

Minutes of the Financial Stability Oversight Council

November 15, 2021

PRESENT:

Nellie Liang, Under Secretary for Domestic Finance (acting pursuant to delegated authority)
Jerome H. Powell, Chair, Board of Governors of the Federal Reserve System (Federal Reserve)
Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation (FDIC)
Gary Gensler, Chair, Securities and Exchange Commission (SEC)
Rostin Behnam, Acting Chairman, Commodity Futures Trading Commission (CFTC)
Rohit Chopra, Director, Consumer Financial Protection Bureau (CFPB)
Sandra L. Thompson, Acting Director, Federal Housing Finance Agency (FHFA)
Michael J. Hsu, Acting Comptroller of the Currency, Office of the Comptroller of the Currency (OCC)
Todd M. Harper, Chairman, National Credit Union Administration (NCUA)
Thomas E. Workman, Independent Member with Insurance Expertise
Dino Falaschetti, Director, Office of Financial Research (OFR), Department of the Treasury (non-voting member)
Steven Seitz, Director, Federal Insurance Office (FIO), Department of the Treasury (non-voting member)
Charles G. Cooper, Commissioner, Texas Department of Banking (non-voting member)
Eric Cioppa, Superintendent, Maine Bureau of Insurance (non-voting member)
Melanie Lubin, Securities Commissioner, Maryland Office of the Attorney General, Securities Division (non-voting member)

GUESTS:

Department of the Treasury (Treasury)

Sandra Lee, Deputy Assistant Secretary for the Financial Stability Oversight Council (Council)
Eric Froman, Assistant General Counsel (Banking and Finance)
Sean Hoskins, Acting Director of Policy, Office of the Financial Stability Oversight Council

Board of Governors of the Federal Reserve System

Andreas Lehnert, Director, Division of Financial Stability

Federal Deposit Insurance Corporation

Travis Hill, Deputy to the Chairman for Policy

Securities and Exchange Commission

Amanda Fischer, Senior Counselor

Commodity Futures Trading Commission

David Gillers, Chief of Staff

Consumer Financial Protection Bureau
Gregory Gelzinis, Advisor to the Director

Federal Housing Finance Agency
Naa Awaa Tagoe, Acting Deputy Director, Division of Housing Mission and Goals

Comptroller of the Currency
Blake Paulson, Senior Deputy Comptroller for Supervision Risk and Analysis

National Credit Union Administration
Andrew Leventis, Chief Economist

Office of the Independent Member with Insurance Expertise
Charles Klingman, Senior Policy Advisor

Federal Reserve Bank of New York
John Williams, President and Chief Executive Officer
Richard Crump, Vice President, Capital Markets Function

Office of Financial Research
Sriram Rajan, Associate Director

Federal Insurance Office
Philip Goodman, Senior Insurance Regulatory Policy Analyst

Texas Department of Banking
Michael Townsley, Policy Counsel, Conference of State Bank Supervisors

Maine Bureau of Insurance
Ethan Sonnichsen, Managing Director of Government Relations, National Association of Insurance Commissioners

Maryland Office of the Attorney General, Securities Division
Vincent Martinez, General Counsel, North American Securities Administrators Association

PRESENTERS:

Report on the Treasury Market by the Staffs of the Inter-Agency Working Group on Treasury Market Surveillance

- *Brian Smith, Deputy Assistant Secretary for Federal Finance, Treasury*

President's Working Group on Financial Markets Report on Stablecoins

- *Jordan Bleicher, Senior Advisor, Office of Domestic Finance, Treasury*
- *Mary Watkins, Attorney-Advisor, Treasury*

2021 Annual Report

- *Jonathan Rose, Senior Economist, Federal Reserve Bank of Chicago*
- *Alexandra Somers, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury (available for questions)*

Executive Session

Under Secretary Liang called the executive session of the meeting of the Council to order at approximately 3:03 P.M. The Council convened by videoconference. Under Secretary Liang began by noting that the Secretary and Deputy Secretary of the Treasury were unavailable for the meeting. She then welcomed Treasury's new Deputy Assistant Secretary for the Council, Sandra Lee. Under Secretary Liang outlined the meeting agenda, which had previously been distributed to the members together with other materials. The agenda for the executive session included (1) the progress report on the Treasury market recently issued by staff of agencies participating in the Inter-Agency Working Group on Treasury Market Surveillance (IAWG), (2) an update on the report on stablecoins issued in August 2021 by the President's Working Group on Financial Markets (PWG), (3) the Council's 2021 annual report, and (4) a vote on the minutes of the Council's meeting on October 21, 2021.

1. IAWG Report on the Treasury Market

Under Secretary Liang turned to the first agenda item, a presentation on the IAWG staff progress report on the Treasury market. She stated that the work of the IAWG on this issue was important because the smooth functioning of the Treasury market is vital for maintaining financial stability and financing the operations of the federal government. She then introduced Brian Smith, Deputy Assistant Secretary for Federal Finance at Treasury.

Mr. Smith began by noting that the IAWG serves as an important mechanism for collaboration on issues related to the Treasury market, and he then summarized the key themes in the report. He stated that recent disruptions in the Treasury market highlighted the importance of improving resilience in this market. He discussed several market disruptions in recent years, most notably in March 2020, when a "dash for cash" precipitated unprecedented sales of Treasury securities, intermediaries' capacity could not keep pace, and market liquidity deteriorated. He said it was important to consider the impact of previous disruptions on different segments of the Treasury market, and he noted that IAWG staff was examining common themes across these episodes.

Mr. Smith stated that demand for liquidity in March 2020 came from many sources, including foreign investors managing cross-border exposures, open-end mutual funds managing redemptions, hedge funds reducing positions and facing margin calls, and pension and insurance funds rebalancing holdings. He noted that challenges to intermediation included increasing risks to market-making, differences across market segments in margin and circuit breakers, and operational difficulties introduced by working from home during the pandemic.

Mr. Smith then described six principles related to the Treasury market that policymakers should seek to promote: resilient and elastic liquidity; transparency that fosters public confidence, fair

trading, and a liquid market; prices that reflect prevailing and expected economic and financial conditions; economic integration across cash, funding, and derivatives markets; financing that does not pose a significant threat to financial stability; and infrastructure that operates effectively and efficiently.

Mr. Smith noted that the IAWG report addressed ongoing efforts in five workstreams to strengthen market resilience: improving resilience of market intermediation by reducing bottlenecks, whether regulatory or technological; improving data quality and availability by enhancing data collection, pursuing additional transparency, and identifying additional data to collect; evaluating the costs and benefits of expanded central clearing; enhancing trading venue transparency and oversight; and assessing the effects of fund leverage and liquidity risk management practices.

Mr. Smith concluded by describing potential policy options and next steps that staff were exploring, including some areas where important progress has already been made. He said that efforts were underway to improve relevant data, noting that the Financial Industry Regulatory Authority (FINRA) was undertaking work to enhance Trade Reporting and Compliance Engine (TRACE) data. He also described efforts to improve the oversight of trading venues, including the SEC's September 2020 proposal to enhance the operational transparency, system integrity, and regulatory oversight for alternative trading systems for certain government securities. In the area of intermediation, he noted that in July 2021, the Federal Reserve announced the establishment of a domestic standing repo facility, to enable the Federal Reserve to conduct daily overnight repo operations against Treasury securities, agency debt securities, and agency mortgage-backed securities. Finally, he noted that on November 17, 2021, the IAWG would convene its seventh annual U.S. Treasury Market Conference to discuss recent developments and proposals to improve Treasury market resilience.

Council members then had a discussion about the report, including potential regulatory actions the SEC may undertake to address issues identified in the report, and the importance of liquidity in the Treasury market.

2. PWG Report on Stablecoins

Under Secretary Liang then introduced the next agenda item, a presentation on the PWG report on stablecoins. She turned to Jordan Bleicher, Senior Advisor in the Office of Domestic Finance at Treasury, and Mary Watkins, Attorney-Advisor at Treasury.

Mr. Bleicher began by noting that the recommendations in the PWG report focused on payment stablecoins, defined as stablecoins that are designed to maintain a stable value relative to a fiat currency and, therefore, have the potential to be used as a widespread means of payment. He stated that the recommendations in the report were intended to reduce prudential risks such as stablecoin runs, payment system risks, and concerns about concentration of economic power. He said that the report made clear that other existing regulatory or supervisory authorities would still apply, including to address market and investor-protection risks.

Mr. Bleicher then described the key recommendations in the PWG report. He stated that the report recommended that Congress enact legislation to ensure that payment stablecoins are subject to a federal prudential framework on a consistent and comprehensive basis. He said that the report also recommended that while Congress considers how to address risks associated with payment stablecoin arrangements, regulatory agencies should continue to use their existing authorities to address prudential risks to the extent possible. He said that the report also recommended that in the event Congress does not act, the Council should consider steps available to it to reduce payment stablecoin risks.

Mr. Bleicher then summarized the report's legislative recommendations with regards to issuers of payment stablecoins. He said the report recommended that such issuers should be required to become insured depository institutions, which are subject to supervision and regulation at the depository institution level by a federal banking agency and consolidated supervision and regulation by the Federal Reserve at the holding company level; are subject to capital and liquidity standards, activity limits, and restrictions on affiliation; and have access to Federal Reserve account services and the Federal Reserve's Discount Window.

Mr. Bleicher next summarized the report's legislative recommendations with regard to custodial wallet providers. He said that the report recommended that custodial wallet providers, defined as wallet providers that users rely on to hold stablecoins, should be subject to appropriate federal oversight. He noted that this recommendation reflected the central role that custodial wallet providers play within a stablecoin arrangement. He said that the report recommended that oversight of custodial wallet providers should include the authority to restrict these providers from lending customer stablecoins, and to require compliance with appropriate risk-management, liquidity, and capital requirements. He said the report also stated that, to address concerns about concentration of economic power, Congress may consider other standards for custodial wallet providers, such as limits on affiliation with commercial entities or on use of users' transaction data.

Ms. Watkins then stated that the final legislative recommendation in the PWG report reflected the fact that stablecoin arrangements may be undertaken by a variety of parties. She said the report included a recommendation to Congress that the federal supervisor of a stablecoin issuer should have authority to require any entity that performs activities critical to the functioning of the stablecoin arrangement to meet appropriate risk-management standards.

Ms. Watkins noted that the PWG agencies were committed to taking action to address risks within each agency's jurisdiction, and to continued coordination and collaboration on issues of common interest across the federal financial regulatory agencies.

Finally, Ms. Watkins stated that in the absence of Congressional action, the report recommended that the Council consider steps available to it to address the risks outlined in the report. She said that such steps may include the designation of certain activities conducted within stablecoin arrangements as, or as likely to become, systemically important payment, clearing, and settlement (PCS) activities. She noted that designation would permit the appropriate agency to

establish risk-management standards for financial institutions that engage in designated PCS activities, such as requirements in relation to the assets backing the stablecoin.

Council members then had a discussion about the report, including steps that Congress may take in response to the recommendations and the potential for the Council to designate PCS activities related to stablecoin arrangements.

3. 2021 Annual Report

Under Secretary Liang turned to the next agenda item, the Council's 2021 annual report. She introduced Jonathan Rose, Senior Economist at the Federal Reserve Bank of Chicago, and Alexandra Somers, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury.

Mr. Rose provided an update regarding the proposed timing for completion of the report, and noted that the Council would vote on the report at its December meeting. Mr. Rose then highlighted certain potential recommendations that the report may include.

Council members then asked questions and had a discussion about the draft report, including potential recommendations that may appear in the report regarding digital assets and other issues.

4. Resolution Approving the Minutes of the Meeting Held on October 21, 2021

BE IT RESOLVED, by the Financial Stability Oversight Council (the "Council"), that the minutes attached hereto of the meeting held on October 21, 2021 of the Council are hereby approved.

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

5. Other Business

Before the meeting concluding, Gary Gensler, Chair of the SEC, noted that the SEC would be issuing a proposed rule on the public disclosure of securities lending transactions, and he described the proposal.

Under Secretary Liang adjourned the meeting at approximately 4:03 P.M.