Record of Meeting

Federal Advisory Council and Board of Governors

Thursday, September 4, 2025

Item #1: Economic Activity

How would Council members characterize their clients' and contacts' assessments of their near-term economic prospects? How are businesses' assessments affecting their production, investment, and inventory management strategies? Are consumers' assessments causing them to alter the level or composition of their spending or saving? What is the Council's outlook for the pace of business and consumer spending through the remainder of this year and into early next?

Council members generally reported fewer concerns about near-term economic prospects than earlier this year, as worst-case trade policy risks have moderated. Council members' uncertainty about tax policy also eased, reflecting the clarity and incentives provided by recent legislation. Overall, Council members reported businesses to be cautiously optimistic while desiring more clarity on the ultimate impact of trade policy and interest rates. Consumers remain financially healthy overall, and sentiment has recovered from the April lows. However, concerns are developing around the weakening labor market and its potential to slow growth in the second half of 2025. One Council member indicated that cuts in federal spending in higher education, health care, biomedical research, and the nonprofit sector are having a negative impact on their District's economy.

Council members reported that businesses are largely maintaining their investment and production plans, though some delays persist as firms await further clarity on trade policy and interest rates. Nonetheless, businesses continue to invest heavily in artificial intelligence (AI) with no sign of slowing. Businesses continue to use inventory levels to help offset the impact of tariffs. One Council member reported that while client inventories in wholesale corporates rose a modest 1 percent year over year within the consumer and retail segments, overall inventories increased 5–6 percent, driven by earlier production, tariff costs, and cautious consumer behavior. Businesses continue to employ actions—such as supply chain management, cost savings initiatives, and margin compression—to minimize the impact of higher costs from tariffs.

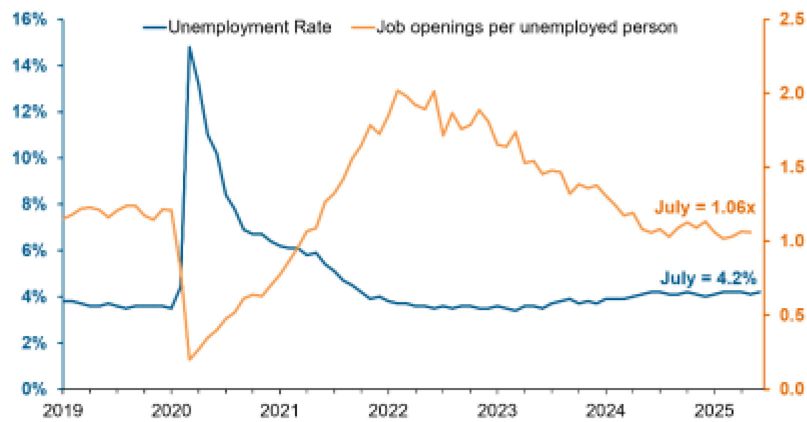
Council members noted that consumer demand remains resilient, with little evidence of significant changes in savings behavior. The earlier increase in spending due to tariff uncertainty appears to have largely abated, and consumers are exhibiting caution in discretionary spending and increasingly prioritizing value alternatives. Several companies in the discretionary goods sector reported weak results or reduced forward guidance, reflecting both tariff effects and more cautious consumer spending.

Looking ahead, Council members anticipate a modest pace of growth in business spending, consumer spending, and the overall economy for the remainder of 2025 and into early 2026. Council members noted that rising M&A activity signals businesses' commitment to moving forward. The primary headwinds to this outlook include labor market conditions, trade policy uncertainty, and elevated interest rates. Offsetting factors include a lower rate environment, greater clarity on trade policy, and tax incentives included in recent legislation.

Item #2: Labor Markets

How strong is businesses' demand for labor at this point, relative to available supply? Are there significant geographical or occupational areas of stress or slack in the market? How does the Council see the levels of employment and compensation evolving through the rest of this year and into early next?

The overall employment market continues to cool but remains fundamentally stable. Job growth slowed significantly over the summer, with only 73,000 jobs added in July following downward revisions to May and June. The unemployment rate held steady at 4.2 percent, close to where it stood a year ago, and the job openings-to-unemployed ratio has declined to roughly one-to-one, signaling balanced supply and demand. Council members reported that job applicant flow has increased, turnover has declined, and incentives to recruit and retain workers have been scaled back. Despite slower hiring, layoffs remain low as employers remain cautious about losing experienced staff.



Labor shortages are concentrated in specific fields, with persistent gaps in healthcare, skilled trades, and specialized technology roles. In contrast, entry-level and general staff positions are drawing more applicants than in prior periods. Council members also noted that recent college graduates are finding it harder to secure jobs; in fact, their unemployment rate is now above the national average. At the same time, automation and AI tools are reducing the need for staff in routine support roles, easing pressures in some areas. However, industries that rely on immigrant labor—such as agriculture, construction, hospitality, and other service-related fields—continued to report challenges as inflows of foreign-born workers remained constrained.

Looking ahead, Council members expect the unemployment rate to remain relatively steady through the remainder of 2025 and into early 2026. Many firms anticipate flat or slightly reduced headcounts in upcoming budget cycles, with new hiring concentrated on revenue-generating or mission-critical roles. Organizations are pursuing internal mobility and employee development in a cost-efficient manner, while approaching external hires more selectively. Firms remain cautious about expansion, but Council members do not anticipate broad layoffs or retrenchment.

Compensation trends also indicate continued moderation. Wage growth remained positive at 3–4 percent annually, though Council members noted that mid-2025 adjustments were negligible. Overall, Council members view the labor market as cooling but still balanced, with selective hiring and more measured compensation growth expected into early next year.

<u>Item #3 Inflation</u>

Have Council members noted any significant changes in price levels or pricing strategies since the last meeting?

- Council members generally reported no significant changes in price levels since the last meeting. Tariffs remained a recurring theme, and Council members' responses included the following:
    - There is uncertainty about the final tariff levels and their potential impacts.

- Most businesses have absorbed tighter margins rather than pass tariff-related costs on to consumers.
- The impact of tariffs is eventually expected to flow through to consumers as well as to the broader economy.

- Labor supply and costs were viewed as less of a concern; however, with ongoing retirements and reverse migration, Council members expect labor conditions to impact inflation over time.
- Food-centric businesses, including restaurants and grocery stores, are passing higher costs on to consumers, which has led to pushback, consumer trade-downs, and declines in foot traffic.

Do Council members see any outsized pressure points on pricing currently or on the horizon?

- Significant concern persists among lower- and middle-income families, driven largely by housing and healthcare costs (including insurance premiums).
- Insufficient investment in energy infrastructure globally may result in upward pressure on energy and utility costs in the next few years—particularly as demand rises to support AI and data center growth.
- Immigration reform may ease shelter costs and contribute to disinflationary pressures, but this effect could be offset by upward wage pressures from changes in labor force composition.
- New car pricing does not fully reflect cost increases, which are not yet being passed through to the buyer. To date, manufacturers have held off passing through tariff-specific additional costs to their dealer networks.

How would Council members characterize the expectations of businesses and households about inflation going forward?

- Businesses impacted by tariffs are expected to raise prices gradually—from moderate to higher levels—rather than immediately, in order to mitigate negative reactions.
- Inflation remains a concern and a drag on small businesses. Higher labor costs, rising prices for raw materials and supplies, and uncertainty over regulatory impacts are leading small businesses to operate cautiously.
- A Delaware-based plastics distributor and laminate manufacturer that sources materials from Denmark has realized a 10 percent increase in material cost as a result of tariffs. The company has responded by raising prices, which has resulted in lost orders and lower volume. The price volatility and uncertainty have also caused the company to pause purchases.

Item #4: Bank Lending

How would the Council characterize the strength of overall loan demand at this point? Are there areas of particular strength or weakness? How do Council members see bank lending to non-bank financial institutions, such as private credit or business development companies, developing over time? What are the main drivers of such developments?

Council members observed moderate demand across consumer and commercial businesses, reflecting near-term economic uncertainty driven by trade policy, high interest rates, and unemployment. Consumer loan demand has been mixed. Auto demand has been strong, as consumers pulled forward purchases ahead of anticipated tariff-driven price increases and the pending expiration of the electric vehicle tax credit. Mortgage demand remains muted with higher interest rates and elevated housing prices impacting both purchase and refinance activity. Credit card and small business lending demand remains stable.

Commercial loan pipelines are up, indicating improving client sentiment and growing interest in financing, though actual loan growth remained modest due to lingering economic uncertainty and delayed investment decisions. Bank competition for commercial loans remains robust, resulting in some pressure on pricing and structure. Strength was observed in multifamily, core middle market, and select industrial sectors (including technology and AI infrastructure). Weakness persists in transportation and office real estate, where both demand and valuations remained under pressure. Overall demand for commercial real estate loans continued to soften, with relative stability for multifamily loans but more pronounced weakening for non-residential, construction, and land development loans. Agricultural lending is also slightly subdued, particularly in regions affected by weak hard grain prices that continue to weigh on farm income and investment.

Bank lending to non-bank financial institutions, developments over time, and main drivers

Council members noted that following the global financial crisis and subsequent U.S. regulatory changes, banks pulled back from higher-risk, illiquid corporate lending and redirected their focus toward core commercial lending. Private credit from institutional investors and private funds stepped in to fill the gap left by banks in middle market lending. Ultra-low interest rates led insurers, pension funds, and family offices to increase allocations to private credit strategies. Since 2020, banks have scaled-up their provision of credit to private credit and business development companies (BDCs), financing more subscription lines, warehouse facilities, capital call lines, and both secured and unsecured credit facilities—as well as direct lending—whenever regulatory and economic conditions are favorable.

Lending to non-bank financial institutions is viewed as a growth opportunity, particularly for larger banks, given that many asset classes carry investment-grade-like risk ratings and lower expected losses in the event of default. BDCs continue to maintain sufficient liquidity to cover unfunded commitments, and the overall credit profile of these types of companies remains stable. Future developments in lending to non-bank financial institutions may be impacted by specific risk drivers, including economic conditions and capital markets access. While the link between bank short-term funding of private credit funds has increased in tandem with the growth in private credit, Council members do not believe that the concentration or liquidity risks that have evolved are untenable within the banks' existing risk management systems and overall lending concentration guidelines. However, concerns were cited regarding "regulatory arbitrage" as more lending activity moves from banks to less-regulated entities.

Item #5: Federal Reserve Policy

What are the Council's views on the stance of monetary policy, including portfolio activities?

Policy rate

Council members agreed that the modestly restrictive monetary policy employed thus far in 2025 has been appropriately cautious. Some Council members noted that a shift toward a more accommodative policy rate is warranted, while others supported a continuation of the current policy rate until economic data becomes more conclusive.

Council members in favor of a rate cut at the September Federal Open Market Committee (FOMC) meeting cited deteriorating labor conditions, moderating inflation, and ongoing economic uncertainty as key factors supporting a near-term policy shift. Recent downward revisions to labor market data indicate weakening employment conditions. Job growth has slowed, and the unemployment rate has increased to the upper end of its range for this cycle. Thus far, inflation has moderated and prices remain resilient against tariff pressure. Persistent economic uncertainty may further entrench cautious behavior among consumers and businesses, potentially stalling economic growth.

Council members in favor of holding the policy rate steady noted that risks to employment and prices seem fairly balanced; however, uncertainty remains as to the longer-term impact of tariffs on inflation. Maintaining a cautious approach is preferred until the FOMC gains more clarity from economic data. To the extent the economic data shows labor market deterioration, the FOMC should stand ready to adjust monetary policy to be more accommodative.

Council members agreed that if the policy rate is reduced, the FOMC should consider a moderate reduction and not commit to a more significant predetermined path of cuts. The FOMC should remain data dependent, with future adjustments guided by evolving economic and financial conditions.

Portfolio activities

Council members support the ongoing reduction of the Federal Reserve's balance sheet at the current pace. The balance sheet reduction continues to run smoothly, and funding markets have remained stable. The Federal Reserve should continue to evaluate funding markets for pressure and quickly address any weakening of liquidity conditions.

Item #6: Fraud

In June 2025, the federal banking agencies requested public input on five potential areas for improvement and collaboration that could help mitigate payments fraud: external collaboration; consumer, business, and industry education; regulation and supervision; payments fraud data collection and information sharing; and Reserve Banks' operator tools and services. As the agencies consider the public comments, how does the Council believe the agencies should prioritize their actions in these areas?

Council members feel strongly that payments fraud is a critical issue that would benefit from all five of the initiatives mentioned. Action regarding regulation and supervision, along with payments fraud data collection and information sharing, would have the greatest impact.

1. External collaboration

Addressing payments fraud requires greater coordination across government agencies and stronger collaboration across all sectors that influence the payment ecosystem. This includes law enforcement, federal consumer protection and communications agencies, as well as private-sector partners such as social media companies, telecom providers, fintech platforms, and technology firms. As the fraud environment has evolved toward more organized criminal networks, coordinated action from both the public and private sectors is required. New threats are leveraging multiple platforms, including social media and phone calls, as well as technologies such as AI and deepfakes, to manipulate consumers. The establishment of a dedicated office in the Executive Branch to coordinate interagency strategy, align regulatory frameworks, and enable cross-sector partnerships would be helpful.

2. Regulation and supervision

The supervisory framework should be modernized to reflect current fraud threats and payment channels. Outdated, inconsistent, and sometimes conflicting requirements across Regulation CC, the Uniform Commercial Code, the Bank Secrecy Act, and consumer protection laws can unintentionally delay or prevent banks from responding promptly to fraud or scams. Challenges include ambiguous definitions for altered and forged checks, limits on placing holds for suspected electronic payment fraud, and uncertainty regarding permissible account-level restrictions. Current regulations are outdated and emphasize procedural compliance over effective fraud prevention. A flexible, risk-based approach is needed, emphasizing outcomes rather than rigid processes.

Agencies should work with industry to harmonize rules, align supervisory expectations, and provide safe harbors for good-faith actions taken to protect customers. Clearer, more consistent regulations would enable banks to balance timely access to funds with effective fraud prevention and improved customer service. These changes need to reflect how fraud occurs in a digital environment with instant payments.

Financial services regulators should coordinate with the Federal Communications Commission and Federal Trade Commission to establish incentives and requirements for telecommunication, social media, and technology companies to implement programs that detect and prevent fraud and scams. Fintech companies should be held to the same regulatory standards as banks for fraud detection, customer verification, cybersecurity, and disclosure to address gaps in consumer protection. Effective oversight of fintech platforms is crucial to protect customers, particularly as GENIUS Act regulations are implemented.

3. Payments fraud data collection and information sharing

Regulators should collaborate with industry and Congress, as needed, to establish clear legal authority and safe harbors for real-time, cross-sector fraud information sharing. Together with consistent, industry-adopted fraud classification standards, this approach would enable faster disruption of criminal activity. Policies and guidance should distinguish between fraud trend data collection (for measurement and analysis) and intelligence sharing (for active prevention and mitigation), as each requires different models and incentives. Clear expectations for fraud intelligence functions within financial institutions should exist, including guidelines for governance, information-sharing participation, and coordination with industry groups such as the Financial Services-Information Sharing and Analysis Center and the National Cyber-Forensics and Training Alliance. Cross-industry initiatives to enhance fraud data and intelligence sharing beyond the banking sector should be enabled and encouraged, as fraud often originates on non-bank platforms (e.g., social media). Regulatory models should reflect this reality.

4. Consumer, business, and industry education

Federal bank agencies should prioritize partnering with the banking industry to educate consumers and businesses on protecting themselves from fraud. Engagement across all levels of the payment ecosystem is essential. Fraud is pervasive: Consumers and businesses face frequent phishing, smishing, spoofing, and other attacks. Education on risks associated with different payment types would also be beneficial. The agencies should recognize that technological advancements are being weaponized in new fraud schemes. Recommended actions include (1) promoting unified public messaging, (2) launching scalable communication campaigns (similar to anti-smoking initiatives) that include education for small businesses, and (3) ensuring that outreach efforts are inclusive.

5. Reserve Banks' operator tools and services

The Federal Reserve should continue to support banks by closing gaps across payment rails and enhancing the interoperability of anti-fraud capabilities. This includes improving risk management tools to enable risk intelligence across payment rails and creating new services, such as confirmation of payee, to verify recipient information before payments are initiated. Requiring senders to tag transactions with a standardized classification framework would enable receivers to better screen inbound payments for risk, reducing losses and enhancing security.

Item #7: Capital

Which leverage capital requirements are most limiting?

Council members believe that there is a role for risk-agnostic, leverage-based requirements in the broader capital framework, serving as back stops to risk-based measures. The requirements are particularly important during periods of economic stress, which are typically accompanied by an increase in system-wide reserves (higher deposits) and increased customer demand for low-risk, high-volume activities (such as U.S. Treasury cash trading and financing).

Which leverage requirements are the most binding varies by bank type. Global systemically important banks (G-SIBs) must comply with the greatest number and most rigorous set of requirements: the supplementary leverage ratio (SLR), enhanced supplementary leverage ratio (eSLR), tier 1 leverage ratio as well as total loss-absorbing capacity (TLAC) and long-term debt (LTD) leverage requirements. Banks with total assets between $250 billion and $700 billion must comply with the SLR and the Tier 1 leverage ratio, while those with less than $250 billion in assets are subject only to the tier 1 leverage ratio. Community banks with less than $10 billion in assets may elect to use the community bank leverage ratio (CBLR) in lieu of the generally applicable capital requirements.

As of the first quarter of 2025, most G-SIBs were bound or nearly bound by eSLR (or in some cases tier 1 leverage). In addition, all insured depositary institutions (IDIs) of GSIBs were bound or nearly bound by the eSLR 6 percent "well capitalized" requirement under the Prompt Corrective Action framework.

Changes were proposed by the Federal Reserve, FDIC, and OCC in their recent notice of proposed rulemaking (NPR) to modify the eSLR, TLAC, and LTD requirements (eSLR NPR) to align the leverage buffer requirements that apply to G-SIBs to 50 percent of the U.S. method 1 G-SIB surcharge. The proposed modifications are a positive step, intended to increase balance sheet capacity to some extent for low-risk activities while avoiding any material reduction in aggregate large-bank capital requirements.

Council members noted that in addition to the eSLR, the U.S. G-SIB surcharge framework is similarly restrictive to low-risk, high-volume activities. Accordingly, reforms to this framework are necessary for the intended effects of the NPR's proposed changes to be fully realized.

In addition to the proposed modifications to eSLR, TLAC, and LTD, temporarily excluding certain assets—such as central bank reserves—from the SLR during periods of extreme macroeconomic stress would further increase balance sheet capacity. This approach is permissible under the final Basel leverage standards.

Overall, regional banks have been less constrained by leverage requirements, although some (or their IDIs) are bound by the Tier 1 leverage ratio. Some Council members suggested that excluding low-risk assets from the Tier 1 leverage ratio would provide a wider universe of banks—beyond G-SIBs—incremental balance sheet capacity. Adoption of the CBLR calibrated at 9 percent has been limited among community banks, as it is more stringent than the other capital rules that apply to the majority of such banks.

How do these affect banks' business decisions, such as asset mix or liquidity profile? To what extent do leverage capital requirements affect banks' intermediation in the market for U.S. Treasury securities?

When banks are leverage constrained, they are disincentivized from engaging in low-risk activities—such as U.S. Treasury intermediation—and may look to pass on incrementally higher costs where feasible to offset the higher capital requirements associated with these high-volume, low-risk activities.

Bank dealer subsidiaries support the U.S. Treasury market through both market-making and financing, generally holding a large book of offsetting long and short positions in cash securities and financing—both of which are impacted by eSLR and G-SIB requirements.

The eSLR NPR will expand G-SIBs' balance sheet capacity and may increase their participation in low-risk activities, such as U.S. Treasury intermediation and deposit taking. This could also provide future flexibility to the financial system to meet surge demand (such as increases in deposits or U.S. Treasury intermediation) during periods of stress. However, Council members strongly caution against the assumption that G-SIBs will materially increase such activity, given the significant costs imposed by the G-SIB surcharge under the current capital framework.

<u>Item #8: Digital Technology</u>

How are Council members' institutions and customers leveraging digital technologies, including artificial intelligence, in business operations? Describe both the benefits that your institutions or customers have realized and the limitations or challenges that have been encountered. Specifically, what are the most impactful ways that AI or other advanced digital technologies have been implemented and what tangible benefits have Council members seen from these implementations (e.g., increased efficiency, cost savings, improved decision-making)? What limitations or obstacles have arisen in adopting or scaling these technologies?

Benefits and use cases

AI and other advanced digital technologies—particularly when combined with process automation—provide innovative ways to perform work and engage with customers. While these developments offer significant benefits, they also introduce risks that need to be carefully assessed and managed within existing risk frameworks.

Generative AI (GenAI) has the potential to transform the banking sector through its ability to process and generate natural language, enabling users to interact directly with AI models through intuitive interfaces. GenAI is an evolution of the AI and machine learning technologies that banks have long employed, which are managed through existing frameworks that cover model, technology, data, and operational risks among others. However, because GenAI requires additional consideration in the areas of explainability, accuracy, data, third parties, and resourcing, its adoption by banks is still in the nascent stages and has focused on low-risk, internal-facing applications with human oversight.

GenAI and other advanced technologies are being deployed to streamline business operations and drive efficiencies in areas such as systems development, customer service, risk management, and other functions that benefit from capabilities like content summarization, analysis, and creation. These technologies will require Council members to upskill and enable their workforce. While the pace and breadth of technological change may threaten some workforce roles, it will also create new roles and allow employees to focus on more complex, higher-value tasks, ultimately improving customer service and risk management.

The benefits from advanced digital technologies are numerous, and they include the following:

- *Systems development*: GenAI can be used to drive efficiency through widespread deployment of new tools across engineering teams.
- *Customer service:* Advanced technologies can be leveraged to improve and streamline customer-facing experiences, reducing demand on operations centers. Tools such as AI-powered transaction search and conversational digital assistants help customers and employees to quickly find information and take specific action on their accounts, resulting in improved customer service.
- *Risk management:* Advanced technologies also offer promising solutions to help detect and prevent threats such as malicious attacks and fraud attempts.
- *General administrative use cases:* Across all industries, GenAI and other advanced digital technologies are being used to increase productivity and help people learn new skills.

Limitations and challenges

Although a growing number of benefits from using AI and other advanced technologies across channels have been observed, some challenges remain.

- *Workforce*: The widespread adoption of advanced digital technologies such as GenAI has resulted in increased demand for employees in this field. However, one challenge has been acquiring talent at reasonable compensation levels. It will be important to continue developing talent internally while also establishing pipelines from higher education. Although technical disruption may impact total employment—with Council members expecting a downward trend in headcount over the next five years—the larger challenge may be adapting the current workforce to an AI-enabled workforce.

- *Data*: Siloed, inconsistent, or incomplete datasets reduce the reliability and limit the predictive power of new digital technologies. Such challenges are particularly acute with unstructured data, where organization and management have historically focused on legal retention and loss prevention rather than on use in AI models.
- *Third-party risk management*: Dependency on and transparency of both established and new third-party vendors remain a challenge. Third-party vendors are not directly subject to the same risk management regulatory expectations as banks, creating challenges in ensuring that the third parties follow appropriate standards of care and due diligence.
- *Governance processes*: Financial institutions may need to assess whether their existing controls and monitoring processes are sufficient for groundbreaking digital technologies. For example, current techniques to assess explainability and accuracy may not be sufficient for GenAI insights that lack an undisputed ground of truth. Similarly, new tools may be required to oversee and manage AI agents.
- *Regulatory framework:* AI and other advanced technologies are often subject to a rapidly changing patchwork of federal, state, and international regulatory frameworks. As a result, banks face heightened regulatory expectations but must both partner and compete with non-bank institutions that are leveraging similar technologies to offer financial services.
- *Resource competition*: AI and other advanced digital technologies, such as certain digital asset processes, place substantial demands on energy, chip technology, and data center capacity. These demands could influence public policy and challenge the economic viability of these technologies.

These challenges will require strong governance and attention to third-party risk management processes. As third-party vendors implement their own AI or develop related capabilities, continuous oversight is critical to ensure they follow the same standards of care and due diligence as banks. This remains a challenge as technologies evolve quickly and new partnership models emerge.

Engagement in public-private partnerships, such as the Financial Services Sector Coordinating Committee, can support a balanced approach to adopting advanced digital technologies. These collaborations support the development of industry-wide standards that strengthen risk management, ensure responsible implementation, and help maximize benefits for customers.