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FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 325

Policy Statement on the Principles for Development and Distribution of Annual Stress Test Scenarios

AGENCY: Federal Deposit Insurance Corporation (“FDIC” or “Corporation”).

ACTION: Interim guidance with request for public comment.

SUMMARY: This interim guidance sets forth the general processes and factors to be used by the FDIC in developing and distributing the stress test scenarios for the annual stress tests required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 as implemented by the Annual Stress Test final rule (“Stress Test Rule”) published on October 15, 2012.¹ Under the Stress Test Rule FDIC-insured state nonmember banks and FDIC-insured state-chartered savings associations with total consolidated assets of more than \$10 billion are required to conduct annual stress tests using a minimum of three scenarios (baseline, adverse and

severely adverse) provided by the FDIC. The Stress Test Rule specified that the FDIC will provide the required scenarios to the covered banks no later than November 15th of each year.

DATES: This interim guidance is effective November 20, 2012. Comments must be submitted on or before January 22, 2013.

ADDRESSES: You may submit comments by any of the following methods:

- *Agency Web site:* <http://www.FDIC.gov/regulations/laws/federal/propose.html>. Follow the instructions for submitting comments.

- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.

- *Email:* comments@FDIC.gov. Include “Policy Statement on the Principles for Development and Distribution of Annual Stress Test Scenarios” in the subject line of the message. Comments received will be posted without change to <http://www.FDIC.gov/regulations/laws/federal/propose.html>, including any personal information provided.

- *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments/Legal ESS, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, DC 20429.

- *Hand Delivery/Courier:* Guard station at the rear of the 550 17th Street Building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m. (EDT).

Instructions: Please use the title “Policy Statement on the Principles for Development and Distribution of Annual Stress Test Scenarios” to

facilitate the organization and distribution of the comments.

FOR FURTHER INFORMATION CONTACT:

George French, Deputy Director, Policy, (202) 898–3929, Robert Burns, Associate Director, Mid-Tier Bank Branch, (202) 898–3905, or Ryan Sheller, Senior Large Financial Institutions Specialist, (202) 412–4861, Division of Risk Management and Supervision; Philip A. Shively, Chief, Economic Analysis Section, (202) 898–6790, Division of Insurance and Research; Mark G. Flanigan, Counsel, (202) 898–7426, Rachel Jones, Attorney, (202) 898–6858, or Grace Pyun, Attorney, (202) 898–3609, Legal Division, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

I. Background

Section 165(i)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires certain financial companies, including FDIC-insured state nonmember banks and FDIC-insured state-chartered savings associations with total consolidated assets of more than \$10 billion (“covered banks”), to conduct annual stress tests. The FDIC published in the **Federal Register** on October 15, 2012 (77 FR 62417), the Stress Test Rule implementing the requirements and setting out definitions and rules for scope of application, scenarios, reporting, and disclosure. Under the Stress Test Rule, covered banks are required to conduct annual stress tests based on the annual stress test cycle set out in Table 1.

PROCESS OVERVIEW OF ANNUAL STRESS TEST

[Using data as of September 30th]

Step	Timeframe for over \$50 billion covered banks	Timeframe for \$10 billion to \$50 billion covered banks
1. FDIC provides covered banks with scenarios for annual stress tests	No later than November 15th	No later than November 15th.
2. Covered banks submit required regulatory reports to the FDIC on their stress tests.	No later than January 5th	No later than March 31st. ²
3. Covered banks make required public disclosures	Between March 15th and March 31st.	Between June 15th and June 30th.

A key component of the annual stress test is the development of the stress test scenarios that are provided to covered

banks on or before November 15th of each year. Scenarios are those sets of conditions that affect the U.S. economy

or the financial condition of a covered bank that the FDIC annually determines are appropriate for use in the stress

¹ 77 FR 62417 (Oct. 15, 2012).

² A covered bank subsidiary may elect to report and issue its required public disclosure on its

parent bank holding company’s or savings and loan holding company’s timeline.

tests, including, but not limited to, baseline, adverse, and severely adverse scenarios. Each scenario includes the values of the variables specified for each quarter over the stress test horizon. The variables specified for each scenario generally address economic activity, asset prices, and other measures of financial market conditions for the United States and key foreign countries. The FDIC annually will determine scenarios that are appropriate for use for each annual stress test. The timeline in Table 1 provides that the FDIC will distribute stress test scenarios to covered banks no later than November 15th of each year. This document articulates the principles that the FDIC will apply to develop and distribute those scenarios for covered banks.

II. Immediate Effective Date and Request for Comment

This interim guidance is effective November 20, 2012 and applicable, to the extent practicable, to the annual stress test cycle beginning this year. As explained in the preamble, the Stress Test Rule was effective immediately upon publication because the stress testing framework represents a critical tool for supervision and is essential for the health of covered banks and the overall financial stability of the economy.³ For this reason, FDIC believed that it was necessary for certain FDIC-insured state nonmember banks and FDIC-insured state-chartered savings associations with total consolidated assets not less than \$50 billion to conduct stress tests under the Stress Test Rule this year. The stress tests conducted under the Stress Test Rule framework will provide important forward-looking information to supervisors to assist in the overall assessment of a covered bank's capital adequacy and will help determine whether additional analytical techniques and exercises are appropriate to identify measure and monitor risk to the financial soundness of the covered bank. Moreover, the FDIC believes that the stress tests will benefit the covered banks by supporting their own forward-looking assessments of their risks and better equip them to address a range of adverse outcomes. Similarly, the FDIC believes that it is necessary to make this interim guidance effective immediately. While the FDIC recognizes that because of timing issues many of the procedural aspects of this interim guidance will not be relevant for the development of the scenarios for this year, the FDIC believes that it is important to give covered banks a sense

of the general processes and factors used for scenario development that the FDIC expects to use going forward, and an opportunity to comment.

The FDIC solicits comment on all aspects of the interim guidance. Specifically, what challenges, if any, exist in applying this guidance generally or at particular banking organizations and are there any terms described by the interim guidance that require further clarification and how should they be defined?

III. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act ("PRA") of 1995 (44 U.S.C. 3506; 5 CFR part 1320 appendix A.1), the FDIC has reviewed this interim guidance. The FDIC may not conduct or sponsor, and an organization is not required to respond to, an information collection unless the information collection displays a currently valid OMB control number. The FDIC has conducted a PRA analysis on all related reporting, recordkeeping and disclosure requirements in the Stress Test Rule and submitted them to OMB for review and approval. The request, which has been assigned OMB Control No. 3064-0187, is still pending. No new collection of information pursuant to the PRA is contained in this interim guidance.

IV. Principles for Development and Distribution of Annual Stress Test Scenarios

The text of the interim policy statement is as follows.

Principles for Development and Distribution of Stress Test Scenarios

I. Introduction

Section 165(i)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 requires certain financial companies, including FDIC-insured state nonmember banks and FDIC-insured state-chartered savings associations with total consolidated assets of more than \$10 billion ("covered banks"), to conduct annual stress tests. The Federal Deposit Insurance Corporation ("FDIC" or "Corporation") published in the **Federal Register** on October 15, 2012, a final rule ("Stress Test Rule") implementing the requirements and setting out definitions and rules for scope of application, scenarios, reporting, and disclosure.¹ Under the Stress Test Rule, each year the FDIC will distribute stress test scenarios to covered banks. This document articulates the principles that the FDIC will apply to develop and

distribute those scenarios for covered banks.

II. Stress Tests

As defined by the Stress Test Rule, a stress test means "the process to assess the potential impact of scenarios on the consolidated earnings, losses, and capital of a covered bank over the planning horizon, taking into account the current condition of the covered bank and the covered bank's risks, exposures, strategies, and activities."² Stress tests help covered banks and the FDIC determine whether those banks have capital sufficient to absorb losses that could result from adverse economic conditions. The FDIC views stress test results as one source of forward-looking information that can help identify downside risks and assess the potential impact of adverse outcomes on capital adequacy. Stress tests are not the only tool the FDIC uses for these purposes; a complete assessment of a covered bank's capital position typically includes review of its capital planning processes, the governance concerning those processes, and the adequacy of capital under established regulatory capital measures. The FDIC expects the board of directors and senior management of each covered bank to consider the results of the annual stress test when conducting capital planning, assessing capital adequacy, and evaluating risk management practices.³ The FDIC also may use stress test results to determine whether additional analytical techniques and exercises are appropriate for a covered bank to employ in identifying, measuring, and monitoring risks to the financial soundness of the covered bank.

Under the Stress Test Rule, each covered bank is required to conduct an annual stress test using its financial data as of September 30th of each year, unless the FDIC requires a different "as of" date for any or all categories of financial data.⁴ The stress test must assess the potential impact of specific scenarios on the regulatory capital of the covered bank and on certain related items over a forward-looking planning horizon, taking into account all relevant exposures and activities.⁵ Under the Stress Test Rule, the planning horizon is at least nine quarters, consisting of the fourth quarter of the current calendar year plus all four quarters of each of the two subsequent calendar years.

² 12 CFR 325.202(l).

³ *Id.* at 325.205(b)(3).

⁴ *Id.* at 325.201(c)(2) and 325.203(a).

⁵ *Id.* at 325.205(a).

³ See *id.*, at 62423.

¹ 77 FR 62417 (Oct. 15, 2012).

III. Scenarios

Scenarios are those sets of conditions that affect the U.S. economy or the financial condition of a covered bank that the Corporation annually determines are appropriate for use in the stress tests, including, but not limited to, baseline, adverse, and severely adverse scenarios.⁶ The FDIC annually will determine scenarios that are appropriate for use under the Stress Test Rule. In conducting the stress test under the Stress Test Rule, each covered bank must use the scenarios provided by the FDIC.

Each scenario includes the values of the variables specified for each quarter over the stress test horizon. The FDIC expects that covered banks may not need to use all of the variables provided and may need to estimate relationships to identify other variables, such as those reflecting local economic conditions, from the values the FDIC provides. The FDIC will review the appropriateness of estimation processes and resulting estimates, or other modifications of variables, through its ongoing supervisory processes.

The variables specified for each scenario generally address economic activity, asset prices, and other measures of financial market conditions for the United States and key foreign countries. Variables that describe economic activity likely include, but are not be limited to, the growth rate of gross domestic product, the unemployment rate, and the inflation rate. The FDIC anticipates that the path of the unemployment rate in particular will be a key variable indicating the severity of economic stress, as this variable provides a simple and widely noted gauge of the state of the U.S. economy. This point is discussed further in this statement in connection with severely adverse scenarios.

Other variables may represent asset prices and financial market conditions, including interest rates. The FDIC expects to specify scenarios using a standard core set of variables, although variables may be added or deleted as the U.S. and global economic environment evolves. The FDIC will attempt to minimize additions, redefinitions, or re-specifications of the stress test variables from year to year, as the use of such new or different variables may potentially require covered banks to modify their testing systems.

The scenarios provided by the FDIC reflect at least three sets of economic and financial conditions, described in the rule as baseline, adverse, and

severely adverse. The baseline broadly corresponds to the set of conditions expected to prevail over the term of the stress tests. The adverse and severely adverse scenarios introduce hypothetical stress conditions intended to test the safety and soundness of covered banks as well as their capital planning processes. The aim is to assess the covered banks' ability to identify and measure the risks they face under adverse conditions, and to ensure that appropriate amounts of capital exist to support those risks. The FDIC will evaluate both the adequacy of the projections and the processes used in the stress test. The FDIC expects covered banks to be able to maintain ready access to funding, continue operations, meet obligations to creditors and counterparties, and continue to serve as credit intermediaries under conditions that are significantly more adverse than expected.

The *baseline* scenario means a set of conditions that affect the U.S. economy or the financial condition of a covered bank, and that reflect the consensus views of the economic and financial outlook.⁷ These views are based on information obtained from government agencies, other public sector organizations, and private sector forecasters as close to the date of the annual stress test as possible. The baseline may be based on one or more of the "consensus" forecasts produced by various organizations, although the FDIC may choose to depart from the consensus if necessary to provide a more appropriate baseline for the stress tests.

The *adverse* scenario means a set of conditions that affect the U.S. economy or the financial condition of a covered bank that are more adverse than those associated with the baseline scenario and may include trading or other additional components.⁸ The adverse scenario may also be used to investigate other risks, such as including operational risks that the FDIC believes should be better understood or more closely monitored.

The *severely* adverse scenario means a set of conditions that affect the U.S. economy or the financial condition of a covered bank and that overall are more severe than those associated with the adverse scenario and may include trading or other additional components.⁹ Three examples of severe recessions from recent U.S. experience may illustrate the anticipated depth of

the severely adverse scenario as it relates to the unemployment rate:

- The 1973–75 recession, during which the unemployment rate increased 4.1 percentage points, from 4.9 percent in third quarter 1973 to 9.0 percent in second quarter 1975 (one quarter after the recession ended).
- The back-to-back recessions in 1980 and 1981–82, during which the unemployment rate increased 4.7 percentage points, from 6.1 percent in fourth quarter 1979 to 10.8 percent in fourth quarter 1982 (the last quarter of the recession).
- The 2007–09 recession, during which the unemployment rate increased 5.3 percentage points, from 4.7 percent in third quarter 2007 to 10.0 percent in fourth quarter 2009 (two quarters after the recession ended).

Other variables under the adverse and severely adverse scenarios would be expected to follow paths consistent with the depth and duration of previous recessions and with models of macroeconomic activity. The severely adverse scenario also may reflect other risks that are especially salient and that might not be captured by past recessions, including elevated levels of systemic risk.

The scenarios distributed by the FDIC for the stress tests cover at least nine quarters. In addition, the FDIC will generally publish scenarios that cover one year beyond the planning horizon of the stress test, to allow for the estimation of loan losses for the year following the stress planning horizon; this additional specification allows covered banks to determine adequate levels of loan loss reserves.

The FDIC believes that as a general matter all covered banks should use the same set of scenarios and planning horizon so that the FDIC can better compare results across institutions. To that end, the FDIC intends to provide one set of scenarios for use by all covered banks. However, the FDIC believes there may be circumstances that would warrant the use of different or additional scenarios or a planning horizon of more than nine quarters. Thus, under the Stress Test Rule, the FDIC reserves the authority to require a covered bank to use different or additional scenarios and/or planning horizons the Corporation may deem appropriate.¹⁰ For example, a covered bank may conduct business activities or have risk exposures that would encounter stress under conditions that differ materially from those that would generate stress for other banks. The FDIC expects such situations to be rare

⁷ *Id.* at 325.202(c).

⁸ *Id.* at 325.202(a).

⁹ *Id.* at 325.202(j).

¹⁰ *Id.* at 325.201(c).

⁶ *Id.* at 325.202(i).

and anticipates making every effort to distribute the same scenarios to all covered banks.

In addition to the minimum three scenarios, the FDIC may require a covered bank with significant trading activities to include factors related to trading and counterparty risk in its stress test. Typically, these factors might include additional shocks to specific market prices, interest rates, rate spreads, or other key market variables consistent with historical or hypothetical adverse market events.

IV. Development and Distribution

As one part of the process of developing scenarios, the FDIC will gather information from outside entities and develop themes for the stress test scenarios, including the identification of potentially material vulnerabilities or salient risks to the financial system, and consider potential paths for individual variables. The outside entities may include academic experts, staffs of international organizations, foreign supervisors, financial institutions that regularly provide forecasts, and other private sector risk analysts that regularly conduct stress tests based on U.S. and global economic and financial scenarios. The FDIC will use the information gathered in this manner to inform its consideration of potential risks and scenarios.

The Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System ("Board"), and the FDIC (collectively, the "Agencies") expect to consult closely to develop scenarios for stress testing. Absent specific supervisory concerns, the FDIC anticipates that the annual stress test scenarios distributed by the FDIC will be the same as or nearly identical to the scenarios developed by the Board for the supervisory stress tests conducted by the Board under Section 165(i)(1). This would mean the same economic and financial variables following the same paths as used in the scenarios for the Board's supervisory stress tests.

Although the Agencies generally expect to consult closely on scenario development, they may have different views of risks that should be reflected in the stress test scenarios used by covered banks for the annual stress test. The FDIC may distribute scenarios to covered banks that differ in certain respects from those distributed by the OCC and the Board if necessary to better reflect specific FDIC concerns. The FDIC expects such situations to be extremely rare, however, and anticipates making every effort to avoid differences in the scenarios required by each agency.

The FDIC anticipates that the stress test scenarios will be revised annually as appropriate to ensure that each scenario remains relevant under prevailing economic and industry conditions. These yearly revisions will enable the scenarios to capture evolving risks and vulnerabilities. The need to ensure that scenarios do not become outdated because of economic and financial developments makes a lengthy process of review and comment concerning scenarios prior to distribution each year impractical. However, the process of consultation with the Board and the OCC, as well as the ongoing interaction of FDIC staff with public and private sector experts to obtain views on salient risks and to obtain suggestions for the behavior of key economic variables, should ensure that the stress conditions reflected in the scenarios are well suited to their purpose.

The scenario development process culminates with the distribution of the scenarios to all covered banks no later than November 15th of each year. The scenario descriptions provided to covered banks will include values for economic and financial variables depicting the paths those variables follow under the scenarios. The FDIC believes that distribution of the scenarios no later than November 15th aligns with similar processes at the OCC and the Board.

Federal Deposit Insurance Corporation.

Dated at Washington, DC, this 14th day of November 2012.

Valerie J. Best,

Assistant Executive Secretary.

[FR Doc. 2012-28104 Filed 11-19-12; 8:45 am]

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 39

[Docket No. FAA-2012-0528; Directorate Identifier 2011-SW-068-AD; Amendment 39-17261; AD 2012-23-05]

RIN 2120-AA64

Airworthiness Directives; Eurocopter Deutschland Helicopters

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Final rule.

SUMMARY: We are adopting a new airworthiness directive (AD) for all Eurocopter Deutschland GmbH (ECD) Model MBB-BK117 C-2 helicopters with certain Generator Control Units

(GCU) installed. This AD requires replacing the GCUs. This AD was prompted by reports of internal short circuits in certain GCUs. These actions are intended to prevent a short circuit, which could result in a loss of electrical generating power, loss of systems required for continued safe flight and landing, and subsequent loss of control of the helicopter.

DATES: This AD is effective December 26, 2012.

ADDRESSES: For service information identified in this AD, contact American Eurocopter Corporation, 2701 N. Forum Drive, Grand Prairie, TX 75052, telephone (972) 641-0000 or (800) 232-0323, fax (972) 641-3775, or at <http://www.eurocopter.com/techpub>. You may review the referenced service information at the FAA, Office of the Regional Counsel, Southwest Region, 2601 Meacham Blvd., Room 663, Fort Worth, Texas 76137.

Examining the AD Docket

You may examine the AD docket on the Internet at <http://www.regulations.gov> or in person at the Docket Operations Office between 9 a.m. and 5 p.m., Monday through Friday, except Federal holidays. The AD docket contains this AD, any incorporated-by-reference service information, the economic evaluation, any comments received, and other information. The street address for the Docket Operations Office (phone: 800-647-5527) is U.S. Department of Transportation, Docket Operations Office, M-30, West Building Ground Floor, Room W12-140, 1200 New Jersey Avenue SE., Washington, DC 20590.

FOR FURTHER INFORMATION CONTACT: George Schwab, Aviation Safety Engineer, FAA, Rotorcraft Directorate, Safety Management Group, 2601 Meacham Blvd., Fort Worth, Texas 76137; telephone (817) 222-5114; email george.schwab@faa.gov.

SUPPLEMENTARY INFORMATION:

Discussion

On May 22, 2012, at 77 FR 30230, the **Federal Register** published our notice of proposed rulemaking (NPRM), which proposed to amend 14 CFR part 39 to include an AD that would apply to ECD Model MBB-BK117 C-2 helicopters with a GCU, part number (P/N) 51530-021EI with no modification (MOD), MOD A, or MOD B installed. That NPRM proposed to require replacing the GCU within 300 hours time-in-service (TIS) or 6 months, whichever occurred earlier. The proposed requirements were intended to prevent loss of electrical generating power, resulting in the loss