PRESS RELEASE
Federal Deposit Insurance Corporation

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INTERIM REGULATORY REPORTING AND CAPITAL GUIDANCE ON FAS 133, "ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES"

FOR IMMEDIATE RELEASE

The Reports Task Force of the Federal Financial Institutions Examination Council (FFIEC), acting under delegated authority, is announcing its decisions regarding the appropriate regulatory reporting treatment for derivatives. The Office of Thrift Supervision and the Federal Reserve Board have reached similar reporting decisions for the savings associations and bank holding companies that they supervise.

Additionally, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (the agencies) are describing the appropriate interim regulatory capital treatment of derivatives for banks, bank holding companies, and savings associations (collectively, banking organizations).

The agencies are taking these actions in response to the June 1998 issuance of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133). Although FAS 133 does not become effective until fiscal years beginning after June 15, 1999, banking organizations may adopt the standard early. This new accounting standard requires that all derivatives be recorded on the balance sheet as assets or liabilities at their fair value. In addition, it significantly changes the accounting for derivatives used for hedging purposes and for financial instruments with certain types of embedded derivatives. These new accounting requirements may affect the amount of a banking organization's recorded assets, liabilities, and equity, and corresponding regulatory capital levels.

The agencies are issuing the attached interim guidance to explain how derivatives should be reported in the bank Reports of Condition and Income (Call Report), the Consolidated Financial Statements for Bank Holding Companies (FR Y-9C), and the Thrift Financial Report (TFR), and treated under the agencies' existing capital standards after a banking organization adopts FAS 133.

Regulatory Reporting

For purposes of the Call Report, FR Y-9C, and TFR, changes in the fair value of many derivatives are to be reflected in net income. However, FAS 133 requires that the effective portion[1] of the change in the fair value of derivatives used in certain types of hedges (cash flow hedges) be excluded from net income and reflected on the balance sheet in a separate component of equity (referred to as "accumulated other comprehensive income" in FAS 133). For banks and bank holding companies, until any revisions are made to the relevant regulatory reports, those accumulated changes in fair value should be reported on the same Call Report and FR Y-9C lines that are used to report net unrealized holding gains (losses) on available-for-sale securities. For savings associations, those accumulated changes in fair value should be reported on the same TFR line that is used to report other components of equity capital.

Regulatory Capital

Until the agencies determine otherwise, the separate component of equity resulting from cash flow hedges should not be included in (i.e., should be excluded from) regulatory capital. Additionally, the existing risk-based capital treatment for derivatives remains in effect, pending further review. In other words, recording a derivative on the balance sheet under FAS 133 will not change the risk-weighted asset amount for that derivative. The implementation of FAS 133, however, may still affect an institution's regulatory capital. Changes in the fair value of derivatives that are recognized in net income will be included in undivided profits (retained earnings for bank holding companies and savings associations), which is a component of Tier 1 capital. Furthermore, the on-balance-sheet reporting of derivatives may affect the total assets reported by banking organizations with derivatives, directly affecting the institution's leverage ratio.

The agencies are evaluating the impact of FAS 133 on regulatory reporting and capital in conjunction with other supervisory issues. However, pending the completion of that analysis, banking organizations should follow the regulatory reporting guidance and capital treatment summarized above and more fully described in the attachment.

[1] In general, the effective portion of a hedge is best described as the change in fair value on the derivative that offsets the change in expected cash flows on the hedged item.

Attachment: Interim Guidance on the Regulatory Reporting and Capital Treatment for Derivatives, December 1998

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