MANAGING INTEREST RATE RISK (IRR) AND LIQUIDITY RISK IN THE CURRENT ENVIRONMENT

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MANAGING IRR & LIQUIDITY RISK

Outline

- State of Banking
- Liquidity Risk
- Interest Rate Risk
- Current Environment

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MANAGING IRR & LIQUIDITY RISK

Objectives

- Gain a General Perspective on the Current Banking Environment
- Understand Liquidity Risk and the Impact on the Bank's Financial Condition & Profitability
- Understand the Importance of Monitoring and Managing Your Interest Rate Risk Position
- Articulate Tactical and Strategic Plans in the Current Environment

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State of Banking

- Credit Quality
- Capital Levels
- Loan and Deposit Growth
- Interest Rates
- Regulators

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Liquidity Risk

Liquidity

Institutions ability to meet its needs for cash to fund loan and deposit outflows.

"You always have more than you need until you don't!" Matz

"Great liquidity management often goes unnoticed." Moran

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Liquidity Risk

Adequate Level of Liquidity

- Sufficient to meet the Bank's cash and collateral obligations – at a reasonable cost
- Capable of meeting expected and unexpected cash flow requirements
- Ability to raise cash quickly (within 30 days), without principal loss – at a reasonable cost

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LIQUIDITY RISK

Key Measures of Liquidity

- Liquidity Ratio – 15%+
- Volatile Liability Dependency Ratio – 0% -
- Loan to Deposit Ratio – 75% or less
- Wholesale Funding to Total Funding (including core deposits) – 15% or less

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LIQUIDITY RISK

Managing Liquidity

- Early Warning System ("Triggers")
  - Bank Specific
    - Ratio Weaknesses
    - Bank Performance Weakness
  - External (Economic, political, etc.)
- Contingency Funding Plan (CFP)
- Liquidity Stress Testing
  - Coordinated with CFP

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LIQUIDITY RISK

Common Mistakes

- Too much reliance on volatile funding
- Do not take economic changes seriously
- Too much reliance on "backward" looking measures
- Lack of Discipline- Willing to change indicators/measures in policy without good reason

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INTEREST RATE RISK

Interest Rate Risk

The risk that a change in market rates will affect a financial institution's income and the market value of its assets and liabilities.

Asset sensitive is where assets are repricing faster than liabilities.

Liability sensitive is where liabilities are repricing faster than assets.

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INTEREST RATE RISK

Components of Interest Rate Risk

- Repricing Risk – Interest rates moving up or down
- Basis Risk – Assets correlated to different market rates than liabilities (Prime vs Libor)
- Yield Curve Risk – Slope of the curve changing (steep, flat, inverted)
- Option Risk – Risk that rate changes prompt changes in amount/maturity of instruments

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INTEREST RATE RISK

Key Measures of Interest Rate Risk

- Earnings at Risk – The % change in net interest income (NIM) from a change in market rates.
- Economic Value of Equity – The % change in the value of assets and liabilities due to a change in market rates
- Sensitivity of Key Modeling Assumptions – Is the Bank more sensitive to a particular assumption relative other key assumptions?

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INTEREST RATE RISK

Managing Interest Rate Risk

- Strategic Positions – Asset or Liability Sensitive
  - Loans – Fixed vs Variable Mix
  - Cash & Investment Securities – Mix & Fixed vs Variable Rates (Duration)
  - Deposits – Non-Maturity Deposits vs CDs
  - Borrowings and Wholesale Deposits
- Tactical Changes - Products
  - Asset Rates and Terms
  - Funding Rates and Terms

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INTEREST RATE RISK

Key Considerations of IRR Management

- No single measure of interest rate risk is totally accurate
- Interest Rate Risk exists in more places than the Bank's NIM (Noninterest income, credit risk, liquidity risk)
- Process is the Key - Not the Tools
  - Team Approach
  - Know your Market/Customers(Pricing/Products)
  - View multiple scenarios/forecasts

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CURRENT ENVIRONMENT

Strategic & Tactical Plans

- Regulator's Stance
- Loan Demand (Fixed vs Variable)
- Deposit Costs (Mix)

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Current Environment

Strategic & Tactical Plans

- What do WE think interest rates will do?
  - Repricing Risk (FOMC)
  - Yield Curve Risk (Bears & Bulls)

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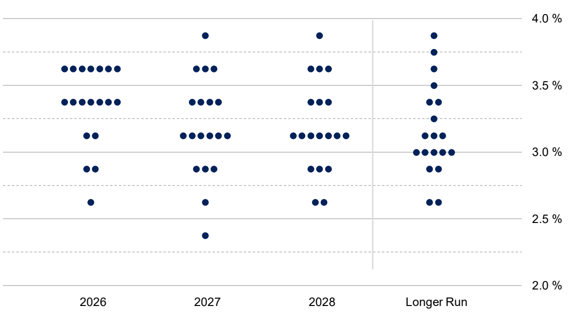
Current Environment

FOMC Dot Plot – March 2026



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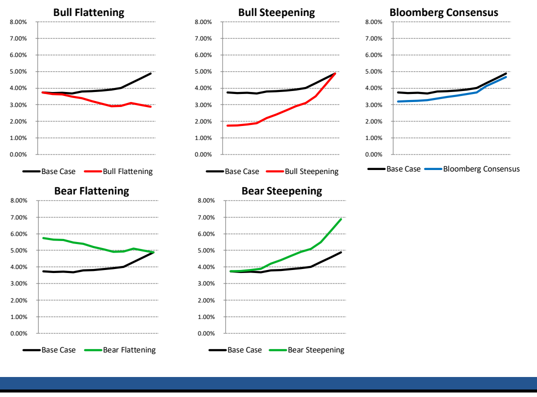
Current Environment



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CURRENT ENVIRONMENT

Strategic & Tactical Plans

- What if rates stay the same or go down?

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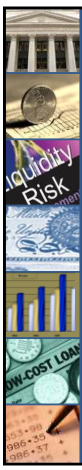

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