

b. Aggregation Rules

Using Schedule RED simplifies the aggregation of data thrifts supply. At present, the conversion of accounting data to CMR fields often involves awkward aggregation rules. For example, balances of fixed-rate fixed-maturity deposits (FRFMD) are reported in buckets that depend on both original and remaining maturity. At the same time, balances on *brokered* FRFMD (a subset of the total) are bucketed only by original maturity. This reduces the number of cells on the form by requiring differential aggregation procedures be applied to total vs. brokered balances.

Moreover, many aggregations must be “unwound” within the NPV model by applying assumptions about how the aggregation should, or might, have occurred. Such derived disaggregations inevitably result in less accurate estimates. The crucial difference between proposed Schedule RED’s system of aggregation and that applied on the CMR is that the RED Schedule’s aggregation rules (described below) are set in the written instructions, rather than being built into the structure of the form itself. The upshot is that adjustments to the aggregation rules—to increase or decrease the level of detail collected—will be significantly simpler, as they would not affect the structure of the form or the definitions of the fields.

Schedule RED allows a wide range of possibilities for aggregating position information. For example, at one extreme, if institutions so chose, RED could allow contract-by-contract reporting of all loans in the portfolio and account-by-account reporting of deposits. At the other extreme, Schedule RED could accept highly aggregated positions, representing large segments of the portfolio as single position entries.⁴

Schedule RED will however constrain the degree of aggregation. In other words, Schedule RED imposes a maximal degree of position aggregation (or, equivalently, a minimum degree of granularity). Under this proposal, reporting institutions could potentially break positions down into more detail than required by the aggregation constraint (possibly down to the contract-by-contract level), but never less. Here are the proposed maximum aggregation limits for fixed-rate mortgages:

Maximum Aggregation Constraints

Aggregation Rule: Mortgages and MBS that match simultaneously on *all* of

the following criteria can be aggregated together and reported as a single position:

1. Mortgage and MBS:
 - 30-year mortgage loans
 - 30-year MBS backed by conventional mortgages
 - 30-year MBS backed by FHA or VA mortgages
 - 15-year mortgage loans
 - 15-year MBS
 - Balloon mortgage loans
 - Balloon MBS
2. Coupon buckets (in quarter-point increments, as follows):
 - 0.00 to 0.25%
 - 0.26 to 0.50%
 - 0.51 to 0.75%
 - 0.76 to 1.00%
 - 1.01 to 1.25%
 - Etc.

3. [IF SUBMITTED] Borrower credit rating type

4. [IF SUBMITTED] 5-digit zip code

Mortgages or MBS that differ in *any* of the above criteria cannot be aggregated together into the same position. NOTE: The aggregation (*i.e.*, bucketing) rules are subject to change.

There are two reasons for such constraints. First, to support current legacy applications, and to track industry trends over time, it must be possible for OTS to convert data submitted in the new RED Schedule back into the legacy CMR format. As a result, Schedule RED must always be at least as detailed as Schedule CMR. Second, OTS would like to see the benefit of the increased reporting detail that Schedule RED allows.

OTS is contemplating allowing any filing firm to submit non-aggregated data (that is, account-by-account position data). OTS anticipates that many filers may find this latter option very attractive, as it alleviates the burden of maintaining programming logic and operator intervention necessary to calculate the aggregations. It may also result in cost reductions when providing the requested information.

4. New Attributes for Loans

Schedule RED includes several new fields measuring basic loan attributes, such as loan-to-value (LTV), borrower credit rating, and collateral. The three largest potential benefits from this innovation are the improvement in OTS’s ability to calibrate the NPV model,⁵ assess interest rate risk in relation to portfolio risk attributes, and

the possibility that the NPV model could someday provide OTS institutions with an analytical toolkit that approximates the Basel II internal-models approach. This could, after further comment and review, and consistent with systems developed by the other federal banking agencies, open the door for OTS-regulated institutions to qualify for more risk-sensitive capital treatment for their mortgage and retail assets in a manner analogous to the evolving standards of Basel II. There is clearly much to be done before such analytics could be deployed, but the underlying credit-quality data would be needed during the development and testing phases, well before any deployment.

One area where the availability of these new dimensions could improve the quality of the interest-rate risk measurement involves credit spreads on loans. Currently, we are forced to assume a fixed, one-size-fits-all credit spread for all institutions, implicitly assuming that none of the observed differences in interest rates across institutions is due to risk. With credit-quality information, we can realistically assign credit-risk-adjusted discount rates to cash flows in the model, improving the quality of the final NPV measurement.

OTS recognizes that some reporting institutions may be reluctant or unable to provide new loan attributes, as these have not been reported heretofore on the TFR. As a result, OTS proposes that reporting of these attributes under Schedule RED be optional.

B. Side-by-Side Comparison of Schedules RED and CMR

To assist the industry in assessing the impact of the proposed RED schedule, this section uses FRMs to exemplify the differences between current CMR procedures and the proposed Schedule RED. The relevant sections of Schedule CMR (pages 30 and 34 of the TFR) and of Schedule RED (FRM and loan memoranda tables) are attached here for reference (See <http://www.ots.treas.gov/docs/78155.pdf> for the full CMR form). In addition, included is a table that provides a full side-by-side comparison of the two schedules.

Schedule RED

⁴ Again, this is in contrast to Schedule CMR, for which the degree of aggregation of position information is built into the structure of the form

itself. This inflexibility is one of the motivations for moving to Schedule RED.

⁵ For example, cash-out refinancing tends to create higher prepayment speeds for low-LTV mortgages.