Minutes of the Financial Stability Oversight Council

May 10, 2024

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, Supervision Risk and Analysis, Office of the Comptroller of the Currency (OCC) (acting pursuant to delegated authority)
Andrew Leventis, Chief Economist, National Credit Union Administration (NCUA) (acting pursuant to delegated authority) (via videoconference)
Thomas E. Workman, Independent Member with Insurance Expertise
James Martin, Acting Director, Office of Financial Research (OFR), Department of the Treasury (non-voting member)
Steven Seitz, Director, Federal Insurance Office (FIO), Department of the Treasury (non-voting member)
Adrienne Harris, Superintendent, New York State Department of Financial Services (non-voting member)
Elizabeth K. Dwyer, Superintendent of Financial Services, Rhode Island Department of Business Regulation (non-voting member)
Melanie Lubin, Securities Commissioner, Maryland Office of the Attorney General, Securities Division (non-voting member)

GUESTS:

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

Board of Governors of the Federal Reserve System
Andreas Lehnert, Director, Division of Financial Stability

Federal Deposit Insurance Corporation
Susan Baker, Corporate Expert, 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 (via videoconference)

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

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

Office of Financial Research
Stacey Schreft, Deputy Director, Research and Analysis

Federal Insurance Office
Philip Goodman, Senior Insurance Regulatory Policy Analyst

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

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

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

PRESENTERS:

Financial Market Utilities Committee Update

- *Alessandro Cocco, Vice President, Financial Markets Group, Federal Reserve Bank of Chicago*

- *Elizabeth Fitzgerald, Assistant Director, Office of Clearance and Settlement, Division of Trading and Markets, SEC*
- *Mark Magro, Manager, Division of Reserve Bank Operations and Payment Systems, Federal Reserve*
- *Megan Wallace, Senior Special Counsel, Division of Clearing and Risk, CFTC*

Developments in Corporate Credit Markets

- *Jordan Pollinger, Associate Director, Markets Group, Federal Reserve Bank of New York*
- *Karen Shultz, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury*
- *Matthew Lieber, Director, Markets Group, Federal Reserve Bank of New York (available for questions) (via videoconference)*
- *Daniel Maddy-Weitzman, Principal, Markets Group, Federal Reserve Bank of New York (available for questions)*

Nonbank Mortgage Servicing Report

- *Sandra Lee, Deputy Assistant Secretary for the Council, Treasury*
- *Sam Valverde, Acting President, Ginnie Mae*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 1:58 P.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 the Council's Financial Market Utilities Committee and (2) an update on developments in corporate credit markets.

1. Financial Market Utilities Committee Update

The Chairperson introduced the first agenda item, an update on the work of Council's Financial Market Utilities (FMU) Committee. She noted that the FMU Committee had essentially been dormant since 2016. She stated that the resilience of FMUs is important for financial stability, and she said that she supported the resumption of the Council's work in this area over the last year. The Chairperson then introduced Alessandro Cocco, Vice President of the Financial Markets Group at the Federal Reserve Bank of Chicago; Megan Wallace, Senior Special Counsel in the Division of Clearing and Risk at the CFTC; Mark Magro, Manager in the Division of Reserve Bank Operations and Payment Systems at the Federal Reserve; and Elizabeth Fitzgerald, Assistant Director in the Office of Clearance and Settlement in the Division of Trading and Markets at the SEC, for the presentation.

Mr. Cocco noted that Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) authorizes the Council to designate FMUs and payment, clearing, or settlement (PCS) activities that the Council determines are, or are likely to become, systemically important. He noted that designation authorizes regulators to impose risk management standards along with other actions. He noted that the Council designated eight FMUs in 2012. He then described certain duties of the FMU Committee under its publicly available charter. He said that the FMU Committee, which was created in 2012, reviewed the eight designated FMUs in 2013, 2014, 2015, and 2016.

Mr. Cocco said that at the end of 2023, Council Secretariat staff and the supervisory agencies for the eight designated FMUs began gathering updated data on these FMUs. He said that agency staff participating in the FMU Committee had reviewed applicable metrics and developments to determine if designation of these FMUs remained appropriate. He noted a number of key trends impacting the designated FMUs, including increased volumes and liquidity exposures, high market concentration, an expansion of services, and increased product offerings.

Mr. Cocco said that when conducting reviews of designated FMUs to evaluate whether the designation remains appropriate, staff had reviewed the considerations for designation under the Dodd-Frank Act: the aggregate monetary value of transactions processed by the FMU; aggregate exposure of the FMU to its counterparties; relationships, interdependencies, or other interactions of the FMU with other FMUs; and the effect that the failure of or a disruption to the FMU would have on critical markets, financial institutions, or the broader financial system.

Ms. Wallace, Mr. Magro, and Ms. Fitzgerald then presented on the FMUs regulated by their respective agencies, including their business activities and developments related to those FMUs since their designation.

Mr. Cocco concluded by noting that the Council has a statutory duty to monitor the financial services marketplace in order to identify potential threats to U.S. financial stability. He also noted that the FMU Committee works to identify and monitor potential threats or risks to U.S. financial stability that could be related to or mitigated through FMU or PCS activities. He then described potential future topics the FMU Committee may consider over the coming year, including developments in market structure, market regulation, and risk monitoring.

Following the presentation, the Chairperson stated that she supported the FMU Committee's work to evaluate the designated FMUs as well as its ongoing monitoring of potential risks.

Council members then discussed the importance of relaunching the FMU Committee, the FMU Committee's review of the designated FMUs, and the importance of reviewing risks associated with FMUs.

2. Developments in Corporate Credit Markets

The Chairperson then introduced the second agenda item, developments in corporate credit markets. She turned to Karen Shultz, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury, and Jordan Pollinger, Associate Director of the Markets Group at the Federal Reserve Bank of New York, for the presentation.

Ms. Shultz stated that, as the Council noted in its 2023 annual report, while corporate fundamentals remained solid overall, some moderate deterioration had occurred, and nonfinancial corporate leverage remained high by historical standards. She said that profit margins had been pressured as businesses faced higher borrowing costs and elevated inflation. She noted that while interest coverage ratios had edged lower, they remained strong due in part to resilient earnings. She stated that the ability of risky borrowers to service their debt burdens had started to show signs of weakness. She said that lower-rated firms with higher leverage and a greater share of floating-rate liabilities had come under greater stress than higher-rated peers due to the faster transmission to higher funding costs. She stated that these issuers were more vulnerable to the potential for sharper-than-expected declines in economic growth. She stated that the Council's 2023 annual report noted the rapid growth in private credit over the last several years and noted uncertainties regarding the extent to which private credit poses risks to financial stability, due in part to the opacity of the market.

Ms. Shultz said that these risks were among the reasons the Council recommended that member agencies continue to monitor levels of nonfinancial business leverage, trends in asset valuations, and implications of the potential for a sustained period of higher interest rates. She noted that the 2023 annual report also supported enhanced data collection to provide additional insight into the potential risks associated with the rapid increase in private credit.

Ms. Shultz then provided an update on market developments since the publication of the Council's previous annual report. She said that the macroeconomic environment had been increasingly supportive for credit issuers this year. She noted that while corporate bond yields had risen over the previous two years, spreads had narrowed, and the interest rate curve had inverted. She stated that supply had been strong this year as issuers had taken advantage of favorable market conditions to refinance and address near-term maturities. She said that the U.S. investment grade primary issuance market experienced its busiest first quarter on record. She noted that the outlook was less sanguine in leveraged loan markets, where below-investment-grade issuers were vulnerable to higher rates due to the floating-rate nature of their debt. She said that these issuers had seen a significant increase in their average coupon payments.

Mr. Pollinger stated that private credit had expanded the pool of lending available to leveraged companies. He said that it provided additional capital and flexibility to firms during the pandemic and the period when higher interest rates contributed to volatility in public markets. He noted, however, that high levels of private credit had not been tested through a full economic cycle and that growing retail participation is factor to monitor. He also said that regulators lack the visibility into this sector that would facilitate a full assessment of potential risks. He said that in addition to uncertainty about market exposures, there is a lack of visibility into underlying borrower fundamentals and loans made by private credit funds. He also noted concerns about the transparency and accuracy of valuation practices. He further stated that there is limited available data on exposures between private credit lenders and other financial companies that would illuminate interconnectedness risks.

Mr. Pollinger said that direct lending is the largest segment within the private credit sector. He said that over the past two years, direct lenders had refinanced a large amount of syndicated loans. He noted that private credit funds did not currently appear to pose fire-sale risks related to asset-liability mismatch, because these funds typically have a closed-end structure in which investors are limited in their ability to withdraw capital during the life of the fund. He also noted that the use of leverage in this segment is typically low.

Mr. Pollinger stated that business development companies (BDCs), a type of investment vehicle that invests primarily in small and developing companies, provide greater transparency through quarterly reporting. He said that BDC investors are primarily retail and high net worth individuals. He stated that perpetual non-traded BDCs offer limited redemption options (up to 5 percent) on a quarterly basis, which could create a first-mover advantage in a crisis. Discussing mitigants for liquidity risk, he said that perpetual BDCs tend to hold a portion of their assets in relatively more liquid securities and may impose redemption gates. He stated that leverage ratios at BDCs had been increasing but that most BDCs have leverage ratios below the maximum allowed, which enables them to maintain investment-grade ratings.

Mr. Pollinger stated that private credit borrowers on average have higher leverage ratios and lower interest coverage ratios than borrowers in public credit markets. He stated that global systemically important banks and other large banks are the primary providers of credit to private credit firms and BDCs. He said that insurance companies also provide leverage to private credit funds, to a lesser extent than banks, and that pension funds and other nonbank financial institutions had also increased their exposure to private credit.

Ms. Shultz stated in conclusion that current risks to financial stability associated with private credit appeared low, but that the sector was growing and opaque. She stressed the need for additional data, as discussed in the Council's 2023 annual report.

Following the presentation, the Chairperson stated that, given the opaque nature of the private credit market, she supported enhanced interagency coordination and information sharing to aid in assessing potential financial stability risks. She said that, consistent with the Council's recommendation in the 2023 annual report, she also supported interagency collaboration to better understand the available data on funds and borrowers in this market, as well as potential data gaps, to identify and mitigate risks.

Council members then had a discussion regarding the features of the corporate credit market and various risks addressed in the presentation.

3. Other Business

Council members then discussed the efforts of the Council's Systemic Risk Committee to monitor and report on each financial sector at least annually.

The Chairperson adjourned the executive session of the meeting at approximately 2:55 P.M.

Open Session

The Chairperson called the open session of the meeting of the Council to order at approximately 3:01 P.M.

The Chairperson outlined the agenda for the open session, which included (1) a presentation and vote on the Council's Report on Nonbank Mortgage Servicing and (2) a vote on the minutes of the Council's meeting on February 23, 2024.

1. Nonbank Mortgage Servicing Report

The Chairperson introduced the first agenda item, a presentation and vote on the Council's Report on Nonbank Mortgage Servicing. She stated that the Council had highlighted in its annual reports the risks associated with the growing share of mortgages serviced by nonbank mortgage companies. She noted that the Council had also promoted collaboration on this issue among member agencies through its Nonbank Mortgage Servicing Task Force. She said that the Council had leveraged its analytic framework for financial stability risks, issued the previous November, to undertake an analysis of risks on a sector-wide basis and make recommendations to address them. She said that nonbank mortgage companies play a critical function in the mortgage market, helping ensure accurate and timely payments to investors and appropriate loss-mitigation options for borrowers. She said that while no single nonbank mortgage servicer owned the servicing rights on more than 5 percent of outstanding mortgage balances, as of the end of 2023, nonbanks collectively originated and serviced the majority of U.S. residential mortgages. She noted that in 2022, nonbanks originated approximately two-thirds of mortgages and serviced the majority of mortgage balances. She said that this represented a substantial increase from 2008, when they originated 39 percent and serviced 4 percent. She said that the share of outstanding mortgages guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae had also increased. She said that together, these shifts meant that exposures to the nonbank mortgage sector had grown significantly.

The Chairperson stated that, as the Council's report outlined, some nonbank mortgage companies have certain strengths, including greater efficiency due to adoption of technology and their role as key mortgage originators and servicers for groups that have historically been underserved. She said, however, that nonbank mortgage companies also present unique risks. She noted that the report found that, due to their specialized business model, these companies are especially susceptible to macroeconomic fluctuations in the housing market, such as changes in housing prices, interest rates, and delinquency rates. She said that they are more reliant than depository institutions on the value of mortgage servicing rights, which she noted may lose value in the event of a downturn in the housing market. She stated that these companies are also vulnerable because they can have high leverage, short-term funding, and operational risks. She said that if a nonbank mortgage company fails, it may be difficult for it to find funding to continue critical servicing operations, such as making required servicing advances or providing adequate loss mitigation for distressed borrowers. She stated that suspending services can in turn harm borrowers and other stakeholders. She said that even transferring the portfolio of a distressed servicer can be a resource-intensive and time-consuming process, and she noted that disorderly servicing transfers can cause additional harm to borrowers. She said that if a new servicer cannot be found, the federal government may be left to assume the servicing obligations itself.

The Chairperson stated that each of these outcomes could disrupt economic activity and the provision of financial services. She stated that because the risk profiles of nonbank mortgage companies are similar, stresses in the mortgage market can affect multiple nonbank mortgage companies simultaneously, and can also spread throughout the sector. She said that a sufficiently large and widespread disruption in this sector could lead to a temporary restriction of mortgage credit. She stated that this would make credit more expensive and difficult to obtain, particularly for borrowers who have been historically underserved by the mortgage market. She said in summary that the vulnerabilities of nonbank mortgage companies can amplify shocks in the mortgage market and undermine financial stability. She noted that in issuing this report, the Council was describing these vulnerabilities in detail for the first time.

The Chairperson stated that, based on its analysis, the Council presented recommendations in the report to address the identified vulnerabilities. She said that, as noted in the report, current state-based requirements and limited federal authorities mean that risks have not been fully addressed. She stated that further action is needed to promote safe and sound operations, address liquidity risks, and promote continuity of servicing operations when a servicer cannot perform its critical functions. She said that the Council encouraged state regulators to strengthen prudential standards if they have not already done so, and to require resolution and recovery planning by large nonbank mortgage servicers to enhance sector resilience. She stated that the Council also made recommendations for Congressional action in the report. She said that Congress should consider legislation to authorize and protect the sharing of confidential information, which would facilitate coordination among Council member agencies, state regulators, and Ginnie Mae. She stated that Congress should also consider providing FHFA and Ginnie Mae with additional authorities to better manage nonbank mortgage company counterparty risk, and should undertake legislation that would enable Ginnie Mae to expand its Pass-Through Assistance Program into a more effective liquidity backstop. She said that to facilitate continuity of servicing, the Council encouraged Congress to establish a fund, financed by the nonbank mortgage servicing sector, that would provide liquidity to failing nonbank mortgage servicers to enable their critical servicing operations to continue until servicing obligations can be transferred in an orderly fashion. She said in conclusion that advancing these recommendations would be crucial to protecting borrowers and preventing disruptions to economic activity. She then introduced Sandra Lee, Deputy Assistant Secretary for the Council at Treasury.

Ms. Lee stated that staff from Council member agencies, including state and federal regulators, and Ginnie Mae had worked closely to develop the Report on Nonbank Mortgage Servicing. She noted that the report presented an analysis of the potential risks to the U.S. financial system arising from the vulnerabilities of nonbank mortgage servicers and the Council's recommendations to address those risks. She said that the report stated that stress in the nonbank mortgage sector could impair the functioning of the mortgage market, harm mortgage borrowers, and disrupt economic activity. She said that while the report explored the vulnerabilities of both nonbank mortgage origination and servicing activities, the report focused on the ability of nonbank mortgage companies to carry out critical mortgage servicing responsibilities in times of stress. She stated that mortgage servicers perform critical functions for the mortgage market. She said that borrowers, guarantors, insurers, and investors depend on servicers to carry out a wide array of loan administration duties in an accurate and timely way. She said that servicers also engage extensively with borrowers, such as working with delinquent borrowers to determine available loss-mitigation plans. She stated that nonbank mortgage companies had grown substantially in recent years and now originate and service the majority of U.S. mortgages. She said that the report recognized the strengths of some nonbank mortgage companies in their operational efficiencies, adoption of financial technology, and specialization. She said that the report also used the Council's analytic framework for financial stability risks to assess the risks posed by vulnerabilities in the nonbank mortgage sector and to evaluate how those risks could be transmitted through the U.S. financial system.

Ms. Lee stated that the vulnerabilities of nonbank mortgage companies, which were identified in accordance with the Council's analytic framework, primarily raise concerns about liquidity, leverage, operational risk, and interconnections. She said that nonbank mortgage companies face considerable liquidity risk due to their combination of reliance on shorter-term credit lines that are callable and mortgage servicing rights assets with volatile values. She stated that they can also face liquidity strains from requirements in servicing contracts. She said that these vulnerabilities are exacerbated by the high use of leverage by some nonbank mortgage companies and inherently high operational risks from the companies' business model. She noted that nonbank mortgage companies often have funders in common. She said that this feature, along with the structure of servicing and sub-servicing relationships, creates interconnections across the nonbank mortgage sector and between nonbank mortgage companies and banks. She said that the report explained that nonbank mortgage companies' vulnerabilities may cause stress to be transmitted to the mortgage market and the broader financial system through the channels described in the Council's analytic framework. She noted that nonbank mortgage companies carry out critical functions in the mortgage market. She said that if a servicer is unable to perform its required activities, borrowers may suffer from disruptions in the servicing of their mortgages, and credit guarantors and insurers may experience sizeable losses. She said that because nonbank mortgage companies had become increasingly important servicers, Fannie Mae, Freddie Mac, Ginnie Mae, investors, borrowers, and other market participants have significant exposures to nonbank mortgage servicers. She stated that commonalities in nonbank mortgage company vulnerabilities and their shared funding providers and sub-servicers could potentially lead to contagion. She said that if nonbank mortgage companies are forced to sell their mortgage servicing rights to preserve capital and liquidity, the sales could further depress mortgage servicing right valuations, leading to broader asset liquidations.

Ms. Lee said that state regulators and federal agencies had taken steps in recent years to mitigate the risks identified in the report, but that concerns remained. She said that to address the risks, the report included several recommendations to promote safe and sound operations, address liquidity pressure, and ensure servicing continuity. She said that to promote safe and sound operations, the report encouraged state regulators to adopt enhanced standards in those states that had not yet done so, further coordinate supervision of nonbank mortgage servicers, and require resolution and recovery planning standards for large nonbank servicers. She said that the report also encouraged Congress to provide additional authorities for FHFA and Ginnie Mae to establish appropriate safety and soundness standards and to directly examine nonbank mortgage company counterparties in order to enforce those standards. She noted that the report encouraged Congress to consider explicitly authorizing and protecting information sharing among Ginnie Mae, state regulators, and Council member agencies to facilitate coordination. She said that to address liquidity pressures, the report encouraged Congress to provide Ginnie Mae the authority to expand the Pass-Through Assistance Program into a more effective liquidity backstop for Ginnie Mae issuers. She said that the report also recommended that federal agencies further explore and evaluate how existing policy tools and authorities could be further leveraged to reduce liquidity pressures for nonbank mortgage servicers. She stated that to enable servicing continuity during a failure, the report recommended that Congress consider establishing a fund financed by the nonbank mortgage servicing sector and designed to facilitate operational continuity until servicing obligations can be transferred in an orderly fashion. She stated that the fund should be designed to avoid taxpayer-funded bailouts and the legislation should provide authority to an existing agency to implement, maintain, and mitigate risks associated with implementing such a fund. She said that the report recommendations were intended to promote financial stability by reducing the risk that vulnerabilities in the nonbank mortgage servicing sector could amplify the effect of a shock to the mortgage market more broadly.

The Chairperson then invited other Council members to offer remarks regarding the Report on Nonbank Mortgage Servicing.

Sandra Thompson, Director of the FHFA, stated that the importance of nonbank mortgage companies to the financial system had increased significantly in recent years. She said that these companies service 60 percent of the single-family loans backed by Fannie Mae and Freddie Mac, an increase from 35 percent a decade ago. She said that nonbank mortgage companies bring strengths to the mortgage market while also presenting vulnerabilities that regulators must address. She said that these companies as a whole had shown a commitment to serving borrowers who had traditionally been underserved. She said that nonbank servicers also provided significant assistance in loss mitigation to borrowers impacted by the COVID-19 pandemic. She said that the companies are nimble and their presence in the market increases competition in the industry and increases choices for consumers. She stated that, at the same time, nonbank mortgage companies are also subject to vulnerabilities that could have outsized impacts on the financial system. She said that liquidity risks arise from servicing advance obligations and margin calls associated with various funding sources. She said that nonbank mortgage companies typically lack diversification and are more sensitive to shocks in the mortgage market, and she noted that mortgage servicing rights are particularly susceptible to abrupt changes in valuations. She said that some nonbanks have high leverage ratios, and she said that operational risks include challenges in maintaining continuity of operations, threats from cyber events, and third-party risk management. She stated that FHFA, in its capacity as regulator and conservator of the government-sponsored enterprises, had monitored and assessed enterprise nonbank counterparty risk, taking actions to limit counterparty exposure and risk where appropriate. She said that in recent years, she had been encouraged by the partnership across the agencies that oversee various segments of the mortgage market. She said that FHFA and Ginnie Mae, for example, had worked together as each agency updated its minimum eligibility requirements related to net worth capital and liquidity of nonbank servicers. She noted that the CSBS had issued model state regulatory prudential standards addressing these issues. She stated that, in addition to ongoing information sharing with federal partners, the previous month FHFA and CSBS had signed a mortgage market information-sharing agreement that established information-sharing protocols between state regulators and FHFA. She said that the Council's report highlighted that, despite these steps, there is more work to be done. She noted that the report recommended enhanced coordination across agencies, adjustments to Ginnie Mae's emergency liquidity program, the establishment of an industry-funded liquidity facility, and an expansion of regulatory authorities at FHFA and Ginnie Mae to better manage the risks posed by nonbank counterparts to the government-sponsored enterprises and to Ginnie Mae. She said that she supported each of these report recommendations.

Director Thompson highlighted the report's recommendation that Congress consider providing FHFA and Ginnie Mae with examination and enforcement authority over nonbank mortgage servicers. She said that the Council had made similar recommendations in its annual report each year since 2015, on the basis that neither FHFA nor the NCUA has examination authority over third-party service providers to its regulated entities. She said that Congress should act on this recommendation. She stated that examination and enforcement authority over third-party service providers is a critical tool that would help FHFA ensure the safety and soundness of its regulated entities.

Jerome Powell, Chair of the Federal Reserve, stated that mortgage servicers perform important functions for the mortgage market. He said that nonbank mortgage servicers had expanded their market share significantly over the past 15 years. He stated that nonbank mortgage servicers also have some significant vulnerabilities. He said that if the mortgage market came under stress, these vulnerabilities might result in nonbank mortgage servicers being unable to carry out their important functions. He said that these vulnerabilities affect firms of all sizes, and at a time of stress, many mortgage servicers are likely to experience problems. He said that this concern did not arise from a small number of very large firms that individually pose a systemic threat. He said that the Council's report leveraged the Council's new analytic framework to describe these vulnerabilities and the possible transmission channels. He stated that the report also described the gaps in existing authorities that could prevent regulators from effectively responding to problems in the nonbank mortgage servicing sector. He said that regulators have a responsibility to mortgage borrowers and other stakeholders in the mortgage market to place this sector on a stronger footing. He stated that the recommendations in the report represented a strong and appropriate response to the threat that the vulnerabilities in this sector may pose to the orderly functioning of the mortgage market.

Gary Gensler, Chair of the SEC, expressed his support for the report. He stated that the $12 trillion mortgage-backed securities market is important to everyone who owns a home or wishes to do so. He said that this market is also interconnected and integrated with the larger financial system. He noted that problems in the mortgage markets had previously spread to the overall U.S. economy. He said that in the financial crisis in 2008, failures in the bank and nonbank sectors caused a collapse that started in the mortgage industry and ultimately destabilized the entire financial system, which resulted in millions of job losses and significant harm to businesses and families. He said that a shift had occurred in the markets since the financial crisis. He noted that the report described how nonbank mortgage companies had continued to expand their role in the market, increasing the share of residential real estate mortgages that they originate and service. He noted that the Council had first addressed the risk of nonbank mortgage servicing in its 2014 annual report. He said that while the Report on Nonbank Mortgage Servicing contributed to the public discussion, it would be important for the Council to remain vigilant in monitoring mortgage-backed securities markets, and the mortgage industry more broadly, including the nonbank mortgage servicing sector and associated risk from liquidity, leverage, and operating risk. He said that the report highlighted how these risks are exacerbated in the nonbank servicing market. He noted that several Council member agencies play an important role in monitoring this sector. He stated that the SEC oversees the mortgage-backed securities markets, and he said that if servicers fail, it would impact this market. He reiterated his support for the report and noted that he also supported the Council evaluating further efforts within agencies' current authorities to enhance the resiliency of this market.

Martin Gruenberg, Chairman of the FDIC, stated that the vulnerabilities described in the report present genuine financial stability risk. He said that nonbank mortgage servicers perform a vital function in the mortgage and housing markets. He noted, however, that mortgage servicing is subject to high liquidity risk, especially in the context of the volatile assets they are holding on their balance sheet. He said that the disorderly failure of one or more large mortgage servicers in times of stress in the mortgage markets could have broad financial stability consequences to both the housing and the financial markets. He stated that the Council would continue to monitor implementation of the report's recommendations and the relevant agencies would work on mitigating the risks identified using their respective authorities. He said that the Council should stand ready to take additional actions if necessary to mitigate such risks in accordance with its statutory authorities.

Rohit Chopra, Director of the CFPB, stated that the family home is the most important asset for most households, and that a safe and stable mortgage market that provides affordable credit and reliable servicing is critical for the U.S. economy. He said that nonbank mortgage companies play an important role in the mortgage market. He noted that these companies are not subject to the same financial requirements as banks, although he said that they pose similar and sometimes larger risks than banks. He stated that these companies are not diversified, do not keep as much available cash as banks, and borrow heavily from banks that can withdraw their funding with little notice. He said that if one or a number of large nonbank mortgage companies failed in a period of stress, this could result in immediate disruptions. He said that it could take a period of time to transfer their servicing activities to a new provider, even if a new provider was available. He said that borrowers could experience issues transmitting their payments. He stated that distressed borrowers may not be able to access or continue under loan modification plans, which he said could lead to a wave of avoidable foreclosures. He said that nonbank failures could reduce access to credit and create other problems for the economy.

Director Chopra acknowledged the progress made in this area by state and federal agencies, but stated that he also supported the report recommendation that Congress act to improve the resilience of individual firms and the sector more broadly. He said that the report noted that legislation should consider enhancing protections to help distressed borrowers keep their homes. He said that Council member agencies should consider how the Council's recently issued analytic framework and interpretive guidance on nonbank financial company determinations could be leveraged to address the vulnerabilities identified in the report. He said that the CFPB and other Council member agencies with mortgage expertise would provide information to the Council about specific companies that may merit further analysis. He said that the CFPB expected to undertake a rulemaking to analyze existing mortgage servicing rules, find ways to strengthen foreclosure protections for borrowers, and enable servicers to be more agile. He stated that the current regulatory framework left some borrowers vulnerable to foreclosure, credit reporting harms, and junk fees and other challenges, in addition to onerous paperwork requirements. He said that the proposed rule under consideration by the CFPB would shift the focus from a "check-the-box" compliance exercise to providing loss mitigation to distressed borrowers more quickly and efficiently. He stated that the harms that may arise from this sector are not theoretical, but can have real impacts on individuals and their communities.

Andrew Leventis, Chief Economist at the NCUA, stated that he supported the release of the Council's report. He said that the report highlighted the systemic risks associated with the growth of nonbank mortgage companies. He said that the report identified their financial vulnerabilities, particularly in the area of liquidity, and set forth actionable recommendations. He noted that the report recommended that Congress consider granting FHFA and Ginnie Mae additional authority to establish appropriate safety and soundness standards and to directly examine nonbank mortgage servicer counterparties for, and enforce compliance with, such standards. He noted that the Council had recommended in prior annual reports that the NCUA, FHFA, and other entities be granted adequate examination and enforcement authorities over third-party service providers, and he said that other entities, including the U.S. Government Accountability Office, had made similar recommendations. He said that at the October 2023 meeting of the NCUA's board, Chairman Harper had highlighted risks resulting from the NCUA's lack of vendor authority. He said that while Chairman Harper had made that comment in the context of cybersecurity issues, the vulnerabilities identified in the report were similarly important. He stated that examination and enforcement authorities over third-party service providers would help address this risk.

Adrienne Harris, Superintendent of the New York State Department of Financial Services, noted that states are the primary prudential regulators of nonbank mortgage companies, and she highlighted the importance of incorporating the perspectives of state regulators. She said that this market had grown and changed considerably since the financial crisis in 2008. She stated that, as noted in the report, states had been working to enhance supervision of these entities. She said that the report also acknowledged, however, that state regulators and federal agencies need to do more. She said that they can better coordinate supervision and strengthen regulatory tools, working together to maintain a safe and sound financial system. She said that since the financial crisis, state regulators had increased collaboration on the supervision of nonbank mortgage companies. She said that states had established model prudential standards, which she said improved supervision. She noted that states had also adopted new processes and tools to license and examine these institutions on a multistate basis. She said that, as noted in the report, more work is needed to facilitate robust real-time information sharing among state regulators and federal supervisors of the mortgage sector, and she expressed her support for efforts to strengthen coordination. She said that she supported the report recommendation that Congress remove legal impediments to information sharing between Ginnie Mae and state regulators. She stated that collaboration between state regulators and federal agencies would be key to improving protections for the housing market and homeowners, particularly during periods of economic volatility and stress.

Superintendent Harris highlighted certain other findings in the report. First, she noted that the report discussed the costs and complexities of current Ginnie Mae program requirements. She said that these requirements, including servicing advance obligations, contribute to liquidity risks and industry concentration. She stated that the report noted that the resiliency of the Ginnie Mae program could be strengthened by modernizing operational requirements for counterparties. She stated that such reforms could also increase the value of mortgage servicing rights and expand market participation. Next, she said that the report recommended that state regulators require the largest nonbank servicers to adopt recovery and resolution plans. She said that given the growth in this industry, such plans could be useful in promoting normal market functions in times of economic stress. She said that if such plans were adopted, regulators should develop requirements that recognize the unique characteristics of the nonbank mortgage market, including the contractual restrictions on counterparties that affect execution of such plans. She said that to be effective, such plans must be practical, actionable, tested, and kept up to date. She noted that the report also recommended the establishment of a liquidity fund for nonbank mortgage servicers that are in bankruptcy or distress. She expressed her support for additional efforts to mitigate servicing disruptions, and said that creating new liquidity programs raises complex operational and policy questions that warrant further evaluation. She said that a feasibility study to explore these issues would help policymakers make informed, data-driven evaluations of proposals, including consideration of unintended consequences. She stated that continued close collaboration and innovation by state regulators and federal agencies would strengthen the nonbank mortgage market. She said in conclusion that the report provided a helpful overview of the current state of this market along with a set of thoughtful recommendations.

The Chairperson then introduced Sam Valverde, Acting President of Ginnie Mae, to provide comments.

Mr. Valverde stated that since the 2008 financial crisis, a significant shift had occurred in the mortgage market away from traditional depository banks to nonbanks, or independent mortgage banks. He stated that this shift had been particularly pronounced in government mortgage lending programs and in Ginnie Mae’s mortgage-backed securities program. He said that while the growth of independent mortgage banks in the mortgage market introduced unique challenges, it had also expanded the reach of these programs. He stated that independent mortgage banks had met the needs of borrowers, adopting new technologies and practices to better serve them, and had helped millions of Americans achieve home ownership. He stated that Ginnie Mae had also experienced growth during this period. He said that Ginnie Mae issuers had helped advance its mission to expand access to affordable credit and housing to historically underserved communities, including low- to moderate-income borrowers, seniors, veterans, and rural and Tribal communities. He stated that these federal programs were originally designed with depository institutions in mind. He stated that independent mortgage banks lack the diverse funding sources that are available to regulated banks. He said that independent mortgage banks’ unique focus on housing finance had provided consumer benefits, but had also contributed to a unique liquidity challenge in the housing market. He said that this typically occurs when liquidity is most needed: to support loss mitigation and orderly servicing transfers during a downturn. He said that Ginnie Mae had expressed this concern for over a decade. He said that Ginnie Mae had invested resources in developing a suite of risk-management and oversight tools to manage these risks. He stated that Ginnie Mae needed new authorities to address these issues in a more holistic manner. He noted the value of having a public conversation regarding these risks and challenges. He said that the report made a number of recommendations for how state and federal agencies could strengthen the housing finance system and address these challenges. He expressed confidence that regulatory collaboration could help support sustainable access to credit while protecting the financial system and consumers from harm.

The Chairperson then presented to the Council the following resolution approving the Council's Report on Nonbank Mortgage Servicing:

WHEREAS, the duties of the Financial Stability Oversight Council (Council) under section 112 of the Dodd-Frank Wall Street Reform and Consumer Protection Act include monitoring the financial services marketplace in order to identify potential threats to U.S. financial stability; identifying gaps in regulation that could pose risks to U.S. financial stability; and making recommendations in such areas that will enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets; and

WHEREAS, on November 3, 2023, the Council approved its Analytic Framework for Financial Stability Risk Identification, Assessment, and Response (Analytic Framework), which describes the approach the Council expects to take in identifying, assessing, and responding to certain potential risks to U.S. financial stability;

WHEREAS, in accordance with the Analytic Framework, the members of the Council have consulted extensively and have drawn on the expertise of the staffs of their agencies to formulate the Council's assessment of financial stability risks and regulatory gaps posed by the nonbank mortgage servicing sector and recommendations to address such risks; and

WHEREAS, the staffs of Council members and their agencies have prepared the draft "Report on Nonbank Mortgage Servicing" attached hereto (the Nonbank Mortgage Servicing Report).

NOW, THEREFORE, BE IT RESOLVED, that the Council hereby approves the Nonbank Mortgage Servicing Report and authorizes the Chairperson, or her designee, to cause the Nonbank Mortgage Servicing Report to be published on the Council's website, in a form and manner acceptable to the Chairperson, or her designee, and to otherwise make it available to the public as the Chairperson, or her designee, deems appropriate; and

BE IT FURTHER RESOLVED, that the Council hereby delegates authority to the Chairperson, or her designee, to make technical, nonsubstantive, or conforming changes to the text of the Nonbank Mortgage Servicing Report, and to take such other actions and issue such other documents incidental and related to the foregoing as the Chairperson, or her designee, deems necessary or appropriate to fulfill the Council's objectives in connection with its publication.

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

2. Resolution Approving the Minutes of the Meeting Held on February 23, 2024

BE IT RESOLVED, by the Financial Stability Oversight Council (Council), that the minutes attached hereto of the meeting held on February 23, 2024 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 3:40 P.M.