Meeting of the Board of Governors and the Federal Advisory Council  
September 3, 2015

Participants:  Chair Janet Yellen, Vice Chairman Stanley Fischer, Governor Daniel Tarullo, Governor Jerome Powell, and Governor Lael Brainard (Federal Reserve Board members); Mark Carey, Sally Davies, Bill English, Michele Fennell, Andrew Figura, Robert Frierson, Trevor Reeve, Lieu Hazelwood, Maria Ling, Ann McKeehan, Margaret Miller, Wanda Quick, and Paula Scharf (Federal Reserve Board staff)

Richard E. Holbrook, James P. Gorman, Scott V. Fainor, Paul G. Greig, Kelly S. King, O.B. Grayson Hall Jr., Frederick H. Waddell, Ronald J. Kruszewski, Patrick J. Donovan, Jonathan M. Kemper, and Ralph W. Babb Jr., and John G. Stumpf (Council members); 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 implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act and presented the attached views on potential revisions to the Comprehensive Capital Analysis and Review, including revisions to incorporate capital buffers for global systemically important banking organizations.

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
What are the Council’s views on how CCAR (Comprehensive Capital Analysis and Review) should be revised? In particular, to what extent should revisions incorporate capital buffers on G-SIBs (global systemically important banks), and what would be the likely effects of such incorporation on these banks?

- The Council is pleased to give additional thought to CCAR, a topic on which the Council has expressed views numerous times over the last several years, given its critical importance to the banking industry and its regulators. At the outset, the FRB should be congratulated for achieving its objectives of systemic safety and soundness: banks are better capitalized and risk-managed than ever before, and the sector’s health has improved tremendously. Recent dividend and buyback approvals reinforce that banks can return capital to shareholders in a way that is consistent with earnings and does not generate outsized systemic or idiosyncratic risk. Having completed the fifth cycle, we now have experience to refine the process in a way that still ensures capital sufficiency and banks’ ability to lend during periods of stress while retaining flexibility in capital planning. In considering whether CCAR’s current form achieves its goals, the FRB has the opportunity to resolve previously discussed issues that remain outstanding, as well as determine the role for G-SIB buffers.

- Some Council members argue to exclude the buffers rather than change existing models for several reasons, including unnecessary duplication with the global market shock and counterparty default scenarios, increased pro-cyclicality, and inconsistency with the buffer’s justification (reducing probability of default) and CCAR’s policy goal (ensuring going-concern value). Others take inclusion as given. What is clear is that simply adding the buffers to CCAR in its present form yields the unintended outcome of failure for most G-SIB banks.

- This is obviously not the regulators’ intent; instead, incorporation should be complemented by adjustments to CCAR that retain its fairness and balance while increasing the transparency of the process. For these reasons, the Council suggests the following revisions to CCAR that enable incorporation of the G-SIB buffer without unintended results:
  - Eliminate the global market shock, which combines one-time shocks across a large set of risk factors that affect asset prices, interest rates, and spreads without the benefit of any risk-management activity and which applies only to the six G-SIBs with significant trading activities;
  - Eliminate the counterparty default scenario, which assumes the instantaneous and unexpected default of each G-SIB’s largest counterparty without any consideration of credit quality or other risk management; and
  - Enable bank balance sheets to evolve as they would in stress – with certain portions adjusted to reflect new, lower market levels and others grown to support lending – rather than the current approach that assumes total balance-sheet growth.

- Other potential revisions include changing the requirement of maintaining capital actions throughout the nine-quarter forecast period, as a bank’s board approval and FRB non-objection to capital actions is limited to a four-quarter period. In any event, the board should have authority to commit to suspension of capital actions at any time during the CCAR
period. The FRB should also consider modifying the sequence of submitting planned capital actions to enable banks, and subsequently the FRB, to assess capital adequacy under the Dodd-Frank Act stress test requirements prior to the banks’ submitting capital actions, eliminating the unnecessary second-guessing associated with FRB results.

- Above all, the revised process must be transparent and clearly communicated to the market so that its capital implications are fully understood well before implementation. To that end, the Council suggests that the FRB publish the G-SIB capital ratios with the changes to existing CCAR relative to the new, higher capital ratios in a stressed environment. This may delay the buffer’s incorporation, but clarity should be prioritized. The 2015 CCAR results indicate no immediate risks that justify trading the market’s understanding of the buffer for its speedier inclusion in CCAR.

- The Council notes and supports recently proposed modifications to the regulations that exclude the supplementary leverage ratio from the 2016 cycle, eliminate the Basel I capital requirement starting with the 2016 cycle, and suspend for an indefinite period the application of the advanced approaches for CCAR stress testing.

- If the G-SIB buffers are to be incorporated, the steps outlined above should be implemented as well to avoid double-counting. As noted, this discussion offers the opportunity to resolve other outstanding issues that have been raised by the Council on multiple occasions.