

# ***Asset/Liability Management Essentials***

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## **Executive Summary**

Asset/liability management is a ***critical*** part of the credit union financial management process. Credit unions that employ ALM effectively tend to be higher performing and serve their members better than credit unions that view ALM as a necessary evil. ALM alone will not guarantee that you will be a higher performing credit union, but it does greatly increase the credit union's chances of success. So if you want to have the potential of being a higher performing credit union, you must take ALM seriously.

### **Who is in Charge of ALM?**

In a broad sense, *everyone* at the credit union. Sooner or later, all actions taken at the credit union (whether it is making loans, member service activities or building a branch) are ALM activities. These activities all affect the balance sheet (assets, liabilities and net worth) and the income statement. More specifically, the board is ultimately responsible for guidance on the risk/return levels expected at the credit union. The asset/liability committee (ALCO), usually composed of senior-level credit union management, is in charge of the day-to-day ALM activities. The board of directors usually oversees the ALM process on a broad basis, but the ALCO performs the "nuts and bolts" of ALM. The ALCO reports ALM results to the board of directors periodically, usually once a month or once a quarter.

### **What Else do I Need?**

This is a short checklist of the bare bones minimum you need for ALM at your credit union.

1. ***Set clear goals for the credit union.*** Goal-setting is part of the credit union's long-range strategic planning process. If the credit union's goals and objectives are clear, understood and perceived to be achievable by the ALCO and the credit union's employees, chances are ALM will be much easier. For goals to be clear, they must be measurable, have a time dimension and be reasonable.
2. ***Be knowledgeable about the ALM process.*** Most ALCO members should know ALM very well. The board of directors should have a good, general understanding of ALM and, at a minimum, know the basics. If not, further education is required. Also, ALM is a subject that constantly evolves. Thus, it is expected that the knowledge level of the credit union personnel responsible for ALM evolves as well. Ongoing education is a must. It is also important to

note that *ALM is a process*. This involves much more than reporting on ALM or just having an ALM policy.

3. **An asset/liability management policy.** The credit union's ALM policy outlines the acceptable risk/return levels, duties of the ALCO and the board of directors, and general procedures for ALM. It is suggested to keep the policy simple, yet provide clear guidance to the credit union.
4. **A mechanism to measure risk/returns of ALM.** The board of directors and the ALCO need a reporting mechanism to look at the past, present and future position of ALM. Many times this is the result of a commercially available ALM model or service option from a vendor. The reporting mechanism should clearly show if the credit union is in compliance with the ALM policy limits, and expose opportunities for the credit union to take further action. One concept that easily illustrates this concept is the **red zone**. The red zone indicators are the limits from the ALM policy. The reporting mechanism should clearly show the various red zones and whether your credit union is in compliance.
5. **Consistent management of the process.** ALM is NOT a measure-and-forget exercise. Constant, consistent, management of the process is a must. The ALCO is the group within the credit union that coordinates the ALM process. From time to time, they report a summary of the ALM results and decisions to the board of directors.
6. **A great attitude.** I believe that if your credit union views ALM as a necessary evil or performs ALM just to appease the examiners, then the credit union's chances for success will greatly decrease. Nothing beats a great attitude when dealing with this subject.
7. **Be aware of some differences between ALM as viewed by examiners and ALM as viewed by the credit union.** The examiners have a slightly different view of ALM than the day-to-day business of managing the ALM process. Both views are correct, but they each have different intents.
8. **Know that ALM is one step in the financial management process.** ALM is only part of the credit union's coordinated financial management process. Other areas, such as long-range strategic planning and the budgeting process, need to be added for ALM to be truly successful. It is the integration of these processes that helps ensure not only the safety and soundness of the credit union but also that the short-term and long-term goals of the credit union are being met.

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