

## Press Releases

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OTS 98-90 - OTS Finalizes Derivatives Rule, Risk Management Guidance

### Office of Thrift Supervision

# NEWS

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For further information

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Contact: Paul Lockwood

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### **OTS Finalizes Derivatives Rule, Risk Management Guidance**

WASHINGTON, D.C., Dec. 1, 1998 - The Office of Thrift Supervision (OTS) today adopted new comprehensive guidance to aid savings associations in managing their risk. The guidance, covering interest rate risk, investment securities, and use of financial derivatives, is consolidated into a single comprehensive bulletin -- Thrift Bulletin 13a - which replaces seven existing OTS thrift bulletins.

OTS also replaced with a single rule three outmoded regulations on forward commitments, futures transactions, and financial options transactions that have remained virtually unchanged since they were first adopted during the period from 1979 to 1982. The new rule establishes general requirements applicable to all derivative instruments, and is designed to work with the bulletin, which provides the kind of specific guidance formerly contained in the regulations. OTS had taken the unusual step of putting the proposed bulletin out for public comment along with the rule. Based on 27 comments received on the proposed risk management policy guidance, a number of changes were made to Thrift Bulletin 13a. The two major changes were:

- the adoption of a less stringent set of quantitative guidelines as the starting point for examiners in their determination of an institution's Sensitivity to Market Risk [the "S"] component rating within the CAMELS rating system, and
- a reduction in the threshold for allowing institutions to use financial derivatives or other complex investment securities in ways that might not reduce the overall level of interest rate risk in their total portfolios.

OTS received no comments recommending any substantive changes to the proposed derivatives rule, and it was adopted without any substantive changes from the version proposed on April 23, 1998.

Both the final rule and the Thrift Bulletin 13a were published in today's edition of the Federal Register. The rule takes effect Jan. 1, 1999, and the bulletin is effective upon publication.

In response to one comment, OTS also announced that it will examine whether it should eliminate the interest rate risk component of its capital regulation in light of the tools that are currently available to measure and control interest rate risk.

The overriding goal of the derivatives rule is to ensure the safe and sound management of the risks associated with financial derivatives and, where possible, to reduce regulatory burden. Federal savings associations can continue to engage in transactions using derivative instruments, provided they are authorized to invest in the assets underlying the instrument, and the transaction is otherwise safe and sound. State-chartered associations may continue to use derivative instruments to the extent permitted by their charter and state law, and the transaction is otherwise safe and sound. The rule sets forth responsibilities of the board of directors and management with respect to financial derivatives, and makes clear that reducing risk exposure generally should be the reason thrifts enter into a transaction using a derivative instrument.

The comprehensive guidance contained in Thrift Bulletin 13a provides guidelines for examiners to use in evaluating the effectiveness of a thrift's risk management practices and identifies a set of "sound practices" that thrift management should consider to improve their own risk management practices. The bulletin describes the qualitative and quantitative guidelines examiners will use to rate an institution's exposure to interest rate risk - the "S" component of the CAMELS rating system. Since the "S" component rating reflects an assessment of both an institution's current exposure to interest rate changes and its ability to manage that exposure effectively, OTS will use the results of its Net Portfolio Value Model, where available, to measure the institution's current exposure. The final quantitative guidelines are less stringent than those in the proposed thrift bulletin, but still provide a common starting point to help examiners determine one of the two elements comprising the "S" component rating - the institution's current exposure to interest rate changes. A thrift's board of directors should frame interest rate risk limits for its institution in terms of its capital position (its economic capital-to-assets ratio). Investment securities and derivatives - particularly those having the potential to alter an institution's risk profile significantly - should be evaluated in terms of their impact on the institution's economic capital. Institutions with greater capacity to absorb potential losses have greater latitude in using derivatives and other complex financial instruments. Similarly, institutions having greater capacity to absorb shocks to their economic capital, all else being equal, will generally receive better "S" component ratings.

The guidance in TB 13a and the new regulation replace:

- regulations governing forward commitments (12 CFR 563.173)
- regulations governing futures (12 CFR 563.174)
- regulations governing options (12 CFR 563.175)
- Thrift Bulletin 13 -- Responsibilities of the Board of Directors and Management with Respect to Interest Rate Risk
- Thrift Bulletin 13-1 (Implementation of Thrift Bulletin 13)
- Thrift Bulletin 13-2 (Implementation of Thrift Bulletin 13)
- Thrift Bulletin 52 (Supervisory Statement of Policy on Securities Activities)
- Thrift Bulletin 52-1 ("Mismatched" Floating Rate CMOs),
- Thrift Bulletin 65 (Structured Notes), and
- New Directions Bulletin 95-10

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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](http://www.ots.treas.gov).