SUPERVISORY AND REGULATORY GUIDELINES
Management of Interest Rate Risk
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GUIDELINES FOR THE MANAGEMENT OF INTEREST RATE RISK FOR CREDIT UNIONS

1. INTRODUCTION

1.1 The Central Bank of The Bahamas ("the Central Bank") is responsible for the registration, regulation and supervision of all credit unions operating in and from within The Bahamas, pursuant to the Bahamas Co-Operative Credit Unions Act, 2015 ("the Credit Unions Act"), and the Central Bank of The Bahamas (Amendment) Act, 2015 ("the CBA"). Additionally, the Central Bank has the duty, in collaboration with financial institutions, to promote and maintain high standards of conduct and management in the provision of credit union services.

1.2 The Central Bank recognizes that credit unions are not-for-profit organizations, and in this respect are different from other deposit-taking financial institutions. The Central Bank is aware that credit unions work as a co-operative, valuing volunteerism, co-operation and member participation. Therefore, the Central Bank is committed to ensuring the unique characteristics of credit unions are maintained, while still fulfilling its obligations to protect the interests of credit union members.

1.3 All registrants are expected to adhere to the Central Bank's registration and prudential requirements, ongoing supervisory programmes and regulatory reporting requirements, and are subject to periodic on-site examinations. Credit Unions are expected to conduct their affairs in conformity with all other Bahamian legal requirements.

2. PURPOSE

2.1 These Guidelines specifically address the key principles, together with the minimum policies and procedures that each cooperative credit union needs to have in place and apply within its interest rate risk management program. It further establishes the minimum criteria these financial institutions should use to prudently manage and control their exposure to interest rate risk.

2.2 The Central Bank endorses the principles and best practices of the World Council of Credit Unions (WOCCU). Credit Unions are encouraged to refer to these principles and best practices on the WOCCU's website at http://www.woccu.org.

3. APPLICABILITY

3.1 These Guidelines apply to all credit unions which are registered under the Credit Unions Act or deemed, by virtue of section 126(1) to be registered under this Act.

4. DEFINITION

4.1 ***Interest rate risk*** is the exposure of a credit union's financial condition (earnings and capital) to adverse movements in interest rates. Interest rate risk arises when a financial institution's principal and interest cash flows from assets do not coincide with the principal and interest cash flows derived from liabilities. In other words, due to increases in the market interest rates, savings deposit interest rates may increase while the interest on fixed-rate loans and investments remains the same, thus causing a potential profitability problem.

5. INTEREST RATE RISK MANAGEMENT PROGRAM

5.1 Managing interest rate risk is a fundamental component in the safe and sound management of each credit union. It involves prudently managing mismatch positions in order to control – within set parameters – the impact of changes in interest rates on the institution.

5.2 Significant factors in managing the risk include the frequency, volatility and direction of rate changes, the slope of the interest yield curve, the size of the interest-sensitive position and the basis for repricing at rollover dates.

5.3 While the particulars of interest rate risk management will differ among institutions depending on the nature and complexity of their asset and liability structure (both on- and off-balance sheet), interest rate risk positions and risk profile, a comprehensive interest rate risk management program requires:

5.3.1 Establishing and implementing sound and prudent interest rate risk policies;

5.3.2 Developing and implementing appropriate interest rate risk measurement techniques; and

5.3.3 Developing and implementing effective interest rate risk management and control procedures. Each cooperative credit union must establish explicit and prudent interest rate risk limits, and ensure that the level of interest rate risk exposures does not exceed these limits.

5.4 Notwithstanding the provisions of Regulation 3 of the Bahamas Co-Operative Credit Unions Regulations, 2015, the Board of Directors (the Board) of each credit union must ensure that the rate of interest to be charged on loans to its members and those offered on deposits are set at levels deemed prudent.

6. THE ROLE OF THE BOARD OF DIRECTORS

6.1 Effective supervision by the Board and senior management is critical for sound interest rate risk management. It is essential that these individuals are aware of their responsibilities with regard to interest rate risk management and that they adequately perform their roles in overseeing and managing interest rate risk.

6.2 The Board is responsible for approving the overall policies of the credit union with respect to interest rate risk. The Board may delegate responsibility for establishing interest rate risk policies and strategies to the Asset and Liability Committee. Larger or more complex credit unions should have such committees, responsible for the design and administration of interest rate risk management.

6.3 Generally, the broad responsibilities of the Board are to:

6.3.1 Establish and define the credit union's tolerance for interest rate risk;

6.3.2 Approve relevant risk limits and other key policies;

6.3.3 Ensure that senior management has full understanding of the interest rate risks

6.3.4 Inherent in the business activities of the credit union;

6.3.5 Provide clear guidance to management regarding the Board's tolerance for risk;

6.3.6 Approve in advance broad objectives and strategies and major policies governing

6.3.7 Interest rate risk management;

6.3.8 Approve policies that identify lines of authority and responsibility for managing

6.3.9 Interest rate risk exposures;

6.3.10 Ensure that adequate resources are devoted to interest rate risk management;

6.3.11 To periodically review information that is sufficient in detail and timeliness to allow it to understand and assess the performance of senior management in monitoring and controlling interest rate risks in compliance with the credit union's board-approved policies; and

6.3.12 Assess periodically compliance with approved policies, procedures, and risk limits; and re-evaluate significant interest rate risk management policies, procedures and risk limits at least annually.

7. THE ROLE OF SENIOR MANAGEMENT

7.1 Senior management should ensure that the credit union's operations and level of interest rate risk are effectively managed and that appropriate risk management policies and procedures are established and maintained. Senior management must also ensure that resources are available to evaluate and control interest rate risk, which allows the credit union to conduct its activities in a safe and sound manner.

7.2 In managing the credit union's activities, senior management should:

7.2.1 Develop and implement policies and procedures that translate the Board's goals, objectives, and risk limits into operating standards that are well understood by the credit union's staff and that are consistent with the board's intent;

7.2.2 Ensure that appropriate policies and procedures are established to control and limit interest rate risks;

7.2.3 Ensure adherence to the lines of authority and responsibility that the Board has approved for managing, measuring, and reporting interest rate exposures;

7.2.4 Oversee the implementation and maintenance of management information and other systems that measure, monitor, control and report the credit union's interest rate risk;

7.2.5 Establish and maintain effective internal controls over the interest rate risk management process;

7.2.6 Monitor the credit union's overall interest rate risk profile and ensure that the level of interest rate risk is maintained at prudent levels;

7.2.7 Ensure that the credit union's operations and activities are conducted by competent staff with technical knowledge and experience consistent with the nature and scope of their activities;

7.2.8 Provide the board with periodic reports and briefings on the credit union's interest rate risk related activities and risk exposures; and

7.2.9 Review periodically the credit union's risk management systems, including related policies, procedures, and risk limits.

8. RISK IDENTIFICATION AND MEASURMENT

8.1 Credit union management should also take appropriate steps to manage interest rate risk

by reviewing and managing the balance sheet structure. This process should include the following:

8.1.1 A determination of rate-sensitive assets and liabilities;

8.1.2 The matching of the maturities for rate-sensitive assets, such as loans and investments with similar term rate-sensitive liabilities, such as loans from external sources and member deposits;

8.1.3 The matching of fixed assets with institutional capital;

8.1.4 The matching of liabilities and member deposits with no maturity with short term (maturity of less than 30 days) assets;

8.1.5 A written analysis of the credit union's balance sheet structure and documentation of matching the rate-sensitive assets with the rate-sensitive liabilities; and

8.1.6 Adequate written liquidity and asset liability management (ALM) policies that are commensurate with the size and sophistication of the credit union.

9. REPORTING REQUIREMENTS

9.1 In addition to adequate systems and controls, capital has an important role to play in mitigating and supporting interest rate risk. In cases where the institutions undertake significant interest rate risk in the course of their business strategy, capital should be allocated specifically to support this risk.

9.2 The appropriate level of capital in support of interest rate risk should be at the discretion of the Board and senior management of the credit union. However, if the Central Bank is of the view that a credit union's level of interest rate risk exposure is high in relation to its capital, it will discuss this concern with senior management of the institution. Depending on the circumstances, the Central Bank may require a credit union to strengthen its capital position or reduce its level of interest rate risk exposure.

9.3 Credit unions are subject to reporting their interest rate risk exposure via the Excel Reporting System (ERS) on a monthly basis, for larger credit unions.

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