[Risk-Based Considerations for a Funds Transfer Pricing Model]

Interview with Christopher Dunn, SVP, Director, Asset/Liability and Capital Planning at Associated Bank

Online PR News â€“ 02-May-2013 â€“ Funds Transfer Pricing is under increasingly sharp focus. Financial institutions need to respond to Basel III as well as the Dodd-Frank Act that signal a fundamental change to the way liquidity is managed and regulated. The efficiency, with which they adapt their business strategy and accordingly, their FTP model, will be a deciding factor in the future profitability of core product lines.

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Christopher Dunn, SVP, Director, Asset/Liability and Capital Planning at Associated Bank answered a series of questions written by GFMI before the forthcoming 2nd Annual Funds Transfer Pricing and Balance Sheet Management Conference, May 15-17, 2013 in New York, NY. All responses represent the views of Mr. Dunn and not necessarily those of Associated Bank.

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How do you feel regulation is impacting the use of FTP?

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Christopher Dunn: Regulations are significantly having an impact on how banks will price loans. Liquidity is an increasing cost in determining transfer prices. Collateralized deposits need to properly account for how much unencumbered securities remain. Furthermore, regulations are emphasizing a more integrated approach in banking. The integration of Asset Liability Management (ALM), Fund Transfer Pricing (FTP) and Credit are critical to evaluate banks risk adjusted profitability.

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How can FTP be integrated into the banks business model?

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CD: Since ALM incorporates all financial assets and liabilities at a record level, it is quite easy to leverage that process by configuring FTP methodologies into the same database.

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FTP is a critical component in determining product profitability by quantifying the funding costs or funding credit. An effective FTP framework ensures the banks total net interest margin is the sum of all the lines of business income, (asset generation and liability generation side) plus income attributed to the funding/mismatch unit.
Once the funding component is determined, the credit component can be assessed for loan pricing. For deposits, price sensitivities and elasticities can be modelled.
What is important, is that consistent assumptions are used when designing new products.

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Do you feel that FTP, ALM and balance sheet management are working together?

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CD: Yes. FTP, ALM and Credit have been integrated to ensure consistent analysis and profitability reporting. At many institutions this is certainly a challenging task because each function resides in very different divisions. FTP is generally with Finance/Profitability, ALM is with Treasury and Credit resides with Credit Administration.

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An integrated framework that leverages all of these functions together ensures consistency. FTP is a mere extension of ALM. ALM primarily views risk at the top of the house, whereas FTP prices at the transaction level. As long as the assumptions are consistent, profitability and interest rate risk management will be consistently managed.

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Most banks have now gone through the first step of implementing FTP. Where do you feel the challenges now lie?

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CD: Banks will need to evaluate their FTP methodologies and determine appropriate ones that can be practically implemented into their core banking systems.
The challenges often reside with implementing best practices for all products throughout the balance sheet. Financial instruments with no optionality are pretty much addressed. Any instrument that exhibits optionality such as mortgages, loans with embedded caps and deposits are more difficult to apply a transfer price. You need a framework that can explicitly value the embedded options.

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Christopher Dunn currently serves as Senior Vice President, Director, Asset/Liability and Capital Planning. He is responsible for overseeing the banks corporate interest rate risk management and capital management. He brings more than 25 years of banking and risk management experience to Associated, most recently holding the position of Director of Client Management at Quantitative Risk Management in Chicago advising clients on measuring and managing risk, and integrating data systems into their risk framework and developing capital and liquidity stress models. He also held positions at Federal Agricultural Mortgage Corporation, KPMG and Freddie Mac. Chris holds a bachelors degree in Economics from the University of California, Berkeley and a masters of business administration degree from the University of Chicago.

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