Funds Management

Funds management encompasses both the treasury management and asset/liability management functions. The goal of funds management is to achieve an association's targeted risk and return objectives through the effective management of the association's resources. Funds management is the management of an association's balance sheet mix and pricing of assets and liabilities.

Funds management encompasses the coordination and integration of a broad range of functions, policies, and decisions that influence the association's net interest earnings, net interest margin, and net portfolio value, including the following:

- Asset and liability composition
- Loan and deposit pricing
- Funds transfer pricing policies
- Capital structure and capital financing
- Asset securitizations
- Hedging activities.

LINKS
Program

An effective funds management process should increase the likelihood that an association will achieve its financial objectives. Successful funds management programs typically have four elements:

- Management that understands how to structure the balance sheet and price deposits, loans, and other products to achieve risk and return objectives.
- A clearly defined funds management process that includes sound policies, procedures, and controls.
- Effective information systems that provide the information needed to make sound funds management decisions.
- An effective performance measurement system.

The sophistication of an association's funds management process and systems should be appropriate to the size and complexity of the association.

In assessing an association's funds management, you should:

- Review the policies, procedure, and controls governing the funds management process.
- Determine whether the policies, procedures, and controls are sufficient given the size and complexity of the association.
- Determine whether the association's information/analytical systems are adequate given the size and complexity of the association.
- Review the reports to the board that summarize major decisions and transactions.
- Determine compliance with policies, procedures, and controls governing funds management.

SETTING FINANCIAL GOADS: THE RISK/RETURN PROFILE

The Risk/Return Tradeoff

The board of directors and senior management should define the association's overall financial objectives with clearly defined risk and return measures.

An association usually states its overall financial objectives regarding return with accounting-based earnings and profitability measures or with economic or market value-based performance measures. In specifying these goals, a number of specific measurement gauges may be appropriate, either individually or in combination.

The most common accounting-based measures are:

- Return on assets
- Return on equity
- Net Interest Margin.

The economic/market value-based measures that associations commonly use are:

- Net portfolio value
- Market value capitalization
- Total return.

Associations sometimes seek to achieve short- term earnings and profitability targets by accepting greater risk and in the process compromise long-term earnings and market value objectives.

The Funds Management Decision-Making Process

You should review the funds management policies and procedures.

- Are the policy limits reasonable given the association's financial condition?
- Is management complying with the board-approved policies?
- Are periodic reports to the board adequate?

An integrated, funds management process is important. A piecemeal approach to funds management, or a structure in which one or more of the financial functions are autonomous, will complicate the attainment of a common overall risk/return profile. The funds management process in small associations may be informal, while in larger associations the process may be very formal.

Funds Management Functions

Presented below are the functions of the typical funds management process:

- Determine financial objectives and set policy for each of the financial functions.
- Provide periodic reports to the board concerning funds management.
- Periodically review the funds management policies with the board.
- Oversee funding activities.
- Coordinate asset and liability product pricing.
- Evaluate proposed strategies and transactions through sound methodology, including simulation and scenario analysis.
- Oversee investment portfolio management activities.
- Monitor the economic and interest-rate environment, including local economic conditions, prepayment trends, and volatility.
- Identify instruments that the board of directors authorized for use to manage the association's risk exposures.
- Oversee funding and capital financing activities, including debt and equity issuance, and dividend policies.

PROCEDURES AND CONTROLS

If the funds management process is not functioning properly, then you should focus on the related operating procedures and internal controls. Typically in a large association, extensive documented procedures are necessary to accommodate a large volume of data flow from numerous functional areas to the manager responsible for funds management. In smaller associations such complex procedures are not necessary.

Internal Procedures

Associations should document and follow procedures that allow for the smooth and timely flow of data to the funds management function. Flow charts documenting the physical flow of data to and from all departments are usually very informative. Other procedures may be necessary to accommodate the funds management function at certain associations.

Internal Control

In small associations, the lack of adequate internal controls may be more of a concern because one individual will often perform multiple functions. For example, the CFO may direct funds management, but may also execute transactions, oversee the disbursement of cash, and authorize the related accounting entries. Associations should segregate these duties to the extent possible to ensure adequate internal control.

You should verify that internal controls are adequate in the following areas:

- Transaction authorizations – both internal (officers authorized to transact business) and external (approved dealers).
- Position and transaction limits, regulatory requirements or limits, and other guidelines.

REFERENCES

Code of Federal Regulations (12 CFR)

§ 563.172	Financial Derivatives
§ 563.176	Interest Rate Risk Management Procedures

Office of Thrift Supervision Bulletins

RB 3a-1	Policy Statement on Growth for Savings Associations
TB 13a	Management of Interest Rate Risk, Investment Securities, and Derivatives Activities

TB 13a-2	Structured Advances

FFIEC Policy Statements

Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities

Financial Accounting Standards Board (FASB)

No. 107	Disclosures About Fair Value of Financial Instruments
No. 115	Accounting for Certain Investments in Debt and Equity Securities
No. 133	Accounting for Derivative Instruments and Hedging Activities

Other References

Standard & Poor's, Inc. Credit Review