

Accounting Primer

VBA School of Bank Management

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Liquidity

The ability to convert assets to cash.

Liquidity

The *Availability* of Cash in the Amount and
at the Time Needed at a Reasonable Cost

Supplies of Liquid Funds (Sources)

- Incoming Customer Deposits
- Customer Loan Repayments
- Sales of Bank Assets
- Borrowings funds

Demands for Liquidity (Uses)

- Customer Deposit Withdrawals
- Loans to quality Loan Customers
- Repayment of Borrowed Funds
- Operating Expenses and Taxes
- Payment of Stockholder Dividends

ALCO Decisions

- With Deficit -- must decide how to raise additional funds
- With Surplus – must decide how to invest and make profit

Too Much or Too Little Liquidity

- What is the impact if a bank has too much liquidity?
- What is the impact if a bank has too little liquidity?

Essence of Liquidity Management

- There is a Trade-Off Between Liquidity and Profitability. The More Resources Tied Up in Readiness to Meet Demands for Liquidity, the Lower is the Financial Firm's Expected Profitability.

Why Banks and Their Competitors Face Significant Liquidity Problems

- Imbalances Between Maturity Dates of Their Assets and Liabilities **Maturity Mismatch**
- High Proportion of Liabilities Subject to Immediate Repayment or Repricing
- Sensitivity to Changes in Interest Rates

Strategies

- Deposit Campaign to fund loans
- Deposit Listing Service (Non-brokered)
- Brokered Deposits
- Public Funds

Deposits

1 source of funds at most
banks.

Two Key Issues

- Raise funds at the lowest possible cost
- Ensure enough deposits to support loans, investments, and withdrawals

Core Deposits

A Stable Base of Funds that is Not Highly Sensitive to Movements in Market Interest Rates and Which Tend to Remain with the Bank

Less vulnerable to swings in interest rates

How Do You Price Deposits?

Price to attract deposits
AND to remain profitable.

Sources of Borrowed Funds

- Federal Funds Purchased
- Securing Advance from the Federal Home Loan Bank
- Borrowing Reserves from the Discount Window of the Federal Reserve
- ** Bank Term Funding Program – through 3/11/24

Advances from the Federal Home Loan Bank Must Be A Member

- Allows Institutions to Use Home Mortgages as Collateral for Advances
- A Way to Improve the Liquidity of Home Mortgages and Encourage more Lenders to Provide Credit
- Maturities Range from Overnight to More than 20 Years
- FHLB Can Borrow Cheaply and Pass Savings to Institutions

ALCO Manages Liquidity

- Liquidity Needs Must be Evaluated on a Continuing Basis
 - Cash Flow Projection

How the Income Statement Articulates to the Balance Sheet

- Year-End Net Income moves to Retained Earnings on balance sheet

Capital Is KING

Capital Adequacy

- What is the purpose of capital?
- How much capital does a bank need?
- What happens if you have too little?
- What happens if you have too much?

BASEL III Capital Ratios

- 2019 completed the phase-in of capital conservation buffer
- Establishes minimum ratios for 4 capital ratios
- If capital guidelines are not met, there are limitations on paying dividends and executive compensation

Community Bank Leverage Ratio

- Applicable for smaller, qualifying institutions
- 9.0% minimum

Capital Ratios

	Minimum Requirement
Community Bank Leverage Ratio (CBLR)	9.0%
Total risk-based capital	10.5%
Tier 1 risk-based capital	8.5%
Common equity tier 1 risk-based capital	7.0%

Risk vs. Reward

Must Consider Risks

- Loans:
- Credit Risk
- Interest Rate Risk
- Concentrations of Credit
- Legal Lending Limit
- Investments:
- Default Risk
- Interest Rate Risk
- Prepayment Risk
- Concentrations
- Liquidity Risk

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Summary

Q&A