



Regulatory Update

Atlanta Regulatory Conference Call

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Interest Rate Risk

**Managing Sensitivity to Market Risk
with an Eye to the Future**





Interest Rate Risk

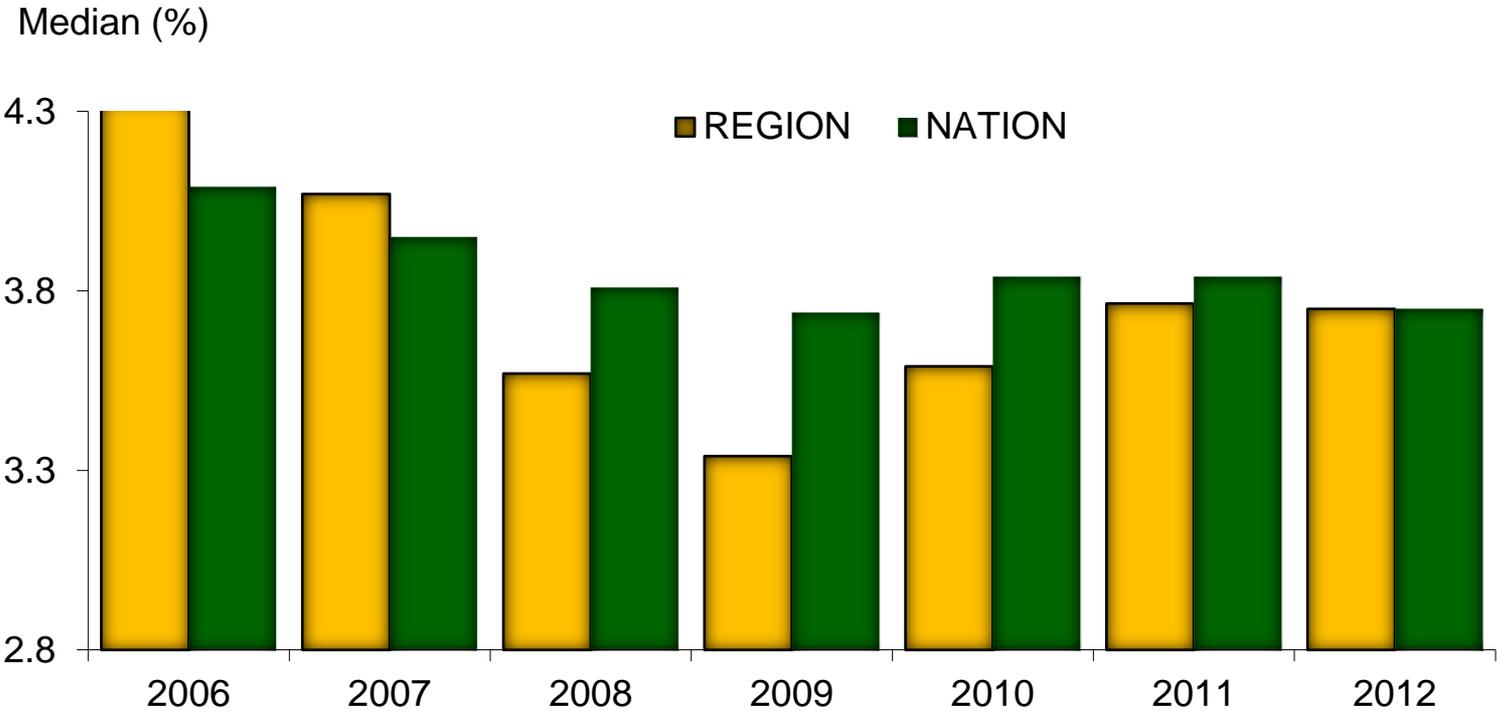
- ❑ Community banking trends indicate increased vulnerability to interest rate risk (IRR)

- ❑ Observed trends
 - ❑ Maturity of assets has extended
 - ❑ Growing mismatches in duration and structure
 - ❑ Greater optionality



Interest Rate Risk Observed Trends

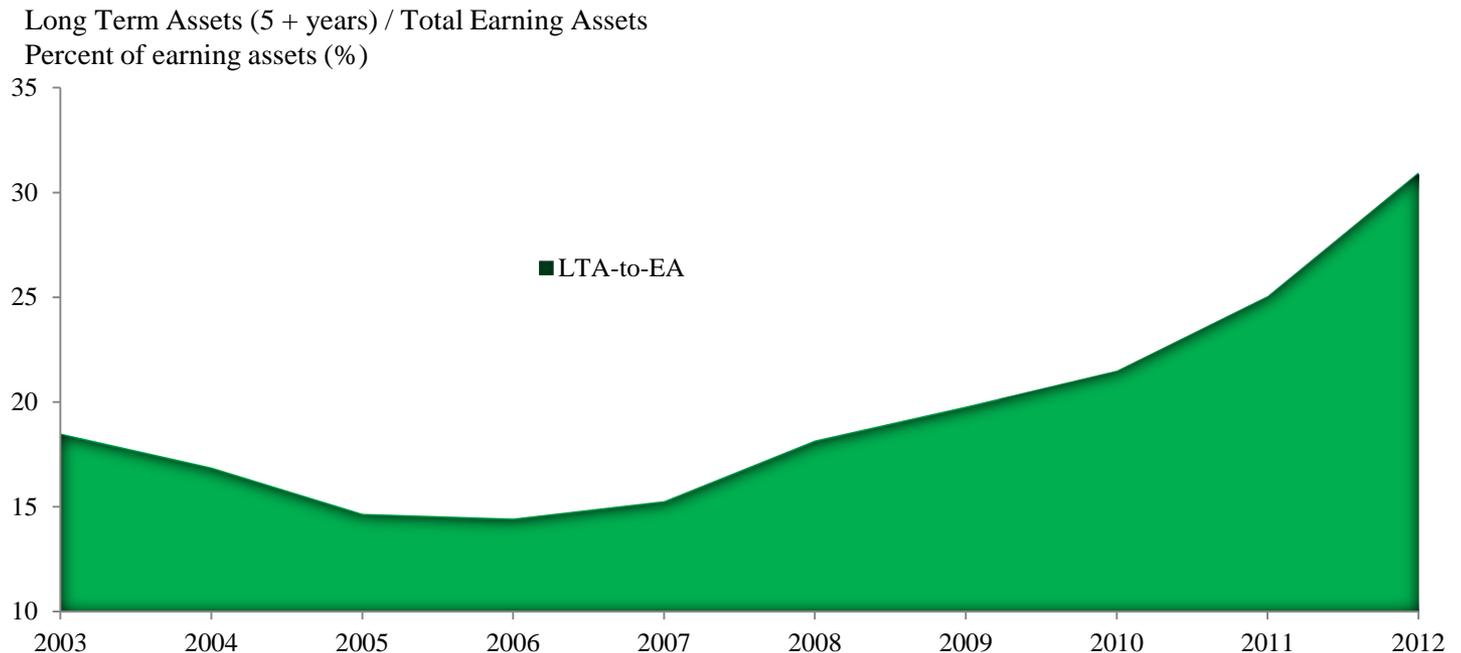
The Median Net Interest Margin has Trended Lower Among
Atlanta Region Community Institutions



Source: FDIC, all insured institutions with assets less than \$1 billion; data as of September 30, 2012.

Interest Rate Risk Observed Trends

Long Term Assets are Trending Higher Among Atlanta Region Community Institutions

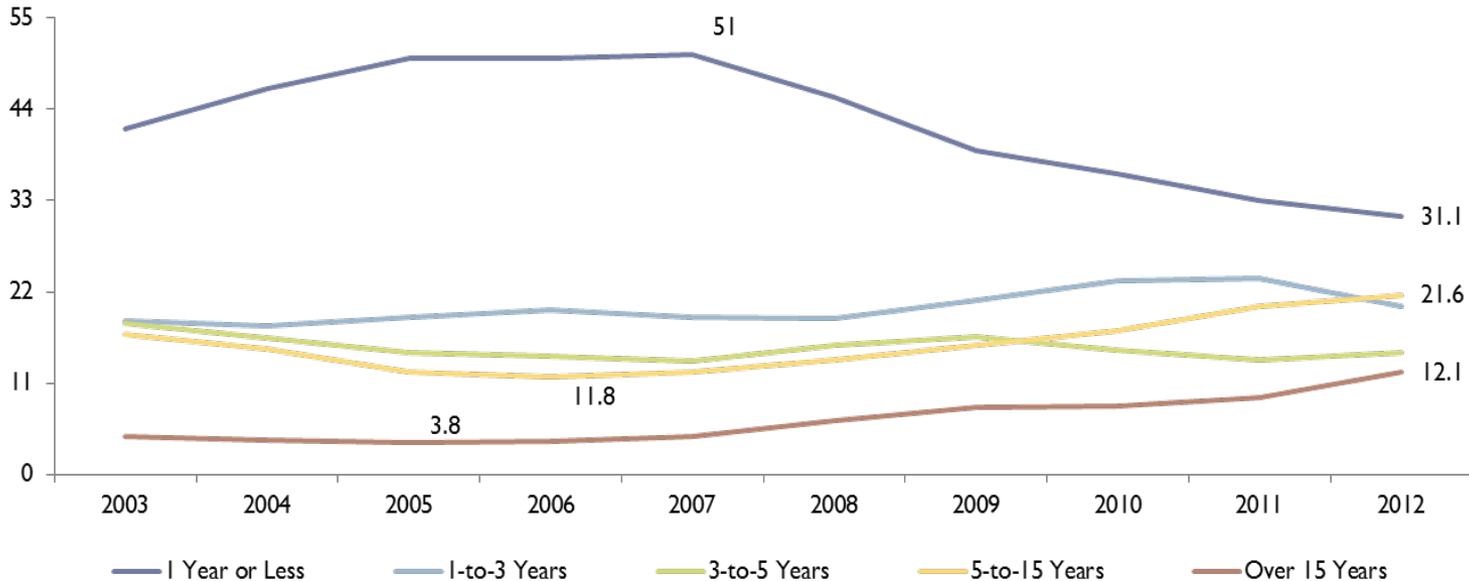


Source: FDIC for all insured institutions in the Atlanta Region with assets < \$1 billion; data as of September 30th.

Interest Rate Risk Observed Trends

The Portfolio Composition of Certain Assets Among Community Institutions has Shifted Toward Longer Term Maturities

Assets By Maturity or Repricing Schedule
Percent of total assets (%)



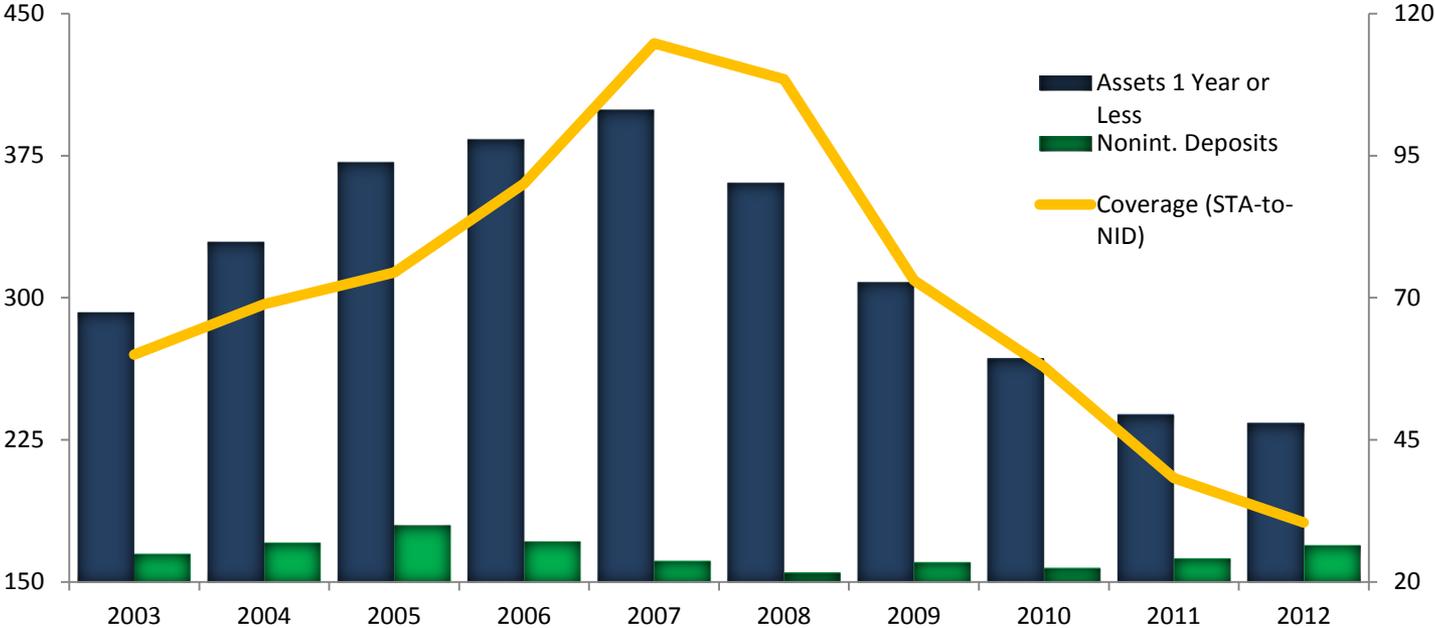
Source: FDIC for all insured institutions in the Atlanta Region with assets < \$1 billion; data as of September 30th.
Note: For our purposes, total assets consist only of securities and loans

Interest Rate Risk Observed Trends

Short Term Asset Coverage of Non-Maturity Deposits is Trending Lower Among Atlanta Region Community Institutions

Short Term Assets-to-Non-Maturity Deposits
Percent (%)

Assets 1 Year or Less &
Non-interest Bearing Deposits
Billions, \$



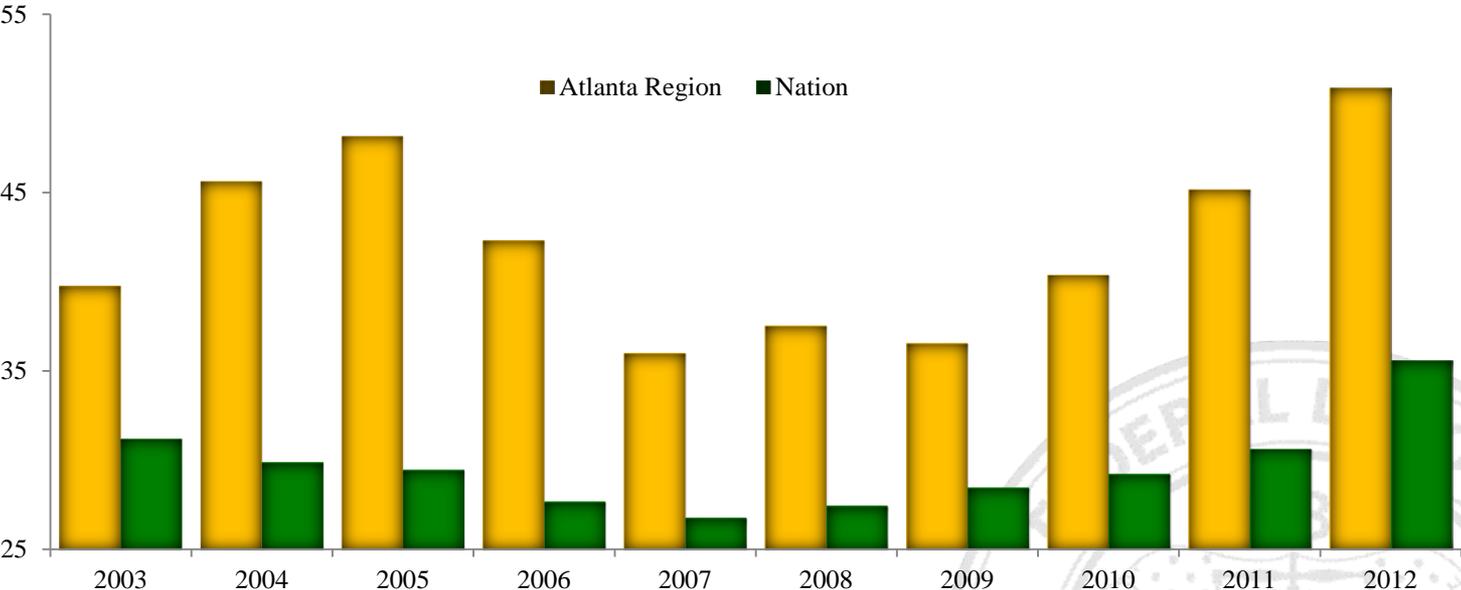
Source: FDIC for all insured institutions in the Atlanta Region with assets < \$1 billion; data as of September 30th.



Interest Rate Risk Observed Trends

Mortgage Assets are Comprising a Larger Share of Earning Assets Among Atlanta Region Insured Institutions

Total Mortgage Assets-to-Earning Assets
Aggregate percent (%)



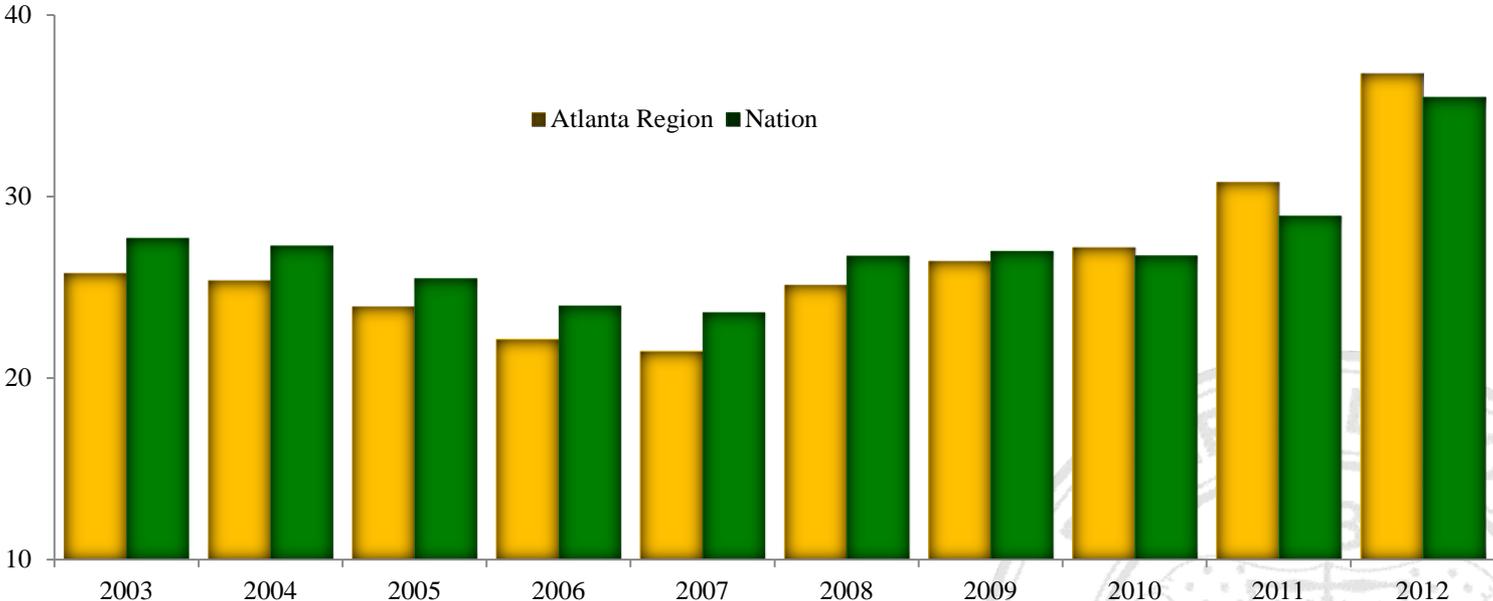
Source: FDIC for all insured institutions.

Note: Total mortgage assets consist of closed-end loans and mortgage pass through securities secured by 1-to-4 family properties as well as residential mortgage backed securities, other residential mortgage backed securities, and commercial real estate mortgage backed securities.

Interest Rate Risk Observed Trends

Mortgage Assets are Comprising a Larger Share of Earning Assets Among Community Insured Institutions

Total Mortgage Assets-to-Earning Assets
Aggregate percent (%)

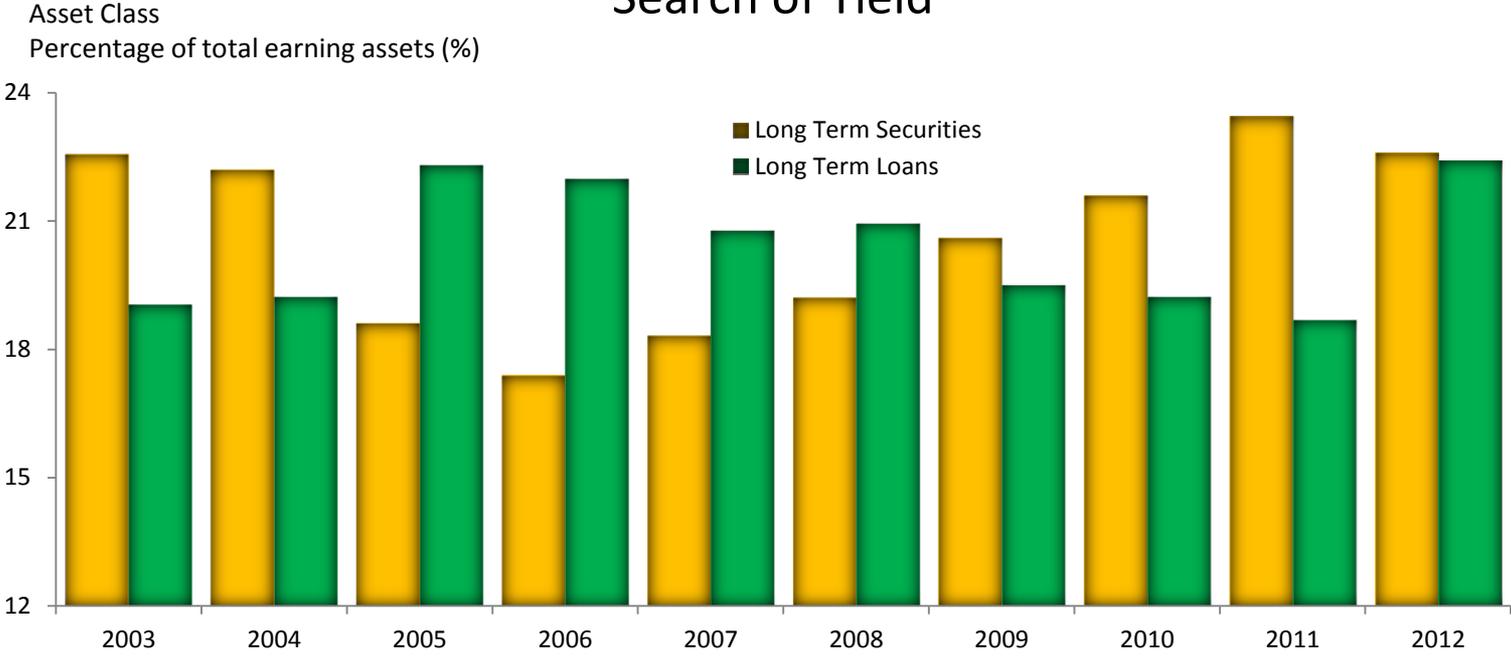


Source: FDIC for all insured institutions with assets less than \$1 billion.

Note: Total mortgage assets consist of closed-end loans and mortgage pass through securities secured by 1-to-4 family properties as well as residential mortgage backed securities, other residential mortgage backed securities, and commercial real estate mortgage backed securities.

Interest Rate Risk Observed Trends

Community Institutions with High Concentrations of Long Term Assets have Lengthened the Maturity of the Securities Portfolio in Search of Yield



Source: FDIC for all insured institutions in the Atlanta Region with assets < \$1 billion and long term asset concentrations of 30 percent or more of total earning assets; data as of September 30th.

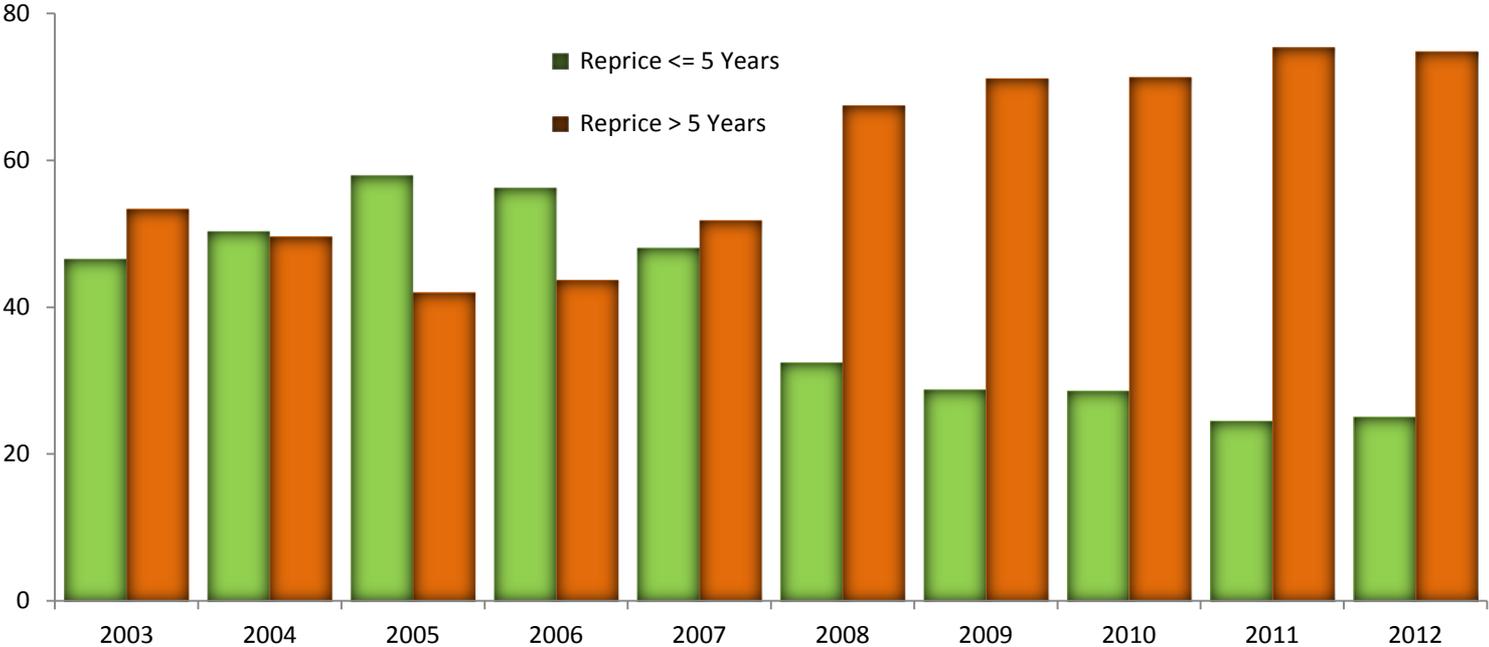
Note: Long term securities and loans reprice or mature in five or more years.



Interest Rate Risk Observed Trends

Duration of the Securities Portfolio Among Atlanta Region Community Institutions has Lengthened

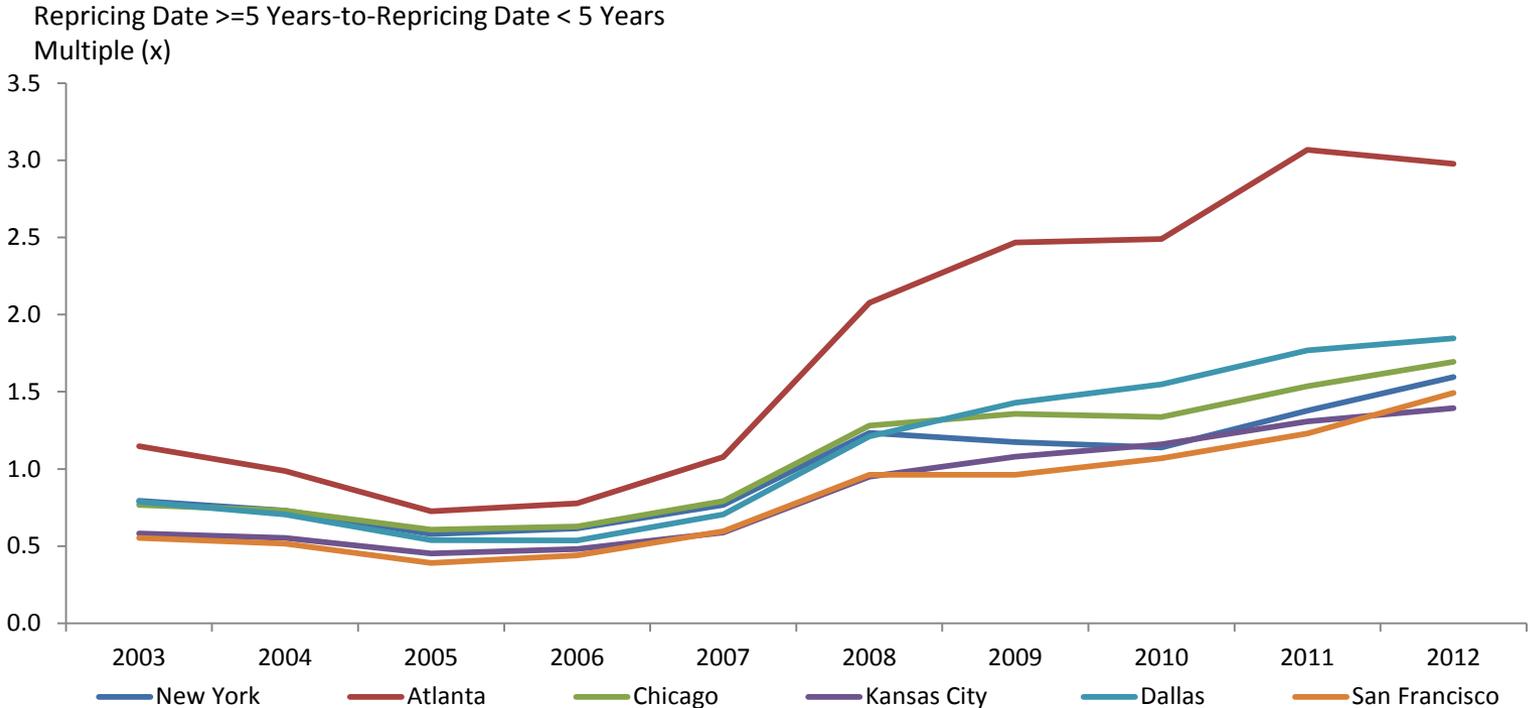
Security Repricing Category-to-Total Securities
Percent of total (%)



Source: FDIC for all insured institutions in the Atlanta Region with assets < \$1 billion; data as of September 30th.
Note: Total securities is the sum of the five individual repricing categories (one year or less; 1-to-3 years; 3-to-5 years; 5-to-15 years; and over 15 years).

Interest Rate Risk Observed Trends

Atlanta Region Community Institutions have Experienced the Greatest Shift Toward Longer Term Securities Relative to Other Regions



Source: FDIC for all insured institutions with assets $<$ \$1 billion; data as of September 30th and is adjusted for failures.
 Note: The repricing date of the securities buckets are calculated as follows (one year or less + 1-to-3 years + 3-to-5 years = repricing date $<$ 5 years; 5-to-15 years + over 15 years = repricing date \geq 5 years).



Interest Rate Risk Observed Trends

❑ From 4Q 2007 to 2Q 2012

❑ Net Interest Earnings at Risk	Increased	42 %
❑ Net Income at Risk	Increased	90 %
❑ Economic Value at Risk (as % of EVE)	Increased	86 %
❑ Economic Value at Risk (as % of Assets)	Increased	114 %

Source: <http://www.olsonresearch.com>



Interest Rate Risk

- Balance sheet changes
 - Lengthened maturities (securities, loans)
 - High levels of non-maturity deposits (NMDs)
 - Increased exposure to mortgages (securities, loans)
 - Added credit characteristics of the investment portfolio (municipal securities, structured notes)
 - New business lines (SBA, consumer finance)



Interest Rate Risk

- ❑ Keys to strong IRR management
 - ❑ Adequate oversight by the board and senior management
 - ❑ Comprehensive risk management process



Interest Rate Risk

- Oversight – board and senior management
 - Board involvement
 - Education
 - Authorities
 - Reporting and monitoring
 - Annual approval (policy, limits, assumptions)



Interest Rate Risk

- ❑ Oversight – board and senior management
 - ❑ Senior Management
 - ❑ Manage IRR long term & day-to-day
 - ❑ Develop & implement policies
 - ❑ Ensure adherence to authorities and responsibilities
 - ❑ Oversee & implement monitoring system
 - ❑ Establish risk controls



Interest Rate Risk

- ❑ Oversight – board and senior management
 - ❑ Policies and limits
 - ❑ Identify potential IRR – existing and new products or services
 - ❑ Related to impact on capital, earnings, liquidity
 - ❑ Limits set relative to normal loss tolerance of bank
 - ❑ Limits for earnings and capital
 - ❑ Policy exceptions



Interest Rate Risk

- ❑ Oversight – board and senior management
 - ❑ Assumptions
 - ❑ Bank-specific
 - ❑ Supported and documented
 - ❑ Consistent with each scenario evaluated
 - ❑ Address maturity, repricing, and cash flow of embedded option within each scenario (i.e., prepayments, depositor movement)



Interest Rate Risk

- ❑ Comprehensive risk management process
 - ❑ Reports - accurate, timely, clearly understood
 - ❑ Considers both earnings and capital
 - ❑ Measures risk against bank-specific stress scenarios and considers current IR environment and historical movements



Interest Rate Risk

- Comprehensive risk management process
 - Measure sufficiently wide range of changes in market rates
 - Appropriate time horizons
 - Documents support of assumptions, including any alterations
 - Reports and addresses all significant findings



Interest Rate Risk

- ❑ Comprehensive risk management process
 - ❑ Model
 - ❑ Measures meaningful stress situations
 - ❑ Static, instantaneous shock
 - ❑ Dynamic, other shock scenarios
 - ❑ Includes all material positions, including repricing and maturity data
 - ❑ Assumptions and model techniques are well documented



Interest Rate Risk

- Comprehensive risk management process
 - Internal controls
 - Enforce authorities and separation of duties
 - Independent
 - Periodic review of risk management process
 - Back-testing and model validation
 - Annual board report



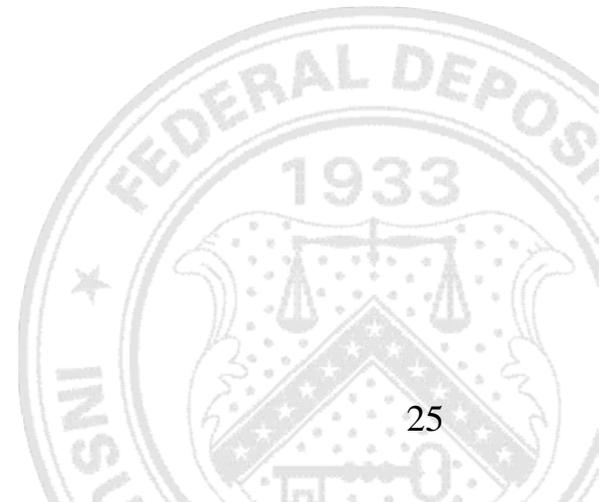
Interest Rate Risk

- Areas for continued improvement
 - Reasonable and Related Limits
 - Assumptions
 - Scenarios – Insignificant Rate Changes and Time Horizon
 - Board – reporting, discussion, education
 - Ramp versus shock
 - Back-testing and validation



Interest Rate Risk

Regulatory Guidance





Interest Rate Risk

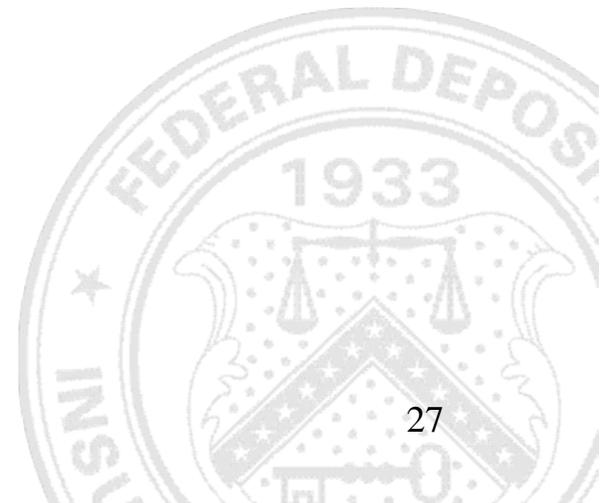
Regulatory Guidance

- Joint Agency Policy Statement on Interest Rate Risk
FIL-52-1996*
- FFIEC Advisory on Interest Rate Risk Management -
FIL-2-2010*
- FFIEC Advisory on Interest Rate Risk Management,
Frequently Asked Questions - FIL-2-2012*



Interest Rate Risk

Appendix





Interest Rate Risk Regulatory Guidance

Joint Agency Policy Statement on Interest Rate Risk FIL-52-1996

- Identified the key elements of sound IRR management and described prudent principals and practices for each element.
 - Adequate oversight – board and senior management
 - Comprehensive risk management process
 - Described critical factors affecting regulatory evaluation of bank's IRR when determining adequacy of capital



Interest Rate Risk Regulatory Guidance

FFIEC Advisory on Interest Rate Risk Management FIL-2-2010

- ❑ Issued to remind institutions of supervisory expectations regarding sound practices for managing IRR.
 - ❑ Effective corporate governance, policies and procedures, risk measuring and monitoring systems, stress testing, and internal controls
 - ❑ Clarified various elements of existing guidance and described selected IRR management techniques used by effective risk managers



Interest Rate Risk Regulatory Guidance

FFIEC Advisory on Interest Rate Risk Management FIL-2-2010

- Appropriate time horizons
 - Earnings simulation – at least two-year periods however, five to seven years are needed for certain products with embedded options

- Static, no growth stress-testing

- Range of alternative future interest rate scenarios should be sufficiently meaningful to identify basis risk, yield curve risk, and risks of embedded options



Interest Rate Risk Regulatory Guidance

FFIEC Advisory on Interest Rate Risk Management FIL-2-2010

- +/- 200 basis point shocks may not be sufficient, +/- 300 and 400 basis points across different tenors should be assessed
- Scenarios should be severe but plausible in light of the existing level of rates and the interest rate cycle
- Characterizes non-complex institutions as those with limited embedded options or structured products



Interest Rate Risk Regulatory Guidance

FFIEC Advisory on Interest Rate Risk Management FIL-2-2010

- Stress scenarios should include but not be limited to:
 - Instantaneous and significant rate shocks
 - Substantial changes in rates over time
 - Changes in relationship between key market rates (basis risk)
 - Changes in the slope and shape of the yield curve (yield curve risk)

- Assumptions – document, monitor, and regularly update key assumptions. Perform sensitivity testing of key assumptions.

- Ensure reasonableness of asset prepayments, non-maturity deposit price sensitivity and decay rates, and key rate drivers for each interest rate shock scenario



Interest Rate Risk Regulatory Guidance

FFIEC Advisory on Interest Rate Risk Management, Frequently Asked Questions FIL-2-2012

- Reiterates the need for sound management of IRR and highlights sound practices.

- Addresses IRR exposure measurement and reporting, model risk management, stress testing, assumption development, and model and systems validation.
 - Stress scenarios should include meaningful interest rate shocks (+ 300 and + 400 basis points) in a low interest rate environment) over longer time horizons
 - Use reporting limits, triggers, or thresholds
 - Model validation



Interest Rate Risk Regulatory Guidance

*FFIEC Advisory on Interest Rate Risk Management,
Frequently Asked Questions
FIL-2-2012*

- Model selection – existing and new products or strategies

- Measurement Methodologies
 - NII and NI (1 -5 year time horizon)
 - EVE (much longer time horizons)

- Data aggregation and stratification.



Interest Rate Risk Regulatory Guidance

FFIEC Advisory on Interest Rate Risk Management, Frequently Asked Questions FIL-2-2012

- Periodic stress scenarios are expected to fully identify significant positions in the four components of IRR – repricing mismatch, basis risk, yield curve risk, and options risk.
- Effective model validation process



Questions?

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