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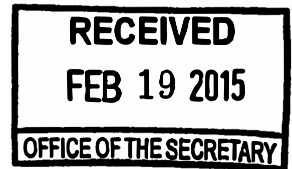

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of THOMAS A. NEELY, JR. Respondent.	Administrative Proceeding File No. 3-15945

PREHEARING BRIEF OF RESPONDENT THOMAS A. NEELY, JR.

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In accordance with Rule 222(a) and this Court's Order of January 7, 2015, Respondent Thomas A. Neely, Jr. ("Mr. Neely"), by and through counsel, files this Prehearing Brief in the matter brought against him by the Securities and Exchange Commission (the "Commission").

INTRODUCTION

Even assuming *arguendo* that the Commission's allegations are true, an assumption Mr. Neely strongly contests, the Commission's arguments are flawed. The crux of their argument is this: although the Commission concedes the statements at issue are not material enough to warrant a restatement, the Commission nevertheless argues that Mr. Neely should pay a six-figure fine (or more) and forever be barred from acting as an officer or director of a public company merely because the Commission believes that Mr. Neely exercised poor judgment in making determinations about certain borrowers' ability to pay. Although Mr. Neely did not actually "make" the statements at issue, according to the Commission the statements at issue incorporated on some level numbers that were derived from the judgment exercised by Mr. Neely. The Commission further argues that because an offer was made by a third party to purchase a certain loan held at Regions Bank ("Regions" or the "Bank"), Mr. Neely should have classified the loan as "held for sale" and discounted the loan to the offer price even though that offer was not acceptable to the Bank. Even assuming that Mr. Neely exercised poor judgment, or that he should have discounted a loan, this is not actionable conduct under the federal securities laws or for the purposes of enforcement of those laws.

Moreover, this type of armchair quarterbacking of matters that are by their nature subjective, day-to-day judgment calls made by individual employees stifles business and fails to advance the Commission's stated mission of "protect[ing] investors, maintain[ing] fair, orderly, and efficient markets, and facilitat[ing] capital formation," particularly where Mr. Neely did not

"make" the statement(s) at issue, violated no laws, policies, rules or regulations that were extant at the time, and the alleged conduct did not result in a misstatement material enough that a restatement was required. These allegations and the Commission's claims also do nothing to advance the aim of the securities laws. To the contrary, under well-established law, the Commission cannot support its legal claims against Mr. Neely. To establish such claims, the Commission must show, among other things, Neely was the "maker" of a "false" statement, made such statement(s) for gain, possessed scienter, and that any such statement was material. This, the Commission cannot do.

The evidence to be presented at the upcoming hearing will show that the Commission cannot support its claims because the allegations set forth in the OIP are unfounded and are insufficient, as a matter of law, to support a finding against Mr. Neely. Mr. Neely not only denies the Commission's allegations, but affirmatively avers that he never violated any provision of the securities laws cited in the OIP, nor did he engage in any intentional misconduct while employed by Regions and its parent holding corporation, Regions Financial Corporation. To the contrary, Mr. Neely properly discharged his duties in accordance with Regions' credit policy and then-existing standards.

At the upcoming hearing of this Administrative Proceeding, Mr. Neely anticipates and expects that the evidence will prove the facts detailed in the proposed stipulations that Mr. Neely submitted for the Division's consideration, a copy of which are attached as Exhibit A.[1]

[1] Mr. Neely has made every legitimate and reasonable effort to comply with the directives of this Court and to insure that the actual hearing will be conducted as efficiently and effectively as possible. In furtherance of those efforts, on February 15, 2015, Mr. Neely submitted the proposed stipulations that are contained in Exhibit A for the Division's consideration. Mr. Neely's stipulations are detailed, were made in good faith, and are facts Mr. Neely anticipates and expects that the evidence will prove. The proposed stipulations to which Mr. Neely and the Division actually agreed will be filed separately with this Court.

Furthermore, at the upcoming hearing Mr. Neely's defenses will include, but not necessarily be limited to[2], the following:

I. The SEC cannot establish primary liability under 10(b), 10b-5, and 17(a).

To establish liability, an officer or director must be "primarily liable." The United States Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.* made clear that aiding and abetting liability does not exist. *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994); *see also Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148 (2008) (holding that an individual who assists in the making of a misstatement cannot be held liable).

To establish primary liability under 10(b) or 10b-5, a person must "make" a misstatement. A person is deemed to have "made" the statement only if that person has "ultimate authority over the statement, including its content and whether and how to communicate it. Without control, a person or entity can merely suggest what to say, not 'make' a statement in its own right. One who prepares or publishes a statement on behalf of another is not its maker. . . ." *Janus Capital Grp., Inc. v. First Derivative Traders*, 131 S. Ct. 2296 (2011). It is not enough for a person to "assist" in the making of the statement. *See Janus*, 131 S. Ct. at 2305. To the contrary, if an officer or employee did not "make" the statement or acted on orders from a higher authority, liability does not exist. *See, e.g.*, *Stoneridge*, 552 U.S. 148 (2008); *see also In re Coinstar, Inc. Sec. Litig.*, No. C11-133 MJP, 2011 WL 4712206, at *10-11 (W.D. Wash. October 6, 2011) (applying *Janus* to individual officer defendants and dismissing the COO, Treasurer and GC from action alleging that

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[2] Mr. Neely's defenses also include the positions advanced by expert witnesses whose opinions, which are incorporated by reference as if fully set out herein, were filed in his behalf on February 2, 2015.

these three officers were liable for alleged financial misstatements made by others at certain conferences); *Hawaii Ironworkers Annuity Trust v. Cole*, No. 3:10CV371, 2011 WL 3862206, at *5 (N.D. Ohio September 1, 2011) (applying *Janus* to claims against corporate insiders and finding four officers who participated in the alleged misstatements relating to a company's financials could not be primarily liable under 10(b), notably relying on the fact that the officers were acting in response to a directive from upper management to manipulate data to increase earnings).

The holding in *Janus* is not limited to actions for civil liability. It applies equally to enforcement proceedings brought by the Commission alleging violations of 17(a), 10(b) and 10b-5 because such claims are functionally the same as claims for civil liability. *See, e.g.*, *SEC v. Kelly*, 817 F. Supp. 2d 340, 345-46 (S.D.N.Y. 2011); *In the Matter of John P. Flannery & James D. Hopkins*, S.E.C. Release No. 438, 2011 WL 5130058 (ALJ, Oct. 28, 2011) (initial decision). For example,

> Where the SEC is attempting to impose primary liability under subsections (a) and (c) of Rule 10b–5 for a scheme based upon an alleged false statement, permitting primary scheme liability when the defendant did not "make" the misstatement would render the rule announced in *Janus* meaningless. It would allow the SEC to allege that the conduct *Janus* held insufficient to establish primary liability under subsection (b) of Rule 10b–5 is scheme-related conduct that supports primary liability under subsections (a) and (c), notwithstanding that the alleged misstatements represent the basis of that claim.
>
> Therefore, because the SEC's scheme liability claim is premised on a misrepresentation and neither defendant "made" a misstatement as *Janus* requires, the SEC's claim under subsections (a) and (c) of Rule 10b–5 must be dismissed.

Kelly, 817 F. Supp. 2d at 344 ("[T]he SEC concedes that *Janus* forecloses a misstatement claim against [certain individual defendants] under subsection (b) of Rule 10b–5, because neither defendant 'made' a misleading statement under the new *Janus* standard."); *see also SEC v. Perry*, No. CV-11-1309 R, 2012 WL 1959566, at *8 (C.D. Cal. May 31, 2012) (applying *Janus* to claims

brought by the Commission under Section 17(a) of the Securities Act); *In re Flannery*, 2011 WL 5130058, at *35.[3]

The facts that will be presented in this proceeding will clearly show that Mr. Neely was not the "maker," within the meaning of *Janus*, of any alleged misstatement by Regions. Thus, he cannot be found liable under 10(b), 10(b)-5, and/or 17(a).

II. Mr. Neely has been denied adequate notice of the alleged charges against him.

By way of example of the manner in which Mr. Neely has been denied adequate notice: in ¶ 37 of the OIP,[4] the Commission alleged that Mr. Neely violated §17(a) of the Securities Act (15 USC § 77q(a)). However, that section contains three separate possible acts which could potentially constitute an alleged violation:

15 USC § 77q. Fraudulent interstate transactions

[3] *See also S.E.C. v. Benger*, 931 F. Supp. 2d 908, 912-13 (N.D. Ill. 2013):

> As the movants point out, there have been at least several cases where the SEC has simply conceded that *Janus* applies to its enforcement actions. *See SEC v. Sentinel Management Group, Inc.*, 2012 WL 1079961, *5 (N.D. Ill. March 30, 2012) (Kocoras, J.) ("In light of the decision the SEC does not dispute that Bloom was not the maker of the statements . . . ."); *SEC v. Geswein,* 2011 WL 4565861, *2 (N.D. Ohio 2011)("Further, as conceded by the SEC, any conduct alleged against Miller pursuant to Section 10(b) and Rule 10b–5(b) are dismissed . . . ."); *SEC v. Kelly*, 817 F. Supp. 2d 340, 342 (S.D.N.Y.2011) ("In its opposition brief to the defendants' motion, the SEC concedes that *Janus* forecloses a misstatement claim against Rinder and Wovsaniker under subsection (b) of Rule l0b–5...."); *SEC v. Daifotis*, 2011 WL 3295139, *2 (N.D. Cal. 2011) ("Both sides agree that this order must reconsider the order granting in part and denying in part defendants' motion to dismiss and strike . . . pursuant to these new principles [from *913 *Janus*]"); and *SEC v. Big Apple Consulting USA, Inc.*, 2012 WL 3264512 (M.D. Fla. 2011) (In light of *Janus,* SEC moved for leave to amend its complaint, withdrawing the claim against defendant for primary violation and substituting a claim of aiding and abetting). And, as already noted, the SEC was rather lukewarm about this issue here, consigning it to a footnote.

[4] "As a result of the conduct described above, Neely aided and abetted and caused Regions' violations of Section 17(a) of the Securities Act and Section 10(b) and Rule 10b-5 thereunder of the Exchange Act." In his Answer to ¶ 37 of the OIP, Mr. Neely denied the allegations and demanded strict proof thereof.

(a) Use of interstate commerce for purpose of fraud or deceit

> It shall be unlawful for any person in the offer or sale of any securities (including 11security-based swaps) or any security-based swap agreement (as defined in section 78c(a)(78) of this title) by the use of any means or instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly
>
> (1) to employ any device, scheme, or artifice to defraud, or
>
> (2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; or
>
> (3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

Based on the plain language of ¶ 37 of the OIP, it is impossible to determine with any precision which subsection of § 17(a) the Commission alleges that Mr. Neely violated. Therefore, Mr. Neely has not received adequate notice of the allegations made against him in ¶ 37 of the OIP and has been denied due process. Mr. Neely reserves the right to raise any and all defenses available to him to the extent the Commission provides notice of the specific claims and allegations against him, including without limitation that Mr. Neely did not obtain money or property in connection with any statement as well as a lack of materiality.

III. Mr. Neely has no "controlling person liability" because he lacked the requisite power to control the affairs of the corporation.

In *Brown v. Enstar Group, Inc.*, 84 F.3d 393 (11th Cir. 1996), *aff'g Brown v. Mendel*, 864 F. Supp. 1138 (M.D. Ala. 1994), *cert. denied*, 117 S. Ct. 950 (1997), the Eleventh Circuit adopted a new standard of controlling person liability. The *Brown* Court held that a defendant is liable as a controlling person "if he or she 'had the power to control the general affairs of the entity primarily liable at the time the entity violated the securities laws . . . and had the requisite power to directly or indirectly control or influence the specific corporate policy which resulted in the primary liability.'" *Brown*, 84 F.3d at 396; quoting Brown v. Mendel, 864 F. Supp. 1138, 1145 (M.D. Ala.

1994). "The Eleventh Circuit has declined to adopt a 'culpable participation' standard . . . ." *City Pension Fund for Firefighters & Police Officers in City of Miami Beach v. Aracruz Cellulose S.A.*, No. 08-23317-CIV, 2011 WL 12502370, at *27 (S.D. Fla. Sept. 16, 2011).

"To succeed on a claim of control liability under § 20(a), a plaintiff must prove that the defendant: (1) had the power to control the general affairs of the entity primarily liable for securities fraud at the time of the violation; and (2) had the power to control or influence the specific corporate policy that resulted in primary liability." *Aranaz v. Catalyst Pharm. Partners Inc.*, 302 F.R.D. 657, 667 (S.D. Fla. 2014). Because Mr. Neely did not have the power to control the general affairs of Regions, and because he did not have the power to control or influence the specific corporate policy that resulted in Regions' alleged liability, Mr. Neely was not a "controlling person" and he had no liability under Section 20(a) of the Securities Exchange Act of 1934. *See Brown*, 84 F.3d at 396.

IV. The Commission has not alleged and cannot establish that any other individual or entity is primarily liable; thus, Mr. Neely cannot be secondarily liable.

"Under . . . section 20(a) of the 1934 Act . . . , Congress imposed secondary liability on controlling persons for securities law violations perpetrated by others, thereby extending liability beyond primary violators." Bradford R. Turner, *Brown v. Enstar Group, Inc.: The Eleventh Circuit Opens the Door for Expansive Controlling Person Liability Under the 1933 and 1934 Securities Acts*, 32 GA. L. REV. 323 (1997) (footnote omitted). The application of *Brown* makes it clear that Mr. Neely has no Section 20(a) liability unless and until the Division of Enforcement ("Division") establishes the liability of a primary violator. Thus, in order to establish that Mr. Neely is liable under 20(a), the Division must establish that Regions (or someone else) is liable under §§ 10(b) or 10b-5. "Of course, without a primary violation of the securities laws, there can be no secondary violation under § 20(a)." *Malin v. Ivax Corp.*, 17 F. Supp. 2d 1345, 1351 (S.D. Fla.

1998) (citing *Shields v. Citytrust Bancorp., Inc.*, 25 F.3d 1124, 1132 (2d Cir. 1994). As no such primary liability has been established Mr. Neely cannot be found liable as a secondary violator.

V. The allegations in this matter do not reach the threshold of Materiality.

Fraud, by its nature, inherently contemplates a form of deception that matters. In order to find Mr. Neely guilty of the charges in the OIP, the Division must prove and the evidence must show that his conduct was "material." The Division recognized this materiality standard as evidenced by the OIP, which specifically alleged that Mr. Neely's conduct was material:

> • II, Summary: "Such deliberate misconduct by the Respondent to evade existing policies and procedures constituted a fraudulent scheme that rendered Regions' financial statements for the quarter ended March 31, 2009 **materially** misstated and not in conformity GAAP,[5] . . . ."
>
> • II E ¶ 32: "The Public Filings did not include other information as was necessary to ensure that the statements made in the Public Filings were not, under the circumstances, **materially** misleading."
>
> • II G ¶ 43: "As a result of the conduct described above, Neely violated Rule 13b-2-2 of the Exchange act when he directly or indirectly made or caused to be made **materially** false or misleading statements, or omitted to state **material** facts necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to accountants in connection with the preparation or filing of documents and reports which were required to be filed with the Commission."

(emphasis added).

4. The OIP also described the consequences of Mr. Neely's alleged misconduct:

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[5] "Generally Accepted Accounting Principles ('GAAP') are the official standards adopted by the American Institute of Certified Public Accountants (the 'AICPA'), a private professional organization, through three successor groups it established: the Committee on Accounting Procedure, the Accounting Principles Board (the 'APB'), and the Financial Accounting Standard Board (the 'FASB'). *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 160 n. 4 (2d Cir. 2000)." *United States v. Ebbers*, 458 F.3d 110, 125 (2nd Cir. 2006). "GAAP does not prescribe a fixed set of rules, but rather represent 'the range of reasonable alternatives that management can use.' *In re Burlington Coat Factory*, 114 F.3d at 1421 n. 10 (citing *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522, 544 (1979)). The SEC treats the FASB's standards as authoritative. See PNC Bancorp, 212 F.3d at 825 n. 1." *Ganino v. Citizens Utilities Co.*, 228 F.3d 154, 160 (2nd Cir. 2000).

• II D ¶16: "Had Regions classified the relevant loans on non-accrual status in accordance with its policies, it would have prompted a determination that the identified loans were impaired in accordance with GAAP. That determination would have resulted in Regions recording a higher allowance for loan and lease losses."

• II D ¶ 19: "Neely's intentional scheme directly resulted in the improper classification of the Loans pursuant to Regions' policies, and further prevented Regions' from appropriately determining [whether] those Loans were impaired in accordance with GAAP at the quarter ended March 31, 2009."

• II E ¶ 28: "Neely's intentional misconduct resulted in Regions' failing to make and keep books, records, and accounts, in reasonable detail, which accurately and fairly reflected the Loans. Further, Regions' accounts were falsified through the intentional misconduct of the Respondents." ***[Note, the OIP here uses "Respondents" in the plural, not the singular "Respondent."]***

• II E ¶ 29: "As a result of failing to properly account for the Loans in accordance with GAAP, for the quarter ended March 31, 2009, Regions' income before income taxes was overstated by $16 million, its net income applicable to common shareholders was overstated by approximately $11 million, and its earnings per common share was overstated by approximately $.02 per share."

• II E ¶ 30: "Had the Shopped Loan been properly written down to fair value in conformity with GAAP and Regions' policies and procedures, Regions' net income available to common shareholders would have been reduced an additional approximately $2.9 million beyond the approximately $11 million overstatement attributable to the Loans."

• II E ¶ 33: "Neely's [sic] knowingly made false statements and/or misleading omissions in the sub-certification when he averred that he was 'now aware of . . . [a]ny significant deficiencies in the . . . internal control over financial reporting . . . [or] [a]ny fraud, whether or not material." Neely knew that the sub-certification would be relied on as part of the financial reporting process for the quarter."

(emphasis added).

Mr. Neely anticipates that the evidence will show that the loans at issue in the OIP (the "Specified Loans") represented an immaterial concentration (approximately 0.1%) of Regions' total assets as of March 31, 2009, and reclassifying the Specified Loans as non-accruing would have had an inconsequential impact on the stock price and total market value of Regions as of March 31, 2009. The per share stock price of Regions' common stock closed at $4.26 on March

31, 2009, and it would not have changed from the actual price of $4.26 per share had the Specified Loans been reclassified as non-accruing.

A. *Judicial Definition of Materiality.*

For purposes of both the Securities Act of 1933 and the Securities Exchange Act of 1934, the United States Supreme Court has defined a general standard of materiality:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. This standard is fully consistent with Mills general description of materiality as a requirement that "the defect have a significant Propensity to affect the voting process." It does not require proof of a substantial likelihood that disclosure of the omitted fact would have caused the reasonable investor to change his vote. What the standard does contemplate is a showing of a substantial likelihood that, under all the circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (footnote omitted); *see also Basic Inc. v. Levinson*, 485 U.S. 224, 232 (1988) ("We now expressly adopt the *TSC Industries* standard of materiality for the § 10(b) and Rule 10b–5 context."). A misrepresentation is immaterial "if it would not have been viewed by the reasonable investor as having significantly altered the total mix of information made available." *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S.Ct. 2398, 2413 (2014) (internal quotation marks omitted).

The United States Court of Appeals for the Eleventh Circuit has defined:

> the "test of materiality in the securities fraud context" as "whether a reasonable man would attach importance to the fact misrepresented or omitted in determining his course of action." *SEC v. Goble*, 682 F.3d 934, 943 (11th Cir. 2012) (quoting *SEC v. Merchant Capital, LLC*, 483 F.3d 747, 766 (11th Cir. 2007)). A fact stated or omitted is considered material when there is a substantial likelihood that a reasonable purchaser or seller of a security would consider the fact important in deciding whether to buy or sell. *See Goble*, 682 F.3d 934, citing *SEC v. Pirate Investor LLC*, 580 F.3d 233, 240 (4th Cir. 2009) (other citations omitted). The court finds as a matter of common sense that misstating loan loss reserves and/or the goodwill of a publicly traded company are both considerations that a reasonable

buyer or seller would find important in deciding whether to invest in a stock or divest of the same.

Local 703, I.B. of T. Grocery and Food Employees Welfare Fund v. Regions Financial Corp., 282 F.R.D. 607, 622 (N.D. Ala. 2012), affirmed in part, vacated in part and remanded in part on the issue of class certification, *Local 703, I.B. of T. Grocery & Food Employees Welfare Fund v. Regions Financial Corp.*, 762 F.3d 1248 (11th Cir. 2014).

The conduct alleged to have been committed by Mr. Neely in the OIP does not rise to the level of "materiality" as either the Supreme Court or Eleventh Circuit has defined the term. The best evidence of the lack of materiality is that the Commission did not believe that a restatement was required. Had there been a substantial likelihood that a reasonable purchaser or seller would consider the fact important in making a decision whether to buy or sell, then the Commission surely would have required Regions to restate the financials for that period.

B. The Commission's Definition of Materiality and Lack of Scienter.

i. The Commission's own definition, as suspect as it may be, does not support that the statement at issue was "material."

On August 13, 1999, the Commission's accounting staff issued Staff Accounting Bulletin No. 99 ("SAB No. 99"), which addresses materiality in the preparation of financial statements. SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150 (August 19, 1999). SAB No. 99 "essentially restates the existing standards of materiality as promulgated thus far by judicial precedent, the Commission itself and applicable accounting and auditing literature. The Accounting Staff notes that SAB 99 is not intended to create new standards or definitions for

materiality."[6] Courts have shown no reluctance to cite SAB No. 99 with approval. *See Hutchison v. Deutsche Bank Securities Inc.*, 647 F.3d 479, 485 (2nd Cir. 2011).[7]

Under SAB No. 99, both quantitative and qualitative factors must be considered in assessing an item's materiality. Under the quantitative factor, the Commission considers the financial magnitude of the misstatement. The financial magnitude – or lack thereof – of the alleged misstatement in this matter is more fully addressed in the expert reports filed in behalf of Mr. Neely on February 2, 2015. Under the qualitative factor, the Commission considers: (1) whether there was a concealment of an unlawful transaction; (2) the significance of the misstatement in relation to the company's operations; and (3) management's expectation that the misstatement will result in a significant market reaction. *In re Lone Pine Resources, Inc.*, No. 12 Civ. 4839 (GBD), 2014 WL 1259653, *4 (S.D.N.Y. Mar. 27, 2014). Mr. Neely anticipates that the evidence will show that none of these three factors is present in this matter: there was no concealment of any unlawful transaction, there was no significant misstatement, and there was no expectation of significant market reaction.

ii. Even if the statements were material, the Division cannot show the requisite fraud or scienter necessary to establish liability.

Multiple courts have recognized that GAAP violations, standing alone, do not equate to securities fraud.[8] In that vein, the United States Supreme Court has noted that "'generally accepted

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[6] Cadwalader, Wickersham & Taft LLP, *SEC Release on Materiality in Financial Disclosure*, Mar. 26, 2008, located at: http://corporate.findlaw.com/finance/sec-release-on-materiality-in-financial-disclosure.html#sthash.1lUL4RQe.dpuf.

[7] Judge Karen Bowdre, Chief Judge for the United States District Court of the Northern District of Alabama, favorably cited SAB No. 99 in *United States v. Scrushy*, No. CR-03-BE-0530-S, 2004 WL 2713262, *3 (N.D. Ala. Nov. 23, 2004). The Second Circuit considers SAB No. 99 "persuasive authority." *See ECA v. JP Morgan Chase Co.*, 553 F.3d 187, 197–98 (2d Cir. 2009).

[8] *See, e.g., In re Carter-Wallace Inc. Sec Litig.*, 150 F.3d 153 (2d Cir. 1998); *In re Software Toolworks Inc.*, 50 F.3d 615 (9th Cir. 1994); *Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422 (6th Cir. 1980).

accounting principles' are far from being a canonical set of rules that will ensure identical accounting treatment of identical transactions . . . [GAAP] tolerate a range of 'reasonable' treatments, **leaving the choice among alternatives to management**." *Thor Power Tool Co. v. Commissioner of Internal Revenue*, 439 U.S. 522, 544 (1979) (internal footnotes omitted) (emphasis added). Similarly, courts have acknowledged that differences of opinions in the usage of GAAP do not necessarily constitute material omissions or misstatements. *See, e.g., Adams v. Standard Knitting Mills, Inc.*, 623 F.2d 422, 432-33 (6th Cir. 1980).

Even if the numbers were inaccurate, in a material or immaterial way, without the requisite showing of scienter, the Division still cannot establish liability. "[T]he mere publication of inaccurate accounting figures, or a failure to follow GAAP, without more, does not establish scienter" in a securities fraud action. *DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385, 390 (9th Cir. 2002) (internal quotation marks omitted). "[A]llegations of GAAP violations or accounting irregularities, standing alone, are insufficient to state a securities fraud claim. Only where such allegations are coupled with evidence of 'corresponding fraudulent intent,' might they be sufficient." *Novak v. Kasaks*, 216 F.3d 300, 309 (2d Cir. 2000) (internal quotation marks omitted).

C. Any Misclassification of the Specified Loans was not Material.

Any misclassification of loans and misstatements in this case was not material. In *ECA, Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187 (2nd Cir. 2009), the shareholders sued the bank for alleged securities violations, contending they were defrauded by bank's complicity in a bankrupt energy company's financial scandals. The court held that the mischaracterization on the bank's financial statements of its prepaid transactions with

related entity and energy company as trades, rather than loans, did not constitute a material misstatement supporting claims for securities fraud claims:

> In order to succeed on a claim, a "plaintiff must establish that 'the defendant, in connection with the purchase or sale of securities, made a materially false statement or omitted a material fact, with scienter, and that the plaintiff's reliance on the defendant's action caused injury to the plaintiff.'" *Lawrence v. Cohn*, 325 F.3d 141, 147 (2d Cir. 2003) (*quoting Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 161 (2d Cir. 2000)); *see Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 172 (2d Cir.2005); *San Leandro Emergency Med. Group Profit Sharing Plan v. Philip Morris Cos.*, 75 F.3d 801, 808 (2d Cir. 1996). In this case, the parties contest whether the complaint adequately alleges (1) a false statement or omission of material fact, and (2) scienter.
>
> A. Materiality
>
> In order to determine whether a misleading statement is material, courts must engage in a fact-specific inquiry. *Basic Inc. v. Levinson*, 485 U.S. 224, 240 (1988). The materiality of a misstatement depends on whether "'there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to [act].' " *Id.* at 231–32 (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)). In other words, in order for the misstatement to be material, "'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'" *Id.* (quoting *TSC Indus.*, 426 U.S. at 449). Therefore, the determination of whether an alleged misrepresentation is material necessarily depends on all relevant circumstances. *Ganino*, 228 F.3d at 162. Because materiality is a mixed question of law and fact, in the context of a Fed. R. Civ. P. 12(b)(6) motion, "'a complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance.'" Id. (quoting *Goldman v. Belden*, 754 F.2d 1059, 1067 (2d Cir. 1985)) (alteration in original).
>
> The SEC has provided internal guidance in Staff Accounting Bulletin (SAB) No. 99 regarding the determination of materiality. According to SAB No. 99, both quantitative and qualitative factors should be considered in assessing a statement's materiality. SAB No. 99 begins the analysis with the quantitative factor. Under this factor, the SEC considers the financial magnitude of the misstatement; while SAB No. 99 suggests a percentage threshold below which the amount is presumptively immaterial, the SEC notes that the challenged amount can be material even though it is below that percentage threshold of assets, liabilities, revenues or net income. *See* SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150, 45150–52 (1999). SAB No. 99 also sets out qualitative factors such as, inter alia, (1) concealment of an unlawful transaction, (2) significance of the misstatement in relation to the company's operations, and (3) management's expectation that the misstatement will result in a significant market reaction. *See*

id. **This Court has deemed SAB No. 99 to be persuasive authority.** *Ganino*, 228 F.3d at 163. **While SAB No. 99 does not change the standard of materiality, we consider the factors it sets forth in determining whether the misstatement significantly altered the "total mix" of information available to investors.**

* * *

However, the classification of the loans as trading assets was immaterial in this case. Under the legal standard set forth in *Ganino*, **both quantitative and qualitative factors must be considered in determining materiality.** Here, the quantitative factor strongly supports JPMC's argument that the classification error, if it was one, was immaterial. Although $2 billion in prepay transactions may sound staggering, the number must be placed in context—reclassifying $2 billion out of one category of trading assets (derivative receivables) totaling $76 billion into another category (loan assets) totaling $212 billion does not alter JPMC's total assets of $715 billion. J.App. 406 (JMPC Annual Report 2000). Moreover, the underlying assets in either classification carry some default risk. As the district court said about this same information, "[c]hanging the accounting treatment of approximately 0.3% of JPM Chase's total assets from trades to loans would not have been material to investors." *JP Morgan Chase I*, 363 F.Supp.2d at 631.

While *Ganino* held that bright-line numerical tests for materiality are inappropriate, it did not exclude analysis based on, or even emphasis of, quantitative considerations. *Ganino*, 228 F.3d at 164. **According to *Ganino*, an alleged misrepresentation relating to less than two percent of defendant's assets, when taken in context, could be immaterial as a matter of law.** *Id.*; *see also Parnes v. Gateway 2000, Inc.*, 122 F.3d 539, 547 (8th Cir. 1997) (finding alleged misrepresentations with regard to two percent of total assets were immaterial as a matter of law); *In re Westinghouse Sec. Litig.*, 90 F.3d 696, 715 (3d Cir. 1996) (stating that a misstatement was immaterial where only one percent of assets was allegedly misclassified). And as the SEC stated in SAB No. 99, "[t]he use of a percentage as a numerical **threshold, such as 5%, may provide the basis for a preliminary assumption that . . . a deviation of less than the specified percentage with respect to a particular item on the registrant's financial statements is unlikely to be material."** SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. at 45151. Here, the five percent numerical threshold is a good starting place for assessing the materiality of the alleged misstatement. In this case, the alleged misrepresentation does not even come close to that threshold. **An accounting classification decision that affects less than one-third of a percent of total assets does not suggest materiality.** However, this preliminary inquiry under the quantitative factor must be supplemented. See *Ganino*, 228 F.3d at 163. We go on to consider qualitative factors that might contribute to a finding of materiality.

Contrary to Plaintiffs' assertions, however, the qualitative factors do not adequately demonstrate the materiality of the decision to classify the prepay transactions as loans. On appeal, Plaintiffs point to three factors set forth in SAB No. 99 as supporting their argument of materiality. The first qualitative factor is whether the misstatement concealed an unlawful transaction. Plaintiffs have not

shown that this factor is present. Although they allege that the transaction should have been described differently, *see, e.g.*, SAC ¶ 261, there is no allegation that the transaction itself was illegal. The second qualitative factor, the misstatements' relation to a significant aspect of JPMC's operations, also favors JPMC. While Plaintiffs allege that Enron is a "key client" of JPMC, it appears clear that JPMC's transactions with Enron were not a significant aspect of JPMC's operations, considering the fact that JPMC earned less than .1% of its revenues from Enron-related transactions each year. See SAC ¶ 54 and J.App. 405 (showing that while JPMC earned $30.1 million and $29.8 million in relationship revenues from Enron in 1999 and 2000 respectively, it earned $29.484 billion and $31.557 billion in total net revenues in those years). Finally, the third qualitative factor that Plaintiffs rely on is the market reaction to the public disclosures of JPMC's role in the Enron collapse. SAB No. 99, while alluding to market reactions as a valid consideration in analyzing materiality, warned that market volatility alone is "too blunt an instrument to be depended on in considering whether a fact is material." SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. at 45152 (internal quotation marks omitted). Indeed, SAB No. 99 limits the usefulness of this factor to instances where management expects "that a known misstatement may result in a significant positive or negative market reaction." *Id.* Plaintiffs have not alleged facts that would permit the inference that JPMC expected that the alleged misclassification of the loans might result in a significant market reaction. For this reason, the market reaction to Enron's collapse and JPMC's involvement in this collapse does not point towards qualitative materiality under SAB No. 99.

These qualitative factors are intended to allow for a finding of materiality if the quantitative size of the misstatement is small, but the effect of the misstatement is large. *See Ganino*, 228 F.3d at 163. Here, Plaintiffs have failed to allege properly that despite the relatively small size of the allegedly misstated transactions, reporting these transactions as loans instead of trades would have made a qualitative difference in JPMC's financial statements. To be sure, misclassification of assets does matter (as Plaintiffs point out, it has implications for ratio analysis), but the tenor of the SAC is that JPMC knew that the prepays were worthless all along—an argument that is not only implausible, but also counter-intuitive.

Plaintiffs also argue that, had the transactions been reported properly, the "subterfuge that JPMC and Enron created" would have been exposed, leading to the public becoming aware of JPMC's involvement with Enron's misdeeds. See SAC ¶¶ 249, 254. As set forth in the complaint, this allegation is wholly conclusory. While Plaintiffs make the assertion that the proper accounting would have revealed JPMC's collusion with Enron, that hardly suggests how the whole arrangement with Enron would have come to light. FN9 And, given that assets in either category carry some default risk, we cannot reasonably infer that there was a substantial likelihood that JPMC's reporting of the transactions as loans rather than as trades would have been viewed by a reasonable investor as having significantly altered the total mix of information made available.

FN9. We also note that JPMC did in fact make at least some minimal disclosure regarding the nature of the trades. JPMC's Annual Report stated, "Loans held for trading purposes are included in Trading Assets and are carried at fair value, with the gains and losses included in Trading Revenue." *JApp*. 414. So even if JPMC did not conform to GAAP, it did provide some notice to investors that its trading assets contained loans.

ECA, Local 134, 553 F.3d at 197-98, 203-05 (emphasis added).

As summarized in the expert opinion of Richard K. Yowell that was filed with this Court on February 2, 2015:

> Given the turbulence of the time when these issues arose, and given the Bank's additional ALLL allocation for "Imprecision and Industry Stress" in the amount of $155 million, it is my opinion that had all the loans in question been placed on non-accrual before March 31, 2009, there was adequate "cushion" in the ALLL so that the impact on the Bank's reported operating results would not have been material. Said another way, the alleged actions of Mr. Neely did not, in my opinion, result in a material misstatement of the Bank's operating results at March 31, 2009.
>
> . . . .
>
> Based on the information provided, I conclude that:
>
> 1. The ALLL would have been adequate to absorb the increased allocations for the loans in question
>
> 2. The impact of the reversed interest would be less than 1% of net operating income, and
>
> 3. The combined impact of moving the loans to non-accrual would have had a less-than-material effect on the Bank's reported operating results.

"The Materiality of Contested Decisions Regarding the Classification of Troubled Loans in Regions Bank," Richard K. Yowell, February 2, 2015, at pps. 3, 8.

CONCLUSION

Mr. Neely anticipates and expects that the evidence will show that he properly discharged his duties in accordance with then-existing standards, and that, furthermore, any alleged fraud or "misclassification" of any loan was not material under any applicable definition of "materiality." Furthermore, Mr. Neely anticipates and expects that the evidence will show the facts contained in

his proposed stipulations presented for the Division's consideration, which are attached as Exhibit A.

Respectfully submitted,

/s/ Augusta S. Dowd

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Exhibit A

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of **THOMAS A. NEELY, JR.** **Respondent.**	**Admin. Pro. File No. 3-15945**

RESPONDENT'S PROPOSED STIPLATIONS

Respondent THOMAS A. NEELY, JR. ("Respondent"), by and through counsel, hereby submits these his Proposed Stipulations for consideration by the Securities and Exchange Commission (the "Division"). Respondent proposes these Stipulations be received into evidence and binding on the parties pursuant to Rule 324 of the Rules of Practice.

1. Respondent received an undergraduate degree from Auburn University in finance in 1982.

2. Respondent began work at AmSouth Bank in October 1983. Respondent served in various roles within AmSouth, including as Commercial Relationship Manager, Senior Credit Officer, and State Credit Officer.

3. On January 26, 2006, then-AmSouth president and CEO Dowd Ritter announced the promotion of Respondent, along with four other "key leaders," to the level of Executive Vice President. Per Ritter, "[t]he title of Executive Vice President recognizes both the important contribution of these individuals and the vital role of the areas in which they serve."

4. Following Regions' merger with AmSouth, Respondent became employed by Regions by virtue of his employment with AmSouth.

5. The Regions-AmSouth merger was, in reality, a "reverse merger" in which the merged entity was named Regions but AmSouth management "won the day."

6. The cultures of the two institutions were very different, and those differences led to some "culture clashes" during the integration period.

7. Following Ritter's assumption of the Regions' CEO role, Ritter implemented the matrix management organization style within Regions.

8. From 2006 through June 2009, Respondent held the position of Commercial Credit Executive at Regions. On January 2, 2007, Respondent was rated by Executive Council Member William C. Wells, II ("Wells") as a "Role Model," one who "[s]erves as an example for others to strive to achieve or surpass especially through imitation. Exceptional & remarkable accomplishments and contributions. Reserved for superlative employees." The Summary Comments attached to Respondent's Senior Officer Performance Summary and Base Salary Review Sheet stated:

> Tom was on the front line of merger and integration activities in 2006. While organizing a team of Commercial Credit Officers with market segmentation, he traveled tirelessly throughout the new footprint, before and after the merger date. His leadership, planning, training, and communication skills were the dominant reasons that a new credit policy and process was introduced, understood and implemented with maximum positive effect, even though it involved significant changes for the geographies.

9. In 2008, Regions began the process of selling problem loans. Respondent oversaw this process.

10. In late 2008 and into 2009, Regions had very high overall concentration levels in commercial real estate and residential real estate with the most concern for portfolio weaknesses in Georgia and Florida, which involved higher risk product types such as raw land and condominium exposure. At the same time, the economy was experiencing the worst recession

since the Great Depression and the FRB employees working on these matters had never experienced such a recession.

11. Regions performed its first stress test in the first quarter of 2009 ("1Q2009"). Wells, as the Chief Risk Officer for Regions, was the key contact for Regions during the stress test.

12. In 1Q2009, the Executive Council of Regions Financial Corporation ("Executive Council") was comprised of the following members:

a. C. Dowd Ritter

b. O.B. Grayson Hall, Jr.

c. David B. Edmonds

d. Irene M. Esteves

e. G. Timothy Laney

f. John B. Owen

g. David H. Rupp

h. Wells.

13. No member of the Executive Council established or set a specific "target," or "goal" for Respondent or any other Regions employee to meet regarding the amount of loans designated as nonaccrual for the 1Q2009, in terms of both the number of non-accrual loans and the aggregate dollar amount of non-accrual loans.

14. In 1Q2009, Respondent reported to Wells; Wells served as Chief Risk Officer Regions during 2008 and 2009.

15. As Chief Risk Officer, Wells was responsible for the Credit division, with Michael Willoughby ("Willoughby"), who served as Chief Credit Officer during 2008 and 2009, reporting to Wells.

16. During 2008 and until July 2009, Willoughby was responsible for the credit quality of Regions.

17. During 2008 and until July 2009, the following departments and individuals reported to Willoughby:

a. Commercial Credit Department - Respondent;

b. Consumer Credit – Barb Godwin;

c. SAD – Jeff Kuehr ("Kuehr");

d. Credit Policy and Training – Tracy Sheehy; and,

e. Credit Reporting – Carey Barrentine ("Barrentine").

18. During 1Q2009, Regions was transitioning its risk rating process.

19. The function of the Special Assets Department ("SAD") was to resolve problem loans. Kuehr was the head of SAD during 2008 and until July 2009, and he directly reported to Willoughby. Accordingly, SAD reported to Willoughby until July 2009.

20. During 2008 and until July 2009, Willoughby had oversight for making sure SAD operated properly.

21. According to the Commercial Loan Policies Manual dated February 16, 2009, it was Kuehr, the head of SAD, who had approval of the non-accrual status of loans $250,000,000 and less.

22. At no time during 2008 until July 2009 did Respondent have authority over SAD.

23. Respondent's role within SAD was one of oversight – he, along with others, was to ensure that the assigned risk rating was correct.

24. A loan's risk rating was determined via a collaborative effort of both the field relationship managers and a credit officer.

25. Due to the influx of problem loans at Regions, throughout 2008 and 2009 SAD was suddenly inundated with a large number of commercial real estate loans. During this time period, Regions' practice was that any loan classified as substandard must be transitioned to SAD. These substandard loans had to have a risk rating of 70 to move into SAD.

26. SAD was understaffed in 2009, and consequently, there was concern that loans were being placed on nonaccrual to alleviate the workload of certain SAD employees.

27. Regions management placed over a billion dollars of loans on nonaccrual in the 1Q2009.

28. No incentivized compensation plan was in place for Respondent in 1Q2009 such that Respondent would have received more or less compensation from Regions based on the amount of loans designated as nonaccrual for the 1Q2009, in terms of both the number of non-accrual loans and the aggregate dollar amount of non-accrual loans.

29. The Asset Quality Forecast ("AQF"), prepared by or at the direction of Barrentine, was an internal Regions document, updated weekly, that listed loans with an outstanding balance of at least $2.5M and the loan's risk rating.

30. The AQF was referred to interchangeably as the "AQF," forecast," "goal," or "target."

31. Weekly meetings were held to discuss the AQF and any changes involving assets listed on the AQF. Willoughby presided over these AQF meetings.

32. In addition to the weekly AQF meetings, Problem Loan Report ("PLR") meetings, accrual verification meetings, and Executive Council meetings were held within Regions.

33. The accrual verification meetings were held at quarter end and were presided over by Shelby Mackey. Relationship managers and employees from the Credit Review Department discussed 70 risk rated loans and justification of a loan's nonaccrual status.

34. During 1Q2009, Regions' Credit Review Department was led by Mark Jarema ("Jarema").

35. The Executive Council met monthly and discussed credit forecasting as well as the level and number of nonaccrual loans and NPL.

36. According to Regions policy, the Business Services Credit Executive or the Chief Credit Officer had the discretion to continue a loan on accrual if they thought it was appropriate.

37. Regions Financial Corporation filed a Form 10-Q for the quarterly period ended March 31, 2009 with the United States Securities and Exchange Commission. R. Exh. 119 is a true and correct copy of this publicly-available document.

38. On page 32 under the Allowance for Credit Losses section, the Form 10-Q for 1Q2009 states "The allowance for credit losses totaled $1.93 billion at March 31, 2009 and $1.90 billion at December 31, 2008. The allowance for credit losses as a percentage of net loans was 2.02% at March 31, 2009 compared to 1.95% at December 31, 2008 and 1.49% at March 31, 2008. The increase in the allowance was primarily driven by deterioration in the residential homebuilder, condominium and home equity portfolios, all of which are tied directly to the housing market slowdown as well as the impact of increasing unemployment rates. Given continuing pressure on residential property values – especially in Florida and North Georgia – and a generally uncertain economic backdrop, the Company expects credit costs to remain elevated."

39. On page 33, the Form 10-Q for 1Q2009 noted "Factors considered by management in determining the adequacy of the allowance include, but are not limited to: (1) detailed reviews

of individual loans; (2) historical and current trends in gross and net loan charge-offs for the various portfolio segments evaluated; (3) the Company's policies relating to delinquent loans and charge-offs; (4) the level of the allowance in relation to total loans and to historical loss levels; (5) levels and trends in non-performing and past due loans; (6) collateral values of properties securing loans; (7) the composition of the loan portfolio, including unfunded credit commitments; and (8) management's analysis of current economic conditions."

40. Page 33 of the 1Q2009 10-Q further noted "Various departments, including Credit Review, Commercial and Consumer Credit Risk Management and Special Assets are involved in the credit risk management process to assess the accuracy of risk ratings, the quality of the portfolio and the estimation of inherent credit losses in the loan portfolio."

41. Page 40 of the 1Q2009 10-Q, second paragraph, states as follows: "At March 31, 2009 and December 31, 2008, Regions had approximately $1.0 billion and $813 million, respectively, of potential problem commercial and commercial real estate loans that were not included in non-accrual loans or in the accruing loans 90 days past due categories, but for which management had concerns as to the ability of such borrowers to comply with their present loan repayment terms."

42. Similar language has been in every 10-Q filed by Regions since filing the 1Q2009 10-Q.

43. Trey Wheeler ("Wheeler"), Regions' Senior Central Point of Contact, Federal Reserve Bank of Atlanta, was responsible for the May 2009 FRB examination of Regions Bank.

44. Through discussions with Scott Corrigan in Spring 2009, FRB examiners were aware of the existence of the AQF and knew the title of the document at the time of their May 2009 targeted exam. However, the FRB examiners did not request the AQF during the targeted

exam. The first time the FRB examiners made a direct request for the AQF – after the nonaccrual exam – their written request was directed to Respondent. In response to the examiners' request, Respondent promptly provided the requested AQF without the need for subpoena.

45. On April 22, 2009, Wheeler was contacted by Jarema, then head of Regions' Credit Review function. Jarema told Wheeler that Wells, at the time Chief Risk Officer for Regions, told Jarema that he, Wells, made the decisions on nonaccruals and if Jarema did not like it, he could take it to the Risk Committee.

46. During the same conversation, Jarema advised "that there were approximately $150 million in loans (ten relationships) that had been identified by SAD personnel . . . as nonaccrual credits and should have been moved to nonaccrual at the end of the first quarter but were not." Jarema, who described wells as an "old school control freak," further stated to Wheeler that "Chief Risk Officer (CRO) Bill Wells made the decision not to move the loans to nonaccrual as these loans were included in the SAD forecasting report and CRO Bill Wells removed them from the final report."

47. In a May 9, 2009 email related to the June 1st Credit Exam, Wells directed Respondent and Willoughby to: (1) notify all relationship managers or SAD that their loans had been selected and that the relationship managers were to immediately increase their knowledge of the credit, and (2) give the relationship managers general guidance for dealing with an examiner, including that the relationship manager always have someone with them for their protection.

48. It was a mutually-agreed upon practice between Regions and the FRB that most of the FRB's requests for information would be in writing and recorded in a formal log in order to track what documents and meetings had been requested and what had been completed.

49. The FRB required Regions to create documentation reflecting a narrative related to certain subject loans and justification for the loan's continued accrual status.

50. Regions later agreed with the FRB examiner that First West Cutler Gardens should have been recognized as non-accrual as of March 31, 2009.

51. Effective May 28, 2009, a Memorandum of Understanding ("MOU") was entered into among Regions Financial Corporation, Regions Bank, the Federal Reserve Bank of Atlanta, and the Superintendent of the Alabama State Banking Department. The MOU was independent of the nonaccrual target exam, and was put in place before the nonaccrual exam was finalized.

52. In June 2009, Regions created a Risk Analytics area headed by Respondent.

53. Wheeler got involved in meetings with Regions personnel in conjunction with the targeted exam in approximately June 2009 regarding a previous request for signatures up and down the line on who made decisions on certain loans. The request was initiated by Jay Repine, and had been made on numerous occasions.

54. In June 2009, Wheeler had a meeting with Wells, Willoughby, Respondent, and Kuehr and asked them one final time what the problem was and why were they not agreeing to complete what the FRB was asking them to do. Wheeler was aware that Regions had reached out to its counsel on that question, and Wheeler did not attribute the refusal of Regions to provide him the information he requested on those signatures to Respondent.

55. On July 10, 2009, Wheeler and David P. Florey, Case Manager, Large Institution Division, Alabama State Banking Department, wrote a letter to Douglas J. Jackson, Senior Vice President and Regulatory Liaison for Regions Financial Corporation, captioned "Re: Nonaccrual Process & Transaction Testing Review." In the "Summary of Findings" section on page 3 of 8, Wheeler and Florey note "It is acknowledged that accrual status decisions require the exercise of

considerable judgment, and, therefore, clear documentation of facts and circumstances that support loan accrual status decisions is critical."

56. Judgment is part of the allowance methodology and part of the process for accrual/nonaccrual decision making. Additionally, management judgment is at play in nonaccrual decisions.

57. On September 25, 2009, on behalf of Regions, Respondent responded to the August 27, 2009 letter from Wheeler and Florey detailing their conclusions from the targeted review conducted in Regions' Atlanta office of the nonaccrual loan process and transactional flow. In the correspondence, Respondent outlined some of the corrective action steps Regions started in June, including contracting with KPMG to review NPL process and other processes in SAD. Respondent noted that "Management has selected KPMG to conduct a third party loan review of SAD. The Statement of Work has been submitted to you for approval. We are awaiting your written confirmation of the scope and coverage of this review." These consulting retentions were actions that were required by the August 27, 2009 conclusion memo.

58. Wheeler reviewed the proposed KPMG scope of work regarding the third-party loan review required by the supervisors as part of the nonaccrual process review, and on October 2, 2009 sent Respondent and others a memo detailing his comments on the proposal. Wheeler's comments were addressed, and KPMG's scope of work on the loan review process was finalized and received the Reserve's final approval.

59. In the Executive Summary of the December 15, 2009 KPMG Regions Financial Corp Regulatory Update, 93.1% of the time KPMG agreed with the rating put in by Regions. Per KPMG, Regions needed to upgrade 1.8% of the loans KPMG reviewed and downgrade another

5.1%. The error rate of just under 7% determined by KPMG "was a big change from previous history" and "showed improvement."

60. On December 18, 2009, Jackson wrote to Wheeler and Florey to respond to a specific question asked during their recent meeting to discuss the KPMG findings for the credit file review project. Jackson wrote "[t]he KPMG report indicates that Regions credit risk ratings had downgrades of 5% (outstanding balances) which John Hale of KPMG characterized as we are 'getting it right'".

61. In July 2010, Respondent was demoted to Problem Asset Manager, where his function was selling problem loans. In November 2010, Respondent was terminated by Regions at the request of "lower-level regulators."

62. On April 16, 2013, Respondent gave sworn testimony in connection with Orders of Investigation issued by the Board of Governors and the Federal Reserve System and the State of Alabama in connection with Regions Financial and Regions Bank. Counsel for the Board of Governors and the Federal Reserve provided Respondent with a document consisting of 31 pages and 234 questions, which was marked as Respondent Exhibit 2 and Respondent and his counsel had an opportunity to review prior to the start of his deposition. Respondent indicated his intention to assert his privilege under the 5th and 14th Amendments against self-incrimination as to each and every question contained in Exhibit 2, and Respondent's counsel inserted a standing objection to form to each and every question listed in Exhibit 2. Counsel for the Board of Governors and the Federal Reserve then concluded the substantive examination.

63. The chart below, which is based on information contained in R. Exh. 17, a non-Bates numbered document produced by the Division and referred to as "Exchange (1)", accurately reflects the Balance Due and the Allowance for Loan and Lease Losses as shown on the books and

records of Regions Bank for the period ending March 31, 2009 for each of the 14 loans that are the subject of the Order Instituting Cease-and-Desist Proceedings filed by the Securities and Exchange Commission.

Borrower	Balance at 3/31/2009	Actual Allowance on 3/31/2009
Designers Choice Cabinetry	2,588,814	323,602
Eighteen Investments, Inc.	5,858,439	732,305
First West Cutler Gardens, LLC	10,928,452	1,366,056
Glove Factory Holdings, LLC	24,733,624	3,091,703
Jones & Jones Investments, LLC	1,799,870	224,984
Kicklighter Custom Homes, Inc.	2,566,718	320.840
McCar Development Corp, ET	9,403,323	1,175,415
Oak Ridge Land Co. LLC	15,723,602	1,965,450
Resorts Construction, LLC	21,154,720	2,644,340
Richland Investments, LLC	41,852,606	5,231,576
River Glen, LLC	3,836,162	479,520
Seahaven Finance, LLC	6,801,133	850,142
Waters Edge One, LLC	15,523,561	1,940,445
Wilval, LLC	5,248,171	656,021
	168,019,195	21,002,399

64. The "Exchange (2)" document, a non-Bates numbered document produced by the Division that has been designated as R. Exh. 18, was authored by Brad Kimbrough of Regions.

65. The stated purpose of the "Exchange (2)" document was "to estimate what the potential income statement impact could have been if the 15 loans listed had been designated as non-accrual during the first quarter of 2009." The 15 loans considered in "Exchange (2)," R. Exh. 18, are the same 15 loans set out in "Exchange (1)," R. Exh. 17.

66. The analysis in "Exchange (2)" considered "1) The reversal of any interest income on the loans during the first quarter of 2009 and 2) the potential increase in the Provision for Loan

Losses (Provisions) that could have resulted from the loans being designated as non-accrual and therefore receiving a different reserve amount through the Company's Allowance For Loan Losses process."

67. "Exchange (2)" referenced certain columns found in the "Exchange (1)" document. As to Column E in "Exchange (1)," "Exchange (2)" stated that it showed "the difference between the reserve amount the loans actually received at 3/31/09 (column C) and the estimated potential specific reserve that would have been calculated if the loans had been classified as non-accrual (column D). This estimate results in approximately $14.8 million in additional reserves."

68. In the "Income statement assessment" section of "Exchange (2)," Regions concluded "[t]he additional $14.8 million in specific reserves would not have resulted in additional provision or allowance for loan losses **because this amount was more than adequately covered by the Company's $155 million allowance allocated to Imprecision and Stressed Industries**. The $1.8 million in pretax interest reversals ($1.1 million after tax) **would clearly be immaterial** to the Company's 1Q09 financial statements as the Company's diluted EPS of $0.04 would have been unchanged" (emphasis added).

69. Although Regions "concluded that the $14.8 million would be absorbed by the Imprecision and Stressed Industry allocation," "Exchange (2)" went on to "assess materiality if it were to be assumed that the $14.8 million was required to be added to the allowance for loan losses." Even under that analysis and based on certain materiality considerations noted in "Exchange (2)," "the Company has concluded that **if this scenario was applicable, it would result in an immaterial adjustment to the 1Q09 financial statements**" (emphasis added).

70. One of the Materiality Considerations noted in "Exchange (2)" was "[w]hether the misstatement masks a change in earnings or other trends." Regions found that "[a] change from

$26 million and $0.04 as reported in 1Q09 to $15 million and $0.02 **would not have resulted in masking a change in earnings trends**" (emphasis added). In fact, Regions went on to note that "[a]nalysts' consensus expectations were for a loss of $(0.39)/share; **therefore, EPS of either $0.04 to $0.02 would have exceeded the expectation**" (emphasis added). Regions concluded that "[t]he item would not result in changing income to a loss."

71. The financial impact of not placing the 14 loans that are the subject of the Order Instituting Cease-and-Desist Proceedings filed by the Securities and Exchange Commission on non-accrual status as of March 31, 2009, was insignificant when compared to the billions of dollars Regions lost in 2008, as reported on its publicly-filed December 31, 2008 earnings report.

72. Tangible price-to-book ratio is a very important pricing tool for measuring the value of bank stocks when there is a lack of visible earnings.

73. Tangible price-to-book ratio is a standard valuation metric known and used by most bank analysts.

STIPULATIONS AS TO AUTHENTICITY OF DOCUMENTS

74. Regions' Non-Accrual Loan Policy as of March 2, 2009, marked as Div. Ex. 96, is a true and correct copy of the policy in effect for 1Q2009.

75. Regions' Accounting Policy Manual – Loans Held for Sale – Accounting Policy and Reporting Updated as of September 15, 2008, marked as Div. Ex. 9 and R. Exh. 124, is a true and correct copy of the policy manual in effect for 1Q2009.

Respectfully submitted,

/s/ **Katherine Rogers Brown**

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