Risk Management Association
Long Island Chapter

Summer 2023 | Volume 1.19

A Message From Our President

I hope you are enjoying the remaining days of summer. Our Young Professionals embraced that theme as they gathered on August 9th for their annual summer edition of the Nine and Dine. Thanks to all who attended and continue to make this event successful year after year.

We look forward to welcoming back our members on October 20th for our first event of the fall season. We always allocate our October event to current trends and topics, and we have a great one planned again this year. Watch this space for more details.

We are truly blessed to have such a steadfast and loyal group of sponsors. They continue to provide the requisite support for us to put on these events. Their sponsorship also allows us to fulfill our not-for-profit mission of giving back to the local business community via our annual scholarship program.

Lastly, you may have seen that on July 19th the Risk Management Association (RMA) announced its intent to merge with the Bank Administrative Institute (BAI). The merger is expected to become effective in December. These are early days and things remain business as usual for the Long Island Chapter of the RMA. Upon completion of the merger, BAI's current CEO, Debbie Biancucci, will become CEO of the new association. Nancy Foster, current RMA CEO, who announced her retirement earlier this year, will transition to an advisory role in 2024. As plans develop and we learn more, we will keep our members informed.

As always, I encourage your feedback at rmalongisland@gmail.com. If I don't hear from you in interim, we'll see you in October!

A final note: We want to congratulate Michael Darcy for completing the LORS Seminar and appreciate him taking the time to keep us apprised. (See page 2)

Sincerely,

Michael Heller

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A Word from Michael Darcy

My name is Michael Darcy. In April, the Long Island RMA afforded me the opportunity to attend the RMA New England Chapters Loan Officer Resident Seminar in Exeter New Hampshire. As the Credit Risk Portfolio Manager for Dime Community Bank, I was excited for this opportunity to expand my lending and credit knowledge.

The classroom style program ran 6 days and covered a multitude of topics ranging from Credit Analysis and Credit Structure to Compliance in Lending and Risk Management. While learning during the day the group was also broken out in the evening into pods where we were tasked with preparing mock loan presentations which would be decisioned by a loan committee consisting of senior executives from the major New England Banks.

The LORS program was one of the most informative training courses I have ever attended. The entire program from the accommodations for the week to the networking events during the evenings were handled with the utmost professionalism. I want to take this opportunity to thank the Long Island RMA for choosing me to represent them and the New England RMA for hosting such a great class.

Young Professionals Oktoberfest

Date: Sep 28, 2023 from 06:00 PM to 10:00 PM (ET)
Venue: Great South Bay Brewery, 25 Drexel Drive, Bayshore, NY, 11706
Register here!

Save the Date

Date: October 20, 2023, 8am – 10am
Venue: Radisson Hotel Hauppauge

Annual Sponsorships Still Available

For information regarding Sponsorship please contact:
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RMA Scholarships

James T. McCarthy Scholarship - $2,500
Dr. Pearl Kamer Scholarship - $2,500
Patrick M. Demery Bankers' Lifetime Achievement Award - $1,500

Application deadline: May 1, 2024

Eligibility:

Bankers and students interested in pursuing their education and career in the area of banking, comercial lending or credit risk management. You must be enrolled at an accredited college, pursuing a pertinent degree program.

Application package must include the following:

- College transcript and evidence of current enrollment at an accredited college
- Essay from applicant stating:
  - Why you have chosen or are interested in a career in banking
  - Your career goals and how this scholarship will help you meet your goals
- Employment history and current job description, if applicable
- Extracurricular activities, community service
- List of leadership positions, honors and awards
- Letter of recommendation from your current employer or professor

Note: Incomplete application packages will be disqualified.

Applications will be reviewed by the
Scholarship Committee of the
Long Island Chapter of Risk Management Association.

Forward questions or your completed application package to:

Bonnie Dougherty, Senior Vice President
Valley National Bank
BDougherty@valley.com

Join. Engage. Lead

It's time to review your financial institution's liquidity and ALM practices: leverage your data to mitigate risk

By Kevin Schalk
Ivan Cilik
Sean Statz
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How can your financial institution prepare, but more importantly, thrive in an uncertain risk environment? Over the past year, banks and credit unions have experienced changes in how they go about managing liquidity and interest rate risk, while also considering what asset liability committees (ALCOs) and examiners may be looking for.

During the pandemic, liquidity was not an issue for most financial institutions because of the massive influx of deposits, and due to the low interest rate environment, many invested in longer-term securities. However, as interest rates have risen over the last year, the value of these investments has declined, and many banks have decided to reclassify to held-to-maturity (HTM) securities to mitigate mark-to-market earnings impacts, which made them relatively illiquid. With the recent bank failures creating fears regarding our banking system, we believe that liquidity oversight and stress-testing requirements will be a huge focus within the banking industry for the remainder of 2023 and beyond.

Understanding and utilizing asset liability management

Asset liability management (ALM) is the process of managing financial risks that result from mismatches between assets and liabilities and the timing of cash flows. The concept of ALM focuses on the timing of cash flows and ensures that assets are available to pay debts as they come due. Changes in interest rates and illiquidity can cause a mismatch between assets and liabilities, and ALM helps to ensure that this does not occur. ALM is a regulatory requirement for both banks and credit unions to monitor interest rate risk, and it focuses on short-term (earnings) and long-term (market value of equity) risks. It is common to run tests quarterly and look at trends in order to gauge the current risk environment and its potential impact on cash flows.

By calculating the economic value of equity (EVE), financial institutions can measure long-term interest rate risk by measuring the fair value of its assets and liabilities over their respective terms. In other words, EVE is calculated by taking the present value of all asset cash flows and subtracting the present value of all liability cash flows. This is a long-term economic measure used to assess the degree of interest rate risk exposure, whereas net interest income (NII) reflects short-term interest rate risk.

As an earnings simulation, NII scenarios project future earnings on assets and cost of funds on its liabilities. This is calculated by subtracting the interest a bank must pay to its clients from the revenue it generates. The amount of NII a bank generates will depend on many factors, including the composition of its balance sheet, quality of the loan portfolio and the collective interest rates each type of loan carries.

ALM's most common stress tests are changes in interest rates, known as interest rate shocks, because they have a large impact on cash flows. Most ALM models run monthly cash flow projections based on contractual instrument data – loans, investments, deposits, borrowings and assumption data. They model cash flows over each instrument's life in order to get a full balance sheet cash flow stream. Cash flows are aggregated for purposes of ALM policy metrics.

The pandemic played a large role in impacting balance sheets and today's interest rate environment. More specifically, it has greatly affected market rates and prepayment rates, which went from a short-term high to a short-term low in a matter of only 24 months, greatly increased interest rate volatility and had a huge impact on cash flow.

Balance sheet management

Scenario analysis and stress testing

An ALM model can be used for more than just standard interest rate risk measurement – it is a cash flow tool at its core. A scenario analysis involves looking toward the future and visualizing what events or conditions are probable, what their consequences or effect may be and how to respond to or benefit from them. Stress testing is used as a complement to a scenario analysis – it focuses on the direct impact of a change in either one specific event or multiple events under extreme circumstances instead of focusing on changes on a more normal scale. Essentially, stress testing can measure the impact of low likelihood, but high-impact events. For example, stress testing uninsured and insured FDIC deposits, considering the size of deposits and historical behaviors related to those higher balance deposits.

On the other hand, reverse stress testing starts from the presumption of failure and seeks to identify the circumstances in which this type of failure could occur. In such cases, we would ask what outcomes could bring an organization to the brink of failure and then ask what could cause those outcomes. These models ultimately connect the dots between interest rate risk (IRR) modeling, budget analysis and its effect on liquidity. Banks continue to increase frequency of model validations especially around ALM and liquidity as part of their annual model risk management process.

Incorporating growth into the balance sheet to gauge drivers of interest income and interest expense can lead to identifying profitable lending strategies, funding sources and strategies and impacts to short-term and long-term liquidity. In terms of balance sheet projections, they can be described as "static" or " dynamic":

Static balance sheet (SBS):

- Most common in ALM modeling
- Balance sheet composition is held constant as of valuation date
- No change in the mix or balance through forecast
- Reinvest cash flows into same account at market interest rates

Dynamic balance sheets (DBS):

- Used to aid strategy
- Incorporates changes in mix or growth into various accounts over forecast (i.e., budgets)
- Reflects risk for current valuation data and expectation of future

Deposit scenario modeling

The large spike in deposit growth that has occurred in recent years has impacted liquidity levels significantly across the banking industry. Nonmaturity deposits are a key driver of scenario modeling because they are assumption driven – there are no certain cash flows and no structured term for nonmaturing deposits. To forecast future cash flows, banks need to look at the recent and historical behavior of deposits. Has there been an increase in average balances, or decline? What has been the historical growth of these deposits, and do we believe surge deposits reside in our portfolio?

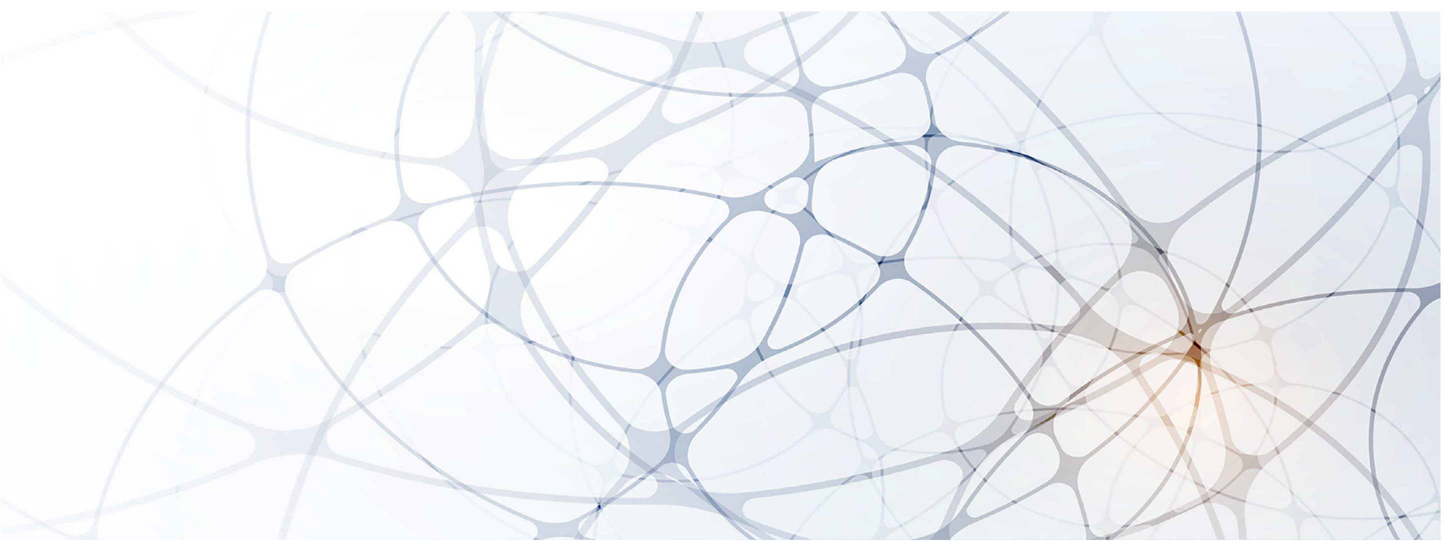
It is vital to analyze interest expense increase year over year, test various term strategies to optimize net interest margin (NIM) and determine whether the asset side of the balance sheet is changing or staying the same. Utilizing data analytics is key in maintaining deposits and analyzing concentration risk – the concentration of liabilities on a bank's portfolio.

Liquidity management

After recent events, liquidity management has become a huge focus and contingency funding plans are proving to be essential. Banks must be able to demonstrate that they understand their current and future liquidity position and understand what risks they are facing. They should consider setting a system in place that will help in identifying liquidity risk and measure projected cash flows across the balance sheet to identify liquidity surplus and deficits. A liquidity stress test will assist in analyzing both short- and long-term liquidity risk. Deposits are key to liquidity stress tests, though they are difficult to forecast. Loan and investment payments are typically contractual and can be forecasted easily. Banks should also consider developing an early warning system and setting a contingency funding plan in place to manage liquidity should a triggering event occur.

Connecting the dots with model risk management

ALM and liquidity are two essential parts of model risk management. For more information on these subjects, refer to the recording from our recent webinar, Leveraging your data to understand your liquidity and interest rate risk: a Compliance+ webinar. If you have any questions regarding ALM and handling your organization's liquidity models, including a review or model validation of your bank's current ALM and liquidity process, schedule a 30-minute meeting with one of our Value Architects™ .



What's next for tech: A technology industry outlook

The technology industry continues to innovate to drive advances throughout the economy, but it's also preparing for what's next on the horizon.

Tony Klaich, Markets & Industries
Managing Partner
Technology, Media & Telecommunications
Crowe LLP

A couple of key developments this year have unsettled the technology industry:

- A parade of layoffs at technology companies, ranging from startups to the most recognized enterprises
- The slowing pace of investments in enterprise and consumer technology
- The swift and sudden collapse of a large financial institution with a major presence in the tech space as well as subsequent bank liquidations of other tech funding sources

While these events have many technology companies more focused on operational resilience in the near term, they might not be the signs of doom and gloom some observers take them for. Layoffs at many tech businesses, for instance, could be seen as a return to trendline growth rather than a sign of future instability.

Additionally, the innovative solutions generated by the technology industry remain critical for organizations in practically every sector. Whether it's increased investments in artificial intelligence (AI) within the insurance space, data analytics in healthcare, or internet of things in manufacturing, interest in advanced technologies remains high in most industries.

As the tech sector continues to adjust to significant changes in the months ahead, we expect three areas to be focal points.

Automation

Find efficiency with advanced technology.

Probably the biggest impact of advanced technologies like AI for tech companies' operations is in automation. Most tech companies have a good level of understanding about how the technology side of this works, but our specialists have found many of them don't always use automation as much as they could within their organizations.

This gap is particularly true as automation has moved beyond management of one or two steps within a process and taken over most or all of entire processes within some organizations. This next-level automation doesn't simply make things move faster. It also drives improvements in efficiency, error reduction, data analytics, and other critical areas.

Another benefit of AI-driven automation is that, if implemented correctly, it only gets better as you use it. Pairing machine learning with the right inputs can help train your AI system over time to run processes even more optimally.

Tech companies also increasingly use responsible AI frameworks to mitigate known risks and potential issues that might arise. Responsible AI frameworks among tech companies include aspects of strategy, control elements, responsible practices definition, and standards for AI validation and monitoring.

Supply chain

New tech may not be the answer for all.

Automation technology is affecting supply chains in interesting and valuable ways. One recent application is the "industrial metaverse," which takes metaverse and Web3 technologies and uses them to virtually map out a supply chain end to end. In this way, it can project the timing, flow, and bottlenecks of supply chains.

Cutting-edge technology isn't always the answer to supply chain problems, however. Using existing platforms or performing relatively simple integrations to improve how you plan, predict, and communicate can be the better way to go both strategically and financially. This approach requires a pragmatic view and a focus on how tech can impact the proficiency of the people and processes that run your supply chain.

For many organizations, there won't be a single silver-bullet tech solution to all their problems. Often, the fixes needed are related to governance, data management, or business intelligence – like whether they have the correct ordering parameters to right-size inventory, for instance, or if they're focused too much or too little on certain SKUs. These kinds of enhancements can be driven by activities like checking in with customers more often or anticipating certain seasonal trends further in advance.

Focusing on issues like these can ultimately provide heightened visibility overall and more of a real-time window into what's happening. Using technology thoughtfully will help you optimize movement of inventory, enhance your supply chain efficiency, and respond more quickly and proactively when unforeseen developments emerge, such as port closures or political upheaval.

ESG

Gear up for new rules and regulations.

Environmental, social, and governance (ESG) issues aren't "new" for the technology industry in the same way they are for, say, the financial services sector. In many important ways, tech has been an ESG standard bearer for several years. That said, the regulatory picture might be evolving, and tech companies are finding they have ESG information gaps, especially if they rely on third-party data sources.

The biggest near-term ESG questions for tech companies will be:

- When will the Securities and Exchange Commission release its final rule on climate-related disclosures, such as greenhouse gas emissions?
- What specific requirements will that rule lay out – and how quickly can companies respond?

The final rule is expected to roll out some time this year, but many investors are already requiring that publicly registered companies reveal how they consider climate risks and the potential environmental effects of the goods and services they provide. So even in the absence of a final rule, tech companies – particularly publicly traded ones – shouldn't remain flat on climate disclosures in the meantime.

More broadly, how ESG aligns to their mission and values will continue to be important for tech companies. And as new regulatory requirements emerge, investors and venture capital will drive a more rigorous approach to ESG issues. Over the long term, the biggest ESG challenges for tech companies will be prioritizing what needs to be done now versus later and building up the capabilities needed to address evolving ESG standards.

Despite shifts in the economy and regulatory environment, innovation continues to hum along. Advanced technologies that continue to revolutionize most other industries also can enhance many areas of tech businesses' operations and provide a clearer view into the challenges and opportunities ahead – no matter what's happening in the market.

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