Qualitative Assessment Remains the Hurdle for CCAR 2016 – Capital Planning Process in Focus

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The Federal Reserve Board (FRB) released the results of its Comprehensive Capital Analysis and Review (CCAR) exercise on June 29, 2016 and reiterated the high expectations for the capital planning process at participating Bank Holding Companies (BHCs). Of the 33 BHCs required to submit capital plans[1], two received objections to their plans due to qualitative reasons[2], while all BHCs passed the quantitative aspect of the review. Additionally, one BHC received a conditional non-objection and must re-submit its capital plan by December 29, 2016[3].

This year's CCAR comes on the heels of new and clarified guidance outlining the FRB's expectations for capital planning. The guidance, which varies between large and complex firms and large and non-complex firms, was provided in supervisory letters SR 15-18 and SR 15-19 in December 2015[4]. The CCAR results, as well as the guidance, have maintained that the largest and most complex firms have the highest expectations and the tallest task in achieving compliance.

From a quantitative standpoint, BHCs have raised their capital levels substantially since the financial crisis with the aggregate Common Equity Tier 1 capital ratio increasing from 5.5% in the first quarter of 2009 to 12.2% in the first quarter of 2016. This substantial build-up of capital, representing an increase of 122%, has provided BHCs a stronger footing to kick-off their stress scenario projections. This was apparent in the quantitative assessment where all but one BHC was projected to maintain capital ratios above required minimums.[5]

There was little discussion from the FRB with respect to leading and lagging practices at BHCs as compared to previous years. In addition, methodology and model discussion was minimized. Based on the commentary provided, we conclude that BHCs have a good understanding of the methodology and modeling requirements for CCAR, however, they are still struggling with process related items such as controls, data and internal audit.

The FRB did outline considerations for the qualitative assessment of the capital plan which highlighted three key areas, including material unresolved supervisory issues, assumptions and analysis underlying the capital plan and controls and governance over the capital planning process. As BHCs look to next year's filing, it would be prudent to take heed of these considerations and increase focus on these areas, in addition to feedback provided in direct response letters.

Figure 1 – Quantitative and Qualitative Highlights

Quantitative Highlights

- Similar to prior years, BHCs were granted one chance to adjust their original proposed capital actions after DFAST results were released. Unlike prior years, only one BHC, M&T Bank Corporation, opted to adjust its capital actions.
- For the 33 BHCs, the FRB estimates that the aggregate Common Equity Tier 1 capital ratio would decrease in the severely adverse scenario from 12.3% in the fourth quarter of 2015 to 7.1% at its minimum over the planning horizon.

Qualitative Highlights

- **Material Unresolved Supervisory Issues** around identification, measurement, and management of firms' material risks as well as the controls and governance supporting those areas were in focus. Supervisory issues were assessed based on severity, pervasiveness and length of time an issue has been unresolved.
- BHCs must continue to challenge the **Assumptions and Analysis Underlying the Capital Plan** including the method for risk identification, developing BHC scenarios and for assessing model limitations and assumptions contributing to capital projections.
- The FRB has demonstrated a continued focus on **Controls and Governance over the Capital Planning Process** including internal control design, the role of Internal Audit, data and IT and senior management oversight.

Planning for CCAR 2017

The FRB's continued focus on the robustness of the capital planning process and the apparent satisfaction with the overall industry understanding of methodology and model requirements for capital projection indicates that BHCs should invest in process related initiatives. Process focus may include quality assurance of the capital planning process, data and technology infrastructure enhancement, internal audit review and additional governance.

The FRB explicitly specified in this year's results that many firms continue to show weaknesses in their internal audit programs surrounding the capital planning process. BHCs need to ensure they have an internal audit function that is actively identifying weaknesses in the capital planning process and has the appropriate expertise to challenge the first and second line of defense. The FRB "tipped their hand" by stating that BHC Internal Audit departments will undergo thorough reviews later in 2016.

The importance of supervisory issue remediation could not be more clear in this year's results and should remain a focus for all BHCs. Detailed remediation plans with key milestones and responsible parties will help to assign accountability and structure around resolving these issues. Detailed planning will also provide the FRB with a guide map into the timeframe for issue closure. Transparency in this process is imperative to mitigate the potential for open supervisory issues to undermine the efficacy of capital planning results.

The Federal Reserve continues to emphasize the need for a strong internal controls and governance framework. Internal controls should surround each of the key components of the capital planning process and leverage existing frameworks as a starting point for compliance with CCAR expectations. Firms should focus on identifying key controls, testing their effectiveness and adding new controls in areas where they identify risks. The need for this is further increased by the pending attestation of the effectiveness of controls around FR Y-14 reporting by LISCC firms' CFOs.[6]

A dedicated quality assurance (QA) team embedded within the first line of defense can help to provide senior management and the Board of Directors assurance of key processes and related control effectiveness. A QA team's responsibilities are similar to the third line of defense, however, their objective is to evaluate appropriate design and functionality of processes to achieve compliance with internal and external requirements. The QA team also plays a critical role in centralizing the tracking and remediation progress of QA team reviews, supervisory feedback, internal audit points and management-identified issues.

Contact Us

For additional information about DHG's quality assurance, stress testing, capital management and internal audit capabilities and how we can assist your company, please contact:

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[1]BHCs required to submit capital plans include BHCs (other than a foreign banking organization) that have $50 billion or more in total consolidated assets as determined based on FR Y-9C reporting results.

[2]Deutsche Bank Trust Corporation and Santander Holdings USA capital plans were objected to due to qualitative reasons.

[3]Morgan Stanley received a conditional non-objection to their capital plan.

[4]Large and noncomplex BHCs have consolidated assets of at least $50 billion but not more than $250 billion. Large and Complex BHCs have consolidated assets above $250 billion or are subject to the Federal Reserve's Large Institution Supervision Coordinating Committee (LISCC) framework.

[5]M&T Bank Corporation was projected to fall below the minimum required post-stress Tier 1 and Total Capital ratios prior to adjusting capital actions.

[6]CFO attestation will be required for all FR Y-14 submissions for LISCC firms; see https://www.gpo.gov/fdsys/pkg/FR-2016-01-21/pdf/2016-01043.pdf.