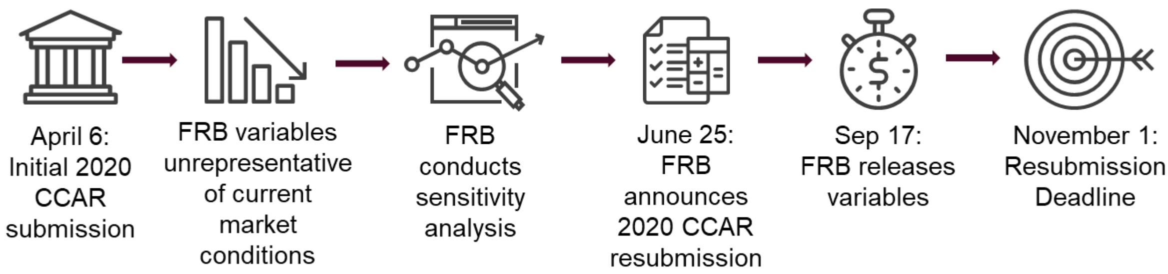
INSIGHT
SEPTEMBER
2020

2020 CCAR RESUBMISSION

The past six months have brought unprecedented economic volatility. As a result, the FRB recognized that the variables elucidated in the initial 2020 CCAR submission did not accurately represent current market conditions (unemployment statistics, interest rates, etc.). This led the FRB to conduct its own sensitivity analysis to assess the economic strength and resilience of the US Banking System, prompting the announcement of a CCAR resubmission by November 2020.

Key requirements for resubmission:

- November 1 deadline
- 2020 Capital Plan and FR Y-14A data
- Run date of June 30, 2020
- Institutions with significant trading activity are required to include a trading and counterparty component, accounting for market shock



CHALLENGES: *There exists significant uncertainty for preparatory action due to the lack of details provided in the Fed's restrictions. The FRB has applied said restrictions through the end of Q3 2020, but the possibility of an extension or modification of the restrictions during forthcoming quarters remains.*

1) **Stock buybacks and dividends:** Restrictions imposed on CCAR banks over stock buybacks and common stock dividends are not discussed in detail in FRB released material. While these restrictions are valid till the end of Q3 2020, the FRB still holds the power to modify or extend these restrictions on a quarterly basis, leading to increased uncertainty for banks and investors.

2) **Foreign Bank IHCs:**
   a) No guidance provided for CCAR banks which are Intermediate Holding Companies (IHCs) of foreign banks. IHCs usually maintain substantial capital beyond their minimum requirements and buffers, hence the dividend cap could potentially and significantly hinder its ability to return excess capital to its parent.
   b) Significant uncertainty as to the extent of the capital planning forecast of CCAR banks. Firms may not be able to accurately predict their 4-quarter dividend component (especially IHC's who have variable dividend structure), thereby greatly diminishing the utility of the Stress Capital Buffer (SCB)[1].

3) **Stress Capital Buffer and Stress Leverage Buffer:**
   a) The SCB would replace the existing 2.5% capital conservation buffer required for all banks as part of the Basel-based capital requirements.
   b) Due to the absence of material discussion about SCB calculation, the FRB has left room open for the recalculation of a firm's SCB based on its resubmitted capital plans which brings forth the possibility of the FRB conducting new stress tests which could become the backbone of the SCB's for 2021 of CCAR banks.

[1] *SCB is calculated as (i) the peak-to-trough decrease in a firm's common equity tier 1 risk-based capital ratio under the Fed's severely adverse scenario, based on the bank's losses in the stress test, plus (ii) planned dividends, which would further reduce capital, for the fourth through seventh quarters of the stress test horizon.*

c) The Proposed Amendment would introduce a new Stress Leverage Buffer ("SLB")[2] to be added to a firm's leverage ratio requirement. However, unlike the SCB, the SLB would not have a minimum floor.

4) **Resubmission Scenarios:** As per the FED's latest release, each scenario includes 28 variables accounting for domestic and global economic activity. These scenarios are more severe than those usually applied to DFAST and CCAR stress tests; hence, CCAR banks should prepare for deeper projected losses and a higher SCB requirement upon resubmission.
   a) Severely Adverse Scenario:
      - Peak unemployment rate of 12.5% in Q4 2021, declining to 7.5% by Q3 2023
      - 3% GDP decrease through Q4 2021
      - Sharp global slowdown
   b) Alternative Severe Scenario
      - Peak unemployment rate of 11% in Q4 2020
      - Unemployment remains consistently high and declines to 9% in Q3 2023
      - 2.5% GDP decrease from Q3 2020 to Q4 2020
   c) Global Market Shock Component:
      - Required of banks with large trading operations and banks with substantial processing operations
      - Above banks need to incorporate the default of their largest counterparty

SIA PARTNERS' CAPABILITIES: *Sia Partners wants to ensure your organization is prepared to respond effectively, even in the absence of definitive guidance on the resubmission process. The following areas will be critical to ensuring an effective response to the Fed exam. Sia Partners has extensive experience in managing CCAR programs with a targeted focus on:*

Tactical Approach - 45 Day Window:

Program Management:
- Provide end to end program management, governance and a streamline approach for each workstream demonstrating a well-integrated CCAR program

Impact Assessment:
- Determine areas impacted as a result of final resubmission guidance
- Identify the root cause of the impact and analyze the solutions
- Define approach and response to the solution implementation

Testing:
- Test changes implemented including SIT, UAT and post-implementation regression testing
- Stress testing for process and system sustainability

Strategic Approach – Post Submission:

Long Term Program Capability Enhancements
- Leverage lessons learned targeting optimization of the overall CCAR program
- Document management providing clear responses and timelines to assist with FRB findings (MRAs & MRIAs)
- Testing automation
  - Using AI to create system self-testing against industry benchmarks to identify outliers

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[2] *The SLB would be calculated as the firm's (i) maximum projected decline in its Tier 1 leverage ratio under the severely adverse stress scenario, plus (ii) its planned common stock dividends for the fourth through seventh quarters of the CCAR planning horizon in addition to continued preferred stock dividends throughout the stress test horizon.*

    - Create step by step system self-checkup for each reporting position, and generate red flags to notify the finance department validators
- Workflow automation
- Intersection of CCAR and CECL processes
- Adherence to baseline scenario on a quarterly basis

Data Management

- Data modeling and forecasting using more qualitative factors such as scenario analysis and material risk indicators.
- Data cleansing and trade disaggregation to ensure data feasibility and data suitability.

Capital Allocation:

- Provide a deeper understand of loan loss reserves, using Sia Partners comprehensive knowledge of loans and operations knowledge.

Macroeconomic Factors Comprehensive Analysis

- Global impact analysis and forecast using multiple scenarios.
- Analysis of CCAR 2020 trends report.

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ABOUT SIA PARTNERS

Sia Partners is a next generation consulting firm focused on delivering superior value and tangible results to its clients as they navigate the digital revolution. Our global footprint and our expertise in more than 30 sectors and services allow us to enhance our clients' businesses worldwide. We guide their projects and initiatives in strategy, business transformation, IT & digital strategy, and Data Science. As the pioneer of Consulting 4.0, we develop consulting bots and integrate AI in our solutions.

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