<u>Minutes of the Financial Stability Oversight Council</u>

June 4, 2025

PRESENT:

Scott K.H. Bessent, 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)
Travis Hill, Acting Chairman, Federal Deposit Insurance Corporation (FDIC)
Paul S. Atkins, Chairman, Securities and Exchange Commission (SEC)
Caroline D. Pham, Acting Chairman, Commodity Futures Trading Commission (CFTC)
Russell Vought, Acting Director, Consumer Financial Protection Bureau (CFPB)
William J. Pulte, Director, Federal Housing Finance Agency (FHFA)
Rodney E. Hood, Acting Comptroller of the Currency, Office of the Comptroller of the Currency (OCC)
Sarah Bang, Chief of Staff, National Credit Union Administration (NCUA) (acting pursuant to delegated authority)
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)
Lise Kruse, Commissioner, North Dakota Department of Financial Institutions (non-voting member)
Elizabeth K. Dwyer, Director, Rhode Island Department of Business Regulation (non-voting member)
Melanie Lubin, Securities Commissioner, Maryland Office of the Attorney General, Securities Division (non-voting member) (via videoconference)

GUESTS:

<u>Department of the Treasury (Treasury)</u>
Michael Faulkender, Deputy Secretary
Jonathan McKernan, Senior Advisor
Christopher Pilkerton, Acting General Counsel
Mark Schlegel, Senior Counsel
Sean Hoskins, Director of Policy, Office of the Financial Stability Oversight Council
Nicholas Steele, Director of Analysis, Office of the Financial Stability Oversight Council

<u>Board of Governors of the Federal Reserve System</u>
Andreas Lehnert, Director, Division of Financial Stability

<u>Federal Deposit Insurance Corporation</u>
Alex LePore, Deputy to the Acting Chairman

Securities and Exchange Commission
Kelsey Pristach, Senior Advisor

Commodity Futures Trading Commission
Meghan Tente, Acting General Counsel

Consumer Financial Protection Bureau
Mark A. Calabria, Senior Advisor

Federal Housing Finance Agency
Aaron Kofsky, Acting Deputy Director, Division of Housing Mission and Goals

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

National Credit Union Administration
Andrew Leventis, Chief Economist

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

Federal Reserve Bank of New York
John Williams, President (via videoconference)
Adam Minson, Policy Advisor, Supervision (via videoconference)

Office of Financial Research
Mark Paddrik, Acting Deputy Director, Research and Analysis

Federal Insurance Office
Stephanie Schmelz, Deputy Director

North Dakota Department of Financial Institutions
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 (NAIC)

Maryland Office of the Attorney General, Securities Division
Vince Martinez, General Counsel, North American Securities Administrators Association (via videoconference)

PRESENTERS:

Bank Supervision and Regulation

- *Mary Aiken, Senior Associate Director, Division of Supervision and Regulation, Federal Reserve*

Digital Assets

- *Tyler Williams, Counselor for Digital Assets, Treasury*

Commercial Real Estate

- *Brandon Kirby, Senior Policy Advisor, Treasury*
- *Hein Bogaard, Economic Expert, OCC*
- *Siobhan Kelly, Associate Director, Office of Multifamily Analytics and Policy, FHFA*
- *James Presley-Nelson, Chief, Financial Analysis Section, FDIC (available for questions)*

Corporate Credit

- *Karen Shultz, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury*
- *Ted Berg, Senior Financial Analyst, OFR*
- *Steve Flantsbaum, Branch Chief, Division of Investment Management, SEC*
- *Michael Spratt, Assistant Director, Division of Investment Management, SEC (available for questions)*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 10:04 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 bank supervision and regulation, (2) an update on digital assets, (3) an update on commercial real estate, (4) an update on corporate credit, and (5) a vote on the minutes of the Council's meeting on March 20, 2025.

1. Bank Supervision and Regulation

The Chairperson introduced the first agenda item, an update on bank supervisory and regulatory frameworks. He said that Treasury was leading an effort to empower the nation's banks to finance the economy's pursuit of job growth, wealth creation, and prosperity for all Americans. He said that in recent years, banks' role as financial intermediaries had been weighed down by unduly burdensome regulatory requirements and supervision that was not consistently focused on material risks. He said that regulation should be efficient, effective, appropriately tailored, and reflect the current needs of the economy. He noted that at the previous Council meeting, he had asked the Council to consider ways to enhance bank supervisory and regulatory frameworks. He turned first to Jerome Powell, Chair of the Federal Reserve, for an update on these efforts.

Chair Powell provided an overview of several Federal Reserve initiatives, including the recalibration of the supplementary leverage ratio, the adjustment of supervisory activities to focus on material financial risks, and efforts to encourage innovation in the banking sector. He then introduced Mary Aiken, Senior Associate Director of the Division of Supervision and Regulation at the Federal Reserve, to read a statement from Michelle Bowman, Governor of the Federal Reserve, who was unable to attend the meeting.

Ms. Bowman said in her statement that she would summarize her priorities for supervision and regulation at the Federal Reserve. She said that the Federal Reserve would work to ensure that supervisory and regulatory priorities are driven by a focus on core, material financial risks; apply a pragmatic and tailored approach in an effort to ensure that regulations are efficient and effective; facilitate a path for innovation in the banking system; and provide clear and transparent expectations for supervision and regulation and a process that recognizes due process. She stated that one of the Federal Reserve's first priorities would be to address the binding constraint that the supplementary leverage ratio can pose for large banks' Treasury securities dealer intermediation activity. She said that the Federal Reserve was collaborating with the other banking agencies and expected to issue a proposal that would recalibrate the requirements. She said that the Federal Reserve expected to follow the publication of this proposal with a broad review of large bank capital framework requirements.

Ms. Bowman said in her statement that the Federal Reserve would adjust its supervisory activities and approach to focus on core, material financial risks. She stated that the Federal Reserve would seek to ensure that the most critical matters are prioritized, returning to a supervisory approach that emphasizes tailoring in requirements based on risk, size, business model, and complexity of the institution. She said that to promote the durability and credibility of these changes, the Federal Reserve would also revise its supervisory ratings frameworks, beginning with its Large Financial Institutions ratings framework, so that it emphasizes material financial risks and reflects the true condition of an institution. She said that the Federal Reserve would also review its other ratings frameworks, including the CAMELS framework, which is used by the Federal Reserve and other banking regulators to assess the financial health of financial institutions they regulate. She said that as Chair of the Federal Financial Institutions Examination Council, she had directed a review of the CAMELS framework to ensure that it is based on clearly articulated principles and requirements that focus on material financial risks. She stated that the Federal Reserve sought to create credible and reliable supervisory ratings frameworks that reflect a firm's true condition, to improve predictability and transparency in the examinations process. She said that the Federal Reserve would also focus on improving its process for issue identification and remediation in its supervisory efforts. She said that the Federal Reserve would also seek to resolve enforcement actions in a timelier manner and improve the process for timely recognition of a bank's remediation of an identified issue.

Ms. Bowman concluded her statement by highlighting several additional priorities for the Federal Reserve related to rescinding its climate guidance, the engagement of banks in digital asset-related activities, the supervision and regulation of community banks, the process for mergers and acquisitions applications, and the Federal Reserve's ongoing review in response to the Economic Growth and Regulatory Paperwork Reduction Act.

The Chairperson then turned to Travis Hill, Acting Chairman of the FDIC, for an update. Acting Chairman Hill discussed recent FDIC activities in a number of areas. He stated that the FDIC was undertaking supervisory reforms to increase its focus on material financial risk. He said that the FDIC was engaged in an interagency rulemaking on safety and soundness. He stated that the FDIC was evaluating potential reforms to the CAMELS rating system. He also said that the FDIC was working to remove references to reputational risk from FDIC rules and guidance. He described the FDIC's efforts to update the agency's supervisory appeals process and to modify internal agency examination procedures. He then discussed FDIC efforts to adjust and index asset thresholds, including thresholds applicable to community banks; interagency efforts related to the enhanced supplementary leverage ratio and Basel III proposals; and potential FDIC actions regarding liquidity requirements and resolution planning. He noted that the FDIC had rescinded guidance regarding digital assets issued during the prior Administration, and he said that the FDIC was working with other agencies to respond to Executive Order 14178 (Strengthening American Leadership in Digital Financial Technology). He concluded by noting that the FDIC was considering issuing guidance addressing several types of specific activities.

The Chairperson then turned to Rodney Hood, Acting Comptroller of the Currency, for an update. Acting Comptroller Hood stated that the OCC was focused on four strategic priorities: reducing regulatory burden; promoting financial access; embracing responsible bank-fintech partnerships; and expanding responsible bank activities involving digital assets. On the first priority, he noted that the OCC had removed references to reputational risk from examiner guidance, in an effort to ensure that supervision remains focused on risks that materially affect a bank's financial condition. He noted that the OCC had clarified that novel activities will be judged by the financial risks they present, not simply because they are new and emerging. He stated that the OCC was collaborating with other agencies to review capital rules, including the enhanced supplementary leverage ratio and the Basel III proposals. He stated that he had announced an OCC realignment to refine the agency's supervisory focus and improve agility.

On the second priority, Acting Comptroller Hood noted that 40 percent of American households are unable to obtain a $400 emergency loan and 70 million households are credit "invisible." He noted that the OCC, through Project REACh, was partnering with banks and nonprofits to expand access to credit, homeownership, and small business lending, particularly in underserved and rural communities. He said that earlier in 2025, the OCC had approved one of the largest bank mergers in decades, between Capital One and Discover. On the third priority, he said that the OCC had recently approved a national bank's transition to a nationwide, technology-enabled small business lending model. He stated that the OCC continued to support community bank digitalization through updated guidance and direct outreach, and he noted the OCC's recently issued request for information on this topic. On the fourth topic, he noted that over 50 million American households hold some form of crypto, and he said that digital assets represent hundreds of billions of dollars in financial activity in the U.S. economy. He said that through Interpretive Letter 1183, the OCC had reaffirmed that national banks may engage in certain digital asset activities under existing authorities, and can do so without unwarranted procedural delays. He concluded by noting that the OCC was actively tracking legislative proposals, particularly regarding crypto markets and stablecoins, and he welcomed collaboration on these issues with other regulators and Congress.

Council members then discussed the impact of potential supervisory and regulatory changes on community banks and other financial institutions.

2. Digital Assets

The Chairperson then turned to the second agenda item, an update on digital assets. He stated that strengthening American leadership in digital assets is a key priority. He said that the United States should be the center of innovation and market activity in digital assets, as it is in traditional capital markets. He noted that in January, President Trump signed Executive Order 14178 (Strengthening American Leadership in Digital Financial Technology) to establish regulatory clarity for digital financial technology and to secure America's position as the world's leader in the digital asset economy. He then introduced Tyler Williams, Counselor for Digital Assets at Treasury, to provide an overview of Treasury's work on digital assets in response to the Executive Order.

Mr. Williams stated that Treasury was working to address two Executive Orders related to digital assets issued since January. He noted that Executive Order 14178 established the President's Working Group on Digital Asset Markets and proposed a whole-of-government approach to regulating the industry. He noted that Executive Order 14233 (Establishment of the Strategic Bitcoin Reserve and United States Digital Asset Stockpile) established the Strategic Bitcoin Reserve and United States Digital Asset Stockpile. He also noted that the Internal Revenue Service's decentralized finance broker rule had been rescinded pursuant to the Congressional Review Act. He noted other recent government actions related to digital asset policy, including that the SEC had rescinded Staff Accounting Bulletin 121 and established a Crypto Task Force, and that the Federal Reserve, FDIC, and OCC were taking regulatory actions regarding banking and digital assets. He said that Treasury encouraged collaboration among member agencies regarding digital assets. He also noted efforts by member agencies to work with Congress on priorities such as stablecoin and market structure legislation.

Mr. Williams stated that Executive Order 14178 set forth several objectives for the President's Working Group on Digital Asset Markets. He said that in February, agencies completed the 30-day objective under the Executive Order by identifying regulations, guidance documents, orders, and other items that affect the digital asset sector. He said that in March, agencies completed the 60-day objective by submitting recommendations regarding whether the identified items should be rescinded or modified, or, for items other than regulations, adopted in a regulation. He stated that agencies were working on the 180-day report to the President, with recommendations to advance the policies established in the Executive Order. He said that the report was expected to address a range of issues, including prudential regulation and access to the banking system, stablecoins, illicit finance, and other topics. He then addressed the market structure section of the report. He said that market structure is an area of ongoing legislative and regulatory activity. He noted that the House Committee on Financial Services was holding a hearing on the Digital Asset Market Clarity (CLARITY) Act of 2025, which seeks to provide a comprehensive regulatory framework for digital asset markets.

Mr. Williams stated that, consistent with the policy direction of Executive Order 14178, Treasury was developing a set of principles in an effort to provide regulatory clarity and certainty for digital assets. He said that it was important to recognize the unique aspects of this market and tailor a regulatory approach that reflects these principles while fostering innovation. He then highlighted three challenges in the digital asset sector: (1) asset classification or token taxonomy; (2) spot market authority, given that U.S. law provides for limited direct federal oversight of spot markets for digital assets that are not securities; and (3) the tokenization of traditional assets. He concluded by noting that Treasury would collaborate with other members of the Working Group on Digital Asset Markets to produce the 180-day report.

The Chairperson then turned to Paul Atkins, Chairman of the SEC, and Caroline Pham, Acting Chairman of the CFTC, for an update on their agencies' efforts on digital assets.

Chairman Atkins stated that a cornerstone of the SEC's work on digital assets is improving transparency and regulatory certainty. He said that the SEC's Crypto Task Force draws on expertise across the agency to foster innovation in capital markets, and he noted that the task force had held four roundtables and approximately 120 meetings with stakeholders so far. He said that the roundtables had focused on the definition of a security in the context of digital assets; custody of digital assets by broker-dealers, funds, and advisors; the trading of digital assets; and tokenization of real-world assets. He said that the final roundtable would address decentralized finance. He also noted that Mark Uyeda, the SEC commissioner and previous acting chairman, had delegated authority on matters of crypto assets to Commissioner Hester Peirce, and Chairman Atkins expressed his support for that delegation.

Chairman Atkins summarized other recent SEC activities in this area. He noted that SEC staff had addressed questions through FAQs, offering guidance on establishing control of crypto asset securities by broker-dealers and clarifying that non-security crypto assets held by a broker-dealer are not protected by the Securities Investor Protection Act, among other topics. He said that the SEC had withdrawn Staff Accounting Bulletin 121 and the 2019 Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities, which he said had made it difficult for broker-dealers and qualified custodians to custody crypto assets. He stated that SEC staff had also clarified the application of portions of the securities laws to various tokens and activities, including that meme coins are generally not securities, and that proof of work and proof of stake do not constitute an offering of securities. He said that the SEC would continue to seek opportunities to foster innovation and establish regulatory clarity for crypto assets. He said that SEC staff continued to provide technical assistance on both the Guiding and Establishing National Innovation for U.S. Stablecoins (GENIUS) Act and the CLARITY Act. He said that the Crypto Task Force was also developing recommendations for actions the SEC could take under its existing authority. He concluded by discussing potential SEC rulemakings.

Caroline Pham, Acting Chairman of the CFTC, provided an overview of the CFTC's approach to regulating digital assets and recent CFTC initiatives in this area. She said that the CFTC had hosted a Crypto CEO Forum to discuss the launch of the CFTC's digital asset markets pilot program for tokenized non-cash collateral such as stablecoins. She noted that the CFTC's Global Markets Advisory Committee had released a recommendation in 2024 through its Digital Asset Markets Subcommittee on expanding the use of non-cash collateral through distributed ledger technology. She said that the CFTC had withdrawn two staff advisories relating to virtual currency derivative product listings and clearing that were no longer needed. She stated that the CFTC had deprioritized certain enforcement cases and refocused its Division of Enforcement on addressing fraud and other priorities. She said that she had directed CFTC staff to comply with the Department of Justice's (DOJ) policy ending regulation by prosecution, which she said had targeted the digital asset industry in recent years, and she noted that she had directed CFTC staff to comply with the President's Executive Orders and Administration policy, consistent with DOJ's digital assets enforcement priorities and charging considerations. She said that the CFTC had issued an interpretative letter confirming the applicability of certain CFTC cross-border definitions for futures and swaps activities. She concluded by discussing CFTC priorities related to digital assets, including continuing to provide technical assistance to Congress on the GENIUS Act and CLARITY Act.

Following the presentations, the Chairperson stated that he appreciated the ongoing work across member agencies to provide regulatory clarity and certainty in digital asset markets. He said that as stablecoins continue to grow, tokenization of real-world assets expands, and interconnectedness between the digital asset sector and the traditional financial system increases, many markets and sectors that Council member agencies oversee would be impacted. He said that it would be important for the Council to continue to coordinate on this issue.

Council members then had a discussion about the regulation of digital assets by state regulators; the importance of legislation regarding digital assets, including for stablecoins; and the role of banking regulators in encouraging innovation in digital assets.

3. Commercial Real Estate

The Chairperson then introduced the next agenda item, an update on commercial real estate. He turned to Brandon Kirby, Senior Policy Advisor at Treasury; Hein Bogaard, Economic Expert at the OCC; and Siobhan Kelly, Associate Director of the Office of Multifamily Analytics and Policy at the FHFA, for the presentation.

Mr. Kirby stated that the presentation would assess the current state of various financial industry participants in the commercial real estate (CRE) market and evaluate the financial stability implications of recent trends. He said that the CRE sector had recently been stabilizing, with transactions and securitization markets growing in 2024 and 2025 after slowing following the bank failures of March 2023. He said that there were continued challenges for the CRE market, with interest rates higher than existing terms nearing maturity, property values decreasing, and expenses and insurance costs increasing, particularly in areas vulnerable to natural disasters. He said that delinquencies had reached new highs in some sectors for the current cycle, but he noted that they remained at historically manageable levels for credit losses for lenders and investors. He stated that regulators had initiated actions to identify, measure, and monitor CRE risks and had required actions to enhance risk management in the past several years.

Mr. Kirby stated that the overall CRE market was $5.9 trillion as of June 30, 2024, and $6.2 trillion at the end of 2024. He said that banks expanded CRE lending until 2022, when bank CRE lending leveled off at approximately $3 trillion for the year. He noted that insurance companies began growing their CRE lending around 2017, and CRE lending by the government-sponsored enterprises represented an increasing share of the market. He discussed data regarding CRE maturities and the amount of loans with short-term extensions or modifications. Turning to

CRE fundamentals, he said that the office segment continued to be the weakest, with vacancy rates slowing but generally expected to continue rising until 2027. He stated that multifamily vacancy rates had increased due to significant new construction in high-growth areas, and he noted that absorption (the rate at which available rental units are leased or occupied in a market) had been stable in the first quarter of 2025. He said that the industrial segment had also experienced a significant amount of new construction, leading to higher vacancy rates. He said that a slowdown in new industrial leases had occurred, given uncertainty associated with imports. He noted that, other than in the office segment, net operating income had been increasing faster than the rate of inflation over the past several years. Addressing property prices, he stated that the office and multifamily segments had decreased in value since 2023, while the industrial and retail segments had been increasing in value. He said that the lower values for office and multifamily properties represented a challenge for properties coming up for refinancing.

Mr. Bogaard then stated that he would discuss CRE lending in the banking sector. He said that banks and bank supervisors had been focusing on CRE-related risks and risk management for several years. He noted that areas of concern remained, particularly regarding the office segment and regional divergence in the performance of multifamily properties. He said that banks appeared to have an understanding of the risks in their loan books and to be managing them appropriately. He said that remaining concerns were partly mitigated by the fact that smaller banks with higher CRE concentrations have lower exposure to large office buildings. He noted further that banks that were seeing larger delinquencies and charge-offs on office buildings generally had lower CRE concentrations.

Mr. Bogaard stated that banks and supervisors were monitoring refinancing risk, the path of interest rates, and the cyclical nature of CRE. He said that supervisors also continued to assess bank risk management, including concentrations and credit loss allowances. He noted that approximately 65 percent of CRE loans held by banks were held by institutions with less than $100 billion in assets. He said that these CRE loans had been performing relatively well compared to the 35 percent of CRE loans held by larger banks. He said that non-performing loan ratios were at multi-year highs for banks with more than $100 billion in assets.

Mr. Bogaard discussed further differences in loan portfolios. He said that larger banks offered loan modifications to borrowers with payment difficulties more frequently than smaller banks. He noted that in 2023, banking regulators issued a policy statement that noted that accommodations and workouts may be in the best interest of borrowers and lenders and should be used by financial institutions when appropriate. He said that, on the one hand, the prevalence of loan modifications, in combination with higher delinquencies, indicated that banks with over $100 billion in assets were seeing more borrowers with repayment challenges than other banks. He said that, on the other hand, the use of loan modifications showed that banks were working with borrowers to mitigate the impact of payment challenges. He noted that banks with more than $100 billion in assets also held more allowances against expected losses on CRE loans, in recognition of higher portfolio risk.

Mr. Bogaard reiterated that office properties continued to perform worse than other CRE, and he said that this trend was also evident in loan performance at banks. He said that the office sector had seen a sharp increase in special mention and classified loans. He said that a recent publication by Federal Reserve economists indicated that CRE portfolio characteristics explained much of the differences in loan performance between banks of different sizes. He stated that supervisory activity also indicated that issues with CRE risk management at individual banks were generally idiosyncratic.

Mr. Bogaard stated that supervisors continued to work to ensure that bank risk management practices are consistent with banks' exposure to CRE and concentration risk. He said in conclusion that CRE markets were stabilizing, although vulnerabilities remained, including the path of interest rates, refinancing risk, remaining weakness in the office segment, and sensitivity to the economic cycle. He stated that these vulnerabilities were generally well-understood by banks and that banks were appropriately managing risks in their portfolios. He said that banking regulators expected to continue to monitor CRE lending and bank risk management in this area.

Mr. Kirby then turned to the nonbank financial sector, which he noted holds 50 percent of CRE. He said that insurance companies participate in two important ways in the CRE market. He discussed the direct loan portfolios of insurance companies, and he noted that 55 percent of their lending is to the office and multifamily segments. He said that delinquencies on direct loans held by insurance companies were currently below 1 percent, which he noted was the lowest rate of any type of CRE market participant. He said this was attributable to the fact that insurance companies offer loans to strong borrowers and provide long-loan terms, so the loans do not need to be refinanced as often. Addressing insurance companies' investments in structured commercial mortgage-backed securities (CMBS), he noted that insurance companies invest much less in agency CMBS, because it has lower yields and insurance companies do not benefit from the capital treatment of the agency guarantee, as do U.S. banks. He noted that non-agency CMBS and collateralized loan obligations (CLOs) can have 10-year structures, and he said that insurance companies invest in the tranches with the least capital-intensive NAIC rating of 1.A.

Mr. Kirby then turned to the market segment that pools and securitizes CRE loans into non-agency CMBS and CLOs, which he noted totaled approximately $500 billion at the end of 2024. He said that private-label CMBS issuance totaled $104 billion in 2024, an increase of 165 percent from 2023 issuance. He noted that most of the 2024 non-agency issuances were single-asset, single-borrower, floating-rate loans, which he said constituted two-thirds of CMBS. He stated that while the CMBS delinquency rate was showing a positive trend in early 2025, it set new highs in March 2025. He said that office CRE continued to have the highest delinquency rate, at 10.6 percent. He said that the CMBS multifamily delinquency rate had increased 360 basis points from March 2024 to March 2025. He noted that the CMBS lodging delinquency rate increased 79 basis points, reaching 7.2 percent, from February 2025 to March 2025. He said that overall, the non-agency CMBS market was finding investor demand and functioning well.

Mr. Kirby stated that CRE real estate investment trusts (REITs) were the smallest segment of the CRE sector, and the only segment with declining CRE assets in 2024. He said that REITs provide liquidity to transitional CRE properties seeking short-term financing to make capital improvements. He noted that the lodging REIT sector had the highest discount to net asset values.

Ms. Kelly then addressed recent trends in the agency CMBS market. She noted that the multifamily sector had experienced some strain, as other sectors had, due to higher interest rates, rising costs, and declining valuations. She said that multifamily fundamentals nonetheless remained strong, and she noted that delinquency rates were very low, with delinquency rates of multifamily mortgages held by Fannie Mae and Freddie Mac (the Enterprises) approximately 60 basis points and 40 basis points, respectively. She said that the Enterprises continued to provide support and stability to the multifamily market, backing almost 50 percent of multifamily mortgage debt currently outstanding. She said that the FHFA worked to ensure that the Enterprises play a countercyclical role in the multifamily market. She said that when capital is less available, such as during the financial crisis in 2008, the Enterprises' share of available capital grows, even if the amount of available capital is smaller. She stated that during times of market strength, the Enterprises' share of the market shrinks, which she noted occurred in 2022, when many markets were experiencing double-digit rent growth, and debt funds were the most active capital source.

Ms. Kelly stated that strains in the multifamily market over the past two years had resulted in increased incidence of fraud. She said that this included valuation fraud (inflation of a borrower's net operating income), misrepresentation of the borrower's experience and strength, misrepresentation of property conditions, and fraudulent acts by third parties such as appraisers, engineers, and brokers. She said that the FHFA's Office of Inspector General had initiated several investigations. She said that the FHFA continued to direct the Enterprises to address fraud through due diligence of borrowers and vendors and information sharing with the FHFA and with each other. She stated that information sharing between the Enterprises helps combat fraud by preventing bad actors from switching between Enterprises to avoid detection.

Mr. Kirby stated in conclusion that continued monitoring is warranted in a number of areas, including CRE loan rates and terms; mortgage modifications and extensions; banks' CRE concentrations; macroeconomic data; the office segment vacancy rate, values, and debt servicing; and specific geographies. He said that while CRE loans and investments had experienced idiosyncratic losses, they were not currently showing signs of systemic financial instability.

Council members then had a discussion about the various types of fraud addressed in the presentation and efforts to address it, and the importance of robust examination practices in identifying CRE vulnerabilities.

4. Corporate Credit

The Chairperson then introduced the next agenda item, an update on developments in corporate credit. He turned to Karen Shultz, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury; Ted Berg, Senior Financial Analyst at the OFR; and Steve Flantsbaum, Branch Chief in the Division of Investment Management at the SEC, for the presentation.

Ms. Shultz stated that the presentation would address developments in the corporate bond and leveraged loan markets, along with developments in private credit. She said that private credit had garnered considerable public attention due to its significant growth in recent years. She noted that the market size of private credit was now similar to the leveraged loan and high-yield bond markets. She stated that the investment-grade bond market continued to be the largest segment of the corporate credit market. She noted that credit spreads had widened significantly in the first half of April, driven by policy uncertainty, broader market volatility, and less-certain U.S. growth prospects. She noted that spreads had since narrowed following positive headlines regarding the direction of trade talks and as risk sentiment improved. She said that lower-rated credits underperformed during the recent market sell-off, particularly the CCC-rated segments of the loan and high-yield bond markets, where spreads still reflected more elevated risk.

Ms. Shultz stated that corporate fundamentals remained robust overall, driven in part by positive earnings growth, and she noted that firms continued to be well placed to service their debt. She said that while higher interest rates had led to a moderate decrease in aggregate interest coverage ratios, they remained at healthy levels, and leverage had remained stable. She said that over the last few years, below-investment-grade firms with higher leverage had been under greater stress. She noted that this was particularly the case in the leveraged loan market, where issuers had faced a faster transition to higher borrowing costs due to their floating-rate debt. She stated that riskier borrowers' ability to service their debt had started to show signs of weakness, as the share of leveraged loan issuers with interest coverage ratios less than 2x had risen over the last several years. She said that these issuers could become further strained if corporate earnings were to fall due to a sharper-than-expected slowdown in economic activity.

Ms. Shultz stated that, apart from the recent period of market stress, the corporate credit market had been well supported by strong investor demand. She noted, however, that in the week ending April 9, significant outflows from credit funds occurred as markets sold off, particularly impacting high-yield and leveraged loan funds as a percentage of assets under management. She said that outflows continued through most of April, although there was a deceleration in the magnitude of outflows as markets stabilized. She stated that market strategists generally expected strong investor demand to return over the longer term, driven by high all-in yields, especially relative to other U.S. dollar-denominated fixed-income asset classes.

Ms. Shultz stated that elevated market volatility reduced issuance, particularly by high-yield and leveraged loan borrowers, during much of April. She said that as fund outflows moderated and markets stabilized, high-yield issuance returned. She noted, however, that April was the slowest month of high-yield issuance since 2008. She said that the leveraged loan market was slower to reopen, which she noted was typical during periods of market stress. She said that investment-grade markets returned to relatively normal issuance levels more quickly.

Ms. Shultz noted that refinancings and repricings made up the vast majority of loan activity in 2024. She said that leveraged loan borrowers repriced existing loans at a record pace last year amid highly accommodative credit conditions. She stated that high-yield bond markets had experienced similar conditions, as issuance had primarily been focused on refinancing existing debt. She said that while market participants had anticipated an increase in mergers and acquisitions activity in 2025, this had not yet occurred.

Ms. Shultz stated that some issuers in the leveraged loan market had experienced greater stress over the last few years and leveraged loan default rates had increased. She noted, however, that default rates remained significantly below levels typically associated with recessionary periods. She said that an increasing share of defaults had occurred in the form of distressed exchanges. She said that while debt exchanges allow firms to avoid bankruptcy proceedings in the short term, many of these firms default a second time and ultimately enter bankruptcy.

Mr. Berg then provided an overview of the private credit industry, highlighting the heterogenous nature of private credit strategies. He described five factors that had driven the industry's secular growth: banking consolidation, which resulted in larger banks focused on larger, more profitable corporate clients; post-financial crisis bank regulations, which resulted in higher capital requirements for banks' business lending and accelerated a shift to an originate-and-distribute lending model focused on larger, broadly syndicated loans; changes in banks' risk appetite, which caused some banks to reduce their exposure to higher-risk corporate loans; the large supply of capital from institutional investors, such as insurers, pension funds, and endowments, directed to private credit investments; and strong demand from companies for private loans.

Mr. Berg then discussed several benefits of private credit. He noted that it enhances the robustness of U.S. lending markets and enables institutional investors to diversify their holdings beyond the public credit market. He said that currently the maturity transformation and leverage risks of private credit are limited. He noted that private credit lending had been countercyclical during market stresses from 2020 to 2023, a period that included the COVID-19 recession, a cycle of significant monetary policy tightening, and the failure of a limited number of regional banks. Finally, he stated that private credit market participants have flexibility to work with borrowers during times of stress, mitigating bankruptcy risk.

Mr. Flantsbaum stated that private funds were the largest type of private credit lenders. He summarized certain features of private funds, noting that they are typically closed-end funds with locked liquidity, and therefore do not offer redemptions; are privately offered, primarily to institutional and high-net-worth investors; provide no public disclosures of their holdings, although investors receive periodic reports; report limited data on regulatory forms, such as the SEC's Form ADV and Form PF; and have contractual limitations on leverage. He said that the remaining private credit lenders are predominantly business development companies (BDCs). He stated that BDCs are subject to requirements under the Investment Company Act of 1940, the Securities Exchange Act of 1934, and the Securities Act of 1933, as applicable, and unlike private funds are required to publicly report investments quarterly, on Forms 10-K and 10-Q. He said that BDC investors include retail as well as institutional and high-net-worth investors. He said that BDCs may be publicly listed on an exchange, or unlisted but offered to retail or private investors. He said that five BDC advisers, which advise 15 out of the total of 161 BDCs, have approximately 50 percent of the market share.

Mr. Flantsbaum noted that there is uncertainty regarding the size of the private credit market and its participants. He said that while lenders are often private funds, offering limited public information, they provide some reporting to regulators. He said that BDCs provide transparency through public financial disclosures four times per year. He said that BDC borrowers are typically private companies that provide limited public financial disclosures. He noted that the nature of the market poses valuation challenges. He stated that market prices are infrequently available and positions are typically reported at fair value. He noted that BDC valuation practices are subject to SEC disclosure requirements and other rules. He said that there was limited information on underlying loan defaults and on the exposures of other market participants, such as banks and insurance companies.

Mr. Flantsbaum stated that private credit funds' liquidity and maturity transformation risk appeared low because they generally have a closed-end structure and typically lock up capital for extended periods. He noted, however, that unlisted BDCs (as well as interval funds, which also invest in private credit) offer limited redemption options, which he said could contribute to liquidity risks in a sustained period of stress. He noted that these funds typically maintain a portion of their portfolios in liquid assets to meet redemptions. He said that recently, a small number of exchange-traded funds had begun investing in private credit, primarily in private credit CLOs. He noted that exchange-traded funds are required to have comprehensive liquidity risk management programs and are prohibited from investing more than 15 percent of their net assets in illiquid positions.

Ms. Shultz stated that while direct lending had historically targeted middle-market companies with smaller loan sizes, substantial growth in the market had enabled direct lenders to make increasingly larger loans to larger companies, providing an alternative to bank-provided broadly syndicated loans. She said that this greater competition had resulted in tighter spreads. She said that, more broadly, there were concerns that the rapid growth in unused available funds in private credit funds and continued inflows to BDCs could compromise underwriting standards, as managers compete for fewer deals. She stated that this increase in competition could incentivize managers to offer looser terms, such as covenant-lite loans, or choose risker deals. She said that another metric to monitor is the share of payment-in-kind (PIK) interest, which she noted had increased in BDCs since 2019. She said that while PIK agreements offer borrowers flexibility, they can mask underlying credit problems and delay recognitions of loss.

Ms. Shultz stated that rising interconnections between private credit, banks, and insurers also merited continued monitoring. She said that banks had facilitated the growth in private credit by extending credit to private funds and BDCs, typically through capital-call facilities and net asset-based borrowings. She said that banks' lending to private credit funds is challenging for regulators accurately to measure due to limited data availability. She noted recent efforts to improve this reporting, through enhancements to bank call reports and Form PF. She stated that private credit funds also invested in synthetic risk transfers, which allow banks to manage risk-weighted assets. She then addressed life insurers, which she said were increasingly adopting alternative investment strategies that use private credit. She noted that life insurers hold private credit loans on their balance sheets, invest in private credit funds as limited partners, and are involved in providing credit facilities to private credit funds. She stated that some insurers were also affiliated with asset managers that invest in private credit. She said that the rise in potentially favorable rating designations for insurers' private credit investments by smaller rating agencies could prompt more risk-taking by insurers and lead to a build-up of underappreciated risks.

Ms. Shultz concluded by summarizing three themes of the presentation. She stated that private credit enhances the robustness of U.S. lending markets and is an important source of funding to small and mid-sized businesses. She noted that while leverage and maturity transformation risks currently appeared to be low, continued monitoring of the asset class is warranted given its rapid growth and lack of transparency. Finally, she said that the growth of retail investor participation through semi-liquid funds, increased competition with public markets, and rising interconnections with banks and insurance companies are additional areas to monitor.

Following the presentation, the Chairperson stated that the depth and breadth of capital and credit markets power the U.S. economy. He said that private credit is a fast-growing market that provides an important source of credit, particularly for small and medium-sized businesses. He stated that while limited leverage and redemption risks in private credit appeared to mitigate potential financial stability risks, the sector continued to warrant monitoring as market practices and macroeconomic conditions evolve. He said that the growth in credit provision outside of the banking system had been driven to some degree by constraints created by regulation. He said that modernizing regulatory requirements could reduce risks to financial stability by leveling the playing field across banks and nonbanks. He said that this was also an important part of the Administration's focus on expanding access to capital.

Council members then discussed the corporate credit sector, including ways in which private credit can promote investment and access to capital, potential vulnerabilities that warrant continued monitoring, the impact of regulatory changes, certain practices in corporate credit transactions, and recent market developments.

5. Resolution Approving the Minutes of the Meeting Held on March 20, 2025

BE IT RESOLVED, by the Financial Stability Oversight Council (Council), that the minutes attached hereto of the meeting held on March 20, 2025 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.

6. Other Business

Before the meeting concluded, Council members discussed preparations by the staffs of Treasury's Office of the Financial Stability Oversight Council and Office of Cybersecurity and Critical Infrastructure Protection for hosting an upcoming interagency tabletop exercise regarding cyber risk. Treasury staff noted that the exercise would focus on understanding disaster recovery plans, agencies' authorities to respond to the hypothetical scenario, mechanisms for interagency coordination, and potential financial stability implications.

The Chairperson adjourned the meeting at approximately 11:41 A.M.