**RiskGPS: Risk Management Bubbles** *(Page 19: “Rate Risk Management Strategy”)*

**Purpose and Overview**

The **Risk Management Bubbles** section of the RiskGPS report provides a clear visual summary of your bank’s interest rate risk position. These visuals help decision-makers quickly assess whether taking on additional risk to enhance margin is prudent—or if doing so might compromise future earnings or lead to regulatory concerns.

This analysis is presented through **three informative charts**:

1. **The Bubble Chart** – shows your bank’s rate risk position at a glance. It shows the yield or cost of assets and liabilities and the treasury yield curve – an indicator of current market incentives for extension risk.
2. **The Important Values table** illustrates the bank’s maturity mismatch and data needed for an analysis of net interest margin contribution.
3. **The Contribution Chart** – Highlights the relative contribution of major balance sheet components.

Together, these charts provide actionable insights for Asset Liability Management (ALM) discussions with executive teams and the board.

**Chart 1: Bubble Chart**

**What It Shows**

The first chart helps evaluate the **bank’s maturity mismatch** by illustrating the yield or cost of assets and liabilities and the **Treasury yield curve**—an important reference for extension risk.

* **Purple Bubble:** Represents earning assets.
* **Yellow Bubble:** Represents interest-bearing liabilities plus non-interest-bearing checking accounts or DDA.
* **Line:** Reflects the **Treasury yield curve** as of the last day of the calendar quarter (data sourced from the Federal Reserve).

**How to Interpret**

* **Vertical Axis (Y-axis):** Displays interest yields. Each bubble’s rate is indicated by its center’s vertical alignment with the axis.
* **Horizontal Axis (X-axis):** Reflects **duration (**in months), which is the maturity average based on discounted total cash flow.

**Key Insights from the Bubble Chart**

* **Duration Mismatch:** The horizontal gap between the asset and liability bubbles represents the **bank’s interest rate exposure**. A wider gap means greater risk.
* **Market Incentives:** When the yield curve is upward-sloping, longer-term assets are typically rewarded with higher yields but penalizes longer maturities for deposits. .
* **Spreads:** The spread between the yield curve and the yield or cost to the bank can vary. The spread can be calculated by looking at the treasury rates at the center of each buttle to the yield for that bubble.

**Chart 3: Balance Sheet Contribution Chart**

The third chart breaks down the relative **contribution of key balance sheet categories** to overall interest rate risk. This view enables institutions to pinpoint which asset or liability categories are most impactful in the overall rate risk profile.

**Strategic Applications**

As you consider how to reposition the bank to reduce rate risk, evaluate both **the feasibility and cost** of altering maturities:

* **Reduce Mismatch:** If the asset bubble lies to the right of the liability bubble (indicating a longer asset duration), strategies might include:
  + Shortening the duration of earning assets.
  + Extending the maturity of liabilities.

However, practical limitations such as **contractual obligations**, **market conditions**, and **customer preferences** may restrict these options.

Importantly, the real value of the bubble charts lies not just in the data—but in the **strategic discussions** they stimulate. Management and boards are encouraged to use this visual tool to challenge assumptions and explore possible adjustments.

**Important Considerations**

* **Dynamic Conditions:** All elements of the charts are subject to change:
  + The **level**, **slope**, and even **direction** of the yield curve can shift.
  + Spreads between bank instruments and Treasury benchmarks may fluctuate—and can even turn negative.

As a result, it's essential to review these risk positions **regularly** and maintain an **ongoing dialogue** about emerging risks and evolving strategies.