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Using ALM as Your Crystal Ball

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Everyone would love to see into the future: Where will I be in one year? Where will the markets be? How will my credit union be performing 12 months from now? One of the greatest resources available to see into the future of your credit union is your Asset Liability Modeling (ALM) reports. These reports project the income and risk profile of your institution, even if the rate environment changes. Too often, however, we see credit unions run their reports for the sole purpose of sharing with the regulators. While the reports are necessary for regulation, their benefits go far beyond and should also be used to help plan your future.

Almost all other financial reports look backwards – balance sheet and income statements examine where you stand as of a certain date. These reports will not provide much insight to the future if balance sheet trends or interest rates change. This is where your ALM reports come into play. Taking your current balance sheet position and examining if the world changes (rate shocks) can be one of the most valuable tools in helping you to prepare for the upcoming year.

Parallel Interest Rate Shocks

The standard ALM reporting looks at “instantaneous, parallel interest rate shocks.” Although, we have been in a low rate environment for an extended time, it is always important to prepare your credit union for an unexpected change. Two important ideas to focus on are the results of a mild change in rates and the worst-case scenario – if the world is jolted by a huge increase in rates, do you know how your credit union is positioned to perform? For some credit unions, a small change in rates may result in a red flag that needs to be addressed immediately. Other credit unions may not see a significant impact until a drastic change in interest rates. In either situation, credit unions should be prepared to discuss potential ideas to address this issue, even if the scenario seems unlikely.

What If Analysis

Another valuable way an ALM report can help see into the future is through a hypothetical “what if” analysis. This is a great resource to assess how a change in your balance sheet structure would impact the risk/return profile of your credit union. For example, a projected increase in mortgage loans may help to increase your net income, but it is vital to assess how these longer-term assets will impact the risk profile of your credit union in a higher rate environment. For credit unions considering launching a new product that may have a significant impact on the balance sheet, it is a due diligence requirement that this type of hypothetical ALM run be done before the product launch.

In conclusion, it is important to remember that ALM cannot capture every risk scenario that may come in the next twelve months. The reports do not examine ideas such as credit risk, fraud or cybersecurity risks. However, they are a valuable resource for projecting how your credit union may perform in the future.

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