Z-CONCEPTS

TOP 7 THINGS YOUR PROSPECTIVE ALM PROVIDER *WON'T* TELL YOU

1. OUR MODEL IS NEVER FOUND IN THE PORTFOLIO MANAGEMENT DEPARTMENT.
2. YOU'LL NEED TO LOAD MULTIPLE CHART OF ACCOUNTS AND DO A LOT OF MANUAL WORKAROUND TO MEET TODAY'S REGULATIONS.
3. OUR MODEL IS HARD TO USE.
4. OUR MODEL WILL TAKE FOREVER TO IMPLEMENT AND BE VERY COSTLY.
5. WE ONLY GIVE YOU ONE DEDICATED SUPPORT PERSON THAT WON'T ALWAYS BE AVAILABLE.
6. WE SAY WE'LL ADD YOUR ENHANCEMENTS BUT WE NEVER DO.
7. WE ONLY OFFER ONE OR TWO 3RD PARTY INTEGRATION POINTS.

You're looking for a new asset liability management (ALM) tool for your financial institution. The great news is you'll find a myriad of cost-effective, well-known ALM software solutions that are great for ALM. The bad news: there's a lot your prospective ALM provider won't tell you, like how long implementation really takes and hidden costs and fees. With increasing federal regulations and more emphasis from boards to implement various types of stress testing, financial analysts are finding (sometimes too late) that their models are limited in what they can't do.

Don't let that happen to you.

ALM SCENARIOS

Most models employ user-definable balance sheet growth and reinvestment rates to determine ALM scenarios. Flexibility to model growth assumptions and the ability to process futures is a also standard option. But can your model actually balance instruments, risks and spreads in one place, with one input and output? Can you balance your spreadsheet? Can you balance your budget? Can you run your risks? Think about where your institution is headed. Will you have the need to build complex simulation logic rules and growth assumptions? Can the model you are looking at handle that complexity?

Ask for examples. See demonstrations of this in action. Also ask how prepayment speeds and new business projections are treated.

(more...)

TERM STRUCTURE MODELS

Sometimes, it's all about building relationships – and we'll get to a little bit more of that when we touch on customer service. Here, it's important when you think about the relationship between yield curves and discount curves and what modeling your ALM software provides. Are stochastic models included? Or does the model discount using a static curve – or worse, just a single rate? Is option-adjusted valuation integrated, or is it a completely separate process? Again, know what you are getting, think about the usefulness of it, and consider how much extra it might cost you.

ANALYTICS AND MORE

When doing your due diligence on ALM software, you almost have to become an investigative journalist. Be sure to ask all the right questions so you know what you are getting, how quickly you can get it, and how much extra it might cost you. Most important: how easy is the model to operate for YOUR users? Some models offer traditional income, valuation and gap analytics, while other models go a few steps further by providing prepay models, user-defined vectors and advanced portfolio analytics. Take time to understand how each model is powered – what type of engine is running the analytics, how are Value at Risk (VaR) and Earnings at Risk (EaR) derived? How do you get your market data and what can be provided? It's important to know if it is just certain forecasts and/or current market rates.

For prepayments, are subscriptions imported or are they part of the model, or both? Do you have to import CMO cash flows from a third party or can the model automatically grab them for you? Can user-defined vectors be built? Remember, not all ALM models are created equal.

What is important to your institution for market scenarios? From comprehensive to user-defined to manually-built, market scenarios are a key factor to what sets models apart. Take time to investigate if market scenarios can be refreshed against new rates automatically, or if there are additional stress testing scenarios available for defaults, recoveries and other assumptions. Ask what metrics are available to compare scenario results (such as DV01, OAS, vega and prepay duration) as well. Most ALM vendors offer standard reporting through Excel, as well as custom reporting tools. Others also offer pivot tables and browser-based custom reporting tools. Some even have board-ready and federal regulation-ready (as PDF) reports available.

IMPLEMENTATION AND CUSTOMER SUPPORT

No one likes downtime, especially your boss (and your boss' boss, etc.). Get all the details about implementation, including the timeline, billable hours and what's needed from you and your staff. Ask the model provider's current clients how their implementation went: was it really four months or did it take eight? Was customer support really helpful or do their users just get sent to the never-ending help desk ticketing system? Ask about enhancements. How approachable is the senior staff and developers? Have you met the CEO? Will you ever see the CEO again? What about the lead developer?

THIRD PARTY INTEGRATION

Third Party data provider integration is instrumental to a successful model. Some models offer subscription-based integration, while some only offer access to one provider (e.g., Intex is the only supported provider for CMO cash flows). Be sure to investigate all options for security attributes, CMO cash flows, prepayment and default modeling. Ask what fees are involved. Clarify number of users. See examples.

RUN THE RISK

Above all else, don't compromise your analytics. Think of the future. After all, that's what you are forecasting against, right? What will be important in three years, five years, or even seven years from now? How might the market change, and how might your institution change as time goes on? Can the model you are looking to choose now grow with you over time? Can the model easily adapt to your needs, or will you be the one that has to adapt to the model? While data out is only as good as the data put in, don't blame your model for not being able to do something it wasn't meant to do – or promised it could do – in the first place.

ZM Financial Systems

ZM Financial Systems (ZMFS) can help you better manage your risk and profitability. Visit www.zmfs.com for more information, or contact us at sales@zmfs.com.

ZM financial systems