rma
THE RISK MANAGEMENT ASSOCIATION
Serving the Financial Services Industry

1801 Market St. • Suite 300 • Philadelphia, PA 19103-1628 • Telephone 215-446-4000 • Fax 215-446-4101 • www.rmahq.org

July 29, 2011

Via E-Mail: regs.comments@occ.treas.gov
Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
Washington, DC 20219

Via E-Mail: regs.comments@federalreserve.gov
Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Via E-Mail: comments@fdic.gov
Robert E. Feldman, Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

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

Response of The Risk Management Association

## I. Introduction and Overview

The Risk Management Association ("RMA") appreciates this opportunity to respond to the "Proposed Guidance on Stress Testing for Banking Organizations with more than $10 Billion in Total Consolidated Assets, ("proposed Guidance") dated June 7, 2011, which outlines broad principles for a satisfactory stress testing framework and describes how stress testing should be used by banking organizations, including in capital planning. One of RMA's most important components of RMA's mission is to provide independent analysis on matters pertaining to risk and capital regulation. In this regard, the comments contained herein are informed by subject matter experts from RMA's member institutions. RMA has stressed that capital requirements should always, as accurately as possible, reflect the risk associated with bank exposures.

The clearly stated purpose of the proposed Guidance is to emphasize the importance of stress testing as a risk management practice for banking companies, which is consistent with statements that the regulators have made to RMA over the past six months. By applying the proposed Guidance not only to the largest and most complex banks, but, as indicated in the title, also including those companies with assets down to $10 billion, it is also clear that the purpose of the proposed Guidance is to express a very broad set of expectations that apply to banks that vary widely in terms of complexity and risk profiles. As noted in the Supplementary Information portion of the issuance, the proposed Guidance does not address the stress testing requirements imposed under Section 165(i) of the Dodd-Frank Act, which will be implemented in a future rulemaking.

While RMA recognizes that stress testing is important from a regulatory and strategic perspective, including capital planning, RMA is nonetheless concerned that the proposed Guidance may overlap or conflict with the stress testing regulations to be promulgated under the Dodd-Frank Act and is concerned that a dual regulatory scheme may prove unduly burdensome and strain bank resources to the extent of any inconsistencies in the stress testing requirements under the proposed Guidance and those that will be forthcoming under the Dodd-Frank Act. Bank capital levels are just one facet of effective bank risk management, and capital levels alone are not an absolute measure of bank soundness. The other facet is the institution's risk level, which is guided by its enunciated risk appetite. Bank soundness flows from a combination of capital levels and risk levels

II. Comment

RMA agrees with the regulators that stress testing is an important component of any risk management program. In addition, RMA endorses the idea of articulating a clear set of principles to the broad set of banking institutions targeted by this proposed Guidance. The largest 19 institutions have already been the focus of supervisory scrutiny of stress testing frameworks through the Federal Reserve Board's Supervisory Capital Adequacy Assessment Program ("SCAP") and Comprehensive Capital Analysis and Review ("CCAR") program carried out over the last two years. This proposed Guidance provides an opportunity for the regulators to share the good practices observed among the largest institutions more broadly and create consistency across the industry. Especially with a forthcoming rulemaking implementing Dodd-Frank requirements for stress testing, the proposed Guidance could be made much more valuable to banking companies if it made the following things clear:

**What is the significance of the issuance of this proposed Guidance in advance of the future rulemaking that will implement Section 165(i) of the Dodd-Frank Act?** If a Dodd-Frank stress testing rule-making is forthcoming, why is this proposed Guidance being issued at this time?

**How will regulators determine whether the complexity of an institution's stress testing framework is commensurate with the risk of the institution?** The proposed Guidance recommends that a banking company implement a stress testing program that is commensurate with its size, complexity, business activities, and overall risk profile. Larger and more complex institutions are already engaged in dialogue with their regulators about the adequacy of their stress testing programs. The 19 largest banking companies in the U.S. have been subject to the

SCAP and CCAR programs and feedback to those companies under the latter program has included assessment of the adequacy of the stress testing framework.

Banking companies beyond the largest group will be expected to implement a stress testing framework, but for some of them this will be new. It is understood that those institutions that are implementing stress testing frameworks for the first time will not face the same expectations as the largest and most sophisticated banking companies, but more details concerning the range of acceptable practice would be helpful.

**How many stress scenarios are reasonable?** The proposed Guidance is open-ended regarding the number of stress scenarios that banking companies should consider. As a practical matter, computational and data-management considerations limit the number of scenarios that can be run. Parsimony is essential and focus is desirable because of this inherent limitation. Since scenario choice is largely a matter of expert judgment rather than a purely objective exercise, banking companies need guidance from the regulators regarding expectations, minimum requirements and best practice in scenario selection. We note that this issue appeared in the past with the development of consensus on regulatory shocks for interest-rate risk measurement. A similar industry-wide consensus on the minimum set of stress scenarios as seen in for interest-rate risk measurement would be helpful.

**Can the Guidance make it clear that capital and liquidity stress testing are not expected to be evaluated in a unified test?** The proposed Guidance emphasizes that the assessment of capital and liquidity adequacy are among the most important uses of stress testing. The proposed Guidance calls for an evaluation between the interaction between capital and liquidity. While the Group members agree that the interaction between capital and liquidity stress tests is an important consideration, we are concerned that examiners might mistakenly expect banking companies to address both stresses in the same model. Capital is not a mitigant against liquidity risk.

III. Summary

In summary,RMA agrees that stress testing is an important component of a risk management program. In the wake of the crisis and with the passage of the Dodd-Frank Act, we expect much more regulatory attention paid to stress testing. But with forthcoming rulemaking implementing the stress testing requirements, RMA feels that the proposed Guidance could be more useful if it were made clearer in a few respects.

Please feel free to contact Ed DeMarco at 215-446-4052 or via email at edemarco@rmahq.org, Mark Zmiewski at 215-446-4085 or via email at mzmiewski@rmahq.org. or Stacy Germano at 215-446-4089.

Sincerely yours,

Edward J. DeMarco, Jr.
General Counsel & Director of
Regulatory Relations

Mark Zmiewski
Director of Enterprise Risk Management

Stacy Germano,
Associate Director of
Enterprise Risk Management