



UNDERSTANDING FUNDS TRANSFER PRICING (FTP)

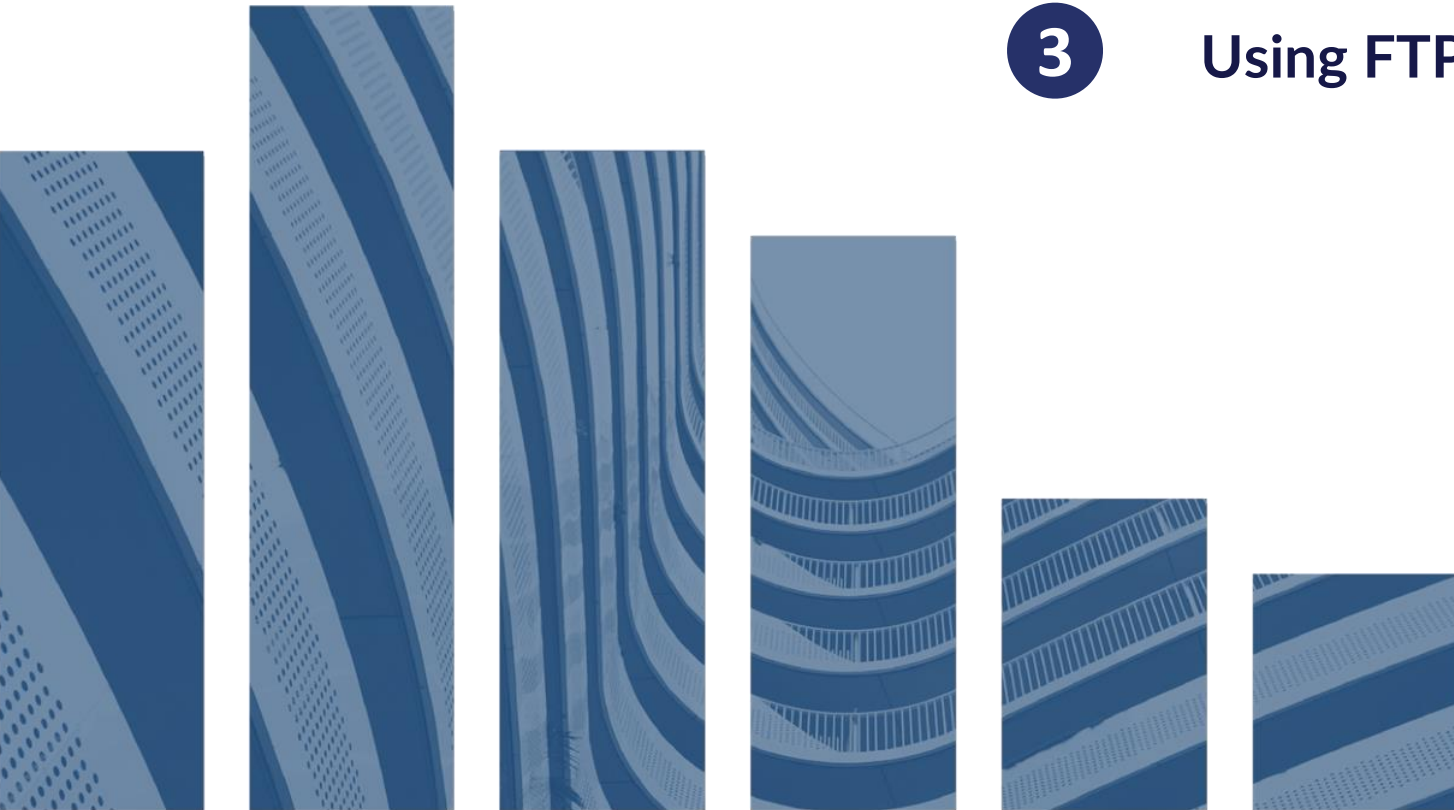
CreditUnions.com

Will Newcomer

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AGENDA

- 1 The four basic components of FTP
- 2 Overcoming the challenges of implementing FTP
- 3 Using FTP to improve Profitability



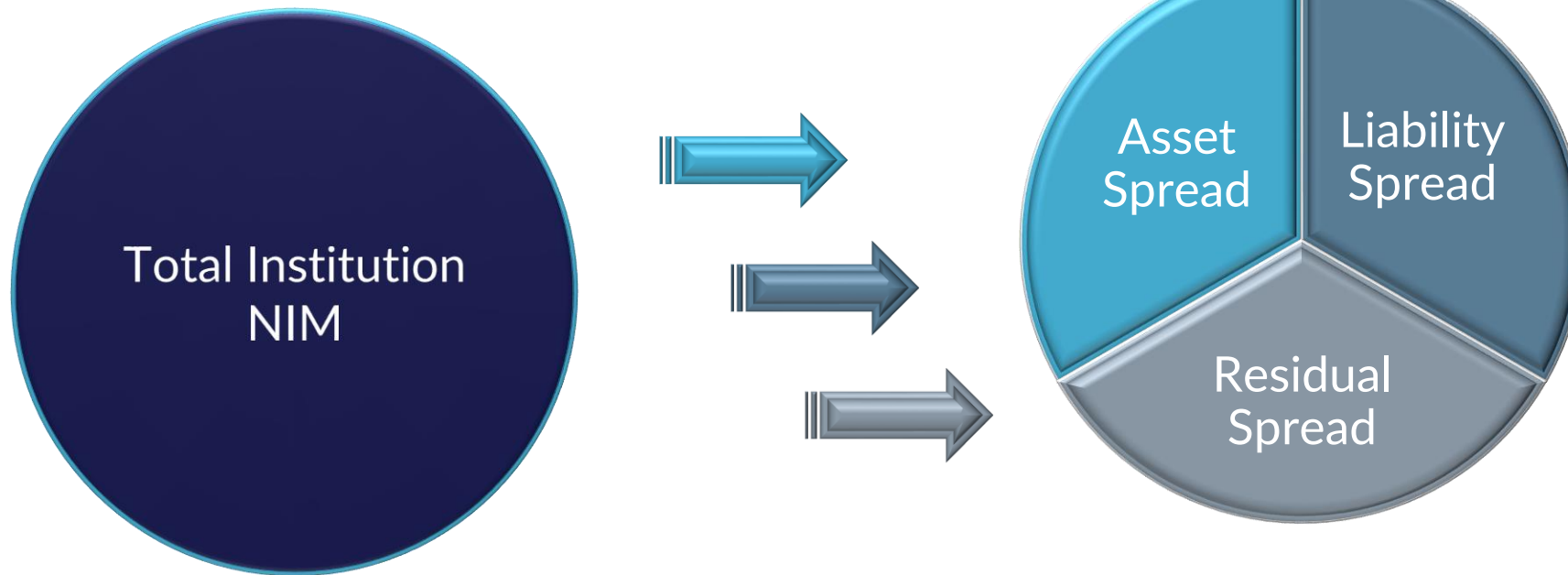
FTP BASIC TENETS

Funds Transfer Pricing Defined

Funds Transfer Pricing is an internal management system designed to allocate (NIM) for every segment of a financial institution

- Departments / Branches
- Products

- Officers
- Customers / Members



FTP BASIC TENETS

Allocating the Margin

Forty years ago, loans were thought to bring all the “profit” to the bank – while deposits had a negative impact on bottom line

Category	Product	Balance	Interest Rate
Assets:	3-Year Loan	100,000	4.55%
Liabilities:	6-month CD	100,000	1.15%
Margin:			3.40%

BUT...

How profitable were the assets?

What value were deposits bringing to the organization?

FTP BASIC TENETS

Allocating the Margin

FTP enables financial institutions to apply a cost/credit in order to value assets and liabilities, calculating a margin for both

The bank's marginal cost to fund the loan.

Category	Product	Balance	Interest Rate	FTP Rate	Spread
Assets:	3-Year Loan	100,000	4.55%	3.30%	1.25%
Liabilities:	6-month CD	100,000	1.15%	2.10%	0.95%
Margin:			3.40%		2.20%

The bank's marginal cost to borrow funds

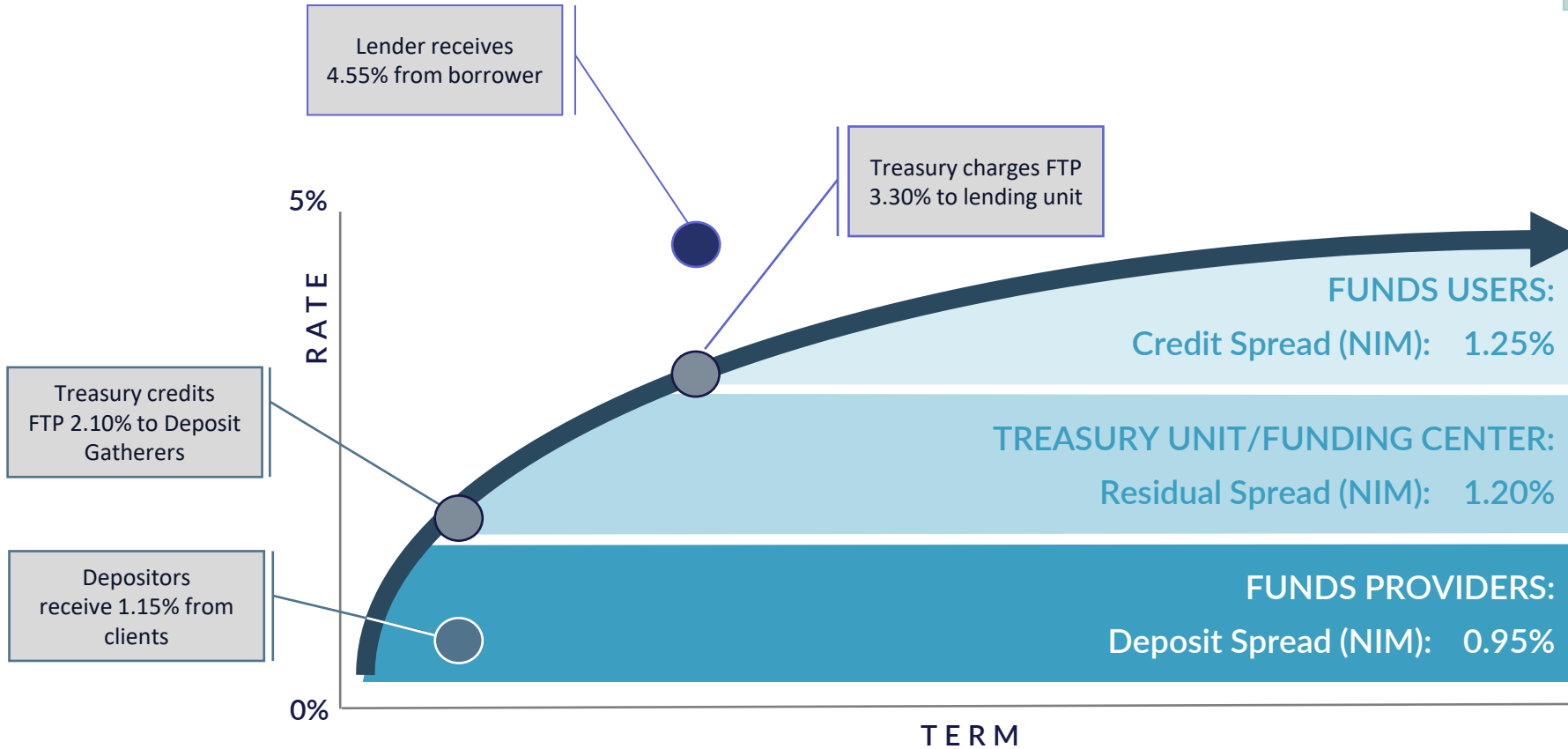
What happened to the 1.20% (3.40% - 2.20%)?

FTP BASIC TENETS

Illustrative Example

Category	Product	Balance	Interest Rate	FTP Rate	Spread
Assets:	3-Year Loan	100,000	4.55%	3.30%	1.25%
Liabilities:	6-month CD	100,000	1.15%	2.10%	0.95%
Margin:			3.40%		2.20%

What happened to the 1.20%
(3.40% - 2.20%)?



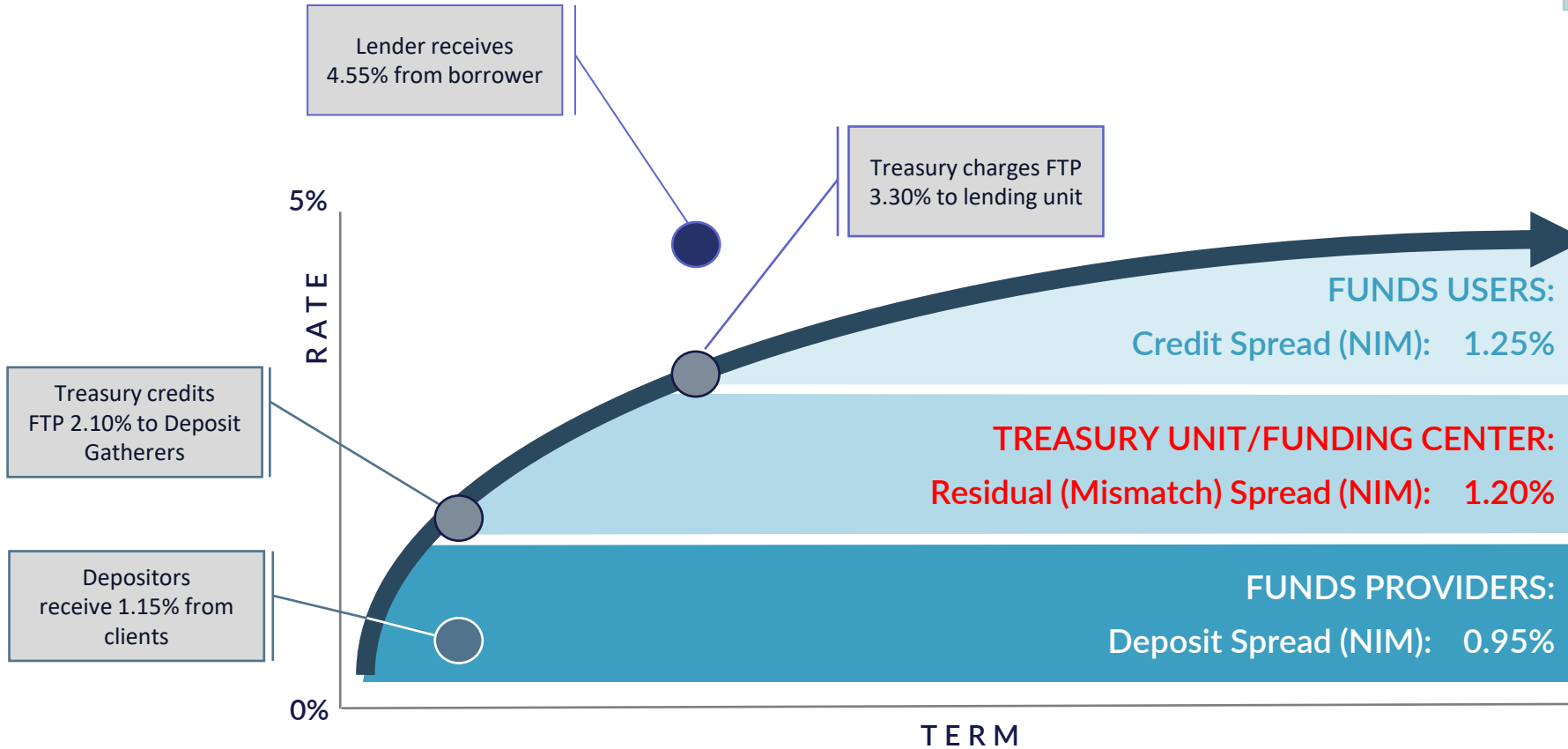
Total Institution NIM:
3.40%

FTP BASIC TENETS

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What happened to the 1.20%
(3.40% - 2.20%)?



Total Institution NIM:
3.40%

FUNDS TRANSFER PRICING METHODOLOGIES



What are the most common transfer pricing methods?

- Net Funds Transfer Pricing
- Portfolio or Pool Transfer Pricing
- Matched-Term Transfer Pricing

Matched-Term Transfer Pricing

The Fundamental Concept

Each instrument needs to be individually priced due to differences in:

- Origination date, repricing date, term, etc.
- Cash flow and pricing characteristics
- Customer behavior expectations

There are different methods within Matched-Term Transfer Pricing that address these differences

MATCHED-TERM TRANSFER PRICING METHODS



What are the most common matched-term methods?

- Assigned Rate
- Term to Maturity
- Cash Flow
- Repricing Term

**Note: There are additional matched-term FTP methods (e.g., duration, weighted average life); however, these are much less common and there are theoretical challenges with them*

MATCHED-TERM FTP METHODS

Assigned Rate Method

Primarily used for floating rate instruments or ambiguous term accounts

- 1** Can use a *specific Rate Index* to assign transfer rates
 - E.g., your FHLB 3 year borrowing rate
- 2** Can use a *derived value based on the rate index*
 - Rolling / Moving Average (i.e. 3 year, average of the 3 year rate index)
 - Blended Rate (20% overnight rate index; 80% 2 year rate index)
- 3** Can *add transfer rate adjustments* to assigned rates
 - E.g., price non-maturity deposits using a short-term rate; but add a liquidity premium for expected life

MATCHED-TERM FTP METHODS

Matched-Term Methods; Cash Flow, Term to Maturity, Repricing Term

Used for any “term” based accounts

- 1** Assign and populate a market-based yield curve (term structure)
 - E.g., FHLB, SOFR, Treasury, Corporate Credit Union Curve, etc.
 - Historical rates are needed
- 2** System looks up the transfer rate based on instrument characteristics
 - Origination Date, Previous Reprice Date
 - Maturity term, Repricing term, Cash flows
 - Customer behavior assumptions (prepayments, early withdrawals, etc.)

The transfer rate remains constant for the ‘term’ of the instrument!

MATCHED-TERM FTP

FTP Methods Matrix

Method	Assign Rate	Term-to-Maturity	Cash flow	Repricing Term
Rate Type	Floating	Fixed	Fixed; Adj.	Adj.
Amortization Type	All	Bullet	Amortizing	Bullet; Amortizing
Term	Assigned Life/ Blended	Maturity	Maturity; Reprice	Reprice
Pricing Date	Business Period	Origination / Rollover	Origination / Rollover; Previous Reprice	Previous Reprice
Standard Accounts	Savings, Checking, Home Equity, Floating Notes	CDs, Bonds, etc.	Auto, Mortgage and Commercial Loans	ARMs, Adj. Commercial Loans, Adjustable Notes

MATCHED-TERM FTP

What Market Rates?



Yield Curves

- Should represent the alternative market rate for funding / investment*
- Should only use a single yield curve
- Examples:
 - FHLB Advance Curve;
 - SOFR Curve
 - Corporate Credit Union Curve



Rate Indexes

- Should represent the alternative market rates for funding / investment*
- Assigned based on repricing characteristics or assumed duration of non-maturity accounts
- Can be a specific rate index, moving average, or blended rate
- Examples:
 - Prime, Fed Funds;
 - 1 mo. FHLB, 3 mo. FHLB, 1 yr. Treasury
 - Moving Average (3-year avg., of the 3-year rate)
 - Blended (20% overnight, 80% 2 yr. FHLB)

* Market rates can be adjusted to reflect your individual institution's ability to borrow funds

SYNCRONIZING DECISION MAKING

Front Line

CEO / CFO



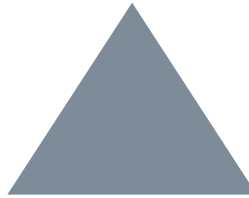
Wouldn't it be nice if the front line made decisions like I would?



PRODUCTION

- LOANS
- DEPOSITS

“VOLUME, VOLUME & MORE VOLUME”



GROWTH

- EPS / ROE / ROA

MAINTAIN

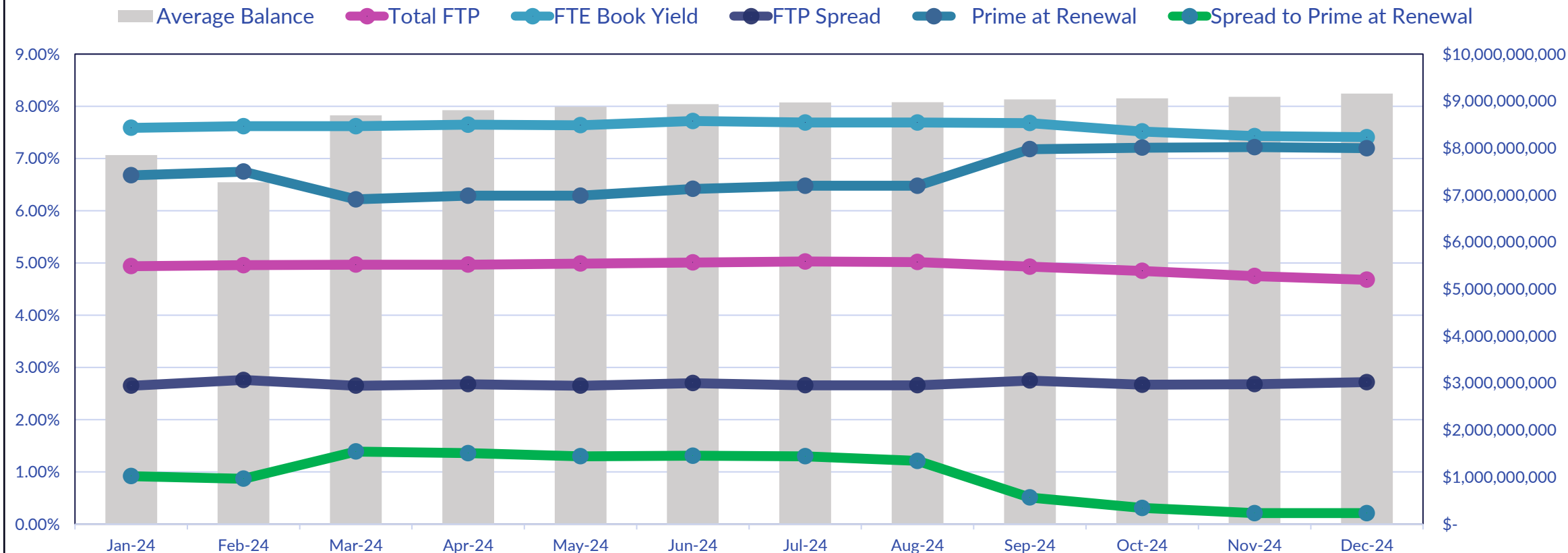
- LIQUIDITY / CAPITAL / CAMELS

Spread and Production

Spreads by Time

Organization: Ledger: Frequency: Time:

Measures	Jan-24	Feb-24	Mar-24	Apr-24	May-24	Jun-24	Jul-24	Aug-24	Sep-24	Oct-24	Nov-24	Dec-24
Total FTP	4.94%	4.96%	4.97%	4.97%	4.99%	5.01%	5.03%	5.02%	4.93%	4.85%	4.75%	4.68%
FTE Book Yield	7.59%	7.62%	7.62%	7.65%	7.64%	7.72%	7.69%	7.69%	7.68%	7.52%	7.43%	7.41%
FTP Spread	2.65%	2.76%	2.65%	2.68%	2.65%	2.70%	2.66%	2.66%	2.75%	2.67%	2.68%	2.72%
Prime at Renewal	6.68%	6.75%	6.22%	6.29%	6.29%	6.42%	6.48%	6.48%	7.18%	7.21%	7.22%	7.20%
Spread to Prime at Renewal	0.92%	0.87%	1.39%	1.36%	1.30%	1.31%	1.30%	1.21%	0.51%	0.31%	0.21%	0.21%
Average Balance	\$ 7,854,380,217	\$ 7,872,599	\$ 8,696,879,946	\$ 8,808,369,288	\$ 8,881,627,447	\$ 8,936,004,607	\$ 8,972,531,748	\$ 8,980,025,460	\$ 9,038,540,585	\$ 9,059,710,114	\$ 9,093,805,230	\$ 9,162,533,872



Maturity Schedule

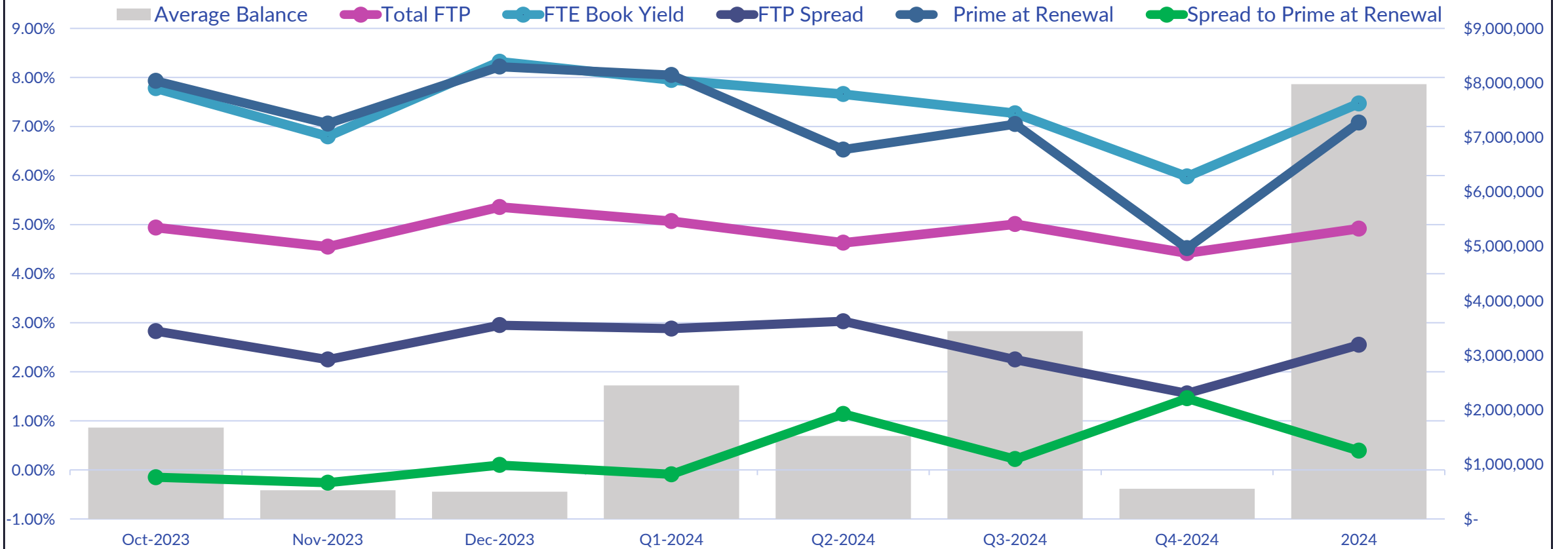
Organization: 0001_Empyrean Main Branch

Ledger: Loan Net of Unearned Income

Officer: 00001 – SMITH, J

Time: Sep-23


Measures	Oct-2023	Nov-2023	Dec-2023	Q1-2024	Q2-2024	Q3-2024	Q4-2024	2024
Total FTP	4.94%	4.55%	5.36%	5.07%	4.63%	5.01%	4.42%	4.92%
FTE Book Yield	7.78%	6.80%	8.32%	7.95%	7.66%	7.27%	5.98%	7.47%
FTP Spread	2.83%	2.25%	2.95%	2.88%	3.03%	2.25%	1.56%	2.55%
Prime at Renewal	7.93%	7.06%	8.22%	8.05%	6.53%	7.05%	4.52%	7.08%
Spread to Prime at Renewal	-0.15%	-0.26%	0.10%	-0.09%	1.14%	0.22%	1.46%	0.39%
Average Balance	\$ 1,677,462	\$ 529,671	\$ 501,183	\$ 2,450,045	\$ 1,525,109	\$ 3,447,747	\$ 553,436	\$ 7,979,336



Thank You!

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