Board of Governors of the Federal Reserve System
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- Docket No. OP-1461
- Proposed Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations With Total Consolidated Assets of More Than $10 Billion But Less Than $50 Billion

Dear Robert deV. Frierson.

Thank you for giving us the opportunity to comment on your Proposed Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations With Total Consolidated Assets of More Than $10 Billion But Less Than $50 Billion.

The Board, FDIC and OCC, (agencies) are issuing this guidance, which outlines high-level principles for implementation of section 165(i)(2) of the Dodd-Frank Act Wall Street Reform and Consumer Protection Act (DFA) stress tests, applicable to all bank and savings-and-loan holding companies, national banks, state member banks, state non-member banks, Federal savings associations, and state chartered savings associations with more than $10 billion but less than $50 billion in total consolidated assets (companies).

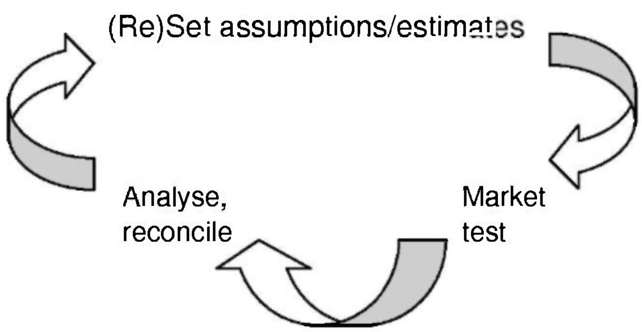
Naturally stress testing should allow for shocks and variations along the following lines:

1) changing individual assumptions and parameters (sensitivity testing);
2) changing several assumptions and parameters at the same time, where the assumptions and parameters could reasonably be expected to change together (scenario testing);
3) changing the dependencies assumed between assumptions and parameters.

The importance of point 3 above is often underestimated. I would recommend that you specifically emphasise the importance of considering dependencies and correlations under stress testing, particularly as typically observed and expected dependencies may not apply in the tail conditions and events that underlie many stress conditions and scenarios.

Under § III.C you state that: “companies may account for hedges that are already in place as potential mitigating factors against losses but should be conservative in making assumptions about potential future hedging activities and not necessarily anticipate that actions taken in the past could be taken under the supervisory scenarios”.[1] For prudency and completeness I would recommend that you should clarify that dynamic hedging should not be anticipated as a risk-mitigation technique under the adverse and severely adverse scenarios.

I agree with § III.C.3 concerning outcome analysis.[2] Companies should also monitor and control the expectations and outcomes of their stress testing by using a control cycle technique as follows:



Companies should be able to reconcile how final outcomes compare to initially expected outcomes by means of a movement analysis. For example: initially expected outcomes, plus or minus any initial changes in models, plus or minus any experience adjustments, plus or minus any variances due to ad hoc features should equal final outcomes.

Yours sincerely

C.R.B.

Chris Barnard

[1] See 78 FR 47222.
[2] See 78 FR 47223.