

Quarterly Outlook



General Market Funding— A Key Component of a Multi-Dimensional Balance Sheet

by J. Ronald Hybarger, President of Hybarger & Associates, Inc.

Our Firm works with a number of Community Banks (less than One Billion in Assets) all across the country. We assist these Banks in all matters related to:

- Asset / Liability Management
- Liquidity Management
- Interest Rate Risk - Assessment & Management
- Contingency Funding Plans
- Financial Forecasting
- Investment Management & Accounting
- Budgeting
- Strategic Planning
- Performance Analysis
- Contingency Modeling
- Financial Board Reporting
- Funds Management Policies

Therefore, all matters related to Funding and Spread Management are vitally important to our Firm, as well as to our Clients. In this regard we have found General Market Funding (Brokered CD's) to be an invaluable management tool. However, we recognize that some Examiners may have little or no practical experience regarding the financial characteristics of this Funding Source, and the experience they have had can sometimes be quite negative. As a consequence, we recognize the responsibility of making a clear, concise, and cognizant case for why General Market Funding is appropriate in a particular Bank's Funding Plans, Liquidity Management techniques, and Interest Rate Risk Assessment & Management.

Funding Issues

We recommend that all of our Client Banks which utilize General Market Funding establish a clearly defined overall Policy Limit for the total percentage of General Market Funding that would be acceptable on the Balance Sheet. In addition, there should also be (as a practical matter) "Funding Limits" for each Broker. We recommend that both of these Limits be expressed as a percentage of Earning Assets.

This assures Board involvement in the setting of these Limits, which addresses one of the primary concerns of the Regulators. It

also provides a predictable frame-work from which Management and the Board can seek to maximize Balance Sheet performance within clearly defined boundaries.



Funding Based Upon Known Terms

Our preference for General Market Funding stems from the predictability of the transaction. Presuming that we are discussing Marginal Funding (the last dollars into the bank), then we can select the appropriate Maturities at a known Rate, at Volumes determined by the bank, and we can be assured (except as the result of death) that the Deposits will remain with us for the full term. These are elements which are generally left

to chance within our local markets.

For example, if the bank aggressively pursues new funding within its own market, this is almost always a function of offering above market rates, otherwise it may run the risk of being totally unproductive. There is also an additional risk to this strategy. Raising rates within a bank's existing market place will almost certainly cannibalize at least a portion of the bank's existing Deposit Base into the higher costing deposits.

Perhaps equally important is the assurance provided by General Market Funding in the event that the bank determines to pursue a strategy of lowering rates within its existing deposit base (based upon a reasonable longer-term strategy). By prudently pursuing a strategy of slowly lowering Deposit Rates over a period of time, the bank will usually find that it only risks losing those deposits that are most Rate Sensitive and therefore subject to loss anyway. If these funds can be replaced by General Market Funding at an equal or lower rate, then the bank has scored a huge victory, as the costs of all of the retained funds will be lower than they would have otherwise been. We find that banks that carefully manage their marginal funding are the ones that perform best and General Market Funding is an ideal component to assist in this style of management.

Liquidity & Contingency Funding

General Market Funding is a critical element in the Contingency Funding Plans of our client banks, for all of the reasons stated above plus some very important additional reasons:

- 1. Diversification of Funding:** Having diversified Funding Sources is critical to any Contingency Funding Plan, but is even more critical to the practical day-to-day management of the bank's Balance Sheet. Funding Sources can come and go, often completely outside of the control, or influence, of the bank, and for reasons that may have nothing to do with the bank itself.
- 2. Pledge Free Deposits:** Unlike Public Funds and many forms of Non-Deposit Funding, General Market Funding requires no pledging of Assets. Therefore, it has the potential to provide Liquidity from two perspectives. One, from access to Funding as previously discussed. The other is due to the fact that General Market Funding may be utilized to replace a Funding Source that requires pledging and frees up some collateral for other purposes, or potential purposes.
- 3. Availability & Usage of General Market Funding:** In the process of measuring and managing Liquidity, one of the single most important elements in dealing with a particular Funding Source is to accurately and



reasonably determine the bank's current and projected availability. A good Liquidity Measurement and Forecasting System will do both and will be able to report to the Board the current and projected usage as well as anticipated availability, as determined by established Policy & Funding Limits.

Implications for Interest Rate Risk & Risk Mitigation

Previous examples have dealt with generally short-term issues. Interest Rate Risk Analysis & Management is concerned more with longer-term and strategic issues rather than strictly tactical issues.

In working with our Clients, we feel that General Market Funding is an ideal tool for addressing certain Interest Rate Risk issues and challenges. By utilizing General Market Funding, we are able to customize a portion of the Liability side of our Balance Sheet in ways that are not possible with any other Financial Instruments that do not require collateral.

By careful selection of maturities, we can literally design a select portion of the Balance Sheet, strategically mitigating a certain degree of identified risks.

One of the most important elements of this process is that it has no impact at all upon the ebb and flow of local market conditions. Therefore, it is completely independent of, and unaffected by, local market rates, which at times can be very counter-productive to longer term Balance Sheet objectives.

It may be virtually impossible, within the local market-place, to shorten maturities during Falling Rates and extend maturities during Rising Rates. However, by having access to General Market Funding, this can become a very routine process.



General Observations

While I'm sure that the reader may have found little that was new in this article, one thing that we have found within our Client Base is that when well defined and documented Policies are fully integrated into the Bank's Financial Reporting, we have seen a significant degree of tolerance from Examiners who may have otherwise approached the entire subject from a less than positive bias.

Except for matters related to questions of Capital Adequacy, we believe that the bank that makes strategic and informed usage of General Market Funding is actually seen in a favorable light by most Examiners, if done responsibly and in moderation.

On behalf of our Clients, we have worked with a number of CD Brokers over the past few years. It has been our experience that Finance 500 has offered consistently competitive rates, outstanding and reliable customer service, and timely execution consistent with expectations. It can sometimes be awkward for one Firm to deal with another on behalf of a third party. However, we have been very satisfied with all of our involvement with Finance 500.



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