



FEDERAL RESERVE SYSTEM

12 CFR Part 217

Docket No. R-1529; RIN 7100 AE-43

Regulatory Capital Rules: The Federal Reserve Board's Framework for Implementing the U.S. Basel III Countercyclical Capital Buffer

AGENCIES: Board of Governors of the Federal Reserve System

ACTION: Final policy statement.

SUMMARY: The Board of Governors of the Federal Reserve System (Board) is adopting a final policy statement (Policy Statement) describing the framework that the Board will follow under its Regulation Q in setting the amount of the U.S. countercyclical capital buffer for advanced approaches bank holding companies, savings and loan holding companies, and state member banks.

DATES: The Policy Statement is effective October 14, 2016.

FOR FURTHER INFORMATION CONTACT: William Bassett, Deputy Associate Director, (202) 736-5644, or Rochelle Edge, Deputy Associate Director, (202) 452-2339, Division of Financial Stability; Sean Campbell, Associate Director, (202) 452-3760, Division of Banking Supervision and Regulation; Benjamin W. McDonough, Special Counsel, (202) 452-2036, Mark Buresh, Senior Attorney, (202) 452-5270, or Mary Watkins, Attorney, (202) 452-3722, Legal Division.

SUPPLEMENTARY INFORMATION:

Table of Contents

- I. Background
- II. Summary of Comments on the Proposal
- III. Policy Statement
- IV. Administrative Law Matters
 - A. Use of Plain Language
 - B. Paperwork Reduction Act Analysis
 - C. Regulatory Flexibility Act Analysis

I. Background

In December 2015, the Board invited public comment on a proposed policy statement describing the framework that the Board would use to set the amount of the U.S. countercyclical capital buffer (CCyB) under the Board’s capital rules (Regulation Q).¹ The CCyB is a macroprudential policy tool that the Board can increase during periods of rising vulnerabilities in the financial system and reduce when vulnerabilities recede or when the release of the CCyB would promote financial stability.² The CCyB supplements the minimum capital requirements and other capital buffers included in Regulation Q, which

¹ 12 CFR part 217. *See also* 81 FR 5661 (February 3, 2016).

² *See* 12 CFR 217.11(b). Implementation of the CCyB also helps respond to the provision in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) that the agencies “shall seek to make such [capital] requirements countercyclical, so that the amount of capital required to be maintained by a company increases in times of economic expansion and decreases in times of economic contraction, consistent with the safety and soundness of the company.” *See* 12 U.S.C. 1467a; 12 U.S.C. 1844; 12 U.S.C. 3907 (as amended by section 616 of the Dodd-Frank Act).

themselves are designed to provide substantial resilience to unexpected losses created by normal fluctuations in economic and financial conditions.

The proposed policy statement outlined the factors the Board would consider in setting the level of the CCyB, and the indicators it would monitor to help determine whether an adjustment to the CCyB is appropriate. The proposed policy statement also described the effects the Board will monitor in determining whether the CCyB is achieving the desired purposes of the CCyB.

The Board received two comments on the proposed policy statement. Commenters raised concerns about the process that the Board would follow in setting the CCyB pursuant to the policy statement, the potential economic impact of the CCyB, and the efficacy and appropriateness of the CCyB as a policy tool. Commenters also made various specific suggestions as to the indicators and standards that the Board should consider in determining whether to activate the CCyB.

After reviewing comments, the Board is revising the final Policy Statement to clarify the following key items: (1) that the Board expects that the CCyB will be activated when systemic vulnerabilities are meaningfully above normal and that the Board generally intends to increase the CCyB gradually, (2) that the Board expects to remove or reduce the CCyB when the conditions that led to its activation abate or lessen and when the release of CCyB capital would promote financial stability. The discussion in Sections II and IV below responds to comments on the proposal regarding the Board's process for setting the CCyB. In particular, as indicated below, the Board would seek

comment on any proposed change to the CCyB amount and include a discussion of the reasons for the change.

II. Purpose of CCyB

The CCyB is designed to increase the resilience of large banking organizations when the Board sees an elevated risk of above-normal losses. Increasing the resilience of large banking organizations should, in turn, improve the resilience of the broader financial system. Above-normal losses often follow periods of rapid asset price appreciation or credit growth that are not well supported by underlying economic fundamentals. As stated in the proposed policy statement, the circumstances in which the Board would most likely use the CCyB as a supplemental, macroprudential tool to augment minimum capital requirements and other capital buffers would be to address circumstances when systemic vulnerabilities are somewhat above normal. By requiring institutions to hold a larger capital buffer during periods when systemic risk is increasing and reducing the buffer requirement as vulnerabilities diminish, the CCyB also has the potential to moderate fluctuations in the supply of credit over time.

The CCyB functions as an expansion of the Capital Conservation Buffer (CCB), which is applicable to all banking organizations subject to Regulation Q. To avoid limits on capital distributions and certain discretionary bonus payments,³ the CCB requires that a banking organization hold a buffer of common equity tier 1 capital that is at least 2.5 percent of the risk-weighted assets in addition to the minimum risk-based capital ratios.

³ 12 CFR 217.11(b)(1)(i).

The CCB is divided into quartiles, each associated with increasingly stringent limitations on capital distributions and certain discretionary bonus payments as the firm's risk-based capital ratios approach regulatory minimums.⁴ The CCyB is an additional, countercyclical buffer that has the same limitations on dividends and capital distributions as the CCB.

The CCyB was introduced for large, internationally active banking organizations (advanced approaches institutions) in June 2013 as part of the revised regulatory capital rules issued by the Board in coordination with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC).⁵ The Board's CCyB rule applies to bank holding companies, savings and loan holding companies, and state member banks subject to the advanced approaches capital rules (advanced approaches institutions).⁶ The advanced approaches capital rules generally apply to banking organizations with greater than \$250 billion in total assets or \$10 billion in on-balance-sheet foreign exposure and to any depository institution subsidiary of such banking organizations.⁷

⁴ 12 CFR 217.11(a).

⁵ See 78 FR 62018 (October 11, 2013) (Board and OCC); 79 FR 20754 (April 14, 2014) (FDIC). The Board's Regulation Q applies generally to bank holding companies with more than \$1 billion in total consolidated assets and savings and loan holding companies with more than \$1 billion in total consolidated assets that are not substantially engaged in commercial or insurance underwriting activities. See 12 CFR 217.1(c)(1).

⁶ An advanced approaches institution is subject to the CCyB regardless of whether it has completed the parallel run process and received notification from its primary Federal supervisor pursuant to section 217.121(d) of Regulation Q.

⁷ 12 CFR 217.100(b)(1).

Because the CCyB is intended to address elevated risks from activity that is not well supported by underlying economic fundamentals, the location of the activity and the economic conditions where the activity take place provide important context.

Accordingly, the CCyB applies based on the location of private-sector credit exposures by national jurisdiction.⁸ Specifically, the applicable CCyB amount for a banking organization is equal to the weighted average of CCyB amounts established by the Board for the national jurisdictions where the banking organization has private-sector credit exposures.⁹ The CCyB amount applicable to a banking organization is weighted by jurisdiction according to the firm's risk-weighted private-sector credit exposures for a specific jurisdiction as a percentage of the firm's total risk-weighted private-sector credit exposures.¹⁰

Regulation Q established the initial CCyB amount with respect to private-sector credit exposures located in the United States (U.S.-based credit exposures) at zero percent.¹¹ The CCyB will not exceed 2.5 percent of risk-weighted assets. This cap on the CCyB will be phased in, with the maximum potential amount of the CCyB for U.S.-

⁸ 12 CFR 217.11(b)(1). The Board may adjust the CCyB amount to reflect decisions made by foreign jurisdictions. *See* 12 CFR 217.11(b)(3).

⁹ 12 CFR 217.11(b)(1).

¹⁰ *Id.*

¹¹ The Board affirmed the CCyB amount at the current level of 0 percent contemporaneously with issuance of the proposed policy statement. *See* <http://www.federalreserve.gov/newsevents/press/bcreg/20151221b.htm>.

based credit exposures 0.625 percentage points in 2016, 1.25 percentage points in 2017, 1.875 percentage points in 2018, and 2.5 percentage points in 2019 and thereafter.¹²

In order to provide banking organizations with sufficient time to adjust to any change in the CCyB, Regulation Q provides that a determination to increase the countercyclical capital buffer amount generally will be effective 12 months from the date of announcement. However, economic conditions may warrant an earlier or later effective date.¹³ For example, it may be appropriate for an increase in the countercyclical capital buffer amount to take effect 12 months from the date that the Board proposes the increase, rather than 12 months from the issuance of a final rule.

Regulation Q states that a decision by the Board to decrease the amount of the CCyB for U.S.-based credit exposures would become effective the day after the Board decides to decrease the CCyB or the earliest date permissible under applicable law or regulation, whichever is later.¹⁴ Moreover, the amount of the CCyB for U.S.-based credit exposures will return to 0 percent 12 months after the effective date of any CCyB adjustment, unless the Board announces a decision to maintain the current amount or adjust it again before the expiration of the 12-month period.¹⁵

The Board expects to make decisions about the appropriate level of the CCyB on U.S.-based credit exposures jointly with the OCC and FDIC. In addition, the Board

¹² 12 CFR 217.300(a)(2).

¹³ 12 CFR 217.11(b)(2)(v)(A).

¹⁴ 12 CFR 217.11(b)(2)(v)(B).

¹⁵ 12 CFR 217.11(b)(2)(vi).

expects that the CCyB amount for U.S.-based credit exposures would be the same for covered insured depository institutions as for covered depository institution holding companies. The CCyB is designed to take into account the broad macroeconomic and financial environment in which banking organizations function and the degree to which that environment impacts the resilience of advanced approaches institutions. Therefore, the Board's determination of the appropriate level of the CCyB for U.S.-based credit exposures would be most directly linked to the condition of the overall financial environment rather than the condition of any individual banking organization. However, the impact of the CCyB requirement on a particular banking organization will vary based on the organization's particular composition of private-sector credit exposures located across national jurisdictions.

III. Description of the Final Policy Statement

The final policy statement (Policy Statement) describes the framework that the Board would follow in setting the amount of the CCyB for U.S.-based credit exposures. The framework consists of a set of principles for translating assessments of financial system vulnerabilities that are regularly undertaken at the Board into the appropriate level of the CCyB. Those assessments are informed by a broad array of quantitative indicators of financial and economic performance and a set of empirical models. In addition, the framework includes a discussion of how the Board would assess whether the CCyB is the most appropriate policy instrument (among available policy instruments) to address the highlighted financial system vulnerabilities.

The Policy Statement is organized as follows. Section 1 provides background on the Policy Statement. Section 2 is an outline of the Policy Statement and describes its scope. Section 3 provides a broad description of the objectives of the CCyB, including a description of the ways in which the CCyB is expected to protect large banking organizations and the broader financial system. Section 4 provides a broad description of the factors that the Board considers in setting the CCyB, including specific financial system vulnerabilities and types of quantitative indicators of financial and economic performance, and outlines of empirical models the Board may use as inputs to that decision. Further, section 4 describes a set of principles that the Board expects to use for combining judgmental assessments with quantitative indicators to determine the appropriate level of the CCyB. Section 5 discusses how the Board will communicate the level of the CCyB and any changes to the CCyB. Section 6 describes how the Board

plans to monitor the effects of the CCyB, including what indicators and effects will be monitored.

The Board has revised the Policy Statement to clarify that (1) the Board expects that the CCyB will be activated when systemic vulnerabilities are meaningfully above normal and the Board generally intends to increase the CCyB gradually, and (2) the Board expects to remove or reduce the CCyB when the conditions that led to its activation abate or lessen and when release of CCyB capital would promote financial stability. These changes were made to sections 1, 3, and 4. In addition, minor clarifying and technical edits were made throughout the Policy Statement.

IV. Changes to Address Comments on the Proposal

As noted, the Board received two comments regarding the proposed policy statement. Commenters expressed concerns about the process that the Board would follow in setting the CCyB pursuant to the Policy Statement, the potential economic impact of the CCyB, and the appropriate uses of the CCyB.

A. Comments regarding the Board's process for setting the CCyB

Commenters expressed concern that the Board would apply the CCyB without completing the procedures required by the Administrative Procedure Act (APA).¹⁶ In particular, commenters argued that notice and comment rulemaking procedures should be used to increase the CCyB above zero, and for each future increase.

The Board's rule implementing the CCyB specifically provides that the Board will adjust the CCyB amount in accordance with applicable law.¹⁷ In accordance with this provision of its rules, the Board expects to set the level of the CCyB above zero through a public notice and comment rulemaking, or through an order issued in accordance with the APA that provides each affected institution with actual notice and an opportunity for comment. In setting the level of the CCyB above zero through a public rulemaking, the Board generally expects that the notice and comment period would be at least 30 days. The Policy Statement is intended to provide insight on the framework that the Board will use to determine the appropriate level of the CCyB, not to alter procedures necessary to increase the CCyB in the future.

¹⁶ 5 U.S.C. 551 et seq.

¹⁷ 12 CFR 217.11(b)(2)(ii).

A commenter suggested that the Board should commit to act jointly with the OCC and FDIC in any decision to activate the CCyB. Consistent with Regulation Q and the proposal, the Board expects that any decision to adjust the CCyB will be made jointly by the OCC, FDIC, and Board. However, the Board will make decisions regarding the appropriate amount of the CCyB for the firms that it supervises based on its judgment of the facts and circumstances presented.

A commenter argued that the Board generally should not reciprocate decisions by foreign jurisdictions regarding the level of the CCyB in such jurisdictions. If the Board did decide to incorporate CCyB decisions of foreign jurisdictions, the commenter argued that the Board should implement a de minimis threshold below which U.S. banking organizations would not have to recognize the CCyB established in the foreign jurisdiction. The Policy Statement describes the framework that the Board will follow in determining the CCyB for U.S. private-sector credit exposures. The Board will address separately CCyB adjustments made by foreign jurisdictions as needed.

B. Comments regarding the calibration of, inputs into, and impact of the CCyB

A commenter argued that the CCyB should be increased only when credit growth was considered excessive, rather than when systemic vulnerabilities were somewhat above normal, as suggested by the proposal.

The CCyB is a macroprudential policy tool intended to strengthen banking organizations' resilience against the build-up of systemic vulnerabilities and reduce fluctuations in the supply of credit. As stated in the proposed policy statement, activation of the CCyB at a time when systemic vulnerabilities are somewhat above normal reflects

the prophylactic and countercyclical goals of this tool as well as the process and 12-month phase-in period that generally applies before any activation of the CCyB amount would take effect. Moreover, activation of the CCyB at a time when systemic vulnerabilities are somewhat above normal rather than delaying until systemic vulnerabilities are excessive would allow gradual increases in the CCyB, which would provide additional flexibility (over and above the 12-month phase-in period) to banking organizations as they adjust to any increases. That is, activation of the CCyB at a time when systemic vulnerabilities are somewhat above normal would likely not be associated with an activation of the CCyB to the upper end of its possible range. Further, the Board considers “systemic vulnerabilities” to be the appropriate reference point because the CCyB could be an effective tool in addressing a variety of financial system vulnerabilities, not merely credit growth.

To further clarify when the Board would expect to increase the CCyB, the Policy Statement has been modified to state that the CCyB would be increased when systemic vulnerabilities are “meaningfully above normal.” For these purposes “meaningfully above normal” would reflect an assessment by the Board that financial system vulnerabilities were above normal and were either already at, or expected to build to, levels sufficient to generate material unexpected losses in the event of an unfavorable development in financial markets or the economy. The text in the policy statement has also been modified to clarify that systemic vulnerabilities being meaningfully above normal would correspond to the Board beginning to increase the CCyB above zero and to

provide additional discussion of when and how the Board would deactivate or reduce the CCyB.

Commenters argued that the Board should conduct and release analyses of the economic impact and costs and benefits of the CCyB in connection with the proposed policy statement as well as with any decision to increase the level of the CCyB.

Commenters contended that such analyses should take into account other existing prudential regulation, including other regulatory capital requirements, and consider whether alternative policy tools may be more effective for a particular situation. The commenters expressed concern that there could be material adverse economic consequences to activation of the CCyB. Similarly, one commenter argued that the Board should conduct a comprehensive analysis of the costs and benefits of regulatory capital requirements, including the CCyB, as well as prudential liquidity regulations and regulations established by other agencies.

Commenters also argued that the Board should provide additional detail regarding the data, models, and metrics that would inform a decision to activate the CCyB, as well as the standards that would be applied to determine the calibration of the CCyB.

Additionally, commenters raised issues with certain of the indicators identified in the Policy Statement. For instance, a commenter cautioned that no academic consensus had been reached with regard to the usefulness of a credit-to-GDP ratio gap as an indicator of economic conditions.

The final Policy Statement provides additional information to the public regarding the framework that the Board will follow in setting the CCyB. The Policy Statement

itself does not change either the CCyB or the capital requirements applicable to advanced approaches banking organizations. As described above, the Board generally would expect to provide notice to the public and seek comment on the proposed level of the CCyB as part of making any final determination to change the CCyB. Any proposed change in the level of the CCyB would include a discussion of the reasons for the proposed action as determined by the particular circumstances.

One commenter stated that the FFIEC 009 reporting form requires firms to report information that is not aligned with the information needed to determine the CCyB amount applicable to a firm and that the Board should amend the FFIEC 009 to align with CCyB in order to reduce burden. The Board may consider reporting for purposes of the CCyB at a later date.

The Board recognizes that no single data point or indicator can provide a comprehensive understanding of economic conditions or systemic vulnerabilities. The items for consideration listed in the Policy Statement are a non-exclusive list of quantitative and qualitative indicators that may inform the Board's assessment of economic conditions and determinations regarding the appropriate level of the CCyB. As explained in the proposed and final Policy Statement, some academic research has shown the credit-to-GDP ratio to be useful in identifying periods of financial excess followed by a period of crisis. However, the Board does not expect this indicator to be used in isolation. Furthermore, as noted, any proposal to increase the CCyB will include a discussion of the indicators informing the proposal, and will seek comment on the interpretation of these indicators. As noted above, the Board expects that the types of

indicators and models considered will evolve over time, based on advances in research and the experience of the Board with this tool.

Commenters argued that the CCyB would not be effective in containing asset bubbles or excessive credit risks because these tend to occur within sectors as opposed to across the financial system equally. A commenter suggested that targeted guidance for particular sectors would likely be more effective at containing risks of this type than a broad based capital charge imposed by the CCyB.

Commenters also argued that the CCyB would not be effective in addressing many systemic vulnerabilities because it applies only to advanced approaches banking organizations, which, while significant, represent a relatively small percentage of the total provision of credit in the U.S. economy. A commenter contended that activation of the CCyB might exacerbate risk in the financial system by shifting lending activity away from large and closely regulated commercial banks and into the shadow banking system. In addition, a commenter argued that advanced approaches banking organizations were subject to significant capital, liquidity, and other prudential requirements such that they were likely to be resilient in the event of adverse economic conditions. As a result, the commenter argued, advanced approaches banking organizations were unlikely to be made materially more resilient as a result of imposition of the CCyB.

As reflected in the Policy Statement, the pace and magnitude of changes in the CCyB will depend on the underlying conditions in the financial sector and the economy, the desired effects of the proposed change in the CCyB, and consideration of whether the CCyB is the most appropriate of the Board's available policy instruments to address the

financial system vulnerabilities. A natural corollary to this analysis would be consideration of whether the CCyB could be expected to increase other systemic vulnerabilities. The CCyB is one of several policy tools available to the Board. In determining whether or not to change the CCyB, the Board will consider whether the CCyB is the most appropriate of available policy tools, and whether the CCyB would be most effective if used in conjunction with other policy tools.

V. Administrative Law Matters

A. Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act (Pub. L. No. 106-102, 113 Stat. 1338, 1471, 12 U.S.C. 4809) requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The Board received no comments on the use of plain language.

B. Paperwork Reduction Act Analysis

In accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3506), the Board has reviewed the Policy Statement to assess any information collections. There are no collections of information as defined by the Paperwork Reduction Act in the proposal.

C. Regulatory Flexibility Act Analysis

The Board is providing a final regulatory flexibility analysis with respect to this Policy Statement. The Regulatory Flexibility Act, 5 U.S.C. 601 et seq. (RFA), generally requires that an agency provide a regulatory flexibility analysis in connection with a final rulemaking.

The Board sought comment on whether the proposal would impose undue burdens on, or have unintended consequences for, small banking organizations. The Board received one comment on this aspect of the proposal, which argued that the Board's initial regulatory flexibility analysis was flawed in asserting that small banking organizations would not be affected by the proposal because of the broader impact that the CCyB could have on lending and economic growth in general.

This Policy Statement will be added as an appendix to Regulation Q to describe the framework that the Board will follow in setting the amount of the CCyB for U.S.-based credit exposures. The CCyB only applies to bank holding companies, savings and loan holding companies, and state member banks that are advanced approaches Board-regulated institutions for purposes of the Board's Regulation Q (advanced approaches banking organizations). The Regulatory Flexibility Act requires consideration only of the impact of the proposed rule on small entities that are subject to the requirements of the rule, as opposed to small entities indirectly affected by the rule through its impact on the national economy.¹⁸ Generally, advanced approaches banking organizations are those with total consolidated assets of \$250 billion or more, that have total consolidated on-balance sheet foreign exposures of \$10 billion or more, that have subsidiary depository institutions that are advanced approaches institutions, or that elect to use the advanced approaches framework.¹⁹ Under regulations issued by the Small Business

¹⁸ See e.g., *Aeronautical Repair Station Association v. Federal Aviation Administration*, 494 F.3d 161, 174-178 (D.C. Cir. 2007).

¹⁹ See 12 CFR 217.100.

Administration, a small entity includes a depository institution, bank holding company, or savings and loan holding company with assets of \$550 million or less (small banking organizations).²⁰ As of June 30, 2016, there were approximately 3,204 small bank holding companies, 157 small savings and loan holding companies, and 594 small state member banks. Banking organizations that are subject to the final rule therefore are expected to substantially exceed the \$550 million asset threshold at which a banking entity would qualify as a small bank holding company. As a result, the final rule is not expected to apply directly to any small banking organizations for purposes of the RFA.

Therefore, there are no significant alternatives to the final rule that would have less economic impact on small bank holding companies. As discussed above, there are no projected reporting, recordkeeping, and other compliance requirements of the final rule. The Board does not believe that the final rule duplicates, overlaps, or conflicts with any other Federal rules. In light of the foregoing, the Board does not believe that the final rule would have a significant economic impact on a substantial number of small entities.

In light of the foregoing, the Board does not believe that the final rule will have a significant impact on small entities.

²⁰ See 13 CFR 121.201. Effective July 14, 2014, the Small Business Administration revised the size standards for banking organizations to \$550 million in assets from \$500 million in assets. 79 FR 33647 (June 12, 2014). The Small Business Administration's June 12, 2014, interim final rule was adopted without change as a final rule by the Small Business Administration on January 12, 2016. 81 FR 3949 (January 25, 2016).

List of Subjects

12 CFR Part 217

Administrative practice and procedure, Banks, banking. Holding companies, Reporting and recordkeeping requirements, Securities.

Authority and Issuance

For the reasons stated in the preamble, the Board of Governors of the Federal Reserve System amends 12 CFR part 217 as follows:

PART 217 – CAPITAL ADEQUACY OF BANK HOLDING COMPANIES, SAVINGS AND LOAN HOLDING COMPANIES, AND STATE MEMBER BANKS (REGULATION Q)

1. The authority citation for part 217 continues to read as follows:

Authority: 12 U.S.C. 248(a), 321–338a, 481-486, 1462a, 1467a, 1818, 1828, 1831n, 1831o, 1831p–l, 1831w, 1835, 1844(b), 1851, 3904, 3906-3909, 4808, 5365, 5368, 5371.

2. Appendix A to part 217 is added to read as follows:

Appendix A to Part 217– The Federal Reserve Board’s Framework for Implementing the Countercyclical Capital Buffer

1. Background

(a) In 2013, the Board of Governors of the Federal Reserve System (Board) issued a final regulatory capital rule (Regulation Q) in coordination with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) that strengthened risk-based and leverage capital requirements applicable to insured depository institutions and depository institution holding companies (banking organizations).¹ Among those changes was the introduction of a countercyclical capital buffer (CCyB) for large, internationally active banking organizations.²

(b) The CCyB is a supplemental, macroprudential policy tool that the Board can increase during periods of rising vulnerabilities in the financial system and reduce when vulnerabilities recede. It is designed to increase the resilience of large banking organizations when there is an elevated risk of above-normal losses. Increasing the

¹ See 12 CFR part 217; *Federal Reserve Board Approves Final Rule To Help Ensure Banks Maintain Strong Capital Positions (July 2, 2013)*, available at <http://www.federalreserve.gov> ; *Agencies Adopt Supplementary Leverage Ratio Notice of Proposed Rulemaking (July 9, 2013)*, available at <http://www.occ.gov>; and *FDIC Board Approves Basel III Interim Final Rule and Supplementary Leverage Ratio Notice of Proposed Rulemaking (July 9, 2013)* available at <https://www.fdic.gov>.

² 12 CFR 217.11(b). The CCyB applies only to banking organizations subject to the advanced approaches capital rules, which generally apply to those banking organizations with greater than \$250 billion in assets or more than \$10 billion in on-balance-sheet foreign exposures. See 12 CFR 217.100(b). An advanced approaches institution is subject to the CCyB regardless of whether it has completed the parallel run process and received notification from its primary Federal supervisor. See 12 CFR 217.121(d).

resilience of large banking organizations will, in turn, improve the resilience of the broader financial system. Above-normal losses often follow periods of rapid asset price appreciation or credit growth that are not well supported by underlying economic fundamentals. The circumstances in which the Board would most likely begin to increase the CCyB above zero percent to augment minimum capital requirements and other capital buffers would be when systemic vulnerabilities are meaningfully above normal. By requiring large banking organizations to hold additional capital during those periods of excess and removing the requirement to hold additional capital when the vulnerabilities have diminished, the CCyB also is expected to moderate fluctuations in the supply of credit over time. Moderating the supply of credit may mitigate or prevent the conditions that contribute to above-normal losses, such as elevated asset prices and excessive leverage, and prevent or mitigate reductions in lending to creditworthy borrowers that can amplify an economic downturn. In this way, implementation of the CCyB also responds to the Dodd-Frank Act's requirement that the Board seek to make its capital requirements countercyclical.³

(c) Regulation Q established the initial CCyB amount with respect to private sector credit exposures located in the United States (U.S.-based credit exposures) at zero percent and provided that the maximum potential amount of the CCyB for credit exposures in the United States was 2.5 percent of risk-weighted assets.⁴ The Board

³ 12 U.S.C. 1844(b), 1464a(g)(1), and 3907(a)(1) (codifying sections 616(a), (b), and (c) of the Dodd-Frank Act).

⁴ The CCyB is subject to a phase-in arrangement between 2016 and 2019. See 12 CFR 217.300(a)(2).

expects to make decisions about the appropriate level of the CCyB for U.S.-based credit exposures jointly with the OCC and FDIC, and expects that the CCyB amount for U.S.-based credit exposures will be the same for covered depository institution holding companies and insured depository institutions. The CCyB is designed to take into account the macrofinancial environment in which banking organizations function and the degree to which that environment impacts the resilience of advanced approaches institutions. Therefore, the appropriate level of the CCyB for U.S.-based credit exposures is not closely linked to the characteristics of an individual institution. Rather, the impact of the CCyB on any single institution will depend on the particular composition of the private-sector credit exposures of the institution across national jurisdictions.

2. Overview and Scope of the Policy Statement

This Policy Statement describes the framework that the Board will follow in setting the amount of the CCyB for U.S.-based credit exposures. The framework consists of a set of principles for translating assessments of financial system vulnerabilities that are regularly undertaken by the Board into the appropriate level of the CCyB. Those assessments are informed by a broad array of quantitative indicators of financial and economic performance and a set of empirical models. In addition, the framework includes an assessment of whether the CCyB is the most appropriate policy instrument (among available policy instruments) to address the highlighted financial system vulnerabilities.

3. The Objectives of the CCyB

(a) The objectives of the CCyB are to strengthen banking organizations' resilience against the build-up of systemic vulnerabilities and reduce fluctuations in the supply of credit. The CCyB supplements the minimum capital requirements and the capital conservation buffer, which themselves are designed to provide substantial resilience to unexpected losses created by normal fluctuations in economic and financial conditions. The capital surcharge on global systemically important banking organizations adds an additional layer of defense for the largest and most systemically important institutions, whose financial distress can have outsized effects on the rest of the financial system and the real economy.⁵ However, periods of financial excesses, for example as reflected in episodes of rapid asset price appreciation or credit growth not well supported by underlying economic fundamentals, are often followed by above-normal losses that leave banking organizations and other financial institutions undercapitalized. Therefore, the Board would most likely begin to increase the CCyB above zero in those circumstances when systemic vulnerabilities become meaningfully above normal and progressively raise the CCyB level if vulnerabilities become more severe.

(b) The CCyB is expected to help provide additional resilience for advanced approaches institutions, and by extension the broader financial system, against elevated vulnerabilities primarily in two ways. First, advanced approaches institutions will likely

⁵ See, *Federal Reserve Board Approves Final Rule Requiring The Largest, Most Systemically Important U.S. Bank Holding Companies To Further Strengthen Their Capital Positions* (July 20, 2015), available at <http://www.federalreserve.gov>.

hold more capital to avoid limitations on capital distributions and discretionary bonus payments resulting from implementation of the CCyB. Strengthening their capital positions when financial conditions are accommodative would increase the capacity of advanced approaches institutions to absorb outsized losses during a future significant economic downturn or period of financial instability, thus making them more resilient.

(c) The second and related goal of the CCyB is to promote a more sustainable supply of credit over the economic cycle. During a credit cycle downturn, better-capitalized institutions have been shown to be more likely than weaker institutions to have continued access to funding. Better-capitalized institutions also are less likely to take actions that lead to broader financial-sector distress and its associated macroeconomic costs, such as large-scale sales of assets at prices below their fundamental value and sharp contractions in credit supply.⁶ Therefore, it is likely that as a result of the CCyB having been put into place during the preceding period of rapid credit creation, advanced approaches institutions would be better positioned to continue their important intermediary functions during a subsequent economic contraction. A timely and credible reduction in the CCyB requirement during a period of high credit losses could reinforce those beneficial effects of a higher base level of capital, because it would permit advanced approaches institutions either to realize loan losses promptly and

⁶ For additional background on the relationship between financial distress and economic outcomes, see Carmen Reinhart and Kenneth Rogoff (2009), *This Time is Different*. Princeton University Press; Óscar Jordà & Moritz Schularick & Alan M Taylor (2011), "Financial Crises, Credit Booms, and External Imbalances: 140 Years of Lessons," *IMF Economic Review*, Palgrave Macmillan, vol. 59(2), pages 340-378; and Bank for International Settlements (2010), "Assessing the Long-Run Economic Impact of Higher Capital and Liquidity Requirements."

remove them from their balance sheets or to expand their balance sheets, for example by continuing to lend to creditworthy borrowers.

(d) During a period of cyclically increasing vulnerabilities, advanced approaches institutions might react to an increase in the CCyB by raising lending standards, otherwise reducing their risk exposure, augmenting their capital, or some combination of those actions. They may choose to raise capital by taking actions that would increase net income, reducing capital distributions such as share repurchases or dividends, or issuing new equity. In this regard, an increase in the CCyB would not prevent advanced approaches institutions from maintaining their important role as credit intermediaries, but would reduce the likelihood that banking organizations with insufficient capital would foster unsustainable credit growth or engage in imprudent risk taking. The specific combination of adjustments and the relative size of each adjustment will depend in part on the initial capital positions of advanced approaches institutions, the cost of debt and equity financing, and the earnings opportunities presented by the economic situation at the time.⁷

4. The Framework for Setting the U.S. CCyB

(a) The Board regularly monitors and assesses threats to financial stability by synthesizing information from a comprehensive set of financial-sector and macroeconomic indicators, supervisory information, surveys, and other interactions with

⁷ For estimates of the size of certain adjustments, see Samuel G. Hanson, Anil K. Kashyap, and Jeremy C. Stein (2011), "A Macroprudential Approach to Financial Regulation," *Journal of Economic Perspectives* 25(1), pp. 3-28; Skander J. Van den Heuvel (2008), "The Welfare Cost of Bank Capital Requirements," *Journal of Monetary Economics* 55, pp. 298-320.

market participants.⁸ In forming its view about the appropriate size of the U.S. CCyB, the Board will consider a number of financial system vulnerabilities, including but not limited to, asset valuation pressures and risk appetite, leverage in the nonfinancial sector, leverage in the financial sector, and maturity and liquidity transformation in the financial sector. The decision will reflect the implications of the assessment of overall financial system vulnerabilities as well as any concerns related to one or more classes of vulnerabilities. The specific combination of vulnerabilities is important because an adverse shock to one class of vulnerabilities could be more likely than another to exacerbate existing pressures in other parts of the economy or financial system.

(b) The Board intends to monitor a wide range of financial and macroeconomic quantitative indicators including, but not limited to, measures of relative credit and liquidity expansion or contraction, a variety of asset prices, funding spreads, credit condition surveys, indices based on credit default swap spreads, option implied volatilities, and measures of systemic risk.⁹ In addition, empirical models that translate a manageable set of quantitative indicators of financial and economic performance into potential settings for the CCyB, when used as part of a comprehensive judgmental assessment of all available information, can be a useful input to the Board's deliberations. Such models may include, but are not limited to, those that rely on small sets of indicators—such as the nonfinancial credit-to-GDP ratio, its growth rate, and

⁸ Tobias Adrian, Daniel Covitz, and Nellie Liang (2014), “Financial Stability Monitoring.” *Finance and Economics Discussion Series* 2013-021. Washington: Board of Governors of the Federal Reserve System, <http://www.federalreserve.gov/pubs/feds/2013/201321/201321pap.pdf>.

⁹ See 12 CFR 217.11(b)(2)(iv).

combinations of the credit-to-GDP ratio with trends in the prices of residential and commercial real estate—which some academic research has shown to be useful in identifying periods of financial excess followed by a period of crisis on a cross-country basis.¹⁰ Such models may also include those that consider larger sets of indicators, which have the advantage of representing conditions in all key sectors of the economy, especially those specific to risk-taking, performance, and the financial condition of large banks.¹¹

(c) However, no single indicator or fixed set of indicators can adequately capture all the vulnerabilities in the U.S. economy and financial system. Moreover, adjustments in the CCyB that were tightly linked to a specific model or set of models could be imprecise due to the relatively short period that some indicators are available, the limited number of past crises against which the models can be calibrated, and limited experience with the CCyB as a macroprudential tool. As a result, the types of indicators and models considered in assessments of the appropriate level of the CCyB are likely to change over

¹⁰ See, e.g., Jorda, Oscar, Moritz Schularick and Alan Taylor, 2013. “When Credit Bites Back: Leverage, Business Cycles and Crises,” *Journal of Money, Credit, and Banking*, 45(2), pp. 3-28, and Drehmann, Mathias, Claudio Borio, and Kostas Tsatsaronis, 2012. “Characterizing the Financial Cycle: Don't Lose Sight of the Medium Term!” BIS Working Papers 380, Bank for International Settlements. Jorda, Oscar, Moritz Schularick and Alan Taylor, 2015. “Leveraged Bubbles,” *Center for Economic Policy Research Discussion Paper* No. DP10781. BCBS (2010), “Guidance for National Authorities Operating the Countercyclical Capital Buffer,” BIS.

¹¹ See, e.g., Aikman, David, Michael T. Kiley, Seung Jung Lee, Michael G. Palumbo, and Missaka N. Warusawitharana (2015), “Mapping Heat in the U.S. Financial System,” *Finance and Economics Discussion Series* 2015-059. Washington: Board of Governors of the Federal Reserve System, <http://dx.doi.org/10.17016/FEDS.2015.059> (providing an example of the range of indicators used and type of analysis possible).

time based on advances in research and the experience of the Board with this new macroprudential tool.

(d) The Board will determine the appropriate level of the CCyB for U.S.-based credit exposures based on its analysis of the above factors. Generally, a zero percent U.S. CCyB amount would reflect an assessment that U.S. economic and financial conditions are broadly consistent with a financial system in which levels of system-wide vulnerabilities are within or near their normal range of values. The Board could increase the CCyB as vulnerabilities build. A 2.5 percent CCyB amount for U.S.-based credit exposures, which is the maximum level under the Board's rule, would reflect an assessment that the U.S. financial sector is experiencing a period of significantly elevated or rapidly increasing system-wide vulnerabilities. Importantly, as a macroprudential policy tool, the CCyB will be activated and deactivated based on broad developments and trends in the U.S. financial system, rather than the activities of any individual banking organization.

(e) Similarly, the Board would remove or reduce the CCyB when the conditions that led to its activation abate or lessen. Additionally, the Board would remove or reduce the CCyB when release of CCyB capital would promote financial stability. Indeed, for the CCyB to be most effective, the CCyB should be deactivated or reduced in a timely manner. Deactivating the CCyB in a timely manner could, for example, promote the prompt realization of loan losses by advanced approaches institutions and the removal of such loans from their balance sheets and would reduce the likelihood that advanced

approaches institutions would significantly pare their risk-weighted assets in order to maintain their capital ratios during a downturn.

(f) The pace and magnitude of changes in the CCyB will depend importantly on the underlying conditions in the financial sector and the economy as well as the desired effects of the proposed change in the CCyB. If vulnerabilities are rising gradually, then incremental increases in the level of the CCyB may be appropriate. Incremental increases would allow banks to augment their capital primarily through retained earnings and allow policymakers additional time to assess the effects of the policy change before making subsequent adjustments. However, if vulnerabilities in the financial system are building rapidly, then larger or more frequent adjustments may be necessary to increase loss-absorbing capacity sooner and potentially to mitigate the rise in vulnerabilities.

(g) The Board will also consider whether the CCyB is the most appropriate of its available policy instruments to address the financial system vulnerabilities highlighted by the framework's judgmental assessments and empirical models. The CCyB primarily is intended to address cyclical vulnerabilities, rather than structural vulnerabilities that do not vary significantly over time. Structural vulnerabilities are better addressed through targeted reforms or permanent increases in financial system resilience. Two central factors for the Board to consider are whether advanced approaches institutions are exposed—either directly or indirectly—to the vulnerabilities identified in the comprehensive judgmental assessment or by the quantitative indicators that suggest activation of the CCyB and whether advanced approaches institutions are contributing—either directly or indirectly—to these highlighted vulnerabilities.

(h) In setting the CCyB for advanced approaches institutions that it supervises, the Board plans to consult with the OCC and FDIC on their analyses of financial system vulnerabilities and on the extent to which advanced approaches banking organizations are either exposed to or contributing to these vulnerabilities.

5. Communication of the U.S. CCyB with the Public

(a) The Board expects to consider at least once per year the applicable level of the U.S. CCyB. The Board will review financial conditions regularly throughout the year and may adjust the CCyB more frequently as a result of those monitoring activities.

(b) Further, the Board will continue to communicate with the public in other formats regarding its assessment of U.S. financial stability, including financial system vulnerabilities. In the event that the Board considered that a change in the CCyB were appropriate, it would, in proposing the change, include a discussion of the reasons for the proposed action as determined by the particular circumstances. In addition, the Board's biannual Monetary Policy Report to Congress, usually published in February and July, will continue to contain a section that reports on developments pertaining to the stability of the U.S. financial system.¹² That portion of the report will be an important vehicle for updating the public on how the Board's current assessment of financial system vulnerabilities bears on the setting of the CCyB.

¹² For the most recent discussion in this format, see box titled "Developments Related to Financial Stability" in Board of Governors of the Federal Reserve System, *Monetary Policy Report to Congress*, June 2016, pp. 20-21.

6. Monitoring the Effects of the U.S. CCyB

(a) The effects of the U.S. CCyB ultimately will depend on the level at which it is set, the size and nature of any adjustments in the level, and the timeliness with which it is increased or decreased. The extent to which the CCyB may affect vulnerabilities in the broader financial system depends upon a complex set of interactions between required capital levels at the largest banking organizations and the economy and financial markets. In addition to the direct effects, the secondary economic effects could be amplified if financial markets extract a signal from the announcement of a change in the CCyB about subsequent actions that might be taken by the Board. Moreover, financial market participants might react by updating their expectations about future asset prices in specific markets or broader economic activity based on the concerns expressed by the regulators in communications announcing a policy change.

(b) The Board will monitor and analyze adjustments by banking organizations and other financial institutions to the CCyB: whether a change in the CCyB leads to observed changes in risk-based capital ratios at advanced approaches institutions, as well as whether those adjustments are achieved passively through retained earnings, or actively through changes in capital distributions or in risk-weighted assets. Other factors to be monitored include the extent to which loan growth and interest rate spreads on loans made by affected banking organizations change relative to loan growth and loan spreads at banking organizations that are not subject to the buffer. Another consideration in setting the CCyB and other macroprudential tools is the extent to which the adjustments by advanced approaches institutions to higher capital buffers lead to migration of credit

market activity outside of those banking organizations, especially to the nonbank financial sector. Depending on the amount of migration, which institutions are affected by it, and the remaining exposures of advanced approaches institutions, those adjustments could cause the Board to favor either a higher or a lower value of the CCyB.

(c) The Board will also monitor information regarding the levels of and changes in the CCyB in other countries. The Basel Committee on Banking Supervision is expected to maintain this information for member countries in a publically available form on its website.¹³ Using that data in conjunction with supervisory and publicly available datasets, the Board will be able to draw not only upon the experience of the United States but also that of other countries to refine estimates of the effects of changes in the CCyB.

By order of the Board of Governors of the Federal Reserve System, September 8, 2016.

**Robert deV. Frierson,
Secretary of the Board.**

BILLING CODE: 6210-01P

¹³ BIS, Countercyclical capital buffer (CCyB), www.bis.org/bcbs/ccyb/index.htm.

[FR Doc. 2016-21970 Filed: 9/15/2016 8:45 am; Publication Date: 9/16/2016]