



**BOARD OF GOVERNORS**  
OF THE  
**FEDERAL RESERVE SYSTEM**

WASHINGTON, D.C. 20551

DIVISION OF BANKING  
SUPERVISION AND REGULATION

**SR 14-3**

**March 6, 2014**

**Revised October 16,  
2017**

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

*On October 16, 2017, the SR letter and Attachment 2 entitled “Tables Comparing General Stress Testing Requirements, Reporting, and Expectations,” were updated to address changes to capital rules and changes to the agencies rules implementing Dodd-Frank Act Company-Run Stress Testing disclosure requirements since the issuance of this letter. In particular, the SR letter and Table 2-A (page 1) of Attachment 2 have been updated to reflect changes in capital assumptions and dates for the submission and disclosure of company-run stress tests. Further, an inactive cross referenced letter was removed. For more information on the changes to the Board’s stress testing rules, see 80 Fed. Reg. 75419, December 2, 2015.*

**SUBJECT: Supervisory Guidance on Dodd-Frank Act Company-Run Stress Testing for Banking Organizations with Total Consolidated Assets of More Than \$10 Billion but Less Than \$50 Billion**

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

The Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) (collectively referred to as the “agencies”) have issued the attached *Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations with Total Consolidated Assets of more than \$10 Billion but less than \$50 Billion* (Attachment 1). The guidance discusses supervisory expectations for the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) stress test practices for companies<sup>1</sup> with total consolidated assets between \$10-50 billion (referred to as “\$10-50 billion

<sup>1</sup> In this guidance, the term “company” refers to state member banks, bank holding companies, and savings and loan holding companies.

companies” in this letter) and offers additional details about methodologies that should be employed by these companies. This guidance builds upon the interagency stress testing guidance issued in May 2012 for companies with more than \$10 billion in total consolidated assets that set forth general principles for a satisfactory stress testing framework.<sup>2</sup>

## **Background**

In October 2012, the agencies issued the DFA stress test rules<sup>3</sup> requiring companies with total consolidated assets of more than \$10 billion to conduct annual company-run stress tests pursuant to section 165(i)(2) of DFA.<sup>4</sup> The agencies determined that providing the accompanying supervisory guidance would be helpful to the \$10-50 billion companies in carrying out stress tests.

The supervisory expectations described in the guidance are tailored to the \$10-50 billion companies, similar to the manner in which the requirements in the DFA stress test rules were tailored for this set of companies. The additional information provided in this guidance should assist companies in complying with the DFA stress test rules and conducting DFA stress tests that are appropriate for their risk profile, size, complexity, business mix, and market footprint.<sup>5</sup>

The DFA stress tests may not necessarily capture a company’s full range of risks, exposures, activities, and vulnerabilities that have a potential effect on capital adequacy. Additionally, the DFA stress tests assess the impact of stressful outcomes on capital adequacy, and are not intended to measure the adequacy of a company’s liquidity in the stress scenarios. Finally, companies subject to this guidance are not subject to the Federal Reserve’s capital plan rule, the Federal Reserve’s annual Comprehensive Capital Analysis and Review (CCAR), supervisory stress tests for capital adequacy, or the related data collections supporting the supervisory stress test. Attachment 2 provides several tables comparing the stress requirements, reporting, and expectations for companies with total consolidated assets of \$50 billion or more to \$10-50 billion companies.

## **Expectations for DFA Stress Tests**

The supervisory expectations contained in the guidance follow the specific rule requirements contained in the final DFA stress test rules for \$10-50 billion companies. The guidance covers several categories, outlined below.

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<sup>2</sup> See 77 *Fed. Reg.* 29458, “Supervisory Guidance on Stress Testing for Banking Organizations With More Than \$10 Billion in Total Consolidated Assets,” (May 17, 2012).

<sup>3</sup> The agencies’ rules for “Annual Company-Run Stress Test Requirements for Banking Organizations with Total Consolidated Assets over \$10 Billion Other than Covered Companies” were issued by the Board on October 12, 2012 (77 *Fed. Reg.* 623962), the OCC on October 9, 2012 (77 *Fed. Reg.* 61238), and the FDIC on October 15, 2012 (77 *Fed. Reg.* 62417).

<sup>4</sup> Pub. L. 111-203, 124 Stat. 1376 (2010).

<sup>5</sup> Notably, the DFA stress tests produce projections of hypothetical results and are not intended to be forecasts of expected or most likely outcomes.

## ***DFA Stress Test Timelines***

Under the DFA stress test rules, stress test projections are based on exposures with the as-of-date of December 31 and extend over a nine-quarter planning horizon that begins in the quarter ending March 31 of the following year and ends March 31 two years later.

## ***Scenarios for DFA Stress Tests***

Under the stress test rules implementing the DFA requirements, \$10-50 billion companies must assess the potential impact on capital of a minimum of three macroeconomic scenarios (that is, baseline, adverse, and severely adverse scenarios) provided by their primary supervisor. A company is not required to use all of the variables provided in the scenario, if those variables are not relevant or appropriate to the company's line of business. In addition, a company may, but is not required to, use additional variables beyond those provided by the agencies. When using additional variables, companies should ensure that the paths of such variables (including their timing) are consistent with the general economic environment assumed in the supervisory scenarios.

## ***DFA Stress Test Methodologies and Practices***

The agencies expect that the specific methodological practices used by companies to produce the estimates of the impact on capital and that other measures may vary across organizations.<sup>6</sup> In addition, DFA stress testing practices for \$10-50 billion companies should be commensurate with each company's size, complexity, and sophistication. This means that, generally, larger or more sophisticated companies should consider employing not just the minimum expectations, but the more advanced practices described in this guidance. In addition, \$10-50 billion companies should consider using more than just the minimum expectations for the exposures and activities of highest impact and that present the highest risk.

- *Data sources.* Companies are expected to have appropriate management information systems and data processes that enable them to collect, sort, aggregate, and update data and other information efficiently and reliably within business lines and across the company for use in DFA stress tests. In some cases, proxy data may be used. Companies should challenge conventional assumptions to ensure that a company's stress test is not constrained by its own past experience.
- *Data segmentation.* To account for differences in risk profiles across various exposures and activities, companies should segment their portfolios and business activities into categories based on common or related risk characteristics. The company should select the appropriate level of segmentation based on the size, materiality, and risk of a given portfolio, provided there are sufficiently granular historical data available to allow for the desired segmentation.

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<sup>6</sup> In making projections, companies should make conservative assumptions about management responses in the stress tests, and should include only those responses for which there is substantial support. For example, companies may account for hedges that are already in place as potential mitigating factors against losses, but should be conservative in making assumptions about potential future hedging activities and not necessarily anticipate that actions taken in the past could be taken under the supervisory scenarios.

The minimum expectation is that companies will segment their portfolios and business activities using the categories listed in the \$10-50 billion reporting form.<sup>7</sup>

- *Model risk management.* Companies should have in place effective model risk management practices, including validation, for all models used in DFA stress tests, consistent with existing supervisory guidance.<sup>8</sup> Companies should ensure that an effective challenge process by unbiased, competent, and qualified parties is in place for all models. There should also be sufficient documentation of all models, including model assumptions, limitations, and uncertainties. Companies should ensure that their model risk management policies and practices generally apply to the use of vendor and third-party products as well. Qualitative elements of models should also be subject to model risk management.
- *Loss estimation.* For their DFA stress tests, companies are expected to have credible loss estimation practices that capture the risks associated with their portfolios, business lines, and activities. Credit losses associated with loan portfolios and securities holdings should be estimated directly and separately, whereas other types of losses should be incorporated into estimated pre-provision net revenue (PPNR).<sup>9</sup> Each company's loss estimation practices should be commensurate with the materiality of the risks measured and well supported by sound, empirical analysis. Loss estimates should include projections of other-than-temporary impairments (OTTI) for securities both held for sale and held to maturity.
- *Pre-provision net revenue estimation.* For the DFA stress test, companies are required to project PPNR over the planning horizon for each supervisory scenario. Companies should estimate PPNR at a level at least as granular as the components outlined in the \$10-50 billion reporting form. Companies should ensure that PPNR projections are generally consistent with projections of losses, the balance sheet, and risk-weighted assets. A company may estimate the stressed components of PPNR based on its own or industry-wide historical income and expense experience. Other types of losses that could arise under the supervisory scenarios should be included in projections of PPNR to the extent they would arise under the specified scenario conditions.
- *Balance sheet and risk-weighted asset projections.* A company is expected to project its balance sheet and risk-weighted assets for each of the supervisory scenarios. In doing so, these projections should be consistent with scenario conditions and the company's prior history of managing through the different business environments, especially stressful ones. The projections of the balance sheet and risk-weighted assets should be consistent with other aspects of stress test projections, such as losses and PPNR.
- *Projections for quarterly provisions and allowance for loan and lease losses (ALLL).* The DFA stress test rules require companies to project quarterly provision for loan and lease losses (PLLL). Companies are expected to project PLLL for each scenario based on

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<sup>7</sup> For purposes of this letter, the term "\$10-50 billion reporting form" generally refers to the FR Y-16. However, for subsidiary banks and thrifts of \$10-50 billion holding companies, it could be the relevant reporting form the subsidiary will use to report the results of its DFA stress tests to its primary federal financial regulatory agency.

<sup>8</sup> Refer to SR letter 11-7, "Guidance on Model Risk Management."

<sup>9</sup> The DFA stress test rules define PPNR as net interest income plus non-interest income less non-interest expense. Non-operational or non-recurring income and expense items should be excluded.

projections of quarterly loan and lease losses and while maintaining an appropriate ALLL balance at the end of each quarter of the planning horizon, including the last quarter.

- *Projections for quarterly net income.* Under the DFA stress test rules, companies must estimate projected quarterly net income for each scenario. Net income projections should be based on loss, revenue, and expense projections.

### ***Estimating the Potential Impact on Regulatory Capital Levels and Capital Ratios***

Companies must estimate projected quarterly regulatory capital levels and regulatory capital ratios for each scenario. Any rare cases in which ratios are higher under the adverse and severely adverse scenarios should be very well supported by analysis and documentation. Projected capital levels and ratios should reflect applicable regulations and accounting standards for each quarter of the planning horizon. In their DFA stress tests, bank holding companies and savings and loan holding companies are required to calculate pro forma capital using a set of capital action assumptions based on contracted payments; a general assumption of no redemptions repurchases, or issuances of capital instruments (except for issuances related to expensed employee compensation or in connection with a planned merger or acquisition to the extent that the merger or acquisition is reflected in the company's pro forma balance sheet estimates); and reasonable assumptions regarding payments of dividends consistent with internal capital needs and projections. There are no specified capital actions for state member banks.

### ***Controls, Oversight, and Documentation***

A company must establish and maintain a system of controls, oversight, and documentation, including policies and procedures that apply to all of its DFA stress test components. Senior management and the board of directors have specific responsibilities relating to DFA stress testing. The board of directors should ensure it remains informed about critical review of elements of the DFA stress tests, especially regarding key assumptions, uncertainties, and limitations. In addition, the board of directors and senior management of a \$10-50 billion company must consider the role of stress testing results in normal business, including in the company's capital planning, assessment of capital adequacy, and risk management practices. A company should appropriately document the manner in which DFA stress tests are used for key decisions about capital adequacy, including capital actions and capital contingency plans. The company should indicate the extent to which DFA stress tests are used in conjunction with other capital assessment tools.

### ***Report to Supervisors***

A \$10-50 billion company must report the results of its DFA company-run stress tests on the \$10-50 billion reporting form (FR Y-16). This report will include a company's quantitative projections of losses, PPNR, balance sheet, risk-weighted assets, ALLL, and capital on a quarterly basis over the duration of the scenario and planning horizon. In addition to the

quantitative projections, companies are required to submit qualitative information supporting their projections.<sup>10</sup>

### ***Public Disclosure of DFA Test Results***

Under the DFA stress test rules, a \$10-50 billion company must publicly disclose DFA stress test results between October 15 and October 31. The summary of the results of the stress test, including both quantitative and qualitative information, should be included in a single release on a company's web site, or in any other forum that is reasonably accessible to the public. A company is required to publish results for the severely adverse scenario only.

### **Conclusion**

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 the following staff in Division of Banking Supervision and Regulation: David E. Palmer, Senior Supervisory Financial Analyst, Risk Section, at (202) 452-2904; Keith Coughlin, Manager, Regional Banking Organizations, at (202) 452-2056; or Joseph Cox, Financial Analyst, Stress Testing Section, at (202) 452-3216. In addition, questions may be sent via the Board's public website.<sup>11</sup>

Michael S. Gibson  
Director

### **Attachments:**

- Attachment 1: *Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations with Total Consolidated Assets of more than \$10 Billion but less than \$50 Billion*
- Attachment 2: *Tables Comparing General Stress Testing Requirements, Reporting, and Expectations (Revised on October 16, 2017)*

### **Cross-references to:**

- SR letter 12-7, "Supervisory Guidance on Stress Testing for Banking Organizations With More Than \$10 Billion in Total Consolidated Assets,"
- SR letter 11-11, "Supervision of Savings and Loan Holding Companies (SLHCs)"
- SR letter 11-7, "Guidance on Model Risk Management"

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<sup>10</sup> The \$10-50 billion companies should look to the instructions for the \$10-50 billion reporting for supervisory expectations regarding what information should be included in the report on the company's DFA stress test. See FR Y-16 instructions:

<http://www.federalreserve.gov/apps/reportforms/reportdetail.aspx?sOoYJ+5BzDbzK2O0R3zNJw==>.

<sup>11</sup> See <http://www.federalreserve.gov/apps/contactus/feedback.aspx>.

- 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 99-18, “Assessing Capital Adequacy in Relation to Risk at Large Banking Organizations and Others with Complex Risk Profiles” (*SR letter 99-18 is inactive as of December 18, 2015. Refer either to SR 15-19, “Federal Reserve Supervisory Assessment of Capital Planning and Positions for Large and Noncomplex Firms,” or SR 15-18, “Federal Reserve Supervisory Assessment of Capital Planning and Positions for LISCC Firms and Large and Complex Firms.”*)

Table 2-A  
**General Stress Testing Requirements**

Last updated: October 16, 2017

<b>Companies with Total Consolidated Assets of \$50 Billion or More</b>	<b>Companies with Total Consolidated Assets \$10 to \$50 Billion</b>
<b>BHCs participate in FRB CCAR exercise</b>	<b>BHCs are not a part of the CCAR exercise</b>
<b>BHCs subject to annual supervisory stress test</b> <ul style="list-style-type: none"> <li>➤ FRB publicly discloses summary results</li> </ul>	<b>No supervisory stress test</b> <ul style="list-style-type: none"> <li>➤ Not applicable (No FRB disclosure of company results)</li> </ul>
<b>BHCs must submit an annual Capital Plan</b> <ul style="list-style-type: none"> <li>➤ Maintain post stressed 5% of tier 1 common ratio</li> <li>➤ FRB approval of results, capital plan, and actions</li> <li>➤ Requires use of both supervisory and BHC-specific scenarios</li> </ul>	<b>Not subject to Capital Plan Rule</b> <ul style="list-style-type: none"> <li>➤ No required minimum stressed capital ratios</li> <li>➤ No supervisory approval associated with stress testing</li> <li>➤ Requires only use of supervisory scenarios</li> </ul>
<b>Company-run stress test</b> <ul style="list-style-type: none"> <li>➤ Semi-annual submission (April 5<sup>th</sup> and October 5<sup>th</sup> of every year)</li> <li>➤ Report using FR Y-14A</li> <li>➤ Two sets of public disclosures by firm (June 30<sup>th</sup> and October 5<sup>th</sup> – November 4<sup>th</sup>)</li> </ul>	<b>Company-run stress test</b> <ul style="list-style-type: none"> <li>➤ Annual submission (July 31<sup>st</sup> of every year)</li> <li>➤ Report using FR Y-16</li> <li>➤ Annual firm disclosure (October 15<sup>th</sup> – 31<sup>st</sup>)</li> </ul>

Note:

- BHC: bank holding company; CCAR: Comprehensive Capital Analysis and Review
- For reporting forms, refer to Federal Reserve’s public website at [www.federalreserve.gov](http://www.federalreserve.gov) under “Reporting Forms.”

Table 2-B  
Reporting for DFA Stress Testing

<b>Companies with Total Consolidated Assets of \$50 Billion or More</b>	<b>Companies with Total Consolidated Assets \$10 to \$50 Billion</b>
<b>FR Y-14A (Only BHC Report)</b> <ul style="list-style-type: none"> <li>➤ Annual and semiannual submission</li> <li>➤ Approximately 2,500 line items per scenario for annual and 1,900 for semiannual</li> </ul>	<b>FR Y-16 (BHC/SMB/SLHC)</b> <ul style="list-style-type: none"> <li>➤ Annual submission</li> <li>➤ Summary report with approximately 100 line items per scenario</li> </ul>
<b>Interim final rule (1/15/14 submission only)</b> <ul style="list-style-type: none"> <li>➤ Must apply revised regulatory capital framework (Basel III) in projections <ul style="list-style-type: none"> <li>• Maintain the tier 1 common ratio calculated under the current capital rule</li> </ul> </li> </ul>	<b>Interim final rule (3/31/14 submission only)</b> <ul style="list-style-type: none"> <li>➤ Not required to apply revised regulatory capital framework (Basel III) until after the projections for the 3/31/2014 report submission <ul style="list-style-type: none"> <li>• Not required to calculate the tier 1 common ratio until after the 3/31/2014 report submission</li> </ul> </li> </ul>
<b>FR Y-14Q (For Supervisory Stress Test)</b> <ul style="list-style-type: none"> <li>➤ Quarterly submission</li> <li>➤ Loan-level data collected</li> </ul>	<b>Not applicable</b>
<b>FR Y-14M (For Supervisory Stress Test)</b> <ul style="list-style-type: none"> <li>➤ Monthly submission</li> <li>➤ Loan-level data collected</li> </ul>	<b>Not applicable</b>

Note:

- BHC: bank holding company; SMB: state member bank; and SLHC: savings and loan holding company.
- For reporting forms, refer to Federal Reserve's public website at [www.federalreserve.gov](http://www.federalreserve.gov) under "Reporting Forms."

Table 2-C  
**Stress Testing Minimum Expectations**

<b>Companies with Total Consolidated Assets of \$50 Billion or More</b>	<b>Companies with Total Consolidated Assets \$10 to \$50 Billion</b>
<p><b>Scenarios</b></p> <ul style="list-style-type: none"> <li>➤ Companies must develop BHC-specific scenarios to stress key vulnerabilities and identify idiosyncratic risk drivers</li> </ul>	<p><b>Scenarios</b></p> <ul style="list-style-type: none"> <li>➤ Companies are not required to prepare their own scenarios</li> </ul>
<p><b>Data Sources and Segmentation</b></p> <ul style="list-style-type: none"> <li>➤ Proxy data acceptable, but companies are generally expected to use internally generated data</li> <li>➤ Data segmented at least as detailed as FR Y-14A (approximately 2,500 lines per scenario)</li> </ul>	<p><b>Data Sources and Segmentation</b></p> <ul style="list-style-type: none"> <li>➤ May use industry data as a proxy under certain conditions</li> <li>➤ Data segmented by FR Y-16 (approximately 100 lines per scenario) and largely reflects Call report and FR Y-9C report</li> </ul>
<p><b>Loss Estimation</b></p> <ul style="list-style-type: none"> <li>➤ Identify key loss drivers; indicate how the scenarios affect those drivers and losses</li> <li>➤ More granular loss estimation expectations using FR Y-14A segmentation</li> </ul>	<p><b>Loss Estimation</b></p> <ul style="list-style-type: none"> <li>➤ May choose to base their stress losses on industry historical loss experience</li> <li>➤ May be able to estimate credit losses on an aggregate level (top-down approach) using FR Y-16 segmentation</li> </ul>
<p><b>Operational Losses</b></p> <ul style="list-style-type: none"> <li>➤ Expected to include operational loss estimates</li> </ul>	<p><b>Operational Losses</b></p> <ul style="list-style-type: none"> <li>➤ Include aggregate operational losses in Pre-Provision Net Revenue (PPNR) only if directly related to macroeconomic and financial scenarios provided by supervisors</li> </ul>

Note:

- For reporting forms, refer to Federal Reserve’s public website at [www.federalreserve.gov](http://www.federalreserve.gov) under “Reporting Forms.”

Table 2-C  
(Continued)  
**Stress Testing Minimum Expectations**

<b>Companies with Total Consolidated Assets of \$50 Billion or More</b>	<b>Companies with Total Consolidated Assets \$10 to \$50 Billion</b>
<p><b>Pre-Provision Net Revenue (PPNR)</b></p> <ul style="list-style-type: none"> <li>➤ Granular estimation approach <ul style="list-style-type: none"> <li>• Use internal revenue and expense data to estimate business lines' revenues and expenses</li> <li>• Identify specific drivers of revenue and expenses and analyze how supervisory scenarios affect those drivers</li> </ul> </li> </ul>	<p><b>Pre-Provision Net Revenue (PPNR)</b></p> <ul style="list-style-type: none"> <li>➤ Less granular "top of the house" approach <ul style="list-style-type: none"> <li>• Project PPNR based on three main components (net interest income, noninterest income and noninterest expense)</li> <li>• Can project at an aggregate, company-wide level, and may be based on industry experience</li> </ul> </li> </ul>
<p><b>Balance Sheet and Risk-Weighted Assets</b></p> <ul style="list-style-type: none"> <li>➤ Projections for each major segment of the balance sheet for FR Y-14A</li> </ul>	<p><b>Balance Sheet and Risk-Weighted Assets</b></p> <ul style="list-style-type: none"> <li>➤ Can in some cases use a simple, constant method for projecting their full balance sheet and risk weighted assets</li> </ul>
<p><b>Controls, Oversight and Documentation</b></p> <ul style="list-style-type: none"> <li>➤ Must be an integral part of preparing and submitting both the capital plan required under the Capital Plan Rules, and the resolution and recovery planning process</li> </ul>	<p><b>Controls, Oversight and Documentation</b></p> <ul style="list-style-type: none"> <li>➤ Must consider the role of stress testing results in the normal course of business (capital planning, assessment of capital adequacy, and risk management)</li> </ul>

Note:

- For reporting forms, refer to Federal Reserve's public website at [www.federalreserve.gov](http://www.federalreserve.gov) under "Reporting Forms."