policy statement.¹ Accordingly, all savings associations now follow SFAS No. 115 for regulatory reporting purposes. Associations reflect unrealized gains and losses on all available-for-sale securities (debt as well as equity), rather than just the net unrealized losses on marketable equity securities, as a separate capital component for regulatory reporting purposes.

II. OTS Proposed Rule and Interim Policy

The issuance of SFAS No. 115 raised the question of how net unrealized gains and losses on available-for-sale securities should be treated for purposes of calculating the amount of an association's regulatory capital under part 567. In its August 16, 1993 policy statement, the OTS permitted savings associations to adopt SFAS No. 115 for both financial reporting and capital purposes as early as June 30, 1993. This early adoption option was expressly permitted by SFAS No. 115, which did not become mandatory until the fiscal year beginning after December 15, 1993.

On June 22, 1994, the OTS published its proposal to amend the OTS capital rule to include the SFAS No. 115 capital component in core capital, replacing the superseded SFAS No. 12 component.² The other Agencies, the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board (FRB), and the Federal Deposit Insurance Corporation (FDIC), published similar proposals to adopt SFAS No. 115 for regulatory capital purposes.³ The stated rationale for these proposals was to conform the Agencies' capital regulations to GAAP and to include unrealized gains and losses on available-for-sale debt and equity securities in regulatory capital.

In its June 22, 1994 notice of proposed rulemaking, the OTS requested comment on all aspects of the proposed rule, and specifically solicited comment on whether unrealized gains and losses under SFAS No. 115 should be included in core capital for purposes of the leverage ratio requirement, for purposes of the risk-based capital requirements and for purposes of Prompt Corrective Action (PCA).⁴ The OTS also specifically solicited comment on what changes, if any, in asset liability management or risk management would likely result from the inclusion of SFAS No. 115 unrealized gains and losses in capital and whether such changes would increase or decrease risk to the Savings Association Insurance Fund (SAIF).⁵

The proposal's comment period closed on July 22, 1994. After consideration of the comments received and in anticipation of its final rule, the OTS issued a November 28, 1994 interim policy statement, which provided that the SFAS No. 115 capital component could no longer be included in regulatory capital.⁶

III. Comment Summary

In response to its notice of proposed rulemaking, the OTS received 10 comments: five from savings associations, one from a commercial bank, one from a state-chartered savings bank, two from financial institution trade associations. and one from an investment banking firm. Eight of the commenters generally opposed the OTS proposal, while two commenters strongly supported the proposal. The OTS has also considered the comments received by the other federal banking agencies in working with the other agencies to develop a consistent interagency position on SFAS No. 115.

A. Comments Opposing a SFAS No. 115 Component

Commenters opposing the proposal raised a number of common concerns. Their primary concern was a belief that the proposal would distort the true picture of savings associations' core capital. These commenters reasoned that the SFAS No. 115 capital component has less bearing on their institutions' financial strength than the institutions' more permanent base of common stock, paid-in surplus and retained earnings. Under SFAS 115, changes in interest rates could dramatically affect institutions' capital positions without affecting their amount of common stock and retained earnings and without them suffering any losses through their income statements.

Commenters asserted that another distortion arises because SFAS No. 115 requires that the change in fair value of securities subject to SFAS No. 115 be included in GAAP capital, but does not require that any offsetting changes in the value of associations' deposit bases and hedging instruments be included in GAAP capital.

A second related concern of commenters objecting to the proposal was that adopting the proposal would result in excessive volatility in associations' regulatory capital levels and present an inaccurate picture of associations' long-range viability. Commenters observed that associations' capital levels would change with temporary movements in interest rates, which in turn cause temporary changes in a security's market value. Commenters argued that associations may have sufficient capital and liquidity to give them the discretion to determine not to sell those securities when the market is unfavorable. These commenters submitted that because associations would not be forced to sell their available-for-sale securities in a market trough, they should not be required to include those unrealized losses on securities in their regulatory capital calculations. Such inclusion could result in volatile temporary fluctuations in the associations' regulatory capital levels, which in turn could trigger more permanent regulatory limitations and subject associations to increased deposit insurance premiums or PCA sanctions. These commenters argued that in the worst case, some associations with the ability to survive a temporary market trough might be forced into receivership because of unrealized losses in their SFAS No. 115 capital component.

A number of commenters stressed that associations might take steps to avoid unrealized losses that could harm their long-term financial viability. Some commenters said that associations would purchase shorter duration securities to avoid the greater volatility in the value of longer term securities. This action would lower the yield on associations' securities and reduce the net income that they could add to their retained earnings. Some commenters added that associations would have the incentive to make up for this lower yield by increasing the credit risk in their portfolios. This strategy would increase associations' yield in a potentially dangerous way not captured by SFAS No. 115 without necessarily affecting their reported capital levels.

Some commenters also contended that because SFAS No. 115 only applies to securities, associations would avoid

¹ See letter of August 16, 1993, from Acting Director Fiechter to the Chief Executive Officers of Savings Associations.

² 59 FR 32143 (June 22, 1994).

³ See 59 FR 18328 (April 18, 1994) (OCC); 58 FR 68563 (December 28, 1993) (FRB); 58 FR 68781 (December 29, 1993) (FDIC).

⁴ See 59 FR at 32144. The OTS's risk-based capital requirements are located at 12 CFR Part 567 and its PCA requirements are located at 12 CFR Part 565.

⁵ See 59 FR at 32144.

⁶See letter dated November 28, 1994, from Acting Director Fiechter to the Chief Executive Officers of Savings Associations, which revised the August 16, 1993 interim policy statement (permitting associations to adopt SFAS No. 115 for financial reporting and capital purposes). The November 28 policy statement gave associations the option either to follow the revised policy for submission of their December 1994 Thrift Financial Reports (TFRs), or to defer implementation as late as submission of their June 1995 TFRs. The OTS provided this optional transition period to give associations sufficient time to plan for the effects of the revised policy on their regulatory capital and to take any appropriate business actions.