

December 9, 2016

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
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Subject: Company-Run Annual Stress Test Reporting Template and Documentation for Covered Institutions with Total Consolidated Assets of \$50 Billion or More Under Dodd-Frank Wall Street Reform and Consumer Protection Act

This letter is in response to the Office of the Comptroller of the Currency's (OCC) request for comment on the agency's proposal to revise information collection requirements. Comments must be received by January 17, 2017.

The OCC invites comments on the whether the collection of the proposed information is necessary for the proper performance of the OCC and whether the information has practical utility. I will provide four comments on why parts of the proposal are unnecessary and lack practical utility.

NO PRACTICAL UTILITY

1. *The requirement for submitting bank-specific baseline and stress scenarios that are duplicate of the bank holding company-specific scenarios submitted to the Federal Reserve under the Comprehensive Capital Analysis & Review (CCAR) is unnecessary and has no practical utility.*

A bank that is a subsidiary of a bank holding company (BHC) will represent either 95% to 99% of that BHC, or it will represent a much smaller fraction of the BHC (say, less than 50%). If a bank represents 98% of a BHC, then the financial results submitted in CCAR effectively represent both the BHC and the subsidiary bank. For example, if the BHC-specific stress scenario results estimate credit losses of \$15 billion over the nine-quarter horizon, then the subsidiary bank's estimated loss over that horizon is no more than \$15 billion, and possibly less (unless the OCC believes that the 2% of the BHC that is outside of the Bank can significantly offset losses in the bank).

Thus, by reviewing CCAR results, the OCC knows the worst-case scenario for a bank by reviewing the BHC-specific scenario. The OCC can easily estimate of the bank's loss under that scenario by considering the size of the bank relative to its parent BHC (e.g., if a bank represents 98% of its BHC, then the bank's loss is somewhere between approximately \$14.7 billion (0.98×15 billion) and \$15 billion – unless the OCC believes the 2% that is outside the bank is hugely countercyclical).

Submitting a Xerox-copy of the BHC-specific scenario is duplicative, unnecessary, and highly inconsistent with the Paperwork Reduction Act. If a bank represents 98% of a BHC, why does the OCC need a more granular estimate than \$14.7 to \$15 billion? The \$15 billion estimate should be good enough for the OCC to assess safety and soundness and meet the spirit and intent of Section 165(i)(2) of the Dodd-Frank Act. If a BHC stresses its *consolidated* risk profile, then there is no reason for the subsidiary bank to duplicate that unless the OCC and Federal Reserve do not share information.

Second example: If a subsidiary bank represents less than 50% of its BHC, then the bank's risk profile may be very different from that of its parent. For example, a bank may have a *significant* foreign exchange and currency derivative portfolio and its BHC may not. In this case, the risk profiles of the two legal entities are different. So, why would the OCC require the bank-specific scenario to be 100% consistent with the BHC-specific scenario?

2. The OCC should remove (delete) the operational risk stress-testing component from the annual stress test.

On March 4, 2016, the Basel Committee announced that it is replacing the Advanced Measurement Approach (AMA) with a simpler standard measurement approach for operational risk. Their announcement reads:

"The Committee believes that modeling of operational risk for regulatory capital purposes is unduly complex and that the AMA has resulted in excessive variability in risk-weighted assets ..."

The essence of the message from the Basel Committee is that operational risk cannot be modeled. If that is the case, the OCC should not require banks model operational losses under specific and deterministic Adverse and Severely Adverse scenarios.

3. If the OCC does not remove (delete) the operational risk component from the annual stress test, then the OCC should at least revise its instructions on page 72 to read:

"Operational losses under the Adverse and Severely Adverse scenarios must be those losses that are **expected** to occur under the Adverse and Severely Adverse scenarios during the nine-quarter planning horizon. Banks should **not overlay or add-on** operational losses that result from idiosyncratic or low probability events that are **unrelated** to the Adverse and Severely Adverse scenarios being modeled."

Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act following the worst recession since the Great Depression. This Great Recession caused eight million people to lose their jobs, and tens of millions of people saw the value of their homes and retirement savings plummet.¹ In response to this *adverse economic event*, Congress passed the Dodd-Frank Act to address weaknesses in the financial system so that the system can better withstand *adverse economic events*.

Section §165(i) of the Dodd-Frank Act is titled "Stress Tests". Subsections §165(i)(1)(A) instructs the Federal Reserve to conduct an annual test on banks with \$50 billion or more in total assets to determine "whether companies have the capital on a total consolidated basis, necessary to absorb losses as a result of *adverse economic conditions*." All other financial companies that are over \$10 billion in total assets and regulated by a federal financial regulator must conduct an annual stress test. The plain text of the law makes it clear that the stress test must evaluate the impact of adverse economic conditions that may affect financial companies (plural). Stress tests under §165(i) are not intended to capture the impact of idiosyncratic operational phenomena that are unrelated to adverse economic conditions or unique to one company and not threatening to financial stability.²

¹ Please see: <https://www.whitehouse.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act>

² Operational risks cover an almost endless array of different hazards, mishaps and events from various causes. For example: computer programming errors, terrorism, fire, cyber attacks, tsunamis, failure of a vendor, embezzlement, litigation, aging population, organizational change, power outage, human error, armed robbery, etc.

Please note that Section §165 of the Act, which addresses enhanced supervision and stress testing, discusses the risk of “credit exposure”; this section of the law does not even mention “operational risk”.

4. The OCC should remove (delete) the Material Risk Identification worksheet and the Operational Risk Scenarios worksheet from the DFAST-14A OpsRisk Schedule. These worksheets are burdensome and unnecessary.

The OCC should evaluate the bank’s material operational risks and custom-tailored operational risk scenarios during its annual, full-scope, on-site examination required by 12 CFR §4.6(a). The OCC should not review this as part of the annual Dodd-Frank Act Stress Test and then review it a second time during the annual, full-scope, on-site examination. That is unnecessarily burdensome and duplicative.

Moreover, having a bank list all of its idiosyncratic, material operational risks as part of the stress test and then crudely estimate losses for each under varying, custom-tailored scenarios is beyond the intent of the Dodd-Frank Act Stress Test. Everyone knows that the 23 individual banks will list material operational risks that will differ and not be directly comparable (illustration below). For example, each bank will think up different hazards, events and phenomena and make estimates using different assumptions, beliefs, and levels of probability and conservatism. The end result is a mixed bag of guesses. Some banks may be very conservative and apocalyptic, while others will mimic Pollyanna. In the final analysis, it is impossible for such an *unstructured* exercise to provide meaningful comparisons across banks and be highly valuable for ensuring the safety and soundness of the banking system.

ILLUSTRATION

Large Bank #1 (\$295B)		Large Bank #2 (\$276B)	
Material Risk	Projected Loss	Material Risk	Projected Loss
Cyber Attack	\$75M	Change Management	\$2.2B
Earthquake	\$40M	Rogue Trader	\$1.5B
Fraud	\$17M	Power Outage	\$1.0B
Model Risk	\$15M	Litigation	\$300M
Aging Population	\$12M	Failure of a Vendor	\$100M

Why don’t the two large banks list the same material operational risks? Does the first bank really not have much litigation risk and the second bank not have much cyber risk? Why the large difference in dollar impacts? Are both banks considering the same level of probability and severity in their risk assessment? If not, how is this useful to regulators?

ACTION ITEMS: In its 30-day notice, the OCC should discuss in full:

- Why the OCC cannot leverage off of the BHC-specific scenarios (CCAR results) when the subsidiary bank represents 95% or more of the consolidated BHC.
- Why it is important for the bank-specific stress scenario to be 100% consistent with that of the BHC-specific stress scenario. This should include a discussion of why the OCC is not interested in banks submitting stress scenarios that capture the bank’s unique vulnerabilities.
- Whether the OCC and Federal Reserve will draw the same conclusion on the adequacy of the singular BHC/Bank stress scenario.
- Why it is important for banks, at their option, to include the impact of low-probability, high severity operational risks that are *unrelated* to the Adverse and Severely Adverse scenarios.

- e. Why the OCC needs to capture material operational risks in the Dodd-Frank Act Stress test and not in its full-scope, on-site examination required by 12 CFR §4.6(a). If such operational risks need to be examined twice a year, please explain the rationale.
- f. Why it is acceptable for banks to use different operational risk scenarios, assumptions, and levels of severity and probability when submitting stress test results on operational risk.

I look forward to reading these explanations in the 30-day notice.

PLEASE CONSIDER ALL PUBLIC COMMENTS

The OCC improves the quality, utility and clarity of information when it attentively responds to all significant public comments before finalizing rules.

Presidential Executive Order 13563 (January 18, 2011) sets forth the general principles of regulation. Section 2 of the Order requires regulations to be adopted through a process involving public participation. To that end, regulations are to be based, to the extent feasible, on the open exchange of information and perspectives among affected stakeholders and the public. Federal agencies are to base their reasoning and conclusions on the rulemaking record, consistent of the comments, scientific data, expert opinions, and facts accumulated during the pre-rule and proposed rule stages.³

If the OCC and American people are to benefit from a process of public comments, it is important for the public to know whether the OCC considered all comments, and if the views or evidence presented was accepted or rejected by the agency. When the OCC leaves unclear whether it considered comments, the public record is incomplete and the OCC creates the perception that it makes final decisions on rules without considering the data, views, and arguments of others.

I appreciate the opportunity to comment on the OCC's proposal. I wish the agency the best of luck.

Sincerely,

Sandra A. Holly
Hyattsville, MD

³ If the rulemaking record contains persuasive new data or policy arguments, or contains difficult questions, there is a presumption that the agency will amend aspects of the rule to reflect these new issues, or terminate the rulemaking.