INTEREST RATE RISK MANAGEMENT AT COMMERCIAL BANKS IN VIETNAM

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Abstract: *The commercial banking system plays an important role in economic and social development. Interest rate risk has always been a concern of commercial banks in Vietnam in recent years. The article uses statistical methods and general analysis to analyze the current situation of interest rate risk management at commercial banks in Vietnam. From the analysis results, some recommendations will be proposed to improve interest rate risk management at commercial banks in the coming time.*

Keywords*: commercial bank, Interest rate risk, risk management, risk*

I. Introduction

Interest rate risk always exists in the operation of credit institutions, is a part of the risk arising in the process of banking operations. When interest rate risk occurs, the bank's income will decrease, a corresponding amount of capital cannot be recirculated, cash flow in the economy cannot be circulated, and the banking system will face liquidity difficulties. Risks also affect the effectiveness of monetary policy, interest rates and money market management of the State Bank. Therefore, commercial bank managers are always interested in interest rate risk management and develop and adjust interest rate policies to suit market fluctuations in each period. What is the interest rate risk management of commercial banks? Interest rate risk management aims to achieve the goal and what should be done? What factors affect the risk management of interest rate risk of commercial banks?... Moreover, in each period and development conditions of the banking system of each country, it is necessary to innovate and perfect the issues theory mentioned above.

Besides, in the industrial 4.0 period, banks not only compete with other banks but also have to compete with businesses outside the industry such as finance, insurance, Fintech companies, etc., so to compete In order to compete with competitors inside and outside the industry, the interest rate policy is a decisive strategy because both depositors and borrowers are interested in interest rates, depositors will choose banks with

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high interest rates, and Borrowers choose banks with low lending rates, so banks have to increase deposit rates and reduce lending rates, leading to asymmetry in the interest rate relationship and therefore increased risks.

II. Theoretical background in interest rate risk management at commercial banks

2.1. Interest rate risk in commercial banks

Interest rate risk is the risk of fluctuations in a bank's income and net worth as market interest rates fluctuate. This is a typical risk of any commercial bank. The asset conversion process is considered as a particularly basic function of the banking system. The asset conversion process includes the purchase of primary securities, i.e. the use of capital, and the issuance of primary securities, i.e. raising capital. The maturity and liquidity of the primary securities in the Asset portfolio are often disproportionate to the secondary securities in the Liabilities. It is the mismatch of maturity between assets and liabilities that makes the bank bear interest rate risk when interest rates in the market fluctuate. Interest rate risk is divided into 3 categories:

- *Outright Risk*: Is the risk that the yield curve will move in parallel up or down, different maturities will behave the same.

- *Yield Curve Risk:* The risk caused by the yield curve changing shape. When interest rates change, interest rates of different maturities will change differently. Yield curve risk is the risk that the yield curve becomes inverted when short-term interest rates become higher than long-term rates..

- Basic Risk: s the risk caused when there is an uneven change of different interest rate bases. For example, the asset side lends US dollars on the basis of the LIBOR rate, while the debt side borrows on the basis of the SIBOR interest rate which these two bases vary. Thus, there will be interest rate risk called fundamental risk in this case.

2.2. Interest rate risk management of commercial banks

Governance is the continuous, organized and oriented influence of the subject of governance on the subject subject to governance in order to make the best use of all potentials and opportunities to achieve the business objectives set out in each period with the motto of optimizing costs used in that process, while ensuring increased profits.

Risk management is determining the level of risk a bank wants, identifying the current level of risk the bank istaking, and using derivatives or other financial instruments to control the risk. Adjust the actual risk to the expected risk.

Interest rate risk management is the establishment of a system of processes by banks to identify, quantify, monitor and control the losses that are and will be caused to the bank's income due to fluctuations in interest rates. interest rates so that we can set out strategies, policies or use tools to prevent and minimize the adverse effects of interest rate fluctuations on the bank's income fully, comprehensively and continuously.

An important goal in interest rate risk management is to minimize the negative effects of interest rate fluctuations on the bank's income. No matter how interest rates change, banks always want to achieve a relatively stable expected income.

In the banking business, there are many objective and subjective factors that bring about interest rate risk, including many force majeure factors, so risks cannot be avoided. In volatile market conditions, changes in market interest rates can lead to property damage as well as impact on bank earnings. The effects of interest rate risk can lead to the risk of undercapitalization and in turn can affect the entire business of the bank. Therefore, every year commercial banks set up a risk compensation fund and are accounted for in expenses. The size of the risk offset fund is based on the level and probability of risk. If the risk is low, the economic efficiency will increase and vice versa.

Interest rate risk exists in the basic operations of commercial banks. Capital mobilization activities, credit activities, foreign currency trading activities... all have potential interest rate risk. Thus, in order for commercial banks to be effective, interest rate risk management needs to be given due attention.

The trend of economic liberalization and globalization makes the banking industry's business activities increasingly complicated, and operational risks are increasing. For a developing country like Vietnam, how to effectively manage risks in a new business environment and volatile market like today? This problem can only be solved through improving risk management capacity.

III. Research Methods

- Statistical method: The author uses appropriate statistics to serve the analysis of the current situation of interest rate risk management of commercial banks in Vietnam.

- Method of synthesis analysis: On the basis of analyzing each specific content, the author gives general assessments about the current situation of interest rate risk management of commercial banks in Vietnam.

- Comparative and contrasting method: Interest rate risk management of commercial banks in Vietnam is considered on the basis of comparison between periods, as well as comparison with actual risk management status. interest rate risk of domestic and international commercial banks.

IV. Result and Recommendations.

4.1. Interest rate policy

For lending activities in the interbank market (short-term), the investment interest rate is determined depending on market movements and the bank's cost of capital. Loans in the interbank market usually have short terms (less than 3 months). Based on the forecast of interest rate movements in the market and the ability to balance capital sources, the bank will make appropriate investment decisions. In the event that interest rates are forecast to have a downward trend, the bank will increase long-term investments to increase profitability. On the contrary, in the case of an upward trend in interest rate forecasts, the bank will increase short-term investments.

For lending activities to customers, the bank sets the lending interest rate on the principle of ensuring the offset of capital costs and management costs, on the basis of considering risk factors, financial value, and other factors. secured assets, interest rates in the market, ensuring the bank's competitiveness and business efficiency. The head office stipulates the lending interest rate floor in each period, business units are allowed to proactively determine the lending interest rates for customers in each period, ensuring that it is not lower than the interest rate floor on the basis of distribution. Analyze and assess credit risks and ensure the completion of the annual profit plan. In addition, because the capital structure mainly focuses on capital with a short-term interest rate re- pricing term, the bank stipulates that all loans must have floating interest rates, periodically adjusted 1- 3 months/time.

For capital mobilization activities, the interest rate is determined according to market principles, combined with the business orientation of the leadership, the bank's capital balance and regulations of the State Bank. The bank's mobilized capital mainly has a short interest rate repricing term.

In lending activities, branches serving 1 customer/group of customers must go through the focal branch to agree on the interest rate applied to customers in the whole system. attract customers and increase the branch's own market share but affect the interests and reputation of commercial banks.

4.2. Orientation of interest rate risk management at Vietnamese commercial banks

- Risk management, interest rate risk management is an important task in the overall development strategy of the bank..

- Policies and mechanisms in credit risk management in general and risk management in particular to ensure that the growth rate of capital sources and loans is maintained, and the bank's profit growth is maintained while maintaining security. in banking activities, especially credit activities, ensuring the bad debt ratio below 0.75%.

- Immerse in risk management culture, strictly comply with Vietinbank's regulations/policies/approval conditions, especially attach importance to compliance with post-disbursement supervision. Strengthening remote credit quality monitoring, early detection of risk signs, and timely and effective warnings.

- Check the actual situation to grasp the financial status, business capacity, collateral and real difficulties of customers. Building and implementing solutions suitable for each customer, minimizing bad debt, overdue debt, accompanying customers to overcome the crisis period.

- Deploying flexibly and synchronously the appropriate debt settlement and recovery measures (Restructuring the repayment term, proactively paying customers, exempting and reducing interest). Customers actively sell assets to pay debts, buy and sell debts through VAMC effectively for each customer and each unit to limit the impact of Circular 02 on debt classification and provisioning effective from June 1, 2014 and credit quality targets of commercial banks (bad debt and overdue debt).

- Strengthening the recovery of bad debts, bad debts that have been handled by the risk reserve fund, speeding up the recovery of suspended interest. Every year, Vietinbank sets the target of recovering bad debts based on the set rates such as: On-balance sheet bad debt recovery rate; Off-balance sheet debt recovery rate.

- Focus on collecting suspended interest, penalty interest, guarantee fee, service fee, pay attention not to omit, enter wrong data leading to under-collecting interest from customers.

- Make provision to ensure adequate financial reserve for possible losses (control the ratio of reserve fund balance/ bad debt for each branch).

- Strengthening credit risk management, interest rate risk management is associated with the application of an advanced credit management model and management strategy suitable to the conditions of technology, human resources, finance and development level of the bank and the roadmap for Basel II compliance under the guidance of the State Bank.

- Applying information technology in interest rate risk management, increasing the use of quantitative methods in credit risk assessment.

- Improve the capacity of the bank's staff in general and staff in charge of interest rate risk management in particular.

- Strengthening interest rate risk management is carried out simultaneously with management of other types of risks such as operational risk, market risk…

4.3. Develop policies and improve interest rate risk management processes

- Legal and Regulatory Authorities: Administrators develop regulations in the bank, it is necessary to create a legal framework, including risk limits and other risk management parameters, which is considered optimal for risk management in the banking system.

- Supervisory Authorities: Monitor financial success and effectiveness of risk management. Check compliance with regulations.

- Shareholders: Appointing the bank's board of directors, auditors.

- Board of Director: Establish risk management policy and other policies of the bank. The board of directors is the most responsible place in the bank.

-Managers:Implementmanagement, create a system to implement the policies set by the Board of Directors, including risk management on a daily basis.

- Internal control/audit committee: Checking the correct implementation of the policies set by the management, ensuring the correctness of the company's management, control system and risk management process.

- External audit: Expressing opinions on financial statements and evaluating risk management policies.

V. Conclusion

Interest rate risk exists in the operation of commercial banks is inevitable. However, when interest rate risk occurs, the bank's interest income will be lost, which will cause negative impacts on commercial banks as well as on the economy. Therefore, interest rate risk management activities for commercial banks in general.

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