Dodd-Frank Stress Tests

Federal Banking Agencies Propose Company-Run Stress Test Data Reporting Templates and Related Documentation for Financial Institutions with Over $10 Billion but Less Than $50 Billion in Assets

SUMMARY

The Board of Governors of the Federal Reserve System (the “FRB”), the Office of Comptroller of the Currency (the “OCC”) and the Federal Deposit Insurance Corporation (the “FDIC”, and together with the FRB and the OCC, the “Agencies”) recently issued notices of proposed rulemaking concerning data collection and reporting requirements for bank holding companies, savings and loan holding companies and depository institutions with total consolidated assets of at least $10 billion but less than $50 billion (the “Covered Institutions”). These new reporting requirements are being proposed in connection with the company-run stress test requirements of Section 165(i)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”).

The notices outline the reports and data that each Covered Institution would be required to provide to the Agency that is its applicable primary regulator in order to meet the Dodd-Frank stress test related reporting requirements. If the proposed requirements are adopted, Covered Institutions would be mandated to complete three templates reporting the results of their company-run stress tests, as well as their underlying assumptions and variables. The Agencies may use collected data to gauge the reasonableness of the stress test results of Covered Institutions and to provide forward-looking information to the Agencies regarding a Covered Institution’s capital adequacy. Although Covered Institutions are not subject to the FRB’s mandatory Comprehensive Capital Analysis and Review program (“CCAR”) because they fall under the CCAR $50 billion asset threshold, these notices appear to further underscore the Agencies’ view of the importance of the Dodd-Frank company-run stress tests and related data as part of their supervisory review and assessment of institutions’ capital adequacy and, by implication, the potential permissibility of planned dividends and other capital distributions.
BACKGROUND

Section 165(i)(2) of Dodd-Frank requires bank holding companies, savings and loan holding companies and depository institutions with total consolidated assets of $10 billion to $50 billion to conduct annual stress tests. In October 2012, the Agencies published final rules outlining the scope, timing, scenarios and methodologies of these stress tests. Under the final rules, Covered Institutions must conduct stress tests at prescribed intervals to assess the potential impact of scenarios on the consolidated earnings, losses and capital of a Covered Institution over the nine-quarter planning horizon, taking into account the Covered Institution’s current condition, risks, exposures, strategies and activities. At a minimum, Covered Institutions must conduct their annual stress tests using three scenarios—baseline, adverse and severely adverse—provided by the Agencies.

Although the FDIC, FRB and OCC are acting independently, the Agencies have indicated their continuing commitment to working together in a coordinated manner to implement the stress test requirements of Dodd-Frank. Under the proposed requirements, Covered Institutions must use particular forms—FDIC DFAST 10-50, FR Y-16 and OCC DFAST 10-50, as applicable—to report the methodologies and results of their company-run stress tests.

I. TEMPLATE REQUIREMENTS

Although the OCC, FRB and FDIC each have their own proposed reporting form, they substantially consist of the same requirements. Any exceptions are noted below. Each form consists of three primary templates: (1) the Results Template; (2) the Scenario Variables Template; and (3) the Contact Information Template. The Agencies note that the information required by the templates from Covered Institutions with total consolidated assets in the $10 billion to $50 billion range is less granular than the information that has been required from institutions with $50 billion or more in total consolidated assets, recognizing the increased complexity of larger institutions’ businesses. Information collected via these reporting requirements may be accorded confidential treatment under the Freedom of Information Act and will not be included in the mandatory publication requirements under Dodd-Frank requiring Covered Institutions to publish a summary of the results of their stress tests. Each template must be submitted to the appropriate Agency annually, on or before March 31, and must cover ten quarters, commencing with the quarter before the nine-quarter “planning horizon” covered by the stress test rules and continuing through the last quarter of the planning horizon.
A. RESULTS TEMPLATE

The Results Template is composed of three worksheets: (1) income statement; (2) balance sheet; and (3) capital. Covered Institutions must submit separate worksheets for each company-run stress test scenario. The proposed templates consist of tables where Covered Institutions input data as line items and memoranda sections where Covered Institutions itemize and describe prescribed information. The basic requirements for these reporting worksheets are as follows:

1. **Income Statement**

   The income statement worksheet collects data for the quarter preceding the planning horizon and for each quarter of the planning horizon for the stress test on projected losses and revenues. The Agencies may use this information to assess losses that Covered Institutions can sustain in baseline, adverse and severely adverse stress scenarios. Components of the income statement include:

   - Net charge-offs;
   - Pre-provision net revenue;
   - Provision for loan and lease losses;
   - Realized gains (losses) on held to maturity (“HTM”) and available-for-sale (“AFS”) securities;
   - All other gains (losses); and
   - Taxes.

   Other information to be included in the worksheet memoranda includes:

   - Net gains and losses on sales of other real estate owned; and
   - Total other than temporary impairment (OTTI) losses.

2. **Balance Sheet**

   The balance sheet worksheet collects data for the quarter preceding the planning horizon and for each quarter of the planning horizon for the company-run stress test on projected equity capital and various assets and liabilities. This data may be used to assess the projected changes in assets and liabilities that Covered Institutions can sustain in an adverse and severely adverse stress scenario, as well as the revenue and loss projections identified in the income statement worksheet. The balance sheet includes the following categories of assets and liabilities:

   - Loans;
   - HTM securities;
   - AFS securities;
   - Trading assets;
   - Total intangible assets;
   - Other real estate; and
Other information to be included in the worksheet memoranda includes:

- Loans and leases guaranteed by other U.S. government or GSE guarantees (non-Agency loss sharing agreements);
- Troubled debt relationships;
- Loans secured by 1-4 family in foreclosure;
- Retail funding (core deposits);
- Wholesale funding;
- Trading liabilities;
- All other liabilities;
- Perpetual preferred stock and related surplus;
- Common stock;
- Surplus;
- Retained earnings;
- Other equity capital components; and
- Average rates for loans, securities, retail funding, wholesale funding, interest-bearing deposits, trading and other liabilities.

3. Capital

The capital worksheet, which is appended to the balance sheet worksheet, collects data for the quarter preceding the planning horizon as well as each quarter of the planning horizon for the stress test in the following areas:20

- Unrealized gains (losses) on AFS securities;
- Disallowed deferred tax asset;
- Tier 1 common capital elements;
- Tier 1 capital;
- Tier 2 capital;
- Total risk-based capital;
- Total capital;
- Risk weighted assets;
- Total assets for leverage purposes;
- Tier 1 common equity ratio; and
- Tier 1 risk-based capital ratio.

Information to be included in the worksheet memoranda includes:

- Sale, conversion, acquisition or retirement of capital stock;

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- Cash dividends declared on preferred stock; and
- Cash dividends declared on common stock.

B. SCENARIO VARIABLES TEMPLATE

In conducting their stress tests, Covered Institutions may project additional economic and financial variables to estimate losses or revenues for some or all of their portfolios. The use of these variables is not mandatory. However, if Covered Institutions choose to use additional variables, they must record the variable name, the actual value of the variable during the third quarter of the reporting year, and the projected value of the variable for nine future quarters.

C. CONTACT INFORMATION TEMPLATE

Although part of the FDIC DFAST 10-50, FR Y-16 and OCC DFAST 10-50 reporting forms, the Contact Information Template does not require substantive data. For this template, covered institutions must supply their RSSD identification, submission date and other contact information.

D. OTHER SUPPORTING DOCUMENTATION

In addition to the three templates and associated worksheets, Covered Institutions must submit clear documentation in support of their projections. The Agencies have not identified a particular form or template for these supplemental materials. The supporting documentation should provide the following:

- A description of the types of risks included in the stress test;
- A summary description of the methodologies used in the stress test; and
- An explanation of the most significant causes for the changes in regulatory capital ratios.

The FRB reserves the general right to require Covered Institutions to include additional information. In contrast, the FDIC and OCC explicitly require additional detail including the methods used to translate the macroeconomic factors into a Covered Institution’s projections; the impact of anticipated corporate events, including mergers, acquisitions or divestitures of business lines or entities; and how changes are reflected in stress test results, including the impact on estimates of losses, expenses and revenues, net interest margins, non-interest income items and balance sheet amounts. A Covered Institution must also explain any company-specific assumptions that differ from the broad macroeconomic assumptions of the FDIC or OCC. In addition, any reliance on historical relationships must be supplemented by a description of the historical data and rationale for why these relationships would be maintained in each scenario.

II. USE OF DATA BY THE AGENCIES

The FDIC and OCC state that they intend to use the proposed reporting requirements, particularly the Results Template, to assess the reasonableness of the stress test results of Covered Institutions.
collected data will also provide the Agencies with forward-looking information regarding a Covered Institution’s capital adequacy. The FRB reserves the right to conduct follow-up discussions and request additional information from Covered Institutions as necessary. The Agencies will also use the results of the stress tests and data gathered on the proposed forms to determine whether additional analytical techniques and exercises are appropriate to identify, measure and monitor risks at the Covered Institution.

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ENDNOTES


2. *Id.* at 16263 (FDIC); 16502 (FRB); 15403 (OCC).

3. 12 U.S.C. § 5365(i)(1). For additional information on the company-run stress test requirements, as well as the supervisory stress tests conducted by the FRB, please refer to our Memorandum to Clients, dated October 26, 2012 “Stress Test Rules—Federal Banking Agencies Publish Final Stress Test Rules on Supervisory and Company-Run Stress Test Requirements Imposed by Dodd-Frank”.


5. 12 C.F.R. § 46.2.

6. *Id.* § 252.145(b).

7. 78 Fed. Reg. at 16264 (FDIC); 15404 (OCC).


9. Note the FRB uses the term “schedule” rather than “template” to refer to the individual sections of FR Y-16. There are no substantive differences between the “schedules” and “templates”. Therefore, to avoid confusion, the term “template” is used to refer to all forms, including the FRB’s FR Y-16.

10. 78 Fed. Reg. at 16264 (FDIC); 15404 (OCC).


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ENDNOTES (CONTINUED)


13 78 Fed. Reg. at 16264 (FDIC); 16504 (FRB); 15404 (OCC).

14 Id.


Under the annual company-run stress test rules, covered institutions must use a planning horizon of at least nine quarters over which the impact of specified scenarios would be assessed. 12 C.F.R. §§ 325.202(e) (FDIC); 46.6(b) (OCC).

16 78 Fed. Reg. at 16264 (FDIC); 15404 (OCC).

17 Id. at 16264 (FDIC); 16504 (FRB); 15404 (OCC).

18 Id. at 16264 (FDIC); 15405 (OCC).

19 Id. at 16264 (FDIC); 16504 (FRB); 15405 (OCC).

20 78 Fed. Reg. at 16264 (FDIC); 16504 (FRB); 15405 (OCC).

21 Id.

22 Id. at 16265 (FDIC); 16504 (FRB); 15403 (OCC).


24 78 Fed. Reg. at 16265 (FDIC); 16504 (FRB); 15405 (OCC).

25 Id. at 16504 (FRB).

26 Id. at 16265 (FDIC); 15405 (OCC).

27 Id. at 16264 (FDIC); 15404 (OCC).

28 Id. at 16504.

29 Id. at 16264 (FDIC); 15404 (OCC).
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