June 16, 2017

The Honorable Blaine Luetkemeyer  
Chairman  
Subcommittee on Financial Institutions  
and Consumer Credit  
House of Representatives  
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your letter dated May 4, 2017, regarding the transparency of the Federal Reserve Board’s Comprehensive Capital Analysis and Review (CCAR) process.

The Federal Reserve strives for transparency in our supervision and regulation of financial institutions. It is particularly important that we do so in connection with the CCAR exercise, given its criticality to our efforts to ensure the largest, most systemically important firms are better prepared for the next financial downturn by enabling them to continue lending to U.S. businesses and households and support the U.S. economy. To that end, the Federal Reserve has taken steps to enhance the transparency of the quantitative and qualitative assessments of the CCAR exercise every year since its inception in 2011. For example, in December 2015, the Federal Reserve issued supervisory guidance on capital planning – Supervision and Regulation (SR) Letters 15-18 and 15-19 – that consolidate and clarify supervisory expectations around capital planning. As described in the SR letters, the Federal Reserve expects the largest firms to have sound analyses and processes supporting their capital planning, including how they are controlled and governed, similar to long-established supervisory expectations for sound risk management. In last year’s results disclosure document, the Federal Reserve published a summary of considerations for CCAR qualitative assessments and additional details on the results of the qualitative assessment. This year’s CCAR disclosure document will include additional insights into the qualitative assessment. Specifically, we will include detailed information on how we undertake that qualitative assessment, and give specific examples from past years’ problems in firms’ capital planning practices.
Your letter recommends that the transparency and efficacy of CCAR could be furthered through a date-certain release of the annual CCAR instructions, reduction in the number of annual scenarios, and publication of the supervisory stress testing models for comment.

Since CCAR 2013, the Federal Reserve has published the CCAR instructions at least two months before the submission date of capital plans. In addition, the CCAR instructions consistently have been published before the supervisory scenarios, the February 15 publication date of which is established by the capital plan rule. Although the Federal Reserve is not obligated by rule to release the CCAR instructions by a certain date, we have endeavored to do so at an appropriate time in advance of the capital plan submission date to foster predictability of the CCAR process, consistency in firms’ capital plan submissions, and coordination across the federal banking agencies. However, in order to provide more certainty to firms, the public, and the other federal banking agencies, the Federal Reserve will commit to release the CCAR instructions at the same time as the supervisory scenarios, by February 15.

On the stress scenarios, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires that the Federal Reserve use three scenarios—baseline, adverse, and severely adverse—in our supervisory stress tests. These scenarios are not tailored to any single firm and are intended to facilitate a horizontal view across firms. As such, the three mandated scenarios do not reflect the unique risk profiles of all the firms subject to CCAR. In contrast, the firm-developed scenarios are expected to stress each firm’s specific vulnerabilities, given its risk profile and operations so that the firm considers the effect of such a stress on its capital adequacy. Together with the supervisory scenarios, these scenarios enable the Federal Reserve and the firm to gain a comprehensive understanding of the banking system’s and the firm’s resilience to multiple sources of stress.

With regard to our supervisory models, the Federal Reserve publishes annually a description of all models used in the stress test, including information about key risk drivers and scenario variables for each modeling area. In the past several years, the Federal Reserve published documents that highlighted material model changes in that year, and began a process of phasing in the most material model changes to smooth the effects of the changes on firms’ projections of net income and capital. The Federal Reserve also hosts an annual model symposium that provides a venue for discussions with the industry about modeling practices.

In working to enhance transparency around the stress test, the Federal Reserve carefully weighs the costs and benefits of disclosing additional details about our supervisory models. We are concerned that releasing all details on the models would give banks an incentive to adjust their business practices in ways that change the results of the stress test without changing the risks faced by the firms. The result could be less effective stress tests that present a misleading picture of the actual vulnerabilities faced by firms. There would also be a risk of increased correlations in asset holdings among the largest banks, making the financial system more vulnerable to adverse financial shocks.
The Federal Reserve remains committed to finding ways to continue to safely enhance transparency and encourage feedback on our modeling approaches. As discussed by former Governor Daniel Tarullo in his speech on April 4 of this year, one way to do so would be to publish loss information for more asset categories than are currently included in the Federal Reserve’s stress test results disclosure. Another would be to publish a set of hypothetical portfolios with the modeled losses on those portfolios. Staff are currently developing methods that would make such disclosures possible and plan to seek feedback from the public on the format of such disclosures in the coming months.

The CCAR and stress testing programs have made, and continue to make, substantial contributions to protecting the safety and soundness of the nation’s largest financial firms and to promoting the stability of the financial system as a whole. Going forward, we will continue to seek ways to ensure that the CCAR and stress testing programs remain effective, but not overly burdensome.

We appreciate your interest in this matter.

Sincerely,

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