

# *FS Regulatory Brief*

## *CCAR 2013: Highlights and insights*

November 2012

### *Executive summary*

The recently published instructions for the 2013 Comprehensive Capital Analysis and Review (CCAR),<sup>1</sup> issued by the Board of Governors of the Federal Reserve (FRB), contain a number of notable updates to the CCAR process. Key updates are the alignment with and incorporation of various regulatory requirements including the FRB Capital Plan Rule,<sup>2</sup> the FRB stress testing rules implementing portions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA),<sup>3</sup> and the proposed US implementation of the Basel III framework.

Other noteworthy revisions include the addition of a new adverse scenario, incorporation of a new set of capital action assumptions to be integrated in supervisory and company-run stress tests, a one-time opportunity for bank holding companies (BHCs) to revise planned capital actions before the final approval decision, changes to disclosure requirements consistent with DFA stress testing rules, and updated disclosure requirements around the projection of risk-weighted assets.

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<sup>1</sup> "Comprehensive Capital Analysis and Review 2013 Summary Instructions and Guidance," Board of Governors of the Federal Reserve, November 2012. "CCAR 2013"

<sup>2</sup>76 *Federal Register* 74631-48 (December 1, 2011), now codified at 12 CFR 225.8.

<sup>3</sup>77 *Federal Register* 62378-96 (October 12, 2012)

Additionally, the FRB has released guidance for the 2013 Capital Plan Review (CapPR),<sup>4</sup> which is materially similar to CCAR, except considering a smaller set of scenarios, running simplified Basel III projections, and not being subject to disclosure requirements.

Finally, the CCAR 2013 stress scenarios again describe a protracted domestic recession very similar to that evaluated as part of CCAR 2012, measured in terms of GDP, unemployment, HPI, and equity index changes. However, the scenarios additionally include a more severe economic slowdown in developing Asia relative to CCAR 2012, which is partially driven by weakening conditions in China.

Overall, given the relative consistency of CCAR and CapPR 2013 with prior exercises, it is anticipated that the CCAR and CapPR BHCs will be able to execute on the revised guidance with only minor enhancements to their current infrastructure. The supervisory evaluation will focus on the quality of capital adequacy processes and relative internal controls. It remains to be seen how different BHC disclosures will be from those issued by regulators.

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<sup>4</sup> "Capital Plan Review 2013 Summary Instructions and Guidance," Board of Governors of the Federal Reserve, November 2012. "CapPR 2013"

## **What are the key updates in CCAR 2013 guidance?**

### ***Alignment of regulatory guidance:***

CCAR 2013 officially incorporates a number of different regulations and pieces of regulatory guidance including the FRB's capital plan rule, the DFA stress testing rules, proposed and final rules implementing the Basel III framework in the US, and the Basel Committee on Banking Supervision's (BCBS) systemically important financial institutions (SIFI) rules. Each of these is discussed in more detail below.

***Capital plan rule:*** CCAR 2013 is conducted pursuant to the FRB capital plan rule which requires BHCs with total consolidated assets of at least \$50 billion to submit annual capital plans.

***DFA stress testing rules:*** CCAR 2013 incorporates the supervisory and annual company-run stress test requirements that are set out in the FRB's final rule implementing sections 165(i)(1) and (2) of the DFA. These requirements include the provision by the FRB of three supervisory scenarios (baseline, adverse, and severely adverse), the mandate for the FRB to conduct a supervisory stress test of each BHC under each of these scenarios, and the requirement for each BHC to complete a company-run stress test under each of these scenarios.

CCAR 2013 also incorporates the stress test results disclosure requirements outlined in the DFA stress testing rules. Pursuant to these requirements and discussed in more detail below, the FRB will publish summary results of the supervisory stress test under the severely adverse scenario by March 31, 2013, and BHCs will disclose company-run stress test results under the same scenario between March 15 and March 31, 2013.

***Basel III framework:*** An assessment of BHCs' plans to address proposed and finalized requirements associated with Basel III and the DFA is included in the FRB's supervisory review. BHCs are expected to demonstrate that they will be able to meet the requirements of the proposed Basel III

framework in the US, particularly as set forth in the following rulemaking:<sup>5</sup>

- Proposed Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action.
- Proposed Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule and the Market Risk Capital Rule.
- Final Risk-Based Capital Guidelines: Market Risk Rule.

It is important to note that those BHCs with over \$250 billion of assets need to incorporate the Advanced Approaches NPR and Market Risk Rule into their projections for CCAR 2013, and they may experience incremental challenges if they do not yet have automated processes for these calculations.

***SIFI surcharge:*** As part of their Basel III projections, BHCs are expected to include appropriate capital surcharges for SIFIs, consistent with guidance from the BCBS set forth in its November 2011 rules, "Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement."<sup>6</sup> Firms are also expected to clearly support the estimated surcharge through detailed documentation.

***Scenarios:*** CCAR 2013 requires BHCs to project capital ratios under five scenarios including three supervisory scenarios (baseline, adverse, and severely adverse), as well as a BHC baseline scenario and at least one BHC stress scenario. However, a BHC is allowed to utilize the supervisory baseline scenario as its BHC baseline if the BHC believes that the supervisory scenario appropriately represents its perspective on expected risk factors relevant to the BHC. Any BHC selecting this option must provide supporting documentation.

<sup>5</sup> BHCs are not required to apply methodologies under the Standardized Approach NPR for CCAR and CapPR 2013.

<sup>6</sup> Basel Committee on Banking Supervision, rules text, BIS, November 2011.

**Capital actions assumptions:** To satisfy both the DFA stress testing and CCAR rules, BHCs must now report multiple sets of capital actions, with two separate FR Y-14A Capital worksheets for certain scenarios. Capital actions are described as the following:

- Planned capital actions: A BHC’s planned capital actions as defined in the BHC baseline scenario;
- Alternative capital actions: A BHC’s assumed capital actions as chosen in the BHC stress scenario; and
- DFA capital actions: Capital action assumptions required under the DFA stress testing rules. These include separate principles related to dividends, payments on other instruments eligible for consideration as regulatory capital, and redemptions and repurchases.

**Figure 1. Capital worksheet requirements**

Scenario	Capital Worksheet 1	Capital Worksheet 2
BHC Baseline	Planned Capital Actions	N/A
Supervisory Baseline	Planned Capital Actions	DFA Capital Actions
BHC Stress	Alternative Capital Actions	N/A
Supervisory Adverse	N/A	DFA Capital Actions
Supervisory Severely Adverse	Planned Capital Actions	DFA Capital Actions

Source: CCAR 2013.

**Adjustment to planned capital actions:** As a significant adjustment to prior years’ submission process, the FRB will now provide the post-stress results back to each BHC when its qualitative and quantitative review is complete. At that point, each BHC will have the opportunity to submit a one-time reduction to its planned capital actions which will be taken into account in the FRB’s final acceptance decision. This interim option will accelerate the capital distribution process for those BHCs which were previously required to resubmit plans and wait for secondary feedback before being approved for capital actions due to falling below the regulatory capital guidelines in the supervisory stress test. Both *original* planned capital actions and *adjusted* planned capital actions will be included in FRB disclosures.

**Disclosures:** By March 31, 2013, the FRB will release two sets of results, rather than one as in prior years, which include the following:

- Detailed results of stress losses and capital ratios for each BHC under the supervisory severely adverse scenario, incorporating DFA capital action assumptions; and
- BHC-specific post-stress capital ratios, including minimum values over the planning horizon, incorporating baseline scenario *original* planned actions and *adjusted* planned actions, as applicable.

As noted above, consistent with the DFA stress testing rules, CCAR guidance now reaffirms that BHCs must publish a summary of their internal supervisory severely adverse scenario results (incorporating DFA capital actions) between March 15 and 31, 2013. While BHCs must at a minimum be compliant with FRB requirements for disclosure, some may choose a strategic, enhanced disclosure in order to increase transparency and showcase their robust risk and capital management programs.

The processes to develop this disclosure must be integrated within each BHC’s existing CCAR and reporting framework and will require collaboration between the stress testing function and regulatory reporting. These disclosures, as well as the incremental data requirements described below, will require the development of additional controls which should be integrated within the BHC’s existing internal control framework.

**Risk-weighted assets (RWA)**

**projections:** CCAR 2013 guidance now specifies that BHCs need to supply more detailed support than previously outlined in CCAR 2012 for assumptions utilized within RWA projections, including the following:

- Components of on- and off- balance sheet projections and mix;
- Income statement projections; and
- Underlying risk attributes of exposures.

An updated FR Y-14A Summary schedule will be issued by December 1, 2012 to capture additional detail on each BHC’s RWA balance and decomposition.

**Detail on European exposures:** For the six BHCs subject to the market shock, the FRB is adding a new data template requirement with detail on European exposures which will be released by December 1, 2012.

### **How does the CapPR 2013 compare to CCAR?**

The CapPR 2013 is materially similar to the CCAR 2013 guidance, with moderate differences primarily attributable to the fact that these BHCs are not subject to the DFA stress testing rules until the 2014 capital planning cycle. The primary differences are highlighted below.

**Scenarios:** CapPR BHCs are required to complete only two supervisory scenarios (severely adverse and baseline), in addition to the BHC stress and baseline scenarios.<sup>7</sup>

**Basel III enhancements:** Consistent with CCAR, CapPR specifies that BHCs must demonstrate the ability to comply with recent Basel III rules as they are expected to be implemented in the US. However, the requirement to consider a potential SIFI surcharge is not included as it is not currently deemed applicable to the CapPR BHCs.

**Capital actions:** All scenarios will incorporate the BHC's planned capital actions, without the mandate to consider alternative capital actions. This eliminates the need to produce multiple FR Y-14A Capital Worksheets.

**Supervisory review and disclosure:** As in CapPR 2012, the FRB will conduct its assessment based upon the BHC's derived results, rather than utilizing supervisory model results as mandated by CCAR. This is in addition to the FRB's review of the BHC's risk framework and overall capital management practices as stated in the previous methodology. Correspondingly, the CapPR BHCs will not be given an opportunity to make a future, limited adjustment to their planned capital actions after the Capital Plan submission. Additionally, as only BHC models are utilized, the FRB will not publish a CapPR summary of stress test results.

<sup>7</sup> CapPR BHCs also have the option to use the supervisory baseline scenario as the BHC baseline.

### **How do the 2013 scenarios compare?**

The severely adverse scenario of the CCAR 2013 methodology<sup>8</sup> again introduces a protracted domestic recession. The contraction in GDP is not as sharp as in the CCAR 2012 methodology<sup>9</sup> in the first few quarters (-6.10% for Q1 of year 1 for CCAR 2013 vs. -7.98% for Q1 year 1 for CCAR 2012), but recovery is notably slower than in previous methodologies. Unemployment is not as strongly stressed, reaching a peak rate of 12.10% for CCAR 2013 as compared to 13.05% for CCAR 2012. Overall, the FRB maintained very similar assumptions regarding real GDP growth, declines in HPI and changes in the Dow Jones Industrials and Market Volatility Index.<sup>10</sup>

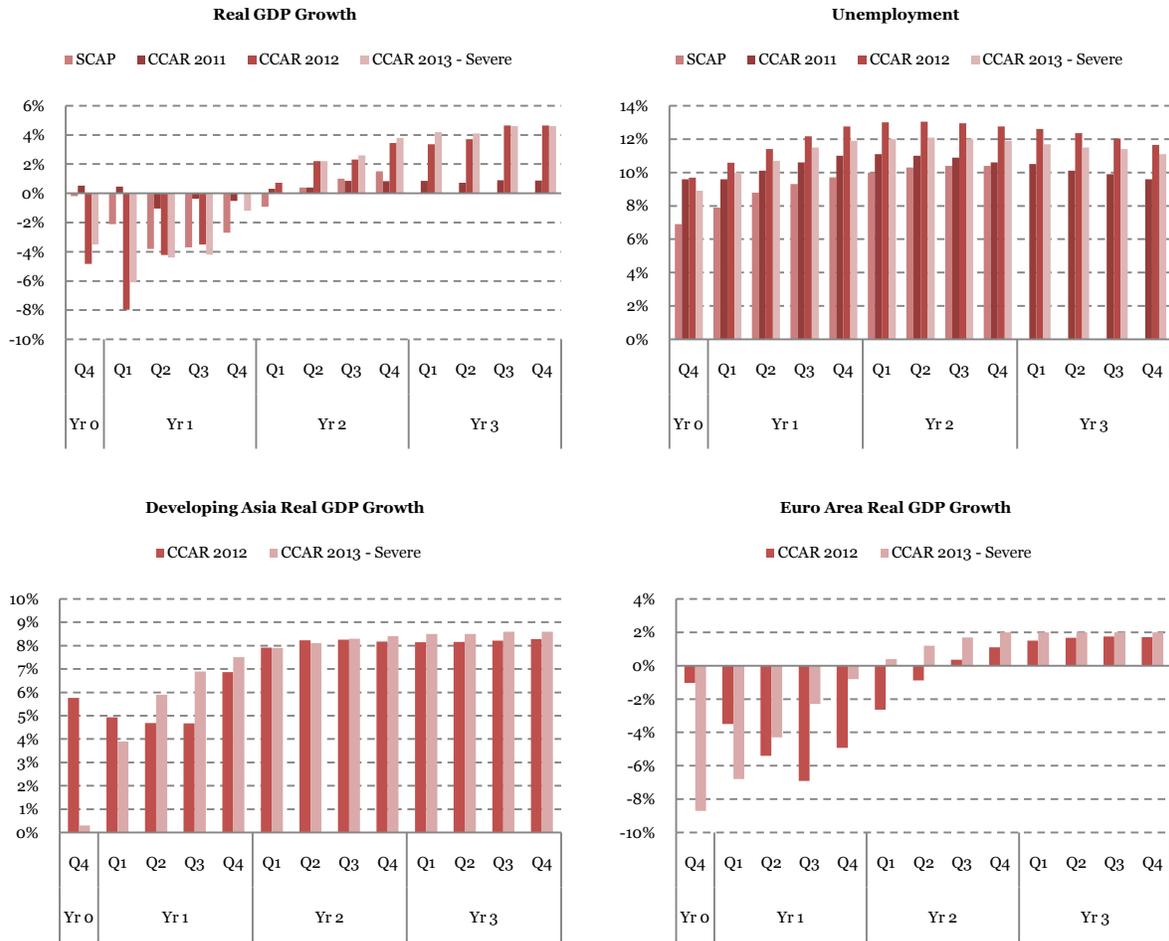
The greatest change in scenario methodology pertains to the international assumptions. The 2013 methodology includes an initial severe slowdown in developing Asia, partially driven by weakening of economic conditions in China. The Euro area, the United Kingdom, and Japan suffer from deeper contractions in the first two quarters of the forecasting period, with the Euro area contracting a total of 5.75% by the end of 2013. While this increased weakness will drive greater losses for BHCs with Asian portfolios and businesses, it is anticipated to affect only a small number of the BHCs subject to this regulation.

<sup>8</sup> "2013 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule," Board of Governors of the Federal Reserve System, November 2012.

<sup>9</sup> "Comprehensive Capital Analysis and Review 2012 Summary Instructions and Guidance," Board of Governors of the Federal Reserve System, November 2011. "CCAR 2012"

<sup>10</sup> Additionally, the 26 variables provided are the same as supplied during the 2012 CCAR run.

**Figure 2. Comparison of key variables from SCAP<sup>11,12</sup> through CCAR 2013**



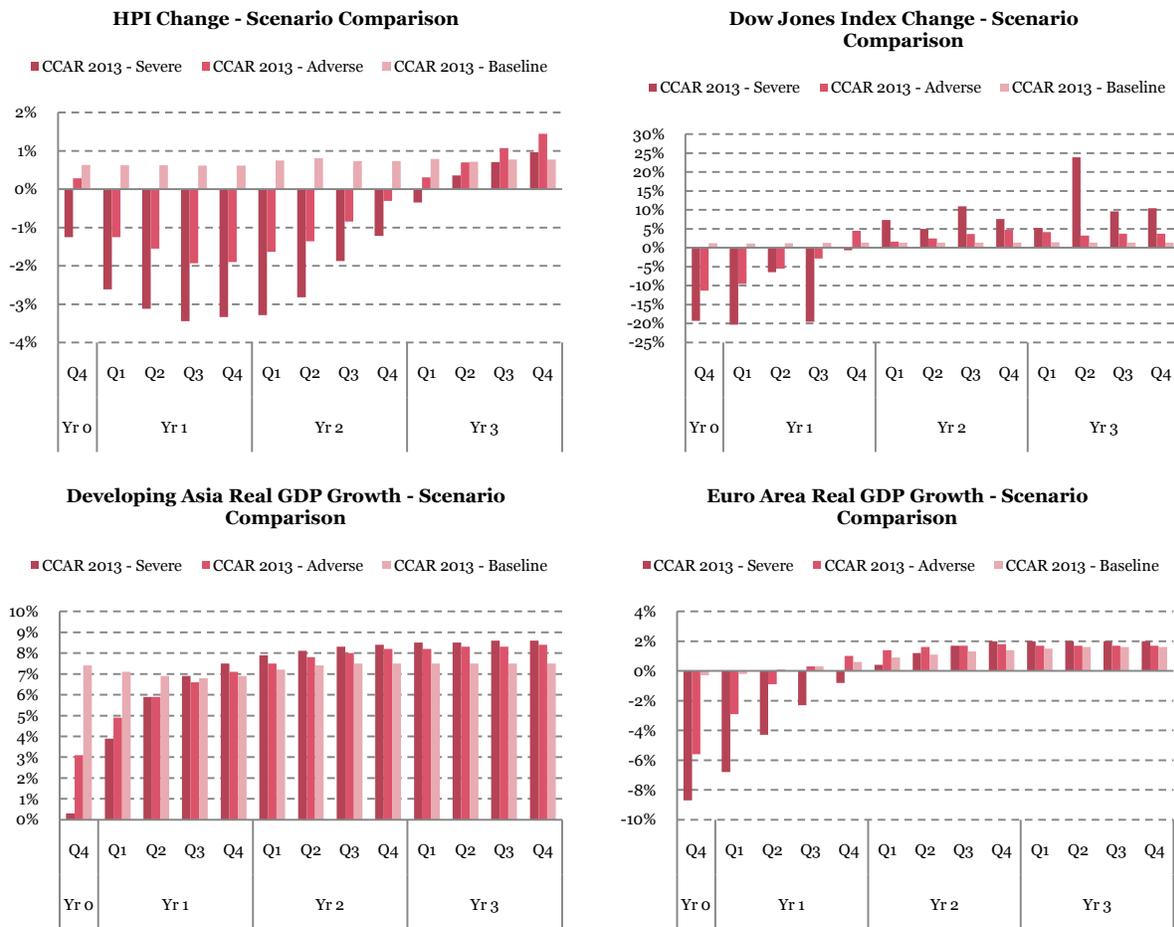
<sup>11</sup> "The Supervisory Capital Assessment Program: Design and Implementation," Board of Governors of the Federal Reserve System, April 2009. "SCAP"

<sup>12</sup> "Comprehensive Capital Analysis and Review 2011 Objectives and Overview," Board of Governors of the Federal Reserve System, March 2011. "CCAR 2011"

With the addition of the adverse supervisory scenario in CCAR 2013, the FRB presents BHCs with an alternative domestic recessionary environment that falls between the severely adverse and baseline scenarios. As shown below in the comparison of HPI and Dow Jones Index changes between the three supervisory scenarios, the adverse scenario

portrays a moderately severe recession with a slightly accelerated recovery in the US as compared to the severely adverse scenario. A review of key non-US variables such as Developing Asia and Euro Area Real GDP growth reveals a similarly moderate severity level for the adverse scenario.

**Figure 3. Comparison of CCAR 2013 supervisory scenario severity**



## ***Strategic next steps***

In response to the updated CCAR and CapPR 2013 guidance, BHCs should consider their next steps in meeting the enhancements and advancing their overall capital management programs. Considerations for strategic next steps include the following:

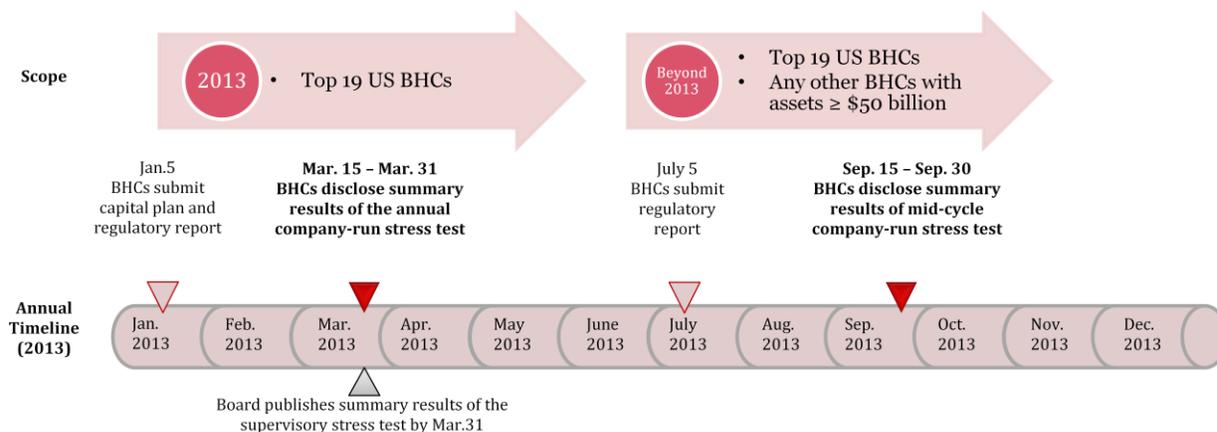
1. **Scenario selection:** BHCs should embrace the supervisory scenarios in the design of their BHC-specific scenarios and should create add-ons to incorporate idiosyncratic factors and risks facing the firm that result in a level of stress comparable to that represented in the supervisory severely adverse scenario for the banking industry as a whole.
2. **Disclosure strategy:** As described above, BHCs must define a disclosure strategy for the stress test results to be released in March, 2013, weighing the importance of enhanced transparency and demonstrating the strength of their risk and capital management programs against the risk of premature release or disclosure of sensitive information.
3. **CCAR framework enhancements:** With the emphasis on process and documentation enhancements throughout the CCAR and CapPR 2013 guidance, BHCs should take this opportunity to focus on CCAR process and capital plan adequacy. BHCs should ensure that their capital plan incorporates considerations of all material risks, contemplates missing risks, quantifies model uncertainty, and identifies and plans remediation steps for process and documentation gaps.
4. **Adjustment to planned capital actions:** BHCs should evaluate the new option to revise capital actions in light of their prior capital action requests, risk appetite, and strategic plan, and may ultimately consider requesting more aggressive action initially. Although the initial and secondary capital actions will both be released in the FRB disclosures in the event of an adjusted action, the delay in approval of capital actions and risk of a public notice of non-approval is reduced, decreasing the extent of BHCs' reputational risk.

## Appendices

**Figure 4: CCAR & CapPR 2013 institutions**

CCAR	CapPR
Ally Financial Inc.	BBVA USA Bancshares Inc.
American Express Company	BMO Financial Corp.
Bank of America Corporation	Citizens Financial Group Inc.
The Bank of New York Mellon Corporation	Comerica Inc.
BB&T Corporation	Discover Financial Services
Capital One Financial Corporation	HSBC North America Holdings Inc.
Citigroup Inc.	Huntington Bancshares, Inc.
Fifth Third Bancorp	M&T Bank Corporation
The Goldman Sachs Group, Inc.	Northern Trust Corporation
JPMorgan Chase & Co.	UnionBanCal Corporation
Keycorp	Zions Bancorporation
MetLife Inc.	
Morgan Stanley	
The PNC Financial Services Group, Inc.	
Regions Financial Corporation	
State Street Corporation	
SunTrust Banks, Inc.	
U.S. Bancorp	
Wells Fargo & Company	

**Figure 5: Overview of timeline for implementation and disclosures**



**Figure 6: Key regulatory guidance references**

<b>Regulatory guidance</b>	<b>Link</b>
Comprehensive Capital Analysis and Review 2013 Summary Instructions and Guidance, November 2012	<a href="http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121109b1.pdf">http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121109b1.pdf</a>
Capital Plan Review 2013 Summary Instructions and Guidance, November 2012	<a href="http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121109b2.pdf">http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121109b2.pdf</a>
2013 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule	<a href="http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121115a1.pdf">http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121115a1.pdf</a>
Capital Plan Rule (now codified at 12 CFR 225.8)	Federal Register notice (76 <i>Federal Register</i> 74631-48 [December 1, 2011]): <a href="http://www.gpo.gov/fdsys/pkg/FR-2011-12-01/pdf/2011-30665.pdf">http://www.gpo.gov/fdsys/pkg/FR-2011-12-01/pdf/2011-30665.pdf</a>
DFA Stress Testing Rules (Supervisory and Company-Run Stress Test Requirements for Covered Companies)	Federal Register notice (77 <i>Federal Register</i> 62378-96 [October 12, 2011]): <a href="http://www.gpo.gov/fdsys/pkg/FR-2012-10-12/pdf/2012-24987.pdf">http://www.gpo.gov/fdsys/pkg/FR-2012-10-12/pdf/2012-24987.pdf</a>
Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action	Federal Register notice (77 <i>Federal Register</i> 52792-886 [August 30, 2012]): <a href="http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16757.pdf">http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16757.pdf</a>
Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule	Federal Register notice (77 <i>Federal Register</i> 52978-3057 [August 30, 2012]): <a href="http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16761.pdf">http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16761.pdf</a>
Risk-Based Capital Guidelines: Market Risk Rule	Federal Register notice (77 <i>Federal Register</i> 53060-115 [August 30, 2011]): <a href="http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16759.pdf">http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16759.pdf</a>
Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement	<a href="http://www.bis.org/publ/bcbs207.pdf">http://www.bis.org/publ/bcbs207.pdf</a>

# Additional information

***For additional information about PwC's Financial Services Regulatory Practice and how we can help you, please contact:***

Dan Ryan  
*Financial Services Regulatory Practice Chairman*  
646 471 8488  
daniel.ryan@us.pwc.com

Alison Gilmore  
*Financial Services Regulatory Practice Marketing Leader*  
646 471 0588  
alison.gilmore@us.pwc.com

***Primary authors:***

Fernando de la Mora  
646 471 5257  
fernando.de.la.mora@us.pwc.com

Alejandro Johnston  
646 471 7517  
alejandro.johnston@us.pwc.com

Pranjal Shukla  
646 471 2733  
pranjal.m.shukla@us.pwc.com

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