Supporting Statement for the
Quantitative Impact Study
(FR 3045; OMB No. to be assigned)

Summary

The Federal Reserve, under delegated authority from the Office of Management and Budget, proposes to conduct a one-time survey, the Quantitative Impact Study (FR 3045; OMB No. to be assigned). The Federal Reserve, in conjunction with the Office of the Comptroller of the Currency (OCC), will survey twenty large bank holding companies (BHCs) as part of a worldwide effort by the Basel Committee on Banking Supervision (the Committee). The Committee will survey leading financial institutions from the thirteen countries participating on the Committee as well as many other countries in order to gauge the likely effects of proposed new capital standards for internationally active banking organizations. The estimated total burden for this survey is 8,000 hours.

The Committee is developing new regulatory capital standards for internationally active banks (the New Basel Capital Accord, or "Accord") to replace the current standard that has been in place since 1988. The proposed new Accord will be more complex than the original 1988 Accord in order to address the advances and innovations in financial instruments and risk measurement practices that have occurred during the past decade. In designing new capital requirements, the Committee is seeking a standard that provides adequate safety and soundness to world financial markets and that is also far more sensitive to different levels of economic risk than is available with the current Accord. To do this, Committee members believe they must rely more heavily than before on an institution's internal risk measurement systems and its own quantitative assessment of risk, particularly for the largest, most complex, and highly sophisticated banking organizations. For others, less complex capital standards could suffice.

With those views, the Committee has structured a proposed standard that entails two different approaches: a simple standard much like the current Accord and a more complex standard that relies on internal risk measurement systems of banks. The latter, in turn, has two variations, a "foundation" and an "advanced" approach. To ensure that each standard would perform sufficiently well, participants to the survey will be asked to calculate their capital requirements under the current rules and also under each of the proposed alternatives.

The primary purpose of this survey is to gather detailed information about each participant's risk profile so that the Committee can sufficiently understand the factors driving the results and can properly modify and "calibrate" new rules. Consequently, in addition to providing "bottom-line" results, respondents will also be asked to provide substantial details about the underlying calculations.

The Federal Reserve and OCC have recently met with senior management of each institution invited to participate in the survey in order to emphasize both the importance of this survey and the resources that would be required. The institutions all appear to understand fully the implications of participation and the mutual benefits it would provide.

Background and Justification

The current Accord was developed in 1988 in order to promote safety and soundness among banking systems worldwide and to bring about greater competitive equity among internationally active banks. Though relatively simple in approach, it reflected banking practices of the time. Since then, however, risk measurement theory and practice have advanced, and financial markets have become more efficient in measuring and pricing risk. The current capital standards, themselves, have spurred much of this innovation as financial institutions sought ways to differentiate among broad classes of risk in order to arbitrage the rules and minimize their regulatory capital requirements. As a result, some of the larger, more complex institutions may be incurring risks without commensurate capital requirements and may be exposing themselves and the financial system to undue risk.

The best way to make regulatory capital standards more effective and more consistent with levels of underlying economic risk is to rely more heavily on internal risk measures of banks--measures that are used for pricing, reserving, performance evaluation, and other purposes. Such measures reflect far more information that is relevant to evaluating economic risk than could be possible under another approach. A crucial requirement, however, is that the internal measure be sufficiently rigorous and comprehensive. Therefore, before any institution would be allowed to use its internal measures for calculating regulatory capital requirements, its risk measurement process must meet specific minimum standards, and supervisors would need to evaluate and approve its practices. This approach has the further expected advantage of stimulating still better risk measurement and management practices in major banking organizations throughout the world.

Before they can propose new capital standards based on internal risk measures of banks, regulators in the United States and abroad need to understand fully the likely effect of such standards. That information can be provided only by the institutions themselves.

This survey is the third in a series of Quantitative Impact Studies (QIS) conducted by the Committee. An earlier version of the QIS was conducted last year among 130 banking organizations around the world, but very few U.S banks participated. The Committee is now presenting a more concrete proposal that incorporates the comments received on the earlier surveys and feedback from the industry and supervisors worldwide.

The Committee will use information provided by the survey to calibrate new capital requirements and to revise the proposal, as necessary, with the expectation that the new Accord would be implemented by year-end 2006. The state of credit and risk management at some depository institutions in the U.S and abroad is so complex that large, internationally active banks would need the time period between the release of the new Accord (year-end 2003) and the implementation target date (year-end 2006) to implement the new Accord. In addition, it is possible the Committee may want to conduct another survey to assess the effect of the new standard and to gauge whether the nature of risk exposure has changed. However, that decision has not yet been made. If a new survey were necessary, it would be subject to review and approval of the Federal Reserve's review committees.

While seeking to develop and implement far more sophisticated and risk-sensitive capital standards, the Committee also needs to assure itself that the new regulatory capital requirements will be both prudent and practical relative to existing capital levels and market expectations. The information requested is designed to guide U.S. bank regulators and other Committee members in making necessary adjustments to meet those objectives. It should also provide the participating banking organizations with a better understanding of forthcoming and complex proposals that a new Accord would entail. That understanding, in turn, should improve the quality of public comments the participants and banking system provide to the agencies once new capital standards are formally proposed.

Description of Information Collection

On a best-efforts basis, BHCs will be asked to provide information about their exposures (e.g., loans and loan commitments) for each major loan portfolio (corporate, interbank, sovereign, and retail) and to identify for each portfolio the estimated effect of potential new regulatory capital requirements. Such information and corresponding *pro forma* capital requirements will be requested using current capital standards and also under each of several alternative approaches: a so-called "standardized" approach, which is similar to current rules, and both "foundation" and "advanced" internal risk-based (IRB) measures. These IRB methods rely on individual risk ratings of exposures prepared internally by banks, with the advanced approach providing banks with greater flexibility in calculating their minimum regulatory capital requirements.

Information will also be requested to identify, for each portfolio and potential regulatory capital method, the extent to which various types of available collateral would reduce the resulting capital charge. Exposures in each portfolio would also be sufficiently detailed to show the full effect of proposed standards. For example, retail credits would be split between residential mortgages and other retail exposures, while corporate loans would distinguish between those to small and medium sized firms versus larger businesses, since different levels of diversification can affect underlying economic risk. Those and other distinctions among exposures would parallel differences embodied in proposed capital standards that differentiate as necessary between types of exposures that appear most relevant in terms of different levels of risk. In some cases, information about the maturity of exposures is also needed.

The survey will be completed using formatted Excel spreadsheets that will calculate each respondent's capital requirements based on the information it provides. Participants will submit their results to a U.S. project coordinator at the Federal Reserve Board, with copies as they wish to other bank supervisors. The Attachment contains sample spreadsheets to illustrate the kind of information the Committee is developing. The Committee will continue to refine the survey form over the summer.

Although the survey spreadsheets are not yet finalized, they are sizeable in number, requiring an estimated 150 pages in present draft form per respondent. Three factors contribute to the large size of the spreadsheets: 1) the new Accord abandons the one-size-fits-all approach and provides a menu of options from which banks can choose; 2) the new Accord adopts more risk sensitivity, and therefore more complex measurement techniques; and 3) the consultative package incorporates descriptions of work in progress, which will be streamlined in the final package. In recognition of the complexity of the spreadsheets and in order to reduce burden and ensure high quality data, several meetings and conference calls among participants and supervisors are planned. Federal Reserve and OCC supervisors will be assigned to work directly with participants, as necessary, throughout the process.

Time Schedule for Information Collection and Publication

The Federal Reserve expects to distribute draft spreadsheets in summer 2002 in order to assist the BHCs in their preparation for the survey that begins October 2002. The Committee expects to finalize survey forms and distribute them to participants worldwide on or around October 1, 2002, and responses will be due December 31, 2002. At that point, coordinators will review, summarize, and compare results, resolve questions, and submit findings to the Committee and to member agencies by mid-February 2003. At present, the Committee expects to issue rules reflecting the survey information in the *Federal Register* by early May 2003 for a 90-day public comment period.

Legal Status

The Board’s Legal Division has determined that this report is authorized by law (12 U.S.C. § 1844). Individual responses are exempt from disclosure pursuant to the Freedom of Information Act (5 U.S.C. § 552(b)(4)).

Consultation Outside the Agency

Supervisory and senior staff from the Board worked in conjunction with the OCC to identify and recruit respondents and are working internationally through the Committee to standardize the spreadsheets.

Estimate of Respondent Burden

Total reporting burden is estimated to be 8,000 hours as shown in the following table. This represents less than 1 percent of total Federal Reserve System annual reporting burden. Board staff estimate, based on information from the previous Quantitative Impact Studies, that respondents would need a team of employees working an average of 50 labor days per BHC to complete the survey forms. The range of required effort may be significant, depending on the structure and adequacy of each institution’s information systems. In some cases, the time required may be greater. As noted above, the Federal Reserve and the OCC would provide a supervisor to each BHC to answer questions and to help ensure high data quality. On the other hand, much of this effort would be conducted unilaterally by participating institutions, in any event, in order to provide senior management the information it needs to understand the effects of and comment on potential regulations that could be crucially important to their organizations' activities. Such information is also relevant to the on-going supervision and risk management activities of the banking organizations.

	Number of respondents	*Annual frequency*	*Estimated average hours per response*	*Estimated annual burden hours*
FR 3045	20	1	400	8,000

Based on an average hourly cost of $50 for senior bank officers and support staff, the annual cost to the public is estimated to be $400,000.

Estimate of Cost to the Federal Reserve System

The estimated cost to the Federal Reserve System for collecting and processing the survey is estimated at $60,000, excluding resources that would otherwise be devoted to related efforts of understanding and finalizing new capital rules or evaluating risk management practices of banks.