

## 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

A. JUSTIFICATION:

1. Circumstances that make the collection necessary:

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.<sup>1</sup> 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<sup>2</sup> provides additional detail that should help institutions satisfy the qualification requirements in the final rule.<sup>3</sup> The Federal banking 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. The requirements for each section are provided below. Examiners use this information to verify compliance with this recordkeeping requirement during examinations.

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<sup>1</sup> See part III, section B. of the final rule 72 FR 69302 (Dec. 7, 2007).

<sup>2</sup> 73 FR 44620.

<sup>3</sup> The supervisory guidance was based on the Basel II international framework, which has been superseded by the Basel III international framework. However, notwithstanding the revisions to the Pillar 1 requirements, nothing changes the dimensions of the supervisory guidance in the context of Pillar 2.

Section 37. Various definitions of institution capital are used in 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 institution should document any changes in its internal definition of capital, and the reason for those changes.

Section 41. Institutions 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 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:

The OCC issued a notice for 60 days of comment on June 9, 2014. 79 FR 33039. No comments were received.

9. Payment or gift to respondents:

None.

10. Any assurance of confidentiality:

The information will be kept private to the extent permitted by law.

11. Information of a sensitive nature:

Not applicable. No personally identifiable information is collected.

12. Burden estimate:

<u>Number of respondents</u>	<u>Estimated annual frequency</u>	<u>Estimated response time</u>	<u>Estimated annual burden hours</u>
26	1	140 hours	3,640

Cost of burden hours: 3,640 x 92 = \$ 334,880

To estimate compensation costs associated with the collection, we used \$92 per hour, which is based on May 2012 Bureau of Labor Statistics wage data for the average of the 90<sup>th</sup> percentile for seven occupations (i.e., accountants and auditors, compliance officers, financial analysts, lawyers, management occupations, software developers, and statisticians) plus an additional 33 percent to cover adjustments and private sector benefits. According to Bureau of Labor Statistics employer costs of employee benefits data, thirty percent represents the average private sector costs of employee benefits.

13. Estimate of annualized costs to respondents:

Not applicable.

14. Estimate of annualized costs to the government:

Not applicable.

15. Changes in burden:

Prior Burden: 51 Respondents; 7,140 Burden Hours

Current Burden: 26 Respondents; 3,640 Burden Hours

Difference: - 25 Respondents; - 3,500 Burden Hours

The decrease is due to the decrease in the number of regulated entities.

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

Not applicable.

17. Display of expiration date:

Not applicable.

18. Exceptions to certification statement:

Not applicable.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS:

Not applicable.