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Office of Thrift Supervision
Department of the Treasury
1700 G Street, N.W., Washington, DC 20552

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Acting Director

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Any attachments to this document are rescinded only as they relate to national banks and federal savings associations.

MEMORANDUM FOR: CHIEF EXECUTIVE OFFICERS

FROM: Jonathan L. Fiechter Jonathan L. Fiechter

SUBJECTS: Postponement of Interest Rate Risk Capital Deduction

Issuance of Thrift Bulletin on Modification of the Interest Rate Risk Component of the Risk-Based Capital Requirement

Introduction

This memorandum explains that the Office of Thrift Supervision (OTS) intends to delay implementation of an automatic capital deduction for interest rate risk pending the testing of an OTS appeals process for certain institutions subject to such deductions. This delay will also provide an opportunity to assess any further guidance from the other three federal banking agencies regarding their planned implementation of a capital deduction. This memorandum also (a) announces that OTS will begin accepting appeals from certain institutions that would be subject to an automatic deduction and (b) provides guidance on what steps an institution should take to gain OTS approval to use its own IRR model to calculate the IRR Component.

Background

Section 305 of the Federal Deposit Insurance Corporation Improvement Act of 1991 requires the Federal banking agencies to ensure that capital standards for insured depository institutions take adequate account of interest rate risk (IRR). To comply with this requirement, the OTS issued a final rule on August 31, 1993 that added an IRR Component to the OTS risk-based capital rule.

Under the final rule, savings associations with a greater than normal level of interest rate risk, as calculated by the **OTS Net Portfolio Value Model** (the OTS Model), are subject to a deduction from total capital for purposes of calculating their risk-based capital requirement.

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The OTS Model was implemented in March 1991 and revised in March 1993. The model is currently used to measure the IRR exposure and sensitivity of individual savings associations that file Schedule CMR of the Thrift Financial Report. The model is also used to prepare quarterly **Interest Rate Risk Exposure Reports** that are sent to each savings association that files Schedule CMR.

The Exposure Reports contain OTS estimates of the effect of interest rates on the economic value of an institution's portfolio of assets, liabilities, and off-balance sheet contracts. Each Exposure Report also contains an IRR Component that will be used to determine an institution's IRR capital deduction, if any, under the OTS risk-based capital rule.

Our experience with the model and the Interest Rate Risk Exposure Reports has been quite favorable. The quarterly reports have served to highlight both the importance of monitoring and managing interest rate risk, as well as changes in individual institution's risk exposure. The results of our model suggest that in general, thrift management are effectively managing their interest rate risk.

Postponement of an OTS Interest Rate Risk Capital Deduction

The Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency (other Federal banking agencies) recently published a final regulation that stipulates interest rate risk will be taken into account when determining a bank's capital adequacy. These agencies have also solicited comment on a proposed supervisory policy statement that describes the process the agencies will use to assess the exposure of a bank's economic value to changes in interest rates.

After they gain experience with this process, the other banking agencies are contemplating issuing standards that would establish an explicit capital charge for interest rate risk in a fashion similar to the approach contained in the OTS' August 1993 IRR regulation. As the other banking agencies refine and finalize their standards for an explicit IRR charge, OTS will review any differences between its approach and that of the other agencies for the purpose of achieving greater consistency and uniformity among all four federal banking agencies.

To provide sufficient time to implement and evaluate the OTS appeals process and other procedures established by Thrift Bulletin 67 (described below), as well as get a better sense of the direction that the other federal banking agencies may take in their implementation of Section 305 of FDICIA, OTS will **not** implement an automatic IRR capital deduction at this time. OTS will continue, however, to closely monitor the level of interest rate risk at individual institutions and retains the authority, on a case-by-case basis, to impose a higher Individual Minimum Capital Requirement for individual institutions with significant interest rate risk.

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Implementation of Appeals Process; Evaluation of Thrift Institution Models

Recognizing that a national model might only approximate the IRR exposure of specific thrift institutions, the final IRR rule also provided for an appeals process to give institutions an opportunity to appeal the IRR Component. On August 15, 1994, OTS issued for comment a proposed Thrift Bulletin entitled "Appeals, Certification, and Petitioning Processes for the Interest Rate Risk Component of the Risk-Based Capital Rule." The comment period closed on September 15, 1994.

OTS is now issuing the Thrift Bulletin entitled "Modification of the Interest Rate Risk Component of the Risk-Based Capital Requirement" (Thrift Bulletin 67), that addresses many of the comments received on the August 15 proposal. Thrift Bulletin 67 and a summary of the comments on the proposal are attached.

Thrift Bulletin 67 describes how, and under what circumstances, an institution may seek (1) an adjustment to the IRR Component generated by the OTS model or (2) approval to use its own internal IRR model to calculate the IRR Component.

Any institution that desires to seek (1) an adjustment to its IRR Component or (2) advance approval to use its own internal IRR model to calculate the IRR Component may now do so, subject to the eligibility criteria, and following the procedures outlined in Thrift Bulletin 67. In determining its eligibility to use its internal IRR model, an institution should use the IRR Components supplied by OTS to determine its IRR capital deduction as if the requirement were in effect.

Questions and comments regarding Thrift Bulletin 67 should be directed to Anthony G. Cornyn (202) 906-5727.

Attachments