FRBSF WEEKLY LETTER

Number 93-26, July 23, 1993

Interest Rate Risk at U.S. Commercial Banks

During the past few years, the composition of U.S. commercial banks' asset portfolios has changed dramatically. Most notably, holdings of securities have grown over 35 percent since the beginning of 1990, while loans to businesses have actually declined over the same period. Some observers argue that if increases in bank securities holdings are concentrated in longerterm issues, then these portfolio shifts may expose banks to increased interest rate risk, especially if rates rise rapidly.

Unfortunately, it is difficult to assess the interest rate risk exposure of the banking system without detailed information on the maturity and cash flow characteristics of bank assets and liabilities. Federal banking agencies have proposed systems to measure this risk, but the data needed to derive these measures are not vet available.

In this Weekly Letter, I provide a preliminary assessment of the interest rate risk of U.S. commercial banks using data that are currently available in bank Call Reports. While the measure I derive is incomplete, it does suggest that some of the concerns about bank interest rate risk may be overstated.

Methodology and assumptions

As part of an ongoing effort to assess bank interest rate risk, the Federal Reserve Board has proposed a risk measurement system that is to be implemented beginning in 1994. Under this proposal, banks will provide detailed data on the maturity and cash flow characteristics of their assets and liabilities. Based on these features, one set of risk weights will be assigned to liabilities, and one set will be assigned to each of three categories of assets: amortizing, nonamortizing, and deep discount. Holdings in each category will be multiplied by the appropriate risk factor, which represents the change in the value of the bank's

position in that category that would result from a shock to interest rates. Netting risk-weighted assets against risk-weighted liabilities, regulators can determine how much a bank's net worth would change in response to a given parallel shift in interest rates. Under the Fed's proposal, banks may be required to hold more capital against interest rate risk if their risk exposure is considered to be "excessive." (For a more detailed description of an earlier, but similar, interest rate risk measure, see Weekly Letter 92-39.)

My measure of bank interest rate risk is based on the March 1993 version of the Fed's proposed methodology. However, several compromises were required because banks currently do not report sufficient information to derive the Fed's interest rate risk measure. First, limited maturity data are available from 1988.Q4 on bank holdings of fixed and floating rate loans, securities, and large CDs in each of four time-to-maturity bands. The Fed's proposed risk measure uses seven time bands. These data are the basis for my interest rate risk calculations.

Second, banks do not currently include data on the cash flow characteristics of their assets. However, whether a loan amortizes or not can significantly affect its interest rate risk. In addition, other characteristics, like prepayment options and interest caps on mortgages, also affect the interest rate sensitivity of these assets. To deal with these issues, it was necessary to make several assumptions. First, I assume that all real estate and personal loans are amortizing, while loans for construction and land development, business loans, and loans to other banks are not. I then calculate the proportion of total loans that are amortizing and nonamortizing, and apply these percentages to each of the four loans-by-maturity categories. For securities, I assume that mortgage-backed securities are amortizing, while all others are not and again

JESTERN BHINNING

Friday of January, April, July, and October.

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apply these percentages to the maturity data. The effects of prepayments and other imbedded options are incorporated in the risk-weights proposed by the Fed. In the absence of additional information, I also assume that banks hold no deep-discount assets.

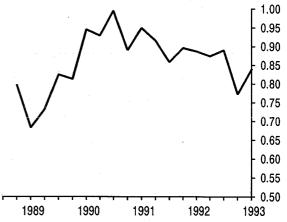
The maturity of deposits is an important issue in determining bank interest rate risk. Deposits with no specific maturity, such as checking and savings accounts, can be thought to have very short maturity since they can be withdrawn on demand. At the same time, however, these deposits are a stable funding source for banks whose rates adjust slowly. Thus, they may have an effective maturity that is quite long. The Fed's proposal gives banks some freedom to allocate their liabilities across the different maturity bands, with guidelines to limit the proportion of deposits in the longer time bands. I follow the proposed guidelines in determining the maturities of bank deposits and other liabilities.

For the risk weights, I use the risk factors in the Fed's most recent proposal. The four time bands for which data are currently available do not match up exactly with the seven bands in the Fed proposal. For the medium-term instruments (1 to 5 years), I use the 3-to-5-year proposed risk weight; for my over 5-year maturity band, I use the Fed's 10-to-20-year risk weight.

Finally, the measure I derive does not include data on off-balance sheet activities. Unfortunately, there are no data to characterize bank's off-balance sheet activities or to determine their maturities. While some argue that off-balance sheet positions pose considerable interest rate risk, others suggest that banks use these activities to hedge against interest rate risks in other positions. The net effect of this omission, therefore, is uncertain.

Results

Using the methodology described above, I estimate the effect on the U.S. commercial banking system of a 200-basis-point across-the-board increase in interest rates. While the effect of interest rate changes would differ if rates rose less or if they fell, this scenario addresses the effect of a large unanticipated positive shock to all interest rates. The interest rate risk measure is the net risk-weighted position, defined as the change in Net Risk-Weighted Position as a Percent of Total Assets (+200 basis point shock to interest rates)



bank net worth resulting from the 200-basispoint rise in all interest rates, divided by total bank assets. Thus, a value of 1.0 would indicate that a 200-basis-point increase in rates would reduce bank net worth by 1 percent of assets. The results of this calculation are presented in the figure for the period from 1988.Q4 to 1993.Q1.

According to this measure, the interest rate risk exposure of U.S. banks' on-balance sheet activities is 0.85 percent of assets as of early 1993. Since some interest rate risk is inherent in banking, this exposure does not seem "excessive." In fact, the Fed has suggested that interest rate risk below 1 percent of assets is within industry norms. The data suggest that interest rate risk among banks as a group has not increased much in recent years. In fact, the figure shows a slight downward trend in interest rate risk since mid-1990.

Thus, there is evidence that recent portfolio shifts at U.S. banks have not resulted in an increased exposure to interest rate risk. This conclusion comes with two caveats. First, aggregation of individual bank balance sheets may conceal increases in interest rate risk at individual banks. While the figures for the industry as a whole indicate no real systematic shift in interest rate risk among banks, this does not preclude jumps in interest rate exposures at individual institutions. Second, the results presented here omit bank offbalance sheet activities. A better assessment of the risk-enhancing or risk-reducing effects of these activities will have to await the availability of better data from the banking system.

> Jonathan A. Neuberger Economist

REGIONAL BANK DATA

MARCH 31, 1993
(NOT SEASONALLY ADJUSTED, PRELIMINARY DATA)

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TIME AND SAVINGS 278,884 2,545 23,425 179,432 10,254 6,429 7,096 16,216 8,346 NOW 41,200 330 3,434 24,508 1,479 1,017 1,289 3,194 1,496 MMDA 94,076 538 7,582 65,902 1,939 1,590 2,370 4,358 1,776 SAVINGS 44,735 689 3,407 27,183 3,126 991 1,572 2,206 1,689 SMALL TIME 68,030 444 7,528 39,464 2,065 2,239 1,045 5,517 2,683 OTHER BORROWINGS 31,979 639 2,396 14,143 5,215 1,427 1,357 2,136 2,334 EQUITY CAPITAL 42,283 617 3,387 26,897 1,649 751 1,639 2,364 1,312 LOAN LOSS RESERVE 10,204 40 556 7,599 240 108 400 450 196	25,139 4,460 8,021 3,864 7,035 1,697 2,332
MMDA 94,076 538 7,582 65,902 1,939 1,590 2,370 4,358 1,776 SAVINGS 44,735 689 3,407 27,193 3,126 991 1,572 2,206 1,680 SMALL TIME 68,030 444 7,552 62,206 2,239 1,045 5,517 2,685 LARGE TIME 30,656 507 1,475 22,291 1,642 592 819 935 698 OTHER BORROWINGS 31,979 639 2,396 14,143 5,215 1,427 1,357 2,136 2,334 EQUITY CAPITAL 42,283 617 3,387 26,697 1,649 751 1,639 2,364 1,312 LOAN LOSS RESERVE 10,204 40 556 7,599 240 108 400 450 198 LOAN COMMITTMENTS 196,628 660 28,638 121,232 6,297 3,279 1,941 10,231 7,133 51	8,021 3,864 7,035 1,697 2,332
SAVINGS 44,735 689 3,407 27,193 3,126 991 1,572 2,206 1,680 SMALL TIME 68,030 444 7,528 39,464 2,065 2,239 1,045 5,517 2,683 LARGE TIME 30,656 507 1,475 22,291 1,642 592 819 935 684 OTHER BORROWINGS 31,979 639 2,396 14,143 5,215 1,427 1,357 2,136 2,334 EQUITY CAPITAL 42,283 617 3,387 26,897 1,649 751 1,639 2,364 1,312 LOAN LOSS RESERVE 10,204 40 556 7,599 240 108 400 450 196 LOAN COMMITTMENTS 196,628 660 28,638 121,232 6,297 3,279 1,941 10,231 7,133 LOAN SOLD 15,630 25 153 14,805 228 25 68 190 55	3,864 7,035 1,697 2,332
SMALL TIME LARGE TIME 68,030 30,656 444 507 7,528 1,475 39,464 2,291 2,065 1,642 2,239 592 1,045 819 5,517 935 2,693 689 OTHER BORROWINGS 31,979 639 2,396 14,143 5,215 1,427 1,357 2,136 2,394 EQUITY CAPITAL 42,283 617 3,387 26,897 1,649 751 1,639 2,364 1,312 LOAN LOSS RESERVE 10,204 40 556 7,599 240 108 400 450 196 LOAN COMMITTMENTS 196,628 660 28,638 121,232 6,297 3,279 1,941 10,231 7,132 LOAN SOLD 15,630 25 153 14,805 228 25 68 190 55	7,035 1,697 2,332
LARGE TIME 30,656 507 1,475 22,291 1,642 592 819 935 698 OTHER BORROWINGS 31,979 639 2,396 14,143 5,215 1,427 1,357 2,136 2,334 EQUITY CAPITAL 42,283 617 3,387 26,897 1,649 751 1,639 2,364 1,312 LOAN LOSS RESERVE 10,204 40 556 7,599 240 108 400 450 198 LOAN COMMITTMENTS 196,628 660 28,638 121,232 6,297 3,279 1,941 10,231 7,133 LOANS SOLD 15,630 25 153 14,805 228 25 68 190 55	1,697 2,332
EQUITY CAPITAL 42,283 617 3,387 28,897 1,649 751 1,639 2,364 1,312 LOAN LOSS RESERVE 10,204 40 556 7,599 240 108 400 450 196 LOAN COMMITTMENTS 196,628 660 28,638 121,232 6,297 3,279 1,941 10,231 7,132 LOANS SOLD 15,630 25 153 14,805 228 25 68 190 55	
LOAN LOSS RESERVE 10,204 40 556 7,599 240 108 400 450 196 LOAN COMMITTMENTS 196,628 660 28,638 121,232 6,297 3,279 1,941 10,231 7,138 LOAN SOLD 15,630 25 153 14,805 228 25 68 190 51	
LOAN COMMITTMENTS 196,628 660 28,638 121,232 6,297 3,279 1,941 10,231 7,131 LOANS SOLD 15,630 25 153 14,805 228 25 68 190 51	3,675
LOANS SOLD 15,630 25 153 14,805 228 25 68 190 51	613
	17,214 86
INCOME TOTAL 11,228 103 743 7,309 429 211 572 621 32	913
INTEREST 8,495 84 585 5,564 377 179 283 449 255	718
FEES & CHARGES 735 6 57 492 12 14 16 47 22	70
EXPENSES TOTAL 9,212 72 662 6,130 334 162 420 482 25	699
INTEREST 2,809 24 209 1,811 154 69 72 145 90 SALARIES 2,330 24 169 1,589 85 32 53 144 54	235
LOAN LOSS PROVISION 846 2 48 628 16 5 86 21 12	28
OTHER 3,227 22 238 2,102 80 58 209 171 98	256
INCOME BEFORE TAXES 2,016 31 81 1,179 95 49 152 139 75	214
TAXES 780 9 28 495 34 18 51 49 28 NET INCOME 1.277 21 40 765 66 26 98 80 44	70 135
NET INCOME 1,277 21 40 765 66 26 98 80 46	135
ROA (%) 1.05 1.81 0.45 0.94 1.17 1.06 2.95 1.28 1.33	1.35
ROE (%) 12.08 13.82 4.74 11.37 15.94 14.07 23.90 13.55 14.00 NET INTEREST MARGIN (%) 4.66 5.09 4.25 4.63 3.98 4.42 6.37 4.86 4.79	14.69 4.85
ASSET QUALITY PERCENT OF LOANS' (LARGE COMMERCIAL BANKS)	
LOAN LOSS RESERVE (ALL BANKS) 3.10 1.77 2.81 3.40 1.74 1.61 5.52 2.62 2.33	2.08
NET CHARGEOFFS, TOTAL 1.00 0.23 0.74 1.19 0.16 0.18 2.88 0.55 0.14	0.34
REAL ESTATE 0.79 -0.08 0.28 1.01 0.09 0.01 0.30 0.38 0.15 COMMERCIAL 0.41 0.54 0.57 0.49 0.13 0.07 5.29 0.11 -0.70	0.18 -0.13
CONSUMER 2.91 0.57 1.83 4.08 0.76 0.49 3.95 1.68 0.71	1.12
AGRICULTURE -0.02 0.00 0.52 -0.15 0.00 0.15 -0.09 -0.13 -0.11	0.12
PAST DUE & NON-ACCRUAL, TOTAL 5.57 2.90 4.13 6.48 3.35 1.93 7.41 2.43 1.97	4.13
REAL ESTATE 7.30 3.05 6.64 8.32 3.44 2.43 8.88 2.47 2.63 CONSTRUCTION 20.65 3.35 18.85 23.17 11.82 9.29 22.67 5.13 3.01	5.37 17.72
CONSTRUCTION 20.65 3.35 18.65 23.17 11.62 9.29 22.67 5.13 3.0 COMMERCIAL 7.59 3.02 11.66 8.98 1.33 2.43 7.46 3.35 3.4	3.21
FARM 8.49 0.00 20.57 9.19 11.33 3.37 0.00 5.59 10.8	2.73
1-4 FAMILY REV 1.13 1.14 0.59 1.20 1.51 0.51 0.50 0.33 0.64	1.18
1-4 FAMILY OTHER 3.05 2.28 2.54 3.42 3.72 1.17 3.49 0.98 1.3 NULT FAMILY 2 14 147 10.00 0.72 112 0.74 271 0.09 0.11	1.34
MULTI-FAMILY 8.18 1.17 10.90 9.70 1.13 0.74 27.13 0.92 0.18 COMMERCIAL 5.46 2.59 6.39 6.12 4.04 1.47 13.31 2.39 2.43	2.83 3.86
CONSUMER 3.34 2.39 2.70 3.90 2.49 1.39 5.78 1.69 1.0	2.59
AGRICULTURE 5.62 0.00 8.01 5.68 26.88 4.50 4.21 5.42 1.80	4.39
NUMBER OF BANKS 742 8 38 447 17 20 18 48 54	92
NUMBER OF EMPLOYEES 245,225 2,676 19,505 159,606 8,474 4,652 6,212 16,234 7,150	20,707

Opinions expressed in this newsletter do not necessarily reflect the views of the management of the Federal Reserve Bank of San Francisco, or of the Board of Governors of the Federal Reserve System.

Editorial comments may be addressed to the editor or to the author. . . . Free copies of Federal Reserve publications can be obtained from the Public Information Department, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 974-2246, Fax (415) 974-3341.

SOURCES: SURVEY OF TERMS OF BANK LENDING AND TERMS OF CONSUMER CREDIT; MOST COMMON INTEREST RATES ON SELECTED ACCOUNTS. * DATA ARE COMPOUNDED ANNUAL RATES.

TYPE OF ACCOUNT OR LOAN	DATE	US	DISTRICT	ARIZ	CALIF	HAWAII	IDAHO	OREGON	UTAH	WASH
SAVINGS ACCOUNTS AND MMDAS MAR 93		2.73	2.87	2.54	2.59	3.03	3.33	2.71	3.09	2.98
	APR 93	2.68	2.81	2.59	2.56	2.81	3.27	2.61	2.99	2.94
	MAY 93	2.65	2.78	2.57	2.54	2.84	3.20	2.50	2.97	2.91
92 TO 182 DAYS CERTIFICATES MAR 93		3.03	2.93	2.70	2.85	2.50	3.09	2.99	3.05	3.25
	APR 93	2.99	2.89	2.76	2.82	2.33	3.00	2.92	3.05	3.24
	MAY 93	2.98	2.87	2.74	2.80	2.25	2.98	2.96	3.04	3.13
2-1/2 YEARS AND OVER CERTIFICATES MAR 93		4.52	4.34	3.83	3.95	4.16	5.08	5.01	4.39	4.48
	APR 93	4.47	4.33	3.92	3.94	4.19	4.90	5.01	4.3 9	4.56
	MAY 93	4.45	4.27	3.81	3.91	4.11	4.90	4.95	4.34	4.54
COMMERCIAL, SHORT TERM*	AVE. RATE	4.80	5.20	6.72	4.92	6.69	7.37	6.49	4.97	5.61
	AVE. MAT. (DAYS)	. 50	84	N/A	264	N/A	N/A	N/A	35	N/A
COMMERCIAL, LONG-TERM*	AVE. RATE	6.32	9.41	N/A	N/A	N/A	N/A	N/A	8.41	N/A
	AVE. MAI. (MONTHS)	42	46	N/A	N/A	N/A	N/A	N/A	48	N/A
LOANS TO FARMERS*	AVE. RATE	7.52	6.72	6.56	6.63	N/A	8.07	6.82	8.71	6.90
	AVE. MAT. (MONTHS)	15	14	N/A	14	N/A	N/A	N/A	7	N/A
CONSUMER, AUTOMOBILE	AVE. RATE	8.17	8.23	8.4	7.84	N/A	N/A	8.02	8.88	8.17
CONSUMER, PERSONAL	AVE. RATE	13.63	13.87	15	18.19	N/A	N/A	9.21	13.65	11.84
CONSUMER, CREDIT CARDS	AVE. RATE	17.15	17.6	14.9	18.38	N/A	N/A	19.25	14.9	18.3

INTEREST RATES ON DEPOSITS AND LOANS AS OF MAY 1993 (%)

97 56 35 83 15 TOTAL DEPOSITS 4 0 4 З 8 83 15 2 65 23 11 DEMAND з NOW ō 66 31 з 92 3 16 6 60 31 9 32 65 3 75 56 37 23 74 59 34 7 54 44 2 43 17 17 SAVINGS & MMDAS 0 10 92 4 16 5 3 25 57 27 17 SMALL TIME 39 57 з з 44 54 LARGE TIME

MARKET SHARE STATISTICS DEPOSITORY INSTITUTIONS REQUIRED TO HOLD RESERVES WITH THE FEDERAL RESERVE ON A WEEKLY BASIS PERCENT OF COMBINED MARKET TOTAL FOR MAY 1993, BY REGION

CALIF

CB SL CU

DISTRICT

CB SL CU

DEPOSIT TYPE

ALASKA

CB SL CU

ARIZONA

CB SL CU

CB = COMMERCIAL BANKS; SL = SA VINGS & LOANS AND SA VING BANKS; CU = CREDIT UNIONS; MAY NOT SUM TO 100% DUE TO ROUNDING

CB SL CU

HAWAI

IDAHO

CB SL CU

NEVADA

CB SL CU CB SL CU

Research Department Bank of San Francisco

OREGON

UTAH

CB SL CU

WASH

CB SL CU

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