

April 30, 2012

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Office of the Comptroller of the Currency
250 E Street, SW
Mail Stop 2-3
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Re: Proposed Rules “Annual Stress Test” (RIN 3064-AD91, FDIC-2012-0006; Docket Number OCC-2011-0029 RIN 1557-AD58)

To Whom It May Concern,

The American Bankers Association¹ (ABA) is pleased to submit comments on the Notice of Proposed Rulemakings² (Proposed Rules) published by the Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC) (collectively the Agencies) to implement the company run stress testing requirements of section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act³ (Dodd-Frank Act).

The Proposed Rules will have a significant impact on midsize banks-those generally ranging from \$10 billion to \$50 billion in total consolidated assets (Smaller Banks). For that reason the ABA has formed a stress testing working group of such Smaller Banks (Stress Testing Group)⁴ to consider the proposals, and particularly to evaluate how they will affect their operations. This letter reflects the work of the ABA’s Stress Testing Group. It is offered in addition and complementary to other views on the Proposed Rules submitted by ABA jointly with other financial trade associations.⁵

¹ The American Bankers Association represents banks of all sizes and charters and is the voice for the nation’s \$13 trillion banking industry and its 2 million employees. Learn more at www.aba.com.

² 77 Fed. Reg. 3166 (Jan. 23, 2012) and 77 Fed. Reg. 3408 (Jan. 24, 2012).

³ Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁴ In addition to providing comment on the Proposed Rules, the Stress Testing Group is designed to help institutions from \$10 to \$50 billion meet the regulatory requirement proposed by the FRB, OCC and FDIC.

⁵ In addition, the ABA has submitted a similar letter to the Federal Reserve representing the views of Smaller Banks. However, the letter to the Federal Reserve also discusses issues outside of stress testing such as risk committees.

ABA is supportive of stress testing as a tool for management and the board to understand and manage risk. However, the Proposed Rules do not appear to encourage stress testing for these purposes. If the Proposed Rules are not corrected, regulatory stress testing will merely become a check-the-box exercise that will absorb bank resources and without adding to sound risk management. Consistent with Governor Tarullo's statements,⁶ we urge the Agencies to distinguish Smaller Banks' stress testing requirements from those with total consolidated asset over \$50 billion. To do so, ABA urges the Agencies to adopt a more flexible, tailored, stress testing regime for Smaller Banks. Specifically, ABA urges the Agencies to:

- Clearly communicate expectations commensurate with an institutions size, complexity and familiarity with stress testing for Smaller Banks;
- Extend the implementation date for Smaller Banks so that the first company-run stress tests submitted to the Agencies are in 2014;
- Provide Smaller Banks a floating submission date;
- Allow banks with small geographic footprints to develop their own scenarios;
- Require Smaller Banks to only disclose stress testing methodologies and capital ratios over the planning horizon.
- Coordinate so that similar scenarios, or guidance to develop scenarios, is provided to depository institutions and bank holding companies; and
- Clearly set forth a robust and transparent process for responding to inquiries in a timely manner and begin this process as soon as possible.

The Agencies should clearly communicate regulatory expectations commensurate with an institution's size, complexity and familiarity with stress testing for Smaller Banks.

Under the Proposed Rules, the company-run stress test requirements would be immediately applicable to all banks over \$10 billion. Smaller Banks have varying degrees of familiarity with stress testing and regulatory expectations. Banks with \$50 billion or more in assets 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 Banks have not participated in these processes and are not familiar with the Agencies' expectations. As a result, these institutions do not know how best to comply with the proposed procedures.

⁶ "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>.)

Ideally, stress testing should be a tool for a bank's board and management to understand and manage risk. Unclear standards leave Smaller Banks 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 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 Smaller Banks with the ability to develop stress testing systems incrementally and internally serve banks and regulators best.

For this reason, we urge the Agencies to differentiate between larger and more complex organizations and smaller and less complex organizations. Each bank should develop stress testing programs commensurate with its size, complexity, and familiarity with stress testing. We also urge the Agencies to clearly communicate these tailored expectations to Smaller Banks. These Smaller Banks 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 Agencies to indicate whether banks will be required to submit a common template and, if so, what data items would be included in such templates.

The implementation date for Smaller Banks should be extended.

The effective date of the company-run stress test rule for small should be delayed. These banks are less familiar with stress testing than larger institutions. Smaller 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 Proposed Rules. 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 institutions 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 smaller institutions do not have a sophisticated Internal Capital Adequacy Assessment Process (ICAAP) that larger banks 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, institutions will be severely challenged to deliver a thoughtful product in the time period provided. Consequently, we strongly urge the Agencies to delay the implementation date of the proposed stress testing requirements for Smaller Banks. For these institutions, the first required company-run stress tests should be based on scenarios distributed in 2013 and submitted in 2014.

The Agencies should provide a floating submission date for Smaller Banks.

Under the Proposed Rules, Banks subject to the Agencies' stress testing requirements will receive the stress scenarios in mid-October or November and be required to submit the results of

their company-run stress tests by January 5 of each year.⁷ 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 Agencies to provide for a floating submission date under which a bank must submit its results, using the previous year's stress scenarios, by December 31.⁸ A flexible submission date would allow banks to conduct the stress tests when they have the resources available. Moreover, a floating submission date would allow banks 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 Banks from the stress testing conducted by larger institutions.

Banks with small geographic footprints should be allowed to develop their own scenarios.

Under the Proposed Rules, each bank would be required to conduct an annual stress test using three economic scenarios reflecting baseline, adverse, and severely adverse conditions⁹. 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 bank. We are concerned that the stress scenarios developed by the Agencies will be national scenarios which will not be relevant to banks with small geographic footprints. Stress testing is a tool for a bank'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 Agencies' stress scenarios are not relevant to banks with small geographic footprints, then the Proposed Rules become a costly check-the-box exercise. As a result, we urge the Agencies to provide banks with small geographic foot prints the option to develop their own stress scenarios. Moreover, we urge the Agencies to provide guidance on how a bank should develop its own stress scenarios should it choose not to use the national stress scenarios provided. In addition, to assist Smaller Banks in developing their own scenarios, ABA urges the Agencies to provide reports on regional economic outlooks that highlight issues that could have an impact on financial institutions in a specific region.

Smaller Banks should only be required to disclose stress testing methodologies and capital ratios at the end of the planning horizon.

The Proposed Rules require banks to publish the stress test results within 90 days of its report to the Agencies. The required information publicly disclosed by each bank would, under the FDIC proposal 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

⁸ For example, if the stress scenarios are distributed on November 15, 2013, the banks results must be submitted by December 31, 2014.

⁹ Proposed FDIC Rule 325.203 and Proposed OCC Rule 46.5.

income, and pro forma capital levels and capital ratios (including regulatory and any other capital ratios specified by the Agencies) over the planning horizon, under each scenario.¹⁰

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 Proposed Rules' 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 Proposed Rules. 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 Proposed Rules are unnecessary as financial data is readily available in call and holding company reports which are filed quarterly and in publically available financial statements.

Third, detailed information regarding stress test results could be misinterpreted by the general public. As requested above, Smaller 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 bank, the publication of detailed financial information and, in particular anything less than favorable stress test results, has the potential for 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 is in trouble when the safety and soundness examination could show an exactly opposite condition.

As a result, we urge the Agencies to only require Smaller Banks 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) the capital ratios at the end of the planning horizon. This limited disclosure would satisfy the statutory requirement and limit the reputation risk of the disclosing bank.

¹⁰ Proposed FDIC Rule 325.207(b). Proposed OCC rule has similar disclosure requirements. However, OCC leaves open the possibility of only disclosure at the holding company level.

The Agencies 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 Proposed Rules, bank holding companies with over \$10 billion in assets 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. With respect to depository institutions, the Federal Reserve would supervise company-run stress tests for state member banks, 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.¹¹ 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 Agencies to develop consistent stress test scenarios and, in the case of banks with small geographic foot prints, consistent guidance for Smaller Banks to develop their own scenarios. To assist Smaller Banks in developing their own scenarios, ABA urges the Agencies to provide reports on regional economic outlooks that highlight issues that could have an impact on financial institutions in a specific region.

The Agencies 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. Banks and the Agencies must partake in an ongoing and continuous dialogue as banks build their systems. A bank 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 Banks to implement the Proposed Rules. In order to facilitate consistency between the Agencies and examination staff, we believe the agencies should open a dedicated email address that banks could use to submit questions and receive answers in a timely manner.

Thank you for considering the concerns raised in this letter. We appreciate the opportunity to share our views and would be happy to discuss any of them further at your convenience. Given the rapidly approaching proposed submission dates, clear communication of regulator expectations is extremely important. After the Proposed Rules are finalized, we urge the banking agencies to meet with the ABA's Stress Testing Group to discuss regulatory expectations and best practices.

¹¹ Proposed OCC Stress Test Rules Section 46.3; Proposed FDIC Stress Test Rules Section 225.203.

If you have any questions, please contact Hugh Carney, Senior Counsel, of the ABA at (202) 663-5324 (e-mail: hcarney@aba.com)

Sincerely,

A handwritten signature in black ink that reads "Hugh C. Carney". The signature is written in a cursive style with a large, stylized "H" and "C".

Hugh C. Carney
Senior Counsel II