

# Interest Rate Risk Exposure and Management in the Current Environment

presented by

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- Consider the unique nature of each bank and recent performance trends (see handout)
- Modeling considerations
- Developing and implementing written strategies
- Getting the most out of ALCO

# Unique Nature of Community Banks



- Each bank has distinct characteristics
  - Core deposit base
  - Balance sheet structure and recent growth
  - Competitive environment (deposits and loans)
  - Local Economy
  - Business model and strategic objectives
- A “one-size-fits-all” approach isn’t reasonable
  - Different banks face different risks depending on characteristics and circumstances

The painter will produce pictures of little merit if he takes the works of others as his standard.

- Leonardo de Vinci

# Performance and Risk Vary Widely



- The gap between top and bottom quartile performers is widest in almost thirty years
- Rural banks have recently outperformed banks in MSA's
- 2003-2007 vintage de novos are struggling
- Small banks have performed as well as larger community banks
- Geographics do matter a great deal (not just the "sand" states)

Until the tide goes out you don't know  
who's swimming naked.

Warren Buffet

- Build assumptions that reflect the uniqueness of the bank, the market conditions and trends
  - What is the bank's specific risk profile and trend?
  - Understand the magnitude of risks and trends
  - Non-maturity deposits present a special challenge
  - Remember floors on adjustable rate loan floors, prepay/yield maintenance in fixed loans and nonaccrual loans

Which risk measurement technique is most appropriate?

- EVE risk measurements have become more critical due to increase in price volatility of complex securities and lengthening duration of assets vis a vis liabilities
- How much of IRR exposure is being captured by one and two years of earnings simulations?
- Consider modeling “black swan” events that may be unique to the bank
  - Not *just* extreme (+400bps) rate shocks
  - Model and manage IRR similar to Liquidity Risk (Contingency Funding Plans) using worst case scenarios



- **Use** the output of A/L model and IRR analyses to develop and implement *written* strategies
  - Define, Measure and Manage IRR
- Demonstration – Model (test) alternative and new strategies *before* implementation
- Documentation – For future assessment as well as regulatory compliance

# Getting the most out of ALCO



- End every ALCO meeting with a “call to action” (see sample agenda)
- In these volatile times *keep things simple* (spend sufficient time on what’s *really* important)
- Educate and engage – Board, ALCO, Management

There's little education in the second kick of a mule.

Success comes from doing ordinary things  
extraordinarily well.

Success is never final.

Winston Churchill