South Carolina Bankers School
Funding Alternatives

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South Carolina Bankers School – Funding Alternatives

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South Carolina Bankers School – Funding Alternatives

Course Objective and Takeaways

- Understand the importance of liquidity management
  - What is it and why is it **important**?
  - What are the **inherent risks** and how to mitigate them?
  - What impacts have **regulatory changes** had?
- Understand alternative funding sources
  - What are they and how are they **different**?
- Takeaway
  - Funding is a **necessary** part of strategic growth and should be **embedded** in overall risk management plans
  - Besides core deposits, know **other alternative sources** of funding

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South Carolina Bankers School – Funding Alternatives

Bank Funding Sources

Retail Funding
- Deposit accounts
- Transaction accounts
- Money market deposit accounts
- Savings accounts
- Small time-deposits

Wholesale Funding
- Federal funds purchased
- Repurchase agreements
- Federal Home Loan Bank advances
- Brokered CDs/Listing Rate CDs

Equity Funding
- Common stock
- Preferred stock
- Retained earnings

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Trends We Follow with Members and the Economy

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Trends We Follow

Current Banking Environment

- Dynamic interest rate movements
- Loan and deposit mixes
- Regulatory demands
- Merger and acquisition activities
- What **strategic challenges and opportunities** are your institutions facing?

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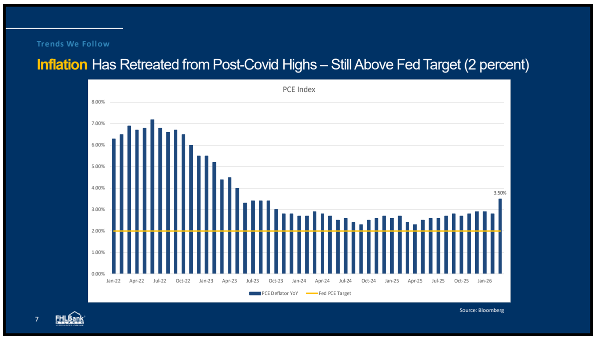
Trends We Follow
Inflation Has Retreated from Post-Covid Highs – Still Above Fed Target (2 percent)
PCE Index
3.50%
PCE Deflator YoY
Fed PCE Target
Source: Bloomberg
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Trends We Follow
Cumulative Inflation Weighing on the Consumer
PCE Cumulative vs. Year over Year
14.73%
12.84%
11.18%
9.07%
6.92%
4.05%
1.78%
PCE Index Cumulative
PCE Deflator YoY
Source: Bloomberg
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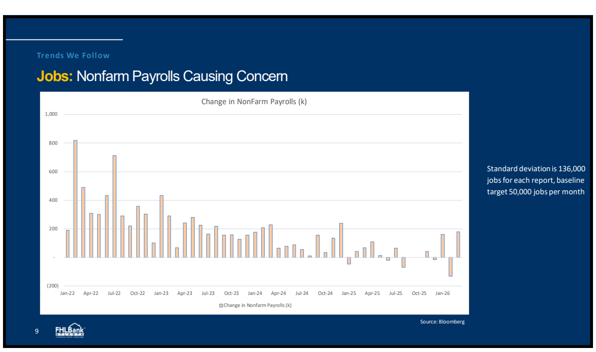
Trends We Follow
Jobs: Nonfarm Payrolls Causing Concern
Change in NonFarm Payrolls (k)
Change in NonFarm Payrolls (k)
Standard deviation is 136,000 jobs for each report, baseline target 50,000 jobs per month
Source: Bloomberg
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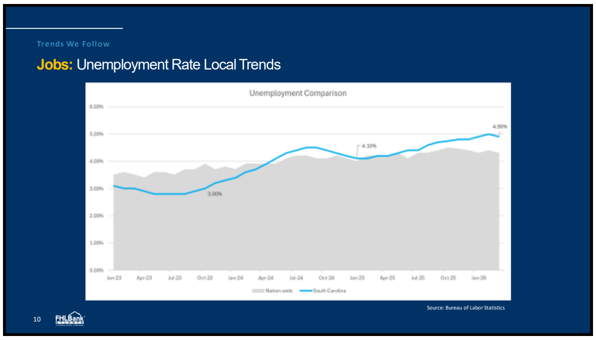
Trends We Follow
Jobs: Unemployment Rate Local Trends
Unemployment Comparison
4.90%
4.10%
3.00%
Nation-wide
South Carolina
Source: Bureau of Labor Statistics
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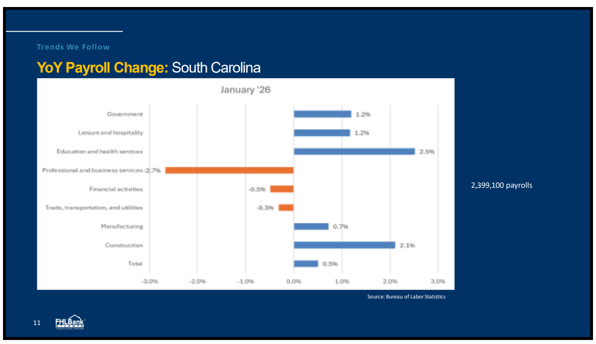
Trends We Follow
YoY Payroll Change: South Carolina
January '26
Government 1.2%
Leisure and hospitality 1.2%
Education and health services 2.5%
Professional and business services -2.7%
Financial activities -0.5%
Trade, transportation, and utilities -0.3%
Manufacturing 0.7%
Construction 2.1%
Total 0.5%
-3.0% -2.0% -1.0% 0.0% 1.0% 2.0% 3.0%
2,399,100 payrolls
Source: Bureau of Labor Statistics
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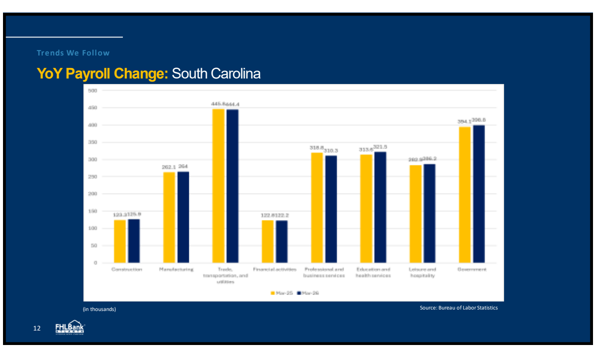
Trends We Follow
YoY Payroll Change: South Carolina
Construction
Manufacturing
Trade, transportation, and utilities
Financial activities
Professional and business services
Education and health services
Leisure and hospitality
Government
Mar-25
Mar-26
(in thousands)
Source: Bureau of Labor Statistics
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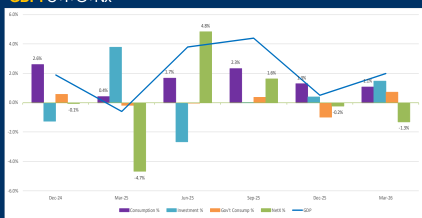
Trends We Follow

GDP: C+I+G+Nx



Consumption carries the heaviest weighting, though net exports have had more influence over the last year.

Source: Bloomberg

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Why is Alternative Funding Important?

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Why Is Alternative Funding Important?

Risks Associated with Funding

- Term vs. non-maturity deposits
- Interest rate risk
  - Originating 5-10 year, fixed-rate loans, versus ability to gather 5-10-year Time Deposits (TDs)
  - As rates move, cost of non-maturity deposits and short-term TDs will also move
  - Current environment – what has happened to cost of funds and net-interest margin (NIM) as short-term rates rose from historical lows?
  - Only interest rate "neutral" if 100 percent of loan portfolio is variable-rate
  - May need to look at alternative longer-term funding sources to mitigate risk
- Surge deposits from COVID-related stimulus
  - Repricing risk and deposit outflows as rates rise
  - Deposit betas

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Why Is Alternative Funding Important?

Liquidity Management

- Liquidity, by definition, means **a bank can meet payment obligations**, primarily from depositors, and has enough money to **originate loans**
- Liquidity management should:
  - Balance the bank's checkbook every day at the Federal Reserve
  - Forecast cash flows into the future to manage future liquidity needs
  - Maintain enough secondary sources available to cover funding gaps
  - Stress-test both sides of the balance sheet with "what-if" scenarios to ensure enough liquidity if deposits drop off at the same time as loan demand surges

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Why Is Alternative Funding Important?

Liquidity Risk

Liquidity Risk is the **risk of a bank not having enough cash** to carry out its day-to-day operations.

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Why Is Alternative Funding Important?

Liquidity Risk **Dynamics**

- Vary according to a bank's funding market, balance sheet, and inter-corporate structure
- Common signs of possible liquidity problems include:
  - Rising funding costs
  - Requests for collateral by correspondents
  - A credit rating downgrade
  - Decreases in correspondent credit lines, or
  - Reductions in the availability of long-term funding
- Regulators added statutory guidelines requiring more on-hand liquidity and more stress-test risk profile analysis
- Many regulatory Consent Orders issued during past banking crises included discussions of weak liquidity planning and low board interaction

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Why Is Alternative Funding Important?

Industry Perspective

- What are the **ongoing primary risks** a bank faces?
  - Credit risk
  - Interest-rate risk
  - Liquidity risk
  - Operational risk (inadequate controls, procedures, oversight)
- How do banks **mitigate these risks**?
  - Proper loan underwriting and loan portfolio management
  - Multiple sources for secondary liquidity, daily liquidity management, cash flow tests, liquidity stress testing
  - Adequate process controls (policies/procedures) and testing framework
  - Risk control self-assessment (verification of measuring and monitoring the risks)

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Why Is Alternative Funding Important?

Mitigating Liquidity Risk

Traditional funding sources are important, but **may not be enough**

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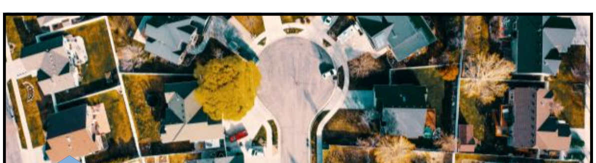

Alternative Funding Sources

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Why Is Alternative Funding Important?

Alternative Ways to Fund

- Federal Home Loan Bank advances
- Fed funds purchased
- Brokered deposits (wholesale CDs)
- IntraFi Network/CDARS/ICS (formerly Promontory Network)
- QwickRate (non-brokered CD marketplace)
- Federal Reserve advances – Discount Window
- Repurchase contracts
- Subordinated debt

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Why Is Alternative Funding Important?

FHLBanks: A Reliable Funding and Liquidity Source

- FHLBanks are self-capitalizing cooperatives created by Congress in 1932
  - Members required to purchase capital stock as a percentage of assets
  - Members required to purchase additional activity-based stock as a percentage of borrowings from FHLBanks
- **Self-capitalizing structure** is a key distinction between the FHLBanks and other providers of liquidity
- Eleven regional FHLBanks with ~$1 trillion in total assets
- Provide **wholesale funding** to members (financial institutions) to help manage asset-liability and liquidity initiatives
- The FHLBank System understands that their offerings **contributed to the survival of many financial institutions** during past crises while maintaining their regulatory capital positions

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Why Is Alternative Funding Important?

Why Use FHLBank Advances?

- Efficient process and **instant funding**
- **Flexible** terms and prepayment
- **Reliable** collateralized lending
- Dividend subsidizes **competitive rates**

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Why Is Alternative Funding Important?

Fed Funds Purchased (FFP)

Lines of credit established between banks or funds brokers for overnight or very short-term funding needs.

- Typically required to pay back daily, but sometimes may keep outstanding for up to two weeks with the rate updated daily
- May be secured with loans or securities through FHLBank and Federal Reserve, or unsecured via correspondent bank lenders
- Closely tied to the FOMC's Fed funds rate (Target Rate) – the rate for borrowing between banks set by the Federal Reserve
  - Rate is "traded" daily (the Effective Rate) and rarely matches the Fed's Target Rate on a daily basis due to open market supply and demand

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Why Is Alternative Funding Important?

Fed Funds Purchased (FFP)

Why Use FFP?

- Quick and **comparatively inexpensive** way to fund shortfalls in funding
- No long-term rate locks, thus only borrow funds on an **as-needed basis**
- Daily requirement to settle up account at the Federal Reserve
  - Late afternoon outgoing wires or loan fundings may cause Fed account to be overdrawn

When to use FFP

- Large deposit wires leaving the bank or funding large loan balances
- To **avoid being overdrawn on Fed account** at the end of the day
- When rates are falling quickly, it may be a cheaper way to fund growth as opposed to locking in long-term funding (time deposits, etc.)
- Test lines at least **twice a year** to make sure they are still viable

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Why Is Alternative Funding Important?

Brokered Deposits (Wholesale CDs)

- Used since the 1950's
- Classified as **more volatile** (less "sticky") than other deposits
- Numerous sources available
- Packaged in \$100k - \$500k pieces with a cumulative CUSIP number
- Rate paid and time required to fill orders based on an Institutional Deposits Corporation rating (regulates MMDA, Fed Funds, etc.)
- Riskier due to **inability to renew the funds** if rating drops too low
- Flexible terms from **two months up to 15 years**

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Why Is Alternative Funding Important?

IntraFi Network (formerly Promontory Network)

CDARS® One-Way Buy®	$1B+	1 - 60 MONTHS	FIXED-RATE	NETWORK MEMBERS with excess liquidity	no collateralization requirements apply
CDARS® Floating-Rate Funding℠	$5M - $1B+	1 - 7 YEARS*	FLOATING-RATE	NETWORK MEMBERS with excess liquidity	no collateralization requirements apply
ICS® One-Way Buy®	$1B+	3+ MONTHS	FLOATING-RATE	NETWORK MEMBERS with excess liquidity	no collateralization requirements apply
IND®	$25M - $1B+	1 - 5+ YEARS	FLOATING-RATE	CASH in millions of brokerage accounts	no collateralization requirements apply**
Yankee Sweep®	$1B+	1 - 5 YEARS	FLOATING-RATE	SOPHISTICATED INVESTORS placing funds via banks or broker-dealers	provides participating U.S. branches of non-U.S. banking organizations with access to funding

Source: www.intrafi.com

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Why Is Alternative Funding Important?

QwickRate

- QwickRate is an **online marketplace** (listing service) for non-brokered funds
- Connect buyers and sellers **quickly and efficiently** with direct, national access to a network of pre-screened institutions
- Provides banks access to a nationwide CD market
- QwickRate states that its offering complies with FDIC requirements as a non-brokered direct deposit CD listing service

QwickRate®

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Why Is Alternative Funding Important?

Federal Reserve Bank's Discount Window

- Established in 1913 with intent of serving as the principal instrument for the central bank to **lend reserve money when needed**
- Discount Window superseded years ago by open-market operations as the #1 monetary policy tool, yet it still plays a complementary role
- Functions as **safety-valve in relieving pressures** in reserve markets
- Extends credit to relieve liquidity strain for individual banks or in the banking system in general
- Helps **ensure the basic stability** of the payment system more generally by supplying liquidity during times of systemic stress
- For details about Discount Window policy/framework, view the Federal Reserve Act (as amended), or the FRB/FDIC websites

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Why Is Alternative Funding Important?

Federal Reserve Bank's Discount Window

Credit Facilities

- Overnight Borrowing: Requires collateral (loans and securities not currently pledged somewhere else, such as to FHLBanks)
  - Rate is **typically higher** than upstream banks or brokered Fed funds purchases
- Historically, borrowing from the Fed may have been seen as a last resort, but today the Fed has become a **reliable and important** source of short-term funding and liquidity
- Primary Credit: Secured loan up to 30 days
- Secondary Credit: Secured loan for banks that can't qualify for Primary Credit
  - Loans are on an overnight basis
- Seasonal Credit: Assist small banks with significant seasonal swings in loans and deposits

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Alternative Funding Strategies

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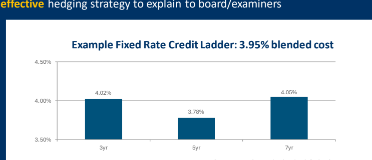
Alternative Funding Strategies

Ladder Funding

- Hedge long-term assets, manage interest-rate risk
- Flexibility: staggered maturities **allow discretion** to pay off versus rolling the funding based on balance sheet needs
- **Simple and effective** hedging strategy to explain to board/examiners



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Alternative Funding Strategies

Liquidity Stress Test Overview

- Important risk management tool
- Covers **"what if"** scenarios when uncommon circumstances occur
  - Natural disasters, a public security breach, sudden/sharp interest rate swings, decrease in credit ratings
  - Increased collateral requirements "haircuts"
- Required by regulators, depending on asset size
- Some of the stress-test scenarios came true in recent crises

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Alternative Funding Strategies

Stress Tests: Projected Cash Flow

- Stresses **both sides of the balance sheet** at the same time over the subsequent 30-60-90+ days
  - Customer draws on credit lines increase at the same time as deposits decrease or run off
- Fill in funding gaps with remaining available funds or correspondent bank credit lines
- If funding is scarce, may have to consider **selling loans** or not renewing balloon notes

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Alternative Funding Strategies

Contingency Funding Plan (**CFP**)

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Alternative Funding Strategies

Creating a Non-core Funding Strategy

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Alternative Funding Strategies

Assume that our FF sold and FF purchase with Upstream Correspondents were $0 over the last weekend and that we have $35mm in a MM Mutual Fund @ 0.35% (policy max is $45mm), $5mm in a Reverse Repo @ 0.50% and $3mm at the Fed @ 0.25%. A negative number below is a "drain" on cash and a positive number is a "faucet" for more cash.

Drains and Faucets	Monday	Tuesday	Wednesday	Thursday	Friday
Excess Funding at Start of the Day					
MM Mutual Fund	$35,000,000	$30,000,000	$0	$0	$28,000,000
Rev Repo	$5,000,000	$5,000,000	$5,000,000	$0	$0
Fed Account Beginning Balance	$3,000,000	$3,000,000	$2,000,000	$2,000,000	$2,500,000
New Loans Funded (money wired from Bank Cash)	($2,000,000)	($6,000,000)	($1,000,000)	($1,500,000)	($500,000)
Debits at the Fed (Decreases in Deposits)	($22,000,000)	($37,000,000)	($18,000,000)	($17,000,000)	($27,000,000)
Credits at the Fed (Increases in Deposits)	$19,000,000	$21,000,000	$24,000,000	$38,000,000	$22,000,000
Brokered CD New/(Matured)		($25,000,000)		$15,000,000	
Term Auction Facility- Maturity					(15,000,000)
Pay Back Overnight Fed Funds	$0	$0	($16,000,000)	($6,000,000)	$0
Total Change in Funds at End of Day	($5,000,000)	($47,000,000)	($11,000,000)	$28,500,000	($20,500,000)
Short-Term Investments / Borrowings					
Fed Funds Sold @ 0.15%					
Rev Repo @ 0.75%			($5,000,000)		
MM Mutual Funds @ 0.35%	($5,000,000)	($30,000,000)		$28,000,000	($21,000,000)
Fed Funds Purchased @ 0.30%		($16,000,000)	($6,000,000)		
Net Balance Left at Fed Overnight	$3,000,000	$2,000,000	$2,000,000	$2,500,000	$3,000,000

Needed extra day to settle

*Interest rates are for example only and not indicative of current rates.

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Alternative Funding Strategies

Conclusions

- Liquidity risk management will always be **an essential part** of the overall enterprise risk management process
- Liquidity risk is tied directly to **understanding the roles of both core and non-core** funding techniques
- Having **sound policies/procedures** around both core and non-core funding is an important risk management component
- Setting limits and measuring/monitoring use of non-core funding is **crucial**

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Thank you

We appreciate your time.

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