Minutes of the Financial Stability Oversight Council

Held November 2, 2015

PRESENT:

Jacob J. Lew, Secretary of the Treasury and Chairperson of the Financial Stability Oversight Council (Council)
Janet Yellen, Chair, Board of Governors of the Federal Reserve System (Federal Reserve)
Martin J. Gruenberg, Chairperson, Federal Deposit Insurance Corporation (FDIC)
Mary Jo White, Chair, Securities and Exchange Commission (SEC)
Timothy Massad, Chairman, Commodity Futures Trading Commission (CFTC)
Richard Cordray, Director, Consumer Financial Protection Bureau (CFPB)
Melvin Watt, Director, Federal Housing Finance Agency (FHFA)
Thomas J. Curry, Comptroller of the Currency, Office of the Comptroller of the Currency (OCC) (by telephone)
Debbie Matz, Chairman, National Credit Union Administration (NCUA)
Roy Woodall, Independent Member with Insurance Expertise
Richard Berner, Director, Office of Financial Research (OFR), Department of the Treasury (nonvoting member)
Michael McRaith, Director, Federal Insurance Office, Department of the Treasury (non-voting member)
John P. Ducrest, Commissioner, Louisiana Office of Financial Institutions (non-voting member)
Adam Hamm, Commissioner, North Dakota Insurance Department (non-voting member)
Melanie Lubin, Securities Commissioner, Maryland Office of the Attorney General, Securities Division (non-voting member)

GUESTS:

Department of the Treasury (Treasury)
Sarah Bloom Raskin, Deputy Secretary of the Treasury
Patrick Pinschmidt, Deputy Assistant Secretary and Executive Director of the Council
Eric Froman, Deputy Assistant General Counsel for the Council
Mark Kaufman, Counselor to the Deputy Secretary

Board of Governors of the Federal Reserve System
Daniel K. Tarullo, Governor (executive session only)
Nellie Liang, Director, Office of Financial Stability Policy and Research

Federal Deposit Insurance Corporation
Jason Cave, Special Advisor to the Chairman for Supervisory Matters

Securities and Exchange Commission
Michael Liftik, Deputy Chief of Staff

Commodity Futures Trading Commission
Lawranne Stewart, Special Counsel

Consumer Financial Protection Bureau
Meredith Fuchs, Acting Deputy Director

Federal Housing Finance Agency
Sandra Thompson, Deputy Director, Division of Housing Mission and Goals

Comptroller of the Currency
Jonathan Fink, Special Counsel to the Comptroller

National Credit Union Administration
Ralph Monaco, Chief Economist

Office of the Independent Member with Insurance Expertise
Diane Fraser, Senior Policy Advisor

Federal Insurance Office
Steven Seitz, Deputy Director (Financial Stability)

Louisiana Office of Financial Institutions
Margaret Liu, Senior Vice President & Deputy General Counsel, Conference of State Bank Supervisors

North Dakota Insurance Department
Mark Sagat, Counsel and Manager, Financial Policy and Legislation, National Association of Insurance Commissioners

Maryland Office of the Attorney General, Securities Division
Joseph Brady, General Counsel, North American Securities Administrators Association

PRESENTERS:

Update on Annual Reevaluation of Nonbank Financial Company Designation

- *Steven Seitz, Deputy Director, Federal Insurance Office, Treasury*
- *Bruce Saul, Senior Policy Analyst, Federal Insurance Office, Treasury*
- *Stephen Ledbetter, Director of Policy, Treasury (available for questions)*

Update on Review of Asset Management Products and Activities

- *Lyndsay Huot, Deputy Director of Policy, Treasury*
- *David Grim, Director, Division of Investment Management, SEC*
- *Sarah ten Siethoff, Assistant Director for Rulemaking, Division of Investment Management, SEC*
- *Sara Cortes, Senior Special Counsel for Rulemaking, Division of Investment Management, SEC*

Update on Cybersecurity

- *Amias Gerety, Acting Assistant Secretary for Financial Institutions, Treasury*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 1:33 P.M. (EST). He outlined the meeting agenda, which had previously been distributed to the members together with copies of the resolution and other materials. The agenda for the executive session of the meeting included an update on the annual reevaluation of a nonbank financial company designation.

1. Update on Annual Reevaluation of Nonbank Financial Company Designation

The Chairperson introduced the first agenda item, an update on the annual reevaluation of a nonbank financial company that the Council had previously designated under section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Chairperson introduced Steven Seitz, Deputy Director (Financial Stability) at the Federal Insurance Office, and Bruce Saul, Senior Policy Analyst at the Federal Insurance Office. Messrs. Seitz and Saul presented on the preliminary staff analysis that had been conducted during this annual reevaluation. The presenters described, among other things, the engagement that had occurred between staff of Council members and member agencies and the company, the consultations staff had conducted with the company's regulators, recent developments at the company, and information submitted by the company to the Council. The Chairperson had to briefly leave the meeting, and after the presentation, Sarah Bloom Raskin, Deputy Secretary of the Treasury, asked if Council members had any questions. Members of the Council then asked questions and had a discussion, including regarding the staff analysis and engagement with companies during annual reevaluations of designations. Chair White of the SEC recused herself from participating in this discussion.

2. Other Business

The Chairperson asked whether there was any other business before the Council adjourned for the open session. Richard Berner, Director of the OFR, raised the OFR's ongoing work related to interagency data sharing. He described progress the OFR and Council member agencies have made in developing best practices for sharing data, but noted that significant obstacles remain and encouraged Council support. He noted the importance of making further progress on a metadata catalogue of datasets that agencies have available. He explained that this type of information should be shared among global supervisory authorities, and that work on this issue is in process.

The Chairperson adjourned the executive session of the meeting at approximately 2:07 P.M. (EST).

Open Session

The Chairperson called the open session of the meeting of the Council to order at approximately 2:15 P.M. (EST). The agenda for the open session included: (1) an update on the Council's review of asset management products and activities; (2) an update on cybersecurity; and (3) a consideration of, and a vote on, a resolution approving the minutes of the Council's meeting on September 21, 2015. Before moving to the agenda, the Chairperson noted that earlier in the day the President had signed into law the budget agreement and debt limit increase that had been passed by Congress, which the Chairperson said was an important step forward.

1. Update on Review of Asset Management Products and Activities

The Chairperson introduced the first agenda item, an update on the staff evaluation of potential financial stability risks arising from asset management products and activities. The Chairperson introduced Lyndsay Huot, Deputy Director of Policy at Treasury; David Grim, Director of the Division of Investment Management at the SEC; Sarah ten Siethoff, Assistant Director for Rulemaking in the Division of Investment Management at the SEC; and Sara Cortes, Senior Special Counsel for Rulemaking in the Division of Investment Management at the SEC.

The Chairperson prefaced the staff presentations by noting that the Council has been actively reviewing potential risks to financial stability in asset management for some time, pointing to the Council's conference on asset management in May 2014 and its subsequent notice seeking public input on potential asset management risks and existing risk management practices. The Chairperson remarked that the Council's ongoing engagement with market participants and other stakeholders has been an important component of its analysis, and that the Council works to be thoughtful and transparent in evaluating potential risks. He stated that probing deeper in certain areas of the financial system does not necessarily mean that there will always be risks that will rise to a sufficient level to warrant action by the Council, but that bypassing certain sectors of the financial system would be shirking the Council's responsibility to understand potential risks to financial stability.

The Chairperson noted that as the financial markets evolve, the nature of potential risks has shifted, and the Council must be vigilant to these changes. He noted that market participants are asking many of the same questions as the Council regarding potential impacts on financial markets, particularly in times of stress. The Chairperson said that, as the work of the Council in this area is not yet completed, the update provided by Council staff would not present any final conclusions or identify final policy options for consideration. He also noted that the Council's focus is on potential financial stability risks, including risks that may cut across the jurisdictions of multiple regulators. He added that the work of the regulators is complementary to the Council's work, and that the SEC is a key contributor to the Council's analysis of asset management products and activities and is now engaged in rulemaking initiatives that touch on many of the same areas raised by the Council in the Council's request for public comment. The Chairperson stated that the SEC rulemakings will help inform the Council's continuing evaluation of potential risks to financial stability, which will incorporate the relevant expertise among the member agencies to make informed, collective judgments. The Chairperson remarked that the Council's judgments will inform a domestic consensus on potential risks from

asset management products and activities and that, given that many of these same issues are being discussed on a global basis, it is important that the United States lead globally in these areas through the Council's process.

The Chairperson then asked Ms. Huot to provide an update on the Council's work. Ms. Huot began by providing the background for the staff analysis, noting that staff had taken a broad approach to evaluating potential areas of financial stability risks. She noted that the Council's notice requesting public comment on asset management products and activities outlined potential risks to financial stability; outlined rules or practices that might mitigate those risks; and asked questions to help the Council assess the existence and degree of risks to financial stability, risk management practices, and the need for additional data. She said that staff had reviewed the public submissions and conducted additional analysis and were working to conduct further evaluation. She also highlighted the SEC's rulemaking proposals regarding asset management, which she noted relate to a number of the areas raised in the Council's request for public comment. She then described the current work being undertaken by Council staff. She said that staff were evaluating six areas as part of its work: liquidity and redemption risk; leverage; securities lending; data and disclosure; operational risks of service provider concentrations; and resolvability and transition planning. Ms. Huot explained that in each of these six areas, staff were working to (1) identify and assess the materiality of potential risks to financial stability, as well as mitigants to those risks; (2) consider the extent to which existing or proposed regulations, where applicable, address the identified risks or whether there are financial stability risks that have not been addressed; and (3) determine, based on the analysis, whether to make recommendations to the Council in response to any potential risks to financial stability that may be identified. Ms. Huot stated that staff expect be in a position to enable the Council to provide a public update on the analysis next spring.

The Chairperson then turned to Chair White of the SEC. Chair White stated that the SEC has been very focused on enhancing the regulation of risks related to the asset management industry, particularly those arising from portfolio composition and operations of registered funds and advisors. She noted that these are critical issues for the SEC to address, as the primary regulator of funds and advisors. She referred to a plan for action she had publicly outlined in December 2014 that involved modernizing the data reported by funds and advisors, enhancing the controls on risks related to liquidity management and derivatives, improving transition planning, and stress testing. She then introduced Mr. Grim, Ms. ten Siethoff, and Ms. Cortes for the presentation.

Mr. Grim provided an update on the SEC's recent rule proposals related to the asset management industry. He noted that SEC staff are working on five initiatives to enhance the regulation of certain risks arising from registered investment companies and investment advisors. He said that these initiatives related to data reporting, fund liquidity, funds' use of derivatives, planning for the transition of client assets, and stress tests. He noted the SEC's approval in May 2015 of a proposal regarding information reported by SEC-registered funds and investment advisors and the SEC's approval in September 2015 of a proposed rule that would require certain funds to adopt liquidity risk management programs and permit swing pricing.

Regarding the proposed rules on investment company and investment advisor reporting modernization, Mr. Grim said first that the proposal would require a new monthly reporting form, Form N-PORT, that would provide the SEC with information on fund portfolios on a more frequent basis and in a format that would enhance the SEC's ability to identify and analyze various risks across the fund industry. He said that, in particular, the form would enhance reporting regarding derivatives, repurchase agreements, and securities lending activities, including information regarding counterparties. He said that the form would also require certain risk metrics related to fund exposures and would provide information regarding liquidity and pricing of fund investments, as well as fund flows. Second, he said that the proposal includes amendments to the SEC's Regulation S-X, including requiring new disclosures regarding funds' investments, use of derivatives, and securities lending activities. Third, he stated that the proposal would create a new Form N-CEN, which would require annual reporting by funds of certain census-type information, including background information, information regarding the funds' service providers, and information about their securities lending activities, with additional questions relevant to ETFs. Fourth, he said that the proposal would permit, but not require, most funds to provide these reports to investors via a website. He added that another part of the proposal would amend Form ADV to require the disclosure of additional information about separately managed accounts.

With respect to liquidity, Mr. Grim noted that a defining feature of open-end mutual funds is that investors can redeem shares on each business day and must receive their assets within seven days. He further noted that many funds promise, and many investors expect, that investors will receive their assets even more quickly, and that liquidity is therefore essential. Mr. Grim pointed out that mutual funds and other open-end funds hold more than $15 trillion of investor assets. He said the SEC's proposal on liquidity would require funds to adopt a liquidity risk management program. Mr. Grim explained that the program would require each fund to categorize and monitor the liquidity of each of its portfolio positions, considering a number of factors, such as trading frequency and volume, bid-ask spreads, and position size. Second, he said that the proposal would require each fund to assess and review its liquidity risk and determine a three-day liquid asset minimum that the fund would be required to maintain. Third, he said that the proposal would codify a current SEC guideline providing that funds should invest no more than 15 percent of their portfolio in illiquid assets. Mr. Grim said that in addition to the liquidity risk management program, the SEC also proposed new disclosure and reporting requirements relating to liquidity risks and risk management, including disclosures relating to how funds meet redemptions. He said that the proposal would permit open-end funds other than money market funds and exchange-traded funds to use, in certain circumstances, swing pricing, which would reflect in a fund's net asset value the estimated costs that arise from shareholder purchase or redemption activity under certain conditions.

Mr. Grim pointed out that Chair White has said that she expects a recommendation from SEC staff by the end of the year on proposed rules that would limit funds' use of derivatives and place appropriate limits on funds' leverage obtained through derivatives. He noted that staff is also working on recommendations related to transition planning and stress testing.

Following the presentation, the Chairperson noted that, while it would be premature to speculate on what steps the Council might take regarding asset management, it was his expectation that the Council would be in a position to provide a public update early next year.

The Chairperson then asked the SEC staff how the SEC's proposed rules would work in periods of substantial stress. Mr. Grim responded that, under the proposed requirements for developing liquidity and risk management programs, funds are required to consider both normal and reasonably foreseeable stress conditions in developing their programs. He also noted that the SEC is working on a separate rulemaking that would require stress tests for funds and that, although stress testing would not be required under the proposed liquidity proposal, it was expected that many funds would perform stress testing and factor such testing into their liquidity risk management programs.

Janet Yellen, Chair of the Federal Reserve, voiced her support for the work that the Council and member agency staff are undertaking on potential risks posed by asset management activities and said that it is appropriate for the Council to explore potential channels of systemic risk in this area. She said that the rule proposals are important steps toward addressing risks and information gaps in the asset management industry. She said the SEC's proposals would play an important role in the Council's consideration of potential risks in this sector.

2. Update on Cybersecurity

The Chairperson then introduced the next agenda item, an update on cybersecurity. He noted that cybersecurity for the financial sector is a priority for all of the Council members and had been addressed in the Council's annual reports. He also noted that the FBIIC has been working to implement the Council's cybersecurity recommendations. He then introduced Amias Gerety, Acting Assistant Secretary for Financial Institutions at Treasury and Chair of the Financial and Banking Information Infrastructure Committee (FBIIC), for the presentation.

The Chairperson had to leave the meeting, and Sarah Bloom Raskin, Deputy Secretary of the Treasury, presided over the remainder of the meeting.

Mr. Gerety noted that the Council had devoted significant attention to cybersecurity in its 2015 annual report. He said that continuing to improve financial services sector cybersecurity is a priority for both government and industry. He discussed the work the FBIIC and its member agencies have done across the categories of information sharing, baseline protections and best practices, and incident response and recovery. He noted that FBIIC is composed of 18 federal and state financial regulators, including all of the Council member agencies. He thanked Council members for their participation in the newly created FBIIC Seniors Committee, and noted that the FBIIC serves as the working group to implement the Council's recommendations on cybersecurity.

Mr. Gerety noted that the Council has identified sharing cybersecurity information sharing as one of the most important ways of reducing overall cybersecurity risk. He said that the Treasury Department has established the Financial Sector Cyber Intelligence Group to help identify information government possesses that may be useful to firms and to share that information in a

timely and actionable fashion with companies. He noted that other government agencies, including the Federal Bureau of Investigation and the Department of Homeland Security, have also undertaken significant efforts to expand their information-sharing activities, for example, by improving mechanisms for downgrading and declassifying sensitive information and by expanding capabilities for automated information sharing. He said that much of the information-sharing work of the private sector is facilitated by the Financial Services Sector Information Sharing and Analysis Center (FS-ISAC) and that financial regulators and the Treasury Department have encouraged firms to consider participating in the FS-ISAC's work.

Mr. Gerety then explained that that government agencies and industry are also taking steps to improve cybersecurity controls to build more secure networks. He said that the National Institute of Standards and Technology's Framework for Improving Critical Infrastructure Cybersecurity can help firms, especially firms with smaller technology staffs, reduce their cyber risk. He also cited the SEC's adoption of Regulation Systems Compliance and Integrity, which imposes requirements on certain key market participants that are intended to reduce the occurrence of systems issues and improve resiliency when systems problems do occur. Mr. Gerety also referred to the Federal Financial Institutions Examination Council's release of its Cybersecurity Assessment Tool to help institutions identify their risks and determine their cybersecurity preparedness. In addition, he cited the National Association of Insurance Commissioners Executive Committee's appointment of a Cybersecurity Task Force to serve as the central focus for insurance regulatory activities related to cybersecurity and the task force's recently adopted principles for effective cybersecurity insurance regulatory guidance. In the international context, he noted that the G-7 finance ministers and central bank governors have established a new working group on financial sector cybersecurity that is being co-chaired by Deputy Secretary Raskin and the Bank of England.

Regarding response and recovery, Mr. Gerety said that the FBIIC is working closely with the Financial Services Sector Coordinating Council (FSSCC) and the Department of Homeland Security to lead a series of public-private tabletop exercises designed to simulate cyber incidents and identify key challenges for effective public-private response and coordination. He said that FBIIC is working closely with the FS-ISAC and others in industry and government to update and further coordinate sector-wide incident response plans. In addition, he noted that FBIIC is working with its partners in the United Kingdom to test processes for responding to incidents impacting both countries.

Mr. Gerety concluded that there are no simple solutions to cybersecurity challenges and that more work will continue to be needed in this area, as cybersecurity threats evolve.

Following the presentation, Deputy Secretary Raskin asked what chief executive officers and other senior executives should do to implement good practices at their companies. Mr. Gerety replied that the assessment of cybersecurity risk is not a one-size-fits-all exercise, and that the FFIEC assessment tool allows firms to identify their current status and map out how to move forward. He also noted that the initiatives he discussed were aimed at reaching across sectors and involving new institutions.

Timothy Massad, Chairman of the CFTC, expressed his agreement with the importance of the focus on cybersecurity. He explained that the CFTC has rules in place that require exchanges and clearinghouses to establish and maintain system safeguards, which have been a focus of examinations. He said that the CFTC is looking into whether firms' boards of directors are devoting sufficient attention to these issues. He said that the CFTC is considering additional standards in this area with respect to testing to ensure adequate evaluation of these risks, including vulnerability testing, penetration testing, controls testing, and security incident and response plan testing. He pointed out that the National Futures Association also recently issued additional guidance on this subject.

Martin Gruenberg, Chairman of the FDIC, noted that cybersecurity is a priority for the Council and its member agencies, and that it is of importance not just to large banks but to community banks and service providers.

Debbie Matz, Chairman of the NCUA, underscored the significance of the FFIEC's assessment tool and said that it will be reflected in the NCUA's examinations of credit unions. She also reiterated the Council's recommendation in its annual report that Congress grant examination and enforcement powers to NCUA and FHFA to oversee third-party service providers engaged with credit unions and the government-sponsored enterprises, respectively.

Michael McRaith, Director of the Federal Insurance Office, noted that the cybersecurity initiatives cited by Mr. Gerety had been a multinational effort, and asked Mr. Gerety how small firms can participate in the cybersecurity work occurring at the national level. Mr. Gerety responded that smaller firms are joining these initiatives, such as FS-ISAC. He said that the FFIEC and others are seeking to make sure their initiatives are appropriately tailored for small institutions. He noted that the FBIIC has partnered with the Department of Homeland Security, the Federal Bureau of Investigation, and the Secret Service to build relationships across the country, including by organizing open houses and regional workshops. He also said that early next year FBIIC is planning to issue an "exercise in a box" that any institution would be able to use.

Thomas Curry, Comptroller of the Currency, expressed the importance of the Council addressing cybersecurity issues. He encouraged Council member agencies to encourage the industry sectors they oversee to adopt appropriate preventive steps to address cybersecurity.

3. Resolution Approving the Minutes of the Meeting held on September 21, 2015

"*BE IT RESOLVED, by the Financial Stability Oversight Council (the "Council"), that the minutes attached hereto of the meeting held on September 21, 2015 of the Council are hereby approved.*"

The Deputy Secretary asked for a motion to approve the resolution, which was made and seconded. The Council approved the resolution by unanimous vote.

The Deputy Secretary adjourned the meeting at approximately 3:14 P.M. EST.