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REGIONS

August 11, 2014

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Robert deV. Frierson
Secretary of the Board
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

RE: Proposed Rulemaking: Amendments to the Capital Plan and Stress Test Rules
Docket No. 1492 and RIN No. 7100-AE 20
Response to the Federal Reserve's Request for Comments

Dear Mr. Frierson:

Regions Financial Corporation ("Regions") is a large bank holding company (BHC).[1] Regions conducts its banking operations through Regions Bank.

Regions appreciates that the Federal Reserve Board ("Federal Reserve") used its experience and that of the industry to further refine and clarify its regulations concerning capital planning and stress testing that are set out in its proposed rulemaking entitled "Amendments to the Capital Plan and Stress Test Rules" dated July 1, 2014 ("Proposed Rule").

Regions believes that many aspects of the Proposed Rule will have practical salutatory effects on the ability of covered banks to conduct their capital planning and stress testing, especially those addressing the shift of the start date of the capital plan and stress test cycles by three months to have them begin in the calendar year.

[1] Regions Financial Corporation (NYSE:RF), with $118 billion in assets, is a member of the S&P 500 Index and is one of the nation's largest full-service providers of consumer and commercial banking, wealth management, mortgage, and insurance products and services. Regions serves customers in 16 states across the South, Midwest and Texas, and through its subsidiary, Regions Bank, operates approximately 1,700 banking offices and 2,000 ATMs. Additional information about Regions and its full line of products and services can be found at www.regions.com.

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Regions, however, is concerned with some comments by the Federal Reserve and a change in the Proposed Rule which appear to swerve from the otherwise realistic, practical approach taken by the Federal Reserve with respect to capital planning and stress testing. These changes in approach will have negative, unintended consequences that will hinder the purposes of the Dodd-Frank Wall Street Reform Act and its implementing regulations and may harm the covered banks in their planning processes and operations. These changes are (1) a rigid quarter-by-quarter adherence to planned capital issuances, (2) some incorrect assumptions by the Federal Reserve arising from BHCs' inability to forecast with precision capital actions in the final three quarters of the nine quarter planning cycle and their attempt to account for such impression, and (3) a requirement that the idiosyncratic BHC stress scenario be at least as severe as the Federal Reserve's severely adverse scenario.

1. Quarter-By-Quarter Restriction on Capital Distributions and Issuances

The Proposed Plan would create a new restriction on a BHC's ability to make capital distributions and require that its actual capital distributions in a given quarter not exceed its planned net capital distributions for that quarter. The Federal Reserve explains in its preamble that this proposed new rule is intended to address an observed behavior of some large BHCs who fail to issue capital instruments that were included in their approved capital plans.[2] The new proposed rule is intended (1) to prevent banks from treating the planning process as a regulatory exercise rather than a realistic and credible projection of the bank's capital requirements, (2) to allow the Federal Reserve to assess properly a bank's capital adequacy and planning process, and (3) to ensure that a bank will have future adequate capital for its operations.

However, Regions does not believe that the proposed quarter-by-quarter rule will achieve the Federal Reserve's intended purposes and indeed, for the most part, will have the opposite effect. The inherent problem with the Federal Reserve approach is that it is too mechanistic, is too rigid in its quarterly boundaries on capital actions, and does not reflect the reality of the planning process, even the best planning processes, or the reality of the marketplace.

Capital planning, like most planning dependent on future market conditions, is inherently imprecise and requires, if it is truly to be effective, flexibility in its execution. The proposed rule assumes a precision in the planning process that is not achievable and would encourage a thoughtless adherence to capital plans. The dissonance of the reality of capital and other financial planning and market conditions with the requirement of quarterly execution of capital actions irrespective of actual market conditions inevitably

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[2] 79 Fed. Reg. at 37425 and 37426.

would make capital planning more, not less, an exercise of fulfilling regulatory requirements rather than the achieving the laudable goal of increased transparency and robustness of capital planning.

The most obvious example of the increased economic risk caused by the rigid quarterly requirement of the proposed rule is where a bank's capital plan has for a given quarter a capital distribution, such as the declaration of common and preferred stock dividends, and a capital issuance of additional preferred stock. However, when the quarter arrives, the preferred market is weak, for example, due to volatility in the U.S. Treasury market. The bank would be then placed in the untenable and unnecessary position of, rather than waiting for a more propitious quarter to issue its preferred stock, making one of two bad decisions. The bank could choose not to issue the preferred stock and thereby be required to cancel the planned dividends. This would undoubtedly cause market participants, including preferred stock investors upon which the bank is reliant for its planned issuance, to question the bank's credibility and its financial condition. As the Federal Reserve has observed many times, a negative market perception of a company's financial position can imperil a bank's ability to access funding and hurt its financial position, even when that perception and loss of confidence does not reflect the reality of its financial position.[3] Here, the bank would be unfairly punished by the market because it would be forced into withholding a stock dividend not because of its financial condition, but because it could not foresee the market volatility and because of a mechanical regulation. The bank's other bad choice would be to preserve its market credibility by declaring its dividends and issuing its preferred stock into a bear market at an economic price that would not be prudent. Here, the bank would suffer unnecessary economic losses that were not market-driven but were regulatory-driven.

In addition, a bank could find a favorable capital market or find an unexpected opportunity for business expansion or acquisition requiring additional capital and choose to accelerate a capital issuance in a quarter prior to the quarter in its capital plan. Under these circumstances, if capital issuance and distribution has to be synchronized on a quarter-by-quarter period, then the bank would either be required to distribute capital in the quarter that it issues capital or cancel a planned distribution in a later quarter. This would be an unintended penalty for prudent capital management.

A bank's inability to predict perfectly the optimum time in the future for its capital actions does not necessarily or even likely reflect bad planning; it only reflects the necessary imprecision of planning and the unpredictability of the market, particularly for a future limited time span. For example, we can determine based on historical precedent with fair certainty that it will rain in Washington, D.C. in October, but picking the day or week that it will rain is pure guesswork.

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[3] *See,* e.g., Federal Reserve System, *Policy Statement on the Scenario Design Framework for Stress Testing* at 16 effective date January 1, 2014.

Moreover, it is unduly restrictive and artificial to require that offsetting capital actions occur in the same quarter. A bank should have the flexibility to choose the appropriate time to issue its capital. The appropriate time should not be determined on a quarterly basis, but at the least on an annual basis so that the bank's management can act prudently with regard to dynamic present market conditions.

Another flaw in the proposed rule is that its blunt rule that capital distributed in each quarter must be less than the capital issued does not take into account the materiality of a gap between the capital distributed and the capital issued in a quarter. A $10 million gap is not material for a bank with $1 billion in capital. A non-material gap is just that – non-material, and a bank should not be forced by a mechanical rule to adjust a distribution artificially because of a non-substantial gap in capital issuance in a given quarter. That's particularly true where such a gap may be bridged in later quarters or has already been bridged in earlier quarters. This proposed rule should be modified to account for the materiality of the negative gap based on size of the bank's overall assets, its capitalization, and the bank's vulnerability to macroeconomic and idiosyncratic stresses.

Throughout its preamble and its comments on capital planning and stress testing, the Federal Reserve has noted and emphasized the need for flexibility both in its supervisory role and in the bank's planning processes. Accordingly, this proposed rule appears to be an anomaly in the Federal Reserve's overall approach to capital planning and stress testing which generally appears rightly to emphasize qualitative, reality-based assessments of the capital plans and stresses on individual banks over rigid, formulistic rules.

Indeed, one of the reasons given for the new rule is that it is concerned that some banks are treating the rules as a regulatory exercise rather than its intended purpose of requiring more rigorous capital planning.[4] The addition of artificial, mechanical requirements such as this proposed rule will encourage and in some sense require planning to focus on the rule's requirements rather than the need for robust capital planning to ensure that adequate capital is available to a bank in times of financial stress.

The Federal Reserve already has in place sufficient authority and tools to address the observed activities that it seeks to correct in its proposed rule. The Federal Reserve is the supervisor of large BHCs and is involved in year-long monitoring of covered banks' capital planning and stress testing activities. The Federal Reserve evaluates and can reject annual capital plans on qualitative grounds. Thus, the historical anomalies that the Federal Reserve has noted in some banks' consistent failures to execute planned capital issuances and to game capital cycles are best appreciated, as it has done, by an

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[4] 79 Fed. Reg. at 37425

examination of a particular's bank's current and historic planning compared with the bank's actual capital actions over a capital plan's cycle.[5] And, the Federal Reserve can directly address those flaws in a bank's capital planning and activities. This is a far better approach for supervising large BHCs and ensuring a well-capitalized banking system, than imposing a very imperfect rule across the board that does not account for market reality, that will likely harm banks who engage in rigorous capital planning, and that, by elevating form over substance, will encourage and may require some gamesmanship of the regulations by businessmen who desire to act prudently in response to actual market conditions.

Finally, the Capital Plan Rule provides the Federal Reserve with the authority to require a BHC to re-submit its Capital Plan if it determines "there has or will likely be a material change in the bank holding company's risk profile."[6] Under this authority, if the Federal Reserve believes a BHC's risk profile has increased due to the inability to issue a capital security, under existing authority, they can require the BHC to suspend any future distributions.

2. The Federal Reserve's Comments Regarding Planned Capital Actions in the Final Three Quarters of the Two and a Quarter Year Capital Plan Cycle.

In its comments on BHCs' capital plans in the final 3 quarters of the 9 quarter planning horizon of the capital plan cycle, the Federal Reserve appears to have unrealistic expectations regarding a bank's ability to predict capital actions in those out quarters and to misinterpret a prudent, conservative response to this inability to precisely predict capital actions so far out in the future as either a flaw in a bank's capital planning or an attempt to game the system.

Specifically, the Federal Reserve indicates that a BHC should project its distributions in the final three quarters in a manner broadly consistent with, or higher than, previous quarters unless it is in fact planning to reduce its distribution.[7] However, in most cases, a BHC will not have sufficient predictive insight into the out quarters to support a realistic assumption around all aspects of capital distribution. Common dividend payout targets tend to be longer term in nature and thus facilitate the ability to make realistic assumptions throughout the forecast horizon. In contrast, total payout ratio targets, which are inclusive of share repurchases, tend to be much more focused on the near term as multiple dimensions must be considered, including, among other things, an assessment of capital adequacy (quantification of excess capital) as well as the availability of economically appealing growth opportunities both organic and strategic in nature. This is especially the case for a BHC which prioritizes capital deployment

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[5] *Id.*
[6] *Id.*
[7] 79 Fed. 37426

through growth above deployment through share repurchases. Predictive assumptions around share repurchases would require accurate foresight into the landscape for and return profile of growth opportunities more than a year into the future. The difficulty of making such assumptions so far into the future greatly limits a BHC's ability to make assumptions on share repurchases with any level of certainty for the out quarters. As growth is prioritized above share repurchases, it would not be prudent for a BHC to include significant share repurchases in a plan that, if conditions allow, would not be executed. Further, if conditions turn out to be unsupportive of incremental growth, a BHC should not be punished for developing a capital plan that was reflective of its prioritization of capital deployment through growth.

If a BHC has a target capital level and includes in its plan capital distributions sufficient to maintain that targeted level, any out-performance from a capital perspective (higher capital generation or lower risk-weighted assets) would cause its capital levels to drift above targets. The only method currently available to BHCs to adjust for this drift is to, in the next annual capital planning cycle, add to the capital distributions that were formerly assumed in its out quarters that are now within the planning horizon. To limit banks' ability to manage capital in this way, as the Federal Reserve suggests, in effect perversely incentivizes banks to produce more aggressive forecasts so as to mitigate the risk of outperformance. Adjusting capital distribution in subsequent capital planning cycles is a conservative approach to address the perplexing problem of the inability to forecast future capital market conditions years ahead with perfect clairvoyance. It is not gamesmanship or poor capital planning.

3. The Idiosyncratic BHC Stress Test Requirement

Regions appreciates the Federal Reserve's focus on an individual company's risk profile and the increased expectations for a company's idiosyncratic stress test to be designed with a stress scenario that is appropriate for the company's business model and portfolios.[8] The Proposed Rule requires that the BHC stress scenario "stresses the specific vulnerabilities of the bank holding company's risk profile and operations, including those related to the company's capital adequacy."[9] As the Federal Reserve commented, this requirement mitigates the limitations on determining an individual company's true exposure inherent in solely testing for macroeconomic stresses and allows for a deeper understanding of an individual company's vulnerabilities.

Regions, however, is concerned with an added requirement appearing in the Federal Reserve's comments that the idiosyncratic stress test is "generally expected to result in an impact to projected pre-tax net income that is at least as severe as the results

[8] 79 Fed. Reg. at 37424
[9] Proposed Rule Section 225.8(d)(2)

of the bank holding company's company run stress test under the Board's severely adverse scenario."[10] Regions' concern with this proposed requirement is two-fold.

One concern is the timing. As the Federal Reserve recognizes the development of appropriate stress scenarios is a critical consideration in obtaining a deeper understanding of an individual company's vulnerabilities and the appropriate capital planning for the company's specific business. Developing an appropriate scenario and obtaining the required internal approvals for an idiosyncratic stress test requires time. Careful planning generally requires a company to engage in this process and begin running its own scenario prior to receiving the Federal Reserve's scenarios. This proposed requirement puts significant pressure on a company to hope that its scenario will produce a lower net income or higher net loss than the scenario required by the Federal Reserve. Rather than leaving its process to a hope, a bank would likely delay its idiosyncratic testing process until it received the Federal Reserve's scenarios so that it would know the appropriate level of loss or reduction in revenue that it would need to achieve to satisfy the Federal Reserve's severity expectations. This would artificially compress the time the company would have for all the stress testing required into a limited period. The Federal Reserve has noted the need for sufficient time to develop and run stress tests. "The Board recognizes the importance of providing covered companies adequate time to implement the company-run stress tests."[11] Indeed, the timing and the need for a company to focus on its capital planning and stress testing is the reason for the timing shift in the Proposed Rules. The severity requirement proposed for BHC testing would run contrary to this goal of adequate time and focus for capital planning and stress testing.

Regions' larger concern with the severity requirement is that it necessarily changes the BHCs' focus from identifying the idiosyncratic stresses appropriate for the company to complying with the required result of severity. Moreover, current requirements that scenarios be internally consistent and stitched together by a narrative may place additional pressure on BHCs attempting to reach a mandated level of severity. These factors will make the BHC stress testing less an important tool for capital planning to more of an exercise to satisfy a regulatory requirement. The banks will naturally be encouraged to tie their BHC stress test scenarios to the Federal Reserve's macroeconomic scenarios. So, rather than building up their own substantial idiosyncratic stress scenarios, banks will more likely utilize idiosyncratic add-ons to obtain the required results and satisfy their regulatory requirements. This would likely produce less robust stress tests and attenuate the insight that the Federal Reserve would otherwise obtain if this severity requirement were not expected.

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[10] 79 Fed. Reg. at 37425

[11] Federal Reserve System, *Policy Statement on the Scenario Design Framework for Stress Testing, supra,* at 12.

Regions believes that consistent with the nature and purpose of an idiosyncratic approach, the Federal Reserve should judge the sufficiency of an individual bank's BHC stress test qualitatively, rather than by a mechanical tie-in to the results of Federal Reserve's macroeconomic severe stress test. This would allow the bank to focus on appropriate factors arising from its own business model, provide the bank sufficient time to prepare its idiosyncratic scenario and testing, and result in a testing model that will both aid the Federal Reserve in its analysis of the sufficiency of the bank's capital planning and stress testing and the bank in developing its own plans.

Again, Regions values the opportunity to comment on the Proposed Rule and appreciates your consideration of the views expressed in this letter. We would be pleased to discuss our comments further with the Board and its staff.

Sincerely,

Deron Smithy

Deron Smithy
Executive Vice President and Treasurer
Regions Financial Corporation