



Lessons Learned for Asset-Liability Management (ALM)

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Contents

Introduction	3
Understanding Earnings, Risk Appetite, Liquidity, Funding, and Balance Sheet Resilience.....	4
1. Why This Matters Now	4
2. Common Gaps in ALM	5
3. Regulatory and Supervisory Context	5
4. What ALM Governance Must Cover.....	6
4.1 Risk appetite and risk-taking capacity.....	6
4.2 Earnings and value sensitivity: NII, EVE, and EaR as one governance topic	7
4.3 Funding and liquidity as the necessary conditions	7
4.4 Concentration risk	8
4.5 Data, models, assumptions, and validation	8
5. Roles and Responsibilities	10
6. Common Pitfalls — What to Avoid.....	10
7. Board and ALCO Checklist.....	14
8. Closing Points.....	17
9. Glossary / Appendix	19

Introduction

In performing their financial intermediation role, deposit-taking institutions — including credit unions — transform customer deposits and other sources of funding into loans, investments, and other earning assets. This transformation creates value, but it also exposes the institution to structural balance sheet risks.

Two of the most important are **interest rate risk** and **liquidity risk**.

- Interest rate risk arises because assets, liabilities, and off-balance-sheet positions do not reprice or mature at the same time, and because customer behaviour may change as market rates change.
- Liquidity risk arises because the institution must be able to meet deposit withdrawals, funding maturities, loan commitments, and other cash obligations under both normal and stressed conditions.

These risks are traditionally managed through the **asset-liability management (ALM)** function. ALM is important because it connects the institution's core business model to its financial resilience.

- Interest rate risk as measured by net interest income is central to the business model of most credit unions, often representing the majority (80+%) of total revenue and therefore a primary driver of profitability, capital generation, and future growth capacity.
- Liquidity is a necessary condition for a deposit-taking institution to operate; without sufficient cash, contingent funding capacity, and market

confidence, even a solvent institution can face severe constraints.

ALM provides the framework for identifying, measuring, monitoring, and managing how the balance sheet responds to changes in interest rates, funding conditions, deposit behaviour, loan demand, and liquidity stress.

The issue is not only whether the institution complies with policy limits, but whether the Board, ALCO, senior management, Treasury, Finance, and Risk have a shared understanding of how interest rate risk, liquidity risk, earnings pressure, capital capacity, and members' behaviour interact under stress.

A well-functioning ALM process links Treasury, Finance, Risk, senior management, the asset-liability committee (ALCO), and the Board. It converts balance sheet data, behavioural assumptions, scenario analysis, and risk limits into practical management information, supporting decisions on funding strategy, asset growth, pricing, liquidity buffers, capital allocation, and overall balance sheet positioning.

This paper focuses on the governance lessons for asset-liability management in credit unions. It covers why ALM matters for Board oversight, where institutions may have gaps or under-govern their balance sheet risk, and how risk appetite and risk-taking capacity should be applied. The paper will cover how net interest income (NII), economic value of equity (EVE), and earnings at risk (EaR) should be interpreted together, why funding and liquidity are necessary conditions for strategy, and how data, models, assumptions, validation, and ALCO governance support effective decision-making. It also identifies common pitfalls, provides Board and ALCO challenge

questions, and includes a glossary of key ALM terms.

The intended audience is Board members, ALCO members, senior management, Treasury, Finance, Risk, Internal Audit, model validation, and supervisors who need to understand whether the ALM process is generating required insight, challenge, and action — not simply confirming compliance.

Understanding Earnings, Risk Appetite, Liquidity, Funding, and Balance Sheet Resilience

1. Why This Matters Now

After a prolonged period of low and relatively stable interest rates and ample liquidity following the global financial crisis and the COVID period, the rapid increase in interest rates during 2022–2023 exposed weaknesses in funding strategy, interest rate risk management, balance sheet positioning, and governance at some institutions. Examples include recent stress in the credit union sector, which materially affected profitability and, in some cases, contributed to forced mergers, as well as high-profile US bank failures such as Silicon Valley Bank (March 2023). These events reinforced the need for a strong ALM culture.

Asset-liability management is not only a technical risk measurement process. For a deposit-taking institution, ALM is the management framework that connects earnings, liquidity, funding, capital capacity, and balance sheet risk-taking.

ALM is central to earnings resilience. For many credit unions, net interest income is the primary revenue engine, often accounting for the majority of total revenue (80+%). Where operating margins are tight and much of the expense base is fixed or not

directly rate-sensitive, relatively small changes in NII can have a disproportionate impact on net income, internal capital generation, and the institution's ability to support future growth.

Liquidity and funding are critical to the sustainability of a credit union. A credit union can be profitable and solvent on paper and still face severe constraints if it cannot meet deposit withdrawals, renew maturing funding, access contingent liquidity, or maintain market and member confidence under stress. Liquidity risk therefore cannot be treated as a secondary control function; it is a core condition for business continuity.

This means ALM governance is not only about avoiding excessive risk. It is also about understanding how earnings are generated, how much balance sheet risk is being taken to generate those earnings, and whether that risk remains within the institution's risk appetite and risk-taking capacity.

Strong ALM governance makes the earnings–risk trade-off visible before stress emerges. It allows the Board, ALCO, senior management, Treasury, Finance, and Risk to understand not only the reported position of the balance sheet, but the assumptions and vulnerabilities behind that position.

ALM governance should be proportionate to the institution's risk profile, size, complexity, and business model. A smaller or less complex institution may not require the same modelling infrastructure as a large credit union or bank, but it still requires clear assumptions, credible stress testing, effective challenge, documented decisions, and timely escalation.

2. Common Gaps in ALM

ALM reports are often presented as a technical reporting package rather than a Board-level decision process. This can create a gap between risk measurement and risk governance: the institution may produce regular ALM reports, but the Board may still lack a clear understanding of what risks are being taken, why those risks are acceptable, and what actions would be required if conditions deteriorate.

Common governance weaknesses include:

- Short-term focus: Focusing on current-year budgeted NII without understanding earnings sensitivity over longer horizons (two to five years);
- Silo approach: Treating EVE, NII, liquidity, and funding (and credit) as separate reports rather than connected scenario dependant balance sheet outcomes;
- Untested liquidity: Assuming cash and securities are and will remain readily available under stress without testing monetization capacity, collateral eligibility, settlement processes, or the operational readiness of repo and other secured funding lines.
- Unchallenged deposit stability: Assuming deposit stability under all scenarios without segmentation, behavioural evidence, or back-testing;
- Disconnected limits: Setting limits (or copying them from peers) without linking them to risk appetite, capital capacity, earnings capacity, liquidity capacity, and growth strategy;
- Unconnected stress testing: Reporting stress results without clear management

actions, escalation triggers, or decision thresholds;

- Review without accountability: Allowing ALCO to review information without documenting challenges, decisions, ownership, and/or follow-up.
- Lack of flexibility: Relying on infrequent or inflexible ALM processes—often constrained by outsourced providers—that cannot refresh scenarios, test emerging exposures, or evaluate management actions quickly during periods of rapid market or funding stress.

3. Regulatory and Supervisory Context

Regulatory and supervisory expectations generally do not require the Board to manage ALM at a technical level. They do, however, require effective oversight of material risks, clear risk appetite, credible stress testing, timely escalation, and evidence that management understands and acts on the results. For credit unions, the practical requirement is that ALM governance be proportionate to size and complexity, but still capable of identifying whether earnings, liquidity, funding, and capital remain resilient under adverse conditions.

The supervisory direction from recent banking stress is that regulatory metrics are necessary but not sufficient. Supervisors are increasingly focused on business model sustainability, governance quality, liquidity readiness, interest rate risk, assumptions, and management action.

BC deposit insurance changes the context for depositor confidence, but it does not remove the need for credible liquidity stress

testing, funding concentration monitoring, collateral planning, and contingency funding execution.

The Board should expect ALM reporting to show whether risk remains within appetite and whether management has the capacity to act under adverse conditions.

The main governance gap is not the absence of ALM reporting. It is reporting that confirms compliance without creating insight or action. Effective ALM reporting should identify the earnings–risk trade-off, the assumptions most under pressure, the limits that matter, and the available/required management actions.

4. What ALM Governance Must Cover

4.1 Risk appetite and risk-taking capacity

ALM risk appetite should define how much balance sheet risk the credit union is willing to accept in pursuit of its strategy, earnings objectives, and member service mandate. It should make clear how much exposure the institution is prepared to accept to changes in interest rates, funding conditions, liquidity stress, deposit behaviour, margin compression, and balance sheet growth.

Risk-taking capacity is different. It reflects how much risk the institution can absorb before earnings, capital, liquidity, or strategic flexibility are materially impaired. This should consider:

- Profitability and earnings resilience (capital generation capacity);
- Capital ratios and internal capital buffers (available capital);

- Available liquidity resources and monetization capacity (counterbalancing capacity);
- Funding diversification and concentration, access to alternative sources of funds;
- Capacity to support planned loan growth, investment strategy, and member service objectives without weakening capital, liquidity, or funding resilience (resilience);

The Board should distinguish between risk appetite and risk capacity. Risk appetite is the amount of risk the institution chooses to take. Risk capacity is the amount of risk the institution can absorb. A credit union may have the capacity to take more risk than it wants, or it may have a strategy that requires more risk than its earnings, capital, or liquidity position can reasonably support.

This assessment should be integrated with the credit union's Enterprise Risk Management (ERM) framework. Enterprise risk appetite establishes the overall boundaries within which strategy is pursued, while ALM translates those boundaries into measurable balance sheet exposures and limits for earnings sensitivity, economic value, liquidity, funding, and related risks. ALM limits should therefore be consistent with the broader enterprise risk appetite, capital and liquidity capacity, strategic plan, and growth objectives—not developed independently within Treasury or ALCO.

The linkage must also work in the other direction. ALM scenarios and stress testing should inform the enterprise view of risk by showing how interest rates, deposit behaviour, funding conditions, credit

performance, and balance sheet growth can interact and affect earnings, capital, and liquidity at the same time. ERM should therefore consider the combined balance sheet outcome, not simply whether individual risk limits are being met. This is particularly important where a strategy appears acceptable against individual metrics but becomes unsustainable when several risks occur together.

ALM limits are often set using generic thresholds or peer comparisons. This can create false comfort if the institution's profitability, capital buffers, funding mix, liquidity resources, and strategic growth plans are materially different from those of peers. ALM limits should therefore be tailored to the institution's risk appetite, risk-taking capacity, and unique circumstances—not simply copied from peers.

4.2 Earnings and value sensitivity: NII, EVE, and EaR as one governance topic

NII, EVE, and EaR are related measures of how interest rate risk affects earnings and balance sheet value. They should not be treated as separate technical outputs ("numbers"). Together, they help the Board and ALCO understand whether current earnings are resilient, how much income is exposed to rate and funding shocks, and whether the balance sheet has longer-term economic value vulnerability.

A key governance improvement is to look beyond the current fiscal year. Multi-year NII and EaR analysis is important where risk emerges through mortgage renewals, investment maturities, funding repricing, hedge maturities, or delayed margin compression.

Current-year NII can look strong while the institution is accumulating risk in future periods. EVE and multi-year EaR help identify whether earnings resilience depends on assumptions that may reverse as assets renew, deposits reprice, or market rates change.

The practical question is not only whether the institution is within its current interest rate risk limits, but whether earnings and value remain resilient as the balance sheet reprices over time. The Board should therefore receive reporting that shows how interest rate risk evolves over time under different scenarios, not only whether current limits are met. The objective is to prevent risk from accumulating unnoticed in later periods simply because current-year earnings remain within appetite.

The Board does not need product-level model detail, but it should understand the major assumptions driving the results, including deposit repricing (betas or pass-through of market movements), non-maturity deposit expected lives (term out), mortgage prepayment and renewal behaviour, term deposit repricing, investment portfolio duration, hedge strategy, and product optionality.

4.3 Funding and liquidity as the necessary conditions

A profitability strategy is only sustainable if the funding and liquidity base can support it. Funding and liquidity should therefore be governed together: funding choices affect margin and growth, but they also determine resilience under stress.

A strategy can be profitable in the base case but difficult to fund under stress. Liquidity and funding governance should therefore assess how changes in deposit behaviour,

funding costs, collateral access, or market conditions could affect funding capacity, earnings, and margins—and ensure Board and ALCO reporting identifies the most vulnerable assumptions, how quickly pressure could emerge, and the actions management would take if the base case does not hold (scenario analysis).

Board reporting should focus on the key liquidity and funding questions: whether the institution has a stable and diversified funding base, whether material concentrations are emerging, whether liquidity resources can be monetized under stress, and what management actions would be available and could be executed if funding conditions deteriorated (i.e. test Contingency Funding Plan).

4.4 Concentration risk

Concentration risk should be assessed relative to the credit union's scale and business model. Smaller institutions may not have sufficient balance sheet size or market breadth to diversify fully across products, industries, geographies, funding sources, or member segments. The governance focus should be on these questions:

- How concentrated is the credit union's balance sheet by product, member segment, industry, geography, funding source, and earnings driver?
- Are these concentrations a deliberate consequence of the credit union's business model and scale, or are they unintended exposures that have accumulated without clear limits or monitoring?
- Where diversification is constrained by size, market, or field of membership, has

management established compensating controls such as stronger underwriting, tighter exposure limits, enhanced liquidity buffers, contingency funding capacity, or more conservative capital planning?

- How would a downturn in a concentrated product line, employer group, industry, geography, or funding segment affect earnings, liquidity, capital, asset quality, and member behaviour?

4.5 Data, models, assumptions, and validation

ALM reporting is only as credible as the data, assumptions, and models behind it. The key governance issue is whether material assumptions are understood, supported by evidence, reviewed regularly, and updated when actual behaviour or market conditions change.

A model can be technically correct and still produce misleading outputs if assumptions are generic, stale, poorly implemented, or not supported by institution-specific evidence. Weak assumption governance often occurs when assumptions are left unchanged for multiple reporting cycles, applied uniformly across materially different products or member segments, or held constant across scenarios where behaviour should reasonably change.

When approving ALM limits and assumptions, ALCO and the Board should ask whether the assumed member behaviour is reasonable under the scenario being tested.

As shown in Figure 1 and Figure 2, based on Bank of Canada data both the mortgage origination and the deposit mix have

changed over time. This demonstrates that balance sheet composition is not static and should not be assumed to remain constant across all ALM scenarios. ALCO and the

Board should expect scenario assumptions to reflect how members may change borrowing, renewal, and deposit decisions when market conditions change.

Figure 1. Mortgage loans origination mix (2013–2016)

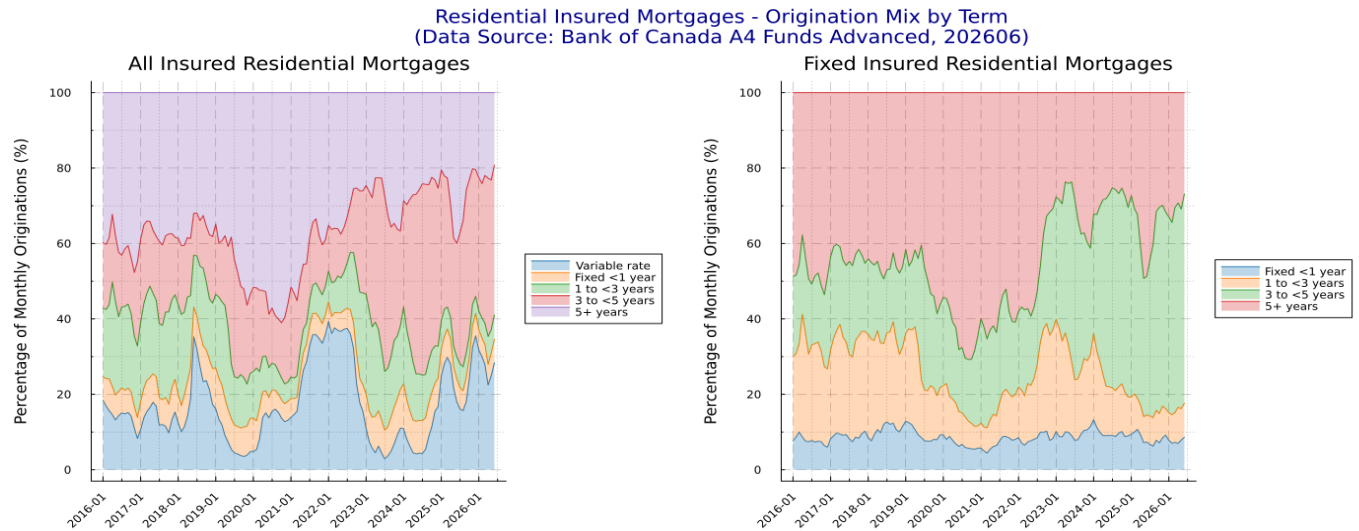
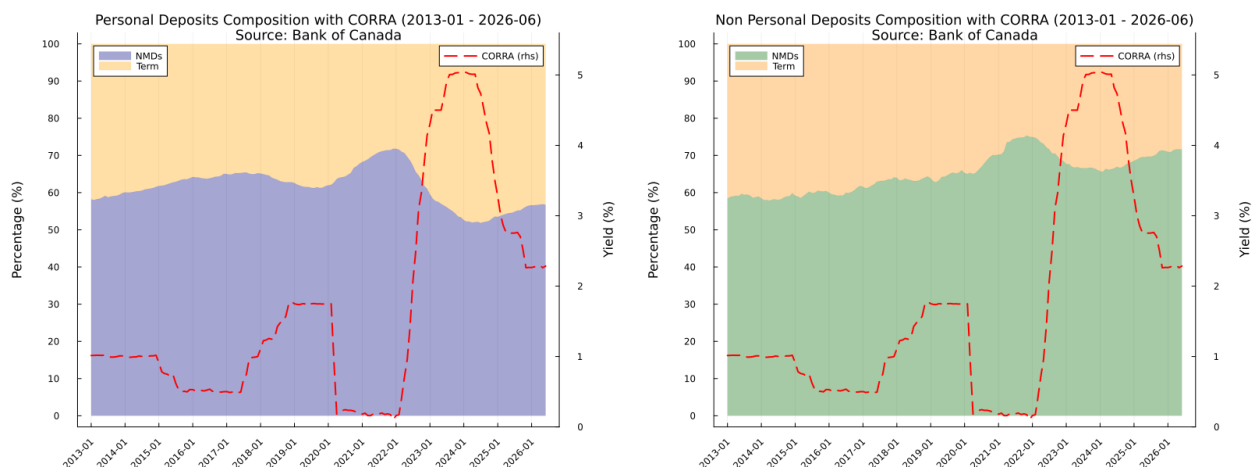


Figure 2. Deposit mix (demand/term – 2013–2026)



Management should maintain evidence supporting key behavioural assumptions, including deposit decay, deposit betas, prepayment behaviour, renewal assumptions, and funding rollover assumptions. These assumptions should be back-tested where possible and subject to clear ownership, approval, and model-

change governance. The objective is to prevent material assumptions from remaining on autopilot and creating false comfort in reported risk measures.

Risk and independent validation should challenge the methodology, data quality, scenario design, assumption calibration, back-testing, limit design, and reporting

accuracy. Internal Audit should assess whether ALM governance works in practice, not only whether reports are produced.

For smaller credit unions, it may not be realistic to maintain all specialized ALM, model validation, liquidity stress testing, behavioural modelling, or systems expertise in-house. In these cases, third-party reviews can provide necessary independent technical challenge, particularly where the institution relies on vendor models, manual data processes, or material judgmental assumptions.

5. Roles and Responsibilities

Effective ALM governance requires clear accountability across the institution. Each function should have a distinct role in turning balance sheet analysis into informed decisions, documented challenge, and timely action.

- **Board:** approves ALM risk appetite, understands risk-taking capacity, challenges material assumptions and exposures, and requires timely escalation and evidence of management action when earnings, capital, liquidity, or funding indicators deteriorate.
- **Senior Management:** ensures that growth, pricing, funding, liquidity, capital, and earnings plans are mutually consistent and achievable within approved risk appetite.
- **ALCO:** acts as the primary management forum for ALM decisions, connecting risk measures to pricing, hedging, investment, funding, liquidity, and growth actions. ALCO should be explicitly responsible for balancing profitability and resilience.
- **Treasury/Finance:** explains how earnings are generated, quantifies balance sheet trade-offs, develops forecasts and scenarios, and recommends management actions.
- **Risk:** provides independent challenge of assumptions, stress scenarios, limit calibration, model outputs, and management interpretation of results.
- **Internal Audit/Validation:** assesses whether ALM governance is operating as intended, including data integrity, model implementation and controls, documented challenge, escalation, and follow-up. This means it should assess “use test” evidence — whether the ALM process is used to make decisions.

Weak ALM governance often occurs when everyone receives the same report, but no one owns the decision. Effective governance requires clear accountability for assumption approval, limit escalation, management action, independent challenge, and follow-up.

6. Common Pitfalls — What to Avoid

Governance and metrics

- Treating ALM as a compliance checklist rather than a strategic governance discipline. This leads to backward-looking reporting focused on policy compliance rather than forward-looking assessment of earnings, liquidity, capital, and funding resilience.
- Presenting EVE or NII/EaR sensitivity as regulatory/technical metrics without explaining their management relevance. The Board and ALCO should understand what these metrics mean, their

limitations, which assumptions drive the results, and what management would do if these indicators started to deteriorate.

- Setting limits without linking them to the institution's own risk appetite and risk-taking capacity. Peer benchmarking may be useful for context, but ALM limits should reflect the credit union's profitability, capital buffers, liquidity resources, funding profile, growth strategy, and balance sheet structure.
- Allowing ALCO minutes to show the presentation of information but no challenge or decision-making. Minutes should show the issue discussed, the challenge raised, the decision made, the accountable owner, and the required follow-up.
- Relying on standardized scenarios without confirming that they are relevant to the credit union's actual balance sheet characteristics (product mix, funding structure, etc.). Outsourced models can support measurement discipline, but Board and ALCO reporting still need to explain why the scenarios are relevant, which assumptions drive the results, and where institution-specific risks may not be fully captured.
- ALM reporting that is not flexible enough and/or cannot be refreshed quickly enough to support decisions when conditions change or provide relevant ALM insights on the impact of strategic

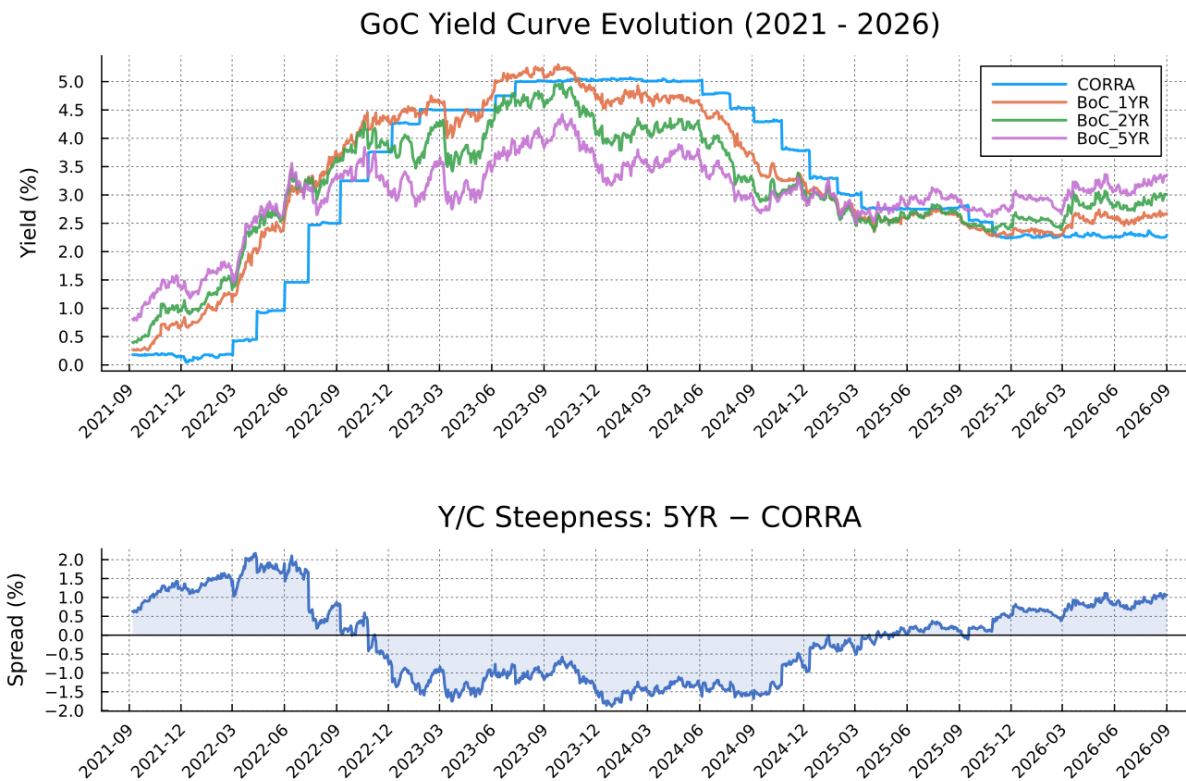
initiatives (e.g. what-if analysis). If management cannot test alternative rate paths, deposit betas, runoff assumptions, funding costs, or liquidity actions on a timely basis, ALCO may be forced to rely on stale information during periods of stress.

- Model "validation": Generic vendor model validation is not enough if it does not assess whether assumptions are appropriate for the credit union's own balance sheet, products, member behaviour, rate environment, and data quality, and have been properly implemented.

Interest rate risk in the banking book

- Reporting current-year NII without showing whether earnings reverse in future years under different scenarios. A 12-month view can miss risk that emerges through mortgage renewals, term deposit repricing, investment maturities, hedge maturities, or delayed funding cost increases.
- Using narrow rate scenarios that create a false sense of conservatism. Scenarios such as ± 25 , ± 50 , or ± 100 bps may be useful for sensitivity analysis, but they are not sufficient stress scenarios, given the rate volatility experienced in recent cycles (see Figure 3, volatile rate environment (level) and changes in steepness of the curve).

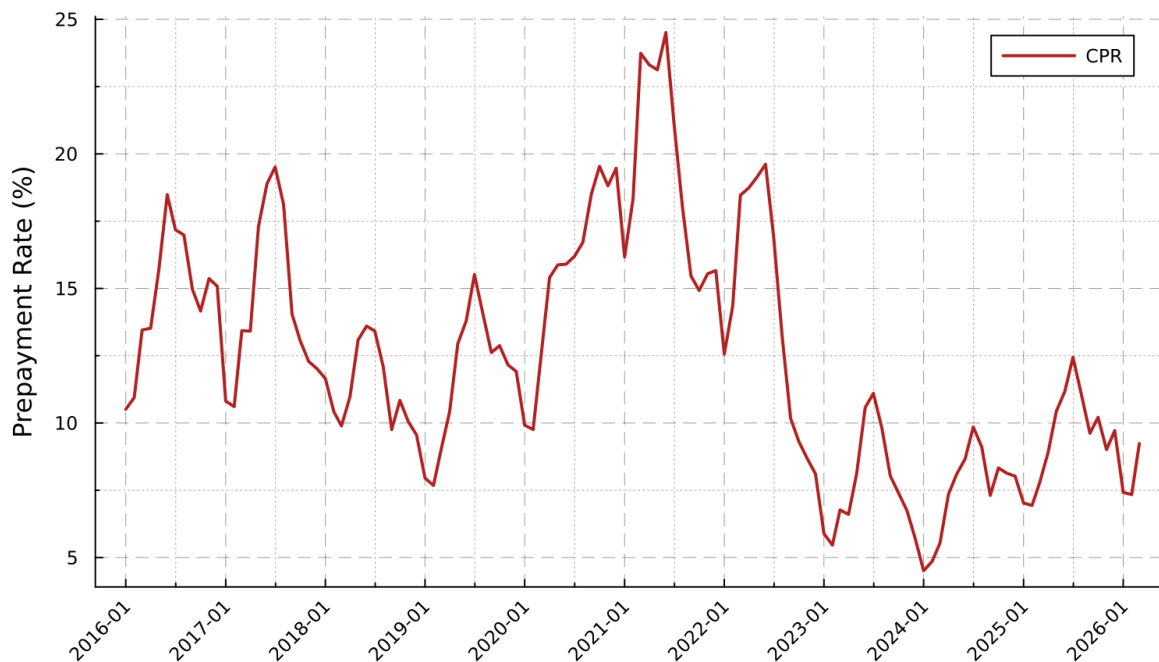
Figure 3. Government of Canada yield curve evolution



- Using administered or non-market product rates (e.g. HISA) to discount fixed-rate or non-maturity products can materially distort EVE. This is particularly problematic for low-yielding deposits, where inappropriate discounting may understate economic value and fail to capture the term structure of market rates or non-parallel rate shocks. Promotional or non-market pricing will distort the calculated value of existing assets or liabilities and send the wrong risk signal to ALCO.
- Assuming a stable prepayment rate on fixed-rate loans across all rate scenarios and loans. Prepayments are scenario-dependent and are influenced by borrower refinance incentives, product features, penalties, housing turnover, and market rate differentials (see Figure 4 – CMHC historical prepayment + liquidation rates).

Figure 4. CMHC observed prepayment rates

Historical CPR for 5-Year Fixed Rate Conventional Insured Mortgages (Pool 975)
Source: CMHC NHA MBS Securitization Reports, 202609



- Failure to capture/model pipeline risk (fixed-rate loan commitments). At a very minimum, this risk needs to be assessed and monitored.
- Ignoring seasonality - assuming the full monthly balance is stable without considering seasonality (seasonal balances expected to runoff over the next few months) and using generic runoff assumptions (e.g., linear runoff over the next 60 months) to term them out (also applicable for IRRBB).
- Relying on short-term (e.g. three-month), high-level NII variance as back-testing. Back-testing should cover a meaningful horizon (aligned with risk metrics, e.g. 12-months) and test key assumptions such as deposit pricing and migration,

prepayments, renewals, funding costs, new business, and product mix.

Liquidity and funding

- Reporting liquidity ratios without testing practical monetization. Liquidity reports should distinguish between assets that appear liquid in policy and assets that can actually be monetized under stress after haircuts, pledging requirements, settlement timing, market depth, and operational constraints.
- Relying only on regulatory runoff factors (e.g. LCR runoffs) for internal liquidity stress testing. Regulatory factors are useful reference points, but internal stress tests should reflect the credit union's own funding mix, member behaviour, concentration, brokered

deposit profile, wholesale access, and contingency funding capacity.

- Assuming deposit insurance eliminates liquidity risk. Full deposit insurance is an important confidence feature in BC, but liquidity risk can still arise from rate competition, large withdrawals, member transfers, brokered maturities, reputational events, operational disruption, or rapid asset growth.
- Treating funding as a cost decision rather than a resilience decision. The lowest-cost funding source may not be the most stable, diversified, or strategically appropriate. ALCO should assess cost together with increased competitive pressure, changing customer behaviour under different rate environments, concentration, maturity, renewal risk, liquidity value, and member relationship impact.
- Ignoring funding concentration because aggregate liquidity appears adequate. A strong liquidity ratio can mask reliance on a small number of large deposits, short-term maturities, external funding channels, or rate-sensitive balances.
- Failing to connect liquidity stress results to management actions. Stress testing should specify what ALCO would do: slow growth, adjust pricing, raise term funding, increase liquidity buffers, pledge collateral, reduce investment duration, activate contingency funding, or escalate to the Board.
- Not having/testing the contingency funding plan (CFP) operationally. A contingency funding plan is not credible unless borrowing lines, collateral pledging, investment sales, securitization options, communication

protocols, and decision authorities have been tested.

- If using brokered deposits or wholesale funding, ensure the credit union has a clearly approved purpose. Brokered and wholesale funding may support liquidity, growth, or balance sheet management but should have Board-approved limits, maturity guidelines, concentration controls, renewal assumptions, and contingency treatment.

7. Board and ALCO Checklist

The Board and ALCO should use ALM reporting to test whether the institution's earnings strategy is sustainable under changing rate, funding, liquidity, and member behaviour conditions. A useful Board checklist should not ask for more data; it should identify the key decisions that must be made when earnings, liquidity, funding, capital, or IRRBB indicators move in different directions.

Core decision questions

- **How is current NII being generated?** Is NII coming from sustainable member lending margins and deposit relationships (low-cost deposits), or from temporary factors such as repricing gaps, delayed deposit repricing, excess liquidity reinvestment, funding mix changes, or favourable optionality?
- **How much of current and projected earnings depends on maturity transformation, deposit behaviour, and optionality?** Under which scenarios would it be at risk?
- **What happens to NII beyond the current fiscal year?** Does the institution understand NII sensitivity over years two

to five under plausible and severe rate paths, especially where mortgage renewals, investment maturities, hedge maturities, or funding repricing occur after year one?

- **What does EVE sensitivity reveal that short-term NII does not?** If NII looks stable but EVE is highly sensitive, the institution may be protecting near-term earnings while accumulating longer-term economic value risk.
- **How much risk-taking capacity is available to support future growth?** Growth capacity should be assessed against earnings resilience, capital ratios, liquidity resources, funding availability, and the ability to absorb adverse scenarios (not only a single base-case scenario).
- **Which assumptions make the reported position look safer?** ALCO should understand which assumptions are most material, how sensitive the results are to those assumptions, and what happens if they are wrong.
- **Which funding sources are most rate-sensitive, concentrated, or renewal-dependent?** Aggregate deposit growth can hide reliance on large balances, brokered deposits, promotional funding, or short-term wholesale sources.
- **How quickly can liquidity be monetized in practice under different scenarios?** The Board should understand available liquidity after haircuts, pledging requirements, settlement timing, operational steps, and market constraints.
- **Are early warning indicators in place and calibrated to trigger action before**

a Board limit is breached? What actions would ALCO take if early warning indicators deteriorated?

Reports should identify pre-agreed actions, escalation points, accountable owners, and decision timelines. If any action has been implemented, whether it is providing the desired results.

Key trade-offs the Board should understand

- **Loan growth vs. liquidity resilience:** New lending may improve NII, but it can also increase the loan-to-deposit ratio, reduce liquidity buffers, consume capital, and increase dependence on external funding.
- **Liquidity resilience vs. earnings:** Holding more cash and liquid securities improves resilience but may reduce NII because those assets often yield less than member loans or longer-duration investments.
- **Margin protection vs. deposit retention:** Holding deposit rates below competitors may protect short-term margin but could increase runoff or migration into higher-cost products. Raising rates may retain funding and member relationships but reduces NII.
- **Current-year NII vs. multi-year earnings resilience:** A strategy may improve this year's NII while creating earnings pressure in later years when assets renew, funding reprices, or hedge protection expires.
- **Earnings stability vs. economic value stability:** A position that stabilizes near-term NII may increase EVE sensitivity. A position that protects long-term value

may make annual earnings more variable.

- **Short-term profitability vs. long-term franchise value:** Reducing deposit rates, lowering liquidity buffers, or extending asset duration may improve current earnings but may weaken member relationships, funding stability, capital flexibility, or future risk capacity.
- **Growth ambition vs. risk-taking capacity:** The strategic plan may require more lending, funding, liquidity, and capital capacity than the institution can prudently support under adverse scenarios.
- **Pricing discipline vs. market share:** Aggressive loan pricing may protect volumes but reduce risk-adjusted returns. Aggressive deposit pricing may protect balances but compress margin. The Board should understand which trade-off management is making.
- **Capital deployment vs. capital flexibility:** Increased leverage (lower capital ratios) to support growth may improve earnings, but it can reduce the institution's ability to absorb margin compression, credit losses, liquidity stress, or strategic opportunities.
- **Member deposits vs. brokered or wholesale funding:** Member deposits may be relationship-based and strategically valuable but may not grow quickly enough to fund planned lending. Brokered or wholesale funding can provide faster term funding but may be more rate-sensitive, less relationship-based, and more dependent on market access.

Scenario analysis and stress testing are valuable because they help identify blind spots before they become losses or liquidity constraints. Their purpose is not simply to confirm that the credit union survives a prescribed shock, but to test where management assumptions may be too optimistic, where risks may interact, and where current plans depend on conditions continuing as expected. Used effectively, they help the Board and ALCO challenge the base case, understand vulnerabilities that may not be visible in standard reporting, and test whether proposed management actions would remain credible under adverse conditions.

New strategies should therefore be assessed under multiple rate, funding, behavioural, and balance sheet scenarios, with reporting that clearly shows the expected impact on earnings, capital, valuation, liquidity, and risk appetite over time.

Board and ALCO discussion should focus on whether the strategy improves the institution's overall resilience or merely shifts risk from current-period earnings to future earnings, capital, or economic value.

Audit/validation questions

- **Do ALCO minutes show challenges, decisions, ownership, and follow-up?** Minutes should show more than the presentation of reports. They should evidence what was challenged, what decision was made, who owns the action, and when follow-up is required.
- **Are ALM assumptions institution-specific and evidence-based?** Assumptions for deposit betas, deposit decay, mortgage prepayments, renewals, and funding behaviour should reflect the credit union's own data,

products, members, and rate environment.

- **Are the most important assumptions independently challenged?** Independent review should focus not only on model mechanics, but also on whether the assumptions materially shaping NII, EVE, liquidity, and funding results remain reasonable.
- **Do stress scenarios inform decisions?** Scenarios should be severe enough to test earnings, capital, liquidity, and funding capacity, and should lead to clear management choices rather than simply producing another report.
- **Are Board and ALCO reports traceable to reliable source data?** Balances, rates, cash flows, product classifications, maturities, and behavioural assumptions should reconcile to authoritative systems and financial reporting where appropriate.
- **Are model changes approved and documented?** Changes to methodology, scenarios, assumptions, data feeds, product mapping, or reporting logic should be governed through a formal change process.
- **Are early warning indicators in place and breaches escalated according to policy?** Escalation should be timely, documented, and linked to management action, not treated as a passive reporting item.

8. Closing Points

Recent periods of rate and funding stress have shown that ALM weaknesses often become visible only after market conditions, member behaviour, or funding access

change. The value of a strong ALM framework is therefore its ability to identify vulnerabilities and blind spots early—before they translate into earnings pressure, liquidity constraints, capital erosion, or reduced strategic flexibility.

ALM should be governed as an integrated balance sheet discipline, not as a collection of separate risk reports. Earnings, economic value, liquidity, funding, capital, concentration, and member behaviour can interact and deteriorate together. Effective governance therefore requires limits, scenarios, stress testing, and management actions to be linked to the credit union's risk appetite, risk-taking capacity, business strategy, and broader enterprise risk management framework.

Strong governance also depends on accountability and capability. The Board, senior management, ALCO, Treasury, Finance, Risk, Internal Audit, and validation should understand their respective roles in challenge, decision-making, escalation, and follow-up.

Effective oversight also requires sufficient ALM knowledge at the Board and senior management level. Directors and executives do not need to be modelling specialists, but they should understand the purpose and limitations of key ALM measures, the main assumptions and behavioural risks, the relationship between earnings, liquidity, funding and capital, and the circumstances that would require management action. ALM education should therefore form part of ongoing Board development and the onboarding of new directors so they can provide informed challenge and discharge their oversight responsibilities effectively.

External advisors and outsourced ALM providers can provide valuable modelling

capability, technical expertise and independent challenge, particularly for smaller credit unions that cannot maintain all specialist skills in-house. However, outsourcing does not transfer accountability. Management and the Board must still understand the methodology and material assumptions, assess whether the analysis is appropriate for the credit union's own balance sheet and member behaviour, challenge results where necessary, and ensure the provider can support timely scenario analysis and management decision-making. Reliance on a vendor should strengthen internal governance, not replace it.

Ultimately, the quality of an ALM framework should be judged by the decisions it

supports. Good ALM reporting should help the Board and ALCO understand where risk is building, distinguish sustainable earnings from temporary benefits (trade-offs), test whether management actions would be practical under stress, and make informed choices about growth, pricing, funding, liquidity, investments, hedging, and capital allocation. The objective is not more reporting; it is better decisions and greater resilience.

9. Glossary / Appendix

- **Asset-liability committee (ALCO):** The management committee responsible for overseeing balance sheet risks, including interest rate risk, liquidity risk, funding strategy, capital usage, and earnings-risk trade-offs.
- **Asset-liability management (ALM):** The process for identifying, measuring, monitoring, and managing risks arising from the structure and behaviour of assets, liabilities, and off-balance-sheet positions.
- **Contingency Funding Plan (CFP):** A documented plan setting out liquidity actions, funding sources, escalation steps, communication protocols, and decision authorities during liquidity stress.
- **Deposit beta:** The proportion of market rate changes passed through to deposit rates.
- **Deposit decay:** The assumed behavioural runoff or maturity profile of non-maturity deposits.
- **Early warning indicator (EWI):** a metric or trigger designed to identify deterioration before a formal limit breach occurs.
- **Earnings at risk (EaR):** the estimated adverse impact on earnings, often NII, under specified scenarios over a defined horizon.
- **Economic value of equity (EVE):** the present value of asset cash flows less the present value of liability and relevant off-balance-sheet cash flows; used to assess longer-term economic sensitivity to interest rate changes.
- **Enterprise Risk Management (ERM):** the framework for identifying, assessing, managing, and monitoring material risks across the institution, and ensuring those risks remain consistent with its strategy, risk appetite, and risk-taking capacity.
- **IRRBB (Interest Rate Risk in the Banking Book):** risk to earnings or economic value/capital position from interest rate movements affecting banking book positions.
- **Liquidity survival horizon:** the period over which the institution can meet obligations under a defined stress scenario without extraordinary support.
- **Loan-to-deposit Ratio (LTD):** loans divided by deposits; a high ratio may indicate greater reliance on non-deposit or external funding.
- **Net interest income (NII):** interest income less interest expense; a core measure of earnings generated by the balance sheet.
- **Stress testing:** scenario analysis used to assess the impact of adverse but plausible conditions on earnings, capital, liquidity, funding, or economic value.

- **Product optionality:** contractual or behavioural features that allow members or management to alter expected cash flows, such as mortgage prepayments, early redemptions, embedded caps or floors, deposit withdrawals, renewal options, or discretionary repricing.
- **Risk appetite:** the amount and type of risk the institution is willing to take to achieve its strategy.
- **Risk-taking capacity:** the amount of risk the institution can absorb before capital, liquidity, earnings, or strategic flexibility are impaired.

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