Supporting Statement
Market Risk Capital Requirements
New Collection (OMB No. 3064-0178)

A. Justification

This statement supports a request for OMB to approve the collections of information contained in a Final Rule that amends the market risk capital requirements of the FDIC. The Final Rule is sponsored jointly by the FDIC, the Federal Reserve, and the Office of the Comptroller of the Currency (the agencies). The amendments are based on 2005, 2009, and 2010 amendments to the June 2004 Basel Committee of Banking Supervision's (BCBS's) final paper entitled *International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel II). The revised framework recognizes developments in financial products, incorporates advances in risk measurement and management practices, and assesses capital requirements that are generally more sensitive to risk.

On January 11, 2011, the agencies issued a joint notice of proposed rulemaking (January 2011 proposal) that sought public comment on revisions to the agencies' market risk capital rules to implement the 2005, 2009, and 2010 revisions to Basel II.[1] The key objectives of the proposal were to enhance the rule's sensitivity to risks not adequately captured, including default and credit migration; enhance modeling requirements in a manner that is consistent with advances in risk management since the agencies' initial implementation of the MRA; modify the definition of "covered position" to better capture positions for which treatment under the rule is appropriate; address shortcomings in the modeling of certain risks; address procyclicality; and increase transparency through enhanced disclosures. When publishing the January 2011 proposal, the agencies did not propose to implement those aspects of the 2005 and 2009 revisions that rely on the use of credit ratings due to certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act).[2] The January 2011 proposal did not include new specific risk add-ons but included as an interim solution the treatment under the agencies' current market risk capital rules. Subsequently, after developing and considering alternative standards of creditworthiness, the agencies issued in December 2011 a joint notice of proposed rulemaking (NPR) that amended the January 2011 proposal (December 2011 amendment) to include alternative methodologies for

[1] 76 FR 1890 (January 11, 2011).

[2] Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010). Section 939A(a) of the Dodd-Frank Act provides that not later than 1 year after the date of enactment, each Federal agency shall: (1) review any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and (2) any references to or requirements in such regulations regarding credit ratings. Section 939A further provides that each such agency "shall modify any such regulations identified by the review under subsection (a) to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations." *See* 15 U.S.C. 78o–7 note.

calculating the specific risk capital requirements for covered debt and securitization positions under the market risk capital rules, consistent with section 939A of the Dodd-Frank Act. The agencies are now adopting a final rule, which incorporates comments received on both the January 2011 proposal and December 2011 amendment and includes aspects of the BCBS's 2005, 2009, and 2010 revisions (collectively, the MRA revisions) to the market risk framework.

The collection requires respondents to (1) clearly define policies and procedures for determining which trading assets are trading positions; (2) clearly define a trading and hedging strategy for trading positions approved by senior management; (3) clearly define policies and procedures for active management of all covered positions; (4) at least annually review its internal models in light of developments in financial markets and modeling technologies, enhancing them as appropriate; (5) at least annually audit and report to the institution's board of directors the effectiveness of controls supporting the bank's market risk measurement systems; (6) backtest each of its most recent 250 business days' trading losses with corresponding daily VaR-based measures and at least once each quarter identify the number of exceptions that have occurred over the preceding 250 business days; (7) demonstrate to the FDIC's satisfaction the appropriateness of any proxies used to capture the risks of the bank's actual positions for which such proxies are used in calculating a VaR-based measure of general market risk of all covered positions; (8) retain and make available to the FDIC certain information for each subportfolio used for backtesting purposes; (9) define policies and procedures that describe how it determines the period of significant financial stress used to calculate the institution's stressed VaR-based measure and notify the FDIC of any material changes to the policies and procedures; (10) use one of several methods to measure the specific risk for each of its debt, equity, and securitization positions with specific risk; (11) obtain the FDIC's prior approval to include portfolios of equity positions in its incremental risk model for measuring the specific risk of a portfolio of debt positions; (12) obtain the FDIC's prior approval to use any of certain specified methods to measure comprehensive risk (i.e., all price risk) for one or more portfolios of correlation trading positions; (13) retain and make available to the FDIC the results of supervisory stress testing, including comparisons with the capital requirements generated by the institution's comprehensive risk model; (14) demonstrate to the FDIC's satisfaction a comprehensive understanding of the features of a securitization position that would materially affect the performance of the position, including conducting and documenting an analysis of the risk characteristics of a securitization position prior to acquiring the position, and no less frequently than quarterly evaluate and update as appropriate the analysis of risk characteristics for each securitization position; (15) publicly disclosure each quarter certain market risk information regarding the institution's capital adequacy and risk profile; (16) adopt a formal disclosure policy, approved by the institution's board of directors, that addresses associated internal controls and disclosure controls and procedures; (17) publicly disclose at least quarterly certain quantitative information for each portfolio of covered positions; and (18) publicly disclose at least annually, or more frequently in the event of material changes, certain qualitative information for each of its covered positions. These requirements are described in Sections 3(a)(1), 3(a)(2), 3(b)(1), 3(c)(4), 3(d)(4), 4(b),

5(a), 5(c), 6, 7, 8, 9(a), 9(c), 10(d), 11(a), 11(b), 11(c), and 11(d) of the NPR. All of these requirements require ongoing compliance. Some of them will be heavily front-loaded. For example, policy and procedures will be written initially and then updated occasionally, as activity requires, likely on an annual basis. Many of the requirements specify either quarterly or annual time periods. For example, sections 4(b), backtesting; 10(d), demonstration of securitization positions; 11(a), quantitative market risk disclosures; and 11(c), quantitative disclosures for each portfolio of covered positions, are quarterly requirements. Other information on trading positions is maintained on a daily basis, but is only made available to the FDIC during examinations and upon request. Details of the estimated burden for each section are provided below.

1. Circumstances and Need

The information collection revises the definition of positions subject to the market risk risk-based capital requirements to reduce regulatory arbitrage between the market risk and the credit risk capital frameworks. It introduces an incremental risk capital requirement to capture default and credit-quality migration risk for non-securitization credit exposures. Further, the collection adds a stressed Value-at-Risk-based capital requirement to banks' general Value-at-Risk-based capital requirement of the existing rule. In addition, the collection will permit banks to use internal models to measure all price risk for correlation trading positions. Finally, it will impose more conservative capital requirements and enhanced disclosure requirements for securitization positions.

2. Use of the Information

The FDIC will use the data in this proposed collection to assess the adequacy of a bank's capital held to cover exposure to market risk associated with foreign exchange and commodity positions and positions located in the trading account.

3. Use of Technology to Reduce Burden

Respondents may use any available technology to reduce burden.

4. Efforts to Identify Duplication

For a number of reasons, including a desire to identify possible duplication in this collection, the agencies are seeking comment for an extended period of time (90 days). The agencies believe the information in this collection is not otherwise available.

5. Minimizing the Burden on Small Entities

This collection of information does not affect small entities; only the largest institutions will be affected.

6. Consequence of Less Frequent Collections

Less frequent collection would prevent the agencies from adequately monitoring capital levels in affected institutions.

7. Special Circumstances

The proposed recollection does not involve any special circumstances.

8. Consultation with Persons Outside the FDIC

The agencies participated with other members of the Basel Committee during the development of the Basel Committee's 2004 final paper. In addition, the January 2011 NPR was open for public comment for a 90-day period and the December 2011 amendment to the January NPR was open for public comment for a 45-day period. The agencies received six comment letters on the January 2011 proposal and 30 comment letters on the December 2011 amendment from banking organizations, trade associations representing the banking or financial services industries, and other interested parties. None of the comments addressed the agencies' burden estimates.

Commenters to the January 2011 NPR expressed general support for the proposed revisions to the agencies' market risk capital rules, although many noted that the BCBS's market risk framework require further improvement in certain areas, particularly with respect to perceived duplications. While the agencies are committed to continued improvement of the market risk framework, they believe that the proposed modifications to the market risk capital rules are necessary to address current significant shortcomings in banks' measurement and capitalization of market risk. Some commenters expressed concerns about differences between the January 2011 proposal and 2005 and 2009 revisions, such as excluding from the definition of covered position a hedge that is not within the scope of the bank's hedging strategy, providing a more restrictive definition of two-way market, and establishing a surcharge for correlation trading position equal to 15 percent of the specific risk capital requirements for such positions. The expressed concern was that these differences could place U.S. banks at a competitive disadvantage to certain foreign banking organizations. In response to the concerns, the agencies revised the definition of two-way market and adjusted the surcharge as discussed more fully in the preamble to the final rule.

While many commenters responding to the December 2011 amendment commended the agencies' efforts to develop viable alternatives to credit ratings, most commenters indicated that the amendment did not strike a reasonable balance between accurate measurement of risk and implementation burden. Commenters' general concerns with the December 2011 amendment include its overall lack of risk sensitivity and its complexity. The agencies have incorporated a number of changes into the final rule based on feedback received from commenters, including modifications to the approaches

for determining capital requirements for corporate debt positions and securitization positions proposed in the December 2011 amendment.

A more detailed discussion of comments on specific provisions of the January 2011 NPR and December 2011 amendment is provided in section III of the preamble to the final rule.

9. Payment to Respondents

None.

10. Confidentiality

Information deemed confidential is exempt from public disclosure under the Freedom of Information Act (5 U.S.C. 552).

11. Information of a Sensitive Nature

None.

12. Burden Estimate

Summary
Frequency of response: varies.
Number of respondents: 2.[3]
Average number of burden hours: 1,964.
Total annual burden: 3,928 burden hours.

Cost per response: $100 per hour.
Estimated annual cost: $136,000.

Discussion: The section numbers in the table below refer to the sections of the notice of proposed rulemaking containing paperwork burden.

Section Number	Description	Frequency of Response	Burden Per Response	Total Burden
3(a)(1)	Policies and procedures for trading positions	1	40	40

[3]The market risk rule applies only if a bank holding company or bank has aggregated trading assets and trading liabilities equal to 10 percent or more of quarter-end total assets or $1 billion or more. Currently, only 2 FDIC-regulated entities meet the criteria.

Section Number	Description	Frequency of Response	Burden Per Response	Total Burden
3(a)(2)	Policies and procedures for trading and hedging strategies	1	16	16
3(b)(1)	Policies and procedures for actively managing covered positions	1	16	16
3(c)(4)	Internal model review	1	16	16
3(d)(4)	Internal audit report	1	16	16
4(b)	Backtesting adjustments to risk-based capital ratio calculations	4	16	64
5(a)	Demonstrate appropriateness of proxies	1	8	8
5(c)	Retention of subportfolio information	1	24	24
6	Policies and procedures for stressed VaR-based measure quantitative requirements	1	40	40
7	Modeled specific risk	1	88	88
8	Incremental risk model – prior approval	1	480	480
9(a)	Comprehensive risk measurement – prior approval	1	480	480
9(c)	Requirements for stress testing	1	80	80
10(d)	Demonstration of securitization positions	4	120	480
11(a)	Quantitative market risk disclosures	4	8	32
11(b)	Disclosure policy	1	40	40
11(c)	Quantitative disclosures for each portfolio of covered positions	4	8	32
11(d)	Qualitative disclosures for each portfolio of covered positions	1	12	12
Total				1,964

Total Burden = 2 respondents x 1964 hours = 3,928 hours

13. Capital, Start-Up and Maintenance Costs

Covered institutions already have established systems to accumulate data and produce reports for the internal calculation of capital held against market risk. Therefore, no additional capital, start-up or maintenance costs are involved.

14. Estimated Annual Cost to the Federal Government

No new costs to the Federal government are anticipated; current bank examination resources will be used to collect and review the information.

15. Reason for Change in Burden

The entire change in burden hours, an increase from zero to 3,928 hours, is a program change due to the adoption of a new regulation that includes recordkeeping and disclosure requirements.

16. Publication

No publication is made of the information.

17. Display of Expiration Dates

Not applicable.

18. Exceptions to Certification

None.

B. Statistical Methods

Not applicable.