Comptroller Ludwig Cites Importance of Managing Interest Rate Risk; OCC Issues New Interest Rate Risk Handbook

WASHINGTON, D.C. -- Comptroller of the Currency Eugene A. Ludwig today reemphasized the importance of banks' managing interest rate risk by releasing a new Interest Rate Risk booklet to provide new guidance for examiners in reviewing national banks' exposure to this critical risk.

"Over the past decade, it has become increasingly critical for banks to recognize and manage their interest rate risk exposure," Mr. Ludwig said. "The new guidance released today underscores the need for national banks to ensure the proper management of interest rate risk now to prevent any broad-based problems for the national banking system down the road."

"While current risk levels and rate volatilities do not pose serious risks threats to the industry, the increasing sophistication of bank products and activities has expanded the complexity of banks' identifying and managing interest rate risk exposures," the Comptroller said. "This development makes it critical that proper risk management practices be in place, before interest rates become more volatile." Interest rate risk management practices continue to grow in importance because of these factors:

- The growth in banks' longer-term asset holdings, particularly mortgage-related loans and securities;
- The growth of "written" (sold) options in asset, liability and off-balance sheet products (e.g., such as the ability to prepay mortgages early without penalty);
- The growing array of investments available to consumers, such as mutual funds and insurance products, and banks' greater reliance on more price-sensitive wholesale funding. These factors have collectively resulted in a more price-sensitive funding structure for banks.

The new Interest Rate Risk booklet, which is part of the Comptroller's Handbook, outlines procedures for bank examiners from the Office of the Comptroller of the Currency (OCC) to evaluate a national bank's systems and controls for identifying, measuring, monitoring and controlling exposure to interest rate risk. The new booklet is being sent to all OCC examiners and national banks, who can use the booklet in assessing an institutions' management of interest rate risk.

"This booklet addresses current issues and evolving practices for measuring, controlling and reporting interest rate risk," Mr. Ludwig said. "It reflects the OCC’s continuing upgrade of guidance provided to examiners and will serve as a basic reference on this crucial banking risk."
The adequacy and effectiveness of a bank's interest rate risk management are important in determining whether a bank's level of interest rate risk exposure poses supervisory concerns or requires additional capital, according to the new Interest Rate Risk booklet.

While the booklet imposes no new requirements for banks, it emphasizes the responsibility of bank management to stay abreast of a bank's interest rate risk exposure and the impact changes in interest rates may have on earnings and capital. The assumption of interest rate risk is a normal part of banking, but excessive interest rate risk or poor management of the risk can jeopardize an institution's profitability and, in extreme cases, can jeopardize an institution's solvency, the OCC said. Accordingly, well-managed banks should have processes that enable management to identify, measure, monitor and control their major sources of interest rate risk on a timely and comprehensive basis.

Examiners will use the new procedures to determine the adequacy and effectiveness of a bank's interest rate risk management process, the level and trend of the bank's risk exposure, and the adequacy of its capital relative to its exposure and risk management process. When OCC examiners review a bank's interest rate risk measurement process, they assess whether: (1) It provides consistent and reasonably accurate risk measures; and (2) it adequately addresses all sources of risk, both short and long term.

The OCC interest rate risk booklet says bank management should: understand their bank's on- and off-balance-sheet positions; ensure that reports furnished to the board and management provide meaningful information to improve the board's decision-making; periodically validate their interest rate risk management process; understand the interest rate sensitivity of fee-related income and expenses; and understand the behaviors of non-maturity deposits, such as demand deposits and NOW accounts.

Copies of the booklet are being mailed to national banks, OCC examiners and subscribers to the Comptroller's Handbook. To order copies of Interest Rate Risk, Comptroller's Handbook, please send your request and a $15 check for each booklet to: Comptroller of the Currency, P.O. Box 70004, Chicago, IL 60673-0004.

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The OCC charters, regulates and supervises approximately 2,800 national banks and 66 federal branches and agencies of foreign banks in the U.S., accounting for more than half the nation's banking assets. Its mission is to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States.