

## CORE DEPOSIT ANALYSIS

Balance sheet risk management is critical to a credit union's long-term success and its ability to serve its members. Modern Asset Liability Management (ALM) techniques involve valuation on a record-by-record basis for all financial instruments. While valuation is straightforward for many of these instruments, non-maturity deposits provide a more challenging task, as we must make critical assumptions about the behavior of these liabilities.

The most conservative approach, from a valuation perspective, is to assume that these balances mature immediately and carry them at book value. However, this forgoes the premium valuation derived from an institution that is able to maintain balances at below market rates. This premium valuation can be unlocked through the discounting process, assuming we can reasonably determine implied maturities for these deposits.

### METHODOLOGY

Core deposits are defined as funds that are marginally affected by the credit union's pricing decisions, notwithstanding changes to the market level of interest rates. To identify core deposits and measure this relationship, we perform a regression analysis that compares the average monthly member account balance by type to the spread differential between the offering and market rates.

Once the regression is completed, the output is analyzed to determine the strength of the relationship between the two key factors. A stronger relationship indicates more sensitivity to a movement in interest rates and, therefore, a shorter implied maturity for the deposit category. A weaker relationship indicates that the deposits are less rate sensitive, implying a longer assumed maturity.

Although this analysis provides an approximation of the relationship, it is not a perfect predictor, as investors withdraw money for reasons other than rate. That said, it provides insight into the level of influence that the spread factor exerts on account balances. For ALM purposes, this process attempts to isolate the effect of interest rate changes on member deposit behavior, providing quantifiable results that can be utilized to substantiate non-maturity deposit assumptions.

### REQUIRED DATA

Data requirements for this service are modest. A minimum of five years of month-end account balance data (including offering rate) is required for each individual deposit type. Each category is separately analyzed, allowing for customized modeling assumptions.

A Core Deposit Analysis is available as a "stand-alone" service, or in conjunction with our comprehensive ALM Modeling & Consulting Service. It may also be done in conjunction with a one-time project such as our ALM Validation Service for a combined, external review of your interest rate risk management process.

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