Comprehensive Capital Analysis and Review for 2012

Frequently Asked Questions

November 22, 2011

1. What is the 2012 Comprehensive Capital Analysis and Review (CCAR 2012)?

Capital is central to a bank holding company's ability to absorb unexpected losses and continue to lend to creditworthy businesses and consumers. The Federal Reserve expects large, complex bank holding companies to hold sufficient capital to maintain access to funding, to continue to serve as credit intermediaries, to meet their obligations to creditors and counterparties, and to continue operations, even in an adverse environment.

It is with this in mind that the Federal Reserve on Tuesday adopted the capital plans rule for bank holding companies (BHCs) with assets greater than $50 billion. The capital plans rule requires these BHCs to develop and submit a capital plan to the Federal Reserve on an annual basis and to request prior approval from the Federal Reserve under certain circumstances before making a capital distribution.

CCAR 2012 is the supervisory exercise that is being conducted to facilitate supervisory assessments of the BHCs' internal capital planning processes, capital adequacy, and proposed capital distributions. The CCAR involves forward-looking, simultaneous analysis of capital planning processes and capital needs at large bank holding companies. The CCAR represents a substantial strengthening of the Federal Reserve's approach to ensuring that large bank holding companies have thorough and robust processes for managing and allocating their capital resources, and that these are supported by effective risk-measurement and risk-management practices.

2. Is CCAR 2012 a stress test?

Capital stress tests are only one, albeit an important, part of CCAR 2012. All participating BHCs will conduct their capital stress tests, under Federal Reserve review, to assess whether they would have sufficient capital to continue operations and to lend to households and businesses, even under adverse conditions. These stress test results are an important tool for a firm's management and board of directors in their evaluation of available capital resources. The supervisory assessment of the BHCs' stress tests will provide supervisors with insight into the risk-measurement and risk-management capabilities of these firms.

In addition, for the 19 largest BHCs that participated in CCAR in 2011, the Federal Reserve will simultaneously conduct a supervisory stress test to help assess the capital plans and the appropriateness of capital levels for those firms.

In the review of the capital plans and stress test evaluations, the Federal Reserve will consider the comprehensiveness of the plan, including an assessment of BHCs' practices for capturing, measuring, and estimating potential losses under stress from the risks stemming from all of a BHC's activities. The Federal Reserve will also assess a BHC's capital policies; the reasonableness of a BHC's assumptions and analysis supporting its internal capital adequacy assessment; and the BHC's ability to maintain capital above each minimum regulatory ratio and above a 5 percent tier 1 common ratio under expected and stressful conditions, with stress testing carried out both by the firms and the Federal Reserve.

3. **Is the baseline or stress scenario the Federal Reserve's forecast for the economy?**

   Neither scenario is the Federal Reserve's forecast. The Supervisory Baseline broadly follows the consensus outlook from private forecasters as of mid-November. The Supervisory Stress scenario is not a forecast for the U.S. or global economy, but a stress scenario that is useful to gauge the strength and resiliency of the 19 BHCs. The stress scenario is designed to represent an outcome that, while unlikely, may occur if the U.S economy were to experience a deep recession while at the same time economic activity in other major economies were also to contract significantly. In particular, this constitutes a deep recession by historical standards where the unemployment rate increases by an amount similar to that experienced, on average, in severe recessions such as those in 1973-1975, 1981-82, and 2007-2009.

4. **Will the European situation be taken into account?**

   The Supervisory Stress scenario provided by the Federal Reserve includes a sizable shortfall in U.S. economic activity and employment, accompanied by a notable decline in global economic activity. In addition, a global market shock will be performed that is based on market price movements seen during the second half of 2008, a time of significant volatility, with adjustments made to incorporate potential sharp market price movements in European sovereign and financial sectors.

5. **What happens if the Federal Reserve objects to a capital plan?**

   CCAR 2012 is a broad supervisory exercise that considers a range of factors for the participating BHCs -- the internal capital planning process, capital distribution policies, pro forma, post-stress capital ratios, and projected path to compliance with regulatory capital standards agreed to by the Basel Committee on Banking Supervision as they are implemented in the United States. Supervisors will evaluate each of these factors and the supervisory response will correspond to any observed deficiencies. For example, a BHC with incomplete or insufficient capital planning processes, or with projected capital ratios that do not appear appropriate given its risk profile and the economic scenarios, may be required to devote more resources to developing and implementing more appropriate processes, may be restricted from some or all capital distributions, and may be required to take actions to improve its capital adequacy.

6. **What are you going to disclose to the public?**

   The Federal Reserve is committed to increasing the transparency of the CCAR process. This will foster market discipline and ultimately make the largest BHCs more resilient as better-informed investors encourage banks toward more prudent risk-taking. The Federal Reserve is releasing the baseline and stress scenarios that will be used to assess the appropriate levels of BHC capital. Moreover, at the completion of the exercise, the Federal Reserve will disclose its estimates of revenues and losses, as well as pro forma, post stress capital ratios for each of the 19 BHCs.

7. **How do the capital plans intersect with what is mandated by the Dodd-Frank Act?**

   The capital plans complement Dodd-Frank in two ways. First, the capital planning requirements are consistent with the Federal Reserve's obligations to impose enhanced capital and risk-management standards on large financial firms under the Dodd-Frank Act. Second, Dodd-Frank mandates that the Federal Reserve conduct annual stress tests on all bank holding companies with $50 billion or more in assets to determine whether they have the capital needed to absorb losses in baseline, adverse, and severely adverse economic conditions. These tests will be integrated into the ongoing assessments of BHC capital required by the capital plans rule. As set forth in the law, the Federal Reserve will be implementing the specific stress testing requirements of Dodd-Frank over the next year. The Federal Reserve expects that the stress tests required in Dodd-Frank will be an important component of the annual assessment of BHC capital plans.