

MountainView's AAM

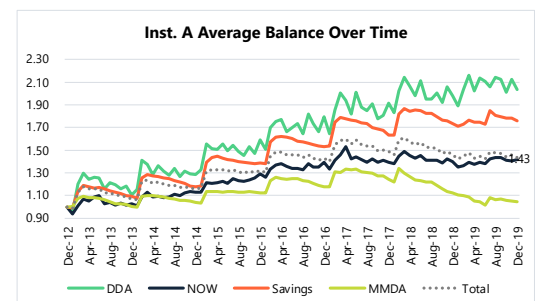
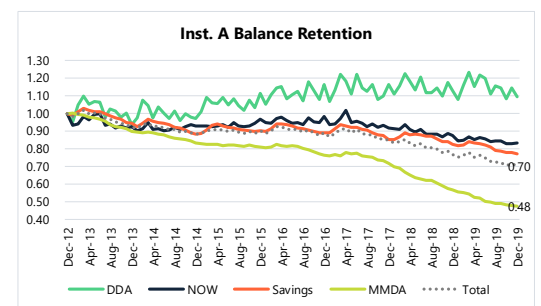
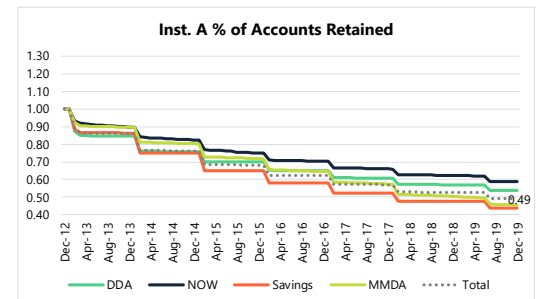
A key component of valuing a financial institution's balance sheet is the assumptions made around non-maturity deposits, which are typically the largest source of funding. MountainView's Advanced Assessment Methodology (AAM) examines the behavior over time of an institution's level of deposits, deposit rates, and level of retained deposits for a fixed set of accounts.

The methodology suggests that the percentage of balances retained is substantially higher than the percentage of accounts retained. Smaller accounts are more likely to close; larger accounts are more likely to remain open; and the average balance in retained accounts is likely to grow.

To demonstrate the effect, we have provided three graphs analyzing two institutions - a bank and a credit union, respectively. The graphs are based on time series of the number of accounts, the total amount of deposits, and the average balances in accounts that are retained. Each institution is presented separately with each of their major categories presented in the graphs. For each series the graph presents the fraction of initial value remaining after a given number of months. The categories examined are determined by the institution and differ by institution depending on their needs.

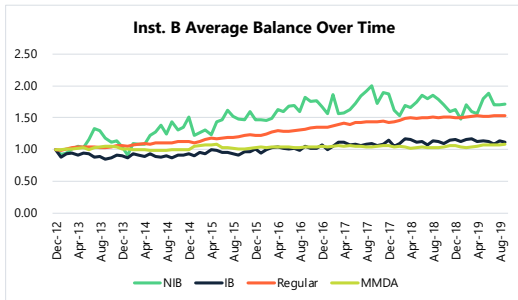
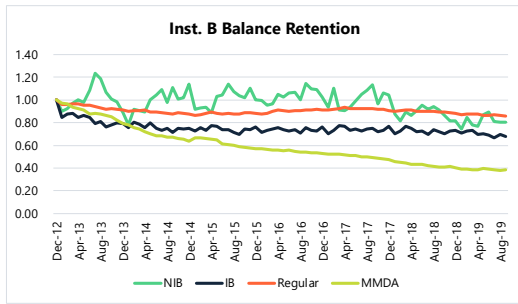
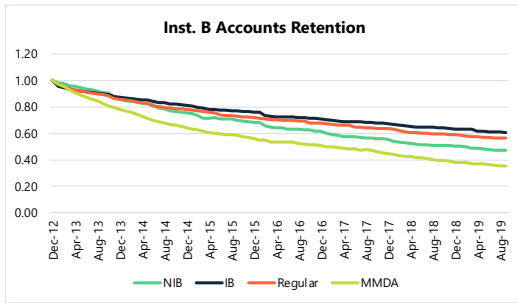
Client Scenario A - Bank

For Institution A for example, the first graph indicates that a number of accounts are purged systematically once per year but there is a steady decrease in the number of all types of accounts. After about seven years almost 60% percent of NOW accounts remained with the institution but only 46% MMDAs remained. The second graph presents the fraction of initial deposits retained. MMDAs are again lowest at about 48% retained while DDAs have over 100 percent retained, NOW 83% and Savings 77%. Looking exclusively at the number of accounts would lead to a significant undervaluation of deposits. The overall picture of under versus overvaluation would depend on the deposit mix, and in this case yielded a dramatic undervaluation. The third graph for Institution A presents average balances by deposit category. As expected, given the prior two graphs, the average balance for MMDA accounts is generally lower than other products, but the average balance for all other types of accounts increases dramatically, with DDA average balances more than doubling over the 7-year period. Had Institution A relied exclusively on the number of accounts, it would have seriously underestimated the value of its retained balances.



Client Scenario B - Credit Union

When it comes to our credit union example, Institution B, the Account Retention graph suggests retention rates are approximately the same as the prior bank. MMDA account retention after 7 years is about 35 percent while NIB, IB and Regular share account retention runs from about 50 to 60 percent. Interestingly, for both NIB and Regular accounts, low-rate accounts have higher retention than higher rate accounts. The Balance Retention graph indicates that MMDA balances decline at about the same rate as MMDA accounts, but NIB, IB and Regular balances are retained at an 80 percent or higher rate over a 7-year period. The Average Balance Over Time graph corroborates this finding with the average balances in these categories increasing by about 50-70 percent above their initial values. Had this credit union's deposits been evaluated using only the number of accounts, deposits would have been seriously understated since the primary deposit categories were Regular and IB accounts.



Results

he results for these institutions are broadly consistent with the results that we repeatedly find for a wide range of institutions. For a few institutions, average balance size of the retention pool does not change as the pool ages. For most institutions, however, the average balance size increases. The implication is that for most institutions using the number of retained accounts to determine the value of deposits will seriously underestimate the value of those deposits. This result does not imply that all institutions must use retained balances rather than retained accounts for valuation purposes, however, it does suggest that all institutions should carefully consider the implications.

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- Follow FASB guidance for ASC 450 and 310

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