Minutes of the Financial Stability Oversight Council

April 21, 2023

PRESENT:

Janet L. Yellen, Secretary of the Treasury and Chairperson of the Financial Stability Oversight Council (Council)
Jerome H. Powell, Chair, Board of Governors of the Federal Reserve System (Federal Reserve)
Martin Gruenberg, Chairman, Federal Deposit Insurance Corporation (FDIC)
Gary Gensler, Chair, Securities and Exchange Commission (SEC)
Rostin Behnam, Chairman, Commodity Futures Trading Commission (CFTC)
Rohit Chopra, Director, Consumer Financial Protection Bureau (CFPB)
Sandra L. Thompson, 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
James Martin, Acting 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)
Adrienne Harris, Superintendent, New York State Department of Financial Services (non-voting member)
Elizabeth K. Dwyer, Superintendent of Financial Services, Rhode Island Department of Business Regulation (non-voting member)
Melanie Lubin, Securities Commissioner, Maryland Office of the Attorney General, Securities Division (non-voting member)

GUESTS:

Department of the Treasury (Treasury)
Nellie Liang, Under Secretary for Domestic Finance
Sandra Lee, Deputy Assistant Secretary for the Council
Laurie Schaffer, Principal Deputy General Counsel
Eric Froman, Assistant General Counsel (Banking and Finance)
Sean Hoskins, Director of Policy, Office of the Financial Stability Oversight Council

Board of Governors of the Federal Reserve System
Michael Barr, Vice Chair for Supervision
Nami Mukasa, Associate Director and Chief of Staff, Division of Financial Stability

Federal Deposit Insurance Corporation
James McGraw, Senior Deputy Director, Division of Complex Institution Supervision and Resolution

Securities and Exchange Commission
Amanda Fischer, Chief of Staff

Commodity Futures Trading Commission
Rahul Varma, Acting Deputy Director, Division of Market Oversight

Consumer Financial Protection Bureau
Gregg Gelzinis, Advisor to the Director

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

Comptroller of the Currency
Jay Gallagher, Senior Deputy Comptroller for Supervision Risk and Analysis

National Credit Union Administration
Elizabeth Eurgubian, Director of External Affairs and Communications and Policy Advisor

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

Federal Reserve Bank of New York
John Williams, President
Richard Crump, Financial Research Advisor, Macrofinance Studies

Office of Financial Research
Sriram Rajan, Associate Director, Research and Analysis Center

Federal Insurance Office
Philip Goodman, Senior Insurance Regulatory Policy Analyst (via videoconference)

New York State Department of Financial Services
Karen Lawson, Executive Vice President for Policy and Supervision, Conference of State Bank Supervisors

Rhode Island Department of Business Regulation
Ethan Sonnichsen, Managing Director, National Association of Insurance Commissioners

Maryland Office of the Attorney General, Securities Division
Dylan White, Associate General Counsel, North American Securities Administrators Association

PRESENTERS:

Update on Market Developments

- *David Bowman, Senior Associate Director, Division of Monetary Affairs, Federal Reserve (available for questions)*

Hedge Fund Working Group Update

- *Ron Alquist, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury (via videoconference)*
- *Alexandra Somers, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury*
- *Michelle Danis, Assistant Director, Risk Supervised Broker-Dealer Program, SEC (available for questions) (via videoconference)*
- *Jay Kahn, Senior Economist, Federal Reserve (available for questions) (via videoconference)*
- *Neth Karunamuni, Quantitative Analyst, OFR (available for questions) (via videoconference)*

Nonbank Mortgage Servicing Task Force

- *Greg Keith, Senior Vice President and Chief Risk Officer, Government National Mortgage Association (Ginnie Mae)*
- *Karen Pence, Deputy Associate Director, Division of Research and Statistics, Federal Reserve*
- *Kevin Silva, Associate Director, Enterprise Counterparty Financial Standards, FHFA*
- *Jeffrey Levine, Principal, Markets Group, Federal Reserve Bank of New York (available for questions) (via videoconference)*
- *Alanna McCargo, President, Ginnie Mae (available for questions) (via videoconference)*
- *Anna Mwangi, Senior Financial Analyst, FHFA (available for questions) (via videoconference)*
- *Sam Valverde, Executive Vice President and Chief Operating Officer, Ginnie Mae (available for questions)*

Proposed Analytic Framework on Financial Stability Risks and Proposed Guidance on Nonbank Financial Company Designations

- *Sandra Lee, Deputy Assistant Secretary for the Council, Treasury*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 9:59 A.M. The Chairperson began by outlining the meeting agenda, which had previously been distributed to the members together with other materials. The agenda for the executive session included (1) an update on recent market developments, (2) an update on the work of the Council's Hedge Fund Working Group, (3) a presentation on the work of the Council's Nonbank Mortgage Servicing Task Force, and (4) the Council's proposed financial stability risk monitoring framework and its proposed interpretive guidance on nonbank financial company designations.

1. Update on Market Developments

The Chairperson introduced the first agenda item, an update on recent market developments. She said that while financial conditions had calmed since the Council's previous meeting and the stress in regional banks appeared less acute, it was important that the Council continue to monitor market developments closely for any signs of stress in the financial sector. She asked the Federal Reserve and the FDIC to share their perspectives. She turned first to Jerome Powell, Chair of the Federal Reserve.

Chair Powell said that the Federal Reserve expected continued slow or modest growth in 2023. He said that while the labor market remained strong, gradual slowing was developing in job and wage growth. He said that inflation continued to be too high. He noted that credit standards at small and midsize banks were tightening. Chair Powell then turned to Michael Barr, Vice Chair for Supervision at the Federal Reserve.

Mr. Barr said that the banking system overall was sound and resilient, with strong capital and liquidity. He said that the Federal Reserve was closely monitoring the banking system, including monitoring mark-to-market losses on investment securities, and examining uninsured deposits at banks, bank exposures to commercial real estate, and potential risks related to the debt limit. He said that it would be necessary to address these and other vulnerabilities.

Mr. Barr then provided a brief update on the transition from LIBOR to alternative reference rates, which he had previously discussed at a meeting of the Council on December 16, 2022. He noted that Council members have emphasized that the overnight Secured Overnight Financing Rate (SOFR) must remain the primary tool for derivatives and capital markets, and the use of Term SOFR and other reference rates must remain limited. He reported that CME Group, the administrator of the Term SOFR rates, had agreed to embed recommendations by the Alternative Reference Rates Committee (ARRC), the private-sector body leading the transition in the United States, into its licensing agreement for Term SOFR.

The Chairperson then turned to Martin Gruenberg, Chairman of the FDIC. Chairman Gruenberg stated that the actions taken by the official sector on March 12, 2023, regarding Signature Bank and Silicon Valley Bank (SVB) were an appropriate step that helped to protect uninsured depositors and support financial stability. He noted that Signature Bank and SVB had been placed into bridge banks and sold to regional banks. He said that the FDIC would continue to monitor developments. He said that the FDIC intended to release a report regarding the FDIC's supervision of Signature Bank; a report on U.S. deposit insurance risks and policy options; and a proposal to implement a special assessment to recover the costs associated with protecting uninsured depositors of Signature Bank and SVB. He said that recent developments in the banking sector had provided lessons regarding financial stability risks.

Council members then asked questions and had a discussion about the recent market developments, including at money market funds and hedge funds.

2. Hedge Fund Working Group Update

The Chairperson then turned to the second agenda item, an update on the work of the Council's Hedge Fund Working Group, including its risk monitor. She noted that previous updates to the Council on the working group had identified potential financial stability risks associated with hedge fund activities. She then introduced Alexandra Somers, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury, and Ron Alquist, Senior Policy

Advisor in the Office of the Financial Stability Oversight Council at Treasury, for the presentation.

Ms. Somers stated that in November 2022, the working group provided the Council with an update on its risk assessment, which focused on two questions: how hedge fund-related vulnerabilities evolved in 2022, and how potential future shocks could interact with hedge fund vulnerabilities to create systemic risks. She said that the update in this meeting would build on the working group's previous analysis and address two topics: the working group's assessment of risks related to hedge funds, with a focus on how funds managed the March 2023 interest rate volatility event, and a review of hedge funds' use of the non-centrally cleared bilateral repurchase agreement (repo) market, in light of the findings from the OFR's bilateral repo data collection pilot project that most hedge funds are obtaining repo funding with zero haircuts.

Ms. Somers then addressed risks related to foreign exchange and interest rate volatility. She said that macro hedge funds funds largely outperformed the broader hedge fund industry in 2022, which she noted may be partly due to historically high levels of leverage. She said that although high leverage ratios likely contributed to macro funds' outperformance, it left them with directional rates positions that are vulnerable to unexpected rate changes. Addressing recent interest rate volatility, Ms. Somers said that the volatility in interest rate markets following the failure of SVB led to significant margin calls and rapid deleveraging at certain hedge funds. She said that reports indicated that multiple funds unwound sizable short interest rate positions to reduce directional exposures.

Ms. Somers stated that the March 2023 events supported the working group's view that liquidations by highly leveraged hedge funds can contribute to market disruptions even if they are not the ultimate source of the adverse shock. She stated that the deterioration in Treasury market liquidity in March 2023 was more consistent with the extreme volatility observed. She said that the resilience of the Treasury market was partly attributable to the diversity of investor flows. She noted that the working group served as an important forum for interagency information sharing during this period of market volatility. She said that the SEC's proposed "current reporting" requirement, which would require advisers to report significant stress at a fund, and the SEC's proposed changes to Form PF, which would require more granular data reporting on positions, would provide the Council with timelier information than it currently receives.

Mr. Alquist then discussed hedge funds' use of the non-centrally cleared bilateral repo (NCCBR) market. He said that hedge fund repo borrowing had roughly doubled over the past five years and approached $1.25 trillion as of the fourth quarter of 2022. He noted that hedge funds generally obtain repo borrowing in two market segments: the NCCBR market and the centrally cleared repo market. He said that large hedge funds often use the NCCBR market because dealers offer low or zero haircuts, and the funds can obtain customized trade terms. He noted that, by contrast, haircuts are higher on Treasury repo in the centrally cleared and tri-party repo markets.

Mr. Alquist stated that discussions with member agencies and market participants had indicated that the lower haircuts in the NCCBR market are attributable to several factors, including bilateral netting practices, cross-product margining, ongoing commercial relationships, and client profitability. He said that although netted packages and cross-product margining may reduce dealers' overall counterparty credit exposure, important risks may remain, particularly during stress events, as the March 2020 collapse of the Treasury cash-futures basis trade illustrated.

Mr. Alquist stated that analysis by the OFR and market outreach indicated that the prevalence of zero-haircut Treasury repo is partially due to the use of netted packages. He said that the OFR estimated that 70 percent of hedge fund Treasury repo borrowing and 57 percent of hedge fund Treasury repo lending at zero haircuts can be netted. He said that there is also a negative relationship between Treasury repo haircut levels and the amount of netting, suggesting that netted packages play a role in driving zero haircuts. He stated that the use of zero haircuts is also partly attributable to cross-product margining, a practice that depends on the dealer's commercial relationship with the client. He said that market participants report that certain dealers do not charge haircuts to clients with which they have a cross-product margining agreement based on the legal rights of cross-default.

Mr. Alquist said that OFR analysis of the NCCBR pilot data found that large hedge funds face considerably lower haircuts. He said that because large funds are likely more profitable to the dealer, this evidence suggests that more favored clients can get better borrowing terms. Addressing possible risks related to zero haircuts, he said that the potential financial stability risks associated with zero haircuts had become more prominent, given the increased presence of hedge funds in Treasury markets in recent years. He said that market participants view netting as risk-reducing and their credit exposure as near zero, and he noted that zero haircuts reflect the liquidity and lower risk of Treasury repo. He noted, however, that zero haircuts permit funds to become highly leveraged and take arbitrage positions where price differentials are small. He said that these types of trades entail several potential risks, including basis risk, liquidity risk, and concentration risk.

Mr. Alquist said in conclusion that NCCBR zero haircut transactions may represent a structural vulnerability during periods of market stress. He stated that shocks to Treasury market liquidity or a divergence in the historical relationship between Treasury securities with different maturities can cause the assumptions underlying netted packages and cross-margining to break down and lead to stressed liquidations of highly leveraged positions. He said that the March 2020 breakdown of the Treasury cash-futures basis trade and its material contribution to the market disruption underscored this risk. He stated that any policy proposal to address identified risks should consider the tradeoffs between reducing excessive volatility in affected markets and liquidity provision.

Council members then had a discussion regarding bank exposures to hedge funds, margining practices for securities financing transactions, Treasury market liquidity, and data gaps.

3. Nonbank Mortgage Servicing Task Force

The Chairperson then introduced the next agenda item, a presentation on the Council's Nonbank Mortgage Servicing Task Force. She noted that the Council had described the risks associated with nonbank mortgage servicers in its annual reports. She welcomed representatives of Ginnie Mae participating in the meeting, including Alanna McCargo, President of Ginnie Mae.

The Chairperson then introduced Kevin Silva, Associate Director of Enterprise Counterparty Financial Standards at FHFA; Greg Keith, Senior Vice President and Chief Risk Officer at Ginnie Mae; and Karen Pence, Deputy Associate Director of the Division of Research and Statistics at the Federal Reserve, for the presentation.

Mr. Silva stated that the Council restarted meetings of the Nonbank Mortgage Servicing Task Force in June 2022 to facilitate interagency coordination and monitoring of risks from nonbank mortgage servicing. He said that nonbank origination and servicing market share had grown rapidly in the last 10 years as banks exited the space. He noted that as of December 31, 2022, nonbanks serviced $6 trillion out of $13 trillion in total single-family mortgage debt outstanding, representing a significant increase in nonbank servicing during the COVID-19 pandemic.

Discussing the reasons why banks were reluctant to return to the mortgage market, Mr. Silva stated that the bank capital treatment of mortgage servicing rights had made it difficult to conduct mortgage servicing at a profitable scale; a rising interest rate environment was making mortgage origination less profitable; and banks had developed long-term profitability concerns about the mortgage origination and servicing business model, among other reasons. He said that a nonbank business model is subject to certain fragilities, including high exposure to mortgage and interest rate market conditions, concentrated sources of funding, volatile assets holdings, and limited emergency liquidity sources. He said that a recent confluence of macroeconomic factors, including the rise in mortgage rates and drop in mortgage refinancings, had strained the nonbank business model, leading to negative profitability and lower liquidity. He stated that nonbanks heavily rely on warehouse credit facilities from depository institutions, and he said that lending may be vulnerable during strained market conditions.

Mr. Keith stated that a rise in delinquencies could lead to significant liquidity strain at nonbank mortgage servicers, because they are typically obligated to make various servicing payments, such as property tax and insurance payments on behalf of borrowers. He discussed the results of stress testing that Ginnie Mae had conducted to evaluate the ability of Ginnie Mae mortgage issuers to withstand certain adverse scenarios.

Ms. Pence said that systemic nonbank strains could produce a number of adverse consequences, and some with potential severe systemic implications. Describing potential risks to consumers, she said that servicers experiencing financial distress may be less responsive to customers, particularly in instances of loan modifications or forbearance requests. She noted that servicer failures may lead to disorderly servicing transfers, with possible harm to consumers. She said that given the reduced bank mortgage business over the last decade, widespread failures in the nonbank sector would further reduce access to mortgage credit. She also discussed counterparty risks to Fannie Mae, Freddie Mac, Ginnie Mae, banks, and other financial institutions. She said that private equity funds, hedge funds, and insurance companies are increasingly providing longer-duration financing to the nonbank sector, and she noted that these exposures can be opaque.

Mr. Silva stated that agencies were taking a number of steps in nonbank oversight and risk management, which were designed to enhance resilience, develop interagency coordination, and promote risk management and monitoring. He said that nonbank mortgage servicers may pose both near and long-term challenges for policymakers. He said that staff intended to focus on interagency coordination, liquidity risks, regulatory and resolution authorities, and oversight of mortgage servicing right valuations.

Council members then had a discussion about mortgage servicing rights, liquidity sources, and potential steps to address vulnerabilities identified in the presentation.

4. Proposed Analytic Framework on Financial Stability Risks and Proposed Guidance on Nonbank Financial Company Designations

The Chairperson then turned to the next agenda item, the Council's proposed financial stability risk monitoring framework and its proposed interpretive guidance on nonbank financial company designations.

She noted that the Council would vote on the two proposals in the open session of the meeting. She said that the proposals would continue to be discussed at meetings of the Council and the Council's Deputies Committee over the coming months.

The Chairperson adjourned the executive session of the meeting at approximately 11:22 A.M.

Open Session

The Chairperson called the open session of the meeting of the Council to order at approximately 11:28 A.M.

The Chairperson outlined the agenda for the open session, which included (1) a presentation on the Council's proposed financial stability risk monitoring framework and its proposed interpretive guidance on nonbank financial company designations, to be followed by votes on the framework and the guidance, and (2) votes on the minutes of the Council's meetings on February 10, 2023, March 12, 2023, and March 24, 2023.

1. Proposed Analytic Framework on Financial Stability Risks and Proposed Guidance on Nonbank Financial Company Designations

The Chairperson stated that the first agenda item was a discussion and votes on two proposals: the Council's proposed framework for financial stability risk identification, assessment, and response, and the Council's proposed interpretive guidance on nonbank financial company designations.

The Chairperson stated that she would first speak about how the recent banking developments demonstrated the importance of the actions the Council was about to take. She said that in March, the government had taken necessary actions to manage the fallout from the failure of two regional banking institutions. She said that the government's goal was to mitigate the risk of contagion and protect the broader banking system and economy. She stated that the situation had stabilized in the past few weeks, and the banking system remained sound, with strong capital and liquidity positions. She noted that the Council was continuing to monitor conditions closely. She said that these developments offered a reminder of the fear and uncertainty that can accompany financial disruptions. She stated that the developments underscored the importance of the Council's work on financial stability and its efforts to continue to improve the resilience of a financial system that can support the economy through both good and bad times.

The Chairperson stated that the events of March demonstrated that the Council's work is not yet done. She said that the authority for emergency interventions is critical, as is a supervisory and regulatory regime that can help prevent financial disruptions from starting and spreading in the first place. She said that she believed the votes the Council would take in the meeting on the two proposals would advance these objectives. She said that the Council would first vote to issue, for public comment, a proposed analytic framework on financial stability. She said that this framework would provide new public transparency into how the Council does its work, including how it identifies, assesses, and mitigates risks to U.S. financial stability. She said that this would be the first time the Council had published such a document. She stated that the framework outlines common vulnerabilities and transmission channels through which shocks can propagate through the financial system, and she noted that it lays out how the Council considers the tools it uses to address these risks.

The Chairperson stated that the framework emphasizes the importance of taking a comprehensive and rigorous approach to the evaluation of U.S. financial stability. She said that addressing the diverse range of financial vulnerabilities that exist today, and that may arise in the future, requires a broad set of flexible tools. She noted that the Council does not broadly prioritize one type of tool over another, but instead examines a risk and designs a response intended to mitigate it. She said that the Council would often determine that a risk should be addressed by existing regulators, using what is sometimes called an activities-based approach. She noted that there may be instances where systemic risks emanate from widely conducted activities in a particular sector or market. She noted that the Council had made activities-based recommendations in traditional areas like money market and open-end funds, as well as in developing areas like crypto-assets. She said that many of these risks and recommendations are described every year in the Council's annual reports. She stated that there may be certain instances when systemic risks could emanate from a particular entity that may not be within the jurisdiction of a regulator with adequate prudential or supervisory authorities. She stated that in this case, an entity-focused approach may be more appropriate. She said that this was why Congress gave the Council the authority to designate nonbank financial companies for Federal Reserve supervision and enhanced prudential standards. She said that this was also the reason why the Council would vote in the meeting on issuing proposed guidance that would enable the Council to use the designation tool more effectively, should it be needed.

The Chairperson then stated that the Council was proposing revisions to elements of the Council's existing guidance that had made it difficult to use its nonbank financial company designation authority. She said that the existing guidance, issued in 2019, had created inappropriate hurdles as part of the designation process. She noted that these additional steps are not required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), and she said that they are neither useful nor feasible. She said that some hurdles were based on a flawed view of how financial crises begin and the costs that they impose. She stated that it had been estimated that a designation process with these steps could take six years to complete. She said that this was an unrealistic timeline that could prevent the Council from acting to address an emerging risk to financial stability before it was too late. She said that the designation tool serves as an important part of regulators' defenses following the 2008 financial crisis. She said that designation is an important preventative tool to address systemic risks that may arise from a nonbank financial company whose activities or distress could threaten the financial system.

The Chairperson stated that the Council was also taking significant steps to ensure that the Council's nonbank financial company designation process is rigorous and transparent. She said that the proposed designation guidance provides for strong procedural protections, and she noted that these include significant engagement and communication with companies under review, designed to minimize administrative burdens on these companies while providing ample opportunities to be heard. She said that under the proposal, the Council would also engage with the company's primary regulator during any designation review. She said that through the separate proposed analytic framework, the Council would provide the public with more information about how nonbank financial company designation fits into the Council's broader approach to financial stability risk monitoring and mitigation.

The Chairperson stated in conclusion that that she believed that the Council's votes on the two proposals were a major step toward strengthening safeguards for the U.S. financial system. She said that the Council looked forward to public comments on the proposals. She then introduced Sandra Lee, Deputy Assistant Secretary for the Council at Treasury, to provide an overview of the proposals.

Ms. Lee stated that the proposed analytic framework describes the approach the Council would take in identifying, assessing, and responding to risks to U.S. financial stability. She said that the framework would apply regardless of whether a risk relates to a widely conducted activity or to specific entities. She said that the proposed analytic framework would not impose obligations on any entity but would help market participants and members of the public better understand how the Council approaches potential risks.

Ms. Lee stated that the proposed analytic framework is composed of three parts. First, she said that it describes the Council's monitoring function. She said that under the framework, to enable the Council to identify potential risks to U.S. financial stability, the Council would monitor a broad range of markets, asset classes, and types of entities. Second, she said that the proposal describes how the Council would assess potential risks. She stated that the Council would work with regulators to evaluate potential risks to determine whether they merit further review or action. She said that the evaluation of a risk would be fact-specific, but she noted that the proposed analytic framework highlights vulnerabilities that most commonly contribute to such risks, such as leverage and liquidity risk, and includes quantitative metrics that the Council may use to measure those vulnerabilities. She said that the proposal also explains four transmission channels that the Council would use in evaluating the potential for the negative effects of a risk to spread to other parts of the financial system. Third, she said that the proposed analytic framework describes how the Council would address identified risks. She noted that the Council has a range of authorities it may use. She said that under the proposal, in many cases, the

Council would work with regulators to seek the implementation of actions to address a risk. She stated that, alternatively, the Council may issue recommendations, or it may use one of its designation authorities. She said that under the proposed analytic framework, the Council would not prioritize among its authorities for addressing risks, and she noted that the Council's actions would instead depend on the nature of the vulnerability. As an example, she said that vulnerabilities from activities that are widely conducted in a market over which a regulator has adequate authority may be addressed through an activities-based approach. She noted that, in contrast, an entity-based action may be appropriate where a particular nonbank financial company's distress could pose a threat to financial stability.

Ms. Lee stated that the second document the Council would consider in the meeting, the proposed interpretive guidance on nonbank financial company designations, focuses solely on the procedural elements of the Council's nonbank financial company designation authority. She noted that under this authority, the Council may designate a nonbank financial company for supervision by the Federal Reserve and prudential standards if the Council determines that material financial distress at the company, or the company's activities, could pose a threat to U.S. financial stability. She stated that the proposed nonbank financial company designation guidance seeks to establish a durable process for the Council's designations under section 113 of the Dodd-Frank Act. She said that the proposal would enhance the Council's ability to address risks to U.S. financial stability, provide transparency to the public and to firms that are reviewed for potential designation, and ensure a rigorous and clear designation process.

Ms. Lee stated that under the proposal, the Council would follow a two-stage process for nonbank financial company designations. She said that during stage 1, a company would be subject to preliminary analysis, based primarily on information available to the Council through public and regulatory sources, and would be notified during the process. She said that if the company is selected for additional review, the Council would engage with the company extensively during stage 2 as the Council assesses potential risks to financial stability. She said that after stage 2, the Council may make a proposed designation, after which the company may request an oral hearing. She stated that after any hearing, the Council may vote to make a final designation. She said that the Council would encourage a designated company or its regulators to take steps to mitigate the identified risks. She said that the Council would reevaluate the designation at least annually, including further engagement with the firm and its regulators, and would rescind the designation if the Council determines that the company no longer meets the statutory standards for designation.

Ms. Lee stated that the proposed nonbank financial company designation guidance addresses only the Council's procedures related to designations. She said that the risk factors the Council would consider are described in the separate proposed analytic framework document. She said that the proposed nonbank financial company designation guidance does not include two analytic factors that were added to the existing guidance in 2019: statements that the Council would consider the likelihood of a company's distress and that the Council would conduct a cost-benefit analysis of each designation. She said that this change was intended to help enable the Council to use its statutory authorities as appropriate while maintaining rigorous procedural protections for companies that are reviewed for potential designation.

Ms. Lee stated in conclusion that the two proposals, if adopted, would result in a more transparent and effective risk-monitoring process for the Council and would bolster the Council's ability to identify, assess, and address potential risks to U.S. financial stability.

Following the presentation, the Chairperson invited other Council members to comment.

Chair Powell stated that he supported the proposed nonbank financial company designation guidance and proposed analytic framework document. He said that he would vote to approve the two proposals for release for public comment. He stated that over a decade had passed since the Dodd-Frank Act gave the Council the power to designate nonbank financial companies. He said that during that time, the Council had gained insight into such designations. He noted that the financial system had continued to evolve, and he said that this evolution underscored that no single solution can address every financial stability risk. He said that it was appropriate for the Council to regularly assess its toolkit and consider how best to use its full range of tools to respond to systemic risks, whether the risk arises from an activity, an event, or a firm. He said that he supported the Council's proposal to publish the analytic risk framework for the first time. He said that it provides an overview of how the Council identifies and assesses risks and delineates the range of authorities available to the Council under the Dodd-Frank Act. He said that it also emphasizes that the actions the Council may take will depend on the nature of the risk it intends to address. He said that the nonbank financial company designation guidance describes the Council's method for determining whether to designate a nonbank financial company. He noted that the proposal provides for several stages of analysis rooted in the analytic risk framework before a designation is approved. He stated that he believed the changes proposed by the Council would create a balanced approach to addressing potential risks to U.S. financial stability and ensure that all the tools available to the Council remain on an equal footing.

Gary Gensler, Chair of the SEC, stated that he would support the two proposals. He said that history provides numerous examples of instances when tremors in one corner of the financial system or at one financial institution spill out into the broader economy. He said that these risks can originate not only from the banking sector, as had occurred in the previous six weeks, but also outside of the banking sector. He reviewed events surrounding the failure of Long-Term Capital Management in 1998. He noted that the 2008 financial crisis was much greater in magnitude, and said it was another example of systemic risk emanating from both the banking sector and the nonbank sector. He noted that millions of people lost their jobs and small businesses failed across the United States during the 2008 financial crisis. He said that Congress, in response, established the Council and tasked it with important authorities and mandates to better guard against systemic risk, recognizing that risks can emanate from both banks and nonbank financial companies. He noted that Congress gave the Council the authority to designate nonbank financial companies and said that such designation would subject them to the regulation and supervision of the Federal Reserve. He said that effective regulation of nonbank financial companies designated by the Council is essential to prevent risk spreading to the U.S. economy and helps to prevent imposing the cost of the failure of financial entities onto taxpayers.

Chair Gensler said that the proposals, if finalized, would reinvigorate the Council's designation process in accordance with its statutory authorities. He expressed support for the comment by the Chairperson and Chair Powell that designation is just one tool in the Council's toolkit. He said that each member agency has important roles within its authority to enhance the resiliency of the U.S. financial system. He noted that the SEC was collaborating with other member agencies to further this goal, by working to enhance the resiliency of the U.S. Treasury market, money market funds, open end funds, private funds, clearinghouses, and dealers, and with regard to cybersecurity. He added that the SEC had adopted rules to shorten the settlement cycles in securities by half. He stated that the Council should build upon the work of the Council's Hedge Fund Working Group. He said that this would involve examining large, interconnected, highly levered hedge funds, the associated repo markets for financing, the prevalence of low to zero haircuts in such funding, and the extension of leverage from banks and prime brokers. He said in conclusion that while it is not possible to remove risk from the U.S. financial system, the Council should continue its efforts to identify, manage, and guard against such risks to protect the American public.

Chairman Gruenberg stated that he supported the two proposals and believed that they would advance the purposes of the Council. He said that the proposals provide transparency into how the Council identifies and evaluates risk and they propose a workable framework to use the full array of the Council's tools. He said that the analytic framework for financial stability risk identification, assessment, and response outlines the types of risks the Council seeks to monitor, flags key transmission channels for those risks to affect the broader financial system, and describes the broad range of tools available to the Council for addressing systemic risks, beyond the regulatory and supervisory work of the member agencies. He said that he viewed this document as the most thorough description of the Council's approach that had been shared publicly. He said that he welcomed this transparency and the opportunity for public comment, so that the Council can consider whether it is reviewing the appropriate set of risks and transmission channels. He said that he also supported the proposed revisions to the Council's guidance for nonbank financial company designations. He said that past crises had demonstrated the need for the Council to be prepared to use all its statutory tools to prevent damage to the U.S. financial system. He said that designating nonbank financial companies for enhanced supervision is one of the Council's available tools, and he stated that the proposals would improve the Council's ability to use this tool credibly and effectively. He stated that the proposed designation guidance would assign responsibility to the Council's staff-level Systemic Risk Committee for regular monitoring and reporting about nonbank financial firms that may pose a risk to financial stability and merit further review. He said that the proposals would also leverage the work of the Council's other working groups and committees that bring together experts from multiple agencies to undertake specialized risk reviews. He said that this process would create a credible systematic review of potential risks in firms across the U.S. financial system and enable the Council to utilize effectively all the tools within its authority.

Michael Hsu, Acting Comptroller of the Currency, stated that he supported the two proposals. He said that revising the guidance on nonbank financial company designations is important to improve the balance and transparency of the Council's work. He stated that the new proposed analytic framework would make it easier for the Council to explain its analysis of potential risks and create an opportunity for richer public input. He said that the two proposals would help make clear that the Council has access to all the tools provided to it by the Dodd-Frank Act so that it can monitor and address risks to U.S. financial stability effectively. He said that recent events had underscored the importance to all Americans of having a sound and resilient financial system and the importance of the Council having access to the broad range of tools that Congress provided it. He said that it is also appropriate that the Council provide transparency to the public about how it might consider using these tools. He said that he supported the publication of the two documents for public comment in furtherance of these goals.

Todd Harper, Chairman of the NCUA, stated that he supported the Council's reconsideration of the framework and the process by which it may designate a nonbank financial company. He said that the statutory intent of the Dodd-Frank Act was to give the Council a range of flexible tools to address potential threats to U.S. financial stability. He noted that this toolkit includes the authority to designate a nonbank financial company for consolidated supervision and enhanced prudential standards by the Federal Reserve when circumstances warrant it. He said that the previous guidance on nonbank financial company designations, finalized in 2019, needlessly hampers the ability of the Council to consider and use this tool and establishes an overly lengthy and complicated process with various hurdles to doing so. He said that the proposed designation guidance is clear, credible, balanced, and consistent and represents a substantial improvement in this process. He said that the events of the prior month had provided a reminder that problems at one financial institution can develop rapidly and spread into the U.S. financial system. He stated that the Council needs to be nimble and proactive in order to be effective, and he expressed his support for publishing both proposals.

Rohit Chopra, Director of the CFPB, expressed a concern that the official sector may experience regulatory amnesia when confronting the dangers in the U.S. financial system. He said that while the 2008 financial crisis damaged the lives of families across the country, memories sometimes fade quickly, including in Washington. He said that a key lesson of the 2008 financial crisis was the lack of attention paid to systemically important financial institutions that were not traditional commercial banks. He noted that major nonbank financial companies were not subject to many key requirements that banks faced. He said that after the failure of Lehman Brothers, the United States entered into a process that resulted in large bailouts of other financial institutions. He said that a key post-crisis reform was the authority granted to the Council to designate nonbank financial companies for Federal Reserve supervision and prudential standards. He noted that no nonbank financial companies are currently designated by the Council. He said that it was reasonable to believe that nonbank financial companies meeting the criteria for designation continued to exist. He said that market participants had started to believe that the Council lacks credibility with respect to nonbank financial company designation, but he said that the Council was taking an important step in the meeting to change this. He stated that in 2019, the Council effectively repealed the ability to designate these institutions by adding an array of dubious process strictures. He said that two former Secretaries of the Treasury and two former Chairs of the Federal Reserve, including Secretary Yellen, predicted that the changes would weaken the designation authority. He stated that the two proposals the Council would vote on in the meeting, if finalized, would create a clear path for the Council to identify and designate nonbank financial companies. He said that this step would help to change the perception of market participants that the Council is not fulfilling its statutory mandate. He said that this step would also accelerate efforts to identify potential shadow banks for potential designation. He said that the Council would be better positioned to conduct rigorous analysis of risks in a number of sectors, including nonbank mortgage companies, hedge funds and others, which he said could potentially lead to designation. He concluded by stating that nonbank supervision is one of the CFPB's most important functions.

Thomas Workman, the Council's independent member with insurance expertise, stated that he supported issuing the two proposals.

Following the discussion, the Chairperson presented to the Council the following resolution approving the proposed analytic framework for financial stability risk identification, assessment, and response:

WHEREAS, the Council's duties under section 112 of the Dodd-Frank Wall Street Reform and Consumer Protection Act include monitoring the financial services marketplace in order to identify potential threats to U.S. financial stability; recommending to the member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies; identifying gaps in regulation that could pose risks to the financial stability of the United States; requiring supervision by the Board of Governors of the Federal Reserve System for nonbank financial companies that may pose risks to the financial stability of the United States in the event of their material financial distress or failure, or because of their activities; and making recommendations to primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that could create or increase risks of significant liquidity, credit, or other problems spreading among bank holding companies, nonbank financial companies, and United States financial markets; and

WHEREAS, the staffs of the Council members and their agencies have prepared a proposed analytic framework (the Proposed Analytic Framework) that describes the approach the Council expects to take in identifying, assessing, and responding to certain potential risks to U.S. financial stability; and

WHEREAS, the staffs of the Council members and their agencies recommend that the Council approve and publish the Proposed Analytic Framework.

NOW, THEREFORE, BE IT RESOLVED, that the Council hereby approves the Proposed Analytic Framework and authorizes the Chairperson, or her designee, to cause the Proposed Analytic Framework to be published in the Federal Register, in a form and manner acceptable to the Chairperson, or her designee, and to otherwise make it available to the public as the Chairperson deems appropriate.

BE IT FURTHER RESOLVED, that the Council hereby delegates authority to the Chairperson, or her designee, to make technical, nonsubstantive, or conforming changes to the text of the Proposed Analytic Framework to ensure that it can be published in the Federal Register; to extend the due date for public comments on the Proposed Analytic Framework; and to take such other actions and issue such other documents incident and related to the foregoing as the Chairperson, or her designee, deems necessary or appropriate to fulfill the Council's objectives *in connection with its publication.*

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

The Chairperson then presented to the Council the following resolution approving the proposed guidance regarding nonbank financial company determinations:

WHEREAS, the Council's duties under section 112 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) include monitoring the financial services marketplace in order to identify potential threats to U.S. financial stability; identifying gaps in regulation that could pose risks to the financial stability of the United States; and requiring supervision by the Board of Governors of the Federal Reserve System (the Federal Reserve) for nonbank financial companies that may pose risks to the financial stability of the United States in the event of their material financial distress or failure, or because of their activities; and

WHEREAS, section 113 of the Dodd-Frank Act authorizes the Council to determine that a nonbank financial company shall be supervised by the Federal Reserve and shall be subject to prudential standards if the Council determines that material financial distress at the company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company, could pose a threat to the financial stability of the United States; and

WHEREAS, on December 4, 2019, the Council approved interpretive guidance (the 2019 Interpretive Guidance) that described the approach the Council intended to take in prioritizing its work to identify and address potential risks to U.S. financial stability and in making determinations regarding nonbank financial companies under section 113 of the Dodd-Frank Act; and

WHEREAS, the staffs of the Council members and their agencies have prepared proposed interpretive guidance (the Proposed Guidance) that would replace the 2019 Interpretive Guidance and that describes the process the Council intends to take in determining whether to subject a nonbank financial company to Federal Reserve supervision and prudential standards; and

WHEREAS, the staffs of the Council members and their agencies recommend that the Council approve and publish the Proposed Guidance.

NOW, THEREFORE, BE IT RESOLVED, that the Council hereby approves the Proposed Guidance and authorizes the Chairperson, or her designee, to cause the Proposed Guidance to be published in the Federal Register, in a form and manner acceptable to the Chairperson, or her designee, and to otherwise make it available to the public as the Chairperson deems appropriate.

BE IT FURTHER RESOLVED, that the Council hereby delegates authority to the Chairperson, or her designee, to make technical, nonsubstantive, or conforming changes to the text of the Proposed Guidance to ensure that it can be published in the Federal Register; to extend the due *date for public comments on the Proposed Guidance; and to take such other actions and issue such other documents incident and related to the foregoing as the Chairperson, or her designee, deems necessary or appropriate to fulfill the Council's objectives in connection with its publication.*

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

2. Resolutions Approving the Minutes of the Meetings Held on February 10, 2023, March 12, 2023, and March 24, 2023

BE IT RESOLVED, by the Financial Stability Oversight Council (Council), that the minutes attached hereto of the meeting held on February 10, 2023 of the Council are hereby approved.

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

BE IT RESOLVED, by the Financial Stability Oversight Council (Council), that the minutes attached hereto of the meeting held on March 12, 2023 of the Council are hereby approved.

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

BE IT RESOLVED, by the Financial Stability Oversight Council (Council), that the minutes attached hereto of the meeting held on March 24, 2023 of the Council are hereby approved.

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

The Chairperson adjourned the meeting at approximately 12:01 P.M.