

Federal Deposit Insurance Corporation

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FINANCIAL INSTITUTION MANAGEMENT OF INTEREST RATE RISK

Financial Institution Letter

FIL-2-2010

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Summary: Current economic conditions present significant risk management challenges to depository institutions of all sizes. Institutions are reminded to not lose focus on their management of interest rate risk (IRR). For a number of institutions, increased loan losses and sharp declines in the value of certain securities portfolios are placing downward pressure on capital and earnings. In this interest rate environment, taking advantage of a steeply upward-sloping yield curve by funding longer-term assets with shorter-term liabilities may pose risks to an institution's capital and earnings should short-term interest rates rise. Depository institutions are expected to manage IRR exposures using policies and procedures commensurate with their complexity, business model, risk profile, and scope of operations. This letter clarifies existing IRR guidance.

Distribution: FDIC-Supervised Banks (Commercial and Savings) Suggested Routing: Chief Executive Officer Chief Financial Officer Chief Risk Officer	 Highlights: The board of directors and senior bank management are responsible for the establishment, approval, implementation, oversight, and annual review of IRR management strategies, policies, procedures, and limits (or risk tolerances).
Referenced Guidance: Joint Agency Policy Statement on Interest Rate Risk, FIL-52-96	 Analysis of an institution's exposure to IRR should include assessing the likely effects of meaningful stress scenarios, including interest rate shocks of at least 300 to 400 basis points
Contact: Kyle Hadley, Chief, Exam Support, at KHadley@fdic.gov or (202) 898-6532 Attachment: FFIEC Advisory on Interest Rate Risk Management	 Capital and earnings should be sufficient to support an institution's IRR profile. If IRR measures approach or exceed risk limits, management should take steps to limit or mitigate the exposure, for example, by hedging or altering the balance sheet.
Note: FDIC financial institution letters (FILs) may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2010/index.html To receive FILs electronically, please visit http://www.fdic.gov/about/subscriptions/fil.html. Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (1-877-275-3342 or 703-562-2200).	• Financial institutions are expected to conduct independent reviews of their IRR models and management processes. If third-party models are used, management should obtain documentation of the results from reviews conducted by the vendor.