



FHLBank Atlanta

Challenges Managing Interest Rate Risk at Community Banks

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► Challenges

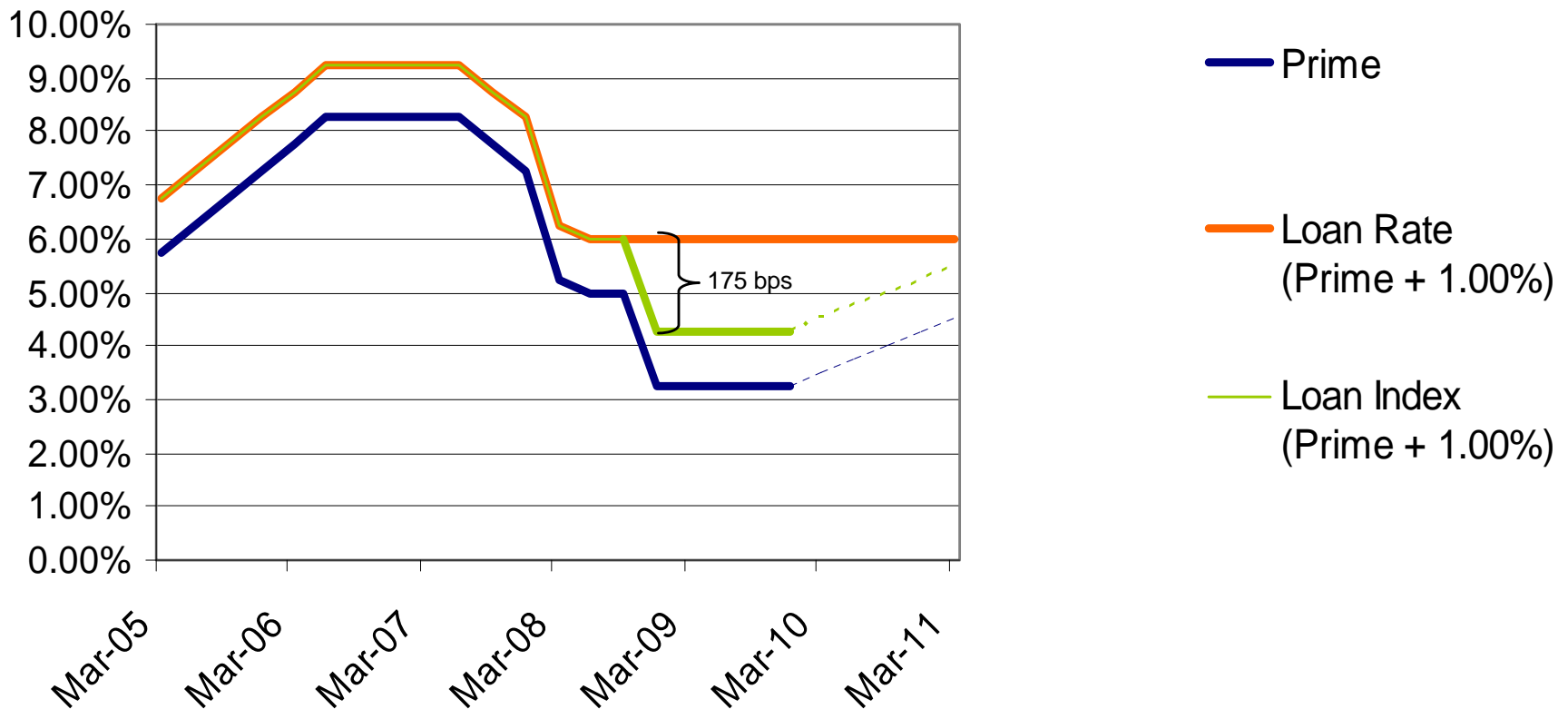
- Assets
- Liabilities
- Excess Liquidity

► Solutions

- Long Term Deposits
- FHLB Advances
- Off-Balance Sheet

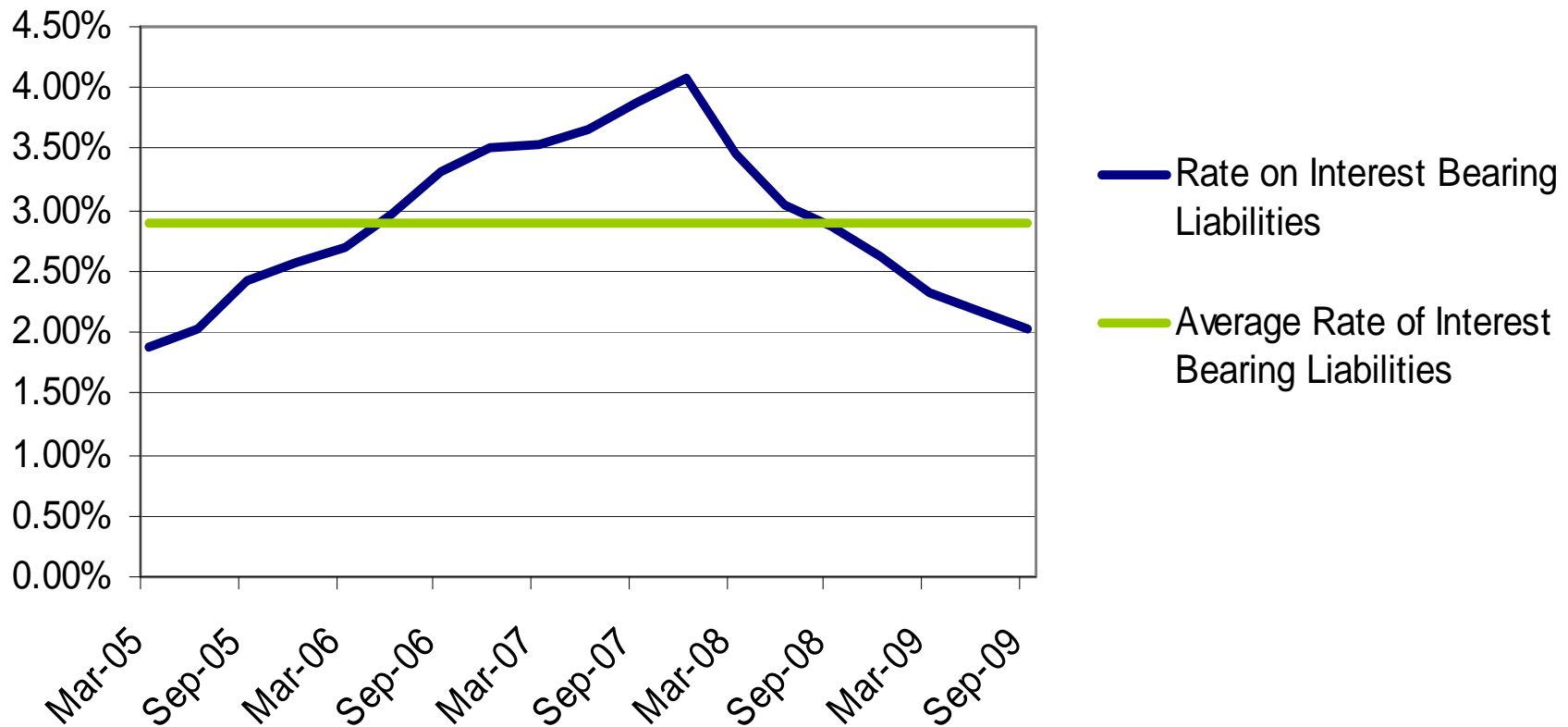
Assets

► Margin Compression in the Future ?

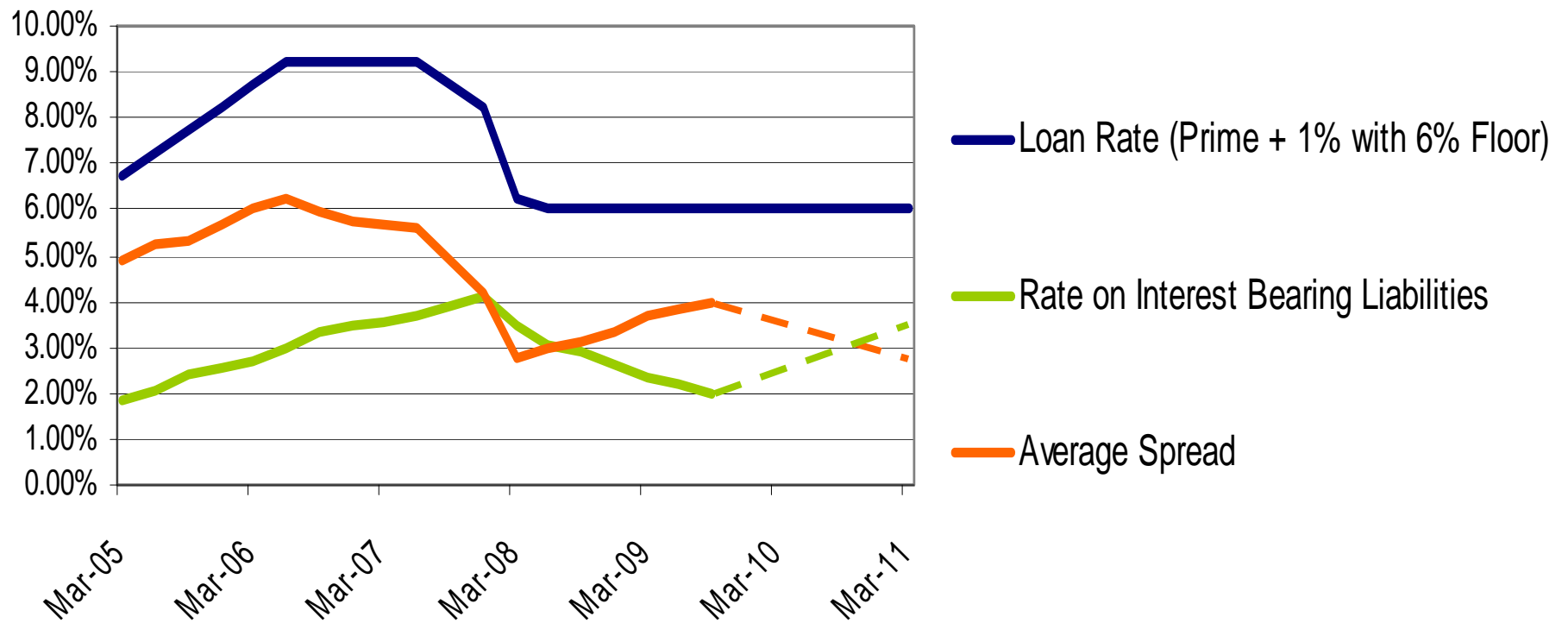


Liabilities

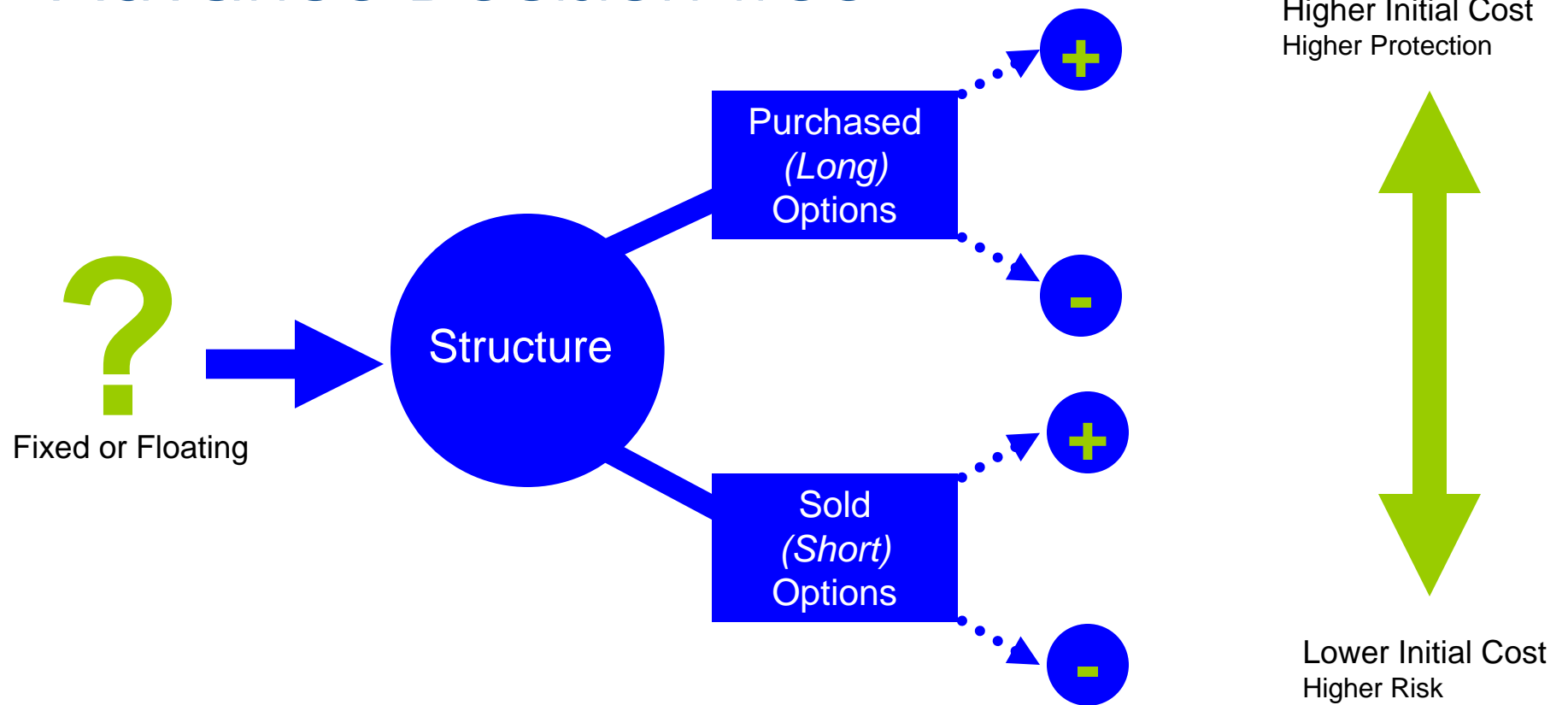
► Funding Costs for Community Banks



Rising Rates Add to Margin Compression



► Advance Decision Tree



Due to accounting requirements, advance rates cannot be negative and realized unwind gains cannot exceed 10 percent of principal.

► Fixed Rate Credit

Pros

- Fixed rate funding with stated maturity
- Think CD
- Hedge for fixed rate assets or loans
- Maturities of one month to 10 years
- Provides longer term funding not typically available in the retail market

Cons

- Community banks do not need additional liquidity

► Purchased Optionality

Managing Risk

- Interest rate risk
- Asset sensitivity
- Liability sensitivity
- Rising rates
- Falling rates
- Prepayment risk
- Member controls the exercise of the option

Base Advance

- Fixed
- Floating

Plus

Cost of option

- Caps
- Floors
- Prepayment
- Expansion

FRC Hybrid with cap

FRC Hybrid with floor

Expander

Callable

► Fixed Rate Credit with Cap

Pros

- Fixed rate funding with stated maturity
- Cost of Cap is embedded into the rate on the advance
- Caps can be leveraged for additional protection (need the protection and not the funding)

Cons

- Market value
- Community banks do not need additional liquidity

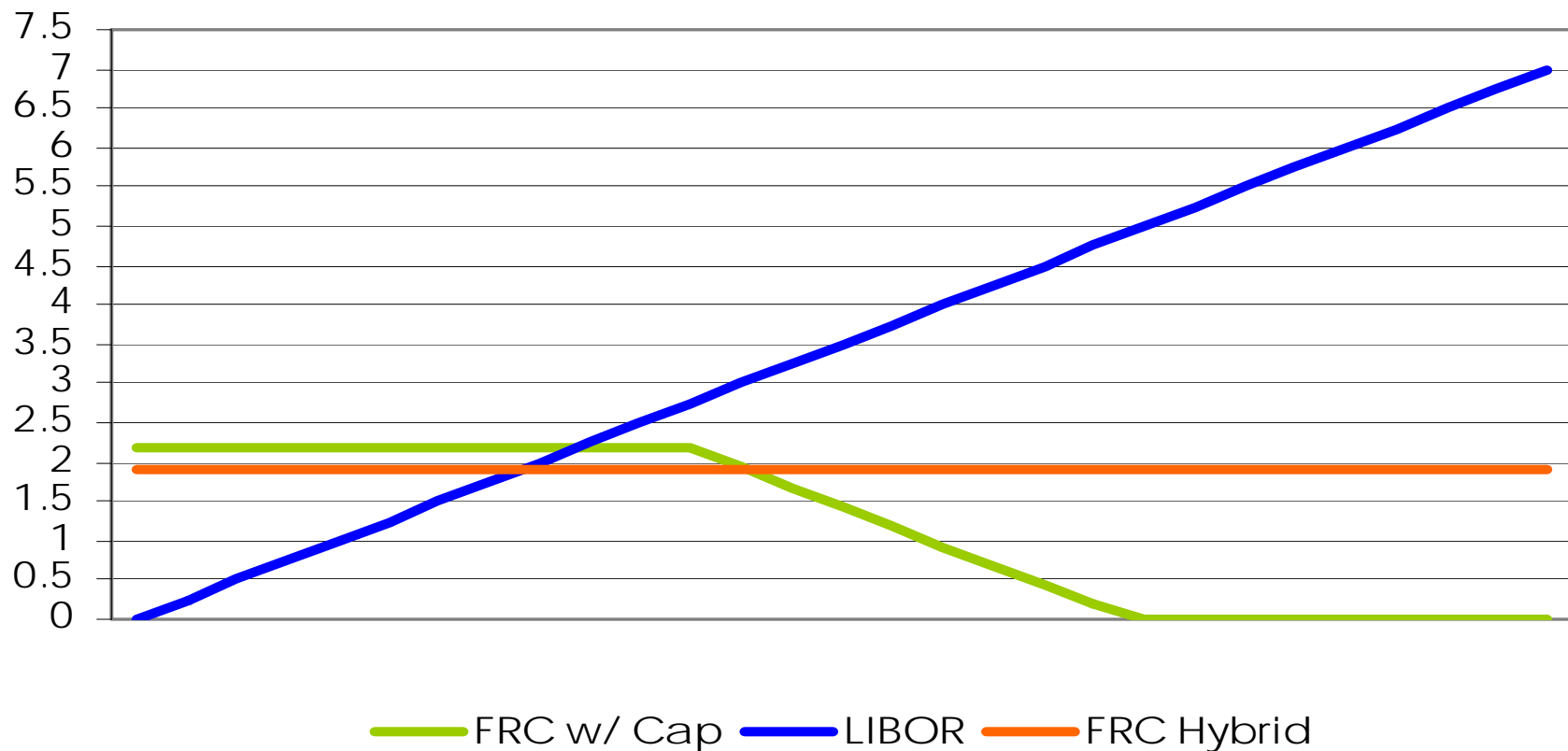
► Fixed Rate Credit With Cap

Example: 3 year FRC Hybrid Advance 1.90%

Cap

Term	3 Years
Strike Index	3-Month LIBOR
Strike Rate	2.75%
Annual Cost 1X	28 BPS

► Fixed Rate Credit Hybrid With Cap



► Callable Advance

Pros

- Fixed rate
- Borrower may repay on specific dates with no penalty
- Prepayment option may be European or Bermuda
- Allows borrower to lower funding costs if rates decline and prepayment on loans or securities increase

Cons

- Expensive
- Borrower is responsible for exercising the option to pay back the advance without a fee

► 5/1 Callable Advance Example

- 5 year Fixed rate advance 2.95%
- 5 year Callable advance and the member owns the option to pay back the advance at 1 year or any six month period there after

5 year Fixed rate advance 2.95%

5/1 year Callable advance 3.23%

Cost of Option .28%

► Final Thoughts

- Balance Sheet structure and interest rate view are critical in this environment
- ALCO process should be refined and proactive
- Liability pricing and liquidity are key drivers for the future