

# Breakout III: Up, Up, and... Balance Sheet Management in a World of Great Uncertainty

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# Up, Up, and... Balance Sheet Management in a World of Great Uncertainty

Bank Director Acquire or Be Acquired

January 30, 2023

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Managing Director

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Managing Director



**PAST**  
2022



?

**FUTURE**

# UNCERTAINTY

FOMC

Liquidity

Flux

Credit

*Loan Growth?*  
*Inverted Yield Curve*

*NIM Pressures*

*Cost of Funds*

## Strategy Development

- ◆ Deposits
- ◆ Wholesale Funding
- ◆ Lending
- ◆ Investments
- ◆ Hedging

## Risk Measurement, Assessment & Management Implications

- ◆ Liquidity
- ◆ IRR
- ◆ Credit
- ◆ Sensitivity & Stress Testing



# *Let Clarity Drive Decision-Making...Not “Fear”*

- ◆ *Change The Conversation*
- ◆ *Look At Yourself Through Different Lenses*
- ◆ *Listen Discerningly...Start With YOUR Balance Sheet*



## 4 Discussion Themes in Mind...

MOST IMPORTANT = What's on YOUR Minds!



Balance Sheet Risk  
Management

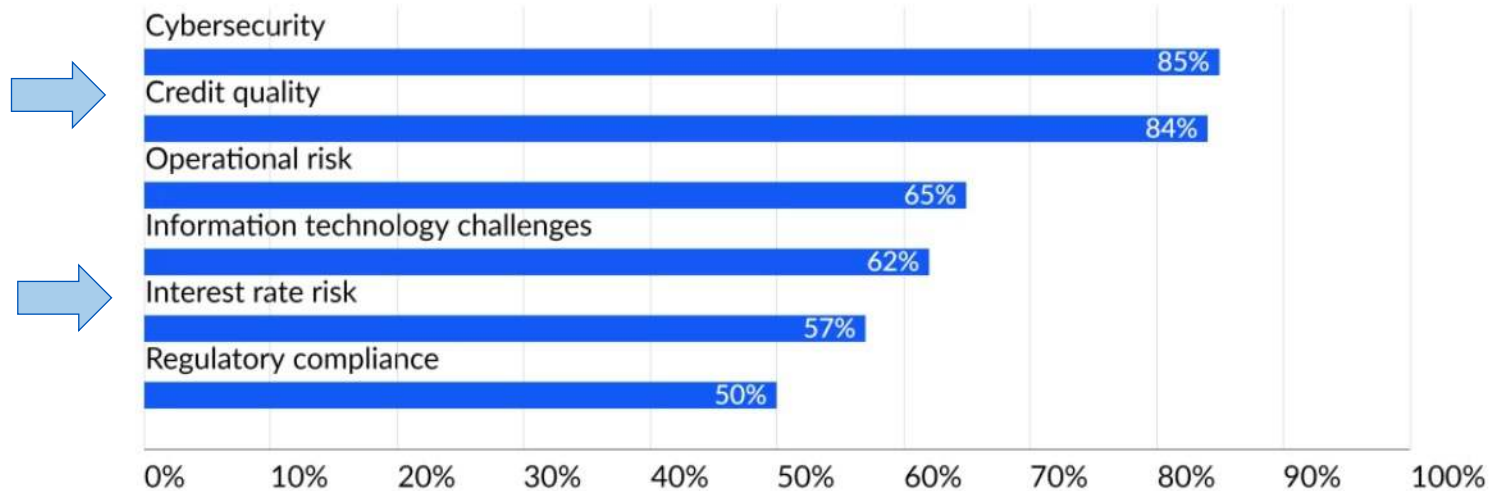
Deposit Pricing &  
Product Strategy

Lending Strategy

Investment Strategy

# What's on Bankers' Minds?

Banks < \$10 Billion



Source: RMA

# B/S Risk Management Realities: Liquidity

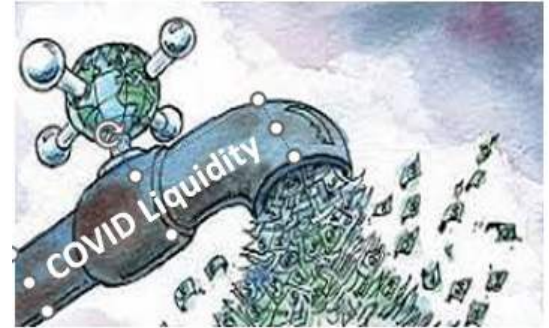
## Things That Should Be on Your Mind

### ◆ Liquidity Philosophy...

- Has your definition and focus changed?
  - Many “conflicted” by 2-3 years of oversized cash position
  - “Noise” from unrealized security losses
- Is Cash really King?
- Role of wholesale

### ◆ Your “Story” Matters Greatly

- Managing the conversation...internally & externally
- Revisit/Reaffirm attitudes, appetites & policies
- Contingency planning



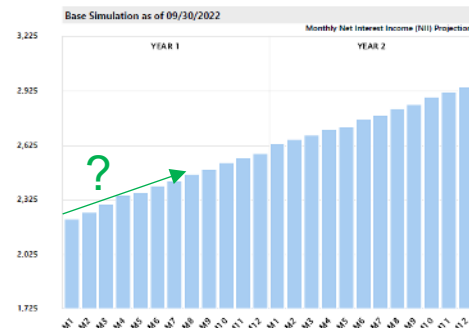
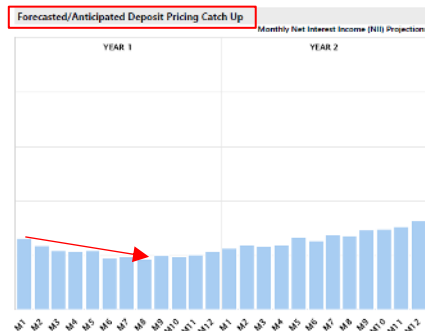


# B/S Risk Management Realities: IRR

## Things That Should Be on Your Mind

### ◆ Current Challenges With “Getting It Right”

- Base Case Risk Assessments Continue To Be Misleading
- The “Catch-up” factor is REAL!
- Many “asset sensitive” banks will feel/appear liability sensitive...soon
  - Has business model changed....  
or temporary phenomenon?
    - How impact strategy...now?



### ◆ Managing “The Street’s” Perception of Your Core Deposit Franchise

- Non-Linear & Life-Cycle Betas

### ◆ Betting on Rates? Good Luck!

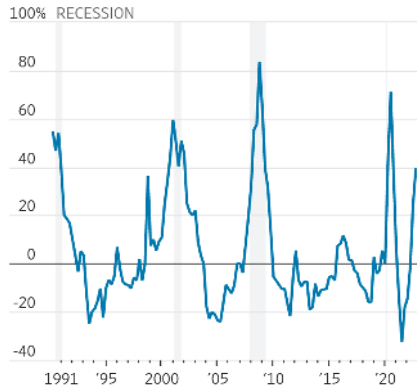
- Let your balance sheet talk

# B/S Risk Management Realities: Credit

## Things That Should Be on Your Mind

- ◆ How Looking at Credit?
  - Risk appetites & conversations changing
- ◆ Reconciling Loan Growth With Credit Outlook
- ◆ Pricing Strategy & Discipline...Rationalizing Pricing?
- ◆ ...And, What About Stress Testing & Capital Planning?

Percentage of U.S. banks tightening lending standards

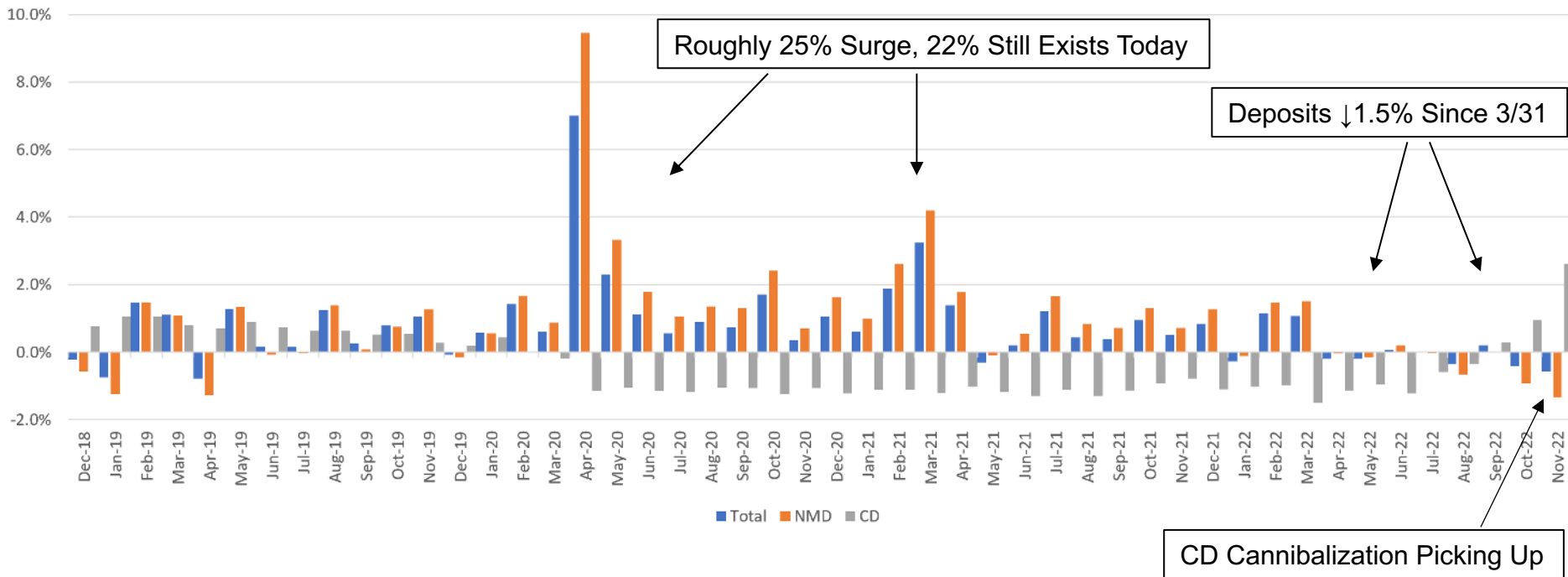


Source: Federal Reserve via St. Louis Fed



# Deposit Trends

## Deposits360® Month-Over-Month Trends (All Clients)



\*Sourced from all institutions that have reported November data through December 25

# Notes to Date

## 1. Betas Very Muted Thus Far (through November)

- ◆ Total NMDs 9%, Interest Bearing NMDs 13%
- ◆ Betas have accelerated over the past few months

## 2. NMD Rates Above 2019 Peak Levels But Well Below 2007 Peak Levels

## 3. Recent Decay Trends Almost 50% Higher Than Pre-Pandemic Levels

- ◆ Attrition has tended to be “Discretionary/Investable” balances

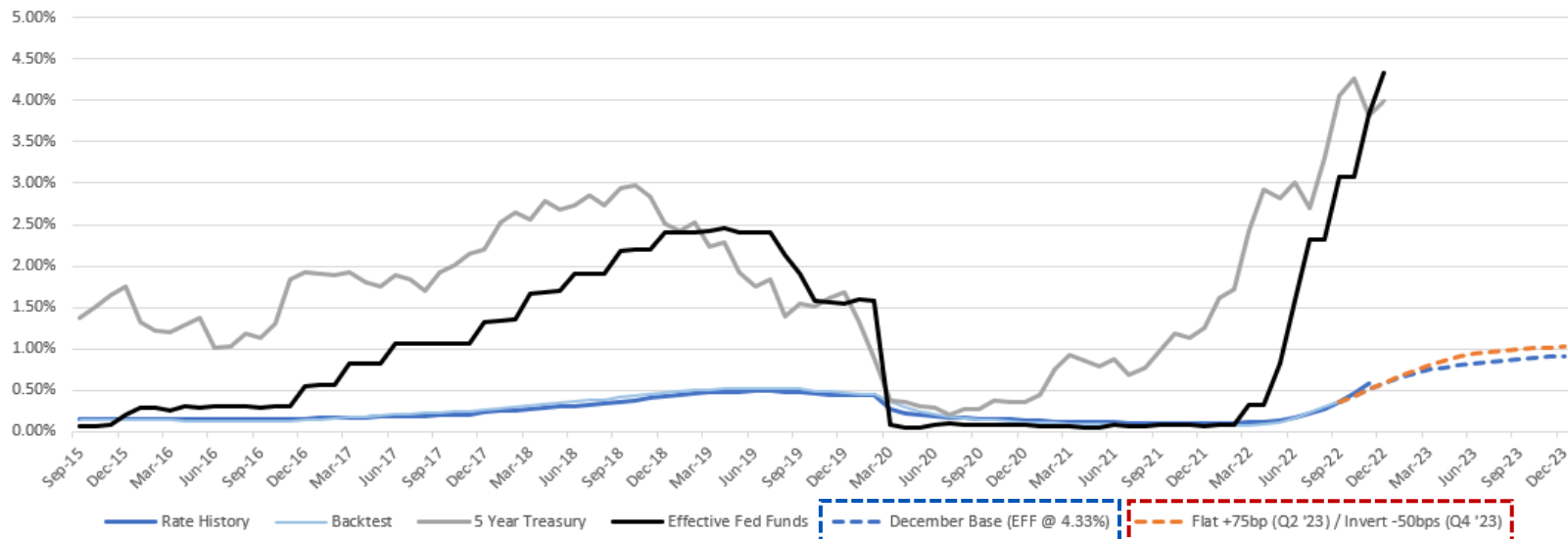
## 4. CD Rate Spreads Relative to Market In Line With Historical Trends

## 5. MMDA Rate Spreads Relative To Market Still Lagging



# NMD Rate Forecast

Deposits360® Analytics: NMD Rate History & Forecast



	NMD Avg Int Rate (End Rate)			
	11/30/2022	3/31/2023	6/30/2023	12/31/2023
Actual	0.59%	-	-	-
December Base (EFF @ 4.33)	-	0.75%	0.83%	0.92%
Flat +75bp (Q2 '23) / Invert -50bp (Q4 '23)	-	0.81%	0.94%	1.03%

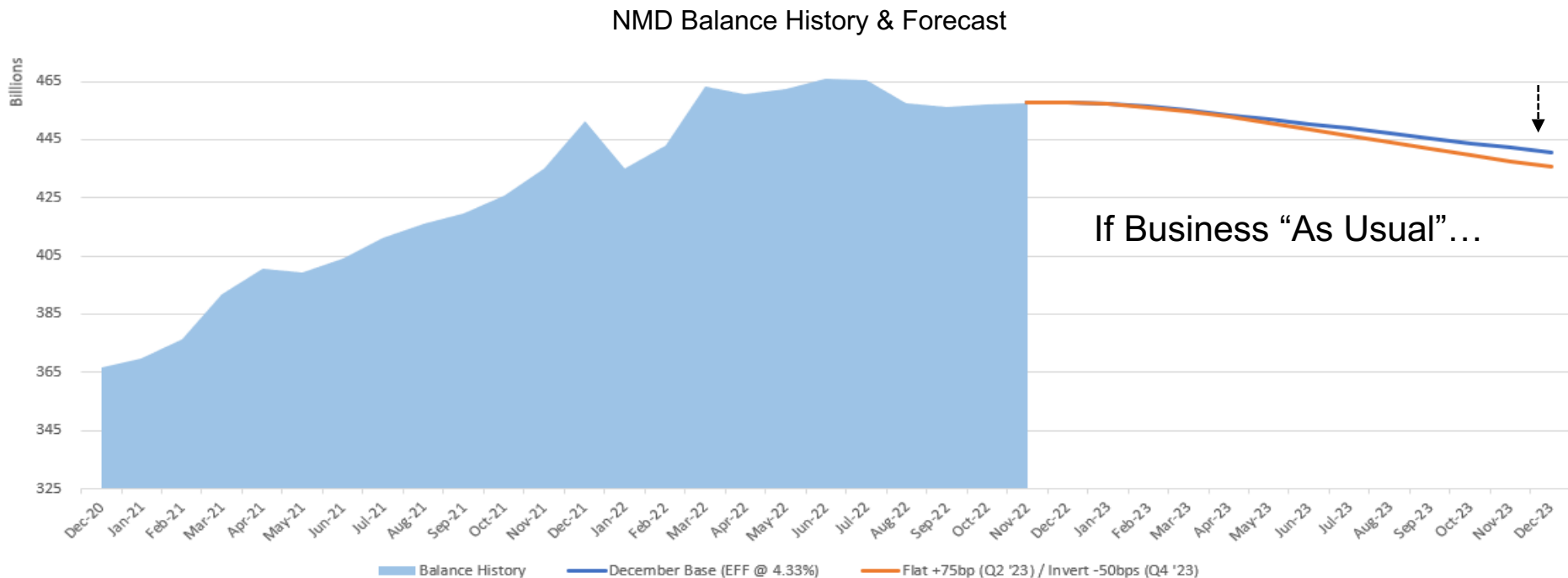
\*EFF increases to 5% by mid '23 then drops back down to 4.50% by year-end

11/30/22 to 12/31/23
Bps Δ From Starting Rate
-
→ +33 bps
→ +44 bps

Forecast derived from Deposits360® - Industry NMD Rates above are balance weighted averages and do not include any outlier removal

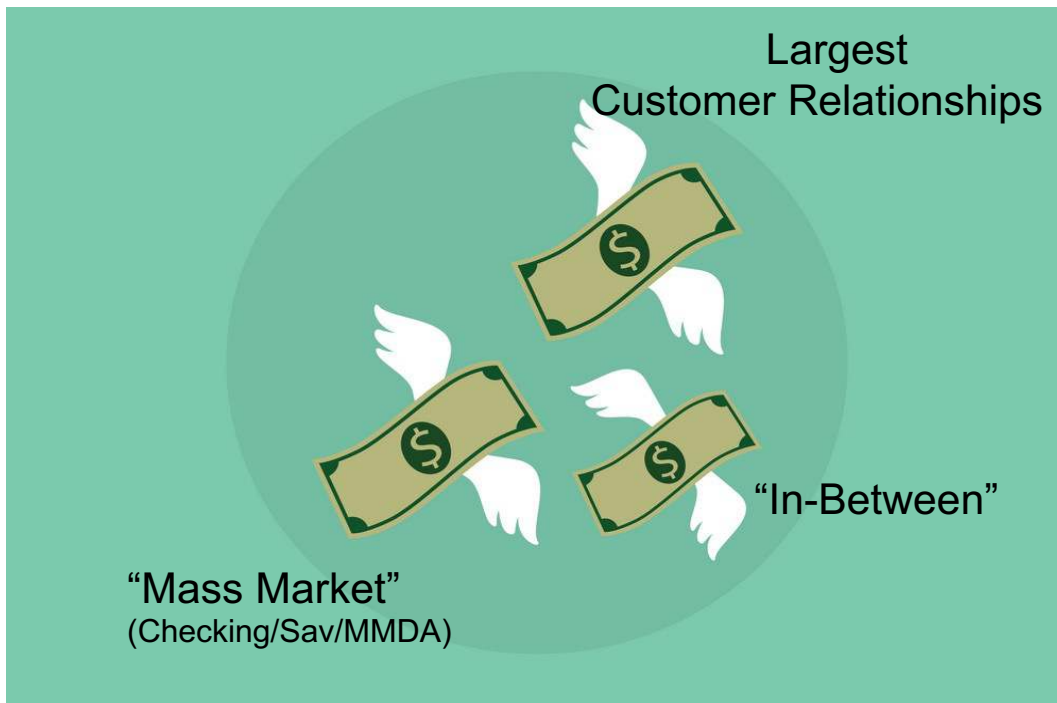


# NMD Balance Forecast



\*Forecast derived from Deposits360®

# Deposit Strategy Discussion: Creating Important Perspective



# Deposit Action Items

## 1. Identify Source of Attrition

- ◆ Losing relationships or decline in average balances? Shift to CDs? Business vs. consumer?
- ◆ Challenge: greater comingling of discretionary vs. core/operating \$
- ◆ Develop early warning systems, execute comeback campaigns

## 2. Need to Be Agile

- ◆ Allow data analytics to guide strategies

## 3. Defining the next MMDA move

- ◆ Trusting the exception process vs. “walking-up” rates...Where do I have to be priced?
- ◆ Review tier structure

## 4. Defining the CD portfolio objective

- ◆ Stack CD offerings (new money, checking balance premium, etc.)
- ◆ **Focus on managing cannibalization**

## 5. Differentiated Product & Pricing Strategies

- ◆ Targeted Customers, Location, Etc.
- ◆ Messaging @ Points of Customer Contact



# Setting the Tone for Deposit Strategy



- ◆ Deposit Special Analysis
- ◆ Migration & Cannibalization
- ◆ Normal Fluctuation vs. Disintermediation
- ◆ Potential Deposits At Risk
- ◆ Segmentation Analysis
- ◆ Relationship Analysis
- ◆ Stickiness Factors
- ◆ Branch Activity Differences
- ◆ CD Maturity Retainage
- ◆ Marginal Cost of Funds
- ◆ Early Warning System
- ◆ Beta and Decay Levels and Trends
- ◆ And More ....

# MMDA Attrition Case Study: Exception Pricing Running Its Course

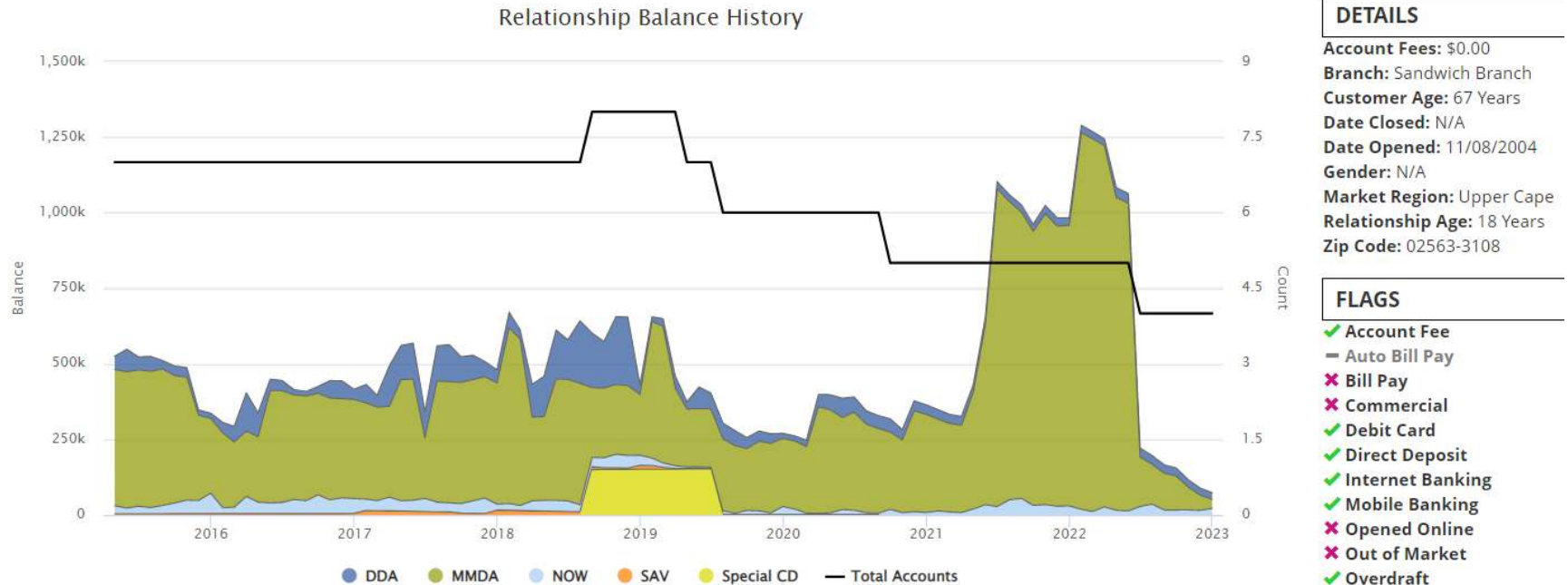
3/31 through 9/30



Total Growth  
**-6%**

	Balance	Rate	# Rel.
<b>Starting Balance</b>	<b>786,389k</b>	<b>0.23</b>	<b>6,803</b>
<b>INFLOW</b>	<b>62,166k</b>	<b>0.34</b>	<b>2,866</b>
New Relationship	9,446k	0.20	61
Existing +	52,720k	0.36	2,805
<b>SHIFTS</b>	<b>945k</b>	<b>-2.11</b>	<b>3,048</b>
DDA	493k	0.00	264
NOW	1,985k	0.10	2,125
SAV	621k	0.08	296
MMDA	-498k	0.37	86
Time Deposits	-1,655k	1.25	277
<b>OUTFLOW</b>	<b>-107,978k</b>	<b>0.24</b>	<b>2,179</b>
Existing -	-95,225k	0.25	2,019
Closed Relationship	-12,753k	0.21	160
<b>Ending Balance</b>	<b>741,523k</b>	<b>0.31</b>	<b>6,678</b>
<b>NET CHANGE</b>	<b>-44,867k</b>	<b>0.08</b>	<b>-125</b>

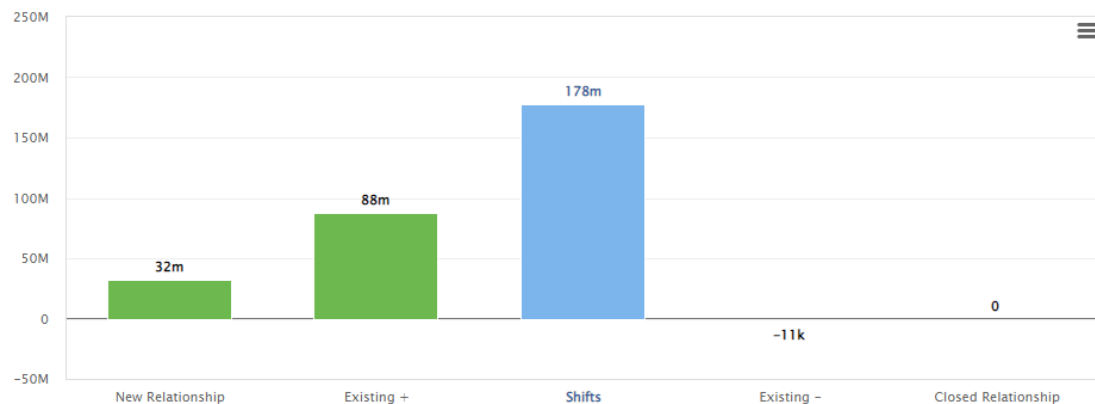
# Setting The Tone For Deposit Strategy: Customer-Level Attrition Analysis



\*Source: Deposits360®



# CD Special w/ High Cannibalization: 11 Month @ 2.85%



MCOF  
**6.30%**

Cannibalization  
**60%**

	Balance	Rate	# Rel.
Starting Balance	1,219k	0.15	63
INFLOW	120,195k	2.87	2,207
New Relationship	32,110k	2.87	296
Existing +	88,085k	2.87	1,911
SHIFTS	178,011k	0.56	3,183
DDA	3,003k	0.00	228
NOW	15,409k	0.27	608
SAV	26,285k	0.72	564
MMDA	26,106k	0.92	271
Time Deposits	107,207k	0.49	1,512
OUTFLOW	-11k	0.15	2
Existing -	-11k	0.15	2
Closed Relationship	0k	0.00	0
Ending Balance	299,415k	2.85	3,254
NET CHANGE	298,195k	2.70	3,191

# Lending Issues & Realities

- ◆ Desire for NIM Restoration
- ◆ Revisit Definition of “Normal” Pricing...& Pricing Strategy
  - Getting paid for risk
  - When do you walk?
- ◆ Loan Pricing Pressures & Related Spreads
  - Talk of Recession (Credit Risk)
  - Elevated Prepayment Risks
  - Competition & Rationalization?
- ◆ Fixed Rate Lending Capacity vs. Appetite
- ◆ Role of Derivatives
- ◆ 2023 Loan Growth Concerns



# Current Loan Pricing in Perspective: That Was Then, This Is Now

September 2018 ... When Loan Rates Peaked Last Cycle  
5 Year CRE Rates = +/- 5.50%

	Treasury	FHLB	Prime Swap	SOFR Swap
5Yr	2.95%	3.20%	5.80%	NA
Spreads	+255BP	+230bp	- 30BP	
Loan Rate	<b>5.50%</b>	<b>5.50%</b>	<b>5.50%</b>	

## Then What?

2019... More of Same

2020... Yikes & Spikes

2021... “Phew” & Contracted

2022... Look Out Below!

Early January 2023 .... “Today”

	Treasury	FHLB	Prime Swap	SOFR Swap
5Yr	3.70%	4.10%	6.60%	3.70%
@ Same Spread	+250BP	+230bp	- 30BP	+240
	6.20%	6.40%	6.30%	6.10%

3 Months Prior = 7.25%+

**What Just Happened  
Over The Last Year?  
& Where Do We Go From  
Here?**



# Investment Portfolio Conundrum



# Wholesale Funding

Philosophy Matters: Wholesale Funding Strategy, Policies & Contingency Liquidity Planning

- ◆ Role of Brokered & Insured Deposits
- ◆ Role of FHLB & Repos
- ◆ Role of Fed
- ◆ Thought Process Is Key: Short-Term/Floating vs. Fixed Rate Funding
- ◆ Fixed Rate vs.
  - Floating/Short-Term with Caps?
  - Short-Term/Floating with Pay Fixed Swaps?
- ◆ Callable Brokered & Prepayable Advances
- ◆ One-Way Insured Deposit Buy/Sell Programs



# DON'T “Just Say No”... The Important Role of Derivatives

Can Create Competitive Advantage



& Provide Important Flexibility



# Some Governance Considerations

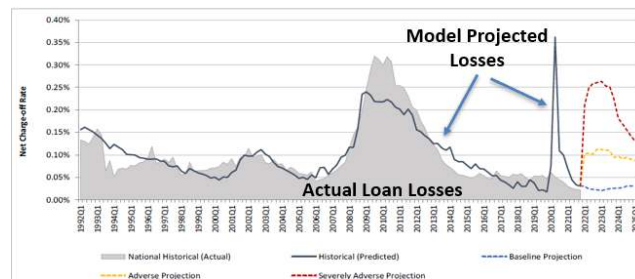
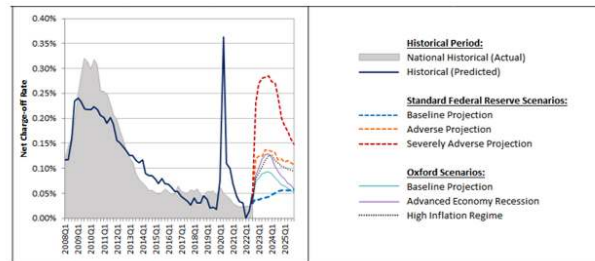
- ◆ Risk modeling & risk assessment has become much more challenging
- ◆ Assumptions need to be revisited/updated & documented
- ◆ Sensitivity testing more critical than ever
- ◆ Community Bank *Model Validation* rigor needs to be revisited



# Benefits of Capital Planning & Stress Testing Discipline

... Not for “Bad Times”

## Bank Capital Management



What will the next recession look like?

# Key Takeaways

## *Let Clarity Drive Decision-Making... Not “Fear”*

- ◆ *Change The Conversation*
- ◆ *Look At Yourself Through Different Lenses*
- ◆ *Listen Discerningly...Start With YOUR Balance Sheet*



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# Thank you!



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