

RECORD OF MEETING

Federal Advisory Council and Board of Governors

Friday, September 8, 2017

Item 1: Current Market Conditions

What is the Council's view of the current condition of, and the outlook for, loan markets and financial markets generally? Has the Council observed any notable developments since its last meeting for loans in such categories as (a) small and medium-size enterprises, (b) commercial real estate, (c) construction, (d) corporations, (e) agriculture, (f) consumers, and (g) homes? Do Council members see economic developments in their regions that may not be apparent from the reported data or that may be early indications of trends that may not yet have become apparent in aggregated data?

General Outlook:

- Measures of business and consumer confidence remain elevated. However, expectations for the timing and magnitude of the Trump administration's fiscal agenda are rolling back.
- Concern had been growing about the potential for a congressional logjam around the debt ceiling debate in September. Now that issue has been postponed until December.
- The threat "saber-rattling" of military force between the U.S. and North Korea has caused a marginal shift toward lower-risk assets.
- The updated Q2 2017 GDP showed the pace of economic growth accelerated from 1.2% in Q1 to 3.0% in Q2.
- Consumer and real estate markets are strong and continue to grow.
- Commercial and industrial (C&I) lending, although growing moderately, remains highly competitive between banks and non-bank lenders.
- Commercial real estate (CRE) markets continue to reflect a stable environment.
- The continuation of a globally synchronized economic expansion will be positive for stocks in 2018, but increased focus on the length and eventual end of the U.S. business cycle may keep equity prices in check after a strong run through 2017.
- Today's more stable and more diversified financial system is better able to support recovery from Hurricane Harvey.

(a) Small and Medium-Size Enterprises

- Small and medium-size enterprises continue to exhibit higher levels of optimism, with the lack of new regulations providing a positive impact thus far in 2017.
- This optimism was further evidenced by a National Federation of Independent Businesses survey in July that showed a record number of small business owners planning to create jobs. This was the highest level of planned job creation since December 1999.
- However, their exuberance has begun to wane since January. This reduced optimism can be attributed to the volatility in Washington and a lack of meaningful legislative change helpful to small business owners.
- Moderate levels of loan demand are observed for medium-sized businesses, with a significant portion driven by M&A activity, which remains robust.

- Large amounts of loan volume with higher leverage and longer tenors are flowing to institutional investors.

(b) Commercial Real Estate

- Council members noted there is wide recognition that the CRE market remains strong, yet its growth is peaking. Investors acknowledge they can no longer rely on the capital markets' cap rate compression they experienced in the earlier part of the cycle to enhance value and drive return.
- Underwriting discipline remains intact, particularly for construction lending. In multifamily, there is an increased focus on geographic concentrations. In major Eastern markets, supply and demand equilibrium appears to be in check, but slowing rental-rate growth and rising vacancies are evident in the luxury segment.
- CRE yields are still attractive relative to other asset classes. Global uncertainty and a still relatively low interest rate environment will likely continue to drive demand for real estate investment in the major metropolitan areas across the U.S., as they are regarded as a global safe haven.
- Retail rents and vacancy rates remained largely stable, although the future is uncertain due to disruptive changes. One notable development was the rise in industrial rents, which are already at record highs, up 2.5% year over year, a contrast to the more flat/stable fundamentals in other property types.
- Real estate equity fundraising remains strong but is moving marginally under the levels raised over the past few years, as returns are more difficult to predict due to higher levels of supply and increased land and construction costs.
- Credit availability for the development of office and retail projects is heavily dependent upon pre-leasing and/or substantial equity contributions. In most markets, demand and/or rental rates have not returned to levels that justify the cost of building these property types on a speculative basis.

(c) Construction

- The U.S. construction sector grew at a healthy pace in the second quarter, led by growth in single-family homebuilding and sustained – albeit moderating – growth in commercial construction. The sector faces headwinds, including labor shortages, limited lot and land availability, rising lumber prices, and higher financing costs due to the sector's increased reliance on nonbank funding sources.
- Construction of new retail and office developments continues to be tenant-driven, with very little speculative activity in the marketplace.
- Demand for single-family tract development financing continues to be tepid, due in most part to the dominance of a publicly held homebuilder in most major markets.
- A general decline in the willingness of banks to provide construction financing is a recent phenomenon. It appears that banks are reserving their construction-loan capacity for their best customers, and even when that capacity is available, banks' underwriting requirements are becoming more restrictive. Specifically, banks are requiring more equity, more and stronger recourse, and higher pricing. CRE loans (funded debt) do not appear to be similarly impacted.

(d) Corporations

- While most Council members noted no significant developments since the last update, a few trends were highlighted.
- In the Midwest, leveraged deals continue to be structured aggressively; in some cases, new credit is being offered at terms 4.25X leverage, causing deals to exceed normal risk appetite. Clients continue to look for acquisitions, while pricing remains somewhat unattractive due to high multiples driven up by private equity players.
- Given post-election expectations, failure to legislate tax reform would likely deflate optimism.
- Pro rata market demand exceeds supply, with banks looking for opportunities to grow. Appetite continues for deals with loose covenants and low pricing. Unregulated or shadow lenders, such as the institutional market, continue to gain market share.

(e) Agriculture

- The U.S. agricultural economy was weak in 2Q 2017. U.S. yields will be generally lower than last year's record, while global yields will be higher. USDA reduced levels of good-to-excellent corn and soybeans to a five-year low due to growing conditions. Additional pressure may exist from shifts in the export landscape.
- Despite these headwinds, farmers have seen some improvement in lower input costs, and farmland values remain strong.
- Noncurrent loans are up since year-end 2016 and at elevated levels not experienced since June 2011.
- Low crop prices did push some farmers out of the industry in 2016, and more farmers will be pushed out in the future. Loans to highly leveraged farmers with negative balance sheets are not being renewed.
- Overall however, stronger balance sheets and low leverage are helping keep the negative impact to a minimum.

(f) Consumers

- Consumer loan demand has remained steady, with growth up several percent in 2Q 2017 compared to 2Q 2016. Overall, asset quality continues to show improvement as banks' origination mix is focused on lower-risk products, resulting in overall improved FICO scores and lower delinquency trends.
- HELOC originations in Q2 2017 grew from Q2 2016, with strong credit quality reflecting home prices at or exceeding pre-crisis levels. For several years now, homeowners have been refinancing their mortgages to reduce their monthly mortgage payments and free up cash. That process has essentially run its course, so households are now more likely to use HELOCs to obtain additional funds, though prime rate increases and continued low mortgage rates may temper this shift.
- One Council member is seeing peer banks scale back and reduce auto volumes in targeted segments.
- Privately underwritten student loans and unsecured origination volumes and credit quality remain strong, with education refinance and debt consolidation a focus.
- Card credit losses have been increasing over the past year, although they remain well below historical standards. Rising charge-offs have been primarily driven by supply-driven credit normalization, along with the seasoning of recent loan growth.

(g) Homes

- One of the biggest changes impacting the mortgage markets today is the decline in the refinance activity that has driven the mortgage industry since the economic crisis. Industry sources (Fannie, Freddie, and the Mortgage Bankers Association) suggest refinance activity is expected to be down 42%, while purchase volume is expected to increase 7% from 2016 to 2017, with total origination activity expected to be down 16%.
- The job markets have improved and home prices are rising, both of which have contributed to improved confidence in homebuying. A recent Realtor survey suggests that 84% of Americans think buying a home is a good idea, the highest percentage since the financial crisis.
- Also supporting the homebuying market, particularly the first-time buyer, is that the number of new home sales to investors for cash was only 18% in the second quarter. The National Association of Realtors reports that this is the lowest level since 2009. This decrease in sales to cash investors is largely reflective of a stability in housing and an increase in prices.
- Supply constraints are supporting home values but contributing to lower-than-expected new home sales. Both foreign and domestic demand contributed to this supply shortage, the former disproportionately impacting Florida, Texas, Washington, and California markets. Tight supply is also expected to increase remodeling expenses.

Do Council members see economic developments in their regions that may not be apparent from the reported data or that may be early indications of trends that may not yet have become apparent in aggregated data?

- Council members continue to report a generally positive outlook for consumers and businesses, though political, economic, and regulatory uncertainty continues to cloud the skies and could more materially impact business demand in future months.
- Most Council members indicate that overall loans outstanding are static in Q3 compared with Q2. Paydowns and robust capital markets appear to be offsetting originations. Ambiguity associated with tax and healthcare reform is clouding the outlook for business owners and curbing appetite for long-term investments. Clarity on the above issues could help spur near-term loan demand.

Item 2: Treasury Report on Financial Regulation

On June 12, 2017, the Treasury Secretary released a report in response to President Trump’s executive order that established “Core Principles” for regulating the U.S. financial system. What is the Council’s overall view of the report and, more specifically, its recommendations for:

- a. Community Reinvestment Act modernization**
- b. Improved regulatory coordination**
- c. Better tailoring of regulatory requirements, including stress testing, liquidity, and capital requirements, to a bank’s size and complexity?**

Which of these or other recommendations in the report does the Council consider to be the highest priority?

Overall View and Highest Priorities

The Council’s overall assessment of President Trump’s executive order that established “Core

Principles” for regulating the U.S. financial system is as follows:

Overall, the Council views the U.S. Treasury report favorably and believes it is a comprehensive and balanced assessment of the current state of U.S. banking regulations. Moreover, the Council is supportive of substantially all of the Treasury Secretary’s recommendations. The Council is encouraged by the report’s openness and transparency towards discussing potential changes to the current regulatory architecture and believes the recommendations are practical and sensible in moving towards a more ”tailored” as opposed to one-size-fits-all approach. These changes would better promote economic growth and job creation while maintaining the safety and soundness of the financial system. Importantly, the Council would expect the regulatory agencies to prioritize those items that can be implemented at the agency level through regulatory interpretations or rules outside the legislative process, given the current gridlock in the sitting Congress. We are hopeful that through further dialogue, some legislative changes can be made over time that benefit the majority of banking organizations and the broader economy. The Council looks forward to regulators and lawmakers achieving an appropriate implementation of the Treasury’s recommendations.

The Council offers a number of recommendations below that it deems to be the highest priorities. The Council is optimistic that many of the recommendations could be pursued without the need for significant congressional legislative action.

- More appropriately tailor regulatory requirements to the complexity and risk profile of the financial institution (versus a size-based approach).
 - The Council believes that existing indicators for a global systemically important bank (G-SIB) provide a better measure of systemic risk than a bank’s asset base.
- While the reforms after the financial crisis have put in place a regulatory and supervisory structure that is well designed to lower the risks to financial stability and that helped achieve a stronger financial system, the Council recommends a regulatory review of the changes implemented through a cost/benefit lens.
 - This “look back” should determine if these changes have achieved their policy objectives and/or have resulted in unintended consequences, such as negative impacts on credit availability and economic growth.
- Re-assess the assumptions in the Comprehensive Capital Analysis and Review (CCAR) process that are unrealistically conservative with respect to balance sheet growth and capital actions. The Council’s feedback includes:
 - Improving CCAR transparency, including (i) providing a national-level single point of contact for each bank; (ii) reducing reliance on a centrally managed Q&A process, and (iii) establishing checkpoints throughout the process;
 - Eliminating the mid-cycle submission;
 - Bringing regulators together with the banks to improve the accuracy of loss modeling; and
 - A belief that the qualitative assessment should no longer be the sole basis for the Federal Reserve’s objection to capital plans for all banks subject to CCAR.
- Adjusting the calculation of the Supplemental Leverage Ratio (SLR) to exempt U.S. Treasury securities, cash on deposit at central banks, and margin.
 - The conflicting requirements between SLR and LCR (Liquidity Coverage Ratio) need to be addressed. Specifically, the LCR requirement to hold increased amounts of high-quality liquid assets (HQLA), including U.S. Treasuries, further

increases a firm's capital requirements under the SLR.

- Improving coordination and engagement across regulatory bodies.
 - There is a desire for an interagency re-assessment of the volume and nature of MRAs (matters requiring attention), MRAs (matters requiring immediate attention), MRBAs (matters requiring board attention), and consent orders in order to establish consistency as well as the greater use of “recommendations,” eliminate overlap, and establish a faster and more certain approach for “clearing” regulatory actions. An example is improving regulatory coordination of the Volcker Rule so that the five agencies with authority for the rule ensure that their guidance, examination, and enforcement are consistent and coordinated.
- Interagency review of potential impacts of the CECL (current expected credit loss) standard on bank capital in order to provide guidance and adjust capital rules in advance of CECL's 2020 implementation.
 - Member banks seek further analysis and guidance to address volatility and pro-cyclical effects of life-of-loan provisioning.
- Revisiting “gold plating” capital rules for G-SIBs.
 - While specific to G-SIBs, feedback includes revisiting risk-based capital surcharges for U.S. G-SIBs, the mandatory minimum debt ratio in the Federal Reserve's total loss-absorbing Capacity (TLAC) and minimum debt rule, and calibration of the enhanced SLR.

Other high priorities shared by the Council included reform of the Consumer Financial Protection Bureau, as well as revisiting the requirements for banks' living wills and board governance.

In summary, the Council looks forward to the regulatory agencies and lawmakers achieving the right adjustments to regulatory and legislative frameworks to preserve safety, soundness, and good customer outcomes, while freeing up resources to allow banks to promote economic growth and invest in their customer offerings.

2a: Community Reinvestment Act modernization

The Council is strongly supportive of the goals of community investment and the report's stated goals regarding the Community Reinvestment Act (CRA) modernization. The Council also believes the 1971 law has become outdated for today's market dynamics, including the needs of communities, institutions, digital delivery channels, and regulatory usage. Specifically, the Council has the following observations and recommendations that we believe will make community investment both greater and more effective:

Flexible Approach to Assessment Areas - Assessment areas should be broadly based on where an institution conducts its lending business and not limited solely to where it has physical locations. Within a broad assessment area, institutions should have discretion to lend, invest, and provide services where there are opportunities to support low- and moderate-income (LMI) communities and where institutions see the greatest need. Additionally, a coordinated approach with other institutions in a market area, especially if the market is either highly or thinly competitive, could maximize CRA impact and should be investigated.

Flexible Approach to Delivery Channels - Advances in technology have reduced the need for branch services and have lessened community reliance upon traditional “brick and mortar” branches. Instead of focusing solely on branch-based offerings, a more flexible approach would

assign CRA credits for products and services offered through cost-effective digital delivery channels that also provide communities with expanded access to products and services. Other services, such as low-cost ATMs, deposit accounts, and low-cost check cashing, also provide value to LMI communities and should be given CRA consideration.

Broader Scope of Community Development Lending and Investment - Currently, CRA credit is given only for community development lending and investing that provides direct benefits to LMI households and communities. CRA consideration should also be given to secondary investment opportunities, such as infrastructure lending and investment, which indirectly provide significant benefits to LMI communities. If institutions partner with local communities and governments, these types of investments should be better aligned with the needs of the communities being served.

Tailored Weighting Structure - The CRA test-weighting structure should reflect the business model, products, and services that are best suited for an institution and its community. Agreed-upon goals should be reflected in tailored CRA lending, investment, and services weightings for each institution.

Financial Education - All legitimate efforts to provide financial education should count towards CRA requirements and not just those efforts targeted for LMI individuals. Financial products can be complex, and many individuals, including children, young adults, and senior citizens, need help and education.

Consumer Compliance Violations - Adverse consumer compliance findings should not automatically impact CRA ratings, unless the violation is directly related to serving the credit needs of the bank's community or promoting financial inclusion.

Expand Scope of Coverage - CRA coverage should be expanded to include all those entities that benefit from engaging in housing-related real estate lending in our communities, not simply FDIC-insured depository institutions. Credit unions, fintech firms, and other nonbank financial service providers should be subject to similar and appropriate requirements. As one indication, today more than 50% of mortgages are originated by entities other than traditional bank providers.

Improve CRA Administration - Currently, CRA examinations are conducted on an irregular basis and can cover time frames of 24 months or longer. The receipt of a final rating can take a year or more. Regulators should commit to clarifying and simplifying exam-cycle standards and completing CRA examinations (and issuing final performance evaluations) in a timely manner (e.g., 12 months from the date of exam commencement). Additionally, rules for what is CRA-eligible are rigid and detailed, and the documentation required is overwhelming and should be reduced.

2b: Improved regulatory coordination

The Council supports Treasury's recommendations on improved regulatory coordination, including improving the regulatory engagement model. These recommendations, if implemented by the regulators, would further promote several of the Core Principles laid out by the administration in Executive Order 13772, including making regulation efficient and effective.

In particular, the Council believes the Financial Stability Oversight Council (FSOC) should be better utilized to coordinate regulatory policies, priorities, and communications, a point recognized by the Treasury with its recommendation to reform FSOC "...to further facilitate

information sharing and coordination among member agencies.” The Council is encouraged by the steps the FSOC has taken with respect to potential changes to the Volcker Rule, and Council members would encourage more interaction and coordination among the member agencies for overlapping areas of supervision, examination, and enforcement. There are numerous examples where regulatory coordination would be beneficial, including (i) cybersecurity policy and requirements (as discussed in prior Council meetings); (ii) AML/BSA oversight and enforcement; (iii) “living will” guidance; and (iv) the appropriate vetting of changes in policy or positions regarding particular banking activities or services, as well as appropriate communication among the regulatory agencies before implementation.

The Council also supports Treasury’s recommendation to broaden FSOC’s statutory mandate so that it “...can assign a lead regulator as primary regulator on issues where agencies have conflicting or overlapping jurisdiction.” However, while the Council supports this recommendation – which would require a statutory change – we would prefer that the FSOC continue to voluntarily look for ways to better coordinate among the member agencies. We encourage both incumbent and incoming heads of the relevant agencies to take a fresh look at harmonization, with the Secretary of the Treasury leading the way.

Treasury’s recommendations on improving the regulatory engagement model, including interagency review and assessment of the collective requirements on boards of directors and the overlap and clearance of regulatory actions (e.g., MRAs), also enhance regulatory coordination. On this note, the Council supports and appreciates the Federal Reserve’s recent proposed supervisory guidance on board effectiveness.

In sum, the Council is encouraged by the renewed focus on regulatory coordination. While there have been efforts to enhance regulatory coordination in the past, these efforts have not always produced meaningful, ongoing regulatory efficiency. The establishment of the FSOC, and its statutory mandate to facilitate information sharing and coordination among the member agencies, provides the natural vehicle through which to ensure these efforts continue. The Council believes regulatory coordination is in the best interests of all parties – preserving and effectively deploying the limited resources of regulatory agencies, while also providing certainty for, and effective oversight of, banking institutions.

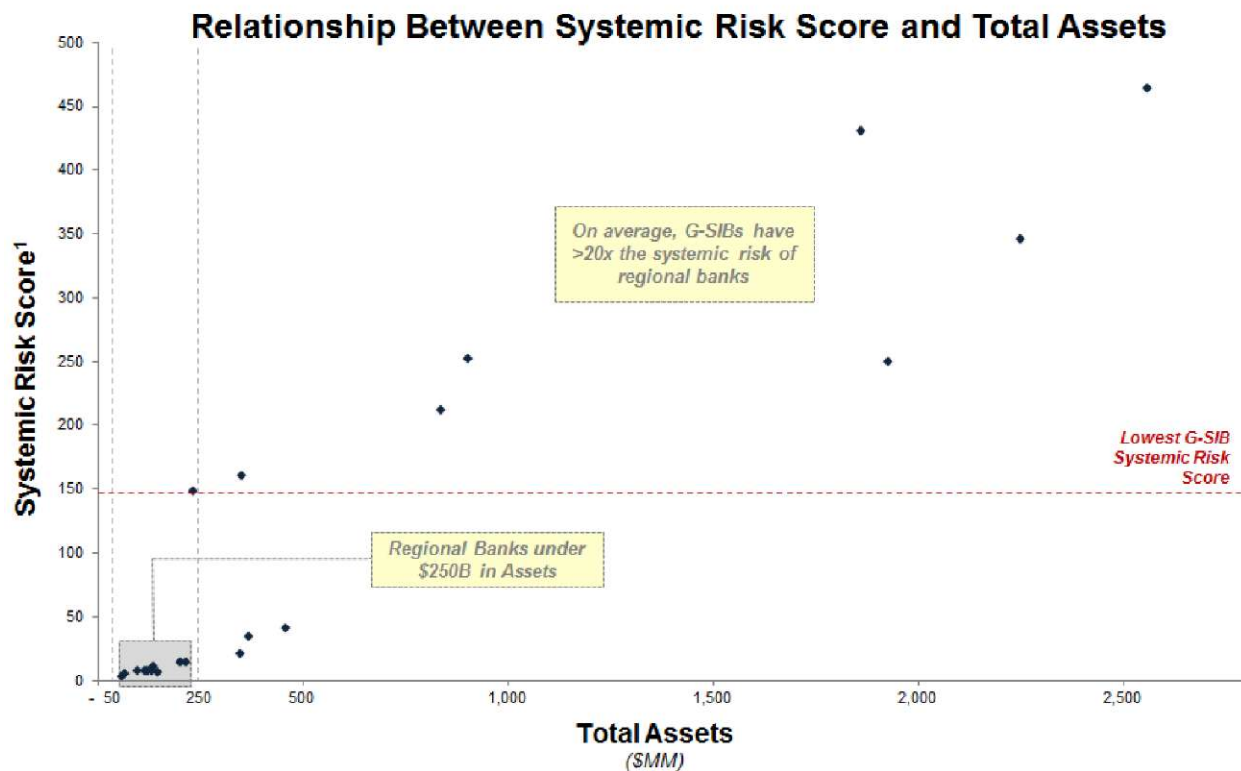
2c: Better tailoring of regulatory requirements, including stress testing, liquidity, and capital requirements, to a bank’s size and complexity

Similar to the Treasury, the Council believes capital/stress testing and liquidity requirements can be tailored to further economic growth, better fulfill the credit needs of consumers and businesses, and make the banking system more efficient without adversely impacting safety and soundness. The Council appreciates the thoughtful views advanced in the Treasury Report and supports many, though not all, of its recommendations.

Tailoring

The Council supports tailoring regulatory requirements based on the true systemic risk inherent within an institution versus merely on the basis of its size. The Council believes existing G-SIB indicators (size, interconnectedness, substitutability, cross-jurisdictional activity, and complexity) provide an adequate representation of a bank’s systemic risk and are a better measure of risk than a bank’s asset base. The Council agrees with the Treasury that “the use of arbitrary asset thresholds to apply regulation has resulted in a ‘one-size-fits-all’ approach” and notes that the G-SIB indicators for banks on either side of these thresholds are often very similar.

Simply put, the vast majority of America’s 6,000 banks have extremely low systemic risk – virtually all of the industry’s systemic risk is concentrated in a small handful of institutions.



Source: SNL Financial; Company FR Y-15 Reports

1. Risk score based on G-SIB assessment methodology that incorporates bank size, interconnectedness, substitutability, complexity and jurisdiction using 2015 data

Capital/Stress Testing

The Council believes capital/stress testing reform can reduce complexity and redundancy, while facilitating lending and economic growth in communities across America. In short, this process can become both more efficient – for banks and regulators/agencies – and effective. The Council supports the following Treasury recommendations:¹

- ***Threshold for Dodd-Frank Act Stress Testing (DFAST):*** “The Council supports revisiting the \$10 billion and \$50 billion threshold based on our assessment of [systemic] risk. The banking regulators should be granted authority to further calibrate the threshold by reference to factors related to the degree of risks and complexity of the institution.”
- ***DFAST Process:*** “The **mid-year DFAST cycle should be eliminated and the number of supervisory scenarios should be reduced from three to two** – the baseline and severely adverse scenario. Further, as a company-led process, leeway should be granted for banks to determine the appropriate number of models that are sufficient to develop appropriate output results, aligned with the scale and complexity of the banking organization and nature of its asset mix.”
- ***CCAR:*** “The Federal Reserve should (i) **reassess assumptions in the CCAR process that create unrealistically conservative results**, such as the assumption that firms continue to make capital distributions and grow their balance sheets and risk-weighted asset exposure in severely adverse scenarios; (ii) improve its modeling practices by better

¹ Italicized text denotes direct quotations from the U.S. Treasury Report. Emphasis added.

recognizing firms' unique risk profiles; and (iii) consider changing the CCAR process to a two-year cycle (with flexibility based on actual results and other relevant considerations)." The Council believes that, regardless of CCAR timing, banks should be required to update their internal capital plans annually.

- ***CECL:*** "U.S. prudential regulators should review the potential impact of the CECL standard on banks' capital levels (to include capacity during economic cycles) and formulate recommendations to harmonize the application of the standard with regulators' supervisory efforts."
- ***Pending Rules:*** "U.S. banking regulators should delay adoption of the Net Stable Funding Ratio and Fundamental Review of the Trading Book standards until U.S. regulators can appropriately assess and calibrate them."

Liquidity

Reform of bank liquidity requirements would increase banks' lending capacity while simultaneously maintaining safety and soundness. The Council agrees with the following Treasury recommendations:

- ***LCR:*** "The scope of application of the LCR should be narrowed to apply only to internationally active banks: the U.S. LCR should be limited to G-SIBs and a less stringent standard (i.e., an LCR that is not "super-compliant") should be applied to internationally active bank holding companies that are not G-SIBs."
- ***Changing liquidity requirements:*** "There should be expanded treatment of certain qualifying instruments as HQLA. This would include categorizing high-grade municipal bonds as Level 2B liquid assets (rather than generally not being counted as HQLA currently). In addition, improvements should be made to the degree of conservatism in cash flow assumptions incorporated into calculations of the LCR to more fully reflect banks' historical experience with calculation methodologies." The Council believes other definitional changes to HQLA would have a more positive impact than a reclassification of municipal securities. Specifically, the Council recommends:
 - Simplifying the LCR numerator by eliminating the Level 2A 40% cap, Level 2A 15% haircut, and the unwind calculation of short-term securities financing transactions.
 - Include FNMA and FHLMC securities as level 1 assets.
 - Incorporate Federal Home Loan Bank (FHLB) capacity as eligible HQLA.

Item 3: Vendor Management

Banks are engaging with a broader array of outside service providers, including fintech firms. What are the Council's observations of banks' evolving management of the attendant risks? How should regulators' oversight of vendor risk management at banks be updated to address recent developments, such as collaboration among institutions using the same vendor or banks' outsourcing of various aspects of their compliance programs?

Banks have had long-standing vendor relationships; however, the scope and scale of risk management systems have resulted in banks' increasingly relying on third parties to provide services. The due-diligence requirements, including model validation, have increased accordingly, and banks are evaluating how to make vendor risk management more effective and efficient.

Banks frequently collect and analyze the same information when evaluating their vendors. The Council believes that bank collaboration on vendor risk management, via a utility, will not only be cost effective, but more importantly, also provide higher- quality results and establish consistent due-diligence standards for evaluating vendors.

The Council believes the regulators should encourage industry collaboration for vendor risk management.

Item 4: Faster Payments

The Faster Payments Task Force resulted in a number of solution proposals and recommended next steps. What are the Council’s views on the proposals and recommendations? Do you believe that the Federal Reserve should assume certain operational roles in supporting ubiquity and competition in, and equitable access to, faster payments?

In establishing the Faster Payments Task Force (FPTF), the Federal Reserve enabled a diverse group of stakeholders to come together to create a framework for enabling faster payments in the U.S. We strongly support the market-driven approach that is described in the paper², as it aligns with the significant progress the industry has made towards enabling faster payments since the Federal Reserve published the *Strategies for Improving the U.S. Payment System* paper in 2015. We believe the Federal Reserve, as a trusted, neutral party, can and should continue to facilitate movement towards competitive, interoperable solutions.

- Most Council members agreed with the report findings that a competitive, market-leveraging solution developed by various entities is the correct end-state for faster payments in the U.S.
 - While some of the effectiveness criteria may not be met as quickly with this approach (e.g., ubiquity and efficiency), ultimately it is better for the private sector to continue to provide solutions to the market.
 - Several of the recommendations from the task force will advance the case for the adoption of a modern faster-payments capability by 2020. Specifically, the recommendations that encourage the Federal Reserve to:
 - Create a formal governance framework.
 - Establish standards and a baseline set of requirements for operators, including nonbanks. While standards will help provide for safety, integrity, trust, and interoperability, it is important that private-sector networks maintain control over their own operating rules.
 - Evaluate laws and regulations affecting payments to ensure they are suited to the unique characteristics of real-time payments.
- We suggest that the Federal Reserve move quickly to address several open items initiated by some task force participants.
- As illustrated by the solution proposals submitted to the task force, existing payments infrastructure is already moving towards support of faster payments. Often, there are unique capabilities in a system that make it well-suited to support specific-use cases.

² <http://fasterpaymentstaskforce.org/wp-content/uploads/faster-payments-task-force-final-report-part-two.pdf>.

- Significant investments have been made in current payments systems, making it difficult to justify adding a new system into the ecosystem.
- Many members expressed confidence that the industry is successfully leveraging existing systems to create a competitive market for faster payments, citing the automated clearing house (ACH), The Clearing House, Zelle, Venmo, and traditional card networks as examples.
- While authorization and clearing is often in real time, settlement lags. The recommendation directing the Federal Reserve to develop a 24x7x365 settlement mechanism is broadly seen as an important step to supporting faster payments.
- Disruption and mandated investment should be minimized.
- The existing business models work for the industry, although the desire to increase payments speed should be balanced with fraud management and security measures.
 - Consumer confidence in the payments ecosystem is high.
 - Financial incentives in the market-based system foster innovation and competition.
 - Caution is needed regarding mandates for payments speed, as they could undermine security and/or fraud management.
 - One member suggested that the Federal Reserve consider providing support for risk mitigation tools or processes (e.g., OFAC (Office of Foreign Assets Control) screening).
- The Federal Reserve should not operate a faster payments system that competes with the private sector.
 - It is unlikely the Federal Reserve could build a new payments system by 2020.
 - Uncertainty about the Federal Reserve's role could create a delay in implementation of private-sector solutions. Several Council members encouraged the Federal Reserve to make its intentions clear to avoid this potential outcome.
 - The private-sector alternatives can quickly respond to customer demands and accelerate the transition to faster payments more effectively than a centralized governing authority.
 - The Federal Reserve should provide leadership in regulating payment systems versus creating a new one on its own.
- There is a strong role for the Federal Reserve to continue to play in order to get to an end state that has solutions that meet the effectiveness criteria:
 - Continue facilitation of cross-industry collaboration and education.
 - Develop faster-settlement capabilities.
 - Support open standards.
 - Ensure that the data needed to compete for faster-payments-transaction volume are not owned or managed by a single entity (e.g., support to ensure a pro-competitive market).
 - Guarantee that smaller financial institutions have equal access to faster payments systems and are not disadvantaged.
 - Develop appropriate regulations to support any unique needs for these types of payments.
 - Ensure that nonbank participants are held to the same standards and oversight as banks.

Item 5: Economic Growth

Economic growth remains moderate, with some evidence of slowing. Please discuss the Council members' observations regarding economic growth in the companies borrowing from banks and what considerations may have dampened or enhanced the pace of growth in recent months.

For a discussion on current conditions, see Item 1. In summary, economic conditions are solid and confidence and optimism are as well.

Impact on Bank Lending:

- At the beginning of 2017, there was much optimism for credit creation. The post-election expectation was that the gain in confidence and financial market deregulation would spur credit creation. While consumers and businesses remain optimistic, that has not translated into significant growth in loan demand, with a broad-based slowing of credit growth post-election across consumer auto and credit card, C&I, and CRE lending. Additionally, the bank regulatory environment has improved as to more regulation, but existing regulation has remained relatively unchanged. Requirements around capital, liquidity, and various operating processes continue to influence banks' lending practices.
- On the consumer side, auto lending has flattened, and credit card growth has slowed. There have also been rising defaults in auto loans, which appear to be driven by weaker lending standards versus weaker economic conditions.
- Honing in specifically on trends in corporate lending, the market remains stable, with a hopeful outlook on expected M&A and capital markets activity providing assurance that loan demand is expected to remain stable. The investment-grade market continues to be moderate and steady, while the leveraged loan market has seen some positive movement, with stabilized commodity markets and stronger economic growth prospects.
- How do we rationalize the conundrum of weakness in credit creation in light of the strength of business and consumer confidence? While credit creation has fallen short of post-election expectations, we see a roughly three-quarter lag between improving confidence and increasing credit creation. If history is a guide, the potential for further improvement in the economy, as indicated by strong survey results, will continue into 2018.

As Council members survey their clients, observations about their prospects are:

- The elimination of further regulatory burden has been well received; however, the customers anticipate and would welcome further relief.
- Clients' optimism and confidence have remained high. Policy uncertainty, particularly with regard to tax reform, creates concern and has resulted in more conservative growth plans by our clients as we have moved through 2017. Failure to achieve tax reform is identified as a potential negative to our business clients.
- Loan demand has decelerated given these factors. Clients are profitable, have access to markets (where applicable), and see solid performance. In the current period, loan demand will remain under pressure pending the policy resolution above.

Item 6: How would the Council assess the current stance of monetary policy?

The Council considers current monetary policy to be appropriately accommodative and concurs with the FOMC's ongoing program of measured movement toward normalization, as rising economic activity supports achievement of the Committee's objectives of maximum employment and price stability.

Council members have noted that despite FOMC actions to tighten monetary policy by raising the target federal funds rate, by some measures, financial conditions have actually eased as Treasury note yields have declined, asset values have continued to climb, and the dollar has weakened against other major currencies.

If the Committee were to accelerate its policy-accommodation removal from the present path, some Council members expect that market rates could go lower still and the yield curve could flatten further, as market participants may question the sufficiency of economic strength to support higher rates.

Conversely, slowing policy accommodation removal from what has already been signaled by the Committee could undermine confidence in the economic recovery, as some would consider it a signal of the FOMC's weak economic outlook. Of course, delaying the normalization of monetary policy may constrain alternatives that the Committee would otherwise have had at its disposal to provide stimulus again if necessary because of a downturn or unexpected event. Rates are still near the zero band, and the size of the Federal Reserve's balance sheet is still elevated.

The Council expects continued moderate economic growth, which should further increase employment and price pressures, resulting in inflation approaching 2% over time. Some Council members expressed concern that inflation could rise at an accelerated rate once a threshold level of labor tightening is achieved, which may precipitate an undesired acceleration of interest-rate-increase expectations by market participants that would have adverse implications for economic growth.

The Council recommends the FOMC commence a measured balance-sheet normalization program in the near term. Most Council members expect negligible economic effect and only limited market reaction (some upward pressure on long-term rates) in response to this well-telegraphed potential action. However, the FOMC should closely monitor for higher asset-price volatility that might be created by the confluence of near-record valuations of many debt and equity instruments, elevated uncertainty of political action in Washington, and concurrent initiation of changes in monetary policy actions.

In summary, the Council supports the Committee's continued removal of policy accommodation that is data dependent and well communicated and believe pursuing this action would continue to demonstrate warranted confidence in the economic outlook.

12:00 pm – Luncheon for Council and Board members in the Board Room