strata | AXIOM

Four Key Elements in Measuring and Reporting Funds Transfer Pricing

Introduction

In a shifting financial landscape marked by margin compression, fluctuating rates, and heightened regulatory and competitive pressures, financial leaders are under constant strain to understand what truly drives profitability. Traditional reporting often fails to provide a complete picture of how and where value is created or lost.

Funds Transfer Pricing (FTP) provides the clarity needed to measure performance more accurately. While FTP is already part of the profitability framework for many institutions, the real challenge lies in how it's measured, analyzed, and communicated.

This e-book highlights four key elements that strengthen the accuracy, transparency, and usefulness of FTP reporting. By mastering these elements, institutions can move beyond calculations to achieve a clear, actionable view of performance across products, customers, and business lines.

The role of funds transfer pricing in profitability

FTP plays a central role in understanding the profitability of customers, products, organizational units, and channels across a financial institution. It helps leaders see how different contributors to net interest margin (NIM) — such as lending, deposit gathering, and interest rate risk management — impact overall profitability. It provides a multi-dimensional view of value creation, leading to more informed decisions about product pricing, funding strategy, and capital allocation.

Yet, many institutions still focus too narrowly on calculating precise FTP rates. Precision matters, but analysis and interpretation are where the value truly lies. Meaningful FTP analysis must be clearly reported, so leaders can best interpret results to guide better pricing, incentive, and performance decisions, helping institutions shift from retrospective reports to forward-looking strategy.

Four key elements in measuring and reporting FTP

One of the first steps a finance leader must take in implementing FTP is to define the institution's transfer pricing curve. The curve should represent an institution's own ability to source funds of various terms on the wholesale market.

Prior to its phase-out beginning in 2022, the LIBOR/Swap Curve was widely used to represent the creditworthiness of non-governmental entities approximating an A+ rating, which serves as a good proxy for a healthy institution. The Alternative Reference Rates Committee (ARRC) — which ceased operations in 2023 — recommended the Secured Overnight Financing Rate (SOFR) as the preferred alternate rate. Leaders should adjust the institution's transfer pricing curve to its market access to ensure the pricing reference is realistic.

Next, finance leaders should apply a matched-term approach. This involves transfer pricing each instrument at origination (or last re-price), assigning a transfer rate to each principal cash flow and integrating those individual rates into a single rate based on a time/balance weighted algorithm. With that foundation in place, four essential elements in FTP measurement and reporting are:

1. **Handling outstanding loan balances and principal payments**
2. **Plotting margin against credit score**
3. **Evaluating loan originations by officer**
4. **Considering the time dimension**

1 Handling outstanding loan balances and principal payments

An amortizing loan isn't a single rate decision — rather, it's a stream of principal cash flows that arrive at different points in time. In a sound FTP framework, each of those principal amounts is matched to the appropriate point on the transfer curve. Because earlier payments are outstanding for a shorter period than later payments, the system applies a weighting factor that reflects both time outstanding and the portion of principal involved. The end product is a composite transfer rate that accurately represents the theoretical funding cost for the entire loan.

For example, consider a 12-month amortizing loan at 4.50%. As the outstanding balance declines, each payment is matched to the appropriate maturity point on the institution's transfer pricing curve to determine its specific cost of funds. The resulting composite transfer rate is 2.33%, leaving a 2.17% spread (4.50% – 2.33%) to cover the credit cost, operating expense, required capital, and the institution's target profit. This example underscores why matched-term pricing is so important: it isolates the economics of pricing and credit from interest-rate positioning and ensures individual loans are judged on their true contribution.

Handling outstanding loan balances and principal payments *continued*

Challenges and refinements:

- **Prepayments:** Customers often pay loans off early, changing expected cash flows. FTP systems account for this using prepayment assumptions and adjust transfer rates accordingly.
- **Optionality:** Option-adjusted spreads (OAS) can be calculated and added to reflect the value of embedded options, such as the ability to prepay or refinance.
- **Undefined structures:** Accounts without fixed cash flows (e.g., money market savings accounts) require modeling based on historical behavior, distinguishing core and volatile portions or studying behavior across different rate cycles to approximate their effective maturity.

The goal is to achieve a consistent, credible framework that reflects how each instrument contributes to profitability.

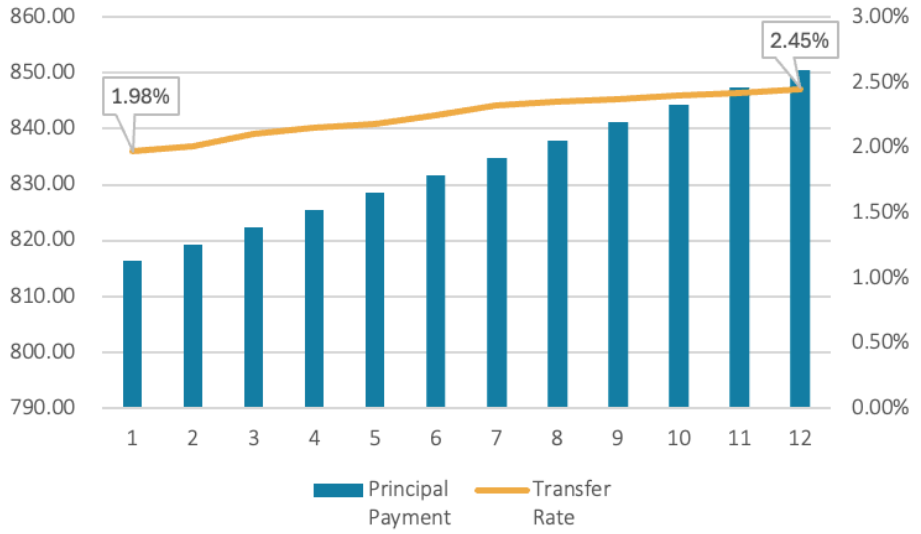
Periodic Principal Payments and Corresponding Funds Transfer Rates

12-Month Loan
$10,000

Interest Rate
4.50%

Composite FTP Rate
2.33%

FTP Rate Spread
2.17%

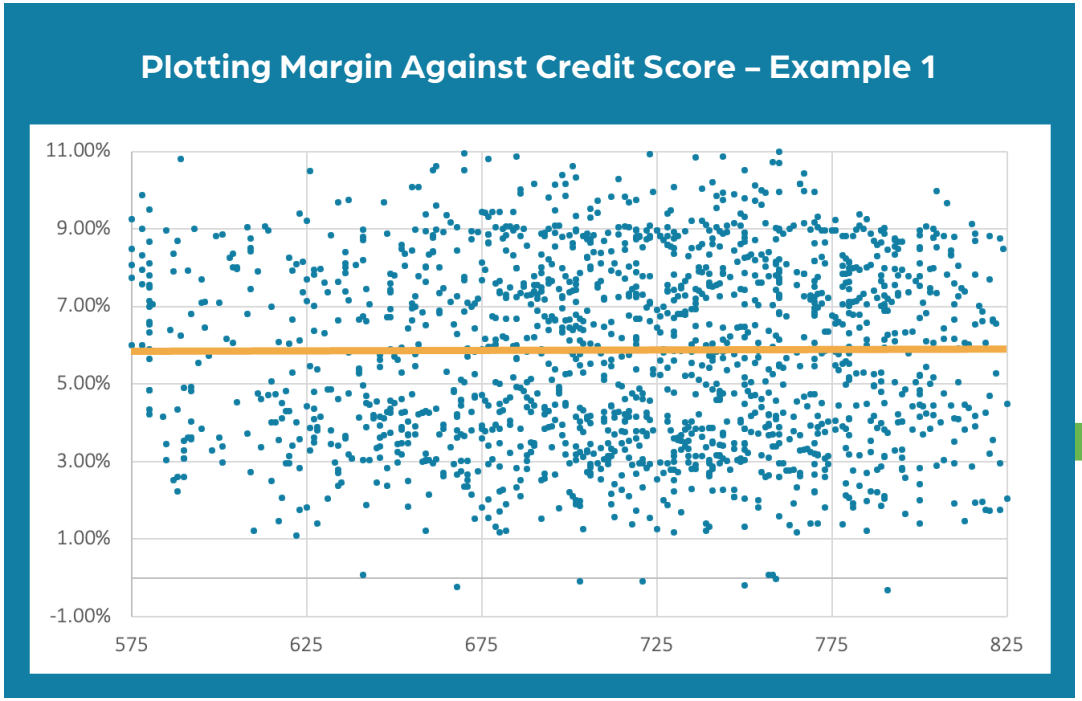


2 Plotting margin against credit score

FTP reporting becomes much more powerful when it connects profitability metrics with risk indicators like credit score. By adding FICO credit scores to each customer record, institutions can test whether risk-based pricing is truly being applied at the point of sale.

In the example below, the FTP spreads (y-axis) are plotted against credit scores (x-axis) across an auto loan portfolio to reveal whether higher-risk loans are earning appropriately higher margins.

In this case, the scatterplot shows little correlation between credit quality and FTP spread, indicating that high-risk borrowers were priced nearly the same as low-risk borrowers. The average FTP spread is strong, but the relatively flat trendline suggests a breakdown. Numerous loans fall below expectations, especially at lower credit scores where risk is greater. Conversely, the institution is not pricing aggressively enough to win high-quality borrowers whose risk merits thinner margins.



Plotting margin against credit score *continued*

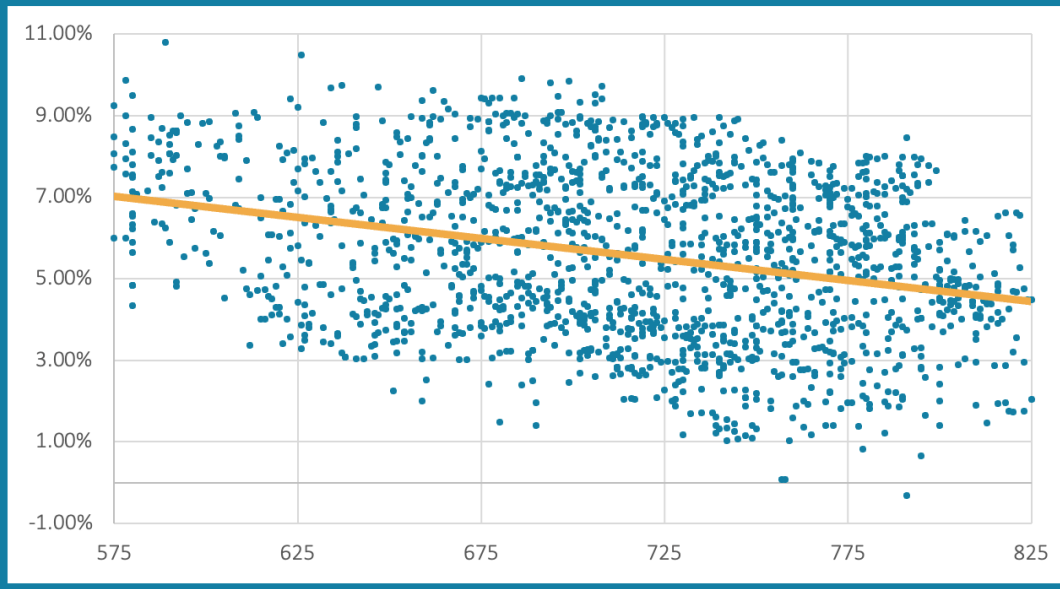
Key insights:

- The analysis reveals that riskier loans were underpriced
- Higher-quality borrowers were not being targeted aggressively enough
- **The solution:** Enforce pricing discipline for riskier credits and strengthen rate competitiveness for prime borrowers

Simple data visualization with FTP metrics can expose these misalignments quickly and help finance leaders refine pricing strategy. In this case, the analysis reveals that the institution needs to reevaluate how it is pricing its loans and the lack of correlation between its pricing and its risk.

The second scatterplot below shows a clear downward slope correlating with higher spreads for lower scores, indicating a more effective risk-based pricing strategy.

Plotting Margin Against Credit Score – Example 2



3 Evaluating loan originations by officer

A common mistake in FTP reporting is focusing too heavily on overall contributions at the portfolio level. While understanding total contribution is useful, it's not actionable. It typically involves the results of historic lending decisions, many of which were made years before and cannot be changed. Incremental analysis that isolates recent originations provides sharper insight into current performance trends. It serves as a good indicator of whether overall portfolio spreads will directionally widen or narrow based on how loans and deposits are being priced today, allowing the institution to course correct if necessary.

Beyond reporting, incremental analysis can be used to help guide other initiatives, such as incentive compensation. Compensation plans that reward volume alone can unintentionally encourage underpricing. By examining FTP-adjusted spreads on newly originated loans by officer, management can see who is generating profitable growth versus who may be chasing volume at the expense of margin.

This enables institutions to devise an incentive plan that rewards loan officers for the incremental net interest income they generate after transfer pricing. In other words, they're rewarded for the economic value they create over time, not just the dollars they book. Some institutions extend this further by incorporating economic capital and expected loss into a risk-adjusted return on capital (RAROC) framework, linking pay to risk-adjusted contribution.

The key is alignment: Measure contribution the same way it is rewarded, so day-to-day behaviors support the institution's margin and risk objectives. For example, one institution found that its top producer by volume ranked only 15th in margin contribution, suggesting the individual may be sacrificing spread for volume. Meanwhile, a newer officer with lower volume produced significantly higher spreads.

In summary, it's imperative that managers value an officer's margin contribution to overall profitability, not just volume. Leveraging this view of the data, leaders are better equipped to coach and manage their loan officers, so personnel behaviors align with corporate objectives to improve the institution's profitability and overall performance moving forward.

Evaluating loan originations by officer *continued*

Why it matters:

- Incremental FTP analysis answers the question: "What's happening now?"
- It highlights whether current pricing decisions are likely to expand or compress future portfolio margins.
- It provides a fair, data-driven foundation for incentive compensation, linking performance rewards to true profitability, not just volume.

By syncing how the institution measures contribution with how it rewards behavior, management ensures that pricing and sales practices support sustainable margin growth.

Quarter to Date Origination Spread by Officer

Top Performers	
Originations	Angelique Collins
FTP Spread	Fay Cannon
Net Interest Income	Lorri McPherson

	Portfolio Balance	QTD Balance	Rank by Orig	New Orig as % of Portfolio	Portfolio Spread	QTD Spread	Ranking Spread	QTD Spread - Portfolio Spread	Incremental NII Effect	Ranking NII Effect
Angelique Collins	19,359,195	3,156,006	1	16.30%	5.30%	5.69%	15	0.39%	12,062	5
Lorri McPherson	13,517,652	1,891,273	2	13.99%	5.56%	7.14%	8	1.58%	29,878	1
Kevin Kinney	10,119,293	1,448,099	3	14.31%	4.80%	5.95%	13	1.15%	16,683	2
Paris Patel	3,513,102	1,329,889	4	37.86%	6.83%	7.60%	6	0.77%	10,140	7
Doreen Gordon	6,452,870	1,069,845	5	16.58%	6.18%	7.62%	3	1.44%	15,431	3
Leslie Espinoza	3,474,927	888,289	6	25.56%	6.12%	7.60%	5	1.48%	13,176	4
Michelle Ross	8,282,330	698,945	7	8.44%	5.35%	6.85%	9	1.50%	10,495	6
Josephina Jacobson	2,599,666	636,562	8	24.49%	5.00%	6.55%	12	1.55%	9,862	8
Noel Glass	5,635,664	484,042	9	8.59%	5.61%	7.29%	7	1.68%	8,123	9
Fawn Bennett	1,006,499	657,556	10	65.33%	5.33%	5.76%	14	0.43%	1,542	14
David Kennedy	3,950,392	278,959	11	7.06%	4.74%	6.74%	10	2.00%	5,590	11
Cassie Henson	2,332,549	212,077	12	9.09%	5.13%	4.13%	16	-1.00%	(2,125)	16
Fay Cannon	1,517,150	147,965	13	9.75%	5.99%	11.08%	1	5.09%	7,532	10
Jeannie Farrell	892,088	106,535	14	11.94%	5.53%	6.57%	11	1.04%	1,112	15
Keli Ewing	1,141,219	78,163	15	6.85%	5.36%	7.61%	4	2.25%	1,758	13
Christina Shawter	1,529,165	75,678	16	4.95%	5.54%	9.24%	2	3.70%	2,797	12

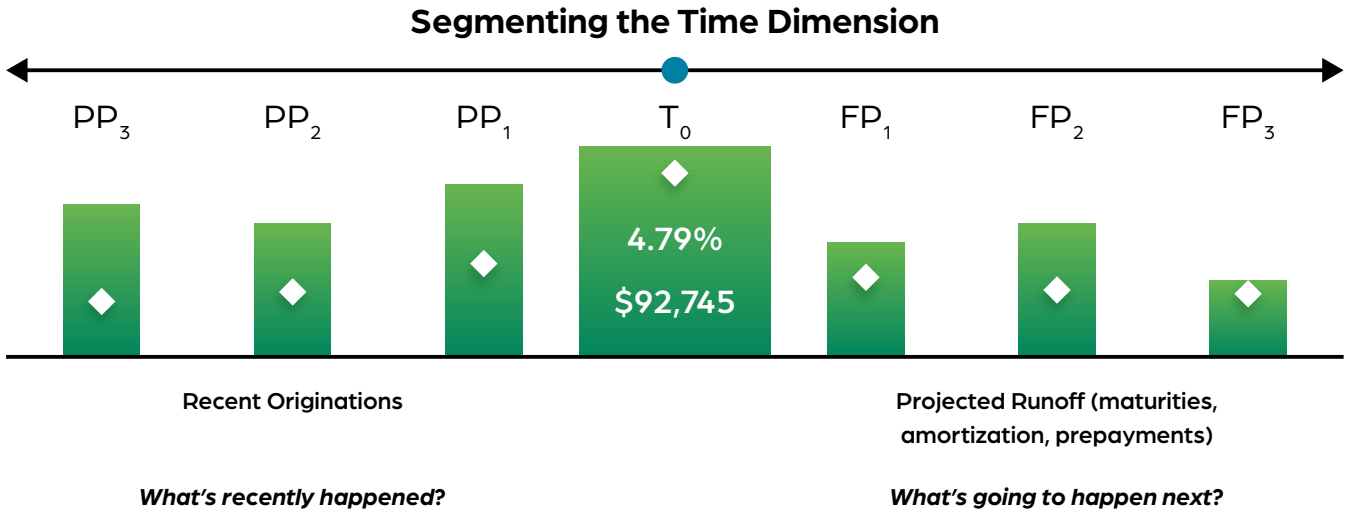
4 Considering the time dimension

Time adds essential context to FTP results. A single period shows where you are, while a time series shows where you've been and where you're likely to go. Looking at trends over time helps institutions distinguish temporary pricing effects from lasting shifts in profitability. A practical way to operationalize this is to evaluate three perspectives side by side:

- **T_0 (current):** The current FTP rate and spread for originated or total portfolio balances. This snapshot anchors performance today.
- **PP_1– PP_3 (past periods):** Historical snapshots that show trends in pricing and spreads, and whether officers, products, or channels have been consistent over time.
- **FP_1– FP_3 (future periods):** A forward-looking view that projects the runoff of current portfolios, illustrating how maturing spreads, repricing events, and assumed new production will affect margin going forward.

When combined with dimensions like loan officer, product, or channel, this longitudinal view highlights whether pricing practices are consistent and whether margins are improving or eroding.

Ultimately, this time-based lens helps leadership see whether the institution's current strategy is sustainable. It turns FTP from a static scorecard into a dynamic planning instrument. Treasury can adjust funding strategies, lending can recalibrate rate sheets, and leadership can set incentive thresholds to protect future profitability with an eye to where the margin is headed, not just where it has been.



Conclusion

FTP is much more than an internal rate-setting mechanism. When measured and reported effectively, it becomes a dynamic framework for understanding value creation across the institution.

By mastering the four key elements — handling balances and payments, connecting margin to credit quality, evaluating loan origination behavior, and analyzing performance over time — financial institutions can:

- Gain deeper insight into what drives profitability
- Align pricing and incentives with true economic value
- Build a more forward-looking view of performance and risk

In an environment where every basis point matters, clarity from FTP can make the difference between incremental growth and sustained profitability.

Solutions like Strata's Axiom® Funds Transfer Pricing help financial institutions implement transparent, accurate, and analytically rich FTP frameworks. Robust FTP solutions provide matched-term FTP rate calculations at the account level, and configurable rules for liquidity premiums, option costs, and management spreads. They also offer real-time analytical reporting and drill-down visibility and seamless integration with profitability, budgeting, and planning tools.

*Visit Strata's website to learn more about **Axiom® Funds Transfer Pricing** or to **request a demonstration**.*

strata

About Strata

Strata Decision Technology, LLC provides innovative enterprise performance management software, data, and intelligence solutions for financial institutions. Following the acquisition and integration with Syntellis Performance Solutions, LLC, its powerful budgeting and planning, profitability, and analytics solutions — including robust reporting and visualization tools — help institutions elevate performance and transform vision into reality. Hundreds of leading banks, credit unions, and farm credit associations rely on Strata's Axiom solutions and proven industry expertise to acquire insights, accelerate decisions, and advance their business plans. For more information, please visit www.stratadecision.com.

FI.1040.01.26