



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

SR 12-7

May 14, 2012

**TO THE OFFICER IN CHARGE OF SUPERVISION AND APPROPRIATE SUPERVISORY
AND EXAMINATION STAFF AT EACH FEDERAL RESERVE BANK AND TO
BANKING ORGANIZATIONS SUPERVISED BY THE FEDERAL RESERVE**

**SUBJECT: Supervisory Guidance on Stress Testing for Banking Organizations with More
Than \$10 Billion in Total Consolidated Assets**

Applicability to Community Banking Organizations: This guidance does not apply to community banking organizations, defined as institutions supervised by the Federal Reserve with total consolidated assets of \$10 billion or less.

The Federal Reserve, together with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) (collectively, the “agencies”), has issued the attached *Guidance on Stress Testing for Banking Organizations with Total Consolidated Assets of More Than \$10 Billion*. The guidance is intended to emphasize the importance of stress testing as an ongoing risk management practice that supports banking organizations’ forward-looking assessment of risks and better equips them to address a range of adverse outcomes.

This joint guidance is applicable to all institutions supervised by the agencies with more than \$10 billion in total consolidated assets. Specifically, with respect to the Federal Reserve, these banking organizations include state member banks, bank holding companies, savings and loan holding companies, and all other institutions with more than \$10 billion in total consolidated assets for which the Federal Reserve is the primary federal supervisor.¹

Summary of the Guidance

For purposes of the guidance, “stress testing” refers to exercises used to conduct a forward-looking assessment of the potential impact of various adverse events and circumstances on a banking organization. An effective stress testing framework provides a comprehensive,

¹ Given the unique structure of U.S. branches and agencies of foreign banking organizations, the agencies recognize that certain aspects of this guidance may not apply to those U.S. branches and agencies (such as the portions related to capital stress testing) or may apply differently (such as the portions related to governance and controls). Supervisors can work with these entities on a case-by-case basis to identify the portions of the guidance that are most relevant for them.

integrated, and forward-looking set of activities for a banking organization to employ in order to assist in the identification and measurement of its material risks and vulnerabilities. Material risks and vulnerabilities may manifest themselves during stressful economic or financial environments, or arise from firm-specific adverse events. A banking organization should develop and implement its stress testing framework in a manner commensurate with its size, complexity, business activities, and overall risk profile.

As described in the guidance, a banking organization should apply the following five principles when designing and implementing a stress testing framework:

- Principle 1: A banking organization's stress testing framework should include activities and exercises that are tailored to and sufficiently capture the banking organization's exposures, activities, and risks.
- Principle 2: An effective stress testing framework employs multiple conceptually sound stress testing activities and approaches.
- Principle 3: An effective stress testing framework is forward-looking and flexible.
- Principle 4: Stress testing results should be clear, actionable, well supported, and inform decision-making.
- Principle 5: An organization's stress testing framework should include strong governance and effective internal controls.

The guidance also describes several approaches and applications that banking organizations should consider using, such as scenario analysis, sensitivity analysis, enterprise-wide stress testing, and reverse stress testing. Organizations should also recognize that stress testing approaches will evolve over time and they should update their practices as needed.

Given the importance of capital and liquidity to a banking organization's viability, the guidance also emphasizes the use of stress testing in these two areas in particular, including an evaluation of the interaction between capital and liquidity, and the potential for both to become impaired at the same time. Stress testing for capital and liquidity adequacy should be conducted in coordination with a banking organization's overall strategy and annual planning cycles. Results should be refreshed in the event of major strategic decisions, or other decisions that can materially impact capital or liquidity.

Federal Reserve Banks are asked to distribute this letter to banking organizations supervised by the Federal Reserve, as well as to their own supervisory and examination staff. Questions regarding this letter should be directed to: Constance M. Horsley, Manager, Capital and Regulatory Policy (202) 452-5239; David Palmer, Senior Supervisory Analyst, Risk Section, (202) 452-2904; or Sean Healey, Financial Analyst, Capital and Regulatory Policy, (202) 912-4611, Division of Banking Supervision and Regulation. In addition, questions may be sent via the Board's public website.²

Michael S. Gibson
Director

² See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.

Attachment:

- *Guidance on Stress Testing for Banking Organizations with Total Consolidated Assets of More Than \$10 Billion*

Cross-references to:

- SR letter 11-11, “Supervision of Savings and Loan Holding Companies (SLHCs)”
- SR letter 11-7, “Guidance on Model Risk Management”
- SR letter 10-6, “Interagency Policy Statement on Funding and Liquidity Risk Management”
- SR letter 10-1, “Interagency Advisory on Interest Rate Risk”
- SR letter 09-4, “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 Commercial Real Estate”
- SR letter 01-4, “Subprime Lending”
- SR letter 99-18, “Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles”