

**Supporting Statement for the  
Market Risk Capital Rule  
(FR 4201; OMB No. 7100-0314)**

**Summary**

The Board of Governors of the Federal Reserve System (Board), under authority delegated by the Office of Management and Budget (OMB), has extended for three years, with revision, the information collections associated with the Market Risk Capital Rule (FR 4201; OMB No. 7100-0314). The market risk rule, which requires banking organizations to hold capital to cover their exposure to market risk, is an important component of the Board's regulatory capital framework (Regulation Q; 12 CFR Part 217). The respondents for this information collection are bank holding companies (BHCs), savings and loan holding companies (SLHCs), intermediate holding companies (IHCs), and state member banks (SMBs) that meet certain risk thresholds described below.

The Board revised the FR 4201 to account for two recordkeeping requirements that were mistakenly omitted from the previous clearance of this information collection.

The current estimated total annual burden for the FR 4201 is 13,148 hours, and would increase to 35,644 hours. The revisions would result in an increase in of 22,496 hours. There are no required reporting forms associated with this information collection (the FR 4201 designation is for internal purposes only).

**Background and Justification**

The market risk rule was adopted in 1996 as an integral part of the Board's revised regulatory capital framework.<sup>1</sup> The rule includes information collections that permit the Board to monitor the market risk profile of Board-regulated banking organizations that have significant market risk and evaluate the impact of the market risk rule on those banking organizations<sup>2</sup> and the industry as a whole. The information collections provide current statistical data identifying market risk areas on which to focus onsite and offsite examinations. They also allow the Board to assess the levels and components of each reporting institution's risk-based capital requirements for market risk and the adequacy of the institution's capital under the market risk rule. Finally, these information collections ensure capital adequacy of banking organizations according to their level of market risk and assist the Board in implementing and validating the market risk framework. This information is not available from other sources.

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<sup>1</sup> See 61 FR 47358 (September 6, 1996). The rule was subsequently amended in 2013 as part of the Board's revised regulatory capital requirements. See 78 FR 62018 (October 11, 2013). On December 18, 2013, the Board adopted revisions, including related to timely quantitative and qualitative disclosures, to the market risk rule to align it with other elements of the revised capital framework. See 78 FR 76521 (December 18, 2013).

<sup>2</sup> For purposes of this supporting statement, banking organizations include bank holding companies, intermediate holding companies, savings and loan holding companies, and state member banks that are subject to the market risk rule.

## Description of Information Collection

The market risk rule applies to any banking organization with aggregate trading assets and trading liabilities equal to (1) 10 percent or more of quarter-end total assets or (2) \$1 billion or more.<sup>3</sup> The Board may exclude a banking organization that meets these thresholds if the Board determines that the exclusion is appropriate based on the level of market risk of the banking organization and is consistent with safe and sound banking practices.<sup>4</sup> The Board may further apply the market risk rule to any other banking organization if the Board deems it necessary or appropriate because of the level of market risk of the banking organization or to ensure safe and sound banking practices.<sup>5</sup> Throughout this supporting statement, organizations that are subject to the requirements of the market risk rule are referred to as “subject banking organizations.” The market risk rule includes certain reporting, recordkeeping, and disclosure requirements in sections 217.203 through 217.210 and section 217.212. Details of the information collection requirements in each section are provided below.

### *Reporting Requirements*

#### **Sections 217.203(c)(1), 217.204(a)(2)(vi)(B), 217.206(b)(3), 217.208(a), and 217.209(a) - Prior Approvals**

Section 217.203(c)(1) of the market risk rule requires subject banking organizations to obtain the prior written approval of the Board before using any internal model to calculate its risk-based capital requirements under subpart F.

Section 217.204(a)(2)(vi)(B) requires subject banking organizations to obtain the prior written approval of the Board before including in its capital requirement for *de minimis* exposures the capital requirement for any *de minimis* exposures using alternative techniques that appropriately measure the market risk associated with those exposures.

Section 217.206(b)(3) requires subject banking organizations to obtain the prior approval of the Board for, and notify the Board if the banking organization makes any material changes to, the policies and procedures required by that section, which are described below.

Section 217.208(a) requires subject banking organizations that measure the specific risk of a portfolio of debt positions using internal models to obtain the approval of the Board, prior to including portfolios of equity positions in its incremental risk model.

Section 217.209(a) requires subject banking organizations to obtain prior approval of the Board before using the method specified in that section to measure comprehensive risk for one or more portfolios of correlation trading positions.

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<sup>3</sup> See 12 CFR 217.201(b)(1).

<sup>4</sup> See 12 CFR 217.201(b)(3).

<sup>5</sup> See 12 CFR 217.201(b)(2).

## *Recordkeeping Requirements*

### **Sections 217.203(a)(1), 217.203(b)(1), and 217.206(b)(3) - Policies and Procedures**

Section 217.203(a)(1) of the market risk rule requires subject banking organizations to have clearly defined policies and procedures for determining which trading assets and trading liabilities are trading positions and which trading positions are correlation trading positions. These policies and procedures must take into account (1) the extent to which a position, or a federal of its material risks, can be marked-to-market daily by reference to a two-way market and (2) possible impairments to the liquidity of a position or its hedge.

Section 217.203(b)(1) requires subject banking organizations to have clearly defined policies and procedures for actively managing all covered positions, and at a minimum, these policies and procedures must require (1) marking positions to market or to model on a daily basis, (2) daily assessment of the banking organization's ability to hedge position and portfolio risks, and of the extent of market liquidity, (3) establishment and daily monitoring of limits on positions by a risk control unit independent of the trading business unit, (4) daily monitoring by senior management of (1) to (3) hereinabove, (5) at least annual reassessment of established limits on positions by senior management, and (6) at least annual assessments by qualified personnel of the quality of market inputs to the valuation process, the soundness of key assumptions, the reliability of parameter estimation in pricing models, and the stability and accuracy of model calibration under alternative market scenarios.

Section 217.206(b)(3) requires subject banking organizations to have policies and procedures that describe how the banking organization determines the period of significant financial stress used to calculate its stressed Value-at-Risk (VaR)-based measure under this section. The policies and procedures must address (1) how the banking organization links the period of significant financial stress used to calculate the stressed VaR-based measure to the composition and directional bias of its current portfolio and (2) the banking organization's process for selecting, reviewing, and updating the period of significant financial stress used to calculate the stressed VaR-based measure and for monitoring the appropriateness of the period to the banking organization's current portfolio.

### **Section 217.203(a)(2) - Trading and Hedging Strategy**

Section 217.203(a)(2) of the market risk rule requires subject banking organizations to have clearly defined trading and hedging strategies for trading positions. The trading strategy must be approved by the organization's senior management and must articulate the expected holding period of, and the market risk associated with, each portfolio of trading positions. The hedging strategy must articulate for each portfolio of trading positions the level of market risk the banking organization is willing to accept and must detail the instruments, techniques, and strategies the banking organization will use to hedge the risk of the portfolio.

### **Section 217.203(f) - General Recordkeeping**

Section 217.203(f) of the market risk rule requires that a subject banking organization adequately document all material aspects of its internal models, management and valuation of covered positions, control, oversight, validation and review processes and results, and internal assessment of capital adequacy.

### **Section 217.205(c) - Backtesting**

Section 217.205(c) of the market risk rule requires a subject banking organization to divide its portfolio exposures subject to the market risk rule into a number of significant subportfolios approved by the Board for subportfolio backtesting purposes. The banking organization must retain and make available to the Board the following information for each subportfolio for each business day over the previous two years (500 business days), with no more than a 60-day lag: (1) a daily VaR-based measure for the subportfolio calibrated to a one-tail, 99.0 percent confidence level, (2) the daily profit or loss for the subportfolio (that is, the net change in price of the positions held in the portfolio at the end of the previous business day), and (3) the probability of observing a profit that is less than, or a loss that is greater than, the amount projected for each day.

### **Section 217.209(c) - Stress Testing**

Section 217.209(c) of the market risk rule requires that a subject banking organization must at least weekly apply specific, supervisory stress scenarios to its portfolio of correlation trading positions that capture changes in (1) default rates, (2) recovery rates, (3) credit spreads, (4) correlations of underlying exposures, and (5) correlations of a correlation trading position and its hedge. A subject banking organization must retain and make available to the Board the results of the supervisory stress testing, including comparisons with the capital requirements generated by the banking organization's comprehensive risk model. A subject banking organization must report to the Board promptly any instances where the stress tests indicate any material deficiencies in the comprehensive risk model.

### **Section 217.210(f) - Securitizations**

Section 217.210(f)(1) of the market risk rule requires that a subject banking organization demonstrate to the satisfaction of the Board a comprehensive understanding of the features of a securitization position that would materially affect the performance of the position by conducting and documenting the analysis set forth in section 217.210(f)(2). The banking organization's analysis must be commensurate with the complexity of the securitization position and the materiality of the position in relation to capital. To support the demonstration of its comprehensive understanding, for each securitization position a banking organization must conduct and document an analysis of the risk characteristics of a securitization position prior to acquiring the position, considering structural features of the securitization that would materially impact the performance of the position, relevant information regarding the performance of underlying credit exposure(s), relevant market data of the securitization, and, for resecuritization positions, performance information on the underlying securitization exposure. The banking

organization also must, on an on-going basis (but no less frequently than quarterly), evaluate, review, and update as appropriate the analysis required above for each securitization position.

### **Section 217.212(b) - Disclosure Policy**

Section 217.212(b) of the market risk rule requires that a subject banking organization must have a formal disclosure policy that addresses the banking organization's approach for determining the market risk disclosures. The policy must be approved by the board of directors and must address the associated internal controls and disclosure controls and procedures.

#### *Disclosure Requirements*

### **Section 217.212(c) - Quantitative Disclosures**

Section 217.212(c) of the market risk rule requires certain public quantitative disclosures. For each material portfolio of covered positions, the subject banking organization must publicly disclose the following at least quarterly (1) the high, low, and mean VaR-based measures over the reporting period and the VaR-based measure at period-end, (2) the high, low, and mean stressed VaR-based measures over the reporting period and the stressed VaR-based measure at period-end, (3) the high, low, and mean incremental risk capital requirements over the reporting period and the incremental risk capital requirement at period-end, (4) the high, low, and mean comprehensive risk capital requirements over the reporting period and the comprehensive risk capital requirement at period-end, with the period-end requirement broken down into appropriate risk classifications, (5) separate measures for interest rate risk, credit spread risk, equity price risk, foreign exchange risk, and commodity price risk used to calculate the VaR-based measure, and (6) a comparison of VaR-based estimates with actual gains or losses experienced by the bank, with an analysis of important outliers. The banking organization must also publically disclose the following at least quarterly (1) the aggregate amount of on-balance sheet and off-balance sheet securitization positions by exposure type and (2) the aggregate amount of correlation trading positions.

### **Section 217.212(d) - Qualitative Disclosures**

Section 217.212(d) requires the following qualitative disclosures at least annually, with any material changes disclosed in the interim (1) the composition of material portfolios of covered positions, (2) the subject banking organization's valuation policies, procedures, and methodologies for covered positions including, for securitization positions, the methods and key assumptions used for valuing such positions, any significant changes since the last reporting period, and the impact of such change, (3) the characteristics of the internal models used for purposes of the market risk rule, (4) a description of the approaches used for validating and evaluating the accuracy of internal models and modeling processes for purposes of the market risk rule, (5) for each market risk category (that is, interest rate risk, credit spread risk, equity price risk, foreign exchange risk, and commodity price risk), a description of the stress tests applied to the positions subject to the factor, (6) the results of the comparison of the banking organization's internal estimates for purposes of the market risk rule with actual outcomes during a sample period not used in model development, (7) the soundness standard on which the

banking organization's internal capital adequacy assessment under the market risk rule is based, including a description of the methodologies used to achieve a capital adequacy assessment that is consistent with the soundness standard, (8) a description of the banking organization's processes for monitoring changes in the credit and market risk of securitization positions, including how those processes differ for resecuritization positions, and (9) a description of the banking organization's policy governing the use of credit risk mitigation to mitigate the risks of securitization and resecuritization positions.

### **Respondent Panel**

The FR 4201 panel comprises BHCs, SLHCs, IHCs, and SMBs that meet certain risk thresholds. The market risk rule applies to any such banking organization with aggregate trading assets and trading liabilities equal to (1) 10 percent or more of quarter-end total assets or (2) \$1 billion or more.

### **Revisions to the FR 4201**

In August 2019, the Board extended for three years, with revision, the FR 4201 and a notice was published in the *Federal Register* (84 FR 39843). Those revisions included removing references to provisions in section 217.210(f) of the market risk rule concerning securitizations. This revision was in error, as the market risk rule contains a recordkeeping requirement concerning securitizations, which is described above. Therefore, the Board reinstated this recordkeeping requirement. Additionally, the Board revised the FR 4201 to account for the general recordkeeping requirement in section 217.203(f) of the market risk rule, described above, which had not previously been accounted for.

### **Time Schedule for Information Collection**

This information collection contains reporting, recordkeeping, and disclosure requirements, as mentioned above. The recordkeeping requirements are ongoing. The prior written approvals are all required on occasion. The disclosures are required quarterly, annually, and on occasion.

### **Public Availability of Data**

No data collected pursuant to this information collection is made available to the public by the Board.

### **Legal Status**

The FR 4201 is authorized pursuant to sections 9(6) and 11 of the Federal Reserve Act for SMBs (12 U.S.C. §§ 324 and 248); pursuant to section 5 of the Bank Holding Company Act of 1956 (BHC Act) (12 U.S.C. § 1844(c)) and, in some cases, section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) for BHCs (12 U.S.C. § 5365); pursuant to section 5 of the BHC Act (12 U.S.C. § 1844), in conjunction with section 8 of the International Banking Act of 1978 (12 U.S.C. § 3106), and section 165 of the Dodd-Frank

Act for IHCs; and pursuant to sections 10(b)(2) and (g) of the Home Owners' Loan Act for SLCHs (12 U.S.C. § 1467a(b)(2) and (g)). The FR 4201 is mandatory.

The information collected pursuant to the FR 4201 is collected as part of the Board's supervisory process, and therefore is afforded confidential treatment pursuant to exemption 8 of the Freedom of Information Act (FOIA) (5 U.S.C. § 552(b)(8)). In addition, individual respondents may request that certain data be afforded confidential treatment pursuant to exemption 4 of the FOIA, which exempts from disclosure "trade secrets and commercial or financial information obtained from a person and privileged or confidential" (5 U.S.C. § 552(b)(4)). Determinations of confidentiality based on exemption 4 of the FOIA would be made on a case-by-case basis.

### **Consultation Outside the Agency**

There has been no consultation outside the Federal Reserve System.

### **Public Comments**

On January 17, 2020, the Board published an initial notice in the *Federal Register* (85 FR 3049) requesting public comment for 60 days on the extension, with revision, of the FR 4201. The comment period for this notice expired on March 17, 2020. The Board did not receive any comments. The Board adopted the extension, with revision, of the FR 4201 as originally proposed. On September 17, 2020, the Board published a final notice in the *Federal Register* (85 FR 58054).

### **Estimate of Respondent Burden**

As shown in the table below, the estimated total annual burden for the FR 4201 is 13,148 hours, and would increase to 35,644 hours with the revisions. These reporting, recordkeeping, and disclosure requirements represent less than 1 percent of the Board's total paperwork burden.

<b>FR 4201</b>	<i>Estimated number of respondents<sup>6</sup></i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
<b>Current</b>				
<b>Reporting</b>				
Sections 217.203(c)(1), 217.204(a)(2)(vi)(B), 217.206(b)(3), 217.208(a), and 217.209(a)	1	1	1,088	1,088
<b>Recordkeeping</b>				
Sections 217.203(a)(1), 217.203(b)(1), and 217.206(b)(3)	37	1	96	3,552
Policies and procedures Section 217.203(a)(2)	37	1	16	592
Trading and hedging strategy Section 217.205(c)	37	1	96	3,552
Backtesting Section 217.209(c)	6	1	12	72
Stress testing Section 217.212(b)	37	1	40	1,480
<b>Disclosure</b>				
Section 217.212(c)	37	4	16	2,368
Quantitative Section 217.212(d)	37	1	12	444
Qualitative	37	1	12	444
<i>Current Total</i>				13,148
<b>Proposed</b>				
<b>Reporting</b>				
Sections 217.203(c)(1), 217.204(a)(2)(vi)(B), 217.206(b)(3), 217.208(a), and 217.209(a)	1	1	1,088	1,088
<b>Recordkeeping</b>				
Sections 217.203(a)(1), 217.203(b)(1), and 217.206(b)(3)	37	1	96	3,552
Policies and procedures Section 217.203(a)(2)	37	1	16	592
Trading and hedging strategy	37	1	16	592

<sup>6</sup> Of these respondents, none are considered small entities as defined by the Small Business Administration (i.e., entities with less than \$600 million in total assets), <https://www.sba.gov/document/support--table-size-standards>.



Section 217.203(f) General recordkeeping	37	1	128	4,736
Section 217.205(c) Backtesting	37	1	96	3,552
Section 217.209(c) Stress testing	6	1	12	72
Section 217.210(f) Securitizedizations	37	4	120	17,760
Section 217.212(b) Disclosure policy	37	1	40	1,480
<b>Disclosure</b>				
Section 217.212(c) Quantitative	37	4	16	2,368
Section 217.212(d) Qualitative	37	1	12	<u>444</u>
<i>Proposed Total</i>				35,644
<i>Change</i>				22,496

The current estimated total annual cost to the public for the FR 4201 is \$777,704, and would increase to \$2,108,343 with the revisions.<sup>7</sup>

### **Sensitive Questions**

These collections of information contain no questions of a sensitive nature, as defined by OMB guidelines.

### **Estimate of Cost to the Federal Reserve System**

The estimated cost to the Federal Reserve System for collecting and processing this information collection is negligible.

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<sup>7</sup> Total cost to the public was estimated using the following formula: percent of staff time, multiplied by annual burden hours, multiplied by hourly rates (30% Office & Administrative Support at \$20, 45% Financial Managers at \$73, 15% Lawyers at \$72, and 10% Chief Executives at \$95). Hourly rates for each occupational group are the (rounded) mean hourly wages from the Bureau of Labor and Statistics (BLS), *Occupational Employment and Wages May 2020*, published March 31, 2021, <https://www.bls.gov/news.release/ocwage.t01.htm>. Occupations are defined using the BLS Standard Occupational Classification System, <https://www.bls.gov/soc/>.