Interest Rate Risk in Today's Environment

Pennsylvania Directors College

2012

Scope of Discussion

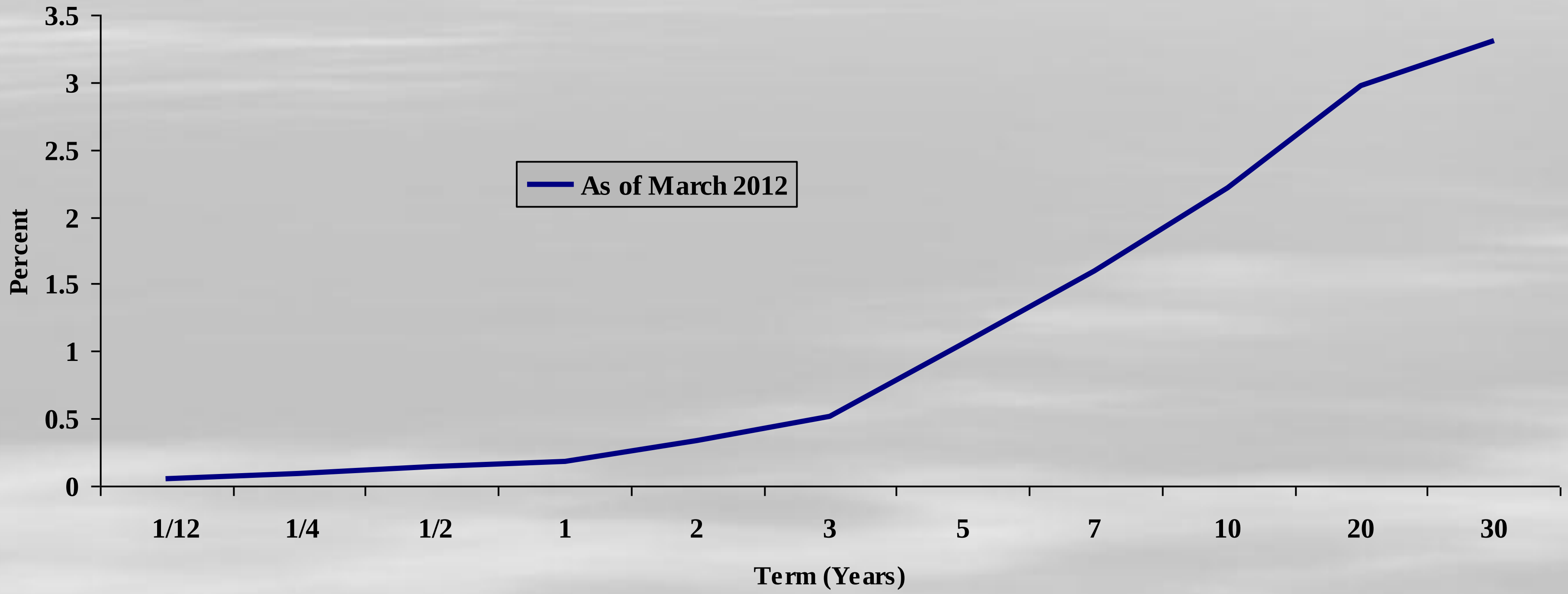
- Challenges in Today's Environment
- IRR Management Techniques and Board Responsibilities
- Case Studies
- Regulatory Guidance Update

Q&A…anytime

Terminology

- IRR Defined
- What is Asset Sensitive
- What is Liability Sensitive
- Long-term Assets Defined

Treasury Yield Curve



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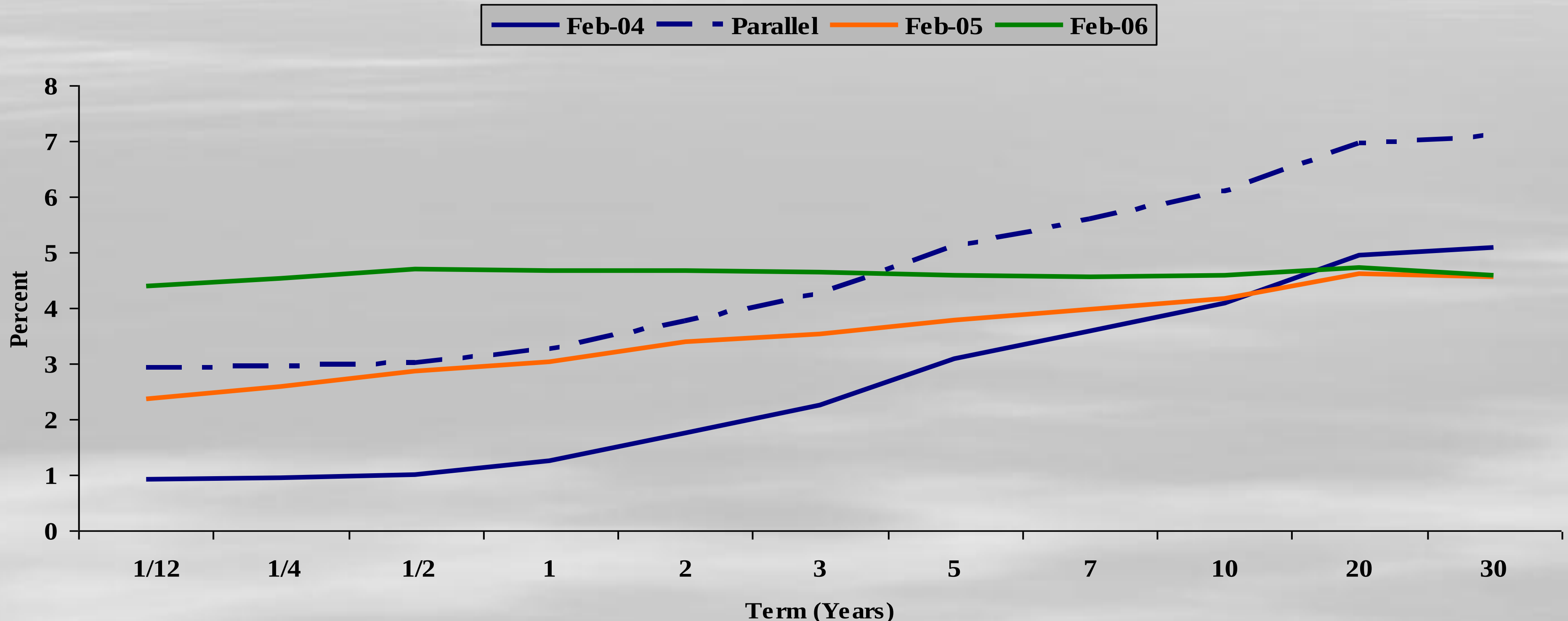
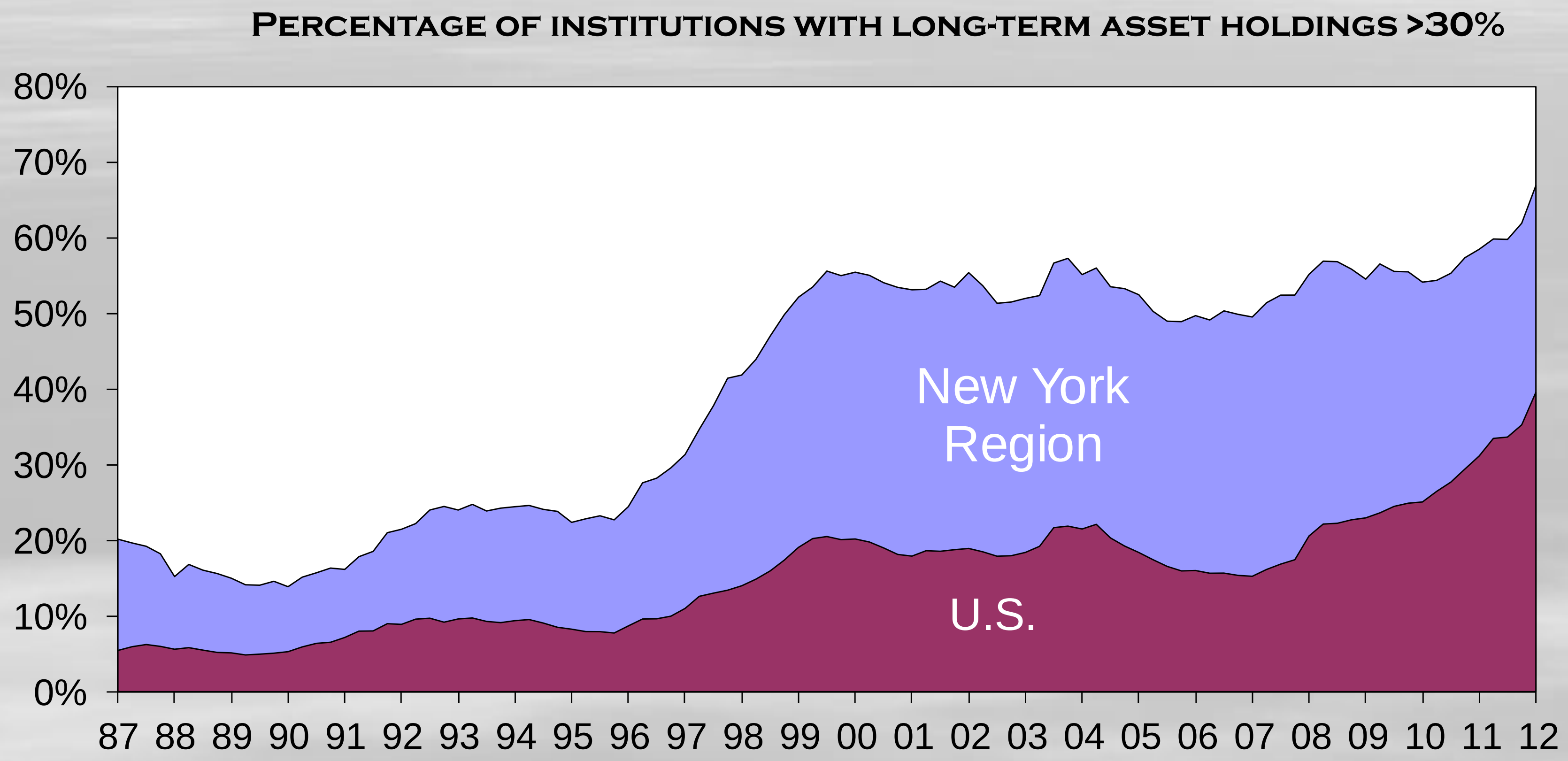
Yield Curve Risk - Flattening



Key Balance Sheet Factors

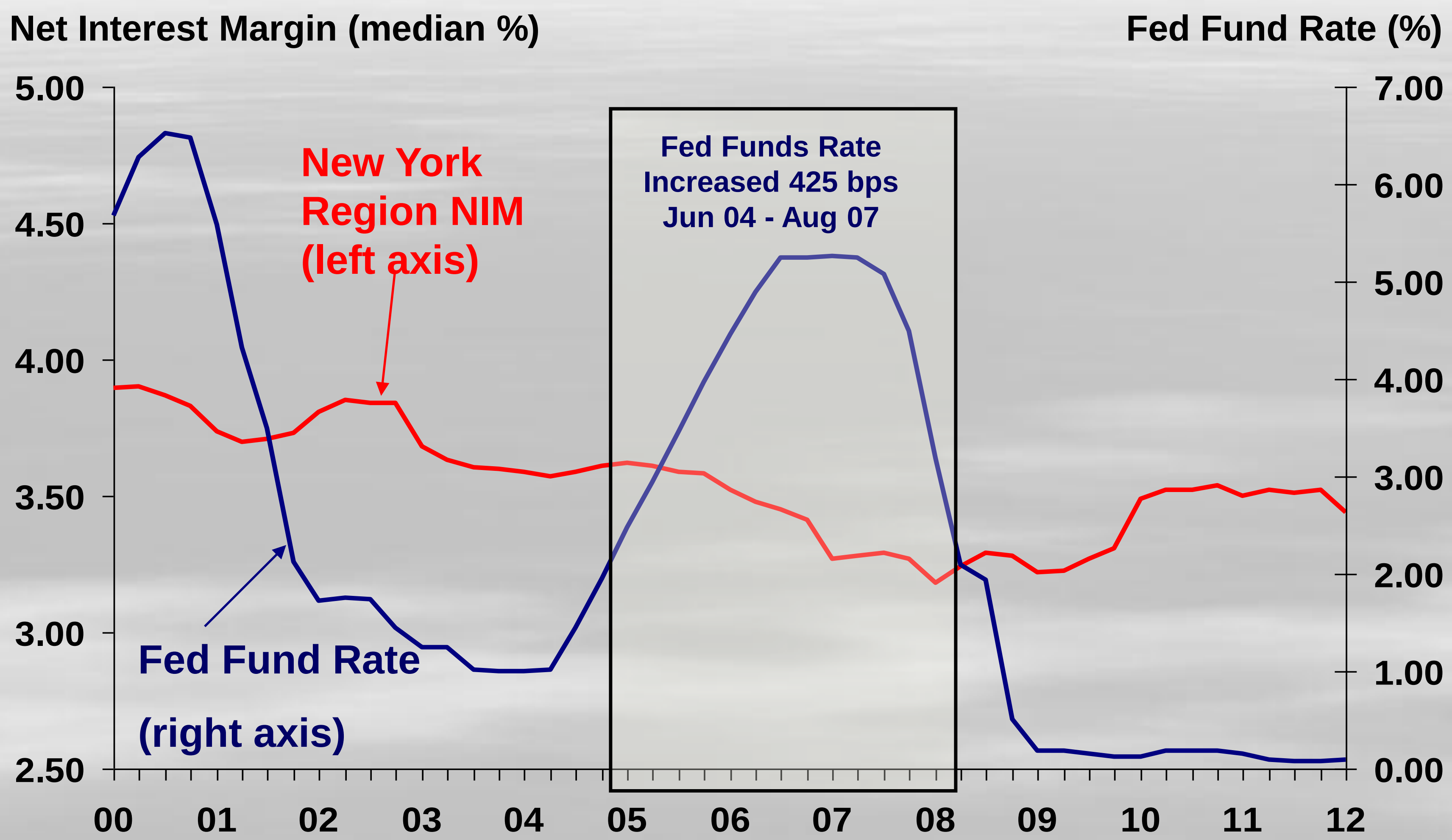
- Long-Term Asset Concentration
- Managing Optionality on the Asset Side
- Level and Trend in Non-Maturity Deposits
- Repricing of Time Deposits
- Credit Quality – Impact Margins

New York Region Institutions Hold Significant Levels of Long-term Assets



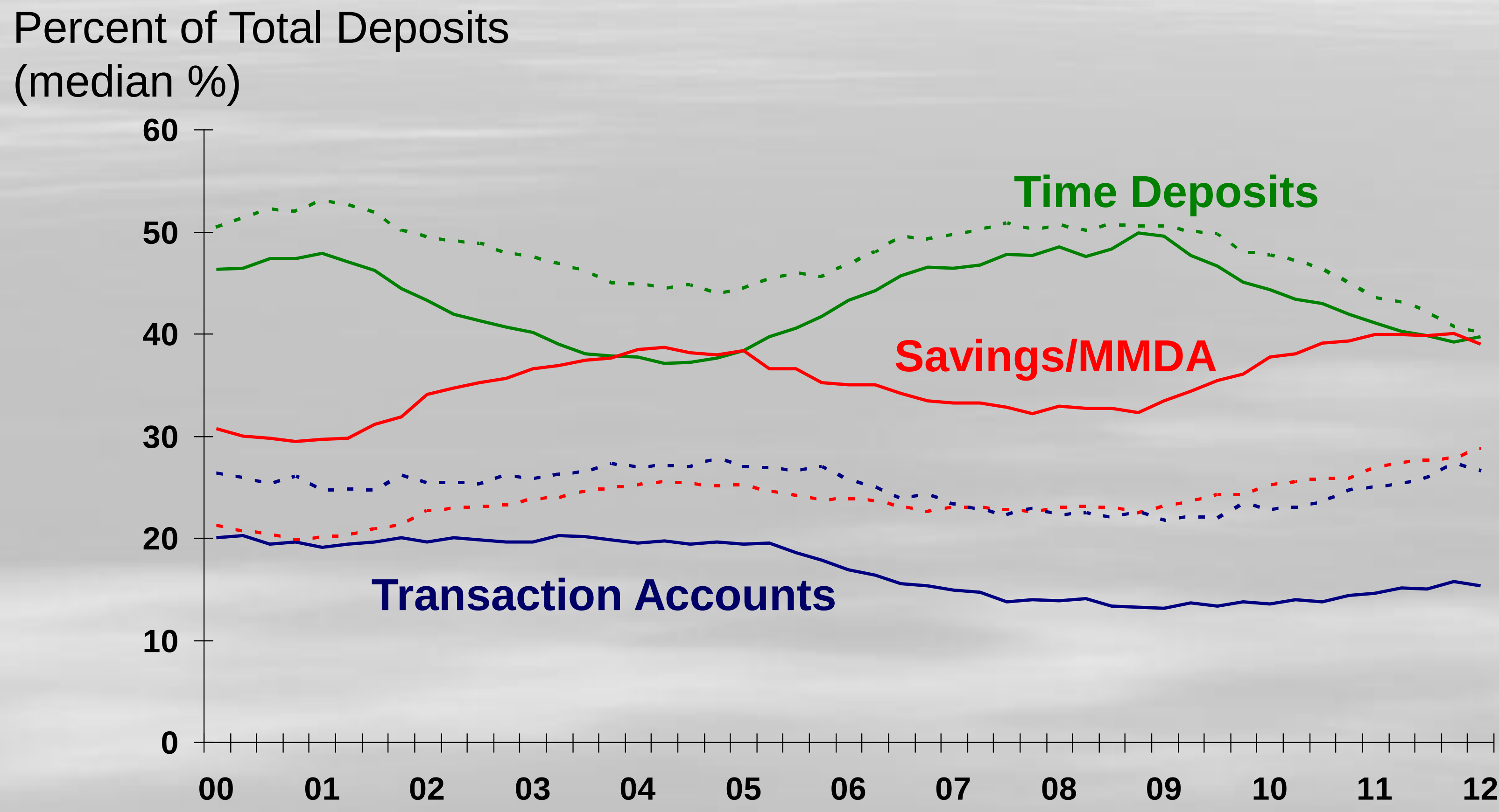
Source: FDIC. Call Filers. Data as of March 31, 2012.

Historic Margin Impact



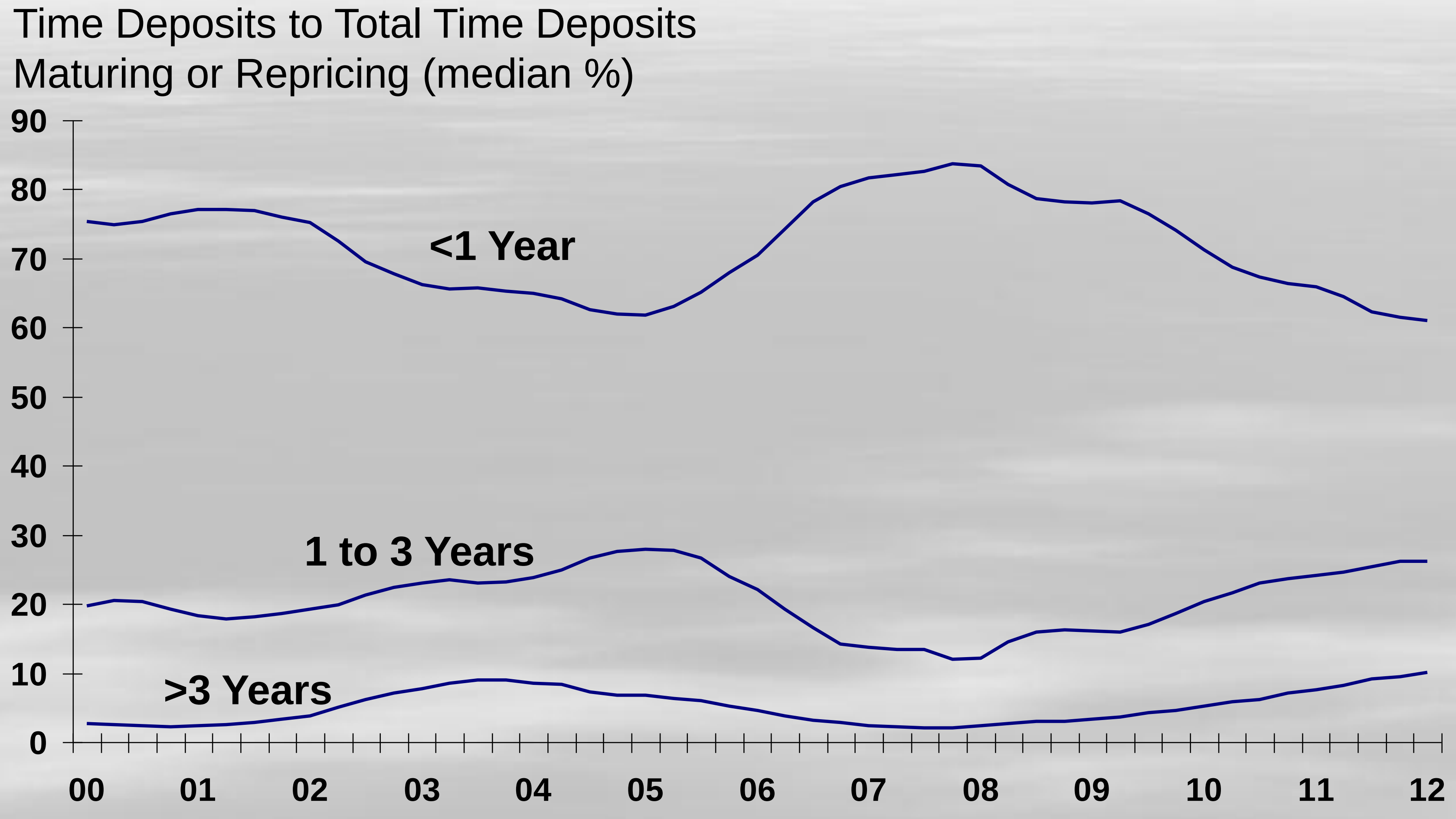
Source: FDIC, Federal Reserve Board, HAVER. Data as of March 31, 2012.

Time Deposits are Declining but are Still Significant



Source: FDIC. Call Filers. Data as of March 31, 2012. (New York Region is solid line, the Nation is dashed.)

Most Time Deposits are Short Term in the Region



Source: FDIC. Call Filers in New York Region. Data as of March 31, 2012.

IRR Management Techniques and Director Responsibilities

IRR Management Responsibilities

- Prudent Oversight & Policies
- Reasonable Risk Tolerances
- Appropriate Measurement Systems
- Supportable Assumptions
- Periodic Reporting
- Adequate Independent Review
- Risk Mitigation Strategies (e.g., action plans)

IRR Management Techniques

Balance Sheet Alteration Strategies

- Asset Sales and Purchases
- Product Mix Changes
- Product Structure Changes
- Growth

Hedging Strategies

* 3 Critical Model Assumptions *

These assumptions typically impact model output:

1. **Rate Changes**
2. **Loan Prepayments**
3. **Non-maturity Deposit Assumptions**

Because of their importance, ask for written assumptions

Non-Maturity Deposit Assumptions

What is the appropriate "Beta"?

$$\frac{\text{Chg in Deposit Rate}}{\text{Chg in Market Rate}} = \frac{20\text{bp}}{100\text{bp}} = 20\%$$

1. How has management historically moved deposit rates in relation to interest rates?

2. Is this strategy changing?

3. What about rising vs. falling rate scenarios?

4. What if those assumptions were wrong?

Sensitivity Testing Assumptions

- Rerunning your suite of scenarios while only changing one critical assumption

	Change in Net Interest Income			
	20% Deposit Beta		**30% Deposit Beta**	
+300 bp	85	**-15%**	65	**-35%**
Base Case	100	-	100	-
-200 bp	105	5%	105	5%

Other IRR Management Issues

- Economic Value of Equity
- Core Deposit Stability (CD Withdrawals)
- Modeling New Initiatives
- Interest Rate Risk Limits

Basic Limit Test

- Assume NIM 3.00%
- NII Limit (15%)
- NIM x NII Limit = (45) basis points
- Assume ROA 0.50%
- Results in Near Break Even ROA
- Is this Limit Appropriate?
- Not Exact, but Good Starting Point

Case Studies

- Loan Prepayment Example
- Deposit Sensitivity Scenario
- Basic Limit Test Example

Additional Resources

- Remo Ficca (724) 742-1877 x8319
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- Alan Liguori (215) 591-9820 x4818
  aliguori@fdic.gov

1996 IRR Joint Policy Statement

http://www.fdic.gov/regulations/laws/rules/5000-4200.html

2010 IRR Advisory

http://www.fdic.gov/news/news/press/2010/pr1002.pdf

2012 Interest Rate Risk Management: Frequently Asked Questions

http://www.fdic.gov/news/news/financial/2012/fil12002.html