

Letter from the Director

This edition of *Supervisory Insights* presents an examiner's perspective on one of the most important issues facing community banks—managing interest rate risk (IRR). This edition features articles authored by FDIC field examiners that specialize in IRR reviews at community institutions. We believe these articles can help your bank enhance its IRR management processes and be better prepared for a period of higher and more volatile interest rates.

Effective governance over IRR is a critical component of a bank's internal control framework. This includes strong asset-liability management policies, reasonable investment and exposure limits, assignment of accountability for risk measurement and controls, and appropriate management information systems that help inform strategic decisions of senior management and the board of directors. "Effective Governance Processes for Managing Interest Rate Risk" discusses supervisory expectations for a community bank's IRR governance process and presents ideas for mitigating on- and off-balance sheet risk.

The usefulness of an IRR measurement system depends on the reasonableness of the assumptions that are used as inputs. "Developing the Key Assumptions for Analysis of Interest Rate Risk" discusses approaches that bank staff can use to arrive at reasonable assumptions for use as inputs to the IRR measurement system.

Bankers inquire about supervisory expectations for independent testing and, in particular, who, when, and what should be tested. In "Develop-

ing an In-House Independent Review of Interest Rate Risk Management Systems," we explore expectations for independent testing as set forth in the 1996 interagency directive on IRR management and present a concept for performing this function effectively with capable bank employees.

And finally, this edition provides an examiner's perspective on how bankers can better prepare for their next IRR examination. "What to Expect During an Interest Rate Risk Review" explains how examiners plan reviews and provides insights on communicating with the examination team regarding IRR findings.

We hope that you find this edition timely and useful as your institution works to refine and strengthen its internal policies and systems for managing rate sensitivity. We welcome your feedback on the articles as well as any topic suggestions for future issues. Please e-mail your comments and suggestions to SupervisoryJournal@fdic.gov.

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