



## Stress Testing and Capital Planning: Federal Reserve Issues Guidance for 2013 Cycle

Today the Federal Reserve Board (the “Board”) issued instructions and guidelines for two 2013 stress testing and capital planning programs, each of which builds on similar programs from last year. The Comprehensive Capital Analysis and Review 2013 (“CCAR”)<sup>1</sup> describes the testing process and resulting capital plans that are required for the 19 bank holding companies (“BHCs”) that participated in the CCAR for 2011 and 2012. The Capital Plan Review 2013 (“CapPR”)<sup>2</sup> sets forth the testing and capital planning requirements for the 11 BHCs with \$50 billion or more in consolidated assets that undertook a similar exercise last year. The instructions and guidelines for both programs implement the capital plan rule, 12 C.F.R. § 225.8, and reflect the supervisory concerns underlying the earlier testing and planning programs.

The CCARs in 2011 and 2012 and the CapPR in 2012, as well as section 225.8, should be familiar to many. Nevertheless, a few observations specific to today’s releases are in order:

- The capital plan that results from the stress testing under either program must demonstrate that the BHC can achieve “readily and without difficulty” the capital ratios that are part of the Basel III framework. The Basel III ratios phase in over several years; presumably a BHC need only demonstrate compliance with the ratios as they take effect in the coming years. These ratios are currently in proposed form and not yet final. Indeed, the Board announced today that the proposed ratios (and other capital requirements) will not take effect on January 1, 2013, as had been the original intent.<sup>3</sup> The lesson for the CCAR and CapPR banks, however, appears to be that the final Basel III-based capital ratios in the United States will change little from the pending proposals.
- The assumptions that are essential to the stress tests—the Board’s baseline, adverse, and severely adverse scenarios—have not been included in today’s materials but should be provided to the participating banks on November 15, 2012.
- The tests will require very substantial amounts of data, some of which the BHCs do not keep in the ordinary course of business but must extrapolate or otherwise generate from existing data. Since the testing must yield results in time to submit a capital plan that has been approved by a BHC’s board of directors to the Board on or before January 7, 2013, very little time is available to collect the necessary data.

<sup>1</sup> Available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121109b1.pdf>.

<sup>2</sup> Available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121109b2.pdf>.

<sup>3</sup> We discussed the announcement in a news bulletin earlier today, *Regulatory Capital: January 1, 2013 Deadline Eased*, available at <http://www.mofo.com/files/Uploads/Images/121109-New-Capital-Rules.pdf>.

- The instructions offer little if any guidance on the methodology of a stress test. While each BHC may (and indeed must) develop its own techniques, these techniques will be the subject of careful scrutiny as part of the Board’s review of the stress test results and the capital plan. The standards of review that the Board will apply are unknown, apart from general requirements regarding the robustness of the testing process. Moreover, the Board must conduct its own stress tests of these banks, and the Board’s own methodology remains a “black box.”

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