American Bankers Association
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Beth Knickerbocker
Vice President & Senior Counsel
202-663-5042
bknicker@aba.com

April 30, 2012

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Re: Docket No. 1438 and RIN 7100-AD-86; Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies

Dear Ladies and Gentlemen:

The American Bankers Association[1] ("ABA") is pleased to submit comments on the Notice of Proposed Rulemaking[2] ("Proposal") published by the Board of Governors of the Federal Reserve System ("Board") to implement the enhanced prudential standards and early remediation requirements of Sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act[3] ("Dodd-Frank"). We thank the Board for the opportunity to comment on the Proposal and support the comment letter that we jointly submitted to the Board on April 27, 2012 with The Clearing House Association, LLC, the Financial Services Forum, the Financial Services Roundtable and the Securities Industry and Financial Markets Association ("Joint Letter").[4]

Summary of Main Points

The ABA strongly supports the goals of Dodd-Frank to reduce systemic risk and to develop and implement adequate tools to identify and mitigate risk. To be effective, these tools need to address the specific risks faced by the implementing institution and should be tailored to its complexity, business model, geographic footprint and size. However, the ABA is concerned that the Proposal as drafted will be implemented in a one-size-fits all manner-- treating all institutions, or all institutions within broad asset size categories, in the same way or by trickling down the requirements to smaller institutions through "best practice" recommendations by examination staff. In addition, the compliance timeframes fail to take into account the amount of time and resources needed to develop the new tools and processes to implement the requirements under the Proposal. Moreover, the Proposal fails to take the evolutionary nature of risk management into account, such as the development of meaningful stress testing processes and

[1] The American Bankers Association represents banks of all sizes and charters and is the voice of the nation's $13 trillion banking industry and its 2 million employees. Learn more at www.aba.com
[2] 77 Fed. Reg. 594 (January 5, 2012).
[3] Pub. L. No. 111-203, (2010).
[4] The ABA also supports the comment letters filed on April 30, 2012 by the Midsize Bank Coalition of America and the Risk Management Association.

the measurement of counterparty credit exposure resulting in a mere check-the-box exercise of little benefit to impacted institutions, and therefore failing ultimately to meet the goals of Dodd-Frank.

The following is a summary of the major points of the letter:

- Prudential standards should not be based on regulatory "cliffs," whereby all institutions over the statutory size thresholds are regulated and supervised the same. Instead, supervision should be graduated based not only on size, but also based on, among other things, complexity, business model and geographic footprint.

- To reduce the impact of the "cliff effect" of the Proposal, a transition period should be created to allow an institution up to one year following the four-quarter period contemplated by the Proposal after it crosses the applicable asset threshold to fully comply with the rules applicable to institutions in that size category.

- Institutions not covered by the applicable sections of the Proposal should not be held to such standards as a result of regulatory trickle-down through "best practice" expectations in examinations.

- The risk committee expertise requirements as currently drafted may limit the ability of institutions, including smaller institutions, to find qualified candidates and the risk expertise definition should be modified to be consistent with the financial expert requirements under federal securities law. Moreover, companies should not be prohibited from having a joint risk committee with its depository institution subsidiary or subsidiaries.

- The effective date of the stress testing provisions Smaller Companies[5] should be delayed to allow those institutions more time to develop the processes and obtain the resources to comply with the Proposal.

- The Board should distinguish Smaller Company and bank stress testing requirements from those for Covered Companies.[6] In doing so the Board should adopt a more tailored approach to Smaller Companies and banks that includes: regulatory expectations commensurate with a bank's size, complexity, and familiarity with stress testing: a floating submission date so that smaller institutions can conduct their stress tests during the annual strategic planning and budgeting process; the option to develop their own regional scenarios; and more limited disclosures.

- The Board should adopt a tiered approach to the effective date of the single counterparty concentration limits ("SCCL") to allow Covered Companies more time to develop the processes and systems and, where necessary, obtain the resources to comply with the

[5] For purposes of this letter "Smaller Company" is defined as a bank holding company with consolidated assets between $10 and $50 billion.
[6] For purposes of this letter, "Covered Company" means any bank holding company other than a foreign bank organization that has $50 billion or more in total consolidated assets.

Proposal. In no event should any Covered Company be required to comply with the SCCL rules until the completion of the transition period established by the Board. Further, individuals should be excluded from the definition of counterparty absence evidence of evasion and daily monitoring and monthly reporting of daily compliance should not be required for counterparty relationships that are not approaching or likely to approach the credit limit.

I. The Proposal and Its Implementation Should be Graduated and Tailored to Size, Complexity, Business Model, and Risk.

Bank examination and supervision not only help ensure the safety and soundness of the overall banking system, but can help individual banks to operate successfully and better serve their customers and their communities. The overall approach of supervision should be risk-based and tailored taking into account a holding company's business model, the complexity of its operations, the nature of its charter, and other factors relevant to the risk of its activities, products, and services. A tailored approach to setting supervisory standards begins by defining baseline expectations for compliance with a particular regulation, clearly defining the goal to be achieved, and developing appropriately flexible or scalable techniques to apply those standards to a diverse industry.

Under Title I of Dodd-Frank, Congress gives explicit authority to the Board to avoid one-size-fits-all supervision and tailor the application of Section165's "stringent prudential standards" by differentiating "among companies on an individual basis or by category…"[7] Tailored application of Section165 may consider differences in "capital structure, riskiness, complexity, financial activities…, size, and any other risk-related factors…"[8]In public statements, Board Chairman Bernanke has acknowledged and affirmed Congressional intent to differentiate between small, regional, and global institutions to avoid substantial regulatory barriers and significant compliance burden arising at the $50 billion asset threshold.[9] ABA urges the Federal Reserve to use its authority under Section 165 to preserve its discretion in the application of Section 165 regulation through a thoughtfully tailored regulatory regime that is well-calibrated and recognizes and accommodates the differences of all banks, including small, midsized and regional banks as well as their varied business models.[10]

a. Implementation of Section 165/166 Regulations Should Avoid Creating a "Cliff Effect" by Providing for a Transition Period for Compliance After the Company Has Crossed the Applicable Asset Threshold.

Dodd-Frank creates an unprecedented number of new regulations and threatens continued top-down regulatory creep as targeted regulatory requirements intended for larger, more complex

[7]Dodd Frank Section 165(a)(2).
[8] Id.
[9] Donna Borak, *Fed Will Differentiate Barely "Systemic" from Truly TBTF*, AMERICAN BANKER, May 6, 2011 (quoting Federal Reserve Chairman Bernanke as saying, "We're going to be very careful not to have a discrete drop, a discrete change, a discrete difference between $49 billion and $51 billion banks. . . . It will not be the case that community banks, or medium-sized regional banks, or international giants will face the same changes in regulation."
[10]See also, Governor Frank Keating, President and Chief Executive Officer, American Bankers Association, response to Chairman Bernanke's comments in a letter dated May 12, 2011 (Attachment A).

institutions are applied to smaller, and in many instances, low-risk traditional banking operations. Prudential supervision as envisioned in the Proposal creates regulations and supervisory expectations applicable to the largest and most complex banks and applies these same rules to all covered financial institutions disregarding the significant differences in business model, complexity, risk, compliance resources, and potential systemic importance. Compliance expectations for institutions over $50 billion in assets should not be applied to institutions under $50 billion in assets as *de facto* best practices or in anticipation that in some point in time in the future the institution may cross the arbitrary $50 billion threshold. The ABA encourages the Board to create a supervisory "runway" that begins at $50 billion, or, where necessary, $10 billion, and develops based on complexity, business model, and risk. The statutory authority permits individualized determination for each financial institution to determine *whether* and *how* an institution should be subject to the proposed Section165 supervision regime.

To address this concern the ABA recommends that the Board develop transition rules that would permit an institution up to one additional year following the four-quarter period contemplated by the Proposal <u>after</u> it crosses the $50 billion or, if applicable, $10 billion asset threshold to phase in full compliance with the new requirements for that asset size. This is especially necessary for the stress testing, liquidity and SCCL provisions due to the significant investments in systems and resources needed.

b. Avoid Regulatory Trickle-Down to Non-Covered Financial Institutions.

Unintended regulatory expansion also occurs informally during the examination process -- in a process informally referred to as "regulatory trickle-down." The trickle-down of best practices and regulations initially created with the largest institutions in mind creates regulatory uncertainty. In order to operate efficiently and make informed business decisions, financial institutions need regulatory certainty and clarity. The application of regulations, whether formal or informal, should not be capricious. There should be a clear understanding of the compliance burden and regulatory application to a financial institution at any given time.

Unfortunately, financial institutions below the Section165 asset thresholds already are reporting that local examiners are suggesting the adoption of large financial institution best practices and Section165 procedures in anticipation that <u>all</u> financial institutions will be subject to the Proposal despite the regulatory asset thresholds. The Board should increase its efforts to remain vigilant in curbing regulatory trickle-down to financial institutions under the $10 billion and $50 billion thresholds. Special attention should be given to the training of supervision and examination staff, and the review of examination reports by regional and headquartered personnel prior to issuance to ensure that trickle down is eliminated.

c. Regulation by Asset Thresholds Threatens the Competitiveness of Small, Midsized and Regional Institutions.

Regulators rightly do not want to permit the repeat of errors of the past, but should not contribute to the sluggishness of the economy, weakening the very institutions whose financial health they are charged with overseeing. Financial institution supervision and examination should contribute to the overall health and strength of the banking industry because of the industry's importance in sustaining the broader health of the economy.

The application of Section165 supervision creates anticompetitive pressures that will have a disproportionate impact on the local and regional financial institution markets given limited resources to satisfy the additional operational burden, compliance costs, and supervisory burdens mandated under Dodd-Frank. The Proposal individually creates substantial new obligations for risk management, liquidity management, stress testing, and counterparty management under tight compliance deadlines. Many institutions, including small, midsized, and regional companies, may not currently have the available staff resources to comply with the Proposal's requirements and will be forced to invest in additional staff, training, and third-party assistance in the form of consultants and technology. These investments in back office operations and staff divert resources from customer-facing operations resulting in reduced efficiency and decreased focus on innovation and customer service and impacting profitability and efficiency. The diversion of resources from business development will make institutions less profitable, hinder their ability to thrive in the marketplace and potentially impact their ability to survive.

As written, the Proposal neither recognizes the aggregate regulatory burden of Dodd-Frank, nor the hurdles created by limited asset size, and the geographic location of financial institutions. For example, as discussed in section II, a smaller or regional institution operating in a rural area may have difficulty locating qualified individuals to serve on a mandated risk committee. Qualified individuals may not live in the local area, or if available, carry a high price tag potentially beyond the reach of a smaller institution. This scenario is not unlike the current difficulty many rural banks have in finding experienced compliance staff in the local area at a reasonable salary. A growing number of community banks are having to share the cost of an experienced compliance officer in order to meet the substantial compliance demands of Dodd-Frank. Experience has shown that indiscriminate application of regulation without regard to need, or to risk, increases compliance costs and drains limited resources without benefit to the institution or the community through improved safety or soundness.

II. Applicable Standards Should be Consistent Among All Federal Banking Agencies

Many smaller and regional holding companies subject to the Proposal are not complex and do not have significant operating activities at the holding company level. Most if not all of the activities of these holding companies occur in one or multiple bank subsidiaries. In many instances, the board membership of the holding company and bank subsidiary or subsidiaries is similar if not identical. Board committees, including committees responsible for board oversight, tend to be joint committees of both the holding company and the bank. In these cases, the bank subsidiary is subject to risk management standards and expectations established by its primary federal bank regulator.

Depending on how the Proposal is implemented by examination staff, inconsistent and potentially conflicting messages and standards could be established, particularly regarding risk management and board oversight, stress testing and liquidity management. To reduce the potential of inconsistent messages, we recommend that the Board avoid conflict with the other federal banking agencies, coordinate reviews with the primary bank regulator and rely upon the findings of the primary bank regulator in reviewing compliance with the applicable sections of the Proposal.

III. Risk Management Provisions of the Proposal

The ABA supports the intent of the Proposal to establish heightened prudential risk governance standards for certain bank holding companies. Strong risk management governance ensures that institutions establish sound enterprise-wide risk management functions and practices. However, the Proposal, as outlined below, should allow more flexibility to address the size, complexity and business footprints of impacted holding companies and the regulatory regimes to which the institutions already are subject.

a. The Risk Committee Expertise Requirements As Currently Drafted May Limit the Ability of Companies, Particularly Midsized and Regional Companies, to Find Qualified Candidates.

Under the Proposal, Covered Companies and publicly traded Smaller Companies are required to establish board enterprise-wide risk committees[11] that include at least one member with "risk management expertise."[12] Under the Proposal, in order to qualify as having risk expertise, the member must not only have an understanding of banking risk management principles and practices, he or she must also have experience:

- Developing and applying risk management practices and procedures;
- Measuring and identifying risks; and
- Monitoring and testing risk controls

All of these activities must be with respect to banking organizations.[13]

While the Proposal does state that risk management expertise should be commensurate with a company's risk profile, size and complexity,[14] the prescriptive nature of the definition may limit the ability of holding companies subject to the rule to find qualified candidates. This is particularly true of midsized and regional institutions with limited geographic footprints. Since practices are still developing, there are a limited number of individuals that would meet the expertise requirement for measuring risk, and monitoring and testing risk controls, regardless of an institution's size and complexity. Midsized and regional institutions could have difficulties in competing with other Covered Companies for these resources. This concern will only be further exacerbated if the requirement is expanded to all committee members. We recommend, consistent with the Joint Letter, that the Board adopt a definition with more flexibility similar to the SEC's definition of an "audit committee financial expert."[15] This alternative would require the risk expert to have more general risk expertise and experience and would be consistent with the requirements under securities law and rules.

[11] 77 Fed. Reg. at 656 (Proposed Section 252.126(a)).
[12] Id. (Proposed Section 252.126(b)(2)).
[13] 77 Fed. Reg. at 655 (Proposed Section 252.125(l)).
[14] 77 Fed. Reg. at 656 (Proposed Section 252.126(b)(2)).
[15] 17 CFR 407(d)(5)

In addition, the risk expertise requirement should not be limited to expertise with banking organizations. Applicable institutions should be able to benefit from the risk management expertise offered by individuals from a wide variety of different industries and have the discretion to determine the best fit for the institution. For example, individuals with risk management experience at insurance companies, securities broker-dealers or other nonbank financial companies should be allowed to be considered given that such firms face many of the same financial risks (e.g., market risk, interest rate risk) as banking organizations. Individuals from energy and other commodity industries also could provide significant expertise in risk management given their involvement and experience in hedging and management of volatile markets.

b. ***Covered Companies and Publicly Traded Smaller Companies Should Not be Prohibited from Having a Common or Joint Risk Committee with its Subsidiary Depository Institution.***

The Proposal (section 252.126(b)(5)(i)) could be read as prohibiting a Covered Company or publicly traded Smaller Company from having a joint risk committee with one or more of its depository institution subsidiaries (i.e., risk committees of the BHC and the depository institution that are composed of the same members and that meet on a joint basis). Such joint committees are common and indeed can be quite helpful in assisting the risk committee of both the holding company and the subsidiary bank or banks in understanding, monitoring and evaluating the risks facing the relevant organization, including risks arising from the activities of affiliated entities. Accordingly, we ask that the Board clarify that the Proposal was not intended to prohibit the maintenance of joint risk committees by a Covered Company or publicly traded Smaller Company and its subsidiary bank or banks.

IV. Stress Testing Requirements Applicable to Smaller Companies and State Member Banks

ABA is supportive of stress testing as a tool for management and the board to understand and manage risk. However, the Proposal does not appear to encourage stress testing for these purposes. If the Proposal is not corrected, regulatory stress testing will merely become a check-the-box exercise that will absorb resources without adding to sound risk management.

Consistent with Governor Tarullo's statements,[16] we urge the Board to distinguish Smaller Company and bank stress testing requirements. To do so, we urge the Board to adopt a more flexible, tailored stress testing regime for Smaller Companies and banks. This tailored approach should include at least: regulatory expectations commensurate with an institution's size,

[16] "Having offered an encomium to these tools, let me end by making clear that a one-size-fits-all approach is no more appropriate here than in most other areas of prudential supervision. While forward-looking assessment is important for capital planning in all banking organizations, the specific, sophisticated character of the kind of stress test we ran this year is surely neither necessary nor suitable for smaller banking organizations. For firms with more than $10 billion but less than $50 billion in total consolidated assets, the nature of any stress testing requirements will be quite different from that used in the CCAR." (Remarks to the Federal Reserve Bank of Chicago Annual Risk Conference: Developing Tools for Dynamic Capital Supervision (Apr. 10, 2012) transcript available at http://www.federalreserve.gov/newsevents/speech/tarullo20120410a.htm.)

complexity and familiarity with stress testing; a floating submission date so that smaller institutions can conduct their stress tests during the budget and strategic planning process; the option for Smaller Companies and banks to develop their own regional scenarios; and limited disclosures.

a. The Board Should Clearly Communicate Regulatory Expectations Commensurate with an Institution's Size, Complexity and Familiarity with Stress Testing for Smaller Companies and Banks.

Under the Proposal, the company-run stress test requirements would be immediately applicable to all banks and holding companies over $10 billion. Institutions that are above $10 billion in total consolidated assets have varying degrees of familiarity with stress testing and regulatory expectations. Covered Companies previously participated in one or more of the Supervisory Capital Assessment Program (SCAP), Comprehensive Capital Analysis and Review (CCAR) or Capital Plan Review (CapPR). Smaller Companies and banks have not participated in these processes and are not familiar with the Board's expectations. As a result, these institutions do not know how best to comply with the proposed procedures.

Ideally, stress testing should be a tool for an institution's board and management to understand and manage risk. Unclear standards leave smaller institutions concerned that they must meet the highest standards. To do so quickly, they will rely on outside vendors at great cost to guarantee compliance which will preclude internal development of the appropriate foundations for stress testing systems. Instead, Smaller Companies and banks should be encouraged to take charge of their own stress testing without fear of being held to standards that are unattainable in the short-term. Standards that provide these institutions with the ability to develop stress testing systems incrementally and internally serve banks and regulators best.

For this reason, we urge the Board to differentiate between larger and more complex organizations and smaller and less complex organizations. Each institution should develop stress testing programs commensurate with its size, complexity, and familiarity with stress testing. We also urge the Board to clearly communicate these tailored expectations to Smaller Companies and banks. These smaller institutions need to understand what regulatory expectations are going to be applied in order to build appropriate systems. As part of this effort, we urge the Board to indicate whether Smaller Companies and banks will be required to submit a common template and, if so, what data items would be included in such templates.

b. The Implementation Date for Smaller Companies and Banks Should Be Extended.

The effective date of the company-run stress test rule for Smaller Companies and banks should be delayed. These institutions are less familiar with stress testing than larger institutions. Smaller Companies and banks will need to develop internal processes and procedures, hire or repurpose staff, and develop appropriate systems, in order to be able to fully comply with the requirements of the Proposal. Assuming that the final rule will be promulgated in the second quarter of 2012, such entities will only have approximately four-and-a-half months to prepare for the arrival of the supervisory stress scenarios for the annual company-run stress tests for 2013. We believe this timing will be unduly burdensome because it will not give such institutions adequate time to properly prepare to run the required stress tests. These institutions are, by definition, smaller in size and therefore have fewer readily available resources to dedicate to fulfilling the mandate of Section 165(i) of Dodd-Frank absent prior experience with SCAP and CCAR. Moreover, Smaller Companies will need time to develop robust capital plans in which to incorporate the stress test results and have these capital plans approved by their board prior to submission. These institutions do not have a sophisticated Internal Capital Adequacy Assessment Process (ICAAP) that larger institutions use for their capital planning. As a result, assuming the submission date is consistent with past practice (early January) and stress test scenarios are not provided until November, Smaller Companies will be severely challenged to deliver a thoughtful product in the time period provided. Consequently, we strongly urge the Board to delay the implementation date of the proposed stress testing requirements for Smaller Companies and banks. For these institutions, the first required company-run stress tests should be based on scenarios distributed in 2013 and submitted in 2014.

c. *The Agencies Should Provide a Floating Submission Date for Smaller Companies and Banks.*

Under the Proposal, institutions subject to the Board's stress testing requirements will receive the stress scenarios in mid-November and be required to submit the results of their company-run stress tests by January 5 of each year.[17] Thus, FDIC and Federal Reserve regulated entities will have only approximately six weeks to complete a great amount of work during the same period which also overlaps with year-end financial closing activities and the seasonal holidays. In light of the forgoing, we urge the Board to provide for a floating submission date under which a Smaller Company or bank must submit its results, using the previous year's stress scenarios, by December 31.[18] A flexible submission date would allow institutions to conduct the stress tests when they have the resources available. Moreover, a floating submission date would allow institutions to conduct their stress tests during the capital planning process, which can occur any time of year depending on the institution. Finally, a floating submission date would serve to distinguish the stress testing conducted by Smaller Companies and banks from the stress testing conducted by larger institutions.

d. *Smaller Companies and Banks with Small Geographic Footprints Should be Allowed to Develop Their Own Scenarios.*

Under the Proposal, each institution would be required to conduct an annual stress test using three economic scenarios reflecting baseline, adverse, and severely adverse conditions.[19] While stress testing may require the review of scenarios, including severely adverse scenarios, we believe it is important that the events be relevant to the institution. We are concerned that the stress scenarios developed by the Board will be national scenarios which will not be relevant to institutions with small geographic footprints. Stress testing is a tool for an institution's board and management to understand and manage risk. The less relevant a scenario is, the less useful a stress test is as a risk management tool. If the Board's stress scenarios are not relevant to

[17] 77 Fed. Reg. at 659 (Proposed Section 252.146(a)).

[18] For example, if the stress scenarios are distributed on November 15, 2013, an institution's results must be submitted by December 31, 2014.

[19] 77 Fed. Reg. at 659 (Proposed Section 252.143(b)).

institutions with small geographic footprints, then the Proposal becomes a costly check-the-box exercise. As a result, we urge the Board to provide institutions with small geographic footprints the option to develop their own stress scenarios. Moreover, we urge the Board to provide guidance on how an institution should develop its own stress scenarios should it choose not to use the national stress scenarios provided. To assist Smaller Companies and banks in developing their own scenarios, ABA urges the Board to provide reports on regional economic outlooks that highlight issues that could have an impact on financial institutions in a specific region.

e. Institutions Should Only be Required to Disclose Stress Testing Methodologies and Capital Ratios at the End of the Planning Horizon.

The Proposal requires institutions to publish the stress test results within 90 days of its report to the Board.[20] The required information publicly disclosed by each institution would, at a minimum, include: (1) a description of the types of risks being included in the stress test; (2) a general description of the methodologies employed to estimate losses, pre-provision net revenue, allowance for loan and lease losses and changes in capital positions over the planning horizon; and (3) aggregate losses, pre-provision net revenue, allowance for loan and lease losses, net income, and pro forma capital levels and capital ratios (including regulatory and any other capital ratios specified by the Board) over the planning horizon, under each scenario.[21]

We have several concerns with the foregoing publication requirements. First, Section 165(i)(2) of Dodd-Frank merely requires publication of a "summary" of the results of the stress tests. However, the Proposal's disclosure requirements require publication of much more than a "summary," including very detailed financial information. Thus, the disclosure requirements are overly broad, and not supported by the statutory language contained in Dodd-Frank.

Second, there is no demonstrated need for the general public to have access to the type of detailed financial information that would be disclosed under the Proposal. This is particularly true for regional and midsized banks that do not pose a systemic risk to the country's financial system. The detailed disclosures required by the Proposal are unnecessary as financial data is readily available in call and holding company reports which are filed quarterly and in publicly available financial statements.

Third, detailed information regarding stress test results could be misinterpreted by the general public. As requested above, Smaller Companies and banks should have tailored and flexible stress testing requirements. Assuming that our recommendations are adopted, stress testing results will not be a helpful tool to compare institutions since the results will be based on different scenarios and released at different times of year. If the stress testing requirements of smaller institutions are fundamentally different than the requirements for larger institutions then the disclosures should be different as well.

Finally, ABA is concerned that disclosed stress testing results could be used as a tool for short traders. In the case of a publicly traded company, the publication of detailed financial information and, in particular anything less than favorable stress test results, has the potential for

[20] 77 Fed. Reg. at 660 (Proposed Section 252.148(a)).
[21] Id. (Proposed Section 252.148(b)).

triggering negative analyst reports which would be seized by short sellers to drive down the price of stock. Publicly traded organizations will not be able to explain that the stress test results are not likely to occur because their ability to discuss the future financial performance of the organization is extremely limited by securities laws and rules. Furthermore, banks are expressly prohibited from disclosing their CAMELS ratings. Therefore, publicly traded financial organizations are unable to rebut false rumors spread by short sellers which are designed to drive down the price of bank stock based on, for example, "doomsday" stress test results. The fact that safety and soundness examinations have remained confidential clearly validates the need to keep these tests confidential. It seems irresponsible to release stress test results that may indicate a bank or company is in trouble when the safety and soundness examination could show an exactly opposite condition.

As a result, we urge the Board to only require banks and holding companies to disclose: (1) a description of the types of risks being included in the stress test; (2) a general description of the methodologies employed; and (3) capital ratios at the end of the planning horizon. This limited disclosure would satisfy the statutory requirement and limit reputation risk.

f. The Board Should Coordinate So That Similar Stress Test Scenarios, or Guidance to Develop Such Scenarios, is Provided to Depository Institutions and Bank Holding Companies.

Under Section 165(i)(2) of Dodd-Frank and the Proposal, Smaller Companies and Covered Companies are required to conduct company-run stress tests. The company-run stress test requirement is also separately applicable to depository institutions having over $10 billion in assets, whether they are national banks, state member banks, or state non-member banks.[22] With respect to depository institutions, the Federal Reserve would supervise company-run stress tests for state member banks under the Proposal, the OCC would supervise stress tests under its own proposed rule for OCC regulated entities pursuant to Section 165(i)(2) of Dodd-Frank, and the FDIC would do so for state non-member banks.[23] Most banking organizations are organized on a consolidated basis with a bank holding company and at least one subsidiary depository institution. Using one set of stress scenarios at the bank holding company level and a different stress scenario at the subsidiary depository institution would be needlessly burdensome. Moreover, it would likely result in the public disclosure of divergent results which would be both confusing and of little value to investors and other market participants. As a result, we urge the banking agencies to develop consistent stress test scenarios and, in the case of banks with small geographic footprints, consistent guidance for these institutions to develop their own scenarios. To assist smaller institutions in developing their own scenarios, ABA urges the banking agencies to provide reports on regional economic outlooks that highlight issues that could have an impact on financial institutions in a specific region.

[22] 77 Fed. Reg. at 658 (Proposed Sections 252.141 and 252.142(i)).
[23] 77 Fed. Reg. 3166 (Jan. 23, 2012) and 77 Fed. Reg. 3408 (Jan. 24, 2012).

g. The Board Should Clearly Set Forth a Robust and Transparent Process for Responding to Inquiries in a Timely Manner and Begin This Process as Soon as Possible.

As described above, clear communication of regulatory expectations is essential. Institutions and the Board must partake in an ongoing and continuous dialogue as institutions build their systems. An institution should never first learn of an issue only after submitting the January 5 report. As a result, we ask that experienced examiners offer instruction, assistance, and feedback to facilitate the good faith efforts of smaller institutions to implement the Proposal. In order to facilitate consistency between the Board and examination staff, we believe the Board should open a dedicated email address that institutions could use to submit questions and receive answers in a timely manner.

V. The Single Counterparty Concentration Limits Provision of the Proposal

a. Implementation of the Single Counterparty Exposure Limits for Covered Companies Should Be Tiered.

Under Dodd-Frank, Covered Companies are prohibited from having credit exposure to any unaffiliated company that exceeds 25 percent of the holding company's capital stock and surplus.[24] The Proposal sets out new definitions of Counterparty and Credit Exposure which will require all Covered Companies to develop new systems and monitoring processes. The costs of developing these systems will be substantial, particularly because the Proposal defines credit exposure, and requires the aggregation of credit exposures, in ways that differ materially from the manner in which exposures are monitored or aggregated for risk management or other regulatory purposes (such as lending limits or capital requirements). The costs associated with these new requirements will pose a special burden for smaller Covered Companies with very little benefit.

In the preamble to the Proposal, the Board specifically asks whether it should consider a longer phase-in for all or a subset of Covered Companies with regard to the single counterparty limits proposed.[25] We strongly support, as discussed in the Joint Letter, a longer phase-in period for all Covered Companies to comply with the Proposal. We recommend a tiered implementation process-- One additional year for Covered Companies between $250 billion and $500 billion in consolidated assets and 18 months for Covered Companies with consolidated assets of $50 to $250 billion. The additional time would allow these companies to develop the necessary systems and processes to comply with the new monitoring requirements. This extended transition period should not present any material risk as smaller Covered Companies pose less risk to the financial system and are unlikely to have single counterparty exposures exceeding the 25% concentration limit. Further, the longer implementation period would allow the Board and the industry to learn from the implementation of the Proposal in larger Covered Companies and the impact the Proposal may have on the financial markets as a whole. This recommended approach to phased implementation is similar to the approach taken by the Board and the FDIC in the Resolution

[24] Dodd Frank Section 165(e).
[25] 77 Fed. Reg. at 614 (Question 21).

Planning Final Rule.[26] In no event should implementation for any Covered Company be required earlier than completion of the transition period established by the Board.

b. Exposures to Individuals Should be Excluded from SCCL, Absent Evidence that Such Exposures Are Used to Evade the Credit Limit Applicable to a Company

Dodd Frank authorizes and directs the Board to issue regulations prohibiting a Covered Company from having credit exposure to any unaffiliated company that exceeds 25 percent or more its capital stock and surplus.[27] The language and purposes of Section 165 make clear that Congress intended the credit limit to generally apply only to exposures to a company, not to an individual. For example, Congress authorized the Board to issue regulations under Section 165(e) "[i]n order to limit the risks that the failure of any individual company could pose to a Covered Company."[28] Similarly, Section 165(e)(3) defines what "credit exposure" to a company means, and each of the specific categories of exposures listed in Section 165(e)(3) define exposures with respect to a company (e.g., including "all extensions of credit to the company, including loans, deposits, and lines of credit).

It is highly unlikely that the credit exposure of a Covered Company to an individual (either alone or in combination with that individual's immediate family) would exceed—or for that matter even approach—a Covered Company's credit limit. Accordingly, applying the limit and all of its associated monitoring and reporting burdens to the millions of individuals and consumers who obtain credit from Covered Companies would be excessively burdensome and unnecessary to achieve the purposes of the SCCL.

Despite the language in Dodd Frank, however, the Proposal defines a "counterparty" for purposes of the counterparty exposure limits to include an individual. No justification or cost-benefit analysis is provided in the Proposal for the inclusion of individuals in the definition counterparty. We believe that, consistent with the language and purposes of Section 165(e), exposures to individuals should not be subject to the credit limits unless there is evidence that the credit extension to the individual was undertaken for purposes of evading the credit exposure limit with respect to a company (such as, for example, if a Covered Company makes a loan to an individual who controls a company that is approaching the credit limit with knowledge that the proceeds of such loan would be transferred by the individual to the company). In such cases, the Covered Company's exposure to the individual resulting from the transaction should be aggregated with the exposure to the company. This result is fully consistent with the terms of Dodd-Frank which allows the Board to determine that a transaction with "any person" should be considered a transaction with a company to the extent that the proceeds of the transaction are used for the benefit of, or transferred to, that company.[29]

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[26] 12 C.F.R. § 360.10(c). The FDIC regulation governing resolution plans for insured depository institutions created three submission dates over a period of 18 months based on the nonbank asset size of the parent company. Financial institutions with parent companies with $250 billion or more in total nonbank assets have the shortest implementation period and will be the first to file a resolution plan in July 2012. Depository institutions having parent companies with fewer nonbank assets will file in July 2013 or December 2013.

[27] Dodd Frank Section 165(e)(2).

[28] Dodd Frank section 165(e)(1) (emphasis added).

[29] Dodd Frank Section 165(e)(4)

c. ***Daily Monitoring and Monthly Reporting of Daily Compliance Should Not Be Required for Counterparty Relationships that Are Not Approaching or Likely to Approach the Credit Limit.***

The Proposal would require Covered Companies to be in compliance with the SCCL on a daily basis and to submit on a monthly basis a report demonstrating its daily compliance.[30] The ABA is very concerned that this provision could be read as requiring a Covered Company to calculate and document on a daily basis the Covered Company's aggregate exposure with each and every counterparty regardless of whether the company's aggregate exposure to the counterparty is reasonably likely to approach the company's credit limit. The overwhelming majority of a Covered Company's credit relationships with its customers will always be far below the 25% (or even 10%, if retained, for certain companies) credit limit. This is particularly true if individuals are continued to be treated as counterparties under the Proposal. Requiring Covered Companies to develop the systems necessary to calculate on a daily basis the company's aggregate credit exposures to thousands or millions of counterparties (including small businesses, community development organizations and, if retained, individuals) when only a relatively small number of counterparties at most will approach the limit is overly burdensome and unnecessary to ensure compliance with the credit limit itself. Accordingly, we do not believe that the imposition of such daily monitoring requirements can satisfy any reasonable cost-benefit analysis.

Daily monitoring and monthly reporting of daily compliance is warranted only for those counterparty exposures that exceed a buffer of a significant percentage of the credit limit (for example 25%). In addition, Covered Companies should be required to maintain policies, procedures and systems reasonably designed to ensure compliance with such a buffer.

The ABA believes that such an approach will both ensure that Covered Companies comply-- and the Board can monitor the company's compliance with the SCCL without imposing unnecessary and overly burdensome monitoring requirements on counterparty exposures that are not anywhere close to approaching the Covered Company's credit limit.

VI. <u>The Federal Reserve Should Preserve Its Discretion, Avoid Automatic Triggers in the Application of Early Remediation</u>

Clear differences between financial institutions subject to the Proposal and those that are not are evident in the early remediation portion of the Proposal. Under the proposed early remediation rules, a troubled institution with a bank holding company of $52 billion in consolidated assets subject to early remediation restrictions would be placed at a disadvantage in comparison to a similarly situated institution with a bank holding company of $48 billion in assets not subject to early remediation restrictions. Given the inequitable application, it is uncertain whether early remediation would lead to more failures among midsized financial institutions. These institutions will have fewer tools to stabilize a troubled bank subsidiary while competing with non-covered financial institutions not subject to the same restrictions. The blunt application of early remediation can be moderated by avoiding Prompt Corrective Action-like automatic triggers, and creating a regime that gives the Board discretion to make a subjective determination of the correct remediation policy based on an institution's individual characteristics.

[30] 77 Fed. Reg. at 654 (Proposed Rule Section 252.96).

a. Uncertain Impact of Early Remediation on Holding Companies with Multiple Retail Banks.

The Proposal appears to assume that a bank holding company has only one subsidiary banking institution. In that case, the safety and soundness of the subsidiary bank and the holding company parent would be closely linked, and the restrictions implemented under early remediation may assist in returning a troubled bank holding company to safe and sound condition. However, it is uncertain how early remediation restrictions will affect a holding company with multiple retail bank subsidiaries, particularly where not all banking subsidiaries are troubled. In that case, a bank holding company will be restricted in the tools available to stabilize a troubled subsidiary, while at the same time restricted in its support of safe and sound subsidiaries. Early remediation should be conducted in a nuanced manner allowing troubled bank holding companies and financial institutions to be resolved when necessary, but without harm to the health of affiliated banks and non-banks.

b. Automatic Removal of Management under Level III Early Remediation Threatens to Undermine the Stability and Continuity of Healthy Banking Subsidiaries in a Multibank Holding Company.

The Board, under early remediation Level III, may dismiss directors and officers at the bank holding company.[31] Although the removal of management may be essential to Dodd-Frank's focus on accountability, the Proposal fails to recognize that the removal of management is of particular concern to holding companies with multiple retail bank subsidiaries where it is common for senior holding company executives to also be the senior management of subsidiary banks. Will senior management be removed as a matter of course from all concurrent positions held within all affiliated entities? The process, procedures and timing for identifying and removing management staff needs to be clarified to allow subsidiaries to prepare business continuity plans, succession strategies and redundancy.

If the intent of early remediation is early intervention and recovery, then a preferred process for multibank holding companies is limiting removal to individuals- not all management- and reserving this authority for instances of substantial individual culpability. The early removal of select individuals assists a viable subsidiary in operating as a going concern, and increases the likelihood that the subsidiary will survive the potential liquidation of a parent, thereby decreasing the cost of resolution and the potential cost to the Federal Deposit Insurance Fund. Moreover, selective removal of management allows the Federal Reserve's early remediation authority to better integrate with similar authority under the Federal Deposit Insurance Act (FDIA)[32] and Orderly Liquidation Authority (OLA) under Dodd Frank Title II.[33] The focus of FDIA and OLA on accountability leading up to or following the failure of a financial institution or bank holding

[31] 77 Fed. Reg. at 662 (Proposed Section 252.162(5)(ii)).
[32] Federal Deposit Insurance Act § 8(e) *Removal and Prohibition Authority*, 12 U.S.C. 1818(e).
[33] Dodd Frank Section 213 *Ban on Certain Activities by Senior Executives and Directors*. The statute authorizes "[t]he appropriate agency…[to] serve upon a senior executive or director…a written notice of the intention…to prohibit any further participation…, in any manner, in the conduct of the affairs of the financial company for a period of time…not less than 2 years." Implementation of the ban must follow the due process requirements under section 8(e) of the Federal Deposit Insurance Act (12 U.S.C. 1818(e).

company provides a better process for the investigation and removal of management across a family of companies. At a minimum, bank holding company subsidiaries need to understand the implications Level III early remediation restrictions on a parent company in order to prepare an emergency plan if faced with unexpected and widespread terminations among senior management.

* * * * *

In conclusion, the ABA appreciates the opportunity to comment on this important piece of Dodd-Frank implementation. We urge the Board to exercise the discretion that Congress gave it in implementing a flexible and graduated approach to prudential supervision under Section 165 and consider the recommendations we have made in this letter as well as the recommendations contained in the Joint Letter.

If you have any questions or need further information, please contact Beth Knickerbocker, Vice President and Senior Counsel at bknicker@aba.com or (202) 663-5042.

Sincerely,

Beth Knickerbocker

Beth Knickerbocker
Vice President and Senior Counsel

Attachment A

American Bankers Association
Building Success. Together.

Frank Keating
President and CEO
202-663-5111
fkeating@aba.com

May 12, 2011

The Honorable Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Dear Chairman Bernanke:

The American Bankers Association (ABA) appreciates your keynote remarks at the Chicago Federal Reserve's Bank Structure Conference last week. I was particularly struck by your statement regarding a graduated approach to safety and soundness regulation. This is a concept that we believe is critical to a regulatory system that assures that banks of many different sizes, business models, risks, and structures will be able to offer competitive services to their customers in a safe and sound manner.

Whether legislated or regulated, we believe that arbitrary bright line cutoffs that are divorced from the factors driving the problem being addressed run the risk of creating incentives that are not based upon economics or rational business decisions. Resources may be shifted to managing the cutoff, not to managing the business. We agree, for example, with your comments that great care must be taken so that there is no discrete change in approach between a bank with assets just under the $50 billion cutoff for being a "systemically important bank" and one with assets just above it.

ABA believes that the graduated or scalable approach has potential far beyond the appropriate differentiation among systemically important banks and those nearing the threshold. We believe that a graduated approach to regulation and supervision should be applied industry-wide in recognition of the great diversity among banks. Regulation and supervision should acknowledge and be implemented based on nature, scope and scale of bank, the complexity of its operations, the charter type, and the ability to absorb and manage risk. A notion that two sizes can fit all cannot lead to a successful regulatory system that encourages prudent risk-taking, innovation, and competitiveness. We believe that such a simplistic approach would prove destructive to the industry over time, creating regulatory advantages or disadvantages for banks independent of their true value to their customers and their communities. A finer calibration is needed, managed to avoid distortive effects across banks of all sizes, business plans, and types.

Application of a more finely tuned bank regulatory program is essential now with the enormous new obligations forthcoming under Dodd-Frank, which raise the cost of traditional banking, reduce the potential income, and make it harder to raise capital. Wherever I travel, bankers tell me about the stresses and difficulties they are having in dealing with the early phases of the Dodd-Frank implementation, and this does not include all the expected new burdens that will flow from restrictions on interchange income, new consumer rules, and greater reporting obligations. There is no question that community banks in particular feel they are at the very edge of survival with the avalanche of regulations rushing their way.

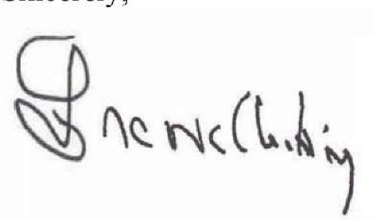
Regional banks are wondering what the new regulatory systems will allow their business model to be. Larger banks see the possibility of their businesses directed to fit into a government-mandated framework rather than one driven by customer needs and bounded by thoughtful risk management and supervisory oversight. Simply put, regulatory risk and uncertainty is rising and will have negative consequences on every bank.

We commend past efforts of the Federal Reserve to tailor specific supervisory activities based on the institution's legal structure, corporate strategy, activities, business lines, risks, and interdependencies. Implementation of such a supervisory approach is no small task in the best of times and has often been less effective than we all would wish. Now the challenge is even greater. We are very concerned that the new layer of regulations and restrictions from Dodd-Frank – implemented at breakneck speed without due regard for the range of impacts they will have across the spectrum of bank business plans – will overwhelm efforts to develop regulations that are scaled to our diverse industry. Such a path takes us in a direction towards a less flexible, more arbitrary approach to bank supervision. It is time to redouble efforts to tailor regulation and create an effective, graduated approach to supervision.

One of the greatest strengths of the U.S. economy and our banking system is its diversity, which enables banks of all sizes to respond to evolving consumer needs in an agile, innovative manner. Regulation and supervision should seek not only to preserve this diversity but to foster it. The enormous increase in regulation from Dodd-Frank escalates the risk that our regulatory system will suppress innovation and even reduce the viability of various charter options and business strategies. Such a result could significantly harm banks and their ability to serve their communities.

We believe that now is the time to engage in a discussion of how to mitigate the adverse impacts of new rules. We are confident that a flexible, effective, well-calibrated regulatory and supervisory program can be developed. Your comments on instituting a graduated approach are encouraging. I understand that you have called upon Governors Duke and Raskin to take a major role in ensuring that the Dodd-Frank regulatory effort does not create harm to community banks. We are eager to support their work and to sit down and discuss practical ways that a graduated approach might be implemented across banks large and small and everywhere in between

Sincerely,



Frank Keating