

**Supporting Statement for the  
Recordkeeping and Disclosure Provisions Associated with  
Stress Testing Guidance (FR 4202; OMB No. 7100-0348)**

*Stress Testing Guidance (Docket No. OP-1421)*

**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 Recordkeeping and Disclosure Provisions Associated with Stress Testing Guidance (Stress Testing Guidance or Guidance) (FR 4202; OMB No. 7100-0348). The Paperwork Reduction Act (PRA) classifies these recordkeeping and disclosure requirements as an information collection and the PRA requires, subsequent to implementation, the Federal Reserve to renew these requirements every three years.

On June 15, 2011, the agencies<sup>1</sup> published a joint notice of proposed guidance (NPG) in the *Federal Register* for public comment (76 FR 35072). The interagency Guidance outlines high-level principles for stress testing practices, applicable to all Federal Reserve-supervised, FDIC-supervised, and OCC-supervised banking organizations with more than \$10 billion in total consolidated assets. The Guidance highlights the importance of stress testing as an ongoing risk management practice that supports a banking organization's forward-looking assessment of its risks. The comment period expired on July 29, 2011. The agencies received 17 comment letters on the proposed Guidance. In response to these comments, the agencies have clarified the requirements of the Guidance and modified the final Guidance in certain respects. A notice of final guidance (NFG) was published in the *Federal Register* on May 17, 2012 (77 FR 29458). The Stress Testing Guidance is effective July 23, 2012. The total annual recordkeeping and disclosure burden for the FR 4202 is estimated to be 40,040 hours.

**Background and Justification**

All banking organizations should have the capacity to understand their risks and the potential impact of stressful events and circumstances on their financial condition.<sup>2</sup> The U.S. federal banking agencies have previously highlighted the use of stress testing as a means to better understand the range of banking organizations' potential risk exposures.<sup>3</sup> The financial

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<sup>1</sup> The Agencies that are party to this rulemaking are the Office of the Comptroller of the Currency (OCC); Board of Governors of the Federal Reserve System (Board); and Federal Deposit Insurance Corporation (FDIC); and are collectively referred to as the agencies or federal banking agencies.

<sup>2</sup> For purposes of this guidance, the term "banking organization" means national banks and Federal branches and agencies supervised by the OCC; state member banks, bank holding companies, and all other institutions for which the Federal Reserve is the primary federal supervisor; and state nonmember insured banks and other institutions supervised by the FDIC.

<sup>3</sup> See, for example, Supervision and Regulation (SR) letter 10-6 or OCC Bulletin 2010-13 or FDIC FIL-13-2010, "Interagency Policy Statement on Funding and Liquidity Risk Management"; SR 10-1 or OCC Bulletin 2010-1 or FDIC Financial Institution Letter (FIL-2-2010), "Interagency Advisory on Interest Rate Risk"; SR letter 09-04, "Applying Supervisory Guidance and Regulations on the Payment of Dividends, Stock Redemptions, and Stock Repurchases at Bank Holding Companies"; SR letter 07-1, "Interagency Guidance on Concentrations in

crisis that occurred between 2007 and 2009 further underscored the need for banking organizations to incorporate stress testing into their risk management, as banking organizations unprepared for stressful events and circumstances can suffer acute threats to their financial condition and viability. The final Guidance is intended to be consistent with industry practices and with international supervisory standards.<sup>4</sup>

Building upon previously issued supervisory guidance that discusses the uses and merits of stress testing in specific areas of risk management, the proposed Guidance provides an overview of how banking organizations should structure their stress testing activities and ensure they fit into overall risk management. The purpose of this Guidance is to outline broad principles for a satisfactory stress testing framework and describe the manner in which stress testing should be employed as an integral component of risk management that is applicable at various levels of aggregation within banking organizations, as well as for contributing to capital and liquidity planning. While the Guidance is not intended to provide detailed instructions for conducting stress testing for any particular risk or business area, the final Stress Testing Guidance aims to describe several types of stress testing activities and how they may be most appropriately used by banking organizations. The Guidance does not explicitly address the stress testing requirements imposed upon certain companies by section 165(i) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). On January 5, 2012, the Federal Reserve published for comment a proposed rulemaking in the *Federal Register* (77 FR 594) implementing the stress testing requirements contained in section 165(i) of the Dodd-Frank Act. The public comment period ended on March 31, 2012. The provisions proposed in the January rulemaking are consistent with the principles in the proposed guidance.

## **Description of Information Collection**

### *General Stress Testing Principles*

An organization should develop and implement an effective stress testing framework that should include several activities and exercises, and not just rely on any single test or type of test, since every stress test has limitations and relies on certain assumptions. The uses of an organization's stress testing framework should include, but not be limited to: augmenting risk identification and measurement; estimating business line revenues and losses; informing business line strategies; assessing capital adequacy and enhancing capital planning; assessing liquidity adequacy and informing contingency funding plans; contributing to strategic planning; and assisting with recovery planning.

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Commercial Real Estate” or OCC Bulletin 2006-46 or FDIC FIL-104-2006, “Interagency Guidance on CRE Concentration Risk Management”; SR letter 99-18, “Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles”; OCC Bulletin 2008-20 or FDIC FIL-71-2008 “Supervisory Guidance: Supervisory Review Process of Capital Adequacy (Pillar 2) Related to the Implementation of the Basel II Advanced Capital Framework”; the Supervisory Capital Assessment Program (see <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20080715a1.pdf>); and Comprehensive Capital Analysis and Review: Objectives and Overview (see [www.federalreserve.gov/newsevents/press/bcreg/20110318a.htm](http://www.federalreserve.gov/newsevents/press/bcreg/20110318a.htm)).

<sup>4</sup> See “Principles for Sound Stress Testing Practices and Supervision,” Basel Committee on Banking Supervision, May 2009.

All risk measures, including stress tests, have an element of uncertainty due to assumptions, limitations, and other factors associated both with the use of measures based on past performance and with forward-looking estimates. An organization should document the assumptions used in its stress tests and note the degree of uncertainty that may be incorporated into the tools used for stress testing. In many cases, it may be appropriate to present and analyze test results not just in terms of point estimates, but also including the potential margin of error or statistical uncertainty around the estimates. Furthermore, all stress tests, including well-developed quantitative tests supported by high-quality data, employ a certain amount of expert or business judgment that should be made transparent. In some cases, when credible data are lacking and more quantitative tests are operationally challenging or in the early stages of development, an organization may choose to employ more qualitatively-based tests, provided that they are properly documented and their assumptions are transparent. Regardless of the type of stress tests used, an organization should understand and clearly document all assumptions, uncertainties, and limitations, and provide that information to users of the stress testing results.

### *Governance Over the Stress Testing Framework*

Governance over an organization's stress testing framework rests with the organization's board of directors and senior management. As part of their overall responsibilities, an organization's board and senior management should establish a comprehensive, integrated and effective stress testing framework that fits into the broader risk management of the organization. While the board is ultimately responsible for ensuring that the organization has an effective stress testing framework, it should task senior management with implementing that framework. Senior management duties should include establishing adequate policies and procedures and ensuring compliance with those policies and procedures, assigning competent staff, overseeing stress test development and implementation, evaluating stress test results, reviewing any findings related to the stress test performance, and taking prompt remedial action where necessary. Senior management, directly and through relevant committees, also should be responsible for regularly reporting to the board on stress testing developments and results from individual and collective stress tests as well as on compliance with stress testing policy. Board members should actively evaluate these reports, ensuring that the stress testing framework is in line with the organization's risk appetite, overall strategy and business plans, and directing changes where appropriate.

An organization should have written policies, approved and annually reviewed by the board, that direct and govern the implementation of the stress testing framework in a comprehensive manner. Policies, along with procedures to implement them, should:

- Describe the overall purpose of stress testing activities;
- Articulate consistent and sufficiently rigorous stress testing practices across the entire organization;
- Indicate stress testing roles and responsibilities, including controls over external resources used for any part of stress testing (such as vendors and data providers);
- Describe the frequency and priority with which stress testing activities should be conducted;
- Indicate how stress test results are used and by whom;
- Be reviewed and updated as necessary to ensure that stress testing practices remain appropriate and keep up to date with changes in market conditions, organization products and

strategies, organization exposures and activities, the organization's established risk appetite, and industry stress testing practices.

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

The documentation required by the Guidance is maintained by each institution; therefore, it is not collected or published by the Federal Reserve System. These recordkeeping requirements are documented on occasion. Bank examiners would verify compliance with the recordkeeping requirements during examinations.

### **Consultation Outside of the Agency**

On June 15, 2011, the agencies published an NPG in the *Federal Register* for public comment (76 FR 35072). The comment period expired on July 29, 2011. The agencies received 17 comment letters on the proposed Guidance. Commenters included financial trade associations, bank holding companies, financial advisory firms, and individuals. Commenters generally expressed support for the proposed Stress Testing Guidance. However, several commenters recommended changes to, or clarification of certain provisions of the proposed Stress Testing Guidance. In response to the comments, the agencies clarified the requirements and modified the Stress Testing Guidance in certain respects, as described in the NFG implementing the Guidance.

Of the 17 comments received, three comments addressed the overall regulatory burden, not specifically paperwork burden, stating that implementation will require a multiple of the 260 estimated hours. The agencies emphasize that the Stress Testing Guidance does not implement the stress testing requirements imposed by the Dodd-Frank Act or the Board's capital plan rule, and does not otherwise impose mandatory stress testing requirements. Currently, the reporting burden associated with mandatory stress tests is accounted for under the Capital Assessment and Stress Testing information collection (FR Y-14A/Q/M; OMB No. 7100-0341). Any paperwork burden associated with other mandatory stress testing would be accounted for in the respective rules that implement those requirements.

In addition, the agencies believe that in some respects, the information collection elements of this Guidance augment certain expectations that already are in place relative to certain existing supervisory guidance. The burden estimates for this Guidance take into consideration only those collections of information, such as documentation of policies and procedures and relevant reports that are specific to this Guidance. Based on these factors, the agencies believe the burden estimates included in the NPG continue to be appropriate.

For a detailed discussion of the changes proposed, the comments received, and the agencies' response, please refer to the "Current Actions" section of the NFG for this submission published on May 17, 2012 (77 FR 29458). The Stress Testing Guidance is effective July 23, 2012.

## Sensitive Questions

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

## Legal Status

The Board's Legal Division has determined that this voluntary information collection is authorized pursuant to sections 11(a), 11(i), 25, and 25A of the Federal Reserve Act (12 U.S.C. 248(a), 248(i), 602, and 611a), section 5 of the Bank Holding Company Act (12 U.S.C. 1844), and section 7(c) of the International Banking Act (12 U.S.C. 3105(c)). To the extent the Federal Reserve collects information during an examination of a banking organization, confidential treatment may be afforded to the records under exemptions 4 and 8 of the Freedom of Information Act, 5 U.S.C. 552(b)(4) and (8).

## Estimate of Respondent Burden

The total annual burden for the recordkeeping and disclosure requirements of this information collection is estimated to be 31,200 hours, as shown in the table below. The Federal Reserve estimates that it would take the 120 Federal Reserve-supervised institutions with more than \$10 billion in total consolidated assets 180 hours to comply with the recordkeeping requirements, including: 40 hours to document the assumptions used in its stress tests and note the degree of uncertainty that may be incorporated into the tools used for stress testing; 40 hours to maintain a summary of test results; 80 hours for the initial creation of the policies and procedures; and 20 hours for training. On a continuing basis the Federal Reserve estimates it will take 80 hours to comply with the disclosure requirements, including: requiring the board of directors to review and approve annually the policies and procedures, and requiring the banking organization to report to the board of directors on stress testing developments and results from individual and collective stress tests as well as on compliance with stress testing policy. These recordkeeping and disclosure requirements represent less than 1 percent of total Federal Reserve System paperwork burden.

	<i>Number of respondents<sup>5</sup></i>	<i>Estimated annual frequency</i>	<i>Estimated average hours per response</i>	<i>Estimated annual burden hours</i>
Recordkeeping	154	1	180	27,720
Disclosure	154	1	80	<u>12,320</u>
<i>Total</i>				40,040

<sup>5</sup> Of the 154 respondents required to comply with this information collection, none are small entities as defined by the Small Business Administration (*i.e.*, entities with less than \$175 million in total assets) [www.sba.gov/contractingopportunities/officials/size/table/index.html](http://www.sba.gov/contractingopportunities/officials/size/table/index.html).

The total cost to the public is estimated to be \$1,795,794.<sup>6</sup>

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

Since the FR 4202 does not require the Federal Reserve to collect any information, the cost to the Federal Reserve System is negligible.

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<sup>6</sup> Total cost to the public was estimated using the following formula: percent of staff time, multiplied by annual burden hours, multiplied by hourly rate (30% Office & Administrative Support @ \$17, 45% Financial Managers @ \$52, 15% Legal Counsel @ \$55, and 10% Chief Executives @ \$81). Hourly rate for each occupational group are the median hourly wages (rounded up) from the Bureau of Labor and Statistics (BLS), Occupational Employment and Wages 2011, [www.bls.gov/news.release/ocwage.nr0.htm](http://www.bls.gov/news.release/ocwage.nr0.htm) Occupations are defined using the BLS Occupational Classification System, [www.bls.gov/soc/](http://www.bls.gov/soc/)