

**Supporting Statement for the  
Basel II Interagency Pillar 2 Supervisory Guidance  
(FR 4199; OMB No. 7100-0320)**

**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, without revision, the Basel II Interagency Pillar 2 Supervisory Guidance (Pillar 2 Guidance)<sup>1</sup> (FR 4199; OMB No. 7100-0320). The Pillar 2 Guidance is intended to assist banking organizations<sup>2</sup> that are subject to the Basel II advanced approaches capital adequacy framework (advanced approaches framework) in applying that framework. Paragraphs 37, 41, 43, and 46 of the Pillar 2 Guidance contain recordkeeping provisions for state member banks and bank holding companies (BHCs) subject to the advanced approaches framework (advanced approaches banking organizations) beyond those required by the Board’s capital rule, and therefore require separate clearance under the Paperwork Reduction Act.<sup>3</sup>

The estimated total annual burden for the FR 4199 is 6,300 hours.

**Background and Justification**

Section 38 of the Federal Deposit Insurance Act (FDI Act) requires each federal banking agency to adopt risk-based capital standards for the depository institutions that they regulate.<sup>4</sup> In addition, among other authorities, the Board may establish capital requirements for state member banks under the Federal Reserve Act,<sup>5</sup> and for state member banks and bank holding companies under the International Lending Supervision Act of 1983 (ILSA),<sup>6</sup> and Bank Holding Company Act of 1956.<sup>7</sup> The ILSA mandates that each federal banking agency require banking institutions to achieve and maintain adequate capital by establishing minimum levels of capital or by other methods that the appropriate agency may deem appropriate.

In 2007, the Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS),<sup>8</sup> Board, and Federal Deposit Insurance Corporation (FDIC) published a final rule to revise the risk-based capital requirements in the United States for large, internationally

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<sup>1</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>2</sup> With respect to entities regulated by the Board, the term “banking organizations” include state member banks and bank holding companies.

<sup>3</sup> See 44 U.S.C. § 3501 et seq.

<sup>4</sup> 12 U.S.C. § 1831o(c).

<sup>5</sup> 12 U.S.C. §§ 321-338.

<sup>6</sup> 12 U.S.C. § 3907.

<sup>7</sup> 12 U.S.C. § 1844.

<sup>8</sup> On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) became law. As part of the comprehensive package of financial regulatory reform measures enacted, Title III of the Dodd-Frank Act transferred the powers, authorities, rights and duties of the OTS to other banking agencies, including the OCC, on the “transfer date.” The transfer date was one year after the date of enactment of the Dodd-Frank Act, July 21, 2011. The Dodd-Frank Act also abolished the OTS ninety days after the transfer date. As a result of the Dodd-Frank Act, OTS transferred this information collection to the OCC.

active banking organizations.<sup>9</sup> The rule set forth a three-pillar framework encompassing regulatory risk-based capital requirements (Pillar 1), supervisory review of capital adequacy (Pillar 2), and market discipline through enhanced public disclosures (Pillar 3).

The advanced approaches framework requires certain state member banks and BHCs to use an internal ratings-based approach to calculate regulatory credit risk capital requirements and advanced measurement approaches to calculate regulatory operational risk capital requirements. Currently, a BHC is required to comply with the advanced approaches framework if it is a global systemically important BHC, a Category II banking organization, or has a subsidiary depository institution that is subject to the advanced approaches framework; a state member bank must comply with the advanced approaches framework if it is the subsidiary of a global systemically important BHC or a depository institution or BHC that is subject to the advanced approaches framework, or is a Category II Board-regulated institution.<sup>10</sup> Banking organizations also may elect to comply with the advanced approaches framework.

The Pillar 2 Guidance supplements the rule. Specifically, the Pillar 2 Guidance provides additional detail to help advanced approaches banking organizations satisfy certain qualification requirements and provides standards to promote safety and soundness and encourage comparability across banking organizations. The Board reviews each advanced approaches banking organization's balance sheet relative to the qualification requirements to determine whether the banking organization may apply the advanced approaches framework and has complied with the regulatory capital requirements.

## **Description of Information Collection**

Advanced approaches banking organizations are required to use an internal ratings-based approach to calculate regulatory credit risk capital requirements and advanced measurement approaches to calculate regulatory operational risk capital requirements. Banking organizations are required to meet certain qualification requirements before they can use the advanced approaches framework for risk-based capital purposes. The Pillar 2 Guidance sets the expectation that such organizations maintain certain documentation as described in paragraphs 37, 41, 43, and 46 of this portion of the guidance. Details of the expectations for each section are provided below.

### *Setting and Assessing Capital Adequacy Goals that Relate to Risk*

**Paragraph 37.** In analyzing capital adequacy, a banking organization should evaluate the capacity of its capital to absorb losses. Because various definitions of capital are used within the banking industry, each banking organization should state clearly the definition of capital used in any aspect of its internal capital adequacy assessment process (ICAAP). Among other things, this paragraph provides that the banking organization should document any changes in its internal definition of capital, and the reason for those changes.

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<sup>9</sup> 72 FR 69288 (December 7, 2007).

<sup>10</sup> 12 CFR 217.100(b)(1).

## *Ensuring Integrity of Internal Capital Adequacy Assessments*

**Paragraph 41.** A banking organization should maintain thorough documentation of its ICAAP to ensure transparency. At a minimum, this should include a description of the banking organization's overall capital-management process, including the committees and individuals responsible for the ICAAP; the frequency and distribution of ICAAP-related reporting; and the procedures for the periodic evaluation of the appropriateness and adequacy of the ICAAP. In addition, where applicable, ICAAP documentation should demonstrate the banking organization's sound use of quantitative methods (including model selection and limitations) and data-selection techniques, as well as appropriate maintenance, controls, and validation. A banking organization 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. A banking organization should have a process to regularly evaluate the performance of third-party and vendor products, services and information. As part of the ICAAP documentation, a banking organization should document the assumptions, methods, data, information, and judgment used in its quantitative and qualitative approaches.

**Paragraph 43.** Among other things, this paragraph provides that 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.

**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. In the event a capital deficiency is uncovered (that is, if capital is not consistent with the banking organization's risk profile or risk tolerance), management should consult and adhere to formal procedures to correct the capital deficiency.

### **Respondent Panel**

The FR 4199 panel comprises state member banks and BHCs that use the advanced approaches framework.

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

These recordkeeping provisions are documented on occasion. Bank examiners may review documents kept based on the recommendations in the Pillar II Guidance during examinations of state member banks and BHCs.

### **Public Availability of Data**

The documentation set forth in the guidance is a recordkeeping provision, and no data related to this information collection is made available to the public by the Federal Reserve.

## **Legal Status**

The FR 4199 is authorized pursuant to the sections 9 and 11 of the Federal Reserve Act authorizing the Board to require a state member bank to submit reports of condition (12 U.S.C. § 324) and authorizing the Board to require a state member bank to submit reports of liabilities and assets (12 U.S.C. § 248(a)); section 5 of the Bank Holding Company Act of 1956 authorizing the Board to require a bank holding company and any subsidiary thereof to submit reports regarding financial condition and compliance (12 U.S.C. § 1844); and section 161 of the Dodd-Frank Wall Street Reform and Consumer Protection Act authorizing the Board to require reports of financial condition and compliance from nonbank financial companies subject to the Board’s supervision (12 U.S.C. § 5361). The FR 4199 is voluntary.

Because the collections of information associated with the guidance is maintained by each institution, the Freedom of Information Act (FOIA) would only be implicated if the Board obtained such records as part of the examination or supervision of a banking organization. In the event the records are obtained by the Board as part of the examination or supervision of a financial institution, this information may be considered confidential pursuant to exemption 8 of the FOIA, which protects information contained in “examination, operating, or condition reports” obtained in the bank supervisory process (5 U.S.C. § 552(b)(8)). In addition, the information may also be kept confidential under exemption 4 of the FOIA, which protects trade secrets and commercial or financial information obtained from a person that is both customarily and actually treated as private by the respondent (5 U.S.C. § 552(b)(4)).

## **Consultation Outside the Agency**

The Board has consulted with the FDIC and OCC and confirmed that there will be no revisions to the guidance, and no revision to the time per response estimates.

## **Public Comments**

On June 9, 2021, the Board published an initial notice in the *Federal Register* (86 FR 30603) requesting public comment for 60 days on the extension, without revision, of the FR 4199. The comment period for this notice expired on August 9, 2021. The Board did not receive any comments. The Board adopted the extension, without revision, of the FR 4199 as originally proposed. On October 18, 2021, the Board published a final notice in the *Federal Register* (86 FR 57674).

## **Estimate of Respondent Burden**

As shown in the table below, the estimated total annual burden for the FR 4199 is 6,300 hours. The Board estimates that it will take each respondent 420 hours to complete the documentation recommendations. These recordkeeping provisions represent less than 1 percent of the Board’s total paperwork burden.

<b>FR 4199</b>	<i>Estimated number of respondents<sup>11</sup></i>	<i>Annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
Paragraphs 37, 41, 43, and 46 of the Pillar 2 Guidance	15	1	420	6,300

The estimated total annual cost to the public for the FR 4199 is \$372,645.<sup>12</sup>

### **Sensitive Questions**

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

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

Since records are maintained at the financial institutions, there is no cost to the Federal Reserve System.

<sup>11</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>.

<sup>12</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/>.