

OFFICE OF FINANCIAL INSTITUTIONS

OFI BULLETIN

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January 9, 2003

TO: THE CHIEF EXECUTIVE OFFICER/MANAGER

SUBJECT: ASSET/LIABILITY MODELS

(Please see that this e-mail message gets to the Chief Executive Officer/Manager of this financial institution.)

Since we continue to see some increased exposure to interest rate risk (IRR) caused by historically low interest rates, now would be a good time to validate key assumptions contained in your asset-liability model. It should be obvious whether your model correctly predicted the direction and impact on earnings that you have experienced in the current interest rate environment. You should also compare your model to previous periods in order to predict how it will perform in a rising interest rate environment. If necessary, adjustments can be made in order to reduce unacceptable variances.

The federal joint agency policy statement on interest rate risk requires “periodic reviews of its risk management process to ensure its integrity, accuracy, and reasonableness.” Depending on the complexity of a financial institution’s model, this independent review is required at least annually. The lack of this review is one of the most common deficiencies cited in recent examination reports.

It is critically important that management and the Board of Directors receive timely and accurate IRR measurement reports. Examiners will continue to verify that management periodically evaluates and validates the measurement system’s adequacy and accuracy and determine if the system’s prior forecasts reasonably estimated actual performance. Having confidence in your asset-liability model enables you to make more accurate decisions that will favorably impact current and future earnings. This is especially important if this function is currently being outsourced.

This bulletin will also be posted on OFI’s website www.ofi.state.la.us. If you have any questions, please contact me directly.

Sidney E. Seymour, CEM
Chief Examiner
Louisiana Office of Financial Institutions
sseymour@ofi.state.la.us
225/925-4675