Tis the Season... to Review Your Funding Strategy

By: D. James Lutter
Co-author: Todd A. Terrazas

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The holiday season is upon us and the Fed is expected to provide an early gift of 25bps. With only five shopping weeks left, financial institutions are scrambling to secure funding prior to year-end. Keep in mind as we enter the winter months, not all funding sources are the same and the longer you wait, the more limited and expensive the options become.

To begin, make your list and check it twice. The key component when developing your funding list is to start by defining your goal. Is it to build out long-term institutional funding sources, secure short-term dollars over year-end, or something in between? When looking to secure funding in a rising rate environment close to year-end, it is important to model based on the current economic cycle and compare to previous experiences, creating realistic expectations.

The question to ask: what funding sources are available, and how can they be deployed to meet our funding goals? Keep your competition in mind, as they are most likely approaching similar funding sources to achieve their goals as well.

IDENTIFY AND DEFINE FUNDING SOURCES

There are a number of institutional funding options available to financial institutions that can serve as a complement to traditional funding when utilized in a prudent manner. This starts with understanding the source behind the deposit. Prior to participating in the institutional deposit market, construct a template outlining rules of engagement, specifically covering the various sources and types, such as:

- When should institutional funding be utilized?
- What are the concertation limits?
- For what duration should they be utilized?
- Are there underlining factors that could limit access?

By answering these simple questions, a financial institution is beginning to create a list.

WHICH FUNDING OPTIONS ARE RIGHT FOR YOUR FINANCIAL INSTITUTION

After recognizing current funding sources and any pitfalls that may exist, a financial institution should look to bridge the gaps. Once you have determined appropriate funding options, the next step is to identify the role each option will play within an operating and contingency funding plan. It is critical that diversification, credit sensitivity and concentration limits be included. A good test of these attributes can be identified through a SWOT analysis (Strengths, Weaknesses, Opportunities and Threats). For example, a SWOT analysis of a municipal depositor may resemble the following:

Strengths – A municipal depositor is typically local, has a predictable deposit cycle and can be a stable funding source.

Weaknesses – Deposit capabilities can fluctuate and are cyclical; usually requiring some form of collateralization (per state statute or investment policy). Credit restrictions may also be present.

Opportunities – A municipal client can become a significant, multifaceted relationship through transaction activity, long-term banking service contracts, borrowing, safekeeping, etc. Additionally, diversification among multiple municipalities may mitigate cyclicality risk.

Threats – The general economic conditions may deteriorate, creating revenue shortfalls from a declining tax base and/or a delay in state or federal aid.

Regulators are taking a close look at financial institutions' funding policies to ensure that proper controls are in place, which should adequately address the environment in which each financial institution operates. Testing sources on a regular basis allows a financial institution to readily access funds as needed, while eliminating the element of surprise.

MONITOR AND MAINTAIN YOUR FUNDING SOURCES

To avoid undue stress, it's important for financial institutions to monitor the inherent risk characteristics of its funding sources, as well as the evolving needs of those sources. Gaining a comprehensive understanding of your funding sources and the relationships to their investors and depositors provides much needed information to help understand how those deposits will respond under stress. Adverse effects to a financial institution's credit profile will increase the institution's cost of funds and may limit their ability to access funding. Different depositors have diverse investment criteria and yield expectations. A comprehensive understanding of these metrics will enhance the financial institution's ability to price and access funding sources. Furthermore, it allows for a risk-averse operating and contingency funding plan to be executed. To build a solid, ongoing understanding of its funding sources, a financial institution should continually ask these important questions:

- How does the market view my financial institution? Do I know the credit criteria my funding sources monitor (qualitative and quantitative)? What are the implications if the criteria are breached?
- Do I understand my funding source's (depositors) investment objectives (safety, liquidity, yield, etc.)?
- Have I identified, and do I monitor, the factors that could affect my ability to access various funding sources?
- Does my funding source have concentration limits?
- Have I documented each funding source's role and communicated it where applicable?

CONCLUSION

Make sure to enter this winter with a well-defined funding strategy and avoid a last minute scramble. Poor execution can negate a well-defined plan and allow the Scrooge to minimize your holiday experience. Remember to fund early, so you can focus this holiday season on family and friends.

About D. James Lutter

D. James (Jim) Lutter is the Senior Vice President of Trading and Operations at PMA Financial Network, Inc. and PMA Securities, Inc. where he oversees PMA Funding., a service of both companies that provides over 1,000 financial institutions with a broad array of cost effective funding alternatives. Mr. Lutter is a Registered Representative with PMA Securities, Inc. and Investment Advisor Representative with Prudent Man Advisors, Inc. Mr. Lutter has the following FINRA licenses with PMA Securities, Inc.: Series 7, 24, 50, 53, 63, 65 and 99.

About Todd A. Terrazas

Todd joined PMA Financial Network, Inc. in 2014 as a Financial Analyst for the firm's Credit Risk Management team. He now serves as Business Development & Product Manager for PMA Funding, where he is responsible for developing financial institution partner relationships and managing funding product solutions and association affiliations. Mr. Terrazas also engages in strategic planning and identifying market trends through extensive market research. Prior to joining the firm, he was a Market Research Analyst at Common Goal Systems, Inc. Mr. Terrazas earned his Bachelor of Arts in Finance from Calvin College.