MARYLAND BANKERS ASSOCIATION

BankExec

Mr. Phil Mantua

Sandy Spring Bank

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2024 Maryland Banking School
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Intro to BankExec

2024 Maryland Banking School
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Sandy Spring Bank

Simulation Environment

- Manage an almost $800 million bank
  - Complete top level management change
  - Only recent financial information
  - Assume many problems (discover and correct)
- Competitive community of several banks
  - Same size, financial conditions and economic environment
  - Any differences in competitive position over time are directly attributable to management

Important Considerations

- Financial position of the bank
  - Earnings rates on various assets, costs of various financing sources, cost effectiveness of overhead operations; maturity structure of assets and liabilities; capital position of the bank; potential problems
- Macro environment
  - Interest rate movements
  - Economic activity
- Review
  - Stockholders, competitors and regulators

Successful Bank Management

- Set goals, determine a course of action (strategic plan), and develop policies to guide your decisions
- Arrange the decision-making process to best utilize the skills and talents of the managers
- Measure actual results against desired results and make logical changes that coincide with your plan

Successful Bank Management

- Avoid trying to indicate the precise effect of a specific change in a decision variable
  - “What If” simulation will help
  - Model “considers” decisions made in earlier quarters
  - Competitors’ decisions impact you
  - Most decisions impact numerous areas of the bank
  - Economy may change in unanticipated ways

- Keep the focus on making logical decisions that lead the bank in the intended direction

Always

- Run the bank as you would in the real world
- Accept that some of your choices will be “less than optimal”
- Don’t worry about “mistakes” or dwell on “what could have been”
- Focus on making the best choices going forward

The Goal of Bank Management

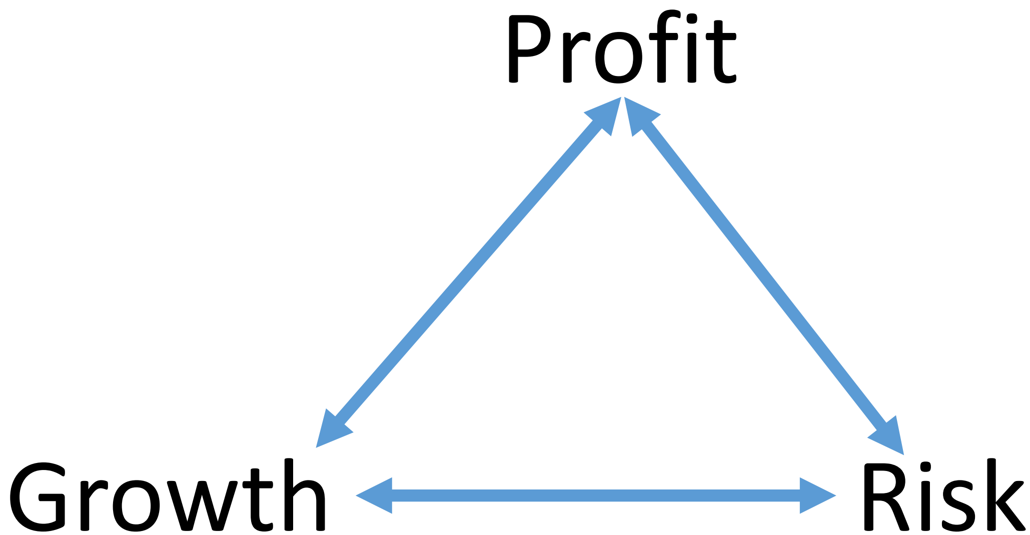
- What is the goal of bank management?
  - Maximize shareholder value
    - Long-run perspective
    - Ongoing concern

- Asset Value/Price
  - Present value of expected future cash flows
    - Profit, growth, risk
  - Bank management must determine the "appropriate balance between risk and return
    - Higher profit often requires taking additional risk
    - Higher ***profit*** does not always translate into higher ***value***

Most Importantly

Implement your own strategy!

Watch competitors and make adjustments, but keep focus on your goals



Some Decision Considerations

- Pricing and mix of assets
- Pricing and mix of liabilities
- Quality and growth of loans
- Service charges and fee income
- Expense control
- Choice to sell assets
- Amount of earning assets
- Ability to manage taxes
- Payment of dividends
- Use of deposits and debt
- Use of additional capital

Drivers of Stock Price in BankExec

- Capital
- Asset Quality
- Management quality
  - EPS forecast accuracy
  - Interest sensitivity gap
- Profitability
- Liquidity
- Dividend Policy
- Growth
- Earnings volatility and risk

BankExec - Decisions

BankExec Model

- Your input is needed on four decision pages
  - Loans
  - Deposits
  - Securities
  - Treasury Management
- The **What-If** allows you to forecast your bank's results based on the decisions you have made
  - Can do multiple What-Ifs
  - Cost increases for each What If
    - First is free each quarter, Second is $5,000, Third is $10,000, Fourth is $15,000, etc.

Loan Decisions

- Decision Required for All Loans
  - Loan Rates (more info to follow)
  - Credit Policy
    - Most restrictive = 1 ⟷ Least restrictive = 5
  - Business Development
    - High (H=4); Medium (M=2); Low (L=1); None (N=0)
    - Sums assigned weights for ***all loans and deposits***
    - Proportionally assigns total budget *(set on deposit page)*
  - Maximum Outstanding
    - Maximum balance allowed (usually keep open)
- Additional individual loan decisions
  - Commercial RE: *max maturity* and *rate adjustment period*
  - Credit Cards: *annual fee*
- Loan Packages Available for Sale

Setting Loan Rates

- Rate generally determined by adding a "spread" to an index rate
  - For example, in BankExec, Business Term Loan rates are set relative to the prime rate

- Market rates reflect the index rate plus spread, so we can use the market rates to set bank rates
  - Market rates are shown on Report C93
    - BoQ = Beginning of quarter; EoQ = End of Quarter
  - Bank rates on C93 are **beginning of quarter rates**

Loan Rates in BankExec

- **Set Rates relative to the current market rate**
  - Do not base on anticipated rate movements
  - Simulation adjusts your rates as quarter progresses
- **First**, determine the bank’s implied end of quarter rates
  - Bank rates shown on C93 are beginning of quarter
  - Adjust for market movement during quarter
    - Use market change or spread to find EoQ rate for bank
- **Second**, modify the implied EoQ rate based on desired results or other material changes

C93

Interest Rate Charged --	Mkt BoQ	Mkt EoQ	Bank 1 ← **BoQ**
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Business Credit Lines	6.43	6.74	6.50
Business Term Loans	6.89	7.13	7.00

Loan Pricing Example

"Implied EoQ Bank Rate" – BoQ Bank Rate + (Mkt EoQ – Mkt BoQ)

For Business Credit Lines:

"Implied EoQ Bank Rate" = 6.50% + (6.74% - 6.43%) = 6.81%

Preserves the beginning of quarter spread versus the market:

"BoQ Spread" = 6.50% - 6.43% = + 0.07%

"EoQ Spread" = 6.81% - 6.74% = + 0.07%

- We now need to adjust the Implied EoQ Bank Rate
  - Do you want to be more or less competitive?
  - Are you changing credit policy?

Deposit Decisions

- Fees for checking and savings
  - Monthly fee and/or item charge (transaction fee)
  - Fees can have a big impact
- Interest rates for all deposits
  - Does market rate change matter?
  - Retail time account rates priced relative to Treasuries
- Minimum balance
  - Checking: balance required to receive interest
  - Savings: “balance” that determines standard or premium rate
- Maximum Issue is **new** amount that will be accepted
- Business Development
  - Emphasis for each deposit type (H, M, L, N)
  - Total Business Development Budget for ***loans and deposits***
    - Salaries and Advertising & Promotion

Security Decisions

- Buy Treasuries, Agencies, Municipals, or Swaps
- Sell existing securities

- Important Considerations:
  - Treasuries, Agencies, & Swaps are marked-to-market
  - Municipals(TE) are **not** marked-to-market
  - Municipals are tax-qualified (tax equivalent yield)
  - Repos available equals amount of Treasuries held
  - Liquidity needs should be considered

Treasury Management

- Model uses Fed Funds to “balance” bank
  - No “decision amount” entered
  - Fed Funds should not exceed Total Capital
- Repos available equal to total of Treasuries held
- CDs (negotiable) – 1 to 4 quarter maturities
- FHLB Rates =

  Treas. Rate (same maturity) + 25 bps + 2 bps per mat year
  - Must hold 10% of assets in resid. mort. to borrow FHLB
  - Amount available equals residential mortgage balance
- Decision for capital notes and common stock is dollar amount in millions that you want to raise
- Remember to enter dividends and EPS forecast

“What If” Analysis

- The “What If” analysis allows you to simulate (forecast) your results for the next quarter
- Will not be perfect since you must estimate:
  - Change in market interest rates
  - Competitors’ average loan and deposit rate changes
- Will help you:
  - See expected impact of your decisions
  - Determine funding needs
    - Enter all decisions except Repos and CDs
    - Run “What If” simulation
    - Fed Funds indicates expected funding shortfall or surplus
  - Develop earnings per share forecast

Regulatory Requirements

- Fed Funds Purchased (FFP – B01)
  - FFP < = Total Capital
  - FFP/Total Capital < = 100% (shown on balance sheet)
- Owner's Equity / Total Assets (B01)
  - Must be > = 5.5% in first year
  - Must be > = 6.0% by the end of the fourth quarter
- Total Capital / Risk Assets (B05)
  - Must be > = 8.0%
  - Must be > = 8.5% by the end of the fourth quarter
- Other regulations may be added at any time

Potential New Regulatory Guidelines

- Liquidity
  - Net liquid assets
  - Loans to Deposits
- Security decision limitations
  - Sale of securities
  - Use of swaps
- Loan portfolio concentration limits
- Further purchased funds limitations
- And on, and on, and on, ………