

**Meeting Between Federal Reserve Staff and  
Representatives of the BIA CFO Roundtable  
September 19, 2012**

**Participants:** Jack Jennings, Suzanne Killian, Pam Martin, Steve Merriett, Lisa Ryu, and Anna Lee Hewko (Federal Reserve Board)

William C. Losch (First Horizon National Corporation); Michael O'Grady (Northern Trust Corporation); Daryl Bible (BB&T Corporation); Karen Parkhill (Comerica); Doyle Arnold (Zions Bancorporation); Todd Gibbons (Bank of New York Mellon); David Turner (Regions Financial Corporation); Rene Jones (M&T Bank Corporation); Jeff Weeden (KeyCorp); Don Kimble (Huntington Bancshares); John Woods (Union BanCal Corporation); and Joseph De Meo and Deborah Bianucci (BAI)

**Summary:** Federal Reserve staff met with representatives of the BIA CFP Roundtable to discuss financial industry topics and issues of concern, including several issues related to outstanding Board rulemakings. These issues included the timing of rulemakings related to regulatory capital and liquidity, the public comment process, the treatment of residential mortgages and accumulated other comprehensive income in proposed capital regulations, and the cumulative regulatory burden of regulations stemming from the Dodd-Frank Act and other financial reforms. Materials provided by the BAI CFO Roundtable are attached.



## **BAI CFO Roundtable Industry Meeting**

**Federal Reserve System**

**1850 K Street -7th Floor**

**Washington, DC**

**September 19, 2012**

**1:30 – 2:30 p.m. EST**

**Goal:** Establish a process for open and constructive dialogue and interaction with the Board of Governors of the Federal Reserve System on financial industry topics and issues of concern.

### **Topic List and Areas for Discussion**

#### ➤ **Current Areas of Focus for 2012 and 2013**

- The Federal Reserve's top priorities – what new initiatives are emerging?
- Key trends, concerns and potential emerging risks that the Federal Reserve is focusing on.
- The BASEL committee has issued several important concept pieces – what is the path and timing for regulations to be issued?
- How will the Federal Reserve co-ordinate with the SEC to ensure loan loss reserves are treated similarly by both agencies?

#### ➤ **Views on the Financial Regulation and Federal Reserve Policy Direction**

- What is the expected timing of the Federal Reserve issuing regulations called for into law, specifically BASEL III, the final capital rules, and the liquidity rule NPR?
- How is the Federal Reserve assessing the total cost of new regulations and the potential for unintended consequences of these new regulations such as the movement of activities into the shadow banking system? Is the Federal Reserve evaluating the cost to consumers, specifically:
  - Impact on deposit-taking for municipalities resulting from LCR requirement for unencumbered securities.
  - Impact on cost of mortgage finance resulting from capital rules for MSR's, the conservative underwriting criteria of a Category 1 mortgage, and the securitization risk retention rules.
  - Impact of the large growth of liquidity in the system to cover the impacts of the LCR, NSFR and swap margin rules.

#### ➤ **Capital**

- How is the Federal Reserve thinking about systemically important institutions getting Dodd Frank? How broad will regulatory oversight be expanded (for example the recent inclusion of certain clearing firms as systemically important)?
- Are there any updates on how Dodd Frank SIFI buffers will be implemented?
- What is the FED specifically thinking about D-SIB buffers vs. G-SIFI buffers?
- Does the Federal Reserve think more capital flexibility will be allowed once we exit the financial crisis? If not, how can the capital planning process be enhanced to give bank management teams the flexibility to address needs and opportunities that arise during the year in a more streamlined fashion?
- What are the Federal Reserve's views on stress testing as an ongoing process and its linkage to capital levels for banks? Specific items of interest:
  - Will the scenario provided each year be intended to provide a similar level of stress? How will the scenario and the interplay with the 5% capital level as "passing" be handled in the future? How can increase transparency be brought to this process so management teams can manage to what is currently a very significant unknown that has considerable market consequences for each institution?
  - Will the passing capital level be the same each year or adjusted for each CCAR exercise? Will it be focused on Tier 1 common or Tier 1 total capital in the future?

## BAI CFO Roundtable Federal Reserve Meeting Agenda – continued

- The Federal Reserve has significantly increased the reporting requirements of banks with quarterly template submission and CCAR documentation. Some of the enhanced requirements do not seem to be risk sensitive items. Does the Federal Reserve intend for these requirements to advance beyond risk to capital and institution viability?
- Is the Federal Reserve considering any revisions in the Call Reports to consolidate the older and newer reporting requirements into a single submission?

### ➤ NPR Process

- Based on comments received regarding the NPR process, is the Federal Reserve evaluating changing position and in what areas would additional comments from the industry be helpful?
- Historically banks have not collected and maintained credit and risk data to a SOX level of quality, however, bank officers are being required to sign-off/certify reported data as being submitted at the SOX level. How should bank executives approach the conundrum this creates?
- How is the Federal Reserve viewing the treatment of SFAS 115 related OCI inclusion in capital? Was the Federal Reserve trying to message the industry with questions 15 and 16 in the capital NPR? Is OCI in capital still an open issue that can be impacted and, if so, what would be helpful to the Federal Reserve in evaluating this important topic?
  - Question 15: To what extent would a requirement to include unrealized gains and losses on all debt securities whose changes in fair value are recognized in AOCI (i) result in excessive volatility in regulatory capital; (ii) impact the levels of liquid assets held by banking organizations; (iii) affect the composition of the banking organization's securities portfolios; and (iv) pose challenges for banking organizations' asset-liability management? Please provide supporting data and analysis.
  - Question 16: What are the pros and cons of an alternative treatment that would allow U.S. banking organizations to exclude from regulatory capital unrealized gains and losses on debt securities whose changes in fair value are predominantly attributable to fluctuations in a benchmark interest rate (for example, U.S. government and agency debt obligations and U.S. GSE debt obligations)? In the context of such an alternative treatment, what other categories of securities should be considered and why? Are there other alternatives that the agencies should consider (for example, retaining the current treatment for unrealized gains and losses on AFS debt and equity securities)?
- The RWA NPR proposes to increase risk weightings on delinquent and non-performing loans from 100% to 150%. This will drive the denominator higher in RW capital calculations in a weakening economic environment. At the same time, banks would be adding to their loan loss reserves; any additional ALLL above 1.25% won't count as any form of capital. Finally, through the CCAR process the Fed will have previously required banks to hold sufficient capital to survive stress without access to additional capital. Will this RW proposal have strong counter-cyclical implications in a downturn (1) for banks' continued willingness and ability to lend, and (2) potentially pushing banks to dump even more aggressively problem loans into a declining market, further depressing collateral values, and thereby perhaps causing more problem loans, etc?
- Has the Federal Reserve evaluated the impact of this measure on U.S. competitiveness since the accounting rules on market-to-market are different between countries?
- Does the Federal Reserve give consideration to U.S. accounting rules that require all "other than temporary impairment" to be immediately recognized in earnings?
- Is the Federal Reserve concerned that if the rule is adopted as proposed that banks will be forced to manage the investment portfolio in a sub-optimal fashion due to the difficulty of hedging OCI volatility? Since banks hedge the balance sheet in its entirety, why has this accounting measure been singled out for special treatment?

## **BAI CFO Roundtable Federal Reserve Meeting Agenda – continued**

### ➤ **Liquidity Standards**

- What is the Federal Reserve's view on liquidity standards emerging from BASEL III?
- What are the significant metrics that will be the focus of U.S. rules?
- Are reports that the LCR / NSFR ratio parameters will be tuned accurate? If so, is there anything you can share about likely changes?
- What is the time-frame for implementation? Will banks be permitted to take advantage of any observation and phase-in periods?
- Is there any concern about liquidity standards impacting the cost and availability of credit?
- Does the Federal Reserve have a point of view regarding proposals for more detailed disclosure of liquidity projections in SEC filings?
- Given their empirically proven performance during the crisis, why are FHLB advances not being given credit as a source of contingent liquidity?

### ➤ **Living Wills**

- Describe what bank holding companies will need to focus on between now and the end of 2013.
- What are your current expectations about the process or what has changed now that you have received the first installment of the plans from the largest banks?

### ➤ **Consumer Financial Protection Bureau (CFPB) and Compliance Enforcement**

- What has been the experience of the Federal Reserve in working with the CFPB? Are the agencies approaching industry issues in a collaborative fashion or is the CFPB setting its own agenda?

### ➤ **Swaps**

- The requirement of banks to post initial margin (IM) seems like it will greatly increase systemic risk. Is the Federal Reserve concerned about having significant amounts of collateral that is not matched with an offsetting risk position sitting at third parties given the recent fraud events at two Futures Commission Merchants?
- Is the Federal Reserve concerned about banks' ability to hedge given the combined requirement for exchange traded swaps (less flexible structures) and Volker requirements?

### ➤ **Forced liquidation of private equity investments**

- The forced liquidation of private equity investments is compelling banks to take significant charges to capital because it creates an unbalanced market where buyers know sellers have no choice except to sell. Would the Federal Reserve consider grandfathering current investments so banks are not subjected to this cost?

### ➤ **Opportunities for Efficiencies in Regulation----Refer to Attachment A**



## BAI CFO Roundtable Industry Meeting Opportunities for Efficiencies in Regulation

### Duplication of FR Y-9C and FR Y-14Q

The FR Y-14Q requires quarterly submission of historical financial data to the Federal Reserve Board starting on December 15, 2012. There are two types of Y-14Q schedules – SAS-based loan data collection schedules and Excel-based financial statements. Many Excel-based schedules duplicate Y9-C schedules at a more granular level of detail. The table below illustrates the duplication by Excel-based schedule.

FR Y14-Q	Duplication with FR Y9-C
PPNR Projections	Noninterest income and expense sections duplicate the HI schedule. Schedule represents pre-provision net revenue by business segment.
PPNR Net Interest Income	Reports interest income/ expense yield and average balances, net of nonaccruals. The schedule is compiled by calculating a more detailed version of HI (income), HC-K (average balances) and HC-N (nonaccrual) data.
PPNR Metrics	Certain metrics appears on the Y9-C schedules: number of employees, OREO balances, nonaccrual loan balances.
Securities	Instrument-level detail of information reported on the HC-B schedule.
Basel III	
Regulatory Capital Instruments	Instrument-level reconciliation of changes in HC-R.

### Capital Adequacy

A great deal of regulatory effort has appropriately been applied to capital adequacy over the years using a multi-pronged approach. As new tools have been promulgated through regulation and supervisory guidance, there has become a growing overlap in approaches. The following table shows the primary capital adequacy requirements.

Basel II	General Approach	Stress Testing	Economic Capital
	Basel II.5		
Basel III Advanced	Basel III Standardized		

There is a great deal of overlap between Basel II, Basel II.5 and economic capital. There are opportunities to revisit the purpose of these tools and reduce the redundancy between these approaches.

### Basel II

BASEL II is now an outdated piece of regulation given Dodd Frank and BASEL III. Basel II was predicated on the use of internal models driving capital levels so capital would be risk sensitive. It was also contemplated that BASEL II banks could hold less capital as a result. However the capital minimums required by BASEL I, BASEL III, and Dodd Frank make BASEL II obsolete. Additionally the comprehensive stress testing models developed for the CCAR exercise required under Dodd Frank are more sophisticated than the BASEL II regime. The stress testing framework provides a forward looking risk analysis which is much more comprehensive than the Basel II approach. Thus, to continue to subject U.S. banks to BASEL II requirements given Dodd Frank results in significant effort which does not result in any capital relief, or improved risk management as was originally intended. The industry risk capital practices have evolved beyond the modeling required under BASEL II and it should be eliminated as obsolete and no longer necessary.



## BAI CFO Roundtable Industry Meeting Opportunities for Efficiencies in Regulation

### Stress Testing

The regulatory agencies are each writing stress testing rules which will apply to their respective areas of focus. The Fed is focused on the consolidated company and the FDIC on the depository. Each will specify different timeframes and scenarios. This will require redundant efforts by banks to comply with these rules.

### Compliance

With regulatory agencies having overlapping responsibilities either through regulation or guidance issued. The following table illustrates the primary areas of overlap for selected regulations.

Rule	Federal Reserve	FDIC	CFPB
Fair Lending	✓	✓	✓
Mortgage Servicing			✓
Overdrafts		✓	✓
SCRA		✓	✓
Flood		✓	✓

The FDIC has in place a FIL for overdrafts. The CFPB is assigned the broad oversight of deposit overdrafts. This is another area of regulatory duplication.

The CFPB, based on its position that issues of safety and soundness of depository institutions affect consumer protection, is examining enterprise-wide prudential issues that are typically covered by other federal regulatory agencies. Under this scenario, banks will have to provide the same data, potentially in different forms, to an additional regulatory agency, essentially duplicating the analysis done by the primary regulator.

There is overlapping regulation of Fair Lending through the Fair Housing Act which is covered by the prudential regulators, ECOA is covered by the CFPB. The CRA rating is issued by the prudential regulators which use HMDA data while both the FDIC and CFPB will issue Fair Lending reports. This overlapping of examinations for Fair Lending is creating significant overlaps in information requests and duplicate coverage of the same areas.

There are several rules which are very complex and difficult to understand, both for banks and consumers. The CFPB is taking steps to simplify the truth in lending and truth in savings disclosures, which is a very positive step for everyone. There are several other rules which are also very complex.

UDAAP	This rule overlaps essentially all existing federal regulations. The standards for UDAAP are difficult to interpret and appear to change over time.
RESPA	This is a very confusing regulation. The FAQs are 200pp. There is a need to simplify this regulation for the benefit of both consumers and the banks which have to comply with the rule.
Privacy notices	These disclosures have become very complex and lengthy. It does not appear that consumers read the disclosures due to their length and technicality.



## **BAI CFO Roundtable Industry Meeting Opportunities for Efficiencies in Regulation**

### **Single Counterparty Exposure Definition**

Single counterparty exposure is calculated and limited under Section 165 of Dodd-Frank, national bank and state bank lending limits, Section 23A of the Federal Reserve Act (with respect to affiliates), and the FDIC's assessment calculations methodology. These multiple approaches contain sharp differences in the calculation of derivative exposure, aggregation of "related" parties, and exceptions, with the result that banks are required to maintain and monitor multiple and conflicting sets of reporting and control functions that produce different results.

### **Agency Guidance**

The regulatory agencies regulatory issue guidance which has the same force and applicability as regulation. Many times, guidance is issued without an opportunity for the industry to comment, which is different than the regulatory rule process. Many of the guidance issuances from the agencies require major efforts by the banks to comply. Examples of these include, model validation, and economic capital.