

Press Releases

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OTS 96-31 - OTS Issues New Guidelines for Valuating CMO Floaters

Office of Thrift Supervision

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OTS ISSUES NEW GUIDELINES FOR VALUATING CMO FLOATERS

WASHINGTON, D.C., May 2, 1996 -- The Office of Thrift Supervision (OTS) today issued guidelines to its regulated institutions describing an approach they should use to estimate and report the market value and interest rate sensitivity of mortgage derivative products that are tied to floating-rate indices ("CMO floaters").

The recommended approach is a refinement of a pricing methodology contained in a supervisory policy statement issued by the Federal Financial Institutions Examination Council (FFIEC) in late 1991.

OTS said thrift institutions should use the new recommended approach because it appropriately accounts for any caps and floors on the interest rate to be paid on the security, whereas the FFIEC methodology does not. While the FFIEC methodology may be useful as a general indicator of interest rate sensitivity, it was not intended to be used as a valuation tool, OTS said. It generally overstates the value of a CMO floater when interest rates increase because it does not account for the existence of an interest rate cap.

Accordingly, the guidelines state that, beginning with the June 1996 Thrift Financial Report (TFR), savings institutions should value the security using an approach that accounts for its cap and floor and that discounts projected cash flows using discount factors based on the zero-coupon Treasury yield curve. The guidelines also contain a detailed methodology developed by OTS that may be used by institutions to meet the two requirements above.

The guidelines state that institutions should continue to determine if a CMO floater is a suitable investment based on the current FFIEC approach. Institutions may also continue to use the current FFIEC approach for valuing fixed-rate CMOs.

OTS reported that as of December 1995, 152 thrift institutions held \$19 billion in CMO floaters, which represented 10 percent of their assets and 90 percent of all CMO floaters held by thrifts.

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The Office of Thrift Supervision (OTS), a bureau of the U.S. Treasury, regulates and supervises the nation's thrift industry. OTS' mission is to ensure the safety and soundness of thrift institutions and to support their role as home mortgage lenders and providers of other community credit and financial services. For copies of news releases or other documents call PubliFax at 202/906-5660, or visit the OTS web page at www.ots.treas.gov.