

**Supporting Statement for the Risk Based Capital Standards: Advanced Capital Adequacy Framework  
(FR 4200; OMB No. 7100-NEW)**

**Summary**

The Board of Governors of the Federal Reserve System, under delegated authority from the Office of Management and Budget (OMB), proposes to implement the Risk-Based Capital Standards: Advanced Capital Adequacy Framework (FR 4200; OMB No. 7100-NEW). The Paperwork Reduction Act (PRA) classifies reporting, recordkeeping, or disclosure requirements of a regulation as an “information collection.”<sup>1</sup> This framework would be an appendix to Regulations H and Y.

The Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) (the agencies) are issuing a joint notice of proposed rulemaking (NPR) to implement a new risk-based regulatory capital framework for institutions in the United States. This framework is based on the June 2004 Basel Committee of Banking Supervision’s (BCBS’s) document, “International Convergence of Capital Measurement and Capital Standards: A Revised Framework” (hereafter referred to as the New Accord). The new framework described in the NPR recognizes developments in financial products, incorporates advances in risk measurement and management practices, and imposes capital requirements that are generally more sensitive to risk. The Federal Deposit Insurance Act (FDI Act) and the International Lending Supervision Act of 1983 (ILSA) require the agencies to have risk-based capital requirements and to ensure that banks maintain adequate capital.

The NPR is intended to produce risk-based capital requirements that are more risk-sensitive, with respect to credit and operational risk, than the agencies’ existing risk-based capital rules. The NPR would require certain large or internationally active banks and bank holding companies (BHCs) to (1) adopt a written implementation plan, (2) update that plan for any mergers, (3) obtain prior written approvals for the use of certain approaches for determining risk-weighted assets, and (4) make certain public disclosures regarding their capital ratios, their components, and information on implicit support provided to a securitization. The Federal Reserve’s total annual burden for this information collection is estimated to be 216,330 hours for the fifteen financial institutions it supervises that would be subject to the NPR. There are no required reporting forms associated with this information collection.

**Background and Justification**

Section 1831(o) of the FDI Act requires each Federal banking agency to adopt a risk-based capital requirement, which is based on the prompt corrective action framework in that section. The ILSA, 12 U.S.C. § 3907(a)(1), mandates that each Federal banking agency require banks to achieve and maintain adequate capital by establishing minimum

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<sup>1</sup> 44 U.S.C. § 3501 *et seq.*

levels of capital or by other methods that the appropriate federal banking agency may deem appropriate. Section 908 of the ILSA, 12 U.S.C. §3907(b)(3)(C), also directs the Chairman of the Federal Reserve and the Secretary of the Treasury to encourage governments, central banks, and regulatory authorities of other major banking countries to work toward maintaining and, where appropriate, strengthening the capital bases of banking institutions involved in international lending.

Current U.S. risk-based capital requirements are based on an internationally agreed upon framework for capital measurement that was developed by the BCBS and endorsed by the central-bank governors of the Group of 10 (G-10) Countries in 1988. This international framework (1988 Accord) accomplished several important objectives. It strengthened capital levels at large, internationally active banks and fostered international consistency and coordination. The 1988 Accord also reduced disincentives for banks to hold liquid, low-risk assets. Moreover, by requiring banks to hold capital against off-balance-sheet exposures, the 1988 Accord represented a significant step forward for regulatory capital measurement. Although the 1988 Accord has been a stabilizing force for the international banking system, the world financial system has become increasingly more complex over the past eighteen years. The BCBS has been working for several years to develop a new regulatory capital framework that recognizes new developments in financial products, incorporates advances in risk measurement and management practices, and more precisely assesses capital charges in relation to risk. On April 29, 2003, the BCBS released for public comment a document entitled “The New Basel Capital Accord” (Proposed New Accord) that sets forth proposed revisions to the 1988 Accord.

On August 4, 2003, the agencies published an advanced notice of proposed rulemaking (ANPR) in the *Federal Register* to seek public comment on a new risk-based regulatory capital framework. This ANPR was based on the Proposed New Accord. Also, the agencies participated with other members of the BCBS during the development of the New Accord, which was issued in June 2004. The agencies also participated in the BCBS’s Fourth Quantitative Impact Study during the fall and winter of 2004-2005 (QIS 4; OMB No. 7100-0303), to better understand the potential impact of the proposed framework on the risk-based capital requirements for banks.

The current NPR reflects the agencies efforts to address the feedback received to date and recognizes developments in financial products, incorporates advances in risk measurement and management practices, and imposes capital requirements that are generally more sensitive to risk. The NPR seeks to build on improvements to risk assessment approaches that a number of large banks have adopted over the last decade. In particular, the NPR requires banks to assign risk parameters to exposures and provides specific risk-based capital formulas that would be used to transform these risk parameters into risk-based capital requirements. The collection of information contained in the NPR is necessary to ensure that the new risk-based regulatory capital framework is implemented in the United States in a safe and sound manner.

## Description of Information Collection

The NPR sets forth a new risk-based regulatory capital adequacy framework that requires certain large or internationally active banks and BHCs to use an internal ratings-based approach to calculate regulatory credit risk capital requirements and advance measurement approaches to calculate regulatory operational risk capital requirements.

Under the NPR, a bank is required to comply with the NPR if it meets either of two independent threshold criteria: (i) consolidated total assets of \$250 billion or more, as reported on the most recent year-end regulatory reports; or (ii) consolidated total on-balance sheet foreign exposure of \$10 billion or more at the most recent year-end. To determine total on-balance sheet foreign exposure, a bank would sum its adjusted cross-border claims, local country claims, and cross-border revaluation gains (calculated in accordance with the Federal Financial Institutions Examination Council (FFIEC) Country Exposure Report (FFIEC 009<sup>2</sup>)). Adjusted cross-border claims would equal total cross-border claims less claims with the head office/guarantor located in another country, plus redistributed guaranteed amounts to the country of head office/guarantor. A bank is also required to comply if it is a subsidiary of another financial institution that uses the advanced approaches.

Under the NPR, a BHC is required to comply with the NPR if the BHC has: (i) consolidated total assets (excluding assets held by an insurance underwriting subsidiary) of \$250 billion or more, as reported on the most recent year-end regulatory reports; (ii) consolidated total on-balance sheet foreign exposure of \$10 billion or more at the most recent year-end; or (iii) a subsidiary depository institution (DI) that is a core bank or opt-in bank. Currently 11 top-tier banking organizations meet these criteria. The agencies note that, using this approach to define whether a BHC is a core bank, it is possible that no single DI under a BHC would meet the threshold criteria, but that all of the BHC's subsidiary DIs would be core banks.

Also, some banks or BHCs may voluntarily decide to adopt the framework. Both mandatory and voluntary respondents would be required to meet certain qualification requirements before they could use the advanced approaches for risk-based capital purposes.

The NPR requires respondents to adopt a written implementation plan, update that plan for any mergers, obtain prior written approvals for the use of certain approaches, and make certain public disclosures regarding its capital ratios, their components, and information on implicit support provided to a securitization. These requirements are described in Sections 21 through 23, 42, 44, 53, and 71 of the NPR. Details of the requirements for each section are provided below.

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<sup>2</sup> The Agencies' OMB Control Numbers for the FFIEC 009 are: Federal Reserve (7100-0035), FDIC (3064-0017), and OCC (1557-0100).

**Written Implementation Plan (Sections 21, 22 and 23).** Sections 21 and 22 require that a covered institution adopt a written implementation plan that addresses how it will comply with the NPR's qualification requirements, including incorporation of a comprehensive and sound planning and governance process to oversee the implementation efforts. The institution must also develop processes for assessing capital adequacy in relation to an organization's risk profile. It must have in place internal risk rating and segmentation systems for wholesale and retail risk exposures, including comprehensive risk parameter quantification processes and processes for annual reviews and analyses of reference data to determine its relevance. It must document its process for identifying, measuring, monitoring, controlling, and internally reporting operational risk; verify the accurate and timely reporting of risk-based capital requirements; and monitor, validate, and refine its advanced systems. Section 23 requires an institution to update its implementation plan after any mergers.

**Prior Written Approvals (Sections 44 and 53).** Sections 44 and 53 require prior written approval by supervisors. Section 44 describes the internal assessment approach (IAA). Prior written approval is required for use of the IAA. An institution must review and update each internal credit assessment whenever new material is available, but at least annually. It must validate its internal credit assessment process on an ongoing basis and at least annually. Section 53 outlines the internal models approach (IMA). Prior written approval is required for use of the IMA.

**Disclosures (Sections 42 and 71).** Section 71 specifies that each consolidated bank must publicly disclose its total and tier 1 risk-based capital ratios and their components quarterly. Section 42 also requires an institution to publicly disclose that it has provided implicit support to a securitization and the regulatory capital impact to the bank of providing such implicit support.

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

This information collection contains both reporting and disclosure requirements, as mentioned above. The creation of a written implementation program is a mandatory one-time requirement, with mandatory updates that are on-occasion. The prior written approvals are all on-occasion and the disclosures are required quarterly.

### **Sensitive Questions**

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

### **Consultation Outside the Agency**

All of the Board's rulemaking activities are subject to the notice and comment requirements of the Administrative Procedure Act. On August 4, 2003, the agencies published an ANPR in the *Federal Register* to seek public comment on a new risk-based regulatory capital framework. The agencies received about 100 comments from banks,

trade associations, supervisory authorities, and other interested parties. The agencies participated with other members of the BCBS during the development of the New Accord, which was issued in June 2004. The agencies worked domestically and with other BCBS member countries to modify the methodologies in the final paper to reflect comments received during the ANPR comment process. The agencies also participated in the BCBS's Fourth Quantitative Impact Study during the fall and winter of 2004-2005 (QIS 4), to better understand the potential impact of the proposed framework on the risk-based capital requirements for banks. The Federal Reserve conducted a survey of five large institutions to help develop the hourly burden estimates. Finally, the agencies have published the NPR for comment in the *Federal Register*.

### **Legal Status**

The Board's Legal Division has determined that 12 U.S.C. 324 and 12 U.S.C. 1844 (c) authorize the Board to require the information collection. If an institution considers the information to be trade secrets and/or privileged such information could be withheld from the public under the authority of the Freedom of Information Act, 5 U.S.C. 552(b)(4). Additionally, to the extent that such information may be contained in an examination report such information may also be withheld from the public, 5 U.S.C. 552 (b)(8).

### **Estimate of Respondent Burden**

The total annual burden for the Basel II capital requirements is 216,330 hours, as shown in the table below. The Federal Reserve estimates that it will take each respondent 13,268 hours to create and subsequently, update their written implementation plan, 1,009 hours to submit prior written approvals, and 36.25 hours per quarter to provide the required disclosures. Most of the burden associated with this information collection is related to the written implementation plan and will only occur during the first year of implementation or once a bank or BHC meets the qualification criteria. This burden represents 5 percent of the total Federal Reserve System paperwork burden.

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	<i>Number of respondents</i>	<i>Estimated annual frequency</i>	<i>Estimated response time</i>	<i>Estimated annual burden hours</i>
Written Implementation Plan	15	1	13,268 hours	199,020
Prior Written Approvals	15	1	1,009 hours	15,135
Disclosures	15	4	36.25 hours	2,175
		<i>Total</i>		216,330

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Based on a rate of \$100 per hour, the estimated cost to the public for this information collection is \$21,633,000.

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

Estimates of cost to the Federal Reserve System will be obtained.