Minutes of the Financial Stability Oversight Council

December 14, 2017

PRESENT:

Steven T. Mnuchin, 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)
Jay Clayton, Chairman, Securities and Exchange Commission (SEC)
J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission (CFTC)
J. Michael Mulvaney, Acting Director, Consumer Financial Protection Bureau (CFPB)
Melvin Watt, Director, Federal Housing Finance Agency (FHFA)
Grace Dailey, Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner, Office of the Comptroller of the Currency (OCC)
S. Roy Woodall, Independent Member with Insurance Expertise
Richard Berner, Director, Office of Financial Research (OFR), Department of the Treasury (non-voting member)
Ray Grace, Commissioner, North Carolina Office of the Commissioner of Banks (non-voting member) (by telephone)
Peter Hartt, Director, Insurance Division, New Jersey Department of Banking & 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)
Craig Phillips, Counselor to the Secretary
Brent McIntosh, General Counsel
Brian Callanan, Deputy General Counsel
Bimal Patel, Deputy Assistant Secretary for the Council
Eric Froman, Principal Deputy Assistant General Counsel (Banking and Finance) and Executive Director of the Council
Stephen Ledbetter, Director of Policy, Office of the Financial Stability Oversight Council

Board of Governors of the Federal Reserve System
Randal Quarles, Vice Chairman for Supervision
Andreas Lehnert, Director, Division of Financial Stability

Federal Deposit Insurance Corporation
Rae-Ann Miller, Associate Director, Division of Risk Management Supervision

Securities and Exchange Commission
Michael Piwowar, Commissioner (by telephone)
Jaime Klima, Chief Counsel

Commodity Futures Trading Commission
Michael Gill, Chief of Staff

Consumer Financial Protection Bureau
Brian Johnson, Senior Advisor to the Acting Director

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

Comptroller of the Currency
Jonathan Fink, Assistant Chief Counsel

National Credit Union Administration
Ralph Monaco, Chief Economist

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

Federal Reserve Bank of New York
William Dudley, President and Chief Executive Officer (by telephone)

Office of Financial Research
Kenneth Phelan, Principal Deputy Director

Federal Insurance Office
Steven Seitz, Deputy Director

North Carolina Office of the Commissioner of Banks
Nathan Ross, Director of Legislative Policy, Conference of State Bank Supervisors

New Jersey Department of Banking & Insurance
Mark Sagat, Assistant Director, Financial Policy and Legislation, National Association of Insurance Commissioners

Maryland Office of the Attorney General, Securities Division
Christopher Staley, Counsel, North American Securities Administrators Association

PRESENTERS:

Presidential Memorandum on Council Designations

- *Bimal Patel, Deputy Assistant Secretary for the Council, Treasury*

MetLife Litigation

- *Brian Callanan, Deputy General Counsel, Treasury (available for questions)*
- *Chad Readler, Acting Assistant Attorney General for the Civil Division, Department of Justice (available for questions)*

Bitcoin Futures

- *J. Christopher Giancarlo, Chairman, CFTC*
- *Michael Gill, Chief of Staff, CFTC (available for questions)*
- *Daniel Gorfine, Director of LabCFTC and Chief Innovation Officer, CFTC (available for questions)*
- *Sigal Mandelker, Under Secretary for Terrorism and Financial Intelligence (available for questions)*

2017 Annual Report

- *Bimal Patel, Deputy Assistant Secretary for the Council, Treasury*
- *Stephen Ledbetter, Director of Policy, Office of the Financial Stability Oversight Council, Treasury (available for questions)*

Project KISS

- *J. Christopher Giancarlo, Chairman, CFTC*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 3:03 P.M.

The Chairperson began by welcoming J. Michael Mulvaney, Acting Director of the CFPB, to his first meeting of the Council. The Chairperson noted that Grace Dailey, Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner at the OCC, was attending the meeting because the Comptroller of the Currency was recused from the meeting. The Chairperson then noted that this was the last Council meeting for Richard Berner, Director of the OFR, and he thanked Director Berner for his participation on the Council and his work standing up the OFR.

The Chairperson then outlined the meeting agenda, which had previously been distributed to the members together with other materials. The agenda for the executive session of the meeting included (1) Treasury's recent report on the Council's designation processes; (2) the MetLife litigation; and (3) bitcoin futures.

1. Presidential Memorandum on Council Designations

The Chairperson introduced the first agenda item, the report issued by the Secretary of the Treasury on November 17, 2017, regarding the Council's processes for designating nonbank financial companies and financial market utilities (the Treasury Report). The Chairperson turned to Bimal Patel, Deputy Assistant Secretary for the Council at Treasury, for an overview of the recommendations in the report.

Mr. Patel noted that the Treasury Report called for the Council to prioritize an activities- or industry-based approach to addressing potential risks to financial stability. He explained that under this approach, the Council would (1) review potential risks to U.S. financial stability arising from financial activities and products; (2) work with relevant regulators to address any identified risks, which could include the issuance by the Council of formal recommendations to the regulators; and (3) if one or more companies may pose risks to financial stability, retain the Council's authority to designate individual nonbank financial companies for supervision by the Federal Reserve and enhanced prudential standards. Mr. Patel then stated that the report also recommended that the Council amend its existing interpretive guidance regarding nonbank financial company designations to provide that the Council would assess costs and benefits of designations, the likelihood of a firm's material financial distress, and specific counterparty loss estimates as part of the designation process. Mr. Patel also noted that the report recommended that the Council create a formal "off-ramp" for nonbank financial company designations and adopt certain changes to increase transparency. Finally, he stated that with respect to the Council's designation of financial market utilities, the report recommended that the Council consider conducting cost-benefit analyses and that the designation and supervision of financial market utilities should continue to be highly tailored to the companies' business models.

The Chairperson then noted that the Council could consider changes to its processes in 2018.

2. MetLife Litigation

The Chairperson then introduced the next agenda item, a discussion regarding the litigation brought by MetLife, Inc. (MetLife) against the Council relating to the Council's designation of the company. The Chairperson introduced Brian Callanan, Deputy General Counsel at Treasury, and Chad Readler, Acting Assistant Attorney General for the Civil Division at the Department of Justice. Chairman Clayton recused himself from participating in the discussion, and Michael Piwowar, SEC Commissioner, participated in the discussion.

In December 2014, the Council made a final determination regarding MetLife under section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The U.S. District Court for the District of Columbia entered judgment in March 2016 rescinding the Council's final determination regarding MetLife. The Chairperson noted that in April 2016, the Council appealed the district court's decision to the U.S. Court of Appeals for the District of Columbia Circuit (the D.C. Circuit). The Chairperson also noted that in August 2017, the D.C. Circuit granted a motion by MetLife to hold the Council's appeal in abeyance pending the issuance of the Treasury Report.

The Chairperson requested Council members' views regarding the litigation in the context of the Treasury Report. Council members asked questions and had a discussion regarding the litigation. Most of the voting members of the Council expressed support for withdrawing the appeal, for reasons including that they agreed with one or more of the district court's independent bases for rescinding the designation, and that the Treasury Report made recommendations consistent with the district court's decision. Voting members of the Council who recommended continuing the appeal expressed the view that MetLife was properly designated and that additional legal clarity from the D.C. Circuit would be useful to the Council. The Chairperson stated that the Council should amend its interpretive guidance regarding nonbank financial company designations on an expedited basis.

3. Bitcoin Futures

The Chairperson then introduced the next agenda item, a presentation on bitcoin futures. The Chairperson noted that Treasury has been monitoring the use of bitcoin, including its potential use for investor speculation or illicit activities. He recommended organizing a working group of relevant regulators to consider these issues. He then turned to J. Christopher Giancarlo, Chairman of the CFTC, for a presentation.

Chairman Giancarlo noted that the CFTC oversees derivatives markets and has authority to protect against fraud and manipulation. He then provided a background regarding bitcoin. He noted that bitcoin is a digital representation that functions as a medium of exchange, a unit of account, or a store of value. He stated that bitcoin is "pseudonymous" (a holder is identifiable by an alphanumeric public key); relies on cryptography for security; and runs on a decentralized peer-to-peer network of computers. He noted that most users of bitcoin are outside the United States. He then described various types of risks associated with bitcoin, including operational risks; cybersecurity risks; speculative risks (in light of substantial price volatility); and fraud and manipulation risks. He then described the CFTC's oversight. He stated that the CFTC first found in 2015 that bitcoin and other virtual currencies are commodities under the Commodity Exchange Act. He noted that the CFTC's jurisdiction is implicated when a virtual currency is used in a derivatives contract, or if there is fraud or manipulation involving a virtual currency traded in interstate commerce.

Chairman Giancarlo then described the CFTC's oversight of bitcoin futures markets. He noted that in 2014, a registered swap execution facility had begun listing a bilateral cash-settled bitcoin swap for trading. He stated that a designated contract market and derivatives clearing organization had listed cash-settled options based on bitcoin from 2014 to 2016, and that a swap execution facility and derivatives clearing organization registered with the CFTC in 2017 to list and clear physically settled bitcoin options. He then explained that in December 2017, two exchanges had self-certified new contracts for bitcoin futures products, and one self-certified a new contract for bitcoin binary options. He described the CFTC's self-certification process for new contracts, and explained how the CFTC had worked with the exchanges before their launch of bitcoin futures markets. He noted that the initial margin requirements for bitcoin futures had been set at high levels. He also stated that the two exchanges had entered into information-sharing contracts with several underlying cash bitcoin market platforms, as a result of which the CFTC receives data on transactions in those cash bitcoin markets. He noted that bitcoin futures traders and holders are not anonymous, but subject to CFTC surveillance. Finally, he described recent trading in bitcoin and bitcoin futures, noting that trading in bitcoin futures had been orderly after certain trading halts on their first trading day.

Members of the Council then asked questions and had a discussion, including regarding the CFTC's self-certification process as it relates to other cryptocurrencies; margin requirements for bitcoin futures; anti-money laundering requirements applicable to institutions transacting in bitcoin; and large financial institutions' participation in bitcoin markets. It was noted that the SEC has not approved any bitcoin-related securities products and has notified broker-dealers about potential risks in this market.

The Chairperson adjourned the executive session of the meeting at approximately 4:02 P.M.

Public Session

The Chairperson called the open session of the meeting of the Council to order at approximately 4:08 P.M.

The Chairperson then outlined the agenda for the open session, which included (1) the Council's 2017 annual report; (2) the CFTC's Project KISS to streamline and modernize its rules; and (3) a vote on the minutes of the Council's meeting on November 16, 2017.

1. 2017 Annual Report

Turning to the first agenda item, the Chairperson noted that the Council's annual report is the product of extensive analysis and collaboration across all of the Council's member agencies. He said that the report explains the Council's views of potential risks in all corners of the financial system for Congress and the public and that it includes recommendations for specific actions to mitigate those risks, where necessary. He said that the report also highlights recent accomplishments and areas where further work is needed. The Chairperson thanked the members of the Council and their staffs for working to prepare this year's report and for their ongoing efforts to make the financial system stronger and more resilient.

The Chairperson then introduced Bimal Patel, Deputy Assistant Secretary for the Council at Treasury, and Stephen Ledbetter, Director of Policy in the Office of the Financial Stability Oversight Council at Treasury, to present on the annual report.

Mr. Patel first noted that the Council is statutorily required to report annually to Congress on activities of the Council; significant financial market and regulatory developments; and potential emerging threats to U.S. financial stability. He also noted that the annual report is required to include any Council recommendations to enhance the integrity, efficiency, competitiveness, and stability of U.S. financial markets; promote market discipline; and maintain investor confidence.

Mr. Patel stated that the report is a collaborative document that reflects the collective judgment of the Council. He said that the Council continues to serve as a forum to facilitate coordination among financial regulatory agencies to monitor market developments and identify potential threats to financial stability. He stated that the report notes that U.S. financial market conditions have generally been stable since publication of the Council's last annual report, and that the U.S. financial system is stronger and better positioned to withstand a market shock or an economic downturn than it was before the financial crisis.

Mr. Patel explained that this year's report also contains a new theme, namely that maintaining a resilient financial system is important because economic growth depends on the financial system's ability to provide capital to businesses and individuals, to provide vehicles for savings, and to intermediate financial transactions even in the face of adverse events.

Mr. Patel said that the report also notes that, with most of the post-crisis regulatory reforms required by the Dodd-Frank Act having been implemented, this is an appropriate time to assess the effectiveness of the reforms and to consider any unintended consequences that could have negative effects on financial stability or economic growth. He said that the report points to the importance of a number of efforts underway across financial regulatory agencies, including the review of the Volcker Rule for potential ways to simplify its requirements and address unintended consequences. He said that the report also recommends that Council member agencies continue to address regulatory overlap and duplication, modernize outdated regulations, and, where authority exists, tailor regulations based on the size and complexity of financial institutions. Mr. Patel then highlighted the 11 risk themes and corresponding recommendations included in the report.

Mr. Patel stated that the report cautions that, as the financial system relies more heavily on technology, there is an increased risk that significant cybersecurity incidents could prevent the financial sector from delivering services and potentially impact U.S. financial stability. He said that the report acknowledges that, through collaboration and partnership, substantial gains have been made by both government and industry in response to cybersecurity risks, in part by refining their shared understanding of potential vulnerabilities. He said that the report emphasizes the importance of sustained attention to these risks, and makes a number of recommendations, including that a private-sector council of senior executives be created to collaborate with regulators and that there be greater information sharing among government agencies and between government and industry.

Mr. Patel said that, with respect to asset management products and activities, the report refers to the work previously done by the Council, notes a number of actions taken by the SEC—including the issuance of rules and proposed rules regarding data improvements, liquidity and redemption risk, and registered funds' use of derivatives—and recommends that the SEC assess these rules and proposed rules to evaluate whether the chosen regulatory approach addresses potential risks effectively and efficiently.

Mr. Patel stated that the report notes the improvements in resiliency of large financial institutions since the financial crisis, due in part to their decrease in leverage and improved ability to respond to potential draws on liquidity. He stated that the report discusses the various rules developed and implemented by the bank regulatory agencies. He stated that the report recommends that the bank regulatory agencies continue to ensure that these institutions have sufficient capital and liquidity to reduce their vulnerability to economic and financial shocks but also recommends that regulators monitor and assess the impact of rules on financial institutions and markets, including on market liquidity.

Mr. Patel then stated that, with respect to central counterparties (CCPs), the report cites their considerable potential benefits, such as enhanced market functioning, reduced counterparty risk, and increased transparency, but also notes that fully realizing these benefits requires CCPs that are highly robust and resilient. He stated that the report recommends that relevant regulators coordinate their supervision of CCPs designated by the Council as systemically important financial market utilities. He said that the report also stresses that evaluating the performance of CCPs under stress scenarios can be a very useful tool for assessing their robustness and resilience and identifying potential operational areas for improvement, and recommends that the agencies continue to refine their use of supervisory stress tests. In addition, he stated that the report recommends that regulators continue to monitor and assess interconnections among CCPs, their clearing members, and other financial institutions; consider additional improvements in public disclosure; and develop resolution plans for systemically important CCPs.

Mr. Patel then stated that another risk theme in the annual report relates to short-term wholesale funding markets. He said the report cites a number of changes that have mitigated certain risks and vulnerabilities in these markets, but that, in light of the continued importance of these markets in the U.S. financial system, the report recommends continued monitoring by relevant regulators for signs of changes in liquidity conditions that could impact financial stability. He stated that, for example, the report highlights the SEC's money market mutual fund reforms that were intended to reduce the likelihood of runs on these cash-management vehicles. He said that the report analyzes the sharp decline in assets in prime and tax-exempt money market mutual funds, and the simultaneous shift to government money market mutual funds, and recommends that the SEC monitor and assess the effectiveness of its regulatory changes. He noted that the report also recommends that relevant regulators monitor the potential migration of activity to other types of cash-management vehicles and the impact of money market mutual fund developments on other financial markets and institutions.

Mr. Patel then stated that, with respect to reliance on reference rates, the report notes the efforts of regulators and market participants over the last few years to improve the resilience of the London Interbank Offered Rate (LIBOR) and develop alternative reference rates. He stated that decreases in the volume of unsecured wholesale lending has made it more difficult to firmly ground submissions in a sufficient number of observable transactions, creating the risk that publishing the benchmark may not be sustainable. He stated that the report thus recommends that regulators and market participants complete their work to develop alternatives to LIBOR and take appropriate steps to mitigate disruptions associated with the transition to a new reference rate.

Mr. Patel then stated that, with respect to data quality, collection, and sharing, the report acknowledges the progress that has been made in addressing some of the data gaps exposed by the financial crisis, but notes the need for continued work to address issues such as the reliance by market participants on legacy processes that use data that are not aligned to standard definitions and do not allow for adequate validation needed for efficient data sharing. He said the report therefore recommends that regulators and market participants continue to work together to improve the coverage, quality, and accessibility of financial data and to increase data sharing between and among relevant agencies.

Mr. Patel then stated that the report includes a brief discussion related to housing finance reform. He explained that the report notes the increased sales of new and existing homes over the past year, decline in foreclosures, and the fall in the share of properties with negative equity, as well as developments at Fannie Mae and Freddie Mac, including the reduction in their retained portfolios and the continued development of a new housing finance infrastructure. However, he stated that the report also notes that, with Fannie Mae and Freddie Mac now into their tenth year of conservatorship, federal and state regulators are approaching the limits of their ability to promote greater investment of private capital and improve operational efficiency. He said that, for this reason, the report emphasizes the importance of housing finance reform legislation to create a more sustainable system that enhances financial stability.

Mr. Patel then stated that the report includes a discussion of the potential challenges associated with the current environment of low but rising interest rates. He said that, although both short-term and long-term interest rates have risen since the last annual report, the report notes that the consequences of past risk-taking may persist for some time. In addition, he said that the transition to higher rates may expose vulnerabilities among some market participants through a reduction in the value of their assets or an uncertain rise in costs of funding for depository institutions. He said, however, that the report notes that these vulnerabilities can be mitigated by regulators and financial institutions closely monitoring increased risk-taking incentives and risks that might arise from rising rates.

Mr. Patel stated that the report also includes a discussion of changes in market structure, such as the increased use of automated trading systems, and the trend towards a wider variety of market participants providing market making and liquidity provision services that were previously concentrated in a small number of large institutions. He stated that the report notes the potential for new risks and vulnerabilities, and the importance of market participants and regulators continuing to try to identify gaps in the Council's understanding of market structure and to fill those gaps through data collection and analysis. In addition, he said that the report notes that greater collaboration by relevant agencies, particularly in periods of market stress, will further the goal of enhancing financial stability.

Finally, Mr. Patel said that the report discusses potential implications of financial innovation. He said the report points out that new financial market participants and new financial products can offer substantial benefits to consumers and businesses by meeting emerging needs or reducing costs, citing examples like virtual currencies, distributed ledger technologies, and marketplace lending. However, he said the report also highlights the potential for these new participants and products to create unanticipated risks and vulnerabilities, and recommends that financial regulators monitor and analyze the effects of new financial products and services on consumers, regulated entities, and financial markets, and evaluate their potential effects on financial stability.

Mr. Patel concluded by stating that the Council will continue to monitor and respond to emerging threats to the stability of the U.S. financial system, including those described in the annual report.

The Chairperson then invited other members of the Council to ask questions regarding the report. Melvin Watt, Director of the FHFA, clarified that the reference in the annual report to the 10-year conservatorship of the government-sponsored entities referred to the housing finance corporations Fannie Mae and Freddie Mac, not to the Federal Home Loan Banks.

The Chairperson then presented to the Council the following resolution approving the annual report:

WHEREAS, the Financial Stability Oversight Council (the "Council") under section 112 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DFA") is required to annually report to and testify before Congress on (1) the activities of the Council; (2) significant financial market and regulatory developments, including insurance and accounting regulations and standards, along with assessment of those developments on the stability of the financial system; (3) potential emerging threats to the financial stability of the United States; (4) all determinations made under section 113 or title VIII of the DFA, and the basis for such determinations; (5) all recommendations made under section 119 of the DFA and the result of such recommendations; and (6) recommendations (a) to enhance the integrity, efficiency, competitiveness, and stability of the United States financial markets; (b) to promote market discipline; and (c) to maintain investor confidence; and

WHEREAS, the staffs of the Council members and their agencies prepared the attached 2017 annual report of the Council (the "2017 Annual Report") pursuant to section 112 of the DFA, and members of the Council have reviewed and commented on the attached report.

NOW, THEREFORE, BE IT RESOLVED, that the Council hereby approves the 2017 Annual Report and authorizes the Chairperson, or his designee, to take such action as they may deem necessary or appropriate to transmit the 2017 Annual Report to Congress and to release it to the public; and

BE IT FURTHER RESOLVED, that the Council hereby delegates authority to the Chairperson, or his designee, to make technical, nonsubstantive, or conforming changes to the text of the 2017 Annual Report and to take such other actions as they may deem necessary or appropriate to prepare the report for transmittal to Congress and release to the public.

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

2. Project KISS

The Chairperson then introduced the next agenda item, the CFTC's Project KISS. He introduced Chairman Giancarlo for the presentation.

Chairman Giancarlo said that Project KISS was an initiative launched by the CFTC in 2017 to simplify the application of its rules and practices in a policy-neutral manner. He explained that the initiative does not involve financial reform or policy changes but rather is a process of assessing the CFTC's rules to make them less burdensome, less costly, simpler, and more up to date.

Chairman Giancarlo explained that some of the CFTC's rules over time had become out of date or were contradicted by other rules. He said that the agency's review process had been conducted internally, through the review of rules by agency staff, as well as externally, through the solicitation of feedback from the public. He said that the input received related to rules that needed to be modernized, clarified, or simplified. For example, he noted that the public called for the modernization of data portals, which the CFTC has since done, and the elimination of outdated technological requirements. As an example of rules that needed to be clarified, he noted some rules' ambiguous calculation methodologies. He also said that as part of this effort, the CFTC had acknowledged permitted practices that had previously been approved only informally, such as using third-party recordkeepers. He also stated that this initiative had empowered CFTC staff in some cases to engage directly with registrants rather than through the commission, for example, to notify registrants of cybersecurity requirements. He also said the CFTC had streamlined its reporting requirements, such as by allowing groups provide one annual compliance report rather than requiring a separate report for each of their affiliates.

3. Resolution Approving the Minutes of the Meeting Held on November 16, 2017

BE IT RESOLVED, by the Financial Stability Oversight Council (the "Council"), that the minutes attached hereto of the meeting held on November 16, 2017 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 4:30 P.M.