July 29, 2011

Office of the Comptroller of the Currency
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Washington D.C. 20219
Regs.comments@occ.treas.gov
Docket No. OCC 2011-011

Jennifer J Johnson, Secretary
Board of Governors of the Federal Reserve System
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Docket No. OP-1411

Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
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Comments on: Proposed Guidance on Stress Testing for Banking Organizations with more than $10 Billion in Consolidated Assets

Ladies and Gentlemen:

Invictus Consulting Group LLC (Invictus) welcomes the opportunity to comment on the aforementioned "Proposed Guidance on Stress Testing for Banking Organizations with more than $10 Billion in Consolidated Assets." Invictus is a boutique advisory firm specializing in the development and implementation of bank stress testing for bank regulators, banks, director and officer liability underwriters for banks, and bank investors.

INVICTUS
CONSULTING GROUP LLC

Invictus was founded in the peak of the subprime crisis in 2008 with its sole objective of bringing stress testing from an operations and risk management level to a senior management level, and introducing it into the general strategic planning framework for banks. We apply our public stress tests to all FDIC insured depository institutions and update them on a quarterly basis. Using public data and applying our unique methodology across all banks allows for direct comparison, rating and ranking of all banks in the country. We provide certain state bank regulators very detailed reports on banks under their jurisdiction. Furthermore we provide these same detailed stress test results for a fee to interested parties and stakeholders including director and officer liability underwriters, investment bankers, investors, bank counterparties, corporate treasurers, and hedge/private equity/40 Act fund managers.

We are also engaged by a number of banks independently to provide customized stress testing using the bank's own internal data. We assist our client banks in bringing stress testing into the board room and "C-level" and director level, showing banks how this information is crucial in the development and implementation of their respective strategies, how they fare versus their direct geographical competition, and where they rank on a state and regional basis.

We believe that stress testing plays a crucial role in the post-crisis analysis of banks, their sustainability, and their competitive position. Invictus is delighted by the recognition of the US Congress in the importance of stress testing and its inclusion in Dodd Frank (Pub L 111-203, 124 Stat. 1376) and further appreciate the rule making roles of the OCC, the Federal Reserve Bank, and the FDIC in this important endeavor to strengthen the US banking system.

Potential dangers in the interpretation and execution of the Bill.

Perspective on the Recession and Stress Testing.

The recession, which resulted in widespread bank failures and an across-the-board weakening of bank financial statements, was not a failure of the capital regulatory process. The primary failure was the inability of practically all econometric models to predict the widespread impact of the recession and its severity. It is absolutely inconceivable that regulators could have defined Tier 1 capital levels for banks that would have prevented the present situation. If they had, they would have effectively destroyed the entire banking structure by imposing unrealistic and highly punitive capital structures on profit-making financial institutions.

What the recession did expose was the fundamental weakness in the methodology used to evaluate and analyze banks and the banking system. Historical analytical shortcuts with a heavy focus on operating statements and provisioning adjustments to these statements had led to a methodology of approximation that had managed to serve the markets' purposes for several decades. In the post recession environment it became clear to all interested parties that these traditional analytical systems were in no way capable of quantifying the impact of the recession on the sustainability and performance of banks. Thus the concept of stress testing was conceived.

The initial "stress tests" were performed under heroic conditions by regulators but were rudimentary and discrete in terms of their methodology. Given the massive task and intense time pressures facing regulators they successfully completed an extraordinary process. However, as subsequent events have shown, these "one time" exercises have had to be repeated due to the understandable limitations of the initial process. The lack of integration of an established low interest rate policy resulted in the "bailout" institutions generating extraordinary profits followed by the inevitable, bonuses, dividends and repayments that created public furor. The discrete focus on limited and specific economic factors resulted in ignoring the global impact of the recession (Greece etc.) that forced regulators back to the stress testing table. These errors will continue to repeat themselves driven by additional global shocks and a wide range of derivative instruments (especially those tied to commodity products in the energy and agriculture arena) that are not properly understood.

The present-day reaction of global regulators has been to focus on increasing banks' capital bases in an effort to create cushions in lieu of the proper analytical methodology that would allow them to more accurately estimate capital requirements under a wide range of specific economic factors. This approximation is not only constraining to banks that are vital to the global economic recovery but also susceptible to political manipulation by individual countries attempting to maintain their own banks' competitive postures. In some ways, these measures have the potential of creating a vicious cycle that strains bank lending activity, which in turn constrains economic recovery, which in turn weakens the bank's customer base, which in turn damages the bank's asset base and so on and so forth. Greece is a classic example where the austerity measures required for their specific bank bailout will inevitably damage its banks' customer base, further ensuring a more catastrophic failure in the near future.

Learned Conclusions.

- Stress testing cannot be performed in a vacuum. Stress tests must incorporate all relevant environmental factors to be effective.
- Stress testing is only effective and comprehensive when applied directly to the asset base of banks. The use of provisioning calculations is too far removed from the actual performance of bank assets to provide any semblance of accuracy.
- The purpose of stress testing is to create realistic and accurate tier 1 requirements without hamstringing the banking market.
- Stress testing must be consistent from bank to bank and take into consideration their operating geographical footprint.
- Stress testing must accommodate the asset mix and funding sources of the bank's balance sheet

Present-day limitations not necessarily addressed in the bill.

Stress testing methodology is not clearly defined.

Stress testing is alien to the traditional bank strategic planning process. If the process and methodology is not clearly defined, bank management would be hard-pressed to create realistic and accurate stress tests on a consistent basis. The result would be a plethora of so-called "stress tests" that would waste valuable management resources and most importantly enormous amounts of time. An education program and a definition of the specific requirements must be laid out for bank management.

There is no historical data for the verification of bank submitted stress tests.

For stress testing to be effective, there is an inevitable push-pull requirement between banks that submit their stress tests and regulators that need to examine and opine on the adequacy of these tests. Even if all banks applied a consistent methodology, which is highly unlikely under present conditions, regulators would find it impossible to verify, adjust and most importantly sign off on management submitted stress tests.

Presently collected bank data is based on historical analytical methodology. The FDIC call report data does not have all the information necessary for both banks and regulators to properly populate their stress testing models.

Banks operate within discrete geographical foot prints defined by their unique economic and competitive factors. Banks need the data that describes the classification movement of their loans under stress within their region to maintain their internal discipline, and regulators must have this data to properly scrutinize and validate bank projected stress tests.

The fortunate part is that the relevant data does exist within all banks. Unfortunately, it is not presently mapped in a manner to be effectively reported and communicated to a central regulatory data bank.

The One Size Fits All Concept

While the methodologies used to stress assets can and should be somewhat universal, certain differences must be recognized and accommodated. The two most prominent differences include regional differences and type of institution. Regional differences are important with respect to differing local economies, customers, and underwriting standards. This is especially true in implementing stress tests for multi-bank holding companies where the subsidiary banks operate in different geographical environments. For a customized stress test it would be a mistake to assume that all of the subsidiaries would be subject to the same stresses. The type of institution -- commercial bank, thrift, trust bank, agricultural bank, subprime consumer lending bank, and *de novo* -- is also obviously an important element to selecting the right stresses.

The Role of Liabilities

While the concept of liabilities is important on their own it takes on increasing importance as the liabilities provide a support base to post-stress assets. The post-stress condition of the asset portfolio can magnify or minimize the impact of liabilities. Brokered deposits have a substantially greater impact on banks that will exhibit a significant amount of asset stress and reduction of Tier 1 Capital, than on stronger banks. Thus the application of stresses to liabilities can only be done after the assets are stressed. Similarly the cost structure of liabilities and the impact of a changing interest rate environment and yield curve are secondary in effect, and in fact can only be computed, after the assets are stressed.

Conclusion

In conclusion, Invictus would like to express its support to the governmental agencies in implementing a rule structure for bank stress testing. A solid discipline of stress testing will make the banking environment stronger, increase consumer confidence, and allow the senior management of banks to make more informed strategic decisions.

Please feel free to contact us directly if you have any additional comments.

Sincerely,

Kamal Mustafa
Chairman

Leonard J. DeRoma
President