MID-SIZE BANK COALITION OF AMERICA

April 30, 2012

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: Annual Stress Test
FDIC RIN 3064-AD91

Ladies and Gentlemen:

On behalf of the Midsize Bank Coalition of America ("MBCA"), I am writing to provide the MBCA's comments on the above-referenced notice of proposed rulemaking ("Proposal") published by the Federal Deposit Insurance Corporation ("FDIC" or "Corporation") on January 23, 2012.[1]

By way of background, the MBCA is a non-partisan financial and economic policy organization comprising the CEOs of mid-size banks doing business in the United States. Founded in 2010, the MBCA, now with 28 members, was formed for the purpose of providing the perspectives of mid-size banks on financial regulatory reform to regulators and legislators. As a group, the MBCA banks do business through more than 3,800 branches in 41 states, Washington D.C. and three U.S. territories. The MBCA's members' combined assets exceed $450 billion (ranging in size from $7 to $30 billion) and, together, its members employ approximately 77,000 people. Member institutions hold nearly $336 billion in deposits and total loans of more than $260 billion.

The Proposal would implement the company-conducted stress test requirement of Section 165(i)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") for FDIC-insured state nonmember banks and FDIC-insured state-chartered savings associations with

[1] *Annual Stress Test*, 77 FR 3166 (Jan. 23, 2012).

555 South Flower Street, 12th Floor | Los Angeles | California | 90071
phone: (310) 888-6080

total consolidated assets of more than $10 billion (“covered institutions”).[2] As the Corporation stated in the Proposal, the annual stress test requirement is meant to facilitate supervisory assessments of an institution’s capital adequacy in light of downside risks, and to help the institution improve its own internal assessments of capital adequacy and overall capital planning. In brief, under the Proposal, a covered institution would be required to conduct an annual stress test using its financial data as of September 30th of that year to assess the potential impact on its capital of at least three different economic scenarios, reflecting baseline, adverse, and severely adverse conditions, over a forward-looking, nine-quarter planning horizon. The Proposal would also require a covered institution to submit a report of the stress test results by January 5 to the FDIC and the Board of Governors of the Federal Reserve System (“Board” or “FRB”). Furthermore, the Proposal would require a covered institution to publish a summary of its annual stress test results within 90 days of submitting its report to the FDIC and the Board.

The MBCA supports the FDIC’s efforts to implement the annual stress test requirement of the Dodd-Frank Act. However, for the reasons set forth below, we have significant concerns with the public disclosures that would be required under the Proposal. We also offer some suggestions on stress test scenarios and the timing of the annual test, commend the FDIC’s commitment to coordinate with other federal banking agencies to issue consistent and comparable regulations, and urge the FDIC to pursue an integrated rulemaking to address all aspects of the annual stress test requirement.

I. Public Disclosures.

Under the proposed rules, a covered institution would have to publish a summary of the results of its annual stress test, including a description of the types of risks included in the stress test, and a general description of the methodologies used to estimate losses, pre-provision net revenue, loss reserves, and changes in capital positions. In addition, the rules would require a covered institution to publish the aggregate losses, pre-provision net revenue, loss reserves, net income, pro forma capital levels and pro forma capital ratios that would result under each scenario for each of the nine quarters of the planning horizon (the “qualitative and quantitative data”). Similar public disclosure requirements are being proposed by the Office of the Comptroller of the Currency (“OCC”) and the Board.[3]

---

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

[3] Proposed FRB Rule 252.148; *Enhanced Prudential Standards for Early Remediation Requirements for Covered Companies,* 77 FR 594 (Jan. 5, 2012); Proposed OCC Rule 46.8; *Annual Stress Test,* 77 FR 3408 (Jan. 24, 2012);.

Publication of the qualitative and quantitative details of stress test results could adversely impact our members. Even assuming a passing grade, and notwithstanding the hypothetical nature of stress tests, any perceived weakness can have a ripple effect in the markets, and may cause the customers, counterparties and investors of a smaller institution to flee for safety (including to the perceived safety of a "too big to fail" institution). In this fashion, publication of detailed stress test data would subvert the Dodd-Frank Act's overall goal of fostering market stability.

The MBCA is particularly concerned that customers and investors would compare the financial projections that different institutions publish as required by the Proposal, even though the practices underlying the projections are vastly different. For example, the amount of an institution's loan loss reserves, which reduces net income, is subject to the judgment of management.[4] Therefore, two institutions that have loan portfolios with nearly identical risk profiles may project different rates of default and loss. Even though an institution's allowance for loan loss as reflected in its Call Report is also subject to management judgment, the subjectivity required is compounded for projections over a planning horizon as long as nine quarters.

In addition, the publication of net income, aggregate losses, pre-provision net revenue, capital level projections and related data for each quarter over a nine-quarter period would significantly increase litigation risk for a covered institution. Under the securities laws, when an issuer of securities publicly provides estimates of projected earnings or similar data, it can face litigation for alleged fraudulent or misleading statements on the basis of the projections or misinterpretations of them. Moreover, when a public projection is made, the issuer may have a duty to monitor and update the projection in light of intervening events.[5] Many publicly-held companies have ceased to provide earnings guidance in order to mitigate the risk of this type of liability. However, the detailed disclosures that would be required under the Proposal would effectively defeat this risk mitigation strategy.

In light of these potential consequences, we are troubled by the Proposal's lack of discussion as to how publishing this type of detailed data (*e.g.*, hypothetical projected aggregate losses over nine quarters) may contribute to a weakening of middle-tier banks. Indeed, the Proposal does not attempt to weigh the potential negative consequences against any identified benefits. Rather, the Proposal merely consigns the issue to a few questions for

[4] *See generally* Interagency Policy Statement on the Allowance for Loan and Lease Losses (Dec. 13, 2006).

[5] *See Ill. State Bd. of Inv. v. Authentidate Holding Corp.*, 369 Fed. Appx. 260, 263 (2d Cir. 2010).

commenters.[6] Surely the FDIC, OCC and the Board must have some data or economic analysis that would enlighten the discussion. In this regard, we urge the Corporation to analyze (a) how the cost of capital may increase for banks of our sizes relative to larger banks, banks that are not subject to the proposed rules, and branches of foreign banks; (b) how customers and counterparties would react, and (c) how the volatility of markets for short-term debt, stocks, bonds, credit default swaps and other instruments may increase after the publication of the qualitative and quantitative data called for by the proposed rules. For these purposes, we believe that a review of market reactions to publication of CCAR data may provide some insight.[7] We also urge the FDIC to conduct a legal analysis of how the public disclosure of the quantitative and qualitative data may implicate liabilities under the securities laws.

In any event, we note that publication of this level of detail is unnecessary to implement the Dodd-Frank Act's requirement that FDIC regulations require covered institutions to "publish a summary of the results of the required stress tests." In light of this straightforward directive and the purpose of stress testing – to verify capital strength – we believe that the Act's mandate would be fulfilled by requiring a covered institution to publish a description of the types of risks included in the stress test and a statement as to whether the institution meets the requirements for being "well capitalized" or "adequately capitalized" under each stress test scenario for each quarter over the planning horizon. We believe that such a summary, without specific numeric projections, is consistent with the purposes of the public disclosure requirement. As the FDIC recognizes in the Proposal, the annual stress test requirement of section 165(i)(2) of the Dodd-Frank Act is intended to enhance prudential

---

[6] 77 FR at 3169. Indeed, the Proposal has no cost-benefit analysis. The Proposal states it would not trigger the Regulatory Flexibility Act's ("RFA's") requirement for a cost-benefit analysis because it would not have a significant impact on a substantial number of small entities (firms with $175 million or less in assets). Yet, it would have a significant impact on many smaller entities that are customers and counterparties of mid-size banks. Smaller entities may incur higher costs when transacting with a covered institution that must recover higher compliance costs, or if they change providers in reaction to stress test results. The RFA applies not only where a rule directly applies to an entity, but where the rule "directly affects" it. *See Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011); *Aeronautical Repair Station Assoc., Inc. v. FAA*, 494 F.3d 161 (D.C. Cir. 2007). The FDIC must also perform a cost-benefit analysis under the Small Business Regulatory Enforcement Fairness Act of 1996 and Executive Order 13579, which directs agencies to consider costs and benefits before decisions. 76 FR 41587 (Jul. 14, 2011). Agencies may not simply request comment on effects, but must affirmatively reach, and provide evidence for, conclusions on the economic impact of a new rule. *Business Roundtable*, 647 F.3d at 1148.

[7] Nonetheless, we note that CCAR data is only a few weeks old, and it may take further time for markets to fully react to its publication. In addition, market reactions to publication of the quantitative and qualitative data for mid-size banks would be different from CCAR data due to differences in size and lines of business.

supervision and maintain financial stability. Accordingly, it should be implemented in a way that contributes to safety and soundness.[8]

Finally, we suggest that the FDIC delay publication of any data for at least the first two annual stress tests. As noted, the results of an institution's stress test depend, to a great extent, on its stress test methodologies and practices. The supervisory agencies need time to review the differing stress test methodologies and practices of the institutions in order to assess how such differences impact stress test results. They should then adjust the public disclosure requirement to help achieve an appropriate level of consistency in the disclosures.

II. Stress Test Scenarios.

The MBCA suggests that the FDIC permit, but not require, a covered institution to develop and use its own scenarios for the annual stress test to supplement the scenarios provided by the FDIC. An institution may wish to develop its own scenarios to capture economic conditions that are particularly likely to impact the institution's business operations, given the institution's client base and offering of products and services. If an institution takes this initiative, the annual stress test will become a more effective risk management tool, and it will better achieve the purpose of helping the institution improve internal assessments of capital adequacy and overall capital planning. Therefore, the FDIC's regulations should encourage this practice.

The MBCA further suggests that the FDIC provide technical assistance in the form of samples of scenarios analysis to demonstrate how a covered institution should translate the macroeconomic conditions in an economic scenario into performance indicators such as default rates. Without such technical assistance, smaller institutions with limited resources would find it necessary to incur substantial costs to engage consultants for the annual stress test. The FDIC should not turn these samples into mandatory guidelines, however, and an institution should be allowed to conduct its own analysis to take into account its unique client base and offering of products and services.

III. Timing of the Annual Stress Test.

The MBCA suggests that the "as of" date for financial data used in the annual stress test should be December 31, with corresponding adjustments to the regulatory reporting date and public disclosure date. The MBCA further suggests that the FDIC should provide the stress test scenarios at the beginning

---

[8] At a minimum, the FDIC should allow a covered institution to exclude the projections for the proximate quarters and the projections under the baseline scenario from the summary that it publishes. These projections would be particularly susceptible of being misconstrued as earnings guidance. The MBCA further urges the FDIC to allow a covered institution to exclude any information that would reveal the institution's business plan.

of the month in which the “as of” date falls, so that there would be approximately four months between the availability date of the stress test scenarios and the regulatory reporting date.

One of the purposes of the annual stress test is to help institutions improve their capital planning, and using the full-year financial data should be more beneficial from a planning perspective. December and January is the busiest time of year for many institutions as they close their books for the year and prepare for the financial statements audit. Holiday scheduling would also make this time of year a difficult one for conducting a new labor-intensive task. Using a September 30 “as of” date, and correspondingly, a January 5 reporting date, would limit the staff and resources that an institution is able to devote to the stress test and thus have an adverse effect on its quality. We believe that, in the event that a December 31 “as of” date is not adopted, either March 31 (with a reporting date of July 5) or June 30 (with a reporting date of October 5) would be less burdensome than September 30.

Further, we suggest that the planning horizon should be the next two calendar years, with financial projections required for each year. Forecasting the balance sheet, income statement, and regulatory capital ratios for each of the next nine quarters would impose an undue burden on institutions. Projections for each of the next two years should be sufficient for monitoring capital adequacy and facilitating capital planning.

In addition, the MBCA suggests that the FDIC introduce the annual stress test requirement on a rolling basis according to asset size. Specifically, the FDIC could first impose the requirement on institutions with more than $30 billion in total consolidated assets. The initial stage of implementation would allow the FDIC to analyze the diversity of stress test methodologies and practices used by different institutions, and study the impact of any public disclosures on institutions and financial stability. The FDIC could then use the experience gained to refine the regulations and provide additional guidance to smaller institutions. Given their limited resources, smaller institutions are particularly vulnerable to unintended consequences of the Proposal. To protect their financial soundness, it is important that they conduct the annual stress test under regulations that have been tested on larger institutions. Furthermore, unlike large institutions, community banks have not participated in the stress tests conducted by the Board and thus have not benefited from that experience, particularly the knowledge of supervisory expectations gained during the stress tests. Although community banks have employed stress tests as a risk management tool, they require a period of time to build any new necessary systems, to refine processes and procedures, and to augment staff and other resources. It is appropriate to delay the application of the annual stress test requirement to them for at least one year.

IV. Coordination Among Agencies.

The MBCA commends the FDIC's commitment to coordinate with the FRB and the OCC in implementing the annual stress test requirements. The MBCA urges the agencies to work together to issue "consistent and comparable" regulations, as the Dodd-Frank Act requires, and to coordinate their supervision of annual stress tests. If the federal banking agencies were to require different stress test scenarios, methodologies, or practices, the stress test results of different institutions would not be comparable at all. Yet they would nevertheless be compared, causing confusion among investors and the general public and penalizing institutions subject to more stringent requirements. In addition, if an institution and its holding company were subject to inconsistent stress testing requirements, each entity would have to run a parallel stress test to meet the different requirements, wasting resources and producing potentially conflicting results.

The MBCA urges the federal banking agencies to consider issuing a joint rule to implement the annual stress test requirement, or at a minimum, to assure meaningful consultation and resolve any differences before each agency issues its own implementing regulations. Furthermore, the MBCA urges the agencies to coordinate their supervision of the annual stress test by developing interagency reporting forms, formulating joint stress test scenarios, and providing consistent guidance on methodologies and practices.

V. Integrated Rulemaking.

The FDIC noted in the Proposal that the exact form and content of the report of the stress test results would be the subject of a separate future proposal. The Corporation did not set forth in the Proposal specific guidance and procedures for scenario development. Nor did it address how it would exercise its reservation of authority to provide exemptions or impose more stringent stress testing requirements.

Regulatory reporting is a key aspect of the stress test requirement, and institutions should understand the specific reporting requirement so that they may provide informed comment on the reporting requirements. The development of scenarios is central to the annual stress test, as it defines the underlying assumptions of the stress test. How the FDIC exercises its reservation of authority will have a substantial impact on covered institutions. All these topics are integral to the FDIC's regulations to implement the annual stress test requirement, and the MBCA urges the FDIC to address all aspects of the annual stress test requirement in one integrated rulemaking.

555 South Flower Street, 12th Floor | Los Angeles | California | 90071
phone: (310) 888-6080

VI. Conclusion.

The MBCA supports the FDIC's efforts to implement the annual stress test requirement of the Dodd-Frank Act, particularly its commitment to coordinate with other federal banking agencies to issue consistent and comparable regulations. We appreciate the opportunity to express our concerns and suggestions. We look forward to discussing these matters with you in the future.

Yours Truly,

Russell Goldsmith
Chairman, Midsize Bank Coalition of America
Chairman and CEO, City National Bank

cc: Mr. Jack Barnes, People's United Bank
Mr. Greg Becker, Silicon Valley Bank
Mr. Daryl Byrd, IBERIABANK
Mr. Carl Chaney, Hancock Bank
Mr. William Cooper, TCF Financial Corp.
Mr. Raymond Davis, Umpqua Bank
Mr. Dick Evans, Frost National Bank
Mr. Mitch Feiger, MB Financial, Inc.
Mr. Philip Flynn, Associated Bank
Mr. Paul Greig, FirstMerit Corp.
Mr. John Hairston, Hancock Bank
Mr. Robert Harrison, First Hawaiian Bank
Mr. Peter Ho, Bank of Hawaii
Mr. John Hope, Whitney Holding Corp.
Mr. Gerard Host, Trustmark Corp.
Mr. John Ikard, FirstBank Holding Company
Mr. Bob Jones, Old National
Mr. Bryan Jordan, First Horizon National Corp.
Mr. David Kemper, Commerce Bancshares, Inc.
Mr. Mariner Kemper, UMB Financial Corp.
Mr. Gerald Lipkin, Valley National Bank
Mr. Stanley Lybarger, BOK Financial
Mr. Dominic Ng, East West Bank
Mr. Joseph Otting, One West Bank

555 South Flower Street, 12th Floor | Los Angeles | California | 90071
phone: (310) 888-6080

Mr. Steven Raney, Raymond James Bank
Mr. William Reuter, Susquehanna Bank
Mr. Larry Richman, The PrivateBank
Mr. James Smith, Webster Bank
Mr. Scott Smith, Fulton Financial Corp.
Mr. Michael Cahill, Esq., City National Bank
Mr. Brent Tjarks, City National Bank

Mr. Drew Cantor, Peck, Madigan, Jones & Stewart, Inc.
Mr. Jeffrey Peck, Esq., Peck, Madigan, Jones & Stewart, Inc.
Mr. Richard Alexander, Esq., Arnold & Porter LLP
Mr. Andrew Shipe, Esq., Arnold & Porter LLP