Supporting Statement

Supervisory Guidance: Supervisory Review Process of Capital Adequacy (Pillar 2) Related to the Implementation of the Basel II Advanced Capital Framework

OMB Control No. 1557-0242

Summary

The Paperwork Reduction Act (PRA) classifies reporting, recordkeeping, or disclosure requirements of agency guidance as an "information collection."[1] On February 28, 2007, the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Reserve Board (Board), and the Federal Deposit Insurance Corporation (FDIC), (the agencies) published proposed supervisory guidance in the Federal Register for public comment,[2] and on July 31, 2008, the agencies published final guidance.[3]

This guidance assists financial institutions implementing revisions to the risk-based capital standards in the United States (New Advanced Capital Adequacy Framework or proposed framework). These revisions were published in the Federal Register on September 25, 2006 as a notice of proposed rulemaking[4] and on December 7, 2007 as a final rule.[5] This supervisory guidance provides additional detail for the supervisory review process that should help institutions satisfy the qualification requirements in the rule.

The proposed supervisory guidance included the Internal Ratings Based (IRB) and Advanced Measurement Approaches (AMA), as well as Pillar 2. The final guidance covers only Pillar 2. The IRB and AMA portions of the proposed guidance were directly related to the information collection requirements in the final rule. The agencies also believe that the burden estimates developed for the proposed and final rules adequately covered the additional specificity contained in the proposed IRB and AMA guidance.

For the Pillar 2 portion of the guidance, the agencies believe that paragraphs 37, 41, 43, and 46 impose information collection requirements that are beyond the scope of the burden estimates developed for the final rule.

A. JUSTIFICATION:

1. Circumstances that make the collection necessary:

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[1] 44 U.S.C. § 3501 et seq.
[2] (72 FR 9084).
[3] 73 FR 44620 (July 31, 2008).
[4] 71 FR 55830.
[5] 72 FR 69288.

Section 1831(o) of the Federal Deposit Insurance Act requires each Federal banking agency to adopt a prompt corrective action framework.

Basel II sets forth a three-pillar framework based on regulatory risk-based capital requirements (Pillar 1); supervisory review of capital adequacy (Pillar 2); and market discipline through enhanced public disclosures (Pillar 3). Basel II requires a process for the supervisory review of capital adequacy under Pillar 2. The rule describes the qualification process and provides qualification requirements for obtaining supervisory approval for use of the advanced approaches.[6] The qualification requirements are written broadly to accommodate the many ways an institution may design and implement robust credit and operational risk measurement and management systems, and to permit industry practice to evolve.

The supervisory guidance provides additional detail that should help institutions satisfy the qualification requirements in the final rule. The Agencies believe that the supervisory guidance documents are necessary to supplement the framework with standards to promote safety and soundness and encourage comparability across institutions. An institution's primary Federal supervisor will review the institution's framework relative to the qualification requirements in the final rule to determine whether the institution may apply the advanced approaches and has complied with the proposed rule in determining its regulatory capital requirements.

2. Use of the information:

The Pillar 2 guidance requires respondents to maintain certain documentation as described in sections 37, 41, 43 and 46 of the guidance. A description of the requirements for each section is provided below. Examiners will verify compliance with this recordkeeping requirement during examinations.

Section 37. Various definitions of institution capital are used within the banking industry. An institution should state clearly the definition of capital used in any aspect of its internal capital adequacy assessment process (ICAAP). Since components of capital are not necessarily alike and have varying ability to absorb losses, an institution should be able to demonstrate the relationship between its internal capital definition and its assessment of capital adequacy. The bank should document any changes in its internal definition of capital, and the reason for those changes.

Section 41. Banks should have thorough documentation covering the ICAAP. At a minimum, this documentation should include a description of the overall process, including committees and individuals responsible for the ICAAP, the frequency of ICAAP-related reporting, and procedures for the periodic evaluation of the appropriateness and adequacy of ICAAP. If applicable, ICAAP documentation should demonstrate the institution's sound use of quantitative methods, including model selection and limitations, and data–selection techniques, as well as appropriate maintenance, controls, and validation. An institution should document and explain the

[6] See part III, section B. of the final rule 72 FR 69302 (Dec. 7, 2007).

role of third-party and vendor products, services and information – including methodologies, model inputs, systems, data, and ratings – and the extent to which they are used within the ICAAP. An institution should have a process to regularly evaluate the performance of third-party and vendor products, services and information. An institution should document the assumptions, methods, data, information, and judgment used in its quantitative and qualitative approaches.

Section 43. The board of directors and senior management have certain responsibilities in developing, implementing, and overseeing the ICAAP. The board should approve the ICAAP and its components, review the ICAAP and its components on a regular basis, and approve any revisions. This review should encompass the effectiveness of the ICAAP, the appropriateness of risk tolerance levels and capital planning, and the strength of control infrastructures. Senior management should continuously ensure that the ICAAP is functioning effectively and as intended, under a formal review policy that is explicit and well documented. An institution's internal audit function should play a key role in reviewing the controls and governance surrounding the ICAAP on an ongoing basis.

Section 46. As part of the ICAAP, the board or its delegated agent, as well as appropriate senior management, should periodically (at least annually) review the resulting assessment of overall capital adequacy. This review should include an analysis of how measures of internal capital adequacy compare with other capital measures, such as regulatory, accounting-based or market-determined. Upon completion of this review, the board or its delegated agent should determine that, consistent with safety and soundness, the institution's capital takes into account all material risks and is appropriate for its risk profile. In the event a capital deficiency is uncovered, management should consult and adhere to formal procedures to correct the capital deficiency.

3. Consideration of the use of improved information technology:

An institution may use any means of improved information technology that meets these requirements.

4. Efforts to identify duplication:

The information required is not otherwise available to the OCC.

5. Minimizing burden on small entities:

The collection of information does not have a significant impact on a substantial number of small entities.

6. Consequences of less frequent collection:

The OCC will not be able to adequately monitor capital levels and ensure safety and soundness.

7. Special circumstances necessitating collection inconsistent with 5 CFR part 1320:

This information collection is conducted in accordance with OMB guidelines in 5 CFR 1320.

8. Consultation with persons outside the agency:

On April 21, 2011 the OCC, FRB, FDIC, and OTS issued a 60-Day Federal Register notice seeking comment on the renewal of the information collection. 76 FR 22450. No comments were received.

9. Payment or gift to respondents:

None.

10. Any assurance of confidentiality:

While there are no statutory assurances of confidentiality, the information will be kept confidential to the extent permitted by law.

11. Information of a sensitive nature:

This collection of information contains no questions of a sensitive nature, as defined by OMB guidelines.

12. Burden estimate:

The total annual burden for the Pillar 2 portion of the guidance is 7,140 hours, as shown in the table below. The OCC estimates that it will take each respondent 140 hours to complete the documentation requirements.

Number of respondents	Estimated annual frequency	Estimated response time	Estimated annual burden hours
51	1	140 hours	7,140

Based on a rate of $100 per hour, the estimated cost to the public for this information collection is $714,000.

13. Estimate of annualized costs to respondents:

Not applicable.

14. Estimate of annualized costs to the government:

Not applicable.

15. Changes in burden:

Former burden: 52 respondents; 1 response per year; 140 hours per response; total burden 7,280 hours

Current burden: 51 respondents; 1 response per year; 140 hours per response; total burden 7,140 hours

Difference: - 1 respondents; - 140 total burden

The prior burden reflected only national banks. On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203, 124 Stat. 1376 (2010) (Dodd-Frank Act) was enacted. Dodd-Frank Act transferred the powers, authorities, rights and duties of the Office of Thrift Supervision to other banking agencies, including the OCC, on July 21, 2011. The Dodd-Frank Act also abolishes the OTS ninety days after the transfer date. As a result of the Dodd-Frank Act, OCC is revising its number of respondents to include the thrift institutions it now regulates. The prior number of respondents (52) was reduced by 4 to 48 due to the decrease in the number of national banks since the last renewal and then increased to 51 to reflect the addition of 3 thrifts, resulting in a net decrease.

16. Information regarding collections whose results are planned to be published for statistical use:

Because the documentation required by the guidance is a recordkeeping requirement, copies of the documentation are not collected by the OCC and are not published. These recordkeeping requirements are documented on occasion. Examiners will verify compliance with this recordkeeping requirement during examinations.

17. Display of expiration date:

Not applicable.

18. Exceptions to certification statement:

Not applicable.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS:

Not applicable.