

August 11, 2014

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve
System
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regs.comments@federalreserve.gov
Docket No. R-1492
RIN 7100-AE 20

Robert E. Feldman, Executive Secretary,
Attention: Comments/Legal ESS
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RIN 3064-AE18

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Docket ID OCC-2014-0015
RIN 1557-AD85

Re: Notice of Proposed Rulemaking Regarding Amendments to the Capital Plan and Stress Test Rules

Ladies and Gentlemen:

The undersigned institutions¹ appreciate the opportunity to provide comments on the notice of proposed rulemaking (the “Federal Reserve Proposal”) issued by the Board of Governors of the Federal Reserve System (the “Federal Reserve”), as well as the related notices of proposed rulemaking issued by the Office of the Comptroller of the Currency (the “OCC”) and the Federal Deposit Insurance Corporation (the “FDIC”) and, together with the Federal Reserve and the OCC, the

¹ The undersigned institutions are regional banking organizations with total consolidated assets of between approximately \$65 billion and \$330 billion, as of June 30, 2014. Our institutions are traditional banking organizations, focused on domestic business activities, whose sizes are modest in relation to both the U.S. banking sector and U.S. economic activity. For example, each of the undersigned, as of June 30, 2014, had a share of national deposits under 3%, total consolidated assets, as of that same date, that represented less than 3% of U.S. GDP, and in the aggregate, had fewer assets than the single largest U.S. globally systemically important bank (“G-SIB”) identified by the Financial Stability Board (the “FSB”). See Financial Stability Board, *2013 Update of Group of Global Systemically Important Banks (G-SIBs)* (Nov. 11, 2013), available at http://www.financialstabilityboard.org/publications/r_131111.pdf (updating the FSB’s list of G-SIBs using year-end 2012 data and the Basel Committee on Banking Supervision’s updated methodology published in July 2013).

“Agencies”) (the “OCC Proposal” and “FDIC Proposal”, respectively, and together with the Federal Reserve Proposal, the “Proposals”).²

The undersigned institutions have taken part in the development of, and fully support, the letters submitted by the Financial Services Roundtable and the American Bankers Association (“FSR/ABA Letter”) as well as The Clearing House Association L.L.C. (the “TCH Letter”, and together with the FSR/ABA Letter, the “Trade Association Comment Letters”). The purpose of this letter is to offer additional support for or information with respect to certain of the issues raised by the Trade Association Comment Letters.

Shift in the Annual Capital Planning and Stress Testing Cycle

We commend the Agencies on their proposal to shift the capital planning and stress testing cycle by a calendar quarter. This meaningful change would address the challenges for banking organizations and their personnel presented by the existing cycle overlapping with the end of the calendar year, and we strongly support this change. Moreover, we strongly encourage the Agencies to accelerate implementation of the proposed timeframe and apply it starting January 1, 2015, thereby delaying the start date for the upcoming 2015 capital planning and stress testing cycle by one calendar quarter. Such early adoption would create a one quarter gap (i.e., 2Q 2015) between bank holding companies’ approved capital plans and their subsequent capital plan submissions. This gap, however, could be appropriately addressed by allowing bank holding companies to make capital distributions in 2Q 2015 consistent with the 2Q 2015 planned capital actions included as part of their 2014 capital plan submissions.³

In addition, we respectfully request that the Agencies issue the supervisory stress scenarios as early as possible in the capital planning and stress testing cycle (e.g., January 1) but no later than January 15th of each calendar year under the proposed capital planning and stress testing cycle. We appreciate the Agencies’ current practice of issuing these scenarios earlier than required by current regulations.⁴ Even with these early releases, however, the timeframe for implementation is very compressed and impacts the design and functionality of a well-managed stress testing process. The need for receiving the supervisory scenarios as early as possible is particularly acute considering the issues presented by the proposed requirements around the BHC stress scenario, as described below. If those requirements are adopted in the final rules, early release of the supervisory scenarios would be critical in order to provide bank holding companies sufficient time to address the issues raised by the newly-defined BHC stress scenario.

² Federal Reserve *Amendments to the Capital Plan and Stress Test Rules*, 79 Fed. Reg. 37,420 (July 1, 2014); OCC, *Annual Stress Test—Schedule Shift and Adjustments to Regulatory Capital Projections*, 79 Fed. Reg. 37,231 (July 1, 2014); and FDIC, *Annual Stress Test*, 79 Fed. Reg. 37,235 (July 1, 2014).

³ Under such an approach, a BHC also should be able to rely (and the Federal Reserve should provide in the final rule that a BHC may rely) on the capital plan rule’s “de minimis” exception process for distributions in 2Q 2015 that exceed such amount. See 12 C F R § 252.8(f)(2).

⁴ See, e.g., Federal Reserve, *2014 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule* (Nov. 1, 2013), available at <http://www.federalreserve.gov/bankinfo/bcreg20131101a1.pdf> (releasing supervisory scenarios ahead of the November 15 regulatory deadline).

New Focus on Quarterly Distribution and Issuances: Failure to Execute Planned Capital Issuances Impacts Planned Distributions

The preamble to the Federal Reserve proposal explains that the Federal Reserve has observed limited instances of behavior that could undermine its assessment of a bank holding company's capital adequacy. The proposal would require a bank holding company to limit its capital distributions in any calendar quarter in which the company's actual capital issuances are less than it projected in its capital plan for that quarter, so that the company's actual net capital issuances and distributions for that quarter equal the proposed net capital issuances and distributions. We believe this proposed requirement is flawed and raises significant issues, as described in detail in the Trade Association Comment Letters. In particular, we strongly support the comments and recommendations offered in the Trade Association Comment Letters that codifying this net distribution test is unnecessary and that the Federal Reserve has sufficient existing authority to address any potential related deficiencies in capital planning processes through the existing capital plan rule and the related supervisory process—the Comprehensive Capital Analysis and Review (“CCAR”).⁵

The burdens that result from imposing a definitive and inflexible test – which are well documented in the Trade Association Comment Letters – are not outweighed by the potential benefit to the Federal Reserve and the public of addressing any potential related deficiencies in bank holding company capital planning processes (including inappropriate planning or “gaming”) under the Federal Reserve's assessment of bank holding company capital adequacy, especially in light of the fact that the Federal Reserve has ample resources and authority to fully address this behavior.⁶ In particular, the incorporation of CCAR into the Federal Reserve's day-to-day supervision provides a mechanism for the Federal Reserve to address – in real time or in advance of a qualitative assessment of the institution's next plan – institution-specific issues it observes.

We believe it would be more appropriate for the Federal Reserve to address significant differences in a bank holding company's planned capital issuances as part of the Federal Reserve's review of the company's next capital plan submission and its day-to-day supervision of the company,

⁵ In a recent speech, for example Gov. Tarullo highlighted the increasing integration of CCAR—in particular the qualitative aspects of capital planning and assessments of capital adequacy processes—into the Federal Reserve's day-to-day supervision. Governor Daniel K. Tarullo, *Stress Testing after Five Years*, June 25, 2014 (“[P]recisely because of its importance to our supervisory program, the qualitative assessment will continue to be progressively more integrated into year-round supervision of the CCAR firms We have already taken steps to further this integration of CCAR and regular supervision I anticipate that we will take additional steps to integrate ongoing supervisory assessments of risk-management and other internal control processes with the annual CCAR exercise, and to assure that communications in both directions are heard The aim of these and additional measures is to make CCAR more the culmination of year-round supervision of risk-management and capital planning processes than a discrete exercise that takes place at the same time as the supervisory stress tests.”).

⁶ The preamble specifically acknowledges that the existing capital plan rule provides the Federal Reserve the requisite authority to object to a bank holding company's capital plan on precisely these types of qualitative grounds. 79 Fed. Reg. 37,426 (acknowledging that under the current capital plan rule “failure to execute capital issuances as indicated in its capital plan may form the basis for objection if the BHC is unable to explain the discrepancy between its planned and executed capital actions”).

rather than by restricting all bank holding companies from making appropriate adjustments to the timing and nature of its capital actions in light of market conditions or institutional needs.

Further Emphasis on the BHC Stress Scenario

We do not believe that the proposed requirement that the newly-defined BHC Stress Scenario must result in an impact to projected pre-tax net income (“PPNI”) that is “at least as severe as” the bank holding company’s results under the supervisory severely adverse scenario is workable. First, by necessity, institutions develop company-defined stress scenarios much earlier than supervisory scenarios are provided, and under the current timeframes for the release of supervisory scenarios, it would be unlikely that an institution would have adequate time to make sufficient adjustments to its BHC Stress Scenario to achieve the more conservative impact required by the proposal. Second, we believe it might be impossible to achieve this more conservative impact with any sensitivity, through up-front evaluation and alteration of the scenario, because changes to the inputs in the BHC Stress Scenario do not have linear relationships to PPNI.

In essence, this requirement would force institutions to create a BHC Stress Scenario (or to “true up” their BHC Stress Scenario after observing that the results of the supervisory severely adverse scenario are more severe on a PPNI basis than the BHC Stress Scenario results) that – contrary to the Federal Reserve’s own policy statement on the development of supervisory scenarios⁷ – may have no historical precedent, may not reflect historical relationships between variables, or may needlessly increase procyclicality, thereby grossly distorting the capital needs of the institution. Otherwise the institution would face undefined consequences for failing to meet the Federal Reserve’s proposed requirement.

Although we appreciate the Federal Reserve’s intended goal underlying the proposal, we believe that the qualitative assessment is the best method to address concerns with an institution’s scenario development. Past experience with the Federal Reserve’s guidance on the BHC stress scenario supports our recommendation. In the instructions for the 2013 CCAR exercise, the Federal Reserve explained its intent to “focus particular attention on the processes surrounding the development and implementation of the BHC stress scenario” to ensure, among other things, “that the scenario is of *comparable severity* for the BHC as the supervisory severely adverse scenario is for the banking industry as a whole”⁸ The “comparable severity” language prompted significant concerns and confusion among bank holding companies leading to numerous questions and requests for clarification. The Federal Reserve revised its instructions for the BHC stress scenario for the subsequent year’s CCAR exercise to provide that “the scenario [should] result[] in a substantial strain on the BHC’s ability to generate revenue and absorb losses and a significant reduction in post-stress capital ratios relative to baseline projections”⁹ The current proposal to define severity on the basis of PPNI does not address the issues presented by the 2013 CCAR instructions and raises

⁷ See Federal Reserve, *Policy Statement on the Scenario Design Framework for Stress Testing*, 78 Fed. Reg. 71,435 (Nov. 29, 2013).

⁸ Federal Reserve, *Comprehensive Capital Analysis and Review 2013 Summary Instructions and Guidance 5* (Nov. 9, 2012), available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20121109b1.pdf>.

⁹ Federal Reserve, *Comprehensive Capital Analysis and Review 2014 Summary Instructions and Guidance 7* (Nov. 1, 2013), available at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131101a2.pdf>.

additional significant issues as noted above and in the Trade Association Comment Letters. Accordingly, we respectfully ask that Federal Reserve not adopt this aspect of its proposal.

Capital Distributions Resulting from Certain Issuances No Longer Require Prior Approval

We would like to express our appreciation and support for this proposed change.

Federal Reserve's Practice of Using Baseline Capital Action to Assess Capital Plans Across All Scenarios

As part of CCAR, it is the Federal Reserve's practice to use a bank holding company's planned capital actions under the BHC baseline scenario as the capital actions that are subject to supervisory evaluation under the supervisory adverse and severely adverse scenarios, i.e., the Federal Reserve assesses whether a bank holding company could continue to meet the minimum capital ratios specified under the rules throughout the planning horizon, even if adverse or severely adverse stress conditions emerged *and* the BHC did not reduce planned capital distributions.¹⁰ We believe that this uniform assumption regarding bank holding companies maintaining capital distributions planned under the baseline scenario throughout the supervisory scenarios is inappropriate.

This practice fails to appropriately take into account that bank holding companies operate subject to internal capital management policies approved by their boards of directors that, among other things, include policy limits that would limit capital distributions and preserve capital in times of stress. We also note that the Federal Reserve's practice of using baseline capital actions to evaluate bank holding companies' capacity to meet minimum regulatory capital requirements under stress would be inconsistent with the soon-to-be-implemented capital conservation buffer requirements under the revised risk-based capital rules.¹¹ Under those rules, bank holding companies must maintain the capital conservation buffer in order avoid limitations on capital distributions (including repurchases and dividend payments) as well as limitations on discretionary bonus payments to executive officers.¹² Accordingly, we support the request made in the Trade Association Comment Letters that, in evaluating whether a bank holding company would be capable of continuing to meet minimum capital ratios specified under the rules throughout the planning horizon under stressed economic conditions, the Federal Reserve consider measures to preserve capital that bank holding companies would implement under approved internal capital management policies.

Federal Reserve Commentary on "Out-Quarters" Projections

In commentary included in the Proposed Rule, the Federal Reserve criticized a practice whereby it observed some firms including lower distributions in the second year of their capital plans relative to the first, and in subsequent capital plans submitting higher distributions in the first year of the plan (relative to those quarters in the previous plan), with lower distributions in the second year.

¹⁰ See, e.g., 2014 CCAR Instructions at 23.

¹¹ The capital conservation buffer requirement will be phased in between January 1, 2016, and January 1, 2019.

¹² See generally 12 C.F.R. § 217.11(a)(4).

The language indicates that a firm may be subject to qualitative objection where this is observed to occur, without indicating that the overall purposes of firms' plans were an equally important context.

The Trade Association Comment Letters more fully articulate these issues, and we believe the Federal Reserve should clearly articulate in the preamble to the final rules that these types of variations may be reasonable, provided they are cogently described and supported in the capital plan. For example, reduced distributions in the out-quarters could be logically tied to lower projected asset growth or earnings, higher projected expenses, projected changes to business plans (such as the exit from a line of business) or acquisition plans in the second year of the capital plan. Rather than being assumed to have deficient capital planning processes, BHCs that project lower distributions for the out-quarters should be required to provide support for that projection. Likewise, if in the next capital plan the firm's requested distributions for those quarters materially differs from the projection made in the previous year's plan, the firm should be required to explain why such changes are appropriate in light of, for example, a materially improved outlook or other material developments. Any pattern of distributions should be evaluated within the context of the appropriateness of a firm's overall capital management plans and strategy, fully taking the BHC's support and rationale into account. We support the request made in the Trade Association Comment Letters that the Federal Reserve withdraw such language from any final rule or alter its language to indicate recognition that there may be sound reasons for a firm to make adjustments to its distributions, increasing or decreasing them, within plans or between them, in managing to its overall capital goals.

Tier 1 Common Ratio

We support the request in the TCH Letter to eliminate the requirement to estimate tier 1 common capital ratios for purposes of the upcoming capital plan and stress test cycle, given that the U.S. Basel III-based capital rules will be effective for all companies subject to these rules on January 1, 2015.

Application of the Advanced Approaches

We strongly support the proposed delay of incorporating the advanced approaches under the revised risk-based capital rules to estimate regulatory capital for stress testing and capital planning purposes. We respectfully recommend, however, that the Agencies indefinitely delay incorporating the advanced approaches into their capital planning and stress testing processes. Consistent with Governor Tarullo's recent speech, we believe it is appropriate for the Agencies to reconsider the costs and benefits of the advanced approaches in the capital planning and stress testing processes.¹³ In particular, incorporating advanced approaches into these processes introduces significant difficulty and additional complexity, both for the institutions as well as the Federal Reserve, and reduces the

¹³ Governor Daniel K. Tarullo, *Rethinking the Aims of Prudential Regulation*, May 8, 2014 ("The combined complexity and opacity of risk weights generated by each banking organization for purposes of its regulatory capital requirement create manifold risks of gaming, mistake, and monitoring difficulty. The IRB approach contributes little to market understanding of large banks' balance sheets, and thus fails to strengthen market discipline. And the relatively short, backward-looking basis for generating risk weights makes the resulting capital standards likely to be excessively pro-cyclical and insufficiently sensitive to tail risk. That is, the IRB approach—for all its complexity and expense—does not do a very good job of advancing the financial stability and macroprudential aims of prudential regulation.").

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existing comparability of results. The Dodd-Frank Act ensures that advanced approaches institutions are subject to the same capital rules as those applicable to the rest of the industry as a floor. Accordingly, the capital planning and stress testing rules should reflect the standardized capital rules that are applicable to the industry as a whole.

* * *

We appreciate the opportunity to comment on the Proposals and respectfully ask for consideration of the comments in this letter as well as the Trade Association Comment Letters. If you have any questions regarding the content of this letter or would like more information on the same, please do not hesitate to contact any of the individuals listed in *Attachment 1* appended hereto.

Sincerely,

Capital One Financial Corporation
Comerica Incorporated
Fifth Third Bancorp
The PNC Financial Services Group, Inc.
Regions Financial Corp.
SunTrust Banks, Inc.

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Appendix

Attachment 1

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