characteristics. These characteristics make it difficult to adequately measure these products in a standardized model without collecting detailed transaction-oriented data.

Self-reporting of market value sensitivities generally would be required for the following products or portfolios:

(1) All mortgage-backed derivative securities that meet the FFIEC's definition of ''high-risk.'' [2]

(2) All structured notes, as defined in the Call Report instructions;

(3) Non-high-risk mortgage derivative securities when those holdings represent 10 percent or more of a bank's assets.

(4) Mortgage servicing rights that are capitalized and reported on the bank's balance sheet;

(5) Off-balance-sheet interest rate options, caps, and floors, including interest rate swaps with embedded option characteristics.

The agencies believe that given the potential price sensitivity of these products or portfolios to interest rate changes, it is reasonable to expect banks to be able to calculate or obtain reliable estimates of their market value sensitivities. Industry comments on the availability of such information are especially welcomed.

d. *Trading account portfolios.* The agencies also propose to change the manner in which trading account positions are treated in the supervisory model. These changes are in response to commenters concerns regarding the burden associated with distributing trading positions into the maturity ladder and applying a 200 basis point rate shock to those positions.

As modified, banks will be asked to self report the change in the economic value of all of their trading account positions for a 100 basis point parallel increase or decrease in interest rates. This rate change, smaller than the 200 basis point change used for the rest of the bank's holdings, reflects the shorter holding period typical for trading account positions. It also is similar to the 100 basis point scenario used by the Basle Committee on Banking Supervision (Basle Committee) in its April 1995 proposal on capital requirements for the market risks of traded debt securities.[3]

The agencies believe the self-reporting treatment for trading accounts is consistent with supervisory guidance issued by each of the agencies that directs banks with significant trading activities to have internal risk measurement and limit systems commensurate with the size and complexity of their activities.

As previously noted, the Basle Committee has recently released for comment a proposal to incorporate the market risks of trading activities into the Basle Accord risk-based capital standards.[4] The agencies published in the **Federal Register** on July 25, 1995 (60 FR 38082) a notice of proposed rulemaking on the Basle market risk proposal. If the agencies adopt a final rule to implement the Basle market risk proposal for banks with a large concentration of trading activities, the agencies anticipate that modifications to this policy statement will be required to ensure that IRR exposures arising from those activities are not ''double-counted.'' One approach that the agencies are considering is to exclude trading activities from this proposed policy statement and IRR measure for those banks that are subject to the market risk proposal. If such an approach is adopted, those banks would be exempted from having to report the changes in the market value of their trading portfolios for the IRR measure. If, however, a bank's trading portfolio offsets the exposure from other components of the bank's balance sheet, this treatment would overstate the bank's total IRR exposure.

e. *Supplemental modules.* The final modification made by the agencies to the supervisory model structure is the development of supplemental modules for fixed-rate and adjustable-rate residential mortgage loans and pass-through securities. A bank whose holdings of these products exceeds certain threshold levels will be required to report additional information on those holdings in their Call Report submissions. The agencies will apply expanded tables of risk-weights to those portfolios. The supplemental module for fixed-rate residential mortgages requires a bank to stratify its balances into eight coupon ranges. The agencies have developed separate risk-weights for each coupon range which reflect the differences in expected prepayment speeds that are associated with the underlying coupon rates. To develop these risk-weights, the agencies have used the September 30, 1994 pricing tables generated by the Office of Thrift Supervision's Net Portfolio Value Model.[5] The agencies will apply this supplemental module and associated risk-weights when a bank's holdings of fixed-rate residential mortgage loans and pass-through securities represent 20 percent or more of its total assets. Schedule 2 in the attached policy statement illustrates the information that will be used in the supplemental module for fixed-rate residential mortgages. This expanded module will be optional for a bank whose holdings of these instruments are less than 20 percent of its assets.

Two levels of supplemental modules have been developed by the agencies for adjustable-rate residential mortgages. The first level, illustrated by Schedule 3 in the attached policy statement, requires information on ARMs to be stratified by reset frequency (as in the baseline model), periodic caps, and the ARMs' distances from lifetime caps. This module will be used by the agencies when a bank's ARM holdings are greater than 10 but less than 25 percent of its assets. The second level, illustrated by Schedule 4 in the attached policy statement, requires that ARM balances be further stratified by the underlying rate index of the ARM. This module will apply to banks whose holdings equal or exceed 25 percent of their total assets. The agencies have developed risk-weights that correspond with each various reset frequency, lifetime cap, periodic cap, and, index combination, again using pricing tables generated from the OTS Net Portfolio Value Model.

The agencies are mindful that many commenters to the September NPR raised concerns about tradeoffs between attempts to improve the supervisory model accuracy and associated reporting burdens, especially with regards to the use of the OTS model. Nonetheless, the agencies believe the distribution of coupons for fixed-rate mortgage portfolios and the interaction of the parameters illustrated in Schedules 3 and 4 significantly affect the price sensitivity of mortgage loans and securities. The agencies believe that by explicitly considering these parameters, the supplemental modules will enhance the accuracy of the supervisory model. The agencies believe that this increased accuracy is

---

[2] Effective February 10, 1992, the agencies and the Office of Thrift Supervision adopted revised supervisory policies on securities activities that were developed under the auspices of the FFIEC. The revised policies established a framework for identifying ''high-risk mortgage derivative products.''

[3] The Basle Committee on Banking Supervision is a committee of banking supervisory authorities which was established by the central-bank Governors of the Group of Ten countries in 1975.

[4] The Committee's proposal is described in a consultative paper, entitled ''Planned Supplement to the Capital Accord to Incorporate Market Risks,'' issued in Basle, Switzerland on April 12, 1995. Copies of that paper may be obtained by contacting: The OCC's Communications Division, Ninth Floor, Office of the Comptroller of the Currency, 250 E Street, S.W., Washington, D.C. 20219. A copy of the paper also is available at the FDIC Reading Room, 550 North 17th Street, NW, Washington, D.C.

[5] Appendix 4 of the policy statement provides a description of the derivation of the risk-weights for the baseline supervisory model and supplemental modules.