

## SUPPORTING STATEMENT

### Risk-Based Capital Guidelines; Capital Adequacy Guidelines: Standardized Framework; Proposed Rule and Notice

#### **INTRODUCTION**

In June 2006, the Basel Committee on Banking Supervision released the *International Convergence of Capital Measurement and Capital Standards: A Revised Framework, Comprehensive Version* (Basel II Accord). The Basel II Accord is designed to promote improved risk-measurement and management processes and better align minimum risk-based capital requirements with risk. It presents three approaches for calculating the risk-based capital requirements for credit risk (standardized, foundation internal ratings-based, and advanced internal ratings-based) and three approaches for operational risk (basic indicator, standardized, and advanced measurement).

On September 25, 2006, the FDIC, jointly with the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Office of Thrift Supervision (collectively, the agencies) issued a notice of proposed rulemaking seeking public comment on the more advanced approaches for credit and operational risk in the Basel II Accord, which included the advanced internal ratings-based approach for credit risk and the advanced measurement approach for operational risk. On December 7, 2007 (72 FR 69288), the agencies published a final rule adopting the internal ratings-based approach for calculating regulatory credit risk capital and the advanced measurement approaches for calculating regulatory operational risk capital (together the advanced approaches). The advanced approaches rule is mandatory for the largest U.S. banks (core banks) and optional for other banks (non-core banks).

Banks that do not plan to adopt the advanced approaches due to the cost and complexity associated with implementation expressed concern that they would be at a competitive disadvantage compared to core banks. In response, on December 26, 2006 (71 FR 77446), the agencies issued the Basel IA notice of proposed rulemaking, which proposed a limited number of changes to the general risk-based capital rules to modestly increase risk sensitivity and address some of the competitive equity issues, while minimizing regulatory burden. Many commenters on the Basel IA notice of proposed rulemaking expressed the belief that implementing the standardized approach provided in the Basel II Accord would improve the risk-sensitivity of the risk-based capital rules and more appropriately address the industry's domestic and international competitive concerns and, therefore, requested the agencies to instead implement the standardized approach in the Basel II Accord. On July 20, 2007, the agencies agreed to issue a proposed rule that would provide all non-core banks with the option to adopt a standardized approach as provided in the Basel II Accord. The current request for OMB review seeks approval for the information collection requirements contained in the proposed rule setting forth a new risk-based capital framework (standardized framework) based on the standardized approach for credit risk and the basic indicator approach for operational risk.

## **JUSTIFICATION**

### **1. Circumstances and Need**

U.S. banks that adopt the standardized approach will be subject to new risk-based capital rules as described in the NPR. The new information collection requirements in the proposed rule are found in Sections 1, 37, 42, and 71. The collections of information are necessary in order to implement the proposed standardized capital adequacy framework.

Section 1 requires banks to provide written notification prior to using the appendix to calculate their risk-based capital requirements (opt-in letter) or ceasing its use (opt-out letter). It also requires written notification prior to applying the principle of conservatism for a particular exposure. Section 37 requires a bank's prior written notification before it can calculate its own collateral haircuts using its own internal estimates. It also requires a bank's prior written notification before it can estimate an exposure amount for a single-product netting set of repo-style transactions and eligible margin loans when recognizing the risk-mitigating effects of financial collateral using the simple VaR methodology. The agencies believe that the notifications in Section 37 would in most cases be included in the opt-in letter discussed in Section 1. Section 42 requires certain public disclosures if a bank provides support to a securitization in excess of its contractual obligation. Section 71 requires a number of qualitative and quantitative disclosures regarding a bank's risk-based capital ratios and their components.

### **2. Use of Information Collected**

The proposed rule requires an opt-in letter and possibly an opt-out letter to notify the FDIC of the banks intention to use or cease to use the standardized approach. The FDIC will use these letters to track banks that adopt the standardized approach and to exercise the FDIC's authority to require a state non-member bank to use a particular risk-based capital framework.

Additional information required by the proposed rule includes written notification before a bank can calculate its own collateral haircuts using its own internal estimates, and prior written notification before a bank can estimate an exposure amount for a single-product netting set of repo-style transactions and eligible margin loans when recognizing the risk-mitigating effects of financial collateral using the simple VaR methodology. The FDIC will use this information to ensure proper adherence to the requirements established in the proposed rule.

The FDIC will use the information collected through public disclosures in the following ways:

- To assess and monitor the levels and components of each reporting entity's risk-based capital requirements under the standardized approach.
- To evaluate the quantitative impact and competitive implications of the standardized approach on an industry-wide basis.
- To supplement the on-site and off-site examination process.

### 3. Use of Technology to Reduce Burden

Banks are free to use the method they deem most appropriate to maintain any documentation required by the information requirements. The qualitative and quantitative disclosures required under Section 71 would be published on the banks external website.

### 4. Efforts to Identify Duplication

No other report collects information pertaining to a bank's calculation of risk-based capital requirements under the standardized approach. The proposed rule requires certain public disclosure requirements (Pillar 3) at the consolidated holding company level. Banks currently submit regulatory reports on a quarterly basis both for the insured bank and the holding company. However, these regulatory reporting requirements are generally more detailed than Pillar 3 disclosure requirements, requiring reporting of greater detail about exposure amounts and the calculation of a bank's risk-based capital ratios, and are more standardized in terms of required information. Pillar 3 disclosure requirements include additional qualitative requirements that are not currently captured in regulatory requirements. It is for this reason that current regulatory reporting would not be an acceptable substitute for Pillar 3 disclosures.

### 5. Minimizing the Burden on Small Banks

Adoption of the standardized approach for calculating risk-based capital requirements is optional for all non-core banks. Banks which determine that the standardized approach is too burdensome can continue operating under the current risk-based capital rules.

### 6. Consequences of Less Frequent Collection

Opt-in and opt-out notices required by the proposed rules are the minimum necessary for effective implementation of the standardized approach. Less frequent reporting of Pillar 3 disclosures would reduce the ability of the FDIC to respond to adverse trends that become apparent through public disclosures. Additionally, less frequent reporting would hinder the off-site examination process.

### 7. Special Circumstances

There are no special circumstances.

### 8. Summary of Public Comments

The current proposal is the result of written comments received in response to the Agencies' Basel IA proposal, published in the Federal Register on December 26, 2006, which proposed revisions to the existing risk-based capital framework that would enhance its risk sensitivity without unduly increasing regulatory burden. The Agencies received 64 comments and the

majority of commenters expressed a belief that the standardized approach in Basel II offers a more risk-sensitive approach than current rules, without creating competitive distortion and undue regulatory burden, and encouraged the Agencies to adopt the standardized approach. After several months of discussion and analysis, the Agencies agreed to issue, as a replacement for the earlier Basel IA proposed rule, a proposed rule that would provide all non-core banks with the option to adopt a standardized approach under the Basel II Accord. All comments received in response to the current proposal will be fully considered in drafting the final rule.

#### 9. Payment or Gift to Respondents

No payment or gift will be provided to respondents.

#### 10. Confidentiality

All documentation required under Sections 1 and 37 would be maintained by the bank and would not be shared publicly. Documentation required under sections 42 and 71 is public information and is part of the agencies goal to foster increased market discipline through meaningful public disclosure.

#### 11. Information of a Sensitive Nature

There is no information of a sensitive nature that is required.

#### 12. Estimate of Annualized Burden

It is estimated that, on average, it will take an FDIC-supervised bank approximately 3 hours per year to meet the opt-in requirements and 36.25 hours per quarter to meet the disclosure requirements and. There are an estimated 61 state nonmember banks that will be required to submit reports under these reporting and disclosure requirements. In addition, the FDIC estimates that 4 banks per year will elect to opt-out of Basel II standardized capital requirements, and that preparation of opt-out submissions will take one (1) hour. The combined estimated annual reporting burden for FDIC-regulated banks is, therefore, as follows:

Opt-in Letter:	61 respondents x 1 per year x 3 hours = 183 hours
Disclosures:	61 respondents x 4 per year x 36.25 hours = 8,845 hours
Opt-out Letter:	4 respondents x 1 per year x 1 hour = 4 hours

Total Burden = 9,032 hours.

These estimates reflect considerations pertaining to the time required to complete other types of regulatory documentation as well as the greater level of detail required in these information collection requirements.

#### 13. Estimate of Total Annual Cost Burden

There will be certain additional costs associated with implementing the proposed rule and these informational requirements relating to developing and maintaining software, data systems, and data processing capabilities. It is difficult to develop estimates of capital and start-up costs as well as operation and maintenance/purchase of services costs that distinguish between those pertaining to these reporting requirements and those related to satisfying the requirements of this proposed rule.

14. Estimate of Total Annual Cost to the Federal Government

The FDIC does not expect to incur material incremental costs in connection with the collection of these data.

15. Reason for Change in Burden

This is a new information collection.

16. Publication

The information collected under the proposed rule is intended primarily to meet the supervisory and policy needs of the FDIC and the other agencies. The qualitative and quantitative disclosures required by the proposed rule would be self-published by the banks on their external websites.

17. Display of Expiration Date

Not applicable.

18. Exceptions to Certification

None.

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

Not applicable.