

# Board of Governors of the Federal Reserve System

## Joint Press Release

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For immediate release

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### JOINT STATEMENT BY

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#### **The Treasury Capital Assistance Program and the Supervisory Capital Assessment Program**

During this period of extraordinary economic uncertainty, the U.S. federal banking supervisors believe it to be important for the largest U.S. bank holding companies (BHCs) to have a capital buffer sufficient to withstand losses and sustain lending even in a significantly more adverse economic environment than is currently anticipated. In keeping with this aim, the Federal Reserve and other federal bank supervisors have been engaged in a comprehensive capital assessment exercise--known as the Supervisory Capital Assessment Program (SCAP)--with each of the 19 largest U.S. BHCs.

The SCAP will be completed this week and the results released publically by the Federal Reserve Board on **Thursday May 7<sup>th</sup>, 2009** at 5pm EDT. In this release, supervisors will report--under the SCAP "more adverse" scenario, for each of the 19 institutions individually and in the aggregate--their estimates of: losses and loss rates across select categories of loans; resources available to absorb those losses; and the resulting necessary additions to capital buffers. The estimates reported by the Federal Reserve represent values for a hypothetical 'what-if' scenario and are not forecasts of expected losses or revenues for the firms. Any BHC needing to augment its capital buffer at the conclusion of the SCAP will have until **June 8<sup>th</sup>, 2009** to develop a detailed capital plan, and until **November 9<sup>th</sup>, 2009** to implement that capital plan.

The SCAP is a complement to the Treasury's Capital Assistance Program (CAP), which makes capital available to financial institutions as a bridge to private capital in the future. A strong, resilient financial system is necessary to facilitate a broad and sustainable economic recovery. The U.S. government reaffirms its commitment to stand firmly behind the banking system during this period of financial strain to ensure it can perform its key function of providing credit to households and businesses.

#### ***Understanding the Results of Supervisory Capital Assessment Program***

##### *The SCAP Focus on the Quantity and Quality of Capital*

Minimum capital standards for a BHC serve only as a starting point for supervisors in determining the adequacy of the BHC's capital relative to its risk profile. In practice, supervisors expect all BHCs to have a level and composition of Tier 1 capital well in excess of the 4% regulatory minimum, and also to have common equity as the dominant element of that Tier 1 capital.

Under the SCAP, supervisors evaluated the extent to which each of the 19 BHCs would need to alter either the amount or the composition (or both) of its Tier 1 capital *today* to be able to comfortably exceed minimum regulatory requirements *at year-end 2010*, even under an more adverse economic scenario.

*The SCAP capital buffer for each BHC is sized to achieve a **Tier 1 risk-based ratio of at least 6%** and a **Tier 1 Common risk-based ratio of at least 4%** at the end of 2010, under a more adverse macroeconomic scenario than is currently anticipated.*

The SCAP focuses on Tier 1 Common capital--measured by applying the same adjustments to "voting common stockholders' equity" used to calculate Tier 1 capital--as well as overall Tier 1 capital, because both the amount and the composition of a BHC's capital contribute to its strength. The SCAP's emphasis on Tier 1 Common capital reflects the fact that common equity is the first element of the capital structure to absorb loss and offers protection to more senior parts of the capital structure. All else equal, more Tier 1 Common capital gives a BHC greater permanent loss absorption capacity and a greater ability to conserve resources under stress by changing the amount and timing of dividends and other distributions.

#### *The Role of the SCAP Buffer*

By its design, the SCAP is more stringent than a solvency test. First, each BHC's capital was rigorously evaluated against a two-year-ahead adverse scenario that is not a prediction or an expected outcome for the economy, but is instead a "what if" scenario. In addition, the buffer was sized so that each BHC will have a cushion above regulatory minimums even in the stress scenario. Thus, any need for additional capital and/or a change in composition of capital to meet the SCAP buffer is not indicative of inadequate current capitalization. Instead, the SCAP buffer builds in extra capital against the unlikely prospect that the adverse scenario materializes.

The presence of this one-time buffer will give market participants, as well as the firms themselves, confidence in the capacity of the major BHCs to perform their critical role in lending, even if the economy proves weaker than expected. Once this upfront buffer is established, the normal supervisory process will continue to be used to determine whether a firm's current capital ratios are consistent with regulatory guidance.

#### *The SCAP and the Capital Planning Process*

Over the next 30 days, any BHC needing to augment its capital buffer will develop a detailed capital plan to be approved by its primary supervisor, in consultation with the FDIC, and will have six months to implement that plan. In light of the potential for new commitments under the Capital Assistance Program or exchanges of existing CPP preferred stock, supervisors will consult with Treasury on the development and evaluation of the plans. The capital plan will consist of three main elements:

- A detailed description of the specific actions to be taken to increase the level of capital and/or to enhance the quality of capital consistent with establishing the SCAP buffer. BHCs are encouraged to design capital plans that, wherever possible, actively seek to raise new capital from private sources. These plans should include actions such as:
  - Issuance of new private capital instruments;
  - Restructuring current capital instruments;
  - Sales of business lines, legal entities, assets or minority interests through private transactions and through sales to the PPIP;
  - Use of joint ventures, spin-offs, or other capital enhancing transactions; and
  - Conservation of internal capital generation, including continued restrictions on dividends and stock repurchases and dividend deferrals, waivers and suspensions on preferred securities including trust preferred securities, with the expectation that plans should not rely on near-term potential increases in revenues to meet the capital buffer it is expected to have.
- A list of steps to address weaknesses, where appropriate, in the BHC's internal processes for assessing capital needs and engaging in effective capital planning.

- An outline of the steps the firm will take over time to repay government provided capital taken under the Capital Purchase Program (CPP), Targeted Investment Program (TIP), or the CAP, and reduce reliance on guaranteed debt issued under the TLGP.

In addition, as part of the 30-day planning process, firms will need to review their existing management and Board in order to assure that the leadership of the firm has sufficient expertise and ability to manage the risks presented by the current economic environment and maintain balance sheet capacity sufficient to continue prudent lending to meet the credit needs of the economy.

Supervisors expect that the board of directors and the senior management of each BHC will give the design and implementation of the capital plan their full and immediate attention and strong support. Capital plans will be submitted and approved by supervisors by June 8th, 2009. Upon approval, these capital plans will be the basis for the BHC's establishment of the SCAP capital buffer by November 9<sup>th</sup>, 2009.

#### ***Mandatory Convertible Preferred under the CAP***

To ensure that the banking system has the capital it needs to provide the credit necessary to support economic growth, the Treasury is making capital available under its Capital Assistance Program as a bridge to private capital in the future. A BHC may apply for Mandatory Convertible Preferred (MCP) in an amount up to 2% of risk-weighted assets (or higher upon request). MCP can serve as a source of contingent common capital for the firm, convertible into common equity when and if needed to meet supervisory expectations regarding the amount and composition of capital. Treasury will consider requests to exchange outstanding preferred shares sold under the CPP or the Targeted Investment Program (TIP) for new mandatory convertible preferred issued under the CAP. In order to protect the taxpayer interest, the Treasury expects that any exchange of Treasury-issued preferred stock for MCP will be accompanied or preceded by new capital raises or exchanges of private capital securities into common equity.

The MCP instrument is designed to give banks the incentive to redeem or replace the government-provided capital with private capital when feasible. The term sheet for MCP is available at [www.financialstability.gov](http://www.financialstability.gov).

The SCAP focused on the largest financial firms to ensure that they maintain adequate capital buffers to withstand losses in an adverse economic environment. Smaller financial institutions generally maintain capital levels, especially common equity, well above regulatory capital standards. There is no intention to expand the SCAP beyond the 19 BHCs that have recently completed this exercise.

The Treasury reiterates that the CAP application process remains open to these institutions under the same terms and conditions applicable to the 19 SCAP BHCs. The Treasury stands ready to review and process any applications received in an expedient manner. For those firms wishing to apply to CAP, supervisors will review those firms' risk profiles and capital positions. In addition, supervisors will evaluate the firms' internal capital assessment processes, including capital planning efforts that incorporate the potential impact of stressful market conditions and adverse economic outcomes.

#### ***Redeeming Preferred Securities Issued under the CPP***

Supervisors will carefully weigh an institution's desire to redeem outstanding CPP preferred stock against the contribution of Treasury capital to the institutions overall soundness, capital adequacy, and ability to lend, including confirming that BHCs have a comprehensive internal capital assessment process.

All BHCs seeking to repay CPP will be subject to the existing supervisory procedures for approving redemption requests for capital instruments.

The 19 BHCs that were subject to the SCAP process must have a post-repayment capital base at least consistent with the SCAP buffer, and must be able to demonstrate its financial strength by issuing senior unsecured debt for a term greater than five years not backed by FDIC guarantees, in amounts sufficient to demonstrate a capacity to meet funding needs independent of government guarantees.