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OCC Seeks Comments on Proposal Assessing Accuracy of  
Banks' Market Risk Model

WASHINGTON, D.C. -- The Office of the Comptroller of the Currency (OCC) announced today that it will issue for comment a proposed rule to require banks with significant trading activities to assess the accuracy of their market risk models. The rule would require banks to use a process called backtesting, which compares estimates from a bank's market risk model with its actual trading results. If the model's performance is poor, the bank's capital requirements for market risk would increase.

The proposal augments a July 25, 1995 proposal by the OCC, FDIC and the Federal Reserve Board to incorporate a measure for market risk into the agencies' risk-based capital standards. That proposal provided for the use of a bank's internal value-at-risk model in calculating the capital requirements if the model met certain qualitative and quantitative standards. Both proposals were recommended by the Basle Committee.

The new proposed rule describes the way the OCC would adjust the capital requirement for market risk for a bank whose internal model proved to be inaccurate. The upward adjustment to a bank's capital requirement from this process of backtesting is called the "plus factor."

Under the proposal, a bank would be required each quarter to compare its internal model estimates of value-at-risk against actual results during the previous 250 trading days. The bank would count the number of times that the trading loss on a single day exceeded that day's value-at-risk estimate -- that is, the number of exceptions. The total number of exceptions in a year would determine whether and how much a bank's market risk capital charge would be increased. The proposal specifies that the plus factor, if needed, would range from a value of 0.4 to 1. The plus factor would increase the scaling factor of three that is used in determining a bank's market risk capital requirement from its value-at-risk exposures estimates.

The market risk capital charge is expected to apply to those banks with significant trading activity starting at the end of 1997. The proposed backtesting procedures would then begin one year later, in 1998.

The public comment period is 30 days.

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The OCC charters, regulates and examines approximately 3,000 national banks and 70 federal branches and agencies of foreign banks in the U.S., accounting for more than half the nation's banking assets. Its mission is

to ensure the safety and soundness of the national banking system.