



Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-2-2012
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Supervisory Guidance Interest Rate Risk Management: Frequently Asked Questions

Summary: The FDIC, with the other Federal Financial Institutions Examination Council (FFIEC) agencies, has issued responses to questions received following the issuance of the Interagency Advisory on Interest Rate Risk (IRR) Management on January 6, 2010. The responses address IRR exposure measurement and reporting, model risk management, stress testing, assumption development, and model and systems validation. Financial institution management should consider the responses in the context of their institution's complexity, risk profile, business model, and scope of operations.

Statement of Applicability to Institutions Under \$1 Billion in Total Assets: This Financial Institution Letter (FIL) applies to all FDIC-supervised financial institutions.

Suggested Distribution:

FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:

Chief Executive Officer
Chief Financial Officer
Chief Risk Officer

Related Topics:

Joint Agency Policy Statement on Interest Rate Risk, FIL-52-1996
FFIEC Advisory on Interest Rate Risk Management, FIL-2-2010

Attachment:

FFIEC Advisory on Interest Rate Risk Management, Frequently Asked Questions

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Note:

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Highlights:

- Institution IRR management processes and measurement systems should be capable of capturing, reporting, and controlling the risks being taken and major new initiatives.
- Management should ensure it stress tests IRR exposures using appropriate scenarios, including meaningful interest rate shocks, to identify the inherent risk. For example, in a low-rate environment, institutions should run interest rate shocks of +300 and +400 basis points. If conditions warrant, institutions should test more severe scenarios.
- Management should use reporting limits, triggers, or thresholds for stress scenarios, including the severe rate shocks discussed above, and others where appropriate, to ensure IRR exposures are within risk tolerance levels.
- Institutions are expected to measure the potential effect of changes in market interest rates on earnings and capital. When measuring risk-to-earnings, most institutions should use income simulations. Economic value of equity and similar models generally are used to measure risk-to-capital. Long-term simulations can supplement capital measures, but are generally not necessary for typical community institutions.
- Management should perform simulations for one- and two-year time horizons, conduct model measurements that do not include new business growth, develop reasonable assumptions reflecting the institution's experience, and perform appropriate back-testing.
- Smaller institutions using less complex vendor-supplied IRR models can satisfy some, but not all, validation requirements with independent attestation reports from the vendor.