Federal Reserve Bank of San Francisco
101 Market Street, San Francisco, California 94105

March 13, 2012

To State Member Banks, Bank
Holding Companies, Financial Holding
Companies, Foreign Bank Offices and
Savings and Loan Holding Companies
in the Twelfth Federal Reserve District

Federal Reserve Releases Paper Describing Methodology Used in 2012 Comprehensive Capital Analysis and Review Stress Test

The Federal Reserve on March 12, 2012 released a paper describing the methodology used in the stress test in the 2012 Comprehensive Capital Analysis and Review (CCAR) as well as the templates for disclosure of the summary results, which will be issued at 4:30 p.m. EDT on Thursday, March 15.

The CCAR is a rigorous exercise to evaluate the capital planning processes and capital adequacy of the largest bank holding companies. This exercise includes a supervisory stress test to evaluate whether firms would have sufficient capital in times of severe economic and financial stress to continue to lend to households and businesses. The Federal Reserve estimated revenue and losses under the stress scenario based on detailed data provided by the firms and verified by supervisors. The CCAR draws on the expertise of hundreds of staff throughout the Federal Reserve System, including supervisors, economists, markets analysts, and others.

The supervisory stress scenario for CCAR 2012, which was designed in November 2011, depicts a severe recession in the United States, including a peak unemployment rate of 13 percent, a 50 percent drop in equity prices, and a 21 percent decline in housing prices. The supervisory stress scenario is not the Federal Reserve's forecast for the economy, but was designed to represent an outcome that, while unlikely, may occur if the U.S economy were to experience a deep recession at the same time that economic activity in other major economies contracted significantly.

The Federal Reserve evaluates institutions' capital plans across a range of criteria, including a stress test that examines whether a firm could make all the capital distributions included in its plan--such as dividends and stock repurchases--while still maintaining capital above the Federal Reserve's standards in a hypothetical supervisory stress scenario. Other considerations for capital distributions include an evaluation of the firms' capital planning processes and plans to meet international capital agreements as new requirements are phased in beginning in 2013. The stress-test results, including projected capital ratios, revenues, and losses in the supervisory stress scenario, will be disclosed for the 19 large bank holding companies that participated.

To illustrate the impact of the stress scenario alone, the Federal Reserve also calculated stressed capital ratios including planned capital actions through March 31, 2012, but excluding proposed actions for the remainder of the stress scenario horizon and assuming no material capital issuances from March 16 through March 31, 2012. Those results will also be disclosed.

Strong capital levels are critical to ensuring that banking organizations have the ability to lend and to continue to meet their financial obligations, even in times of economic difficulty. U.S. firms have built up their capital levels under the Federal Reserve's leadership since government stress tests were conducted in early 2009. The 19 bank holding companies that participated in those tests and in the 2011 and 2012 CCAR have increased their tier 1 common capital levels to $759 billion in the fourth quarter of 2011 from $420 billion in the first quarter of 2009. The tier 1 common ratio for these firms, which compares high-quality capital to risk-weighted assets, has increased to a weighted average of 10.4 percent from 5.4 percent.

The increase reflects in part substantially lower capital distributions by bank holding companies, a result of the Federal Reserve's move to ensure the firms reduced or eliminated dividends to maintain safety and soundness. Following the CCAR in 2011, the Federal Reserve allowed those financial institutions with well-developed capital plans and capital positions that would remain strong even under adverse conditions to increase distributions, but at a prudent pace that would ensure continued increases in capital. The 19 institutions paid out 15 percent of net income in common dividends in 2011 after paying out 38 percent of net income in 2006. They also raised more in common equity than they repurchased in 2011.

Additional Information

All circulars and documents are available on the Internet through the Federal Reserve Bank of San Francisco's website, at http://www.frbsf.org/banking/letters.

For additional information, please contact:

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Attachment: Methodology for Stress Scenario Projections (PDF)

Template of Estimates of Minimum Tier 1 Common Ratios (PDF)

Template of Supervisory Stress Scenario Tables (PDF)