



Velligan-Blaxall Consultants, LLC

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# Life After the Flat Yield Curve

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## Disclaimer

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## Introduction

1. Knowledge – External
2. Knowledge – Internal
3. Dynamics
4. Be prepared



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## Knowledge – External

Flat yield curves and rate volatility make banking more challenging

"Common sense is uncommon"  
Voltaire



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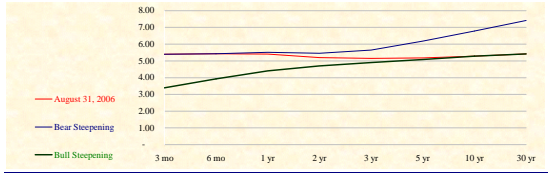
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## Knowledge – External

### Yield curve shape

Interest Rates:	3 mo	6 mo	1 yr	2 yr	3 yr	5 yr	10 yr	30 yr
August 31, 2006	5.40	5.43	5.41	5.20	5.15	5.18	5.29	5.41
Bear Steepening	5.40	5.43	5.51	5.45	5.65	6.18	6.79	7.41
Bull Steepening	3.40	3.93	4.41	4.70	4.90	5.08	5.29	5.41




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## Knowledge – External

### The economic environment

Housing slowdown + Easing inflation



= Lower short term rates  
(in '07)




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## Knowledge – Internal

### SWOT

- Strengths
- Weaknesses
- Opportunities
- Threats

### What are your core competencies

- Deposit gathering
- Lending – Leasing, Credit Card
- Servicing




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## Knowledge – Internal

### Core competencies (imbedded characteristics)

- Fixed/Float
- Repricing characteristics
- Indexes
- Options (prepayments/pricing)



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## Knowledge – Internal

### Understand your existing position

- Where is the exposure (Stress Tests)
  - Curve twists
  - Prepay shocks
  - Balance sheet dynamics

### Build on and compliment existing position



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## Knowledge – Internal

### Goals

- ROE/ROA
- Margin
- Growth
- Value
- Cash flow



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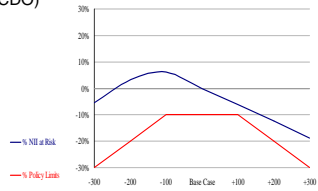
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## Dynamics

### Flat rates

- Option taking (Flipper Repo)
- Credit risk (CDO)




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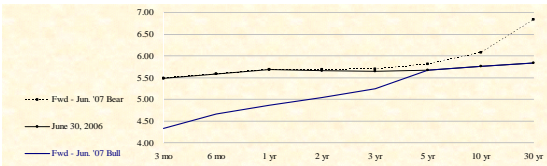
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## Dynamics

### Bear steepening

- Extend liabilities
- Shorten assets (swap fixed for float)




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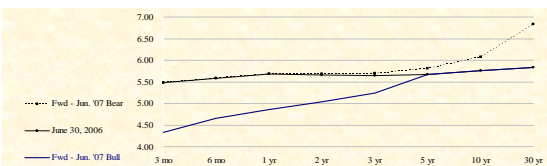
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## Dynamics

### Bull steepening

- Short liabilities
- Long assets (buy floors)




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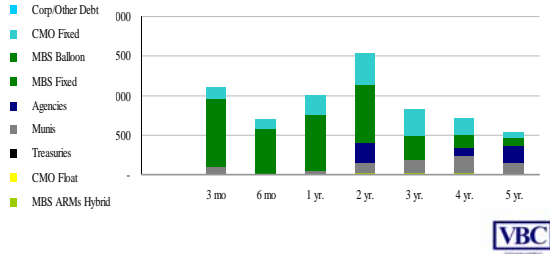
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## Dynamics

### Opportunities – Assets Investments



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## Dynamics

### Opportunities – Assets

- Investments
  - Types
  - Mix
  - HTM/AFS
  - Optionality (calls/prepays)
  - Repricing (Hybrid Arms, caps)
  - Cash flow (bullet, amortizing)
  - Yield (Credit Quality)



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## Dynamics

### Opportunities – Assets

#### Loans - Turning the tap on.

- Product type
  - Real Estate (commercial, residential)
  - Home Equity
  - Commercial/Business
  - Installment
- Product Structure (Amortizing / Interest Only / Fixed / Variable / Float)
  - Hybrid ARMs
  - Balloon
  - Interest only
- Pricing
  - Competition
  - Retention



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## Dynamics

### Opportunities – Liabilities

- Deposits
  - Core
  - Time
- Borrowing
  - Term/Structured Repo
  - Brokered Deposits/CDARS
  - FHLB Bullets/Convertible Select/Amortizing



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## Dynamics

### Opportunities – Liabilities

- Deposit growth significant to bottom line
- Deposit growth has declined significantly
  - Competition between banks
  - Competition with brokers/insurance companies
- Deposit mix impacted by changing interest rates
- Past performance does not predict future results
  - Core deposit decay rates
  - Market opportunities



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## Dynamics

### Opportunities – Liabilities

- Manage BOTH sides of the balance sheet
- Utilize market inefficiencies
- Diversify and expand lines of credit
- Develop strategies not just “specials”
- Analyze the performance of your strategy



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## Dynamics

### Opportunities – Derivatives

- Swaps (floating for fixed)
- Caps/Floors
- Collars/Corridors (insurance policy)



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## Be Prepared

Know the environment  
Know your institution  
Know your goals  
Know your choices  
You're ready for anything

"Preparedness prevents peril"  
Ancient Chinese proverb



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