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Savings associations capital requirements for rate contracts covered by bilateral netting agreements under the attached rule proposed by the Office of Thrift Supervision (OTS).

A bilateral netting agreement is a master contract between two parties, for example, two savings associations, which enter into various interest rate and exchange rate contracts with each other to protect themselves from possible market losses. They may agree, for instance, to exchange interest payments on identical amounts of principal, swapping a fixed rate for a variable rate.

Traditionally, depending on which way the market moves, Party A would have to pay everything it owes to Party B and vice versa. But under a bilateral netting contract, the parties agree to total all the amounts owed each other under their off-balance sheet netting arrangements and pay only the difference, or net, of all the deals.

One result is that both parties are required to hold risk-based capital against only the net amount of their exposure, not the entire amount.

Under current regulations, only identical types of contracts with the same settlement dates may be netted in computing capital requirements.

The proposed change would broaden that concept to allow netting, for capital purposes, of all rate contracts, as long as:

between the same two parties,

- only interest rate contracts or exchange rate contracts are netted for capital purposes, and
- the bilateral netting contract would be upheld by the courts of relevant jurisdictions.

In calculating required risk-based capital, these off-balance sheet rate contracts are marked to market before the amounts each party owes the other are netted.

The OTS proposal parallels recent amendments proposed by the Federal Reserve and the Comptroller of the Currency and is consistent with proposed revisions to the international Basle Accord.

The notice of proposed rulemaking was published in the June 14, 1994 edition of the *Federal Register*, Vol. 59, No. 113, pp. 30538-30543. Written comments must be received on or before July 14, 1994, and should be addressed to: Director, Information Services, Public Affairs Office, Office of Thrift Supervision, 1700 G Street, N.W., Washington, DC 20552.

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Attachment