



June 7, 2023

THE CRITICAL INGREDIENTS OF THE MODERN CAPITAL PLAN

CALCULATING INTERNAL LIMITS, DEFENDING THEM WITH REGULATORS,
EARLY WARNING INDICATORS TO CONSIDER IN 2023

Adam Mustafa, CEO and Co-Founder, Invictus Group

Today's Agenda



1. A Conceptual Perspective of a Capital Plan
2. Ideal Structure of the Capital Plan



SECTION 1

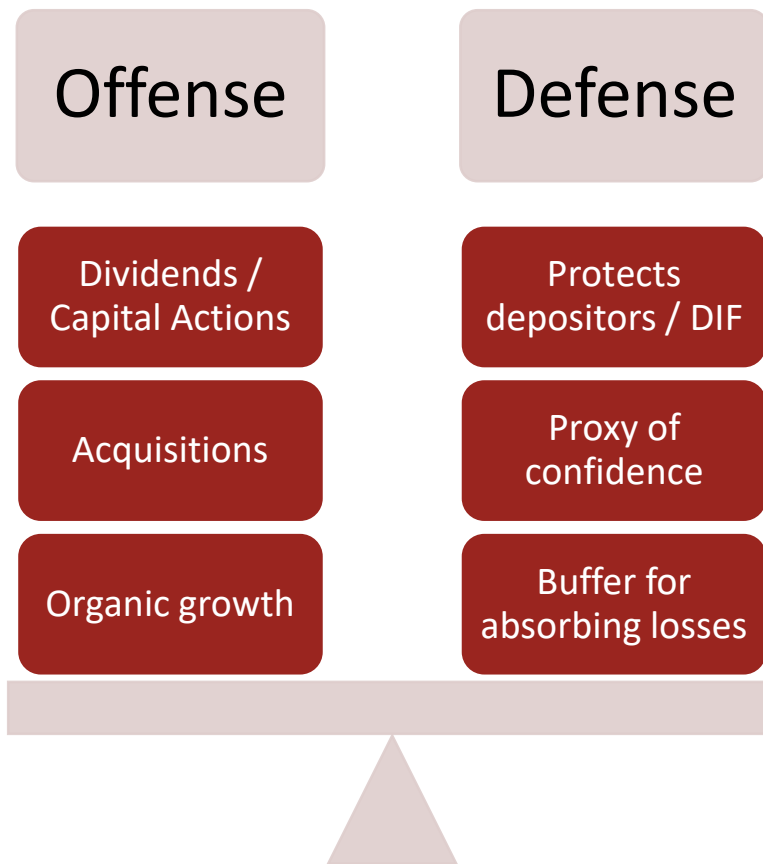
A Conceptual Perspective of a Capital Plan

What is Capital?



*Your Strategic
Plan is your
Offensive
Playbook...*

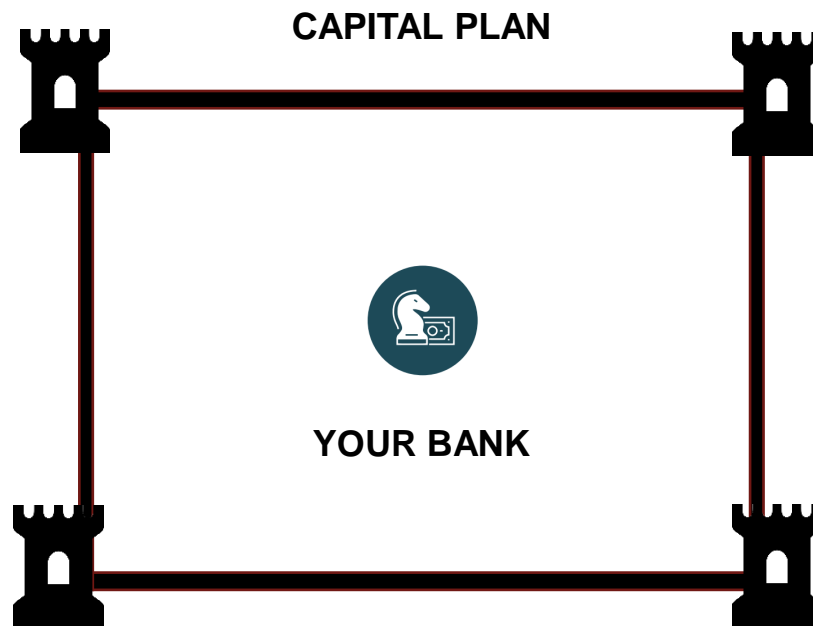
*Your Capital Plan
is your Defensive
Playbook*



WINTER IS COMING?

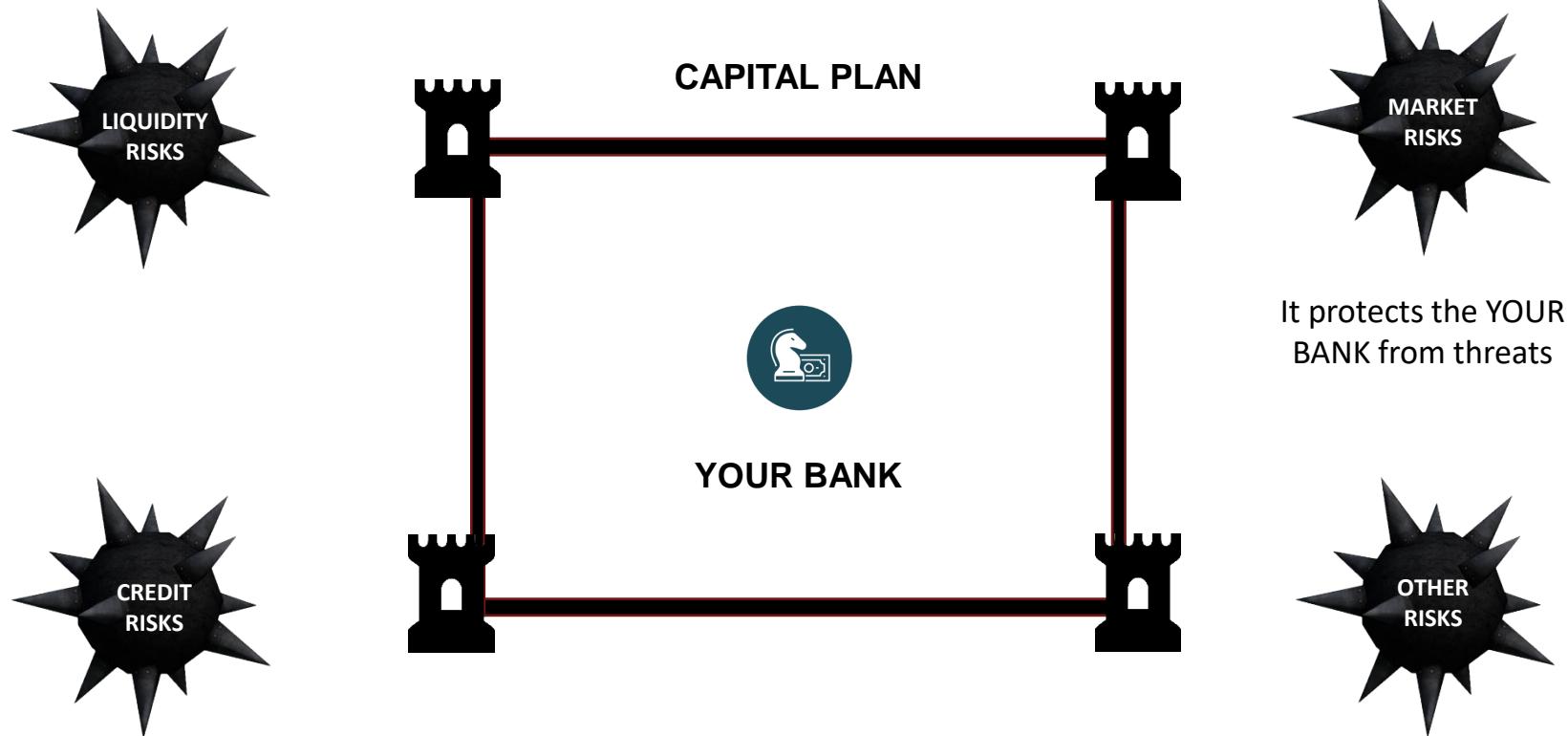


What is a Capital Plan?

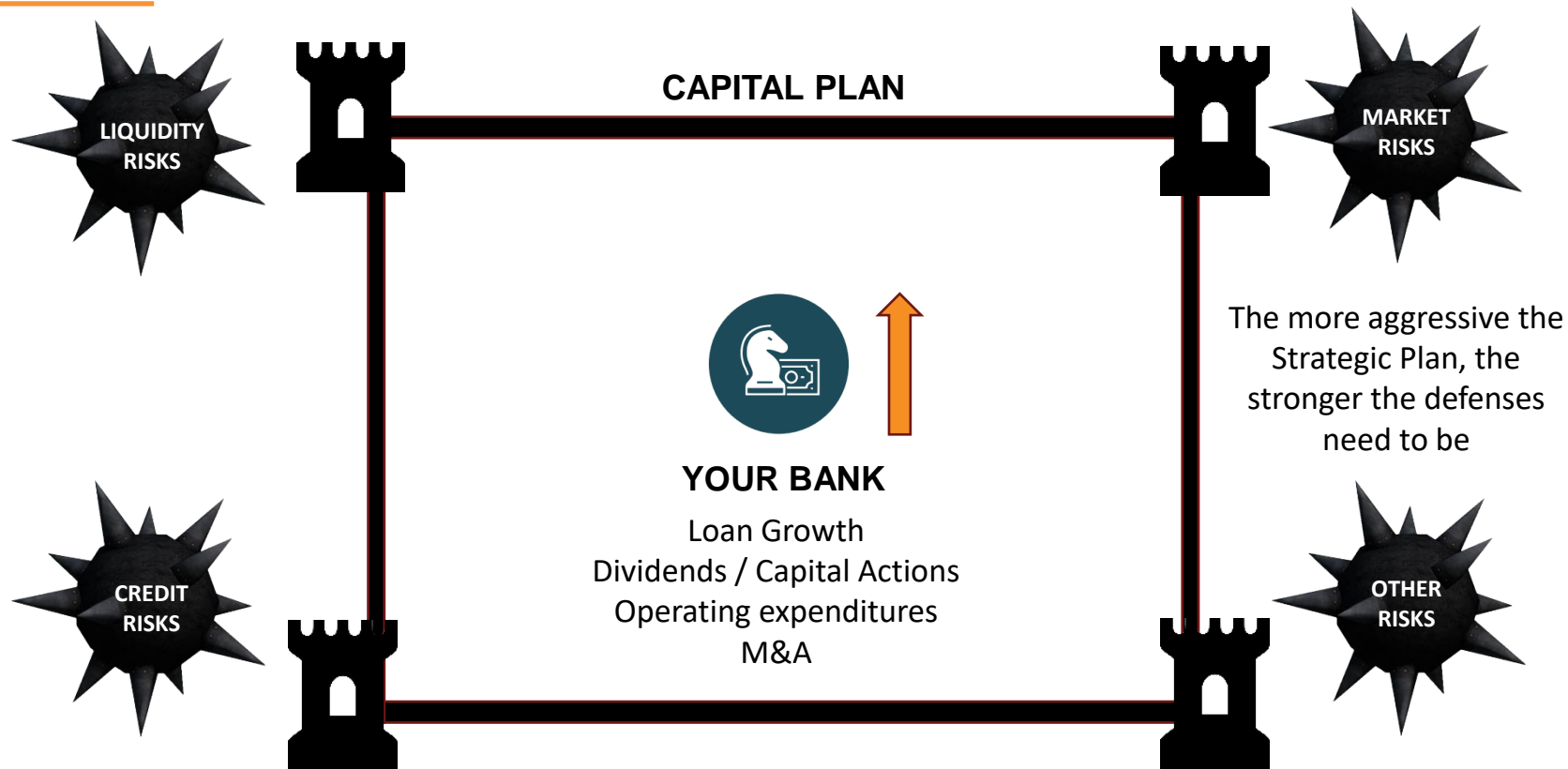


The Capital Plan is the protection around the Strategic Plan

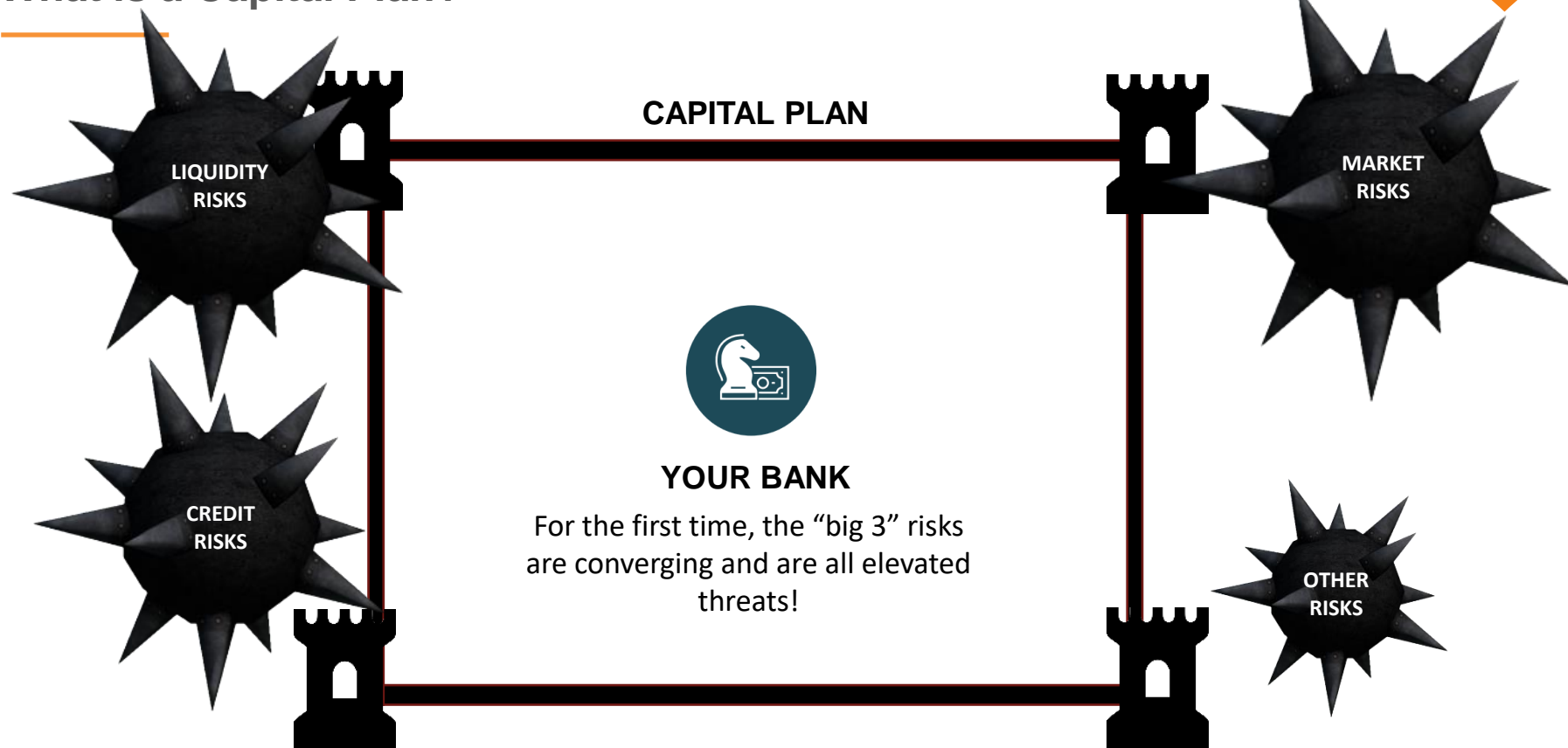
What is a Capital Plan?



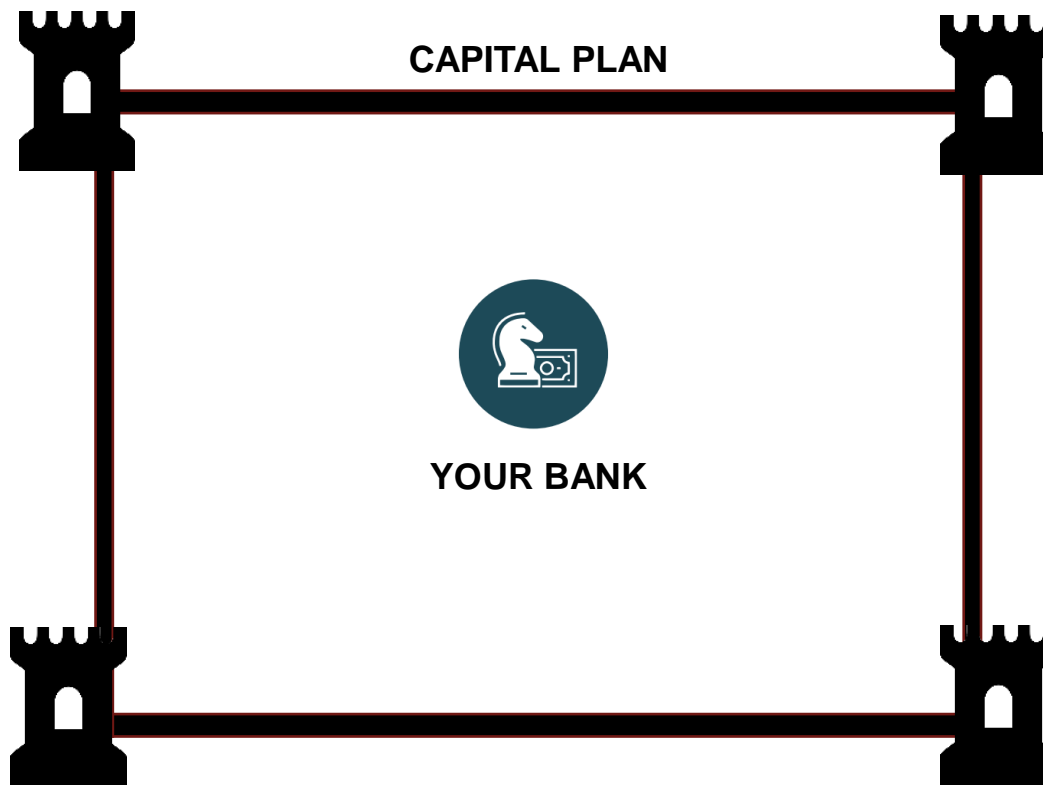
What is a Capital Plan?



What is a Capital Plan?



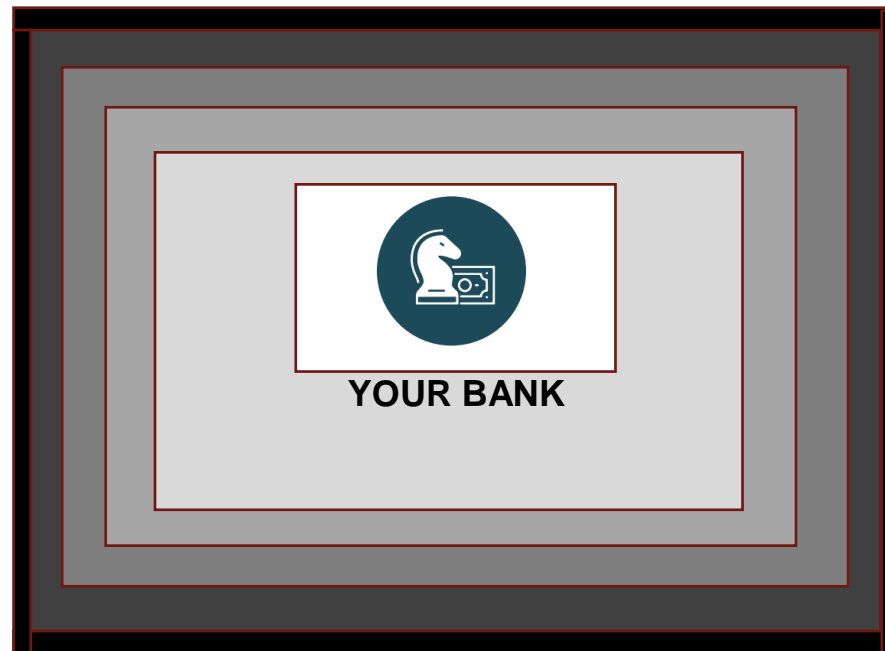
A Deeper look at the Capital Plan



A Deeper look at the Capital Plan



CAPITAL PLAN



A quality Capital Plan has
at least four layers

A Deeper look at the Capital Plan



CAPITAL PLAN

KRI Triggers



YOUR BANK

Key Risk Indicators (KRIs)
provide an early warning
system.

A Deeper look at the Capital Plan



CAPITAL PLAN

KRI Triggers



YOUR BANK

Key Risk Indicators (KRIs) provide an early warning system.

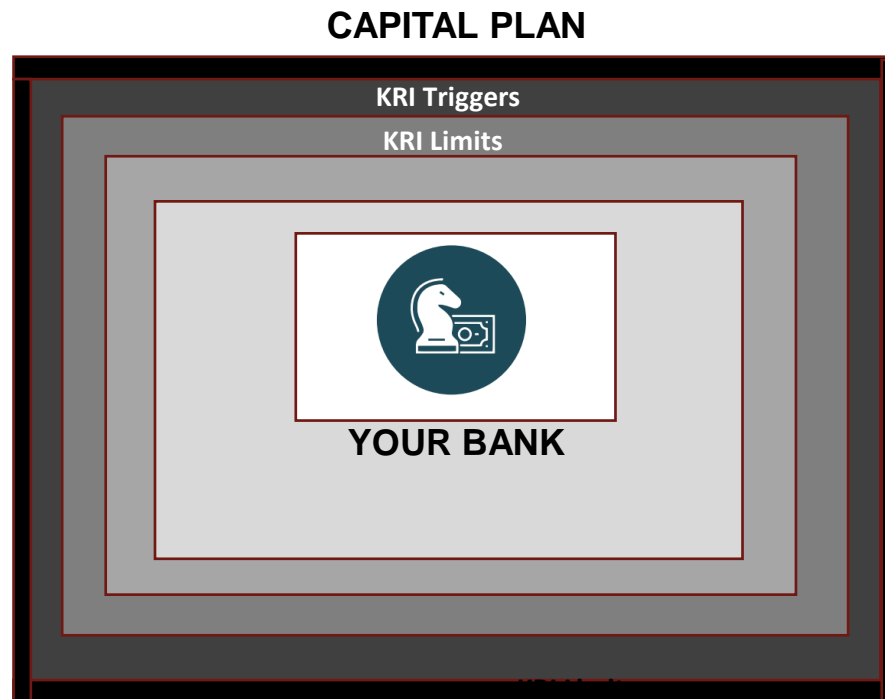
Triggers are the first line of defense.

If a KRI trigger is breached, the Bank may need to alter its Strategic Plan.

A Deeper look at the Capital Plan



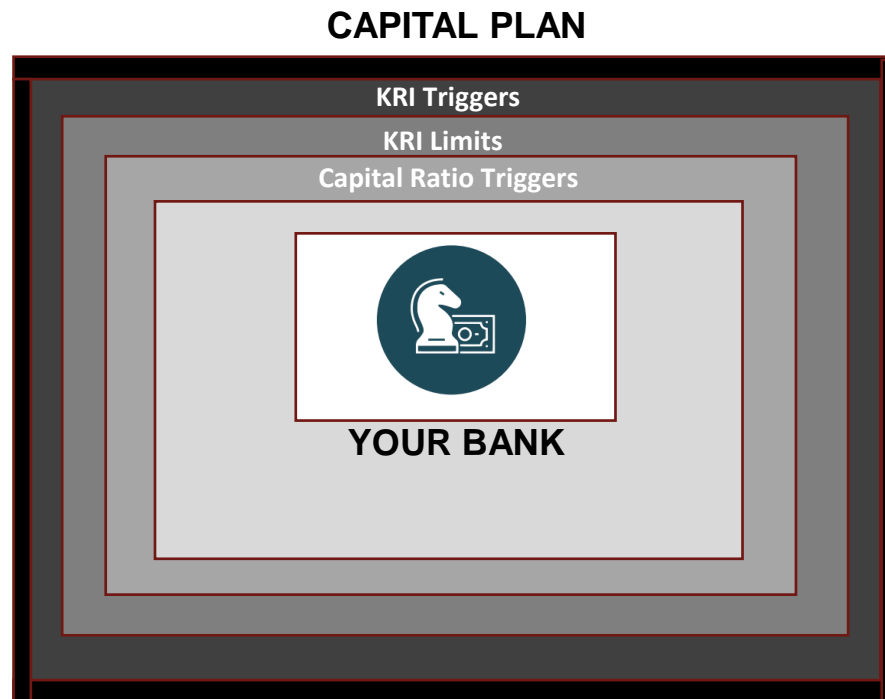
Limits associated with KRI's should require action BEFORE capital ratios fall towards internal thresholds.



A Deeper look at the Capital Plan



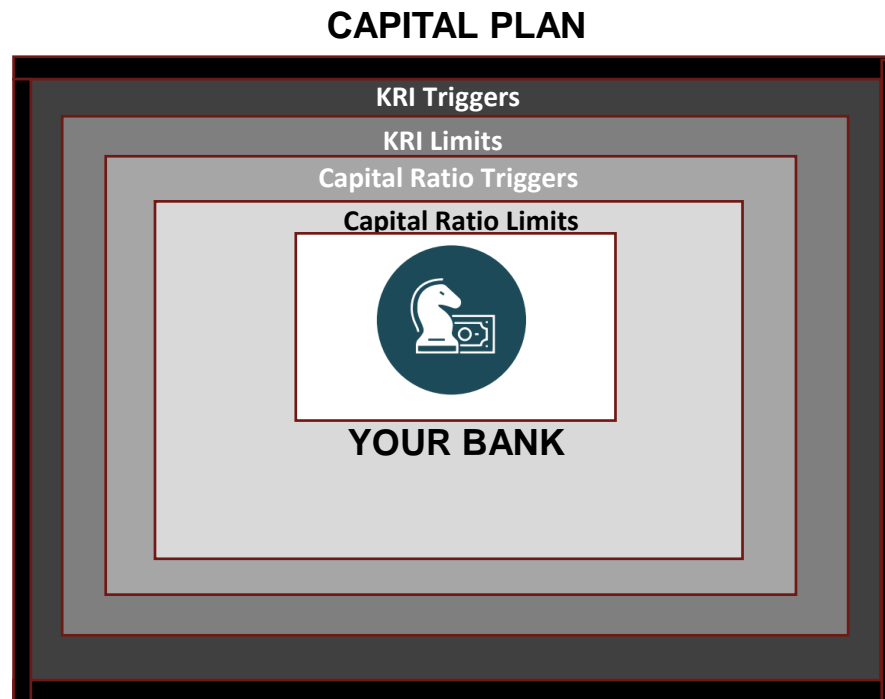
Capital ratios should have triggers to create awareness and potentially trigger action before limits are reached.



A Deeper look at the Capital Plan



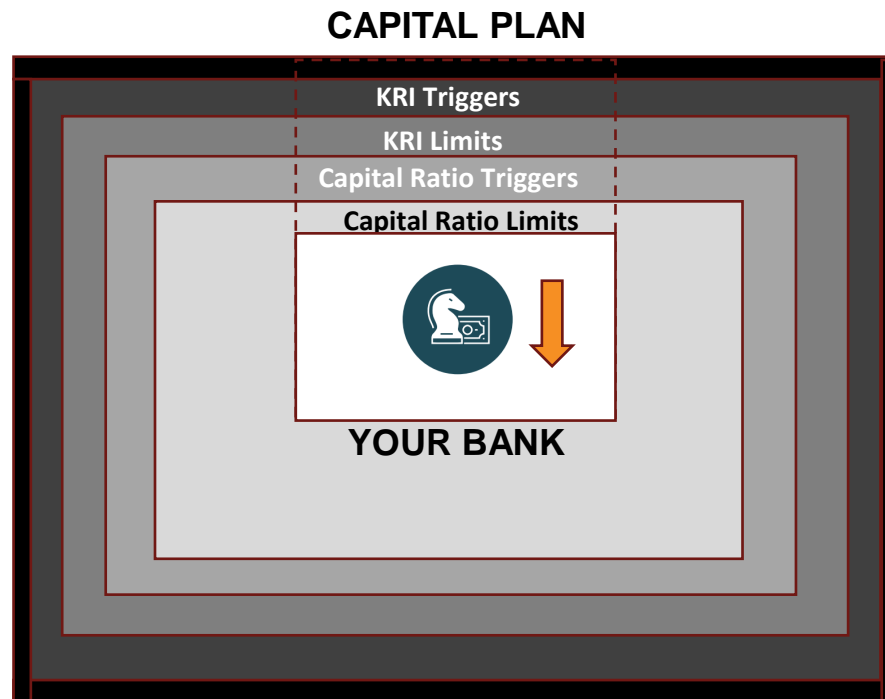
Capital Ratio limits are hard limits that should be the last line of defense before the Bank needs to course correct.



A Deeper look at the Capital Plan



The Strategic Plan
needs to shrink to
compensate if
contingency plans
must be activated





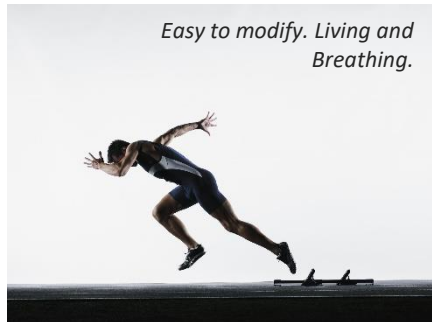
SECTION 2

Ideal Structure of a Capital Plan

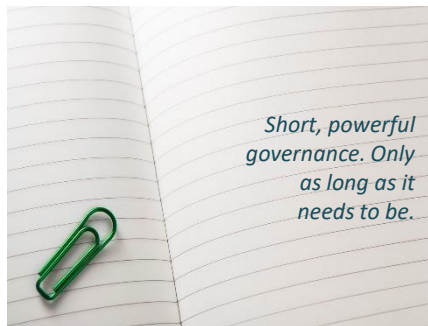
Capital Plan – Key Principles



Agile



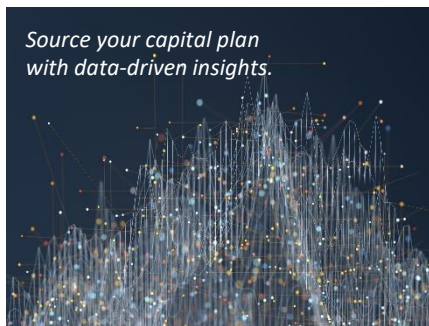
Lean



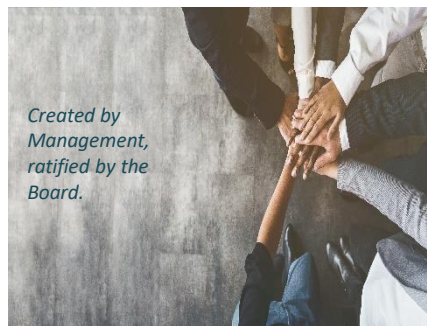
Meaningful



Data-Driven



Shared



Sections of Your Capital Plan



Introduction	Capital & KRIs	Capital Sources/Uses	Governance
<ul style="list-style-type: none">✓ Scope✓ Executive Summary	<ul style="list-style-type: none">✓ Capital Thresholds✓ Key Risk Indicators✓ Other Risks	<ul style="list-style-type: none">✓ Dividends & Other Actions✓ Strategic Plan Assessment✓ Contingency Planning	<ul style="list-style-type: none">✓ Policies & Procedures✓ References/Works Cited

Scope



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Make it clear this document is meant to be a Capital Plan, not a history book.













Clarify how the holding company is incorporated into the capital plan (if applicable).



Define terms such as KRIs, thresholds, limits, and triggers.

Executive Summary



Introduction	Capital & KRIs	Capital Sources/Uses	Governance
 Scope	 Capital Thresholds	 Dividends & Other Actions	 Policies & Procedures
 Executive Summary	 Key Risk Indicators	 Strategic Plan Assessment	 References/Works Cited
	 Other Risks	 Contingency Planning	



Create the proper context for your capital limits and KRIs.



Clarify that the purpose of the capital plan as it relates to your strategic plan.



Summarize a risk assessment of the Bank and the strategic plan (focus on the big picture/primary uses of capital).



Refer to how strategic plan has already been adapted to reflect current industry conditions (liquidity risks, etc.).



Discuss any other critical transitions (CBLR to Basel III, etc.).

Capital Ratios



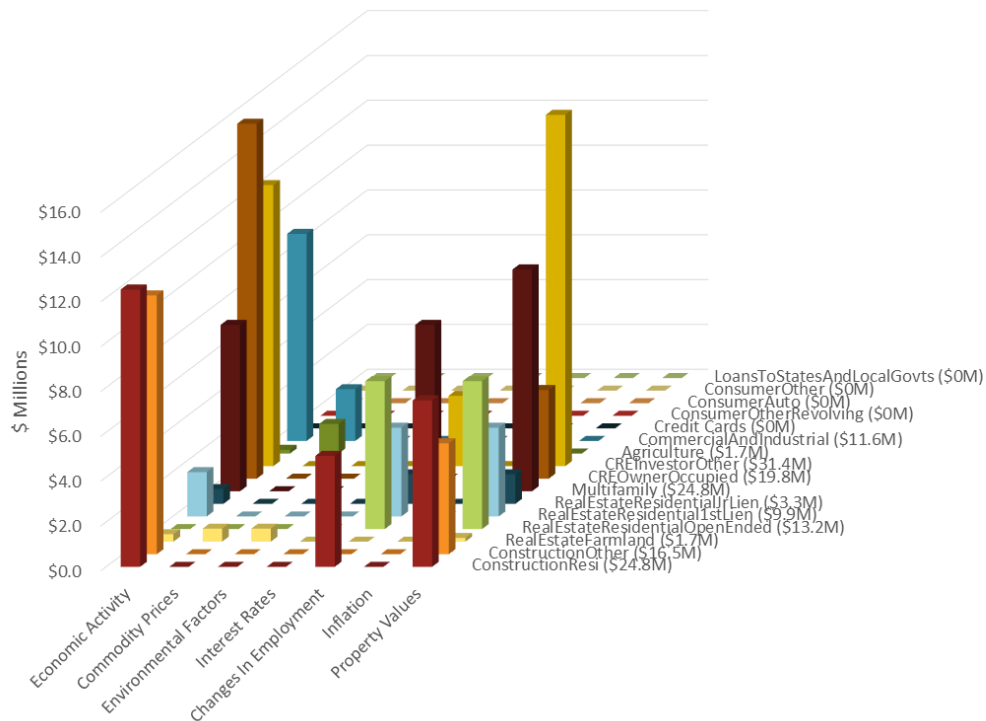
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*Quantify your Limits with
Stress Testing*

Capital Ratios



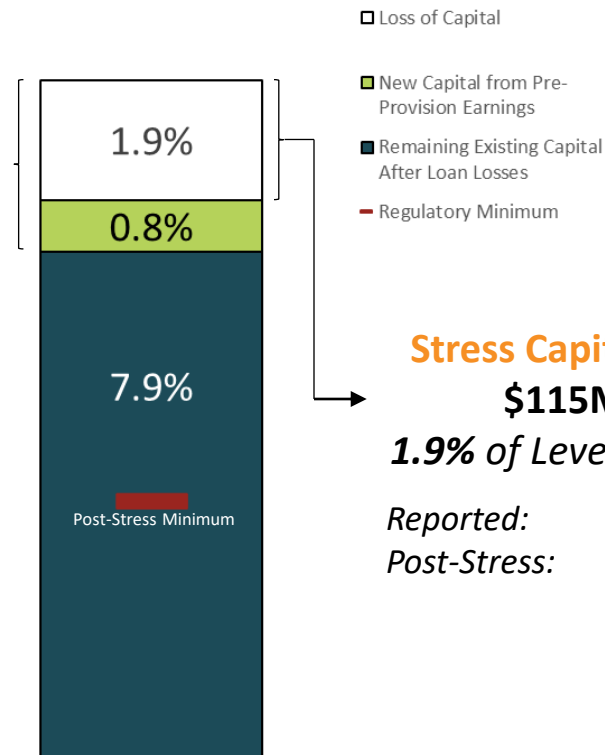
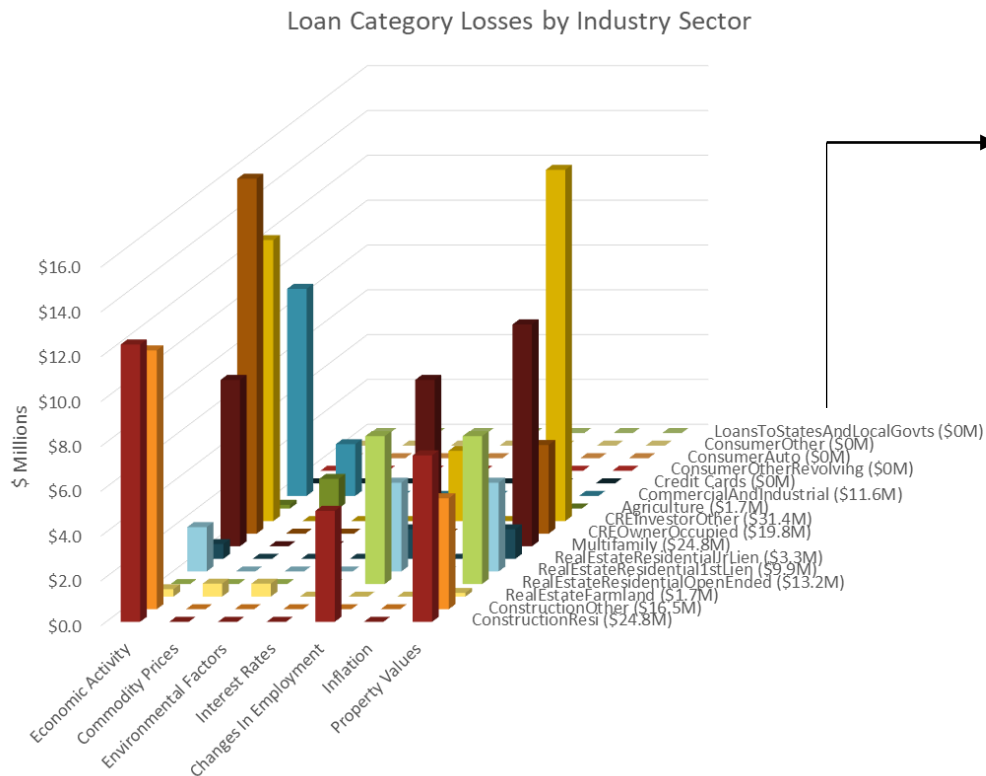
Loan Category Losses by Industry Sector



Capital Ratios



Leverage Ratio

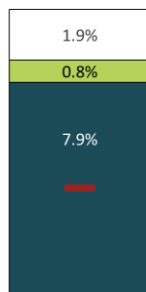


Capital Ratios



Custom Capital Requirement: Leverage Ratio

Leverage Ratio

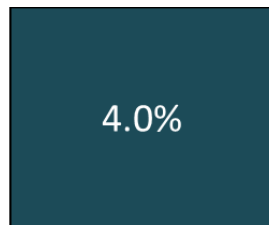
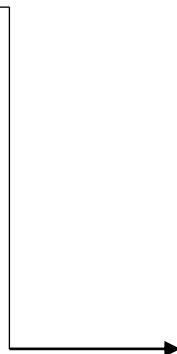
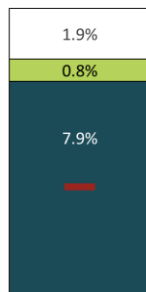


Capital Ratios



Custom Capital Requirement: Leverage
Ratio

Leverage Ratio

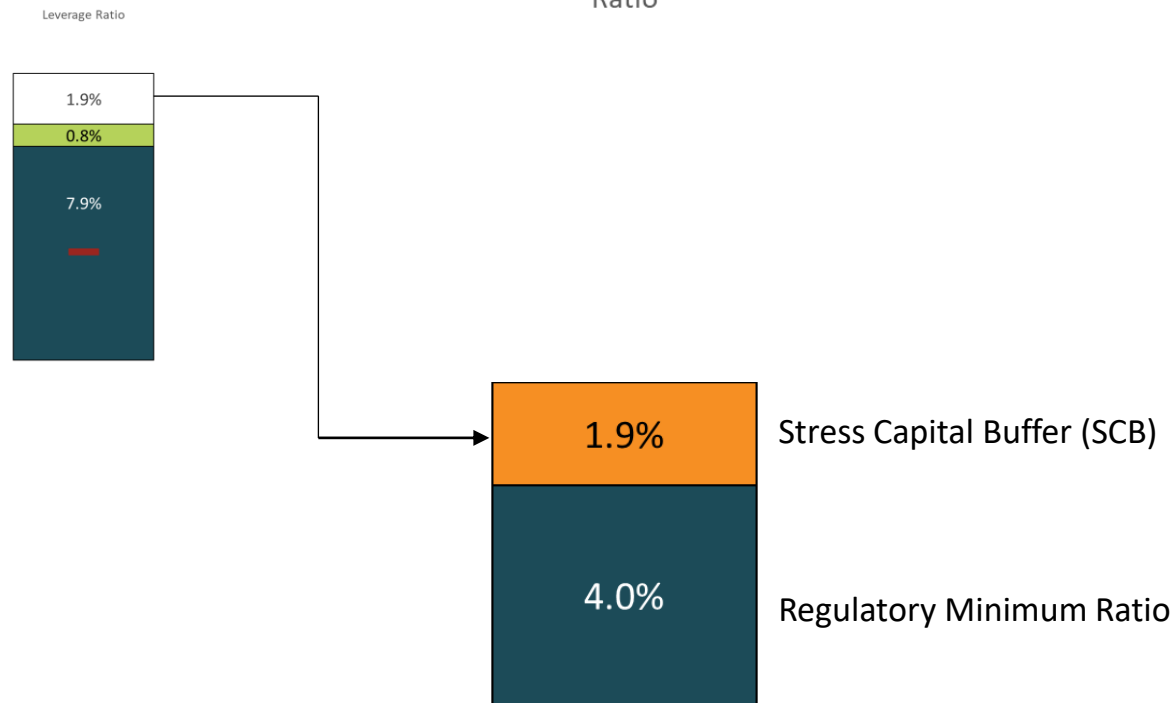


Regulatory Minimum Ratio

Capital Ratios



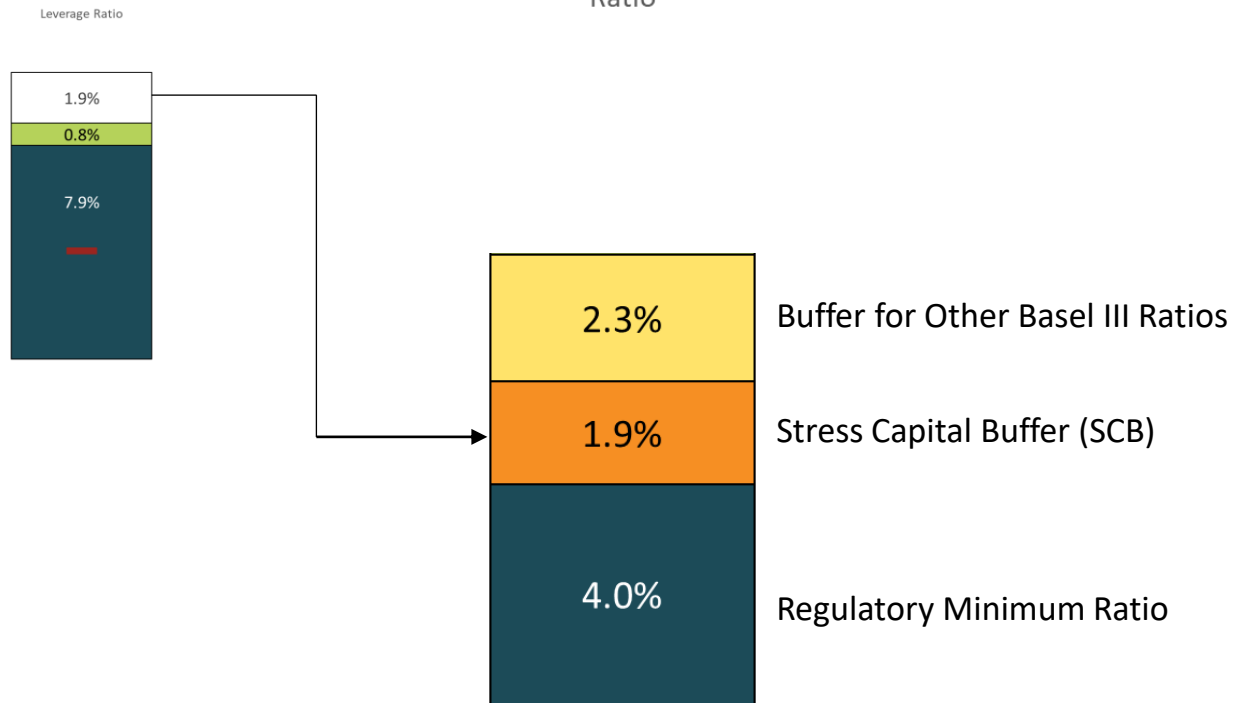
Custom Capital Requirement: Leverage Ratio



Capital Ratios



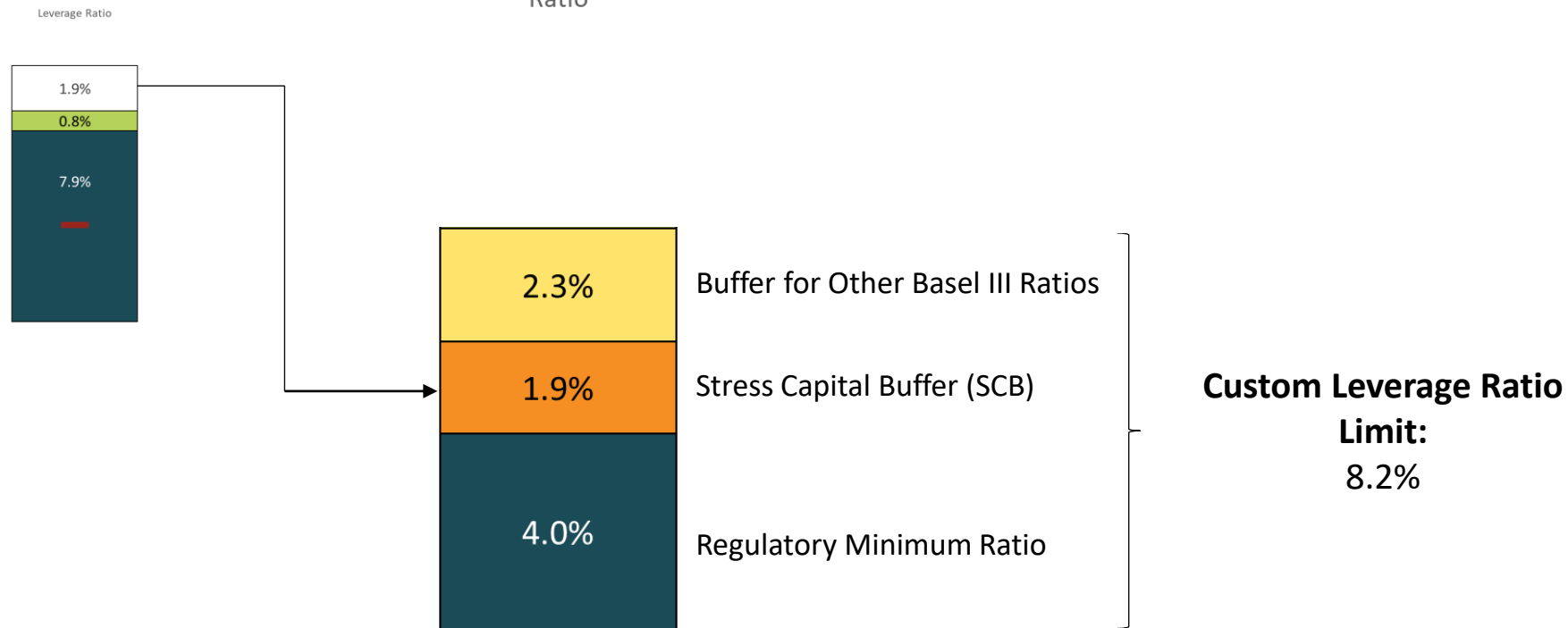
Custom Capital Requirement: Leverage Ratio



Capital Ratios



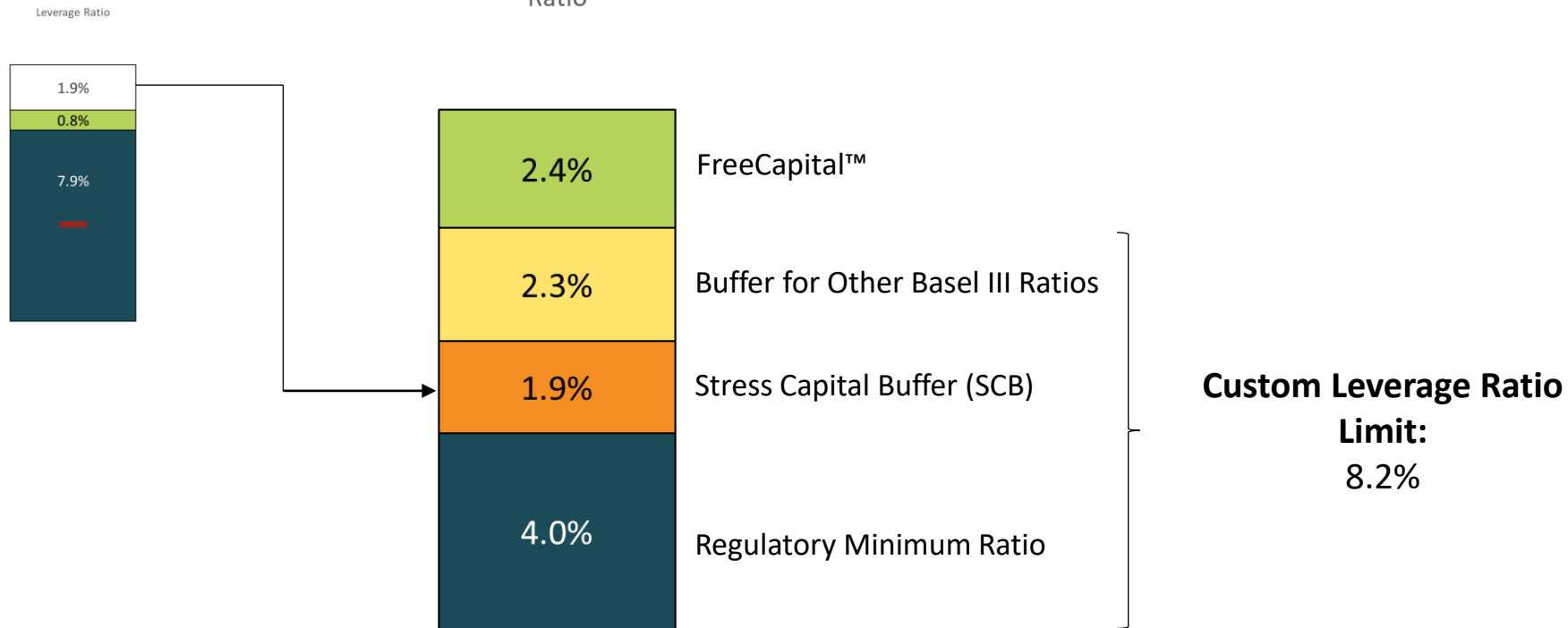
Custom Capital Requirement: Leverage Ratio



Capital Ratios



Custom Capital Requirement: Leverage Ratio





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Ideally 10-12. Not too many!



If possible, quantify them using the stress test.



Concentration ratios are critical.



Include non-regulatory capital ratios.



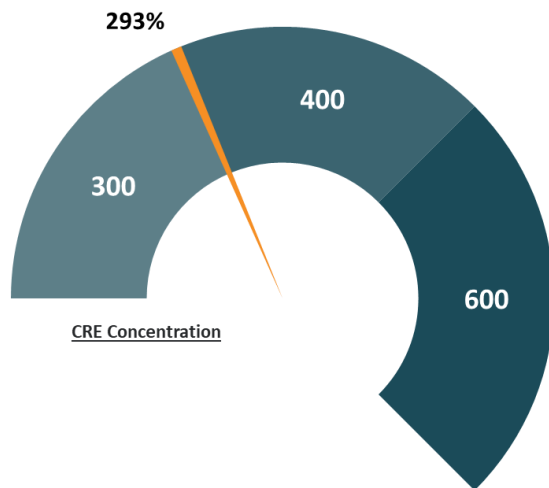
Include key liquidity ratios (critical in a post-SVB world).



Include the most important ALM metrics.



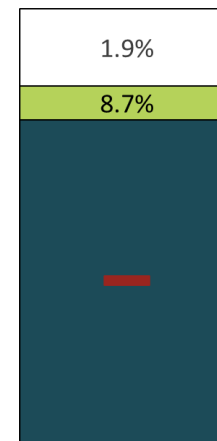
Quantify KRIs with Stress Testing



Reported CRE Concentration

Corresponds to

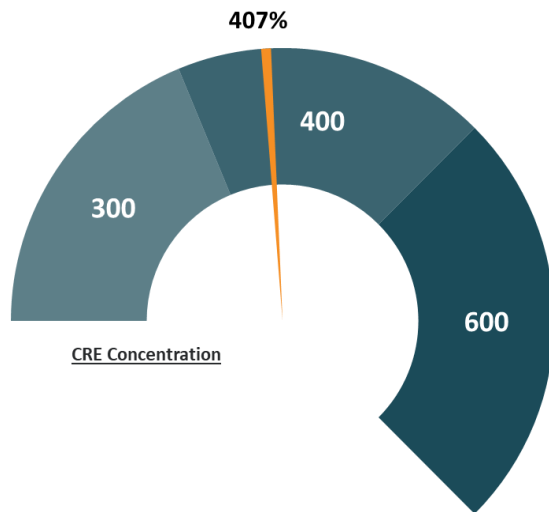
Leverage Ratio



8.7% Post-Stress Capital



Quantify KRIs with Stress Testing

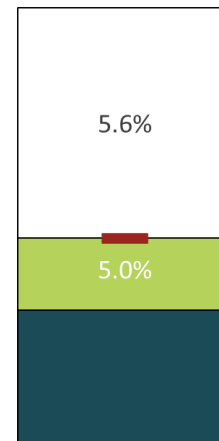


407% CRE Concentration

Corresponds to

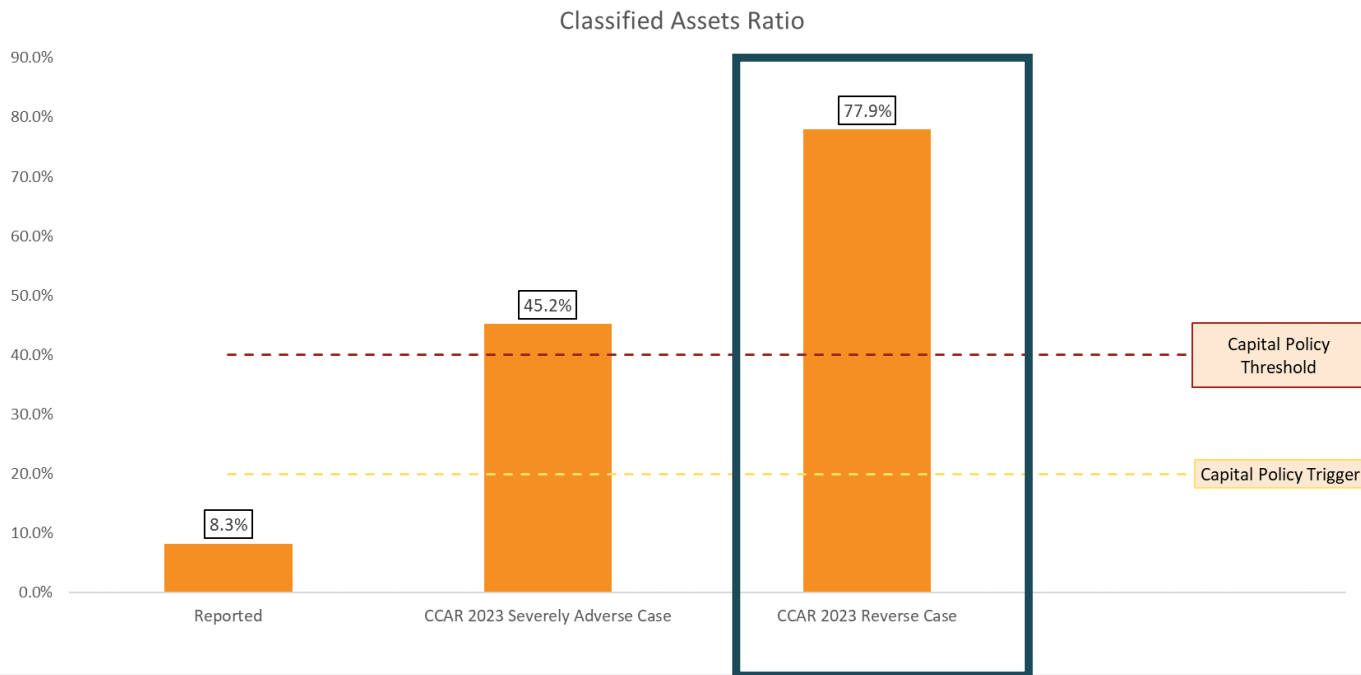
5.0% Post-Stress Capital Ratio
(i.e. *Well-Capitalized*)

Leverage Ratio





Quantify KRIs with Stress Testing



KRIs - Selected Ratios for Consideration in a Post-SVB World



Include non-regulatory capital ratios.

- ☐ Holdco Double Leverage Ratio
- ☐ Tangible Common Equity (includes AOCI)
- ☐ EVE / Assets



Include key liquidity ratios (critical in a post-SVB world).

- ☐ Liquidity Coverage Ratio (LCR)
- ☐ Uninsured deposit coverage ratio
- ☐ Uninsured deposit concentration ratio
- ☐ Primary Liquidity ratio



Include the most important ALM metrics.

- ☐ EVE Sensitivity +/- 200%
- ☐ NII Sensitivity +/- 200%



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Should refer to other risks that are difficult to quantify:



Operational Risk



Compliance Risk



Cybersecurity Risk



Reputational Risk



BSA/AML Risk



Fraud Risk

*How are you
Monitoring
these risks?*

Dividends and Capital Actions



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What's contained in the Strategic Plan?



Debt-Service to holding company?
Shareholder dividends?



Stock buybacks? Capital Raises?



Set dividend policies.



“Must-pay” dividends should have
limits of possible distribution.



“Nice to have” dividends could be
linked to Net Income.

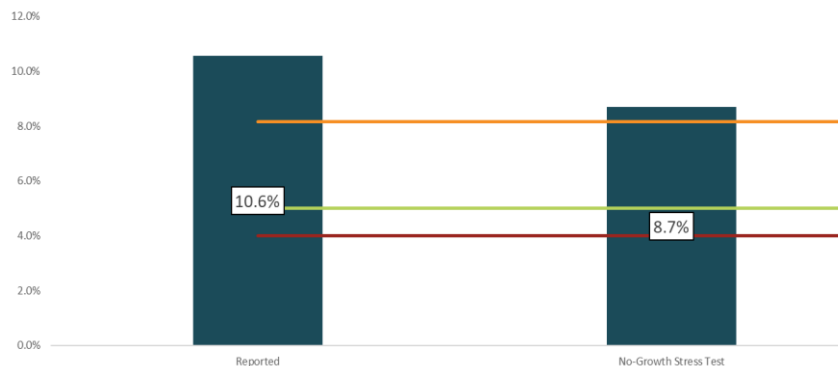
*Dividends
policies
should
require
board
approval.*

Strategic Plan Assessment



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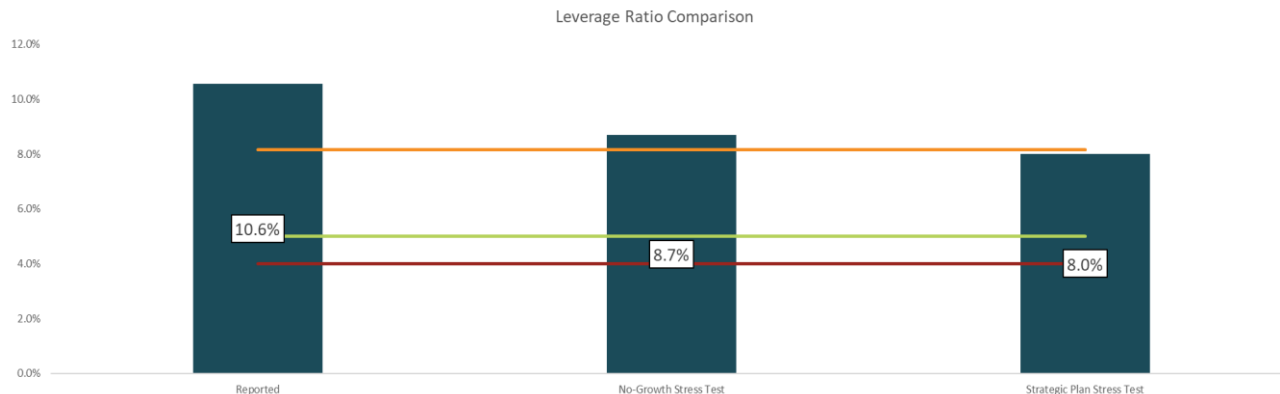
Leverage Ratio Comparison



Strategic Plan Assessment



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Additional loan growth & dividends results in increased capital utilization.

Are you still above your *Capital Thresholds*?

Contingency Planning



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What if your strategic plan shows a Capital or KRI Limit breach?

Consider testing your contingency actions in your stress testing framework. Do they solve the problem?



Outline your contingency framework in order of difficulty.

- Reduced loan growth vs Strategic Plan
- No loan growth
- Gradual de-leveraging
- Accelerated de-leveraging (asset sales)
- Reduced capital actions
- Cost reductions
- Holdco injections
- Capital raises – be realistic!

Policies & Procedures



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Who is responsible for monitoring/maintaining/updating?



How often is the capital plan re-evaluated?



When/how is the board informed?



When is board approval required?



What must bank management do in the event of a KRI or Limit breach?



When is the underlying stress testing updated? What about validation?

References/Works Cited



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This helps keep the capital plan lean! Don't reproduce everything. Just cite it.



Strategic Plan/Budget



Stress Test Reports



ALM Reports



Internal Audit Reports



ERM Reports/Scorecards



Investor Presentations

Think about other documents you might need to include here.

Get a Template Based on This Presentation



FREE WHITEPAPER

Sample Capital Plan

for Community Banks



Patti Casaleggio
Head of Operations
pcasaleggio@invictusgrp.com



INVICTUS

GROUP

For more information about capital planning, please contact:

Adam Mustafa

Chief Executive Officer

amustafa@invictusgrp.com



Patti Casaleggio

Head of Operations

pcasaleggio@invictusgrp.com

