ALCO MEETING
THIRD BANK
July 30, 2020

1. Historical and Trend Information – CURRENT AND PAST POSITION
    a. Current Financial Position
        i. Loan Portfolio Balance and Trend
        ii. Investment Portfolio Balance and Trend
        iii. Deposit Portfolio Balance and Trend
        iv. Funding/Liquidity Position and Stress Test Results
        v. Capital Position and Stress Test Results
    b. Net Interest Margin History and Trend
    c. Current Interest Rate Risk Position
        i. Gap Analysis
        ii. Modeling Results

2. Economic and Interest Rate Forecast – FUTURE/FORECASTS

3. Lending Decisions - DECISIONS
    a. Forecast net growth goals and pipeline, market
    b. Rate+Fee/Term-Duration/Risk/Capacity targets
    c. **Actions** to meet goals

4. Core Deposit Decisions - DECISIONS
    a. Forecast net growth goals, market, maturities
    b. Rates/Funds pricing
    c. **Actions** to meet goals

5. Treasury/Investment Decisions - DECISIONS
    a. Investment Maturities
    b. Investment **Actions**
    c. Wholesale funding **Actions/Needs**
    d. Capital **Actions/Needs**

<u>TB ALCO Scenario</u> - The economy has been picking up yet with competition winning quality new loan customers and balances is tough. Your competition has been using low interest rates, looser credit standards and long-term fixed rate financing in order to grow their loan portfolios. TB has seen growth slow considerably in their loan portfolio while at the same time their net interest margin has been declining, reducing net interest income, net income and earnings per share. **<u>The Board of Directors has directed management to grow earnings per share and net income, which can only be accomplished by growing the overall balance sheet with a focus on loans or higher yielding securities.</u>**

TB is asset sensitive with more assets repricing faster in the next year than liabilities – but liability sensitive beyond one year which would expose the bank to potentially reduced earnings when interest rates begin rising. The Federal Reserve has signaled short-term rates will continue to grow over the next 12-24 months. How does ALCO accomplish this and keep TB independent.

NATURAL INTERNAL CONFLICTS AMONG THE TEAM

<u>CEO Focus</u> – The <u>new</u> CEO rose through the ranks as a commercial lender. They are under some pressure to meet the demands of the board of directors to grow earnings and earnings per share, like their predecessor accomplished before they retired. If growth cannot be accomplished soon the board may consider selling the Bank, or replacing the CEO, which will put them out of a prestigious job in the community. While the CEO understands interest rate risk, they are focused on the short-term need to grow. The investment bankers like to see growth, and this is driving community bank stock prices, and a better stock price will allow the bank to remain independent. In the current market this can only be accomplished by booking longer-term fixed rate loans at close to and even below the prime rate, and/or by reducing credit standards related to borrowers, collateral and guarantor requirements. They assume if rates increase this means the economy has improved, and therefore collateral values would improve along with general business conditions. Now is the time to be aggressive at all costs and grow loans.

<u>Senior Lender Focus</u> – Loan Growth is your primary measure of success, with asset quality a distant second. The bank has been able to grow during the past few tough years as many of the competitors were damaged with troubled loan portfolios. Now everyone is fighting for every loan, with 5 to 15 year fixed rate loans becoming the standard for commercial real estate, the banker's primary loan growth target. Lending mistakes from the last recession are being forgotten in your markets. While rates for long term loans are low the bank has to be competitive to not only grow, but to keep your existing customers from leaving. You feel the need to be aggressive with rate, term and in more and more cases your loan policy standards. You think the CFO should find ways to hedge or match fund this longer-term rate risk, and don't understand or care to understand the reduced margins and accounting challenges they face providing your bankers long term funding. You are also doing more C&I lending, even though your bank has limited experience monitoring these business asset-based loans.

<u>Head Retail/Deposits</u> – You have worked hard to grow low cost checking account balances, but you have several competitors that are beginning to advertise higher deposit rates and promotions to move accounts, and deposit growth has slowed. New community bank and credit union branches have opened in several of your markets and are upsetting market pricing on your money market accounts and CDs. Your staff is asking for higher rates on your money market and CD accounts to retain existing rate-sensitive clients, they are making many rate exceptions to retain customers, and asking for reduced fees on your commercial checking accounts. You have been told by the CEO you need to grow core deposits by $100 million to meet your annual goals and bonus plan, and the CFO continues to set frustratingly low deposit rates which is impacting your growth. You need a plan.

<u>CFO Focus</u> – While the CFO understands the need to grow, they also understand the risks the bank faces with its balance sheet. You continue to communicate this at your ALCO meetings with your modeling results but people are becoming impatient with your message and the lack of growth. Investment yields are improving, and the capital impact of holding securities in available for sale is dangerous if rates continue to rise. Are there funding options to offset the anticipated risk of taking on even more long-term fixed rate loans? You know with the decline in loan yields you have to be careful about managing any increase in funding costs, which limits your ability to take down a high volume of longer term and more costly (yet available) wholesale funds from the FHLB. Liquidity is fine today but if loans do grow and deposits/funding does not this could put some pressure on the balance sheet. Maybe now isn't the time to grow, but to retrench and focus on efficiency. Maybe growing the investment portfolio is the answer to meet the CEO's earnings growth demands. The others look to you for wisdom.