

## 1 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 set 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 also provided for a process for the supervisory review of capital adequacy under Pillar 2. The OCC rule implementing the regulatory risk-based capital requirements<sup>1</sup> into the OCC's Capital Rule<sup>2</sup> describes the qualification process and provides qualification requirements for obtaining supervisory approval to use the internal models in the advanced approaches risk-based capital requirements. 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 that contains the information collection, "Supervisory Review Process of Capital Adequacy (Pillar 2) Related to the Implementation of the Basel II Advanced Capital Framework" (Guidance),<sup>3</sup> was issued subsequent to the implementing rule and provides additional detail that is intended to help institutions comply with the qualification requirements in the rule.<sup>4</sup> The OCC believes that the Guidance provides useful information to banks, which can be used to supplement the risk-based capital framework with standards that promote safety and soundness and encourage comparability across institutions. The OCC uses the information provided in response to the information collection in determining whether each institution (i) has satisfied the qualification requirements for implementing the advanced approaches; (ii) has a rigorous process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining appropriate capital levels; and (iii)

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

<sup>2</sup> 12 C.F.R. part 3.

<sup>3</sup> Supervisory Guidance: Supervisory Review Process of Capital Adequacy (Pillar 2) Related to the Implementation of the Basel II Advanced Capital Framework, 73 FR 44620 (July 31, 2008).

<sup>4</sup> The Guidance draws on the Basel II international framework, which has been superseded by the Basel III international framework. However, the Pillar 2 standards described in the Guidance remain in effect.

maintains a satisfactory risk management and control structure, consistent with its capital position and overall risk pro

## ***2. Use of the information:***

The Guidance recommends that respondents maintain certain documentation, as described in paragraphs 37, 41, 43 and 46. As described above, OCC examiners use the information provided as part of the Pillar 2 supervisory process. The specific recommendations are as follows:

Paragraph 37. Various definitions of 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.

Paragraph 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 and distribution of ICAAP-related reporting, and procedures for the periodic evaluation of the appropriateness and adequacy of the 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.

Paragraph 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, as well as the strength of control infrastructures. Senior management should continually 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.

Paragraph 46. As part of the ICAAP, the board or its delegated agent, as well as appropriate senior management, should periodically review the resulting assessment of

overall capital adequacy. This review, which should occur at least annually, 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 (that is, if capital is not consistent with the bank's risk profile or risk tolerance), 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. *If the collection of information impacts small businesses or other small entities, describe any methods used to minimize burden.***

There are no alternatives that would result in lowering the burden on small institutions, while still accomplishing the purpose of the rule.

**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 part 1320.

**8. *Consultation with persons outside the agency:***

The OCC issued a notice for 60 days of comment on May 14, 2020, 85 FR 29019. 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>
19	1	140 hours	2,660

**Cost of Burden Hours**

$$2,660 \times \$115.19 = \$ 306,405.40$$

To estimate wages the OCC reviewed May 2019 data for wages (by industry and occupation) from the U.S. Bureau of Labor Statistics (BLS) for credit intermediation and related activities excluding nondepository credit intermediaries (NAICS 5220A1). To estimate compensation costs associated with the rule, the OCC uses \$115.19 per hour, which is based on the average of the 90th percentile for six occupations adjusted for inflation (3.1 percent as of Q1 2020 according to the BLS), plus an additional 33.4 percent for benefits (based on the percent of total compensation allocated to benefits as of Q4 2019 for NAICS 522: credit intermediation and related activities).

**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: 3,220 Burden Hours.

Current Burden: 2,660 Burden Hours

Difference: -560 Burden Hours

The change is due to a reduction in the number of respondents.

**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.