

**Title:**

Management of Interest Rate Risk in the Banking Book of Australian Credit Unions and Building Societies

**Abstract:**

The Basel Committee has released a consultative document (Basel (2003)) on the management and supervision of interest rate risk (IRR). This document outlines a standardised model to calculate a duration-based proxy for IRR in depository institution balance sheets. We utilise this methodology to define an IRR measure which we denote *BIRRM* (Basel Interest Rate Risk Measure). It is the change in the value of a financial institution produced by a 200 basis-point increase in interest rates at all maturities, relative to Tier I and Tier II capital.

This study has three primary objectives. Firstly, we utilise *BIRRM* to provide an overview of IRR exposure of Australian Credit Unions and Building Societies (CUBS) over the period September 1997 to September 2007. Secondly, we seek an understanding of the relationship between *BIRRM* and measures of CUBS' interest rate sensitivity over a period of rising interest rates (December 1998 to September 2000) and another period of falling rates (September 2000 to December 2001). Finally, we seek an understanding of the economic factors that influence IRR exposure decisions of CUBS by modelling the determinants of CUBS' IRR exposure.

We find that IRR exposure of CUBS is relatively low and, on average, CUBS are exposed to falling interest rates. We also find significant relationships between *BIRRM* and measures of CUBS' interest rates sensitivity consistent with *a priori* expectations, supporting the use of the Basel Committee's measure of IRR, in identifying CUBS with large IRR exposures. The models examining the determinants of CUBS' IRR have relatively low explanatory power. There are however significant relationships between a number of factors and CUBS' exposure to changing rates.

**Key Words:**

Interest rate risk; Credit Unions; Building Societies; Basel II; duration; prudential supervision;