July 29, 2011

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. OP-1421

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219
Docket No. OCC-2011-0011

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

Re: Proposed Guidance on Stress Testing

Dear Sir or Madam:

The Financial Services Roundtable (the "**Roundtable**"), The Clearing House Association L.L.C. ("**TCH**"), the American Bankers Association (the "**ABA**"), and the Securities Industry and Financial Markets Association ("**SIFMA**" and, together with the Roundtable, TCH, and the ABA, the "**Associations**")[1] appreciate the opportunity to comment on the joint notice of proposed guidance (the "**NPG**")[2] issued by the Board of Governors of the Federal Reserve System

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1 See Annex 1 for a description of the Associations.

2 76 Fed. Reg. 35072 (Jun. 15, 2011).

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(the "**Board**"), the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (together, the "**Agencies**") to propose guidance on stress testing for banking organizations with more than $10 billion in total consolidated assets.

The Associations recognize the value of stress testing as a risk management tool at both a portfolio and enterprise-wide level, as well as the benefits it brings to capital and liquidity planning and generally support adoption of the proposed guidance.

<u>We Commend the Principles-Based Approach.</u>

The proposed guidance provides an overview of how an affected banking organization should structure its stress-testing activities to ensure they fit into overall risk management. The proposed guidance outlines broad principles and describes the manner in which stress testing should be employed. By its terms, the proposed guidance is not intended to provide detailed instructions for conducting stress testing for particular risks or business activities.

The Associations commend the principles-based approach of the proposed guidance and the Agencies' recognition that a prescriptive approach to this subject would be inappropriate in certain circumstances. The Associations urge the Agencies to follow a similar principles-based approach in future rulemakings, including implementing Section 165(i) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**").

We believe that, while affected banking organizations are expected to perform robust stress testing, every line of business need not be stress tested and each stress testing approach or application mentioned in the guidance need not be utilized. Under a principles-based approach, such a determination would be up to the banking organization's judgment. Examiners would assess that judgment during the normal supervisory process. We believe it would be helpful for the Agencies to confirm this view in the final guidance.

<u>Any Section 165(i) of the Dodd-Frank Act Rulemaking and the Guidance Should Be Harmonized.</u>

By its terms, the NPG expressly does not address the stress testing requirements to be imposed upon certain companies by Section 165(i) of the Dodd-Frank Act. Instead, the NPG indicates that the Agencies expect to implement Section 165(i) in a future rulemaking that would be consistent with the proposed guidance.

Section 165(i) requires two types of stress testing. First, it requires that the Board, in coordination with other agencies, conduct annual analyses in which nonbank financial companies supervised by the Board and bank holding companies with total consolidated assets of $50 billion or more are subject to evaluation of whether they have sufficient consolidated capital necessary to absorb losses as a result of adverse economic conditions. Second, such firms are to conduct their own semiannual stress tests, and all other federally regulated financial companies with total consolidated assets of $10 billion or more also are to conduct annual stress tests in accordance with regulations to be prescribed by Federal primary financial regulatory agencies in coordination with the Board and the new Federal Insurance Office.

We support the Agencies' intentions to implement the Section 165(i) rulemaking consistent with the principles enunciated in the proposed guidance.

General Suggestions

First and foremost, we applaud that the proposed guidance provides considerable flexibility to adjust stress-testing programs to the size and complexity of each institution. Some firms will require more lead time than other institutions to comply with this new guidance. This additional time may be needed, for example, to retain consultants, organize governance of the process, educate personnel, build systems, etc. Therefore, we urge the Agencies to avoid rigid initial application of the proposed guidance. Rather, the Associations believe a more iterative approach that accounts for variations in firms' situations would be appropriate.

Second, we would suggest that, rather than calculate total consolidated assets as of a given date for ascertaining whether the $10 billion consolidated asset test is met, total consolidated assets should be calculated as an average of the four quarters prior to an agreed upon triggering date. Otherwise, banking organizations might be more likely to fall within the guidance's coverage one quarter and outside of its coverage the next quarter.

Third, we would ask that experienced examiners offer instruction and assistance to facilitate the good faith efforts of smaller affected banking organizations to implement the proposed guidance.

Fourth, the Associations believe that it is important to recognize that individual stress tests, whether comprehensive or focused on one aspect of bank operations, are part of a composite effort to present an overall picture of the potential risks confronting an institution. Broad conclusions about the risk-management operations of a firm cannot be drawn from one result; instead, the Agencies should consider the totality of a firm's risk profile. Thus, we would hope that examiners would not unduly focus on a single individual stress test result.

While stress testing may require the review of scenarios, including acute-stress scenarios, we believe it is important that the events in a scenario must be "coherent" and "logical." Stress testing is a tool for management and the board to understand better, and, ultimately, to manage, risk; the more extreme and unrealistic a scenario is, the less useful it is as a management tool. Thus, for example, a scenario in which interest rates move dramatically in a given direction ought not to be required to disregard the effect of interest rate hedges a banking organization has in place because the scenario also posits failure of hedge counter-parties.

Finally, it is not clear that the proposed guidance would apply to savings and loan holding companies. Some thrift holding companies, of which we believe there may be approximately 35, operate under business models in which subsidiary thrifts are not the principal activity of the organization. In such cases, stress-testing models would be quite different than those applicable to more traditional bank holding companies. Appropriate assumptions and scenarios for stress-testing such unitary thrift holding companies would be significantly different than the stress testing exercises with which examiners are familiar. We suggest that, if the Board wishes to require stress-testing of such holding companies, that requirement be the subject of a separate proposal.[3]

In sum, it is important to recognize that an iterative process should be expected as stress-testing practices are developed, implemented, and improved by firms and by regulators.

Requirement for Assessment of Effectiveness of the Stress Testing Framework Needs Clarification

The proposed guidance suggests that banking organizations subject to the guidance should formally review and assess the effectiveness of their stress testing frameworks at least once a year. The precise nature of the Agencies' expectation on this is not clear. A banking organization may test effectiveness by considering how it determines and constructs reasonable stress-test scenarios, how the results are used in decision-making processes, and whether the oversight process used is likely to ensure the overall framework and its components are working properly. Effectiveness should not be measured by assessments of the success of actions based on stress-test results or whether stress scenarios actually come to be. Consequently, we believe that an annual review to ensure that the correct systems and correct business units are involved in the stress testing would meet the Agencies' expectations and that a quantitative measure is not expected, but that should be clarified.

In addition, with regard to the Agencies' expectations as to the proper formal review and assessment regarding the effectiveness of a stress-testing framework, and the application of the guidance in general, we suggest that practice should differentiate between larger and more complex organizations and smaller or less complex organizations. Therefore, we support the proposed guidance's suggestion that "[e]ach banking organization should apply these approaches and applications commensurate with its size, complexity, and business profile, and may not need to incorporate all of the details described in the proposed guidance."

The Benefits of Reverse Stress Testing Would Be Limited.

The guidance suggests that a banking organization should conduct reverse stress testing, which would evaluate the combined effects of several types of extreme events and circumstances, such as a high level of unemployment, a market disturbance, and a specific fraud on the bank, which might together threaten the survival of the banking organization even if each, in isolation, were manageable. However, extreme events must be plausible and not so far-fetched that results lose credibility with management. We are concerned that designing a "break the bank" scenario creates multiple challenges and would produce output of questionable value to management. We believe that the multiple testing approaches currently employed by our members offer management the opportunity to compare and contrast outcomes with a greater probability of occurrence. These approaches provide useful results to inform management and board decisions. The proposed guidance suggests that the benefit of

[3] We would, however, agree that it would be appropriate for the proposed guidance to apply to an intermediate holding company.

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reverse stress testing is to help an organization consider scenarios beyond normal expectations, challenge common assumptions, and evaluate combined effects of several types of extreme events. Should the Agencies elect to include reverse stress testing in the final guidance, we believe that it should be used for purposes of risk assessment as opposed to a basis for action planning.

"Actionable" Results Should Not Require Action Plans.

Proposed Principle 4 provides that stress test results should be "actionable," but makes clear that "[a] banking organization may decide to maintain its current course based on test results; indeed, the results of highly severe stress tests need not always indicate that immediate action has to be taken." We believe this clarification is an important point which should be reflected in the final guidance.

Governance Requirements Should Not Unduly Involve the Board of Directors.

The Associations agree that strong governance of the stress testing process is important. We also agree that an organization's board of directors should ensure the organization has an effective stress testing framework, but that implementation responsibility rests with senior management. However, the guidance provides that senior management should report to the board on individual stress-test results (among other things). We believe that stress test results should be taken into account in board discussions of capital and liquidity planning, and other areas as appropriate, but boards should only review and evaluate stress tests that would be expected to have a material impact on the overall organization.

This particular guidance is one small part of a series of regulatory requirements that each increases the role of the board of directors in risk management. Our members are concerned that the Agencies may be over-burdening bank boards and, therefore, limiting their flexibility to prioritize and respond to other critical review and oversight duties as warranted by conditions or more generally to perform their key role in setting the bank's strategic direction.

We would urge that the full board of directors of an organization be involved at the outset to establish and approve the original stress-testing framework, but that boards be expressly authorized to delegate receipt of subsequent reports and monitoring to a committee of the board.

Burden Estimate Is Understated.

The NPG estimates that the average information collection burden imposed by the proposed guidance would be 260 hours a year, which works out to approximately four and a half weeks of the time of one full-time employee. The Associations believe that, for even the smallest affected banking institution to undertake a reliable effort at stress testing, it would require considerably more than a single full-time employee and would take many months of effort. Additionally, the Agencies may not be considering management and board time to review, consider, and react to stress test-results. From discussions with our members, we believe that the actual amount of time to comply with the proposed guidance will average several thousands of hours depending on a banking organization's size, complexity, risk exposure, and experience with stress testing. We believe the Agencies have underestimated the amount of time it will take for banking organizations to comply with the proposed guidance. Stress testing, while a valuable risk-management tool, can require a large expenditure of resources in terms of time, people, and money. Consequently, we urge the Agencies to weigh the particular needs of and potential benefit to each individual institution with the costs.

Thank you for the opportunity to express our views on the proposed guidance. We, of course, would be pleased to answer any questions you or your colleagues might have about our views.

Best wishes,

The Financial Services Roundtable

Richard M. Whiting

Rich Whiting, Executive Director & General Counsel

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The Associations

TCH is an association of major commercial banks. Established in 1853, TCH is the United States' oldest banking association and payments company. It is owned by the world's largest commercial banks, which collectively employ 1.4 million people in the United States and hold more than half of all U.S. deposits. TCH is a nonpartisan advocacy organization representing through regulatory comment letters, amicus briefs, and white papers the interests of its member banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost $2 trillion daily and representing nearly half of the automated clearing-house, funds-transfer, and check-image payments made in the U.S. See TCH's web page at www.theclearinghouse.org.

The ABA represents banks of all sizes and charters and is the voice of the nation's $13 trillion banking industry and its 2 million employees. The majority of ABA members are banks with less than $165 million in assets. Learn more at www.aba.com.

The Roundtable is a national trade association of 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to American consumers and businesses. Roundtable member companies account directly for $74.7 trillion in managed assets, $1.1 trillion in revenue, and 2.3 million jobs.

SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to develop policies and practices which strengthen financial markets and which encourage capital availability, job creation and economic growth while building trust and confidence in the financial industry. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association.