Non-detailed minutes
- Lack of stress tests
- Assumptions not properly explained
- Unused finding sources not tested
- Inadequate Cash Flow analyses

Questions





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Thank You!

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