

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

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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 Announces Summary Results of Latest Round of Bank Stress Tests

The Federal Reserve on March 13, 2012 announced summary results of the latest round of bank stress tests, which show that the majority of the largest U.S. banks would continue to meet supervisory expectations for capital adequacy despite large projected losses in an extremely adverse hypothetical economic scenario.

The Federal Reserve in the Comprehensive Capital Analysis and Review (CCAR) evaluates 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.

Reflecting the severity of the stress scenario--which includes a peak unemployment rate of 13 percent, a 50 percent drop in equity prices, and a 21 percent decline in housing prices--losses at the 19 bank holding companies are estimated to total \$534 billion during the nine quarters of the hypothetical stress scenario. The aggregate tier 1 common capital ratio, which compares high-quality capital to risk-weighted assets, falls from 10.1 percent in the third quarter of 2011 to 6.3 percent in the fourth quarter of 2013 in the hypothetical stress scenario. That number incorporates the firms' proposals for planned capital actions such as dividends, share buybacks, and share issuance.

Despite the large hypothetical declines, the post-stress capital level in the test exceeds the actual aggregate tier 1 common ratio for the 19 firms prior to the government stress tests conducted in the midst of the financial crisis in early 2009, and reflects a significant increase in capital during the past three years. In fact, despite the significant projected capital declines, 15 of the 19 bank holding companies were estimated to maintain capital ratios above all four of the regulatory minimum levels under the hypothetical stress scenario, even after considering the proposed capital actions, such as dividend increases or share buybacks.¹

It's important to note that the Federal Reserve's stress scenario estimates are the outcome of deliberately stringent and conservative assessments under hypothetical, adverse economic conditions and the results are not forecasts or expected outcomes.

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 the government stress tests in 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

¹ The capital plans rule stipulates that the firms must demonstrate their ability to maintain tier 1 common ratios above 5 percent. Further, the minimum levels for firms to be considered adequately capitalized are 4 percent for the tier 1 ratio, 8 percent for the total capital ratio, and 3 or 4 percent for the tier 1 leverage ratio, depending on whether the institution is subject to the market risk capital charge. Ratios can be found on table 2 of the attached paper.

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 stronger capital position 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 first 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 compared with a payout of 38 percent of net income in 2006. They also raised more in common equity than they repurchased in 2011.

The stress test is just one component of the Federal Reserve's evaluation of a bank holding company's proposal to make capital distributions. Other considerations include the strength of the firm's capital planning processes and plans to meet international capital agreements as new requirements are phased in beginning in 2013.

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 and Results for Stress Scenario Projections \(PDF\)](#)