Minutes of the Financial Stability Oversight Council

February 10, 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)
Jay Gallagher, Senior Deputy Comptroller for Supervision Risk and Analysis, Office of the Comptroller of the Currency (OCC) (acting pursuant to delegated authority)
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 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
Andreas Lehnert, Director, 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
David Gillers, Chief of Staff

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
Jonathan Fink, Associate Chief Counsel

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

New York 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
Vincente Martinez, General Counsel, North American Securities Administrators Association

PRESENTERS:

Update on Council Priorities

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

Report on Cloud Services Adoption in the Financial Sector

- *Todd Conklin, Deputy Assistant Secretary for Cybersecurity and Critical Infrastructure Protection, Treasury*

Council Options for Financial Stability Risks and Nonbank Financial Company Designations

- *Sandra Lee, Deputy Assistant Secretary for the Council, Treasury*
- *Eric Froman, Assistant General Counsel (Banking and Finance), Treasury*
- *Devin Mauney, Attorney-Advisor, Treasury (available for questions)*
- *Carol Rodrigues, Attorney-Advisor, Treasury (available for questions)*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 9:31 A.M. The Council convened by videoconference. The Chairperson began by congratulating Martin Gruenberg, Chairman of the FDIC, on his recent confirmation and welcoming Adrienne Harris, Superintendent of the New York Department of Financial Services, as the Council's new state banking member. She then outlined 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 the Council's priorities, (2) a presentation on Treasury's recently issued report on cloud services adoption in the financial sector, (3) an update on the Council's options for financial stability risks and nonbank financial company designations, and (4) a vote on the minutes of the Council's meeting on December 16, 2022.

1. Update on Council Priorities

The Chairperson introduced the first agenda item, an update on the Council's priorities. She introduced Sandra Lee, Deputy Assistant Secretary for the Council at Treasury.

Ms. Lee provided an overview of Council priorities, including an overview of the progress made on the Council's priorities in 2022 and a preview of proposed priorities for 2023. She stated that the Council had made progress in each of the four areas that the Council identified as priorities in 2022: climate-related financial risk, nonbank financial intermediation, digital assets, and Treasury market resilience. She said that, following the publication of the Council's Report on Climate-related Financial Risk in October 2021, the Council established a new Climate-related Financial Risk Committee, or CFRC, and created working groups on data, risk assessment, and scenario analysis to help advance the report's recommendations. In the area of nonbank financial intermediation, she said that the Council's Hedge Fund Working Group developed a quantitative risk monitor, drawing on data sets from regulators, to inform the Council's understanding of hedge fund risks. She also highlighted the Council's Report on Digital Asset Financial Stability Risks and Regulation, which was published in October 2022. She stated that the report resulted from extensive interagency engagement and provided a foundation for the Council's efforts to identify and mitigate potential financial stability risks posed by digital assets. In the area of Treasury market resilience, she said that the Council's work on hedge funds and open-end funds informed the efforts of the Inter-Agency Working Group on Treasury Market Surveillance (IAWG) to examine the effects of leverage and fund liquidity risk management practices on Treasury market liquidity. She also noted that the Council had issued its 2022 annual report, which the Council streamlined and restructured to focus on key financial stability vulnerabilities.

Ms. Lee said that the Council intended to make further progress on each of these four priorities in 2023. With respect to climate-related financial risk, she said that the OFR's Joint Analysis Data Environment, which is intended to make a variety of data, computing resources, and analytic software available to Council member agencies, would continue onboarding data sets and users across member agencies, helping fill critical data and analytical gaps. She noted that the Council was developing climate-related risk indicators for the banking and insurance sectors and for capital markets, including new exposure metrics for bank and insurance holdings of commercial and residential real estate and other asset classes. She also stated that member agencies were sharing best practices regarding climate scenario risk analysis. She said that, as discussed in the Council's climate report, the CFRC would provide updates to the Council at least semiannually on efforts by the Council and its members to identify and address climate-related financial risk. She also noted that the Council planned to convene the first meeting of its new Climate-related Financial Risk Advisory Committee, or CFRAC, in March 2023, which would enable the Council to gather information and analysis from a broad array of stakeholders and advance its understanding of climate-related financial risks.

With respect to nonbank financial intermediation, Ms. Lee noted that the meeting would include a presentation on a potential approach for issuing a new framework for the Council's efforts to monitor and address potential risks to financial stability and replacing the Council's existing guidance on nonbank financial company designations. Ms. Lee also said that digital assets would continue to be a focus of Council efforts. She noted that the Council expected to reestablish its Digital Assets Working Group to provide a forum to share information and monitor developments in digital asset markets. With respect to Treasury market resilience, she said that the Council's Hedge Fund Working Group would continue in 2023 to conduct risk analyses and consider approaches to mitigate potential risks, in coordination with IAWG colleagues working on related issues. She also said that in 2023 staff expected to continue to assess risks related to nonbank mortgage servicing. Finally, she noted that she expected to continue efforts to increase the headcount of the Council Secretariat at Treasury in order to enhance the Council's broader financial stability monitoring efforts.

Discussing other areas of Council focus, she said that the Council was seeking to conduct more robust risk monitoring in various areas. She said that the Council also intended to enhance its staff-level coordination with the Financial and Banking Information Infrastructure Committee (FBIIC) on cybersecurity and operational resilience, to enhance the ability of the staffs of Council and FBIIC member agencies to share information and analysis on areas of common concern.

Following the presentation, the Chairperson said that she looked forward to continued progress in 2023 on the four Council priorities. She said that it was also important for the Council to consider additional areas of focus, such as cyber risks and operational resilience, and remain vigilant regarding other emerging threats to financial stability.

Council members then discussed the Council's priorities for 2023, including specific areas of focus.

2. Report on Cloud Services Adoption in the Financial Sector

The Chairperson then turned to the second agenda item, a presentation on Treasury's recent report, The Financial Services Sector's Adoption of Cloud Services. She introduced Todd Conklin, Deputy Assistant Secretary for Cybersecurity and Critical Infrastructure Protection at Treasury.

Mr. Conklin stated that on February 8, 2023, Treasury issued a report on the potential benefits and challenges associated with the increasing trend of financial sector firms adopting cloud services technology. He stated that Treasury prepared the report in coordination with members of the FBIIC. He noted that he had presented on the development of the report at the October 3, 2022 Council meeting. He also said that Treasury had consulted with various federal agencies and external stakeholders on cloud adoption and vulnerabilities.

Addressing the report's primary findings, Mr. Conklin stated that there was a range of maturity with respect to cloud services adoption. He said that cloud services was no longer an emerging technology and was widely used for e-mail and videoconferencing. He noted that financial institutions were starting to use it for core operations, and that cloud services adoption was expected to continue. He stated that many smaller financial institutions had moved almost all of their operations to the cloud, but he noted that smaller institutions had also experienced difficulty negotiating cloud services contracts and that the shift can be more expensive for smaller firms. He stated that when configured correctly, cloud services can provide significant benefits to firms in terms of redundancy, scalability, and security.

Mr. Conklin stated that Treasury had identified six main challenges to greater cloud adoption by financial institutions: obstacles to transparency; gaps in expertise and tools; exposure to potential operational incidents, including from incidents originating at a cloud service provider; potential impact of market concentration on the sector's resilience; dynamics in contract negotiations; and the international landscape and regulatory fragmentation. He said that Treasury, as it evaluates next steps, would seek to support the resilience of the financial sector's use of cloud services. He said that Treasury's long-term objectives address risk assessment and mitigation; sector-wide concentration; and domestic and international collaboration and coordination. He stated that Treasury, as part of a multi-year effort on cloud services, would set up an interagency Cloud Services Steering Group, which would provide updates to both the Council and FBIIC, to coordinate on issues raised in the Treasury report. He said that key objectives of this group would include the development of common definitions and terms; the enhancement of interagency information sharing and risk management; and the development of an incident-response protocol involving cloud services. He stated that Treasury would also pursue continued engagement with the private sector on various issues raised in the report, including issues related to risk-management practices and contracting. He said that Treasury would lead ongoing engagement with the Financial Services Sector Coordinating Council (FSSCC), which he said would create a working group to address industry perspectives on cloud adoption. He said that Treasury would also emphasize engagement with international partners, including continued development of international standards, principles, and recommendations, at the G7 Cyber Expert Group, Financial Stability Board, and international financial standard-setting bodies.

Following the presentation, the Chairperson stated that cloud services has the potential to enhance security and operational resilience among financial institutions. She noted that the financial sector's concentrated dependency on a limited number of providers of critical cloud services is a potential risk. She expressed support for the report's proposals for enhanced coordination between the public and private sectors.

Council members then asked questions and had a discussion regarding oversight of cloud service providers, the use of artificial intelligence in cloud services, cybersecurity events involving cloud service providers, and next steps for Treasury's engagement on this issue.

3. Council Options on Financial Stability Risks and Nonbank Financial Company Designations

The Chairperson then introduced the next agenda item, an update on a potential analytic framework describing how the Council identifies, evaluates, and addresses risks, and potential new guidance on the Council's process for designating nonbank financial companies for Federal Reserve supervision and prudential standards. The Chairperson began by emphasizing that the Council should be able to use any of its statutory authorities when appropriate. She said that in most cases, the Council would address issues across an entire sector, or promote collaboration and information sharing among regulators. She stated, however, that there can be cases where designation is appropriate. She said that she believes it is necessary to revise the Council's current nonbank financial company designation guidance to enable that work. Second, she said that the Council should have a robust approach to identifying and addressing financial stability risks, whether they arise from activities or entities. She said that staff had made progress in developing an approach on these issues.

She then introduced Sandra Lee, Deputy Assistant Secretary for the Council at Treasury, and Eric Froman, Assistant General Counsel (Banking and Finance) at Treasury.

Ms. Lee stated that the Council's Deputies Committee had collaborated to develop a new proposed approach for the Council's risk assessment efforts and the Council's process for nonbank financial company designations. Mr. Froman then provided a brief background on the history of the Council's nonbank financial company designations guidance. He said that the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) lists 14 duties for the Council, which largely address risk monitoring, information sharing, and making recommendations. He said that one of the Council's duties is to designate nonbank financial companies for Federal Reserve supervision and prudential standards. He said that the Dodd-Frank Act sets forth the standard for designation—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 U.S. financial stability. He noted that the Dodd-Frank Act also lists the factors the Council is required to consider in designating a nonbank financial company. He said that the Dodd-Frank Act also provides a high-level process for a proposed and final designation.

Mr. Froman stated that in 2012, the Council adopted a regulation on nonbank financial company designations, to which interpretive guidance was attached as an appendix. He said that the interpretive guidance described the substance of the Council's review of nonbank financial companies for designation, and set forth additional procedures, creating what was at that time a three-stage process. He stated that the Council, applying the 2012 guidance, designated four nonbank financial companies in 2013 and 2014. He said that in 2015, the Council approved supplemental guidance that provided additional due process, primarily in the form of expanded engagement between the Council and companies under review. He stated that between 2016 and 2018, all four previous nonbank financial company designations were rescinded, one by court order and the other three by Council votes.

Mr. Froman stated that in 2019, the Council replaced the 2012 interpretive guidance with new guidance. He noted three aspects of the 2019 interpretive guidance. First, he said that it described how the Council would prioritize its efforts to identify, assess, and address potential risks and threats to U.S. financial stability through a process that begins with an activities-based approach. Second, he said that it described the Council's analytic approach in nonbank financial company designations, including adding requirements for cost-benefit analysis and the consideration of the likelihood of a nonbank financial company's material financial distress when evaluating it for a potential designation. Third, he said that it described the Council's procedures for designation. Mr. Froman noted that the process for nonbank financial company designations set forth in the 2019 guidance made few changes to the Council's existing guidance and practices at that time regarding engagement with companies under review and their regulators.

Ms. Lee described the new proposed approach, which contemplates issuing a framework for monitoring and addressing risks and replacing the Council's 2019 guidance with new procedures for nonbank financial company designations. She said that, in developing the new framework and guidance, the Council was promoting three goals: focusing on the Council's duty to identify and respond to risks to financial stability, without prioritizing some of its tools over others; providing transparency to the public on how the Council identifies and addresses financial stability risks; and removing the impediments established in the 2019 guidance that would unduly limit the Council's ability to designate nonbank financial companies. She stated that to fulfill the Council's statutory mandate, it is important for the Council to have a rigorous framework in place for identifying, assessing, and addressing risks. She said that the Council's approach should promote its ability to identify risks whether they arise from activities, firms, or elsewhere, and should also enable the Council to address those risks using any of its tools as appropriate.

Ms. Lee then described the draft Council framework for identifying, evaluating, and addressing risks, which sets forth the substantive analytic approach the Council takes in its work. She noted that the framework would apply to any of the Council's work, regardless of whether that work resulted in a nonbank financial company designation, informal regulatory collaboration, or another outcome. She noted that the Council has a wide range of statutory tools for addressing identified risks, and that nonbank financial company designation is only one of those tools. She also noted that the Council most frequently relies on its authority to work with Council member agencies to share information, collaborate, and address risks.

Mr. Froman described a separate document under development, which would replace the 2019 guidance and would be attached as an appendix to the Council's 2012 regulation on nonbank financial company designations. He stated that the draft document would address the Council's process for nonbank financial company designations, rather than the analytical substance of such designations. He described the process set forth in the draft guidance. He concluded by discussing the next steps in the development of the new framework and procedures, including anticipated issuance of the proposals for public comment.

Council members then asked questions and had a discussion about the Council's authorities under the Dodd-Frank Act to address risks to U.S. financial stability, the Council's process for identifying and reviewing nonbank financial companies and the process for issuing the new framework and guidance.

4. Resolution Approving the Minutes of the Meeting Held on December 16, 2022

BE IT RESOLVED, by the Financial Stability Oversight Council (Council), that the minutes attached hereto of the meeting held on December 16, 2022 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 10:52 A.M.