2013 CCAR Process Begins and U.S. Basel III Rules Are Delayed

November 14, 2012

The Federal Reserve launched the 2013 capital planning and stress testing process for large bank holding companies ("**BHCs**") with the publication, on November 9, 2012, of two sets of instructions: one set for the 19 BHCs that participated in the 2011 Comprehensive Capital Analysis and Review ("**CCAR**") process ("**CCAR BHCs**") and another set for the 11 other U.S.-domiciled, top-tier BHCs with total consolidated assets of $50 billion or more that did not participate in the 2011 CCAR process ("**non-CCAR BHCs**").[1] On the same day, the Federal Reserve joined with other U.S. banking agencies to announce that recent proposals to implement Basel III in the United States will not become effective on January 1, 2013.

The Federal Reserve's instructions for the CCAR BHCs, which reveal how the Dodd-Frank Act's stress testing requirements will be integrated with the Federal Reserve's capital planning requirements, are instructive for the non-CCAR BHCs that will become subject to Dodd-Frank stress-testing requirements in the 2014 capital planning cycle. Similarly, nonbank financial companies designated by the Financial Stability Oversight Council ("**FSOC**") for supervision by the Federal Reserve will be subject to Dodd-Frank stress-testing requirements and, under a proposal by the Federal Reserve, would also be required to submit annual capital plans to the Federal Reserve.[2]

For the CCAR BHCs, the two most significant changes from the 2012 process are:

- Each CCAR BHC will be given a one-time opportunity to make a downward adjustment to its original capital distribution plans after reviewing the Federal Reserve's post-stress capital analysis of its capital plan. If a CCAR BHC makes such an adjustment, the Federal Reserve will disclose the post-stress capital ratios of the BHC reflecting both its original and adjusted planned capital actions.
- Each CCAR BHC will be required to publish summaries—between March 15 and March 31, 2013—of the results of their company-run stress tests under the severely adverse economic scenario provided by the Federal Reserve.

U.S. Basel III Rules Will Not Go Into Effect on January 1, 2013

The Federal Reserve, OCC and FDIC announced that they do not expect any of the three notices of proposed rulemaking to implement Basel III in the United States to become effective on January 1, 2013.[3] This announcement confirms that the United States, like certain other major jurisdictions, will not implement Basel III beginning on January 1, 2013, as originally agreed upon by members of the Basel Committee on Banking Supervision ("**Basel Committee**").[4] The banking agencies did not indicate when they expect to issue final rules, but noted that they "take seriously . . . internationally agreed timing

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[1] The Federal Reserve's instructions for the 19 CCAR BHCs are available **here**. The Federal Reserve's instructions for the 11 non-CCAR BHCs are available **here**.

[2] *See* Federal Reserve, *Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies*, 77 Fed. Reg. 594 (Jan. 5, 2012). A Davis Polk memorandum on the Federal Reserve's proposed enhanced prudential standards is available **here**.

[3] *See* Press Release, Federal Reserve, FDIC and OCC, Agencies Provide Guidance on Regulatory Capital Rulemakings (Nov. 9, 2012), available **here**. A Davis Polk memorandum on the U.S. Basel III proposals is available **here**.

[4] *See* Basel Committee, *Report to G20 Finance Ministers and Central Bank Governors on Basel III Implementation* (Oct. 2012), available **here**.

commitments regarding the implementation of Basel III and are working as expeditiously as possible to complete the rulemaking process." The agencies also stated that they will take operational and other considerations into account when determining appropriate implementation dates and associated transition periods.

As discussed below, this delay does not affect the requirement for CCAR BHCs to project, as part of their capital plan submissions, their capital position under two of the proposed Basel III rules and the Market Risk Final Rule.

CCAR 2013: Integration with Dodd-Frank Stress Testing and Other Changes from 2012

With the publication of summary instructions on November 9, 2012, the Federal Reserve announced the beginning of the 2013 regulatory capital planning and stress testing process for U.S.-domiciled, top-tier BHCs with total consolidated assets of $50 billion or more. The economic scenarios under which a BHC must model its financial performance and capital position will not be released until November 15, and the "market shock" that six BHCs with large trading operations must incorporate into certain scenarios will be released by December 1, 2012.[5] BHCs are required to submit their capital plans no later than January 7, 2013.

The instructions explain how to submit a capital plan,[6] what a capital plan must include, how the Federal Reserve will assess a capital plan and how the Federal Reserve will address proposed capital actions set forth in a capital plan. Consistent with the previous year, the Federal Reserve released two sets of instructions: one set for the 19 CCAR BHCs and another for the 11 non-CCAR BHCs. The discussion that follows focuses on the instructions for CCAR BHCs. Key differences between the two sets of instructions, which primarily stem from the fact that non-CCAR BHCs are not yet subject to the supervisory and company-run stress test requirements promulgated by the Federal Reserve pursuant to the Dodd-Frank Act ("**Stress Test Rule**"),[7] are highlighted at the end of this memorandum.

Together with changes adopted in October 2012 to the FR Y-14A, FR Y-14Q and FR Y-14M reporting forms that BHCs must use in connection with their capital plans,[8] the 2013 instructions contain a number of differences from the 2012 process, including adjustments to reflect the implementation of Basel III in the United States, as reflected in the Basel III and Advanced Approaches NPRs and the Market Risk Final Rule. An important feature of the 2013 instructions is the integration of the annual stress testing requirements imposed by the Stress Test Rule and the Capital Plan Rule[9] into a single exercise for BHCs subject to both rules.

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[5] The instructions also note that the six BHCs with large trading operations will be provided with a supplementary reporting schedule by December 1, 2012 to provide the Federal Reserve with additional information on European exposures.

[6] As defined in the Federal Reserve's Capital Plan Rule, a capital plan is "a written presentation of a company's capital planning strategies and capital adequacy process that includes certain mandatory elements." These mandatory elements are organized into five main components: (i) an assessment of the expected uses and sources of capital over the planning horizon; (ii) a description of all planned capital actions over the planning horizon; (iii) a discussion of any expected changes to the BHC's business plan that are likely to have a material impact on the BHC's capital adequacy or liquidity; (iv) a detailed description of the BHC's process for assessing capital adequacy; and (v) a BHC's capital policy.

[7] *See* Federal Reserve*, Supervisory and Company-Run Stress Test Requirements for Covered Companies* (Oct. 12, 2012), *available* **here**. For more information on the Stress Test Rule, please refer to Appendix A to this memorandum.

[8] The Federal Reserve's description of changes to the FR Y-14A, FR Y-14Q, and FR Y-14M reporting forms is available **here** and **here**.

[9] *See* Federal Reserve, *Capital Plans* (Dec. 1, 2011), available **here**. For more information on the Capital Plan Rule, please refer to Appendix A to this memorandum.

Integrating the Stress Testing Requirements under the Capital Plan Rule and Stress Test Rule

Company-run Stress Tests

U.S.-domiciled, top-tier BHCs with total consolidated assets of $50 billion or more are subject to annual stress testing requirements under both the Stress Test Rule and the Capital Plan Rule. A key difference between the two sets of stress testing requirements relate to the assumptions BHCs must make regarding capital actions.[10] To satisfy the requirements of the Capital Plan Rule, a BHC must project its capital position, accounting for any capital actions the BHC plans to take, under a baseline economic scenario developed by the BHC and must identify any alternative capital actions it would take in an adverse stress scenario developed by the BHC.[11] To satisfy the requirements of the Stress Test Rule, a BHC must project its capital position, using the capital action assumptions required by the Stress Test Rule,[12] under the baseline, adverse and severely adverse scenarios provided by the Federal Reserve.

The 2013 capital plan instructions for CCAR BHCs indicate that CCAR BHCs will be able to satisfy both sets of *annual* stress testing requirements as part of the CCAR process.[13] Specifically, the instructions for CCAR BHCs indicate that the stress tests that CCAR BHCs are required to perform in developing their capital plans pursuant to the Capital Plan Rule and the stress tests they are required to perform pursuant to the Stress Test Rule will generally be conducted using the same economic scenarios and over the same nine-quarter planning horizon.

In order to satisfy the different requirements of the Capital Plan Rule and Stress Test Rule with respect to capital action assumptions, CCAR BHCs will need to submit multiple versions of form FR Y-14A's capital worksheet for certain economic scenarios and conduct two different projections. The capital worksheet requirements for CCAR BHCs are set forth in **Table 1** below.

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[10] The Capital Plan Rule and Stress Test Rule both define a "capital action" as "any issuance of a debt or equity capital instrument, any capital distribution, and any similar action that the Federal Reserve determines could impact a bank holding company's consolidated capital."

[11] The 2013 instructions for CCAR BHCs indicate that the adverse stress scenario developed by the BHC must reflect "a severely adverse economic and financial market environment."

[12] Under the Stress Test Rule, a BHC must project its capital position based on (a) actual capital actions taken during the first quarter of the nine-quarter planning horizon; and (b) for the second through ninth quarters of the planning horizon, (i) common stock dividends equal to the quarterly average dollar amount of such dividends paid in the 12-month period prior to the second quarter of the planning period, (ii) payments on any other instrument that is eligible for treatment as regulatory capital equal to the stated dividend, interest or principal due on such instrument during the quarter, and (iii) an assumption of no redemption or repurchase of any capital instrument that is eligible for treatment as regulatory capital.

[13] However, the 2013 instructions for CCAR BHCs do not appear to provide guidance with respect to the mid-cycle stress tests a BHC must conduct pursuant to the Stress Test Rule. Under the Stress Test Rule, the Federal Reserve will not provide scenarios to BHCs for the mid-cycle company-run stress tests. Rather, a BHC will be required to develop and use a minimum of three sets of its own scenarios—a baseline, adverse, and severely adverse scenario.

Table 1: Capital Worksheet Requirements for CCAR BHCs

Economic Scenario	Capital Worksheet 1	Capital Worksheet 2
BHC Baseline[14]	Planned Capital Actions[15]	N/A
Federal Reserve Baseline	Planned Capital Actions	Stress Test Rule Capital Actions[16]
BHC Stress	Alternative Capital Actions[17]	N/A
Federal Reserve Adverse	N/A	Stress Test Rule Capital Actions
Federal Reserve Severely Adverse	Planned Capital Actions	Stress Test Rule Capital Actions

The Federal Reserve also provided the following explanation regarding the multiple capital worksheets that CCAR BHCs must provide:

> For all scenarios except the supervisory baseline and supervisory severely adverse, a BHC should include only one capital worksheet within each FR Y-14A Summary schedule. For the BHC-defined scenarios, a BHC should include pro forma projections using the BHC's planned capital actions as deemed appropriate by the BHC for that scenario. For the supervisory adverse scenario, a BHC should include pro forma capital projections using the capital action assumptions required under the [Stress Test Rule]. For the supervisory baseline and supervisory severely adverse scenarios, a BHC should include two sets of pro forma projections, reported in two separate capital worksheets within the FR Y-14A Summary schedule—one set of projections using the BHC's planned capital actions under the BHC baseline scenario and another set using the [Stress Test Rule] capital action assumptions as outlined above.

The 2013 instructions provide specific guidance regarding a number of elements that BHCs should incorporate into their pro forma calculations, including the following with respect to how BHCs should project their risk-weighted assets:

- ***Risk-Weighted Assets Projections.*** BHCs will need to "provide detailed support for all assumptions used to derive projections of [risk-weighted assets], including assumptions related to components of balance sheet projections (on- and off-balance sheet balances and mix), income statement projections, underlying risk attributes of exposures, and any known weakness in the translation of assumptions into [risk-weighted asset] estimates for each scenario." Moreover, the 2013 instructions for CCAR BHCs state that the Federal Reserve is requiring CCAR BHCs to provide more information with respect to their risk-weighted asset projections than in 2012, including "a decomposition of overall [risk-weighted asset] projections into components reflecting . . . credit [risk-weighted assets] and market-risk-related [risk-weighted assets]." The instructions note that the FR Y-14A reporting form has not yet been updated to reflect the additional information that the Federal Reserve will request with respect to risk-weighted assets and that an updated form will be issued by December 1.

[14] The Federal Reserve noted that a CCAR BHC may use the same baseline scenario as the supervisory baseline scenario if the BHC believes the supervisory baseline scenario appropriately represents its view of the most likely outlook for the risk factors salient to the BHC. Any BHC electing to do so would need to provide appropriate supporting documentation.

[15] Planned Capital Actions refer to a BHC's planned capital actions under the BHC baseline scenario.

[16] Stress Test Rule Capital Actions refer to capital action assumptions required by the Stress Test Rule.

[17] Alternative Capital Actions refer to a BHC's assumed capital actions under the BHC stress scenario.

- ***Market Risk Projections*****.** The 2013 instructions also reflect the U.S. banking agencies' recent adoption of the Final Market Risk Rule. Specifically, while projections for the first quarter of the planning horizon (the last quarter of 2012) should be based on the existing market risk capital rule,[18] projections for the remainder of the planning horizon (the second through ninth quarters) must reflect the revised Market Risk Rule, which will go into effect on January 1, 2013.[19]

Supervisory Stress Tests

Consistent with the 2012 CCAR process, the 2013 instructions for CCAR BHCs indicate that the Federal Reserve will conduct its own supervisory stress tests of CCAR BHCs. Specifically, the Federal Reserve will conduct supervisory stress tests of a CCAR BHC pursuant to the Stress Test Rule under the baseline, adverse and severely adverse economic scenarios provided by the Federal Reserve and based on the capital action assumptions of the Stress Test Rule. Pursuant to the Capital Plan Rule, the Federal Reserve will also conduct its own projections of a CCAR BHC's capital position based on a BHC's planned capital actions under the BHC's baseline economic scenario and under the Federal Reserve's severely adverse scenario. The Federal Reserve will in part be assessing if a CCAR BHC would be capable of continuing to meet supervisory expectations for "minimum capital ratios" and a tier 1 common capital ratio[20] of at least 5 percent throughout the planning time horizon even if severely adverse stress conditions emerged and the BHC did not reduce planned capital distributions.

Both the Capital Plan Rule and the Stress Test Rule define minimum regulatory capital ratio by reference to the minimum risk-based and leverage capital ratios under *current* U.S. bank capital rules, not those set forth in the U.S. Basel III proposals. However, the 2013 instructions note that "the Federal Reserve will . . . evaluate whether . . . proposed capital actions are appropriate in light of the BHC's plans to meet the proposed Basel III requirements." The Federal Reserve also stated that, in addition to supervisory stress tests and other quantitative assessments,[21] qualitative assessments are also critical components of its review of a CCAR BHC's capital plan.[22]

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[18] *See* 12 C.F.R pt. 225, App. E.

[19] The 2013 instructions also note that if a BHC does not have an approved Stressed Value at Risk ("**SVaR**") model as of January 6, 2013, the Federal Reserve will specify a substitute capital requirement for this charge. The Federal Reserve stated that, by December 3, 2012, it will notify in writing each BHC without an approved SVaR model of the applicable requirement.

[20] Under the Capital Plan Rule, "tier 1 common ratio" means the ratio of a BHC's "tier 1 common capital" to total risk-weighted assets. "Tier 1 common capital," in turn, is defined as tier 1 capital less the non-common elements of tier 1 capital, including perpetual preferred stock and related surplus, minority interest in subsidiaries, trust preferred securities and mandatory convertible preferred securities. This definition of "Tier 1 common capital" is different from the definition of common equity tier 1 capital in Basel III. The Federal Reserve noted in the adopting release for the Capital Plan Rule that the Capital Plan Rule's definition of "tier 1 common capital" will remain in force until the Federal Reserve adopts the Basel III tier 1 common ratio.

[21] The Federal Reserve categorizes "Common Dividend Payouts" and "Basel III Transition Plans" as quantitative assessments that it expects to consider in evaluating a BHC's capital plan. The Federal Reserve's expectations with respect to Basel III Transition Plans are discussed in the next section. As regards common dividend payouts, the Federal Reserve "expects that capital plans will reflect conservative common dividend payout ratios." In particular, requests that imply common dividend payout ratios above 30 percent of projected after-tax net income available to common shareholders in either the BHC baseline or supervisory baseline will receive particularly close scrutiny.

[22] The Federal Reserve noted that even if the supervisory stress test for a given BHC results in a post-stress tier 1 common capital ratio exceeding 5 percent and other regulatory capital ratios above the minimums, the Federal Reserve could nonetheless object to that BHC's capital plan for other reasons. These reasons include: (i) there are outstanding material unresolved supervisory issues; (ii) assumptions and analyses underlying the BHC's capital plan are inadequate; (iii) the BHC's capital adequacy process, including the risk measurement and management practices supporting this process, is not sufficiently robust; and (iv) the CCAR assessment results in a determination that a BHC's Capital Adequacy Process or proposed capital distributions would otherwise constitute an unsafe or unsound practice, or would violate any law, regulation, Federal Reserve order, directive, or any condition imposed by, or written agreement with, the Federal Reserve.

Basel III Transition Plans

As part of its capital plan submissions, but separate from the stress tests it must conduct, BHCs must submit a Basel III transition plan, including projections of its capital position under the proposed Basel III capital framework as it would be implemented in the United States. Whereas the planning horizon for stress tests is nine-quarters—i.e., through the end of 2014—the Basel III schedule of the FR Y-14A reporting form and the instructions for that reporting form indicate that a BHC must project its capital position under Basel III through the end of 2017.

- ***Overview***. Generally consistent with the 2012 capital plan and CCAR instructions, the 2013 instructions note that BHCs must (i) project under the Federal Reserve's baseline economic scenario "the composition and levels of regulatory capital, risk-weighted assets, and leverage ratio exposures used to calculate minimum regulatory capital ratios (including the capital conservation buffer and any [G-SIB] surcharge that may be required) under the Basel III framework, as set forth by the Final Market Risk Rule[23] and the proposed requirements of the Basel III NPR,[24] the Advanced Approaches NPR[25] for applicable BHCs, and the Basel Committee's [G-SIB] surcharge framework" and (ii) demonstrate an ability to maintain steady progress toward satisfying the fully phased-in minimum Basel III requirements in 2019. Reflecting the issuance of proposed rules to implement the Basel III framework in the United States, the instructions expressly require BHCs to model their compliance with the U.S. Basel III proposals. Interestingly, the 2013 instructions do not appear to require BHCs to model their compliance with the Standardized Approach NPR,[26] which would, as of its proposed effective date of January 1, 2015, implement a modified, U.S. version of the Basel Committee's standardized approach and become the new "floor" for advanced approaches banking organizations.
- ***G-SIB Surcharge.*** Consistent with the 2012 instructions, the 2013 instructions instruct CCAR BHCs to take into account their "best estimate" of any capital surcharge they may be subject to as global systemically important banks ("**G-SIBs**"). As in last year's instructions, CCAR BHCs are asked to look to the methodology released in November 2011 by the Basel Committee for identifying G-SIBs.[27] The 2013 instructions, however, do not refer to the latest list of G-SIBs and associated capital surcharges published by the Financial Stability Board ("**FSB**") in November 2012.[28] Applying the Basel Committee's methodology to year-end 2011 data, the FSB's November 2012 list *provisionally* identifies 28 G-SIBs and indicates the common equity tier 1 capital surcharge (ranging from 1 percent to 2.5 percent of risk-weighted assets) associated with each G-SIB.[29] The 2013 instructions for CCAR BHCs do not specify the extent to which a CCAR BHC should rely on the FSB's latest provisional

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[23] *See* Federal Reserve, OCC and FDIC, *Risk-Based Capital Guidelines: Market Risk* (Aug. 30, 2012), available **here**.

[24] *See* Federal Reserve, OCC and FDIC, *Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action* (Aug. 30, 2012), available **here**.

[25] *See* Federal Reserve, OCC and FDIC, *Regulatory Capital Rules: Advanced Approaches Risk-based Capital Rule; Market Risk Capital Rule* (Aug. 30, 2012), available **here**.

[26] *See Regulatory Capital Rules: Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements* (Aug. 30, 2012), available **here**.

[27] *See* Basel Committee, *Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement* (2011), available **here**.

[28] *See* FSB, *Update of Group of Global Systemically Important Banks* (2012), available **here**.

[29] The FSB stated that the November 2012 G-SIB list and corresponding capital surcharge are "provisional and will be based in the future on the best and most current available data prior to implementation."

G-SIB list for its projections for 2016 and beyond versus the BHC's own "best estimate" of whether it would be a G-SIB in November 2014 and any associated capital surcharge.[30]

Public Disclosures and Interim Communication between BHCs and the Federal Reserve

In a change from 2012, the 2013 instructions for CCAR BHCs provide that after the Federal Reserve has completed its assessments of BHCs' capital plans, but prior to the disclosure of the final CCAR results, each CCAR BHC will be provided the results of the post-stress capital analysis for that particular BHC and given an opportunity to make a one-time downward adjustment to its original capital distribution plans. The Federal Reserve's final decision to object or not object to the CCAR BHC's capital plan will be informed by any adjusted capital distribution plans. However, as explained below, the Federal Reserve will disclose the fact that a CCAR BHC has availed itself of the opportunity to reduce its original capital distribution plans.

The Federal Reserve will publish by March 31, 2013 the results of two of the stress tests it conducts for each CCAR BHC under the Federal Reserve's severely adverse economic scenario—one stress test based on the capital action assumptions required by the Stress Test Rule and another based on a CCAR BHC's planned capital actions. The instructions note that the published results of the supervisory stress test under the Stress Test Rule will include the Federal Reserve's projections of a CCAR BHC's losses, revenues and capital ratios. In contrast, the published results of the supervisory stress test under the Capital Plan Rule will include only a CCAR BHC's projected capital ratios—both under its original planned capital actions as well as under any subsequent downward adjustments to those planned capital actions. The disclosure tables that the Federal Reserve will use to publish the results of its stress tests are set forth in Appendix 2 to the 2013 instructions for CCAR BHCs.

In addition, consistent with the requirements of the Stress Test Rule, the 2013 instructions for CCAR BHCs note that CCAR BHCs will be required to publish summaries—between March 15 and March 31, 2013—of the results of their company-run stress tests under the severely adverse economic scenario provided by the Federal Reserve. In 2012, when stress tests were conducted solely pursuant to the Capital Plan Rule, CCAR BHCs were not required to publish such a summary.

Capital Planning and Stress Testing for Non-CCAR BHCs

While the 2013 instructions for non-CCAR BHCs are generally comparable to those for CCAR BHCs, there are some important differences for non-CCAR BHCs that largely stem from the fact that non-CCAR BHCs need not comply with the Stress Test Rule until the 2014 capital planning and stress testing cycle.

Non-CCAR BHCs will be required to conduct stress tests as part of their capital plans pursuant to the Capital Plan Rule, and the Federal Reserve will provide non-CCAR BHCs with the same economic scenarios that it provides to CCAR BHCs under the Stress Test Rule. However, non-CCAR BHCs will not need to conduct a stress test under the Federal Reserve's adverse economic scenario. Similarly, non-CCAR BHCs will not be required to project their capital positions according to the capital action assumptions of the Stress Test Rule and will therefore not be required to submit as many capital worksheets with their FR Y-14A submission as CCAR BHCs. The capital worksheet requirements for non-CCAR BHCs are set forth in **Table 2** below.

[30] Under the Basel Committee's G-SIB framework, the capital surcharge for G-SIBs will be phased in starting in 2016, initially for those banks identified as G-SIBs in November 2014.

Table 2: Capital Worksheet Requirements for Non-CCAR BHCs

Economic Scenario	Capital Worksheet
BHC Baseline	Planned Capital Actions[31]
Federal Reserve Baseline	Planned Capital Actions
BHC Stress	Alternative Capital Actions[32]
Federal Reserve Severely Adverse	Planned Capital Actions

In line with the 2012 capital plan process, the 2013 instructions for non-CCAR BHCs state that the Federal Reserve will not conduct its own stress tests of non-CCAR BHCs but will instead evaluate a non-CCAR BHC's planned capital actions based on the BHC's own projections. Reflecting the fact that the Federal Reserve will not conduct its own stress tests of non-CCAR BHCs, such BHCs will not be provided with an opportunity to make a downward revision to planned capital distributions.

The 2013 instructions for non-CCAR BHCs do not include those portions of the CCAR BHC instructions that are only applicable to the six large trading BHCs (which are all CCAR BHCs) and do not require such non-CCAR BHCs to take into account any potential G-SIB surcharge.[33]

Finally, the Federal Reserve will not publish a summary of BHC-specific results for non-CCAR BHCs, and non-CCAR BHCs are not themselves required to publish any summary of their own stress tests.

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[31] Planned Capital Actions refer to a BHC's planned capital actions under the BHC baseline scenario.

[32] Alternative Capital Actions refer to a BHC's assumed capital actions under the BHC stress scenario.

[33] None of the 11 non-CCAR BHCs are identified in the FSB's November 2011 provisional list of G-SIBs, see supra note 28, but the parent companies of some non-CCAR BHCs are provisionally identified by the FSB as G-SIBs.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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Appendix A

SCAP and the Stress Test Rule

In 2009, pursuant to its general supervisory authority, the Federal Reserve required 19 BHCs—the same BHCs that participated in the 2011 CCAR process—to part take in the Supervisory Capital Assessment Program ("**SCAP**"). The Federal Reserve described SCAP as "a forward-looking exercise designed to estimate losses, revenues, and reserve needs for eligible [BHCs] under two macroeconomic scenarios: a baseline and a more adverse scenario"—i.e., a stress test. Building on SCAP, Section 165(i)(1) of the Dodd-Frank Act requires the Federal Reserve to conduct annual supervisory stress tests for BHCs with total consolidated assets of $50 billion or more and for nonbank financial companies designated by the FSOC for supervision by the Federal Reserve (collectively, "**Covered Companies**"). Section 165(i)(1) of the Dodd-Frank Act requires Covered Companies to conduct semiannual company-run stress tests and requires all other financial companies that have total consolidated assets of more than $10 billion and are regulated by a primary federal financial regulatory agency to conduct annual company-run stress tests.

In October 2012, the Federal Reserve adopted the Stress Test Rule to implement this requirement for Covered Companies and a separate stress-testing rule for entities with total consolidated assets of more than $10 billion and for which the Federal Reserve is the primary federal financial regulatory agency. Under the Stress Test Rule, the Federal Reserve will conduct annual supervisory stress tests for Covered Companies under baseline, adverse and severely adverse economic scenarios constructed by the Federal Reserve. Among other things, each Covered Company must update its Dodd-Frank resolution plan as the Federal Reserve determines appropriate, based on the results of the supervisory stress test. Each Covered Company is also required to conduct an annual company-run stress test under the Federal Reserve's scenarios as well as a separate mid-cycle company-run stress test based on baseline, adverse and severely adverse economic scenarios developed by the Covered Company itself. The Stress Test Rule becomes effective in November 2012 for the 19 CCAR BHCs and will go into effect in November 2013 for the 11 non-CCAR BHCs.

CCAR and the Capital Plan Rule

In 2011, pursuant to its general supervisory authority, the Federal Reserve required 19 BHCs—the same BHCs that participated in SCAP—to participate in the CCAR process. The Federal Reserve described the initial CCAR as "a forward-looking, detailed evaluation of capital planning and stress scenario analysis" in which "the Federal Reserve assessed the firm's ability, after taking into account the proposed capital actions, to maintain sufficient capital levels . . . in stressed economic environments, including under an adverse scenario" and evaluated whether planned capital distributions should be allowed.

In November 2011, the Federal Reserve adopted the Capital Plan Rule, which formalized the CCAR process and expanded it to all U.S.-domiciled, top-tier BHCs with consolidated assets of $50 billion or more. Under the Capital Plan Rule, a BHC must submit an annual capital plan that includes, among other things, (i) planned capital actions and (ii) projections of revenues, losses, reserves and capital levels under a variety of baseline and stressed economic scenarios developed by the Federal Reserve and the BHC. The Capital Plan Rule provides that the Federal Reserve's assessment of a BHC's capital plan could involve the Federal Reserve conducting its own projections of a BHC's revenues, losses, reserves and capital levels under baseline and stressed economic scenarios. In the 2012 CCAR process, the first performed pursuant to the Capital Plan Rule, the Federal Reserve conducted its own projections for the 19 CCAR BHCs, but not for the 11 non-CCAR BHCs.