

**Meeting of the Board of Governors and the Federal Advisory Council
November 30, 2016**

Participants: Chair Janet Yellen, Governor Daniel Tarullo, and Governor Lael Brainard (Federal Reserve Board members); Robert Frierson, Michael Gibson, Wayne Passmore, Linda Robertson, Clement Ancrì, Megan Drefchinski, Daniel Grantham, Sarah Gosky, Jon Hiratsuka, Ann McKeehan, Wanda Quick, Paula Scharf, PJ Tabit, and Aleksandra Wells (Federal Reserve Board staff)

Richard E. Holbrook, Michael Corbat, Mark A. Turner, Paul G. Greig, Kelly S. King, O.B. Grayson Hall Jr., Frederick H. Waddell, Ronald J. Kruszewski, Kenneth J. Karels, Leslie R. Anderson, Ralph W. Babb Jr. (Council members); Steve Gardner (representing the Federal Reserve Bank of San Francisco); Herb Taylor (Secretary), and Katie Taylor (Deputy Secretary)

Summary: Members of the Federal Reserve Board met with the Federal Advisory Council (“the Council”), a statutorily created advisory group that is composed of twelve representatives of the banking industry (one member from each Federal Reserve District). The Council ordinarily meets four times a year to provide the Board with information from the banking industry’s perspective.

The Council discussed the Board’s proposed rule (Docket No. R-1548) to modify its capital plan and stress testing rules for the 2017 cycle, as well as the proposed extension and revision of the Capital Assessments and Stress Testing information collection (FR Y-14A/Q/M) (ICP-201623). Among other matters, the discussion included considerations for and the impact of removing the qualitative assessment of the capital plans of certain large and noncomplex firms from the Comprehensive Capital Analysis and Review and instead conducting the qualitative assessment for these firms through the supervisory review process.

The information collected from the Council at the meeting is summarized in the attachment. The viewpoints expressed in the attachment are solely those of the Council.

Attachment

Stress Testing

After a recent review of stress testing by the Federal Reserve, including the Comprehensive Capital Analysis and Review (CCAR), changes have been suggested as a further step in the evolution of these tests. What are the Council's views on these suggested changes?

With regards to the Notice of Proposed Rulemaking (NPR) released on September 26, 2016, along with remarks discussing additional proposed changes, the Council supports the efforts of the Board of Governors to tailor CCAR and DFAST by recognizing differences between bank holding companies (BHCs) of different sizes and business models. However, the Council also has concerns with certain elements of the NPR and requests further clarifications on the additional proposals as part of a future rulemaking in 2017.

Analysis and Discussion of the NPR and Additional Proposals:

Elimination of the Qualitative Objective for Large, Noncomplex BHCs:

- The Council members support the NPR's removal of the qualitative objection for large, noncomplex BHCs. Shifting this review to the regular supervisory process, with its targeted horizontal assessments, is an appropriate step given the progress the industry has made toward meeting capital-planning and stress-testing requirements.
- Further clarity and details surrounding the application of the qualitative review to the supervisory process would help to facilitate a better understanding of what will be required during these reviews:
 - The NPR states a reduction in the supporting documentation for the CCAR submission. However, the NPR also indicates that this same documentation may be required to be produced on request as part of the supervisory examinations.
 - How will this supervisory process function? Will it differ from other examination procedures and protocols?

FR Y-14 Reporting Requirements:

- The proposed changes to reporting requirements are welcomed, but the Council would encourage the Board to further review the FR Y-14 reporting requirements and eliminate other reporting provisions that are unnecessary and/or outdated:
 - While the increase in materiality thresholds from 5% of tier 1 capital basis to 10% is appreciated, the thresholds may result in many banks still reporting relatively small portfolios. One suggestion is a change to calculating the thresholds as a percentage of risk-weighted assets.
 - Eliminating certain components of the pre-provision net revenue (PPNR) schedules, such as the PPNR metrics worksheet and the reporting detail on the other PPNR schedules, would meaningfully reduce regulatory reporting associated with the FR Y-14A reports.
 - Consider moving the FR Y-14M reports to a quarterly as-of date.
 - Given that the FR Y-14 schedules tend to evolve and expand over time, an internal Board review of the schedules on a regular, repeating basis may create a

mechanism by which the schedules are systematically simplified and clarified as appropriate.

- The Council supports the proposed modifications to the FR Y-14 reporting schedules by raising the materiality threshold for material portfolios and changing the modeling losses to the median loss rate. However, these changes are limited, and the materiality threshold is still a marginal amount at the increased 10%.

Simplification of Initial CCAR Applications:

- The Council welcomes proposed changes to the initial CCAR applications. Extending the deadline for an initial filing, harmonizing DFAST and CCAR submissions, and extending the time for new entrants to submit FR Y-14M reports are welcome proposals that will assist new entrants to the capital-planning and stress-testing process.

Blackout Period:

- The Council believes the proposed blackout period is unnecessary because unforeseen events could justify a proposed capital action outside of the normal CCAR process. Moreover, this change could disrupt markets by introducing significant risks to the financial system, such as a market disruptor that prevents acquisitions of troubled institutions, conditions capital decisions on nonmarket factors, and may encourage the shifting of financial activities to shadow banking entities.

De Minimis Limitation:

- The NPR proposes a significant reduction in the size of any de minimis capital distribution from 100 bps (1.00%) of tier 1 capital to 25 bps (.25%).
- The Board included this provision because it stated some institutions were using the de minimis process as an automatic additional capital distribution.
- This significant reduction will further lead BHCs with state member banks to only seek capital distributions annually as part of the CCAR process and lead to excessive pressure to maximize capital distributions during the CCAR process.
- As an alternative, the Council recommends that the Board consider keeping the de minimis exemption at 100 bps (1.00%) but tie the use of the exemption to the performance of the BHC compared to the BHC's capital plan.

Stress Capital Buffer (SCB):

- A proposal to replace the capital conservation buffer with a new SCB, which would be an individualized calculation and minimum common equity tier 1 capital under the Federal Reserve's severely adverse scenario. The SCB would have a minimum floor of 250 bps (2.50%), and any breach would have restrictions on capital distributions and executive compensation.
- The SCB could potentially be punitive for some BHCs, although potential offsets could be available through changes to the severely adverse scenario and risk-weighted asset assumptions.
- Additional details on how the SCB would work are necessary for the Council to opine on the notion of an SCB.

Assumed Capital Actions in the Severely Adverse Scenario:

- Further possible amendments outlined a proposed change to a BHC's assumed capital actions under the severely adverse scenario.
- This proposal would allow a BHC to assume only four quarters of common dividend payments and would discontinue share repurchases in the severely adverse scenario.
- The Council supports this proposal, as this assumption appropriately balances supervisory goals with realistic capital distributions that BHCs would more likely pursue under the severely adverse scenario.

Static Risk-Weighted Asset Projections:

- The additional amendments proposed simplification of the assumption on balance sheet size under the severely adverse scenario by assuming a flat balance sheet and risk-weighted assets in the supervisory severely adverse scenario.

The Council supports this proposal, as it is an appropriate assumption under the severely adverse scenario that also reduces uncertainty related to scenario assumptions.