American Bankers Association
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Via Email

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Re: Proposed Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations with Total Consolidated Assets of More than $10 Billion but Less than $50 Billion; Board Docket No. OP-1461, OCC Docket ID OCC-2013-0013; 78 Federal Register 47217 (August 5, 2013)

To Whom It May Concern:

The American Bankers Association[1] (ABA) is pleased to submit comments on the proposed supervisory guidance[2] (Proposed Guidance) published by the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (The Board), 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 Act[3] (Dodd-Frank Act, or DFA).

The Dodd-Frank Act stress testing requirements will have a significant impact on midsize banks—those generally ranging from $10 billion to $50 billion in total consolidated assets

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 trillion banking industry and its 2 million employees. Learn more at www.aba.com.

[2] 78 Fed. Reg. 47217 (Aug. 5, 2013).

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

(Midsize Banks). For that reason ABA formed a working group of such Midsize Banks (Stress Testing Group) to consider stress testing issues, and particularly to evaluate how the new rules will affect their operations. This letter reflects the work of ABA's Stress Testing Group.

ABA supports stress testing as a tool for management and the board to understand and manage risk. The final rules implementing section 165 of the Dodd-Frank Act have created a flexible stress testing regime for Midsize Banks that will allow banks to tailor their stress tests to their operations to understand their risks better. ABA supports the tailored approached to midsize stress testing that the Agencies have pursued within the statutory confines of the Dodd-Frank Act.

ABA appreciates the steps the Agencies took to engage Midsize Banks before proposing the guidance. Midsize Banks have varying degrees of familiarity with stress testing and related regulatory expectations. These banks have not participated in one or more of the Supervisory Capital Assessment Program (SCAP), Comprehensive Capital Analysis and Review (CCAR), or Capital Plan Review (CapPR) processes. ABA believes that the reviews of Midsize Banks conducted by the Agencies to learn about their practices as well as the various ways the Agencies communicated regulatory expectations were helpful and useful.

The Proposed Guidance maintains the flexible approach taken by the Agencies to date and helps clarify expectations further. We note that, as the Agencies begin implementing any final guidance, they must clearly set regulatory expectations for individual banks commensurate with an institution's size, complexity, and familiarity with stress testing. Unclear standards leave Midsize Banks concerned that they must meet the most complex standards. To do so quickly, they will rely on outside vendors at great cost to guarantee compliance which will preclude development of the appropriate foundations for stress testing systems. Instead, Midsize 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 Midsize 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 continue 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 communicate clearly these tailored expectations to Midsize Banks and to the examination staff at the Agencies charged with review of stress tests. Midsize Banks need to understand which regulatory expectations are going to be applied in order to build appropriate systems.

In addition, to assist Midsize Banks in their first submission, we urge the Agencies to make the clarifications and take the actions listed below.

The Agencies should provide greater clarity on the model validation process of third party vendors.

Midsize Banks are dedicating significant resources to comply with stress testing requirements. Most Midsize Banks are working with third parties to develop models and systems incrementally as they approach their first submission date. Because systems are still in development, the model validation requirements in the proposed guidance appear overly burdensome. The Agencies should provide clarity about what exactly is expected from the validation process. In particular, we urge the Agencies to clarify that models do not need to be validated before stress testing results are submitted.

We also note that, with the limited resources available to Midsize Banks, it is extremely burdensome to require independent parties to validate every banks third-party models, especially when ABA expects Midsize Banks to rely on roughly a half-dozen service providers to develop their models. ABA would like to work with the Agencies to identify ways to prevent repetitive model validation.

The Agencies should review third party service providers or provide regional variables.

Under the final stress testing rules, each Midsize Bank is required to conduct an annual stress test using three economic scenarios reflecting baseline, adverse, and severely adverse conditions. While stress testing may require the review of scenarios we believe it is important that the events be relevant to the bank. In order to make the stress tests a useful exercise it is reasonable for the Agencies to expect Midsize Banks to "translate" the national macroeconomic scenarios into their regional foot prints. However, many midsize banks do not have the expertise to translate the macro variables. As a result, we anticipate pervasive use of third-parties as part of the translation process.

The Proposed Guidance requires Midsize Banks that engage third-parties to understand fully the methods and assumptions used to develop their variables. This type of validation would be difficult, and possibly cost prohibitive, for many Midsize Banks. As a result, we urge the banking agencies to evaluate third-party data providers and develop for banks a list of acceptable vendors who can assist in translating the macro economic scenarios. Alternatively, to assist Midsize Banks in translating the macro 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. Regional Federal Reserve Banks, for example, regularly monitor and compile reports on their local economies.

The Agencies should clearly state that they do not favor a bottom-up approach for Midsize Bank stress testing.

To date, our dialog with the Agencies has indicated that they have no preference for either a top-down (portfolio level) or bottom-up (loan level) approach to stress testing. However, the Proposed Guidance requires institutions to have an allowance in accordance with GAAP at the end of the 9-quarter planning horizon. To determine an allowance in accordance with GAAP, banks would need to review many loans individually as is done in their ALLL methodology used in reporting in the Call Report. Effectively this would require a bank to adopt a bottom-up stress testing regime. We strongly encourage the Agencies to permit general allowance projections by removing the reference to GAAP.

The Agencies should clarify when simpler approaches are acceptable.

The Proposed Guidance permits use of a constant portfolio assumption for certain projections. Any final guidance should articulate in what circumstances it may be appropriate to assume a constant portfolio.

The Agencies should help set board expectations through their education programs.

A company's board of directors is ultimately responsible for the company's DFA stress tests. Board members must receive summary information about DFA stress tests, including results from each scenario. The board or its designee should actively evaluate and discuss this information, ensuring that the DFA stress tests appropriately reflect the company's risk appetite, overall strategy and business plans, overall stress testing practices, and contingency plans, directing changes where appropriate. The Agencies have numerous training programs and materials to help educate board members about their general responsibilities. We urge the agencies to amend their education programs to include the board's stress testing obligations.

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 engage in an ongoing and continuous dialogue as banks build their systems. A bank should never first learn of an issue only after submitting its report. As a result, we ask that experienced examiners offer instruction, assistance, and feedback to facilitate the good faith efforts of Midsize Banks. In order to facilitate consistency between the Agencies and examination staff, we ask the Agencies to 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 guidance is finalized we would invite the Agencies to meet with ABA's Stress Testing Group to discuss regulatory expectations and best practices.

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

Sincerely,

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