Meeting of the Board of Governors and the Federal Advisory Council
February 10, 2017

Participants: Chair Janet Yellen, Governor Daniel Tarullo, Governor Jerome Powell, and Governor Lael Brainard (Federal Reserve Board members); Andrew Figura, Robert Frierson, Joseph Gruber, Ann McKeehan, Wayne Passmore, Robin Prager, Trevor Reeve, Michelle Smith, Clinton Chen, Megan Drefchinski, Geoffrey Gerdes, Sarah Gosky, Daniel Grantham, Maria Ling, Mark Manuszak, Margaret Miller, Daniel Nikolic, Wanda Quick, and Paula Scharf (Federal Reserve Board staff)

Bruce Van Saun, Mark Turner, Beth Mooney, Brian Moynihan, William Rogers Jr., Ronald Kruszewski, Kenneth Karels, Leslie Andersen, Ralph Babb Jr., Robert Sarver (Council members); David Nelms (representing the Federal Reserve Bank of Chicago); Herb Taylor (Secretary), and Katelyn 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.

Council members presented the attached views on regulation in the banking industry. The viewpoints expressed in the attachment are solely those of the Council.

Attachment

Regulation of the Banking Industry

> **Regulation of the banking industry has again become part of the national debate. What changes in regulation seem most likely? What is the Council's view of such changes, and what principles should guide those changes?**

What changes in regulation seem most likely?

On February 3, 2017, President Trump signed an executive order delineating six Core Principles that will guide financial regulation during his presidency. The executive order also directs the Secretary of the Treasury to identify the extent to which existing laws and regulations promote these principles. As a result, the Dodd-Frank Act and its associated regulations will be reviewed and potentially revised.

Those aspects of the Dodd-Frank Act and its associated regulations that touch on community banks and affect small to medium-size businesses are the most likely to be addressed in the immediate future. Additionally, the portions of the law and associated regulations that set forth the requirements for the larger, so-called systemically risky firms are likely to be revised by scaling the rules to match the particular risk profile of covered entities. Opportunities for making regulations more risk focused include adjustments to the requirements and timing of resolution-plan submissions; exemptions from Volcker Rule restrictions; relief from CCAR supervisory-run stress tests, including the allowance of capital planning independent of the annual CCAR exercise; and modification of liquidity coverage ratio and net stable funding ratio requirements.

New leadership at federal agencies is likely to be a major driver of change. It is also likely that the structure of regulatory organizations, particularly the CFPB, will be considered. A number of members of Congress and other policymakers have suggested that the CFPB's single-director structure should be changed to a multimember commission and that the organization's budget should be subject to the congressional appropriations process. There are also many aspects of the Basel III standards that are likely to be reviewed or revised in 2017. Pending CECL (current expected credit loss) accounting changes may have significant impacts on bank loan-loss reserves, capital levels, and lending capacity. Implementation details will need to be carefully considered.

President Trump also signed a presidential memorandum on February 3, 2017, delaying implementation of the Department of Labor's Fiduciary Rule. Other recently proposed or finalized regulations will likely be reviewed and possibly revised or eliminated in 2017, including the following:

- the CFPB's Arbitration Rule;
- the FDIC's Record Keeping Rule; and
- the interagency Incentive-Based Compensation Arrangements Rule (proposed).

Additionally, cybersecurity protections for the financial services sector and the Nation are necessary; however, in the past two and one-half years, the financial services sector has been subject to 30 different regulatory proposals from over a dozen regulatory agencies. The recent Advance Notice of Proposed Rulemaking, "Enhanced Cyber Risk Management Standards," will further complicate the already fragmented regulatory space and dilute cybersecurity resources. It is necessary for the public and private sectors to collaborate to establish a more unified and risk-based framework that is useful across all sectors and that aligns to the existing federally endorsed NIST Cyber Security Framework.

While not specifically a regulatory matter, there is a chance that comprehensive corporate tax reform will be enacted in the next 6 to 18 months. It is likely that the tax rate before deductions could be significantly reduced, and a number of structural changes could impact banks and their customers. Key provisions for banking, such as the deduction for business interest expense, the mortgage interest deduction, and the low-income housing and business development tax credit programs, could be significantly modified or even eliminated. There is also the possibility that bank taxes, financial transaction taxes, or other "pay fors" affecting banks could become part of the tax code.

What is the Council's view of such changes, and what principles should guide those changes?

In addition to the principles enunciated by President Trump, the Council proposes the following principles to guide regulatory reform:

- No bank should be so big, complex, or concentrated that its potential failure would put the economic or banking systems at risk.
- Regulation should move from a one-size-fits-all regime to an approach that is risk-based and individually tailored to take into account a wide variety of factors, including an institution's size, complexity of operations, and other factors relevant to the riskiness of its activities, products, and services.
- Any legal or regulatory change should be evaluated on the basis of whether the proposal achieves the optimal outcome for short- and long-term economic growth and short- and long-term financial stability.
- Every regulation should undergo a cost/benefit analysis.
- Regulations should prescribe the boundaries within which financial institutions can take measured risk and facilitate the efficient allocation of capital.
- Financial regulatory agencies should increase coordination and reduce overlap to produce more effective regulation.

Since the enactment of the Dodd-Frank Act and its statutory size thresholds, banking regulators have relied heavily on the asset size of financial institutions, creating regulatory "cliffs" whereby all institutions over a certain size are regulated and supervised in the same manner. The unintended consequences of making size the sole determinant of risk are regulatory classifications and duties that can be highly limiting and destroy market value. ROE for the industry has still not recovered sufficiently to overcome the hurdle posed by the cost of equity capital, and the number of U.S. commercial banks continues to dwindle. Although size-only regulation may be a simple shortcut for supervising financial institutions, it is needlessly burdensome for many financial institutions with noncomplex operations and business models and results in increased costs and reduced products and services to bank customers. The Basel Committee regards size as only one of five equally weighted factors in considering whether to designate a particular institution as a GSIB. Far more important than simple size is the aggregated weight of other factors, such as cross-jurisdictional activity, interconnectedness, substitutability/financial institution infrastructure, and complexity.