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FINANCIAL SERVICES ROUNDTABLE

August 11, 2014

Submitted via Email: regs.comments@federalreserve.gov

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

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

Dear Mr. Frierson:

The American Bankers Association[1] (ABA) and the Financial Services Roundtable[2] (FSR) (collectively, the Associations) are pleased to submit comments on the notice of proposed rulemaking[3] titled "Amendments to the Capital Plan and Stress Test Rules" (Proposed Rule) published by the Board of Governors of the Federal Reserve System (Federal Reserve).

The Associations appreciate the proposal to adjust the timeframe for the annual capital plan submissions and for the conduct of company-run and supervisory stress tests. The proposed time frame for capital plan submissions and stress tests would address the challenges for banking organizations and their personnel presented by the existing timeframe overlapping with the end of the calendar year.

The Associations have long supported the goals of the Federal Reserve's capital plan rule and stress testing framework to evaluate how large bank holding companies (BHCs) are prudently managing risks and holding appropriate capital against potential market-wide and idiosyncratic stresses. The Federal Reserve's capital planning and stress testing framework will be successful for our economy to the extent that if is flexible enough to recognize and accommodate how BHCs employ a variety of strategies to manage their businesses to serve their customers while adhering to overall rigorous capital standards. Notwithstanding our support and appreciation for the proposed capital planning and stress testing timeline, we have serious concerns about several other aspects of the Proposed Rule. These other provisions would impose new requirements that

[1] The American Bankers Association is the voice of the nation's $14 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits and extend nearly $8 trillion in loans. Learn more at www.aba.com.
[2] As advocates for a strong financial future™, FSR represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $98.4 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.
[3] 79 Fed. Reg. 37,420 (July 1, 2014).

would effectively result in increased regulatory management of business decisions, including those affecting the timing of capital actions within a calendar year. We believe these other requirements are unnecessary in light of the Federal Reserve's strong supervisory framework related to the stress testing and capital planning process. Maintaining rigorous capital standards within a strong supervisory framework while preserving BHCs' flexibility in managing their business would be better served by a stress testing and capital planning framework that—

- Relies on existing tools to address deficiencies in a BHC's capital planning processes rather than establishes a mechanical process focused on quarterly net issuances/distributions with little, if any, flexibility to respond to constantly evolving market conditions;
- Maintains its current guidance regarding the BHC stress scenario, rather than requires the BHC stress scenario to be "at least as severe" as the Federal Reserve's severely adverse scenario;
- Adopts the proposed timeframe early for the upcoming 2015 capital planning and stress testing cycle; and
- Shortens the planning horizon from nine quarters to eight quarters.

We elaborate on these points further and raise a couple of other related points below.

I. Proposed Focus on Quarterly Distributions and Issuances is Impractical

The Proposed Rule would modify the existing capital plan rule with a requirement that would limit a BHC's capital distributions made in a calendar quarter under its approved capital plan if the proceeds from the company's net issuances of capital instruments in that quarter are less than the amount projected in the BHC's approved capital plan for that quarter. The preamble to the Proposed Rule explains that this new quarterly net distribution test would memorialize the Federal Reserve's existing practice of approving repurchases of common stock on both a net and gross basis and would extend that practice to other forms of capital distributions.[4] Moreover, the Proposed Rule indicates this requirement is designed to address potential weaknesses in a BHC's capital planning processes and methodologies where it consistently fails to execute on planned capital issuances.[5]

We believe that codifying the net distribution test is unnecessary. The Federal Reserve, through the existing capital plan rule, the Comprehensive Capital Analysis and Review (CCAR), and general supervisory authorities, has the appropriate tools to address the types of deficiencies in capital planning processes in a more targeted and specific way than would the proposed requirement. Imposing the rigid net distributions test on all CCAR BHCs would impair their ability to conduct reasonable, tactical management of their capital profiles, and it fails to

[4] The preamble indicates that, in the context of approving repurchases of common stock, it has been the Federal Reserve's practice to approve repurchases of common stock on both a net and a gross basis. In other words, a BHC would be required to reduce repurchases of common stock to the extent that it does not issue as much common stock as planned. Proposed Rule at 37,425.

[5] The preamble explains that consistently failing to complete planned capital issuances "may be indicative of shortcomings" in a BHC's capital planning processes, i.e., that the assumptions and analysis underlying the BHC's capital plan, or its capital adequacy process, may not be reasonable or appropriate. Id. at 37,426.

recognize that the timing of capital issuances may vary due to normal changes in market conditions.[6] We believe, for example, that it would be more appropriate for the Federal Reserve to address material differences in a BHC's planned capital issuances as part of its review of the BHC's next capital plan submission.[7] The Federal Reserve would have sufficient grounds to object to a BHC's proposed capital plan on qualitative grounds if there were no adequate explanation why planned capital issuances under an approved capital plan were not completed in the prior year.[8] We believe that the regulatory framework should balance the need for rigorous capital planning with sufficient flexibility to permit BHCs to manage their franchises in response to evolving market and business conditions. Imposing rigid quarter-by-quarter measurements could have the unintended effect of forcing BHCs to issue capital instruments at inopportune times or postpone capital distributions, based on quarter-end dates, even where acceleration or postponement is not justified based on the BHC's financial condition or the condition of the markets generally.

There are numerous valid business reasons why a BHC might modify its planned capital actions (especially issuances of capital instruments) in a given calendar quarter that do not raise concerns about the adequacy of a BHC's overall capital assessment process nor represent an attempt to "game" the capital planning process. Variables affecting capital outcomes include market conditions (e.g., the relative costs or benefits of issuing capital instruments or making a capital distribution based on interest rates and similar macro-economic variables), competitive pressures (e.g., whether a peer firm issues instruments in close proximity, leading to reduced market capacity), and firm-specific conditions (e.g., shifts in business strategies in response to market opportunities, greater or lesser loan or asset growth than originally forecast, or managing changes that impact the glide path to capital targets, or reductions in assets or risk-weighted assets). The Appendix to this letter contains numerous examples that illustrate our concerns with the quarterly net distribution test.

The annual capital planning process currently provides firms with appropriate flexibility to respond to such variables while still remaining subject to rigorous oversight and capital expectations. The Federal Reserve has sufficient existing tools and supervisory authority to monitor and, where necessary, address deficiencies in a BHC's capital planning processes, including, for example, material differences in a BHC's planned and completed capital issuances over the course of a capital plan cycle. The Proposed Rule's inflexible approach would cause BHCs to incur real economic costs, and we respectfully submit that this aspect of the Proposed Rule should not be finalized.

[6] Having the flexibility to time capital issuances appropriately to take advantage of favorable market conditions (e.g., favorable pricing and increased demand) is vital to BHCs and is consistent with prudent capital management principles.

[7] The preamble specifically acknowledges that the existing capital plan rule provides the Federal Reserve the requisite authority to object to a BHC's capital plan on precisely these types of qualitative grounds. Proposed Rule at 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").

[8] Id. Moreover, the Federal Reserve could make clear that, if requested distributions for a particular year are significantly supported by planned capital issuances, those issuance should occur early enough to avoid situations where market timing concerns would create issues.

The Proposed Focus on Quarterly Distributions and Issuances is Particularly Problematic When Applied to Employee Incentive Compensation (EIC) Programs

The Proposed Rule's net quarterly distribution test would be particularly problematic when applied to employee incentive compensation (EIC) programs. Many BHCs have EIC programs through which the BHC issues common stock or other capital instruments to employees as a form of compensation. It is not possible to calculate with precision the total amount of common stock that will be issued in an EIC program during the coming year, since actual issuances will vary in response to the market value of the stock and personnel changes, among other variables.

Issuances of capital instruments through EIC programs represent valid capital issuances which are captured in income statements. EIC programs represent an important tool of capital management for BHCs as well as an appropriate form of compensation that aligns the long-term interests of employees with BHCs to foster prudent risk management. The Federal Reserve has previously considered EIC program stock issuance projections to be reliable inputs of capital planning without limiting recognition of such projections against actual issuances even under the Dodd-Frank Act stress test capital actions (DFA Action). This recognition has been an exception to the Federal Reserve's more general DFA Action guidance that BHCs may not include regulatory capital issuance assumptions in their capital plans, with the Federal Reserve explicitly noting that EIC program issuance projections can be included.[9] We urge the Federal Reserve to continue to recognize the importance of incorporating EIC program issuance projections without any intra-year limitation based on actual issuances under such programs.

II. Mandating Equivalence of the BHC Stress Scenario and the Federal Reserve's Severely Adverse Scenario Undermines the BHC Scenario Development Process

The Proposed Rule would establish enhanced expectations for the BHC stress scenario by requiring 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 and financial condition," and results in an impact to projected pre-tax net income that is "at least as severe" as the results of the BHC's company run stress test under the Federal Reserve's severely adverse scenario.[10] We believe that these proposed requirements compromise the integrity of the BHC stress scenario and should not be finalized.

Robust idiosyncratic scenarios are extremely important for BHCs to appropriately manage their risks. Scenarios that capture a BHC's idiosyncratic risk produce useful results that are incorporated into their capital planning and decision making process. Expressly linking the BHC stress scenario to the Federal Reserve's severely adverse scenario could, however, have an unintended dampening effect on BHCs' scenario development.[11] An "at least as severe" standard would potentially discourage BHCs from making independent judgments of risk and instead incentivizes them to try and replicate the Federal Reserve's supervisory severely adverse

[9] *See* Comprehensive Capital Analysis and Review 2014 Summary Instructions and Guidance, November 1, 2013, page 19, n. 42 ("[A] company should assume that it will not issue any new common stock, preferred stock, or other instrument that would be included in regulatory capital in the second through ninth quarters of the planning horizon, *except for common stock issuances associated with expensed employee compensation*.") (emphasis added).
[10] Proposed Rule at 37, 425.
[11] The Associations also have similar concerns with the Federal Reserve's current ability to provide the additional components or scenarios as part of the mid cycle stress tests.

scenario. Management of regulatory risk would drive BHCs to model their scenarios as closely to the Federal Reserve scenarios as possible. Of course, that would undermine the underlying policy goal of strengthening capital management through two checks, one designed by the Federal Reserve and one designed by the BHC. We recognize the Federal Reserve's intent with the proposal is to ensure that BHCs have robust BHC stress scenarios. However, we believe the current qualitative approach, as laid out in the Federal Reserve's instructions for the 2014 CCAR exercise, is better suited to meet that goal.

The "at least as severe" standard would be difficult to evaluate since the stress scenario includes multiple elements. Perhaps in some categories the BHC may incorporate more severe assumptions than the Federal Reserve, but not in others. We note that looking only at pre-tax net income as a means to assess severity of the BHC Stress scenario relative to the supervisory severely adverse scenario may not by itself support a robust comparison between the two. Past experience with the Federal Reserve's guidance on the BHC stress scenario supports our recommendation above. In the instructions for the 2013 CCAR exercise, the Federal Reserve explained its intent for that CCAR exercise 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 . . . ."[12] The "comparable severity" language prompted significant concerns and confusion among BHCs, leading to numerous questions and requests for clarifying guidance. 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 . . . ."[13] The "comparable severity" language was appropriately dropped.

Finally, as discussed further in part III, this proposed requirement could result in CCAR BHCs waiting until they receive the Federal Reserve scenarios before developing the BHC scenario. This would compress all scenario stress testing (both BHC and Federal Reserve) into the same limited time frame leaving less time and fewer resources available to build and run robust idiosyncratic BHC stress scenarios and further challenging BHCs' ability to execute well-controlled and governed processes.

Imposing an "at least as severe" standard is unnecessary since the Federal Reserve has the ability to review capital plans both qualitatively and quantitatively, and any concerns about inadequate or in appropriate BHC stress scenarios can be addressed through the CCAR and ancillary supervisory processes without inhibiting high quality idiosyncratic scenarios developed by the BHC.

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[12] 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.
[13] 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 ("2014 CCAR Instructions").

III. Proposed Shift in Stress Testing Cycle Eases BHC Stress Testing with Certain Process Adjustments

The Associations appreciate and support the proposed change of the start date of the capital planning and stress testing cycle for BHC's subject to the capital plan rule. The Proposed Rule would move the start date for the annual capital planning and stress testing cycle from October 1 to January 1. As proposed, this change would become effective for the capital planning and stress testing cycle beginning January 1, 2016. The Proposed Rule clarifies that, in order to provide a transition to the proposed timing, the Federal Reserve's decision on a BHC's 2015 capital plan would cover a five-quarter period, i.e., Q2 2015 through Q2 2016. The Associations welcome the change of the start date as the current date results in a capital planning and stress testing process that overlaps with the end of the calendar year, presenting numerous challenges for many banking organizations and their personnel. The Associations believe that the proposed timeframe largely would address these challenges.

Accordingly, we encourage the Federal Reserve to accelerate implementation of the proposed timeframe and apply it starting January 1, 2015, *i.e*., delay the start date for the upcoming 2015 capital planning and stress testing cycle by one calendar quarter. Early adoption would, however, create a one quarter gap (i.e., 2Q 2015) between BHC's approved capital plans and their subsequent capital plan submissions. However, this gap could appropriately be addressed by allowing BHCs to make capital distributions consistent with the planned capital actions included as part of their 2014 capital plan submissions.[14] Additionally, early adoption will provide BHC's an additional 3 months of development time to resolve regulatory findings arising from CCAR 2014.

Considering the shift in the stress testing cycle, the Federal Reserve also should reduce the number of quarters for which BHCs are required to provide projections. When the capital plan rule was first adopted,[15] the Federal Reserve was able to receive two full years of projections only by defining the planning horizon as a nine-quarter period. Shifting the start of the stress testing cycle from October 1 to January 1 would allow the Federal Reserve to capture two full years' projections by adjusting the planning horizon to just eight quarters. The Associations note that shortening the time horizon to eight quarters would increase the ability of banks to take advantage of the phase in period of Basel III. Therefore, we believe reducing the time horizon from nine quarters to eight quarters would be appropriate.

The Associations also encourage the Federal Reserve to continue its practice of releasing the supervisory scenarios earlier than the regulatory deadline. Even though the current deadline is November 15, in 2013 the Federal Reserve released the scenarios roughly two weeks earlier,[16] providing BHCs with a critical amount of additional time that added to the ability to gather information, operate appropriate processes, and engage in appropriate planning. The Proposed Rule would shift the scenario distribution date from November 15 to February 15. Even with the

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[14] Under such an approach, BHCs seeking to exceed planned capital actions for 2Q 2015 could, to the extent appropriate, be permitted to rely on the capital plan rule's "de minimis" exception process. See 12 C.F.R. § 252.8(f)(2).

[15] 76 Fed. Reg. 74,6431 (Dec. 1, 2011).

[16] See 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/bankinforeg/bcreg20131101a1.pdf.

proposed shift, the Associations believe it is vital for the Federal Reserve to continue the current practice of releasing the scenarios early. Absent special circumstances, we believe the scenarios, as well as the Global Market Shock or other scenario components, should be distributed as early as possible, but no later than January 15.

The need for receiving the supervisory scenarios as early as possible is particularly acute considering the proposed requirements around the BHC stress scenario. Most institutions currently run their BHC stress scenarios before the Federal Reserve releases the supervisory scenarios. However, as noted, the Proposed Rule includes a requirement that the BHC's stress scenario result in an impact to projected pre-tax net income that is "at least as severe" as the results of the BHC's company-run stress test under the Federal Reserve's severely adverse scenario. This would be impossible to do, however unwise, if BHCs had to begin their scenarios without the ability to compare them with the Federal Reserve scenarios.

IV. Capital Actions Not Requiring Approval Provide Needed Flexibility

Under the Federal Reserve's existing capital plan rule, a BHC must request prior approval/provide prior notice for capital distributions that exceed the amount described in the BHC's approved capital plan.[17] This existing provision applies to all capital distributions, including, for example, distributions outside of the approved capital plan that are associated with issuances of regulatory capital instruments (e.g., dividend-paying common stock). To reduce burden, the Proposed Rule would remove this prerequisite for distributions involving the incremental issuance of instruments eligible to be included in a BHC's common equity tier 1, additional tier 1, or tier 2 capital. The Associations are supportive of the Federal Reserve's effort to allow BHCs to make these type of capital issuances without approval.

V. Federal Reserve's Practice of Using Baseline Capital Action to Assess Capital Plans across All Scenarios is Inappropriate

As part of CCAR, it is the Federal Reserve's practice to use a BHC's planned capital actions in the BHC baseline scenario as the capital actions that are subject to supervisory evaluation under the supervisory adverse and severely adverse scenarios. That is to say, the Federal Reserve assesses whether a BHC could continue to meet minimum regulatory capital requirements and a tier 1 common capital ratio of at least 5 percent throughout the planning horizon, even if adverse or severely adverse stress conditions emerged and the BHC did not reduce planned capital distributions.[18] The Associations believe that this uniform assumption regarding BHCs maintaining capital distributions planned under the baseline scenario throughout the supervisory scenarios does not reflect actual practice and governance policies in effect at BHCs. This assumption does not recognize that BHCs operate subject to internal capital management policies—approved by their boards of directors—that, among other things, include non-discretionary actions intended to limit capital distributions and preserve capital in times of stress.

Accordingly, we would propose the Federal Reserve explore recognizing that BHCs may moderate planned capital actions in stressed environments, either based on triggers prescribed by the Federal Reserve (e.g., decline in capital or cushion above the regulatory minimums), or on

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[17] 12 C.F.R. § 252.8(f).
[18] See, e.g., 2014 CCAR Instructions at 23.

something more closely aligned to BHCs' capital management policies. This framework would be much more reflective of actions that BHCs would actually take under stress.

VI. The Federal Reserve's Commentary on BHCs' "Out-Quarters" is too Inflexible

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. 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 - including their capital management objectives, capital ratios, and capital targets – are an equally important context.

The Associations 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. Firms should be able to describe the goals of their capital plans and distribution assumptions, rather than being assumed to have deficient capital planning processes because they project lower distributions for the out-quarters.

In terms of subsequent plans, it should be recognized that an intervening period will have passed, which firms will find it necessary to adapt to. It may find that its capital ratios are higher than desired or expected relative to its capital plan goals.[19] In such a case, the firm's distribution plans in the subsequent year may change (and may increase) from those included for the same period in its previous plan.[20] Firms should be able to describe the goals of their capital plans and the appropriateness of any changes to distributions in light of intervening developments, changes in expectations, etc. Any pattern of distributions should be evaluated within the context of the appropriateness of a firms' overall capital management plans and strategy, fully taking the BHC's support and rationale into account.

Accordingly, we respectfully request 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.

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[19] For example, loan or asset growth may have been lower than expected in the first year, or loan or asset growth expectations for the second year may be lower than previously expected.

[20] CCAR rules only allow firms to adjust distributions downwards, not upwards. Therefore, after a CCAR plan is submitted, firms are not able to adjust distributions higher if their capital ratios turn out to be higher than desired or expected. As a result of this limitation imposed by CCAR rules, it may be common for firms with higher than desired or expected capital to find it necessary to increase distributions in their subsequent plans versus those originally projected, in order to maintain course to achieve consistent capital targets and goals.

VII. Considering the Adoption of Basel III, the Tier 1 Common Ratio Should be Removed

The Proposed Rule maintains the current requirement for BHCs to calculate a Tier 1 Common Ratio (T1C Ratio) under the formerly-applicable Basel I-based generally applicable risk-based capital rules. However, the Basel III rules were phased in for advance approaches BHCs beginning in 2014 and will become effective for all other BHCs beginning in 2015. Although the T1C Ratio is a regulatory capital ratio that was used for supervisory purposes before and after the financial crisis, it is not a minimum capital requirement. Beginning with the adoption of the Basel III regulatory capital minimum requirements for all BHCs in 2015, the T1C will cease to be a regulatory capital ratio for any purposes but capital planning and stress tests. Accordingly, the Associations urge the Federal Reserve to eliminate the requirement that BHCs calculate the T1C Ratio and demonstrate in its capital plan that it will maintain a 5% T1C Ratio under stressed conditions. Instead, BHCs should only be required to calculate their applicable capital requirements for the upcoming and subsequent capital planning cycles pursuant to the final U.S. Basel III-based capital rules and their applicable regulatory capital minimum requirements.

VIII. Effective Date

The Proposed Rule is unclear with respect to when the proposed changes would be effective. Many of the proposed changes would affect banks' internal processes. As a result, except for our request for adoption of the proposed shift in time cycle for the upcoming 2015 CCAR cycle (discussed in part III above), we respectfully request, that other proposed changes not take effect until the 2016 CCAR cycle.

Thank you for considering the concerns raised in this letter. We appreciate the opportunity to share our views. If you have any questions, please contact Hugh Carney of the ABA at 202-663-5324 or Rich Foster of the FSR at (202) 589-2424.

Sincerely,

Hugh C Carney

Hugh Carney
Senior Counsel
Office of Regulatory Policy
American Bankers Association

Rich Foster

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The Financial Services Roundtable

APPENDIX

- **<u>Scenario A: Small Timing Difference (delayed issuance)</u>.** BHC X's approved capital plan indicated that it would raise $500M of capital and make $400M of capital distributions in Year Y, with capital issuances and distributions of $125M and $100M, respectively, in each quarter during the year. BHC X executes on this strategy in Q1. In Q2, BHC X plans to issue capital instruments amounting to $125M in late June. One week before the planned capital issuance, BHC X becomes aware that a peer firm is planning to issue $300M of instruments in late June, which BHC X anticipates will weaken demand for its own instruments. BHC X intends to postpone the $125M capital issuance to mid-July while continuing to make the $100M planned distribution in Q2. Inability to make the $100M distribution in Q2 would weaken BHC X's market credibility and provide false signals of financial distress, despite this not being justified by company fundamentals.[1]

- **<u>Scenario B: Small Timing Difference (delayed issuance).</u>** BHC X's approved capital plan indicated that it would raise $500M of preferred stock in Q2 and repurchase $500M of common stock ($125M in each of Q2 – Q5). Whereas the proposed changes to the Capital Plan Rule would no longer require BHC X to request permission for the preferred stock issuance, it deems it prudent to include the issuance in its Capital Plan given the BHC has not yet filled its Basel III requirement of 150 bps of non-common tier 1. In addition to the share repurchases noted previously, the BHC also has approved quarterly distributions of $30M and $50M for dividends on existing preferred and common stock, respectively. During Q2, there is extreme volatility in the U.S. Treasury's market which has resulted in associated volatility in the preferred stock market. This volatility was not expected at the time the BHC developed its Capital Plan. Whereas BHC X could still issue the required $500M of preferred stock, given the market backdrop, it would have to pay a much higher dividend than it would expect to have to pay if it waited until Q3 to do so. Under the proposed changes to the rule, the BHC would either have to: 1) Issue the security into the market and pay a much higher dividend (on a perpetual security) than it would expect to pay if it waited or 2) Choose to wait a quarter when the markets are potentially less volatile but have to suspend its planned share repurchases as well as suspend its common and preferred dividends to attempt to offset the $500M planned issuance. As one would expect, to the extent possible, BHC X would likely choose option 1 to avoid having to cut its common and preferred dividends, and then would be forced to issue into a volatile market and bear the economic hit on the perpetual security.

[1] Given that these issuances and distributions may commonly be a non-common issuance and an ongoing, normal common stock dividend, the synchronous timing requirement would be significantly problematic. Therefore, if the Federal Reserve retains this requirement, we strongly urge that any required reduction to distributions only apply to redemptions (i.e., repurchases) or distribution increases (i.e., dividend increases), rather than "run-rate" distributions that are well within the company's ability to continue even without a new issuance.

- **Scenario C: Small Timing Difference (accelerated issuance).** BHC X's approved capital plan indicated that it would raise $500M of capital and make $400M of capital distributions in Year Y, with capital issuances and distributions of $125M and $100M, respectively, in each quarter during the year. BHC X executes on this strategy in Q1. In Q2, BHC X plans to issue capital instruments amounting to $125M in late June. One week before the planning capital issuance, BHC X becomes aware that a number of peer firms may be planning to issue similar instruments during Q3, which BHC X anticipates will weaken demand for its own instruments for the third quarter. BHC X intends to accelerate the $125M capital issuance for Q3 by issuing a total of $250M late June. Even though BHC X would have made the issuance earlier and have the same cumulative issuances by the end of the third quarter, inability to make the $125M issuance in Q3, under the proposed rule, would eliminate the firm's ability to make the $100M planned Q3 distribution. This would weaken BHC X's market credibility and provide false signals of financial distress. The Associations note that a cumulative annual approach would allow a bank to accelerate issuances without weakening a BHC's market credibility.

- **Scenario D: Acquisitions**. BHC X intends to acquire BHC Y. BHC X's approved capital plan indicates that it will raise $500M in capital evenly over 4 quarters to facilitate the acquisition. Midway through the year estimates of the cost of the acquisition reduce significantly and the BHC now only needs to raise a total of $400 million to support the acquisition, which is completed during the second quarter. As a result, issuances in the approved capital plan greatly exceed what is needed. While the Proposed Rule includes a limited exception for capital actions in connection with merger or acquisition proposals that are not consummated, there is no exception where the actual capital issuance needed to support a *consummated* merger or acquisition is less than that originally estimated. As a result, BHC X would be forced to adhere to its initial best estimate of the capital needed to support an acquisition, even when that estimate was made several quarters prior to the acquisition solely for purposes of the capital plan submission. Forcing an institution either to reduce distributions if the institution takes only what capital is needed economically to support the acquisition, or to take economically unnecessary capital to preserve its capital distribution rights distorts the capital planning process in actual economic environments.

- **Scenario F (no increase in common stock dividend):** BHC X's submitted capital plan includes its ordinary common stock dividend of $90 million a quarter (approved in the prior CCAR year), ongoing dividends on outstanding preferred stock, and the potential issuance of preferred stock of $100 million in Q2 of the new CCAR period intended to further fill its non-common Tier 1 capital "bucket." The BHC proposes no common dividend increase and no redemptions or repurchases of any common stock or other capital instruments. In Q2, market conditions are such that the company would prefer to conduct the issuance in a later quarter. Under the proposed rule, should the BHC pursue this path, it would be required to eliminate its normal common stock dividend for Q2, and reduce its preferred dividends by $10 million. Under these circumstances, the BHC would have little choice but to follow the original contemplated timing of the preferred issuances. However, the risk of these circumstances would strongly discourage the BHC from even including the contemplated preferred issuance in its submitted plan. By way of this example, we believe that BHC X's "normal" capital distributions should not be put at risk by its contemplation of a capital issuance; rather, it would be more reasonable that capital <u>redemptions</u> and distribution <u>increases</u> should be the capital actions that are at risk in any form of new rules related to the timing of issuances.