



*By electronic submission to [www.regulations.gov](http://www.regulations.gov)*

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*Re: Proposed Guidance on Stress Testing for Banking Organizations with more than \$10 Billion in Total Consolidated Assets*

Barclays appreciates the opportunity to respond to the proposed guidance issued by the Agencies regarding stress testing for US banking organizations with more than \$10 billion in assets. We support the proposed guidelines, and believe that these are aligned with our own view that robust, forward-looking stress testing is an important contributor to well-informed risk management, including comprehensive assessments of capital and liquidity adequacy.

We have additional comments in three areas specifically related to the design and operation of banks' enterprise-wide stress tests.

#### **1. Time horizon**

To be most effective, it is important that banks estimate the impact of potential stress events over the time horizon required to assess projected business performance through a range of plausible adverse scenarios. Certain adverse scenarios are appropriately assessed under a shorter time horizon, while for other scenarios a two-year horizon may be insufficient to evaluate the full impact of projected stress events. This is particularly important for understanding the risks in "traditional" retail and commercial banking operations, where there may be significant time lags between the occurrence of adverse movements in the macroeconomic outlook, and consequent changes in business performance. This point is empirically demonstrated by the fact that banks in some jurisdictions experienced declines in their capital ratios for periods that exceed the 24-month horizon cited in the proposed guidance.

Moreover, for some longer maturity portfolios, management actions taken to address the effects of economic deterioration may take a significant period of time initially to affect the flow of new business, and then to affect materially the composition and asset quality of the overall portfolios. Extending the time horizon to a third year is therefore valuable in enabling banks and regulators

to have an informed discussion of both the full impact of various scenarios, and banks' capacity to mitigate such scenarios by taking appropriate management actions.

Indeed, it would be possible to argue for extending the time horizon further to four, or even five, years. However, we believe that other trade-offs start to outweigh the benefits of stress testing results at that point. In particular, projecting over longer time horizons naturally brings greater forecasting error, reducing the reliability of the results. Additionally, over longer time horizons, it is increasingly likely that banks would be able to raise additional capital either by material asset sales or through additional capital issuance. Hence, as a test of capital adequacy, we believe that there is some natural limit to the time horizon over which it is necessary to project stressed performance.

## **2. Liquidity and capital**

Barclays supports the proposed guidance that "an effective stress testing framework should explore the potential for capital and liquidity problems to arise at the same time or exacerbate one another". Our experience is that it is important that both capital and liquidity are considered within the strategic and business planning processes, under both base case and a range of adverse scenarios, and that the management body of the firm therefore has appropriate understanding of both the capital and liquidity risk associated with business plans.

Some aspects of this interaction are amenable to incorporation within a single set of stressed business performance and capital projections, such as: the increase in interest expense or lost interest income when liquidity buffers are deployed under stress; the costs of re-establishing the liquidity buffer and the higher costs of raising debt in an adverse scenario; and revenue impacts and corresponding regulatory capital reductions that would result from reducing balance sheet growth in a stress scenario.

However, capital adequacy is typically assessed over a multi-year adverse scenario, whereas liquidity adequacy is typically assessed over a much shorter horizon of a matter of weeks and months. While, this difference in time horizons means that capital and liquidity adequacy assessments do not lend themselves to being easily incorporated into a single set of projections, the interaction between capital and liquidity in certain stress events means that it is important that each is considered in the context of the other in certain circumstances.

The interaction between capital and liquidity, and its appropriate treatment within banks' stress testing frameworks, is one in which we believe banks' and regulators' views of appropriate practices may continue to evolve over the next few years, and we would welcome the opportunity to discuss this further.

## **3. Legal entities**

In addition to consolidated capital supervision, many large banks have material subsidiaries that are also individually subject to local regulatory capital regimes. Banks in certain jurisdictions may also be subject to regimes, such as the UK FSA's Solus regime, in which certain sets of deposit-taking entities are subject to separate capital standards. Adequacy of capital resources within a consolidated banking group is therefore determined not just by the total amount of capital in the group, but also by the transferability of that capital between legal entity balance sheets within the group in a range of adverse scenarios. For banks with material subsidiaries, reflecting movements of capital between the material entities – such as capital injections and dividend flows

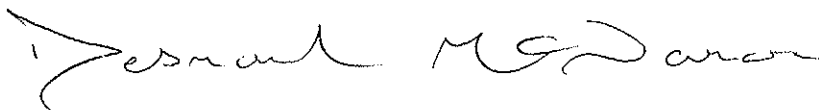
between subsidiaries and parent companies – supports the overall assessment of the capital adequacy of a banking group.

One of the key considerations that legal entity stress testing can therefore enable large international banks and their regulators to address is whether, in a severe stress, the available capital held at the parent level is sufficient to meet the potential need for capital injections into the bank's subsidiaries. To address this consideration effectively, we believe that it is important that:

- a) The overall assessment of capital adequacy is performed as part of a group-level stress test which also incorporates subsidiary views (rather than standalone stress tests on the subsidiary). In this case, banks should be able to demonstrate that the scenarios assessed in a group-level stress test appropriately stress the relevant subsidiaries
- b) A bank's home regulator leads the assessment of capital adequacy, taking into consideration the mitigating effects of parental support to subsidiaries.

We appreciate the Agencies' consideration of the views set forth in this letter and welcome the opportunity to discuss any part of this letter in greater detail.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Desmond McNamara', written in a cursive style.

Desmond McNamara  
Group Head of Economic Capital  
Barclays