

Balance Sheet Decisions That Can Help NEV Results

By Maria Nichols, Vice President / Relationship Manager

Summary

- *The National Credit Union Administration's new approach to supervising interest-rate risk has resulted in a standardized measurement approach and redefined risk classification levels*
- *New measurement standards differ from the historic approach, causing some credit unions that thought they had "low" interest-rate risk to immediately move into the "moderate" and sometimes even "high" risk categories*
- *FHLBank Boston's in-house NEV calculator tool can help with balance sheet decisions to incrementally improve test results*

The Net Economic Value Supervisory Test

The National Credit Union Administration (NCUA) updated its approach to supervising interest-rate risk in 2017, and one key change was the development of the **Net Economic Value (NEV) Supervisory Test**, a capital-at-risk measurement that uses standardized values for non-maturity shares to assess a credit union's level of interest-rate risk.

The test uses redefined risk classification levels to categorize the supervisory risk level. For credit unions with total assets below \$50 million, the NCUA developed the Estimated Net Economic Value Tool, an automated measurement of the NEV Supervisory Test.

NEV is measured by calculating the present value of assets minus the present value of liabilities. It quantifies the economic value of the entire balance sheet, expresses it as a single amount, and serves as a proxy for a market-based valuation of an institution's net worth. The NEV analysis quantifies the degree to which economic values of a credit union's balance sheet position change under different rate scenarios.

Impact on Credit Unions

FHLBank Boston has heard from some member credit unions that this new approach creates difficulties, as the test includes standardized values for non-maturity shares of one percent in the base case (book value x 99 percent) and four percent in the +300 basis points shock scenario (base value x 96 percent).

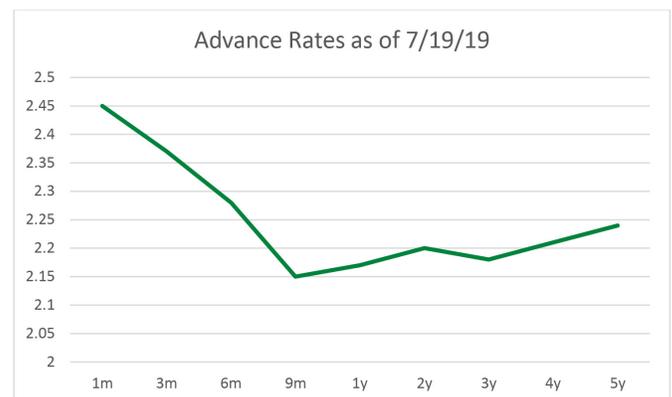
The NCUA's use of standardized values for non-maturity shares differs from how many credit unions have been historically analyzing non-maturity deposits. Backed by deposit studies and institution-specific experience in asset/liability management, credit unions have been assigning longer implied duration to those deposits versus the results imposed by the new NEV Supervisory Test.

This creates differences between the NCUA's interest-rate sensitivity metrics and the credit union's NEV model outputs, causing some credit unions that thought they had "low" interest-rate risk to immediately move into the "moderate" and sometimes even "high" risk categories.

The shape and level of the yield curve is a significant driver of balance sheet sensitivity, but some balance sheet decisions can incrementally improve the NEV results.

Two Ways FHLBank Boston Can Help

1. **Extend liabilities.** Some members keep their FHLBank Boston advances funding short-term to boost their net interest income. As the graph below shows, now that the advance curve has flattened (and at some points, even inverted), lengthening borrowings can improve the results of the NEV test, while also boosting net interest income.



The worksheet below comes from FHLBank Boston's in-house NEV calculator tool. It shows a credit union with total assets of \$750 million and \$75 million in six-month advances. Results demonstrate how two strategies can improve NEV exposure by managing FHLBank Boston advances strategically.

Solution 1: Lengthen the maturity of existing borrowings. For credit unions currently rolling short-term funding, lengthening a portion of those advances can have a considerable positive impact on NEV. In the +300 case, extending the duration of the existing advances from six months to 4.5 years improves the NEV results by 1.20 percent.

Solution 2: Increase the relative amount of FHLBank Boston advances on the balance sheet. Adding advances, depending on the term, can have more favorable sensitivity than non-maturity deposits, and can help improve the NEV results. For example, if a credit union adds 2.5 percent of additional advances and makes the same extension from six months to 4.5 years as in Solution 1, that would produce a positive 1.44 percent impact to the NEV test.

- Sell fixed-rate mortgage loans.** Secondary market sales can be an efficient way to reduce the amount of long-term assets on the balance sheet and improve your NEV results. The recent rally in mortgage rates has improved the potential prices that could be realized through secondary market sales. This is a good alternative when a credit union has capital limitations and shrinking the balance sheet is the best alternative.

Through our Mortgage Partnership Finance® (MPF) Program, member credit unions can sell one- to four-family owner-occupied and second home mortgage loans. The program's MPF 35® product offers a competitive execution with no loan level price adjustments and an opportunity to earn credit enhancement fee income. The MPF Program also offers current pricing on the sale of qualified portfolio loans with up to 24 months of payments made and negotiated pricing of seasoned loans older than 24 months.

Take Steps Today

Contact us to access our NEV calculator tool. The calculator can help you understand the impact your advance portfolio could have on the NEV ratio by changing the mix and/or size of your borrowings.

Determine a break-even on your marginal cost of funds when considering a new CD special. If you are looking to extend your liabilities, sometimes borrowing is the most efficient way to do it since it does not risk cannibalizing your existing lower-cost deposits. During periods of higher interest-rate volatility such as the present, advances could be more cost efficient than raising funds via term deposits.

Please note that it is important to work with your NCUA examiner when looking to implement any of these solutions.

Our strategy team works with you to provide customized funding strategies based on your overall sensitivity position, objectives, and other needs. Contact your [relationship manager](#) for more information.

Net Economic Value & FHLBank Boston Borrowings Analysis

Assumptions					
Base Duration	FHLBank Boston Borrowings	% of Assets	Book Value	Base Case	
				Base Case	Up 300 Case
0.50		60.00%	450,000,000	445,500,000	432,000,000
		10.00%	75,000,000	75,187,500	74,059,688

Solution 1- LENGTHEN FHLBank Boston borrowings					
Duration	Book Value	Base Case	Up 300 Case	Change \$	Impact to NEV Ratio vs. Base Case
1.00	75,000,000	75,187,500	72,931,875	1,127,813	0.15%
3.00	75,000,000	75,187,500	68,420,625	5,639,063	0.75%
4.50	75,000,000	75,187,500	65,037,188	9,022,500	1.20%

Solution 2- INCREASE FHLBank Boston advances vs. non-maturity deposits							
	FHLBank Boston as % of Assets	FHLBank Boston Duration	Book Value	FHLBank Boston Up 300	NMD Up 300	Change \$	Impact to NEV Ratio vs. Base Case
Current	10.00%	0.50	75,000,000	74,059,688	432,000,000	N/A	N/A
	12.50%	0.50	93,750,000	92,574,609	414,000,000	-514,922	-0.07%
	12.50%	3.00	93,750,000	85,525,781	414,000,000	6,533,906	0.87%
	12.50%	4.50	93,750,000	81,296,484	414,000,000	10,763,203	1.44%
	15.00%	0.50	112,500,000	111,089,531	396,000,000	-1,029,844	-0.14%
	15.00%	3.00	112,500,000	102,630,938	396,000,000	7,428,750	0.99%
	15.00%	4.50	112,500,000	97,555,781	396,000,000	12,503,906	1.67%