The Financial Stability Oversight Council approved the attached resolution by notational vote on January 6, 2025, with ten members voting in favor of the resolution and none opposed.

RESOLUTION APPROVING MINUTES
OF THE DECEMBER 6, 2024 MEETING

BE IT RESOLVED, by the Financial Stability Oversight Council (Council), that the minutes attached hereto of the meeting held on December 6, 2024 of the Council are hereby approved.

Minutes of the Financial Stability Oversight Council

December 6, 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)
Michael J. Hsu, Acting Comptroller of the Currency, Office of the Comptroller of the Currency (OCC)
Todd M. Harper, Chairman, National Credit Union Administration (NCUA)
Thomas E. Workman, Independent Member with Insurance Expertise
James Martin, Acting Director, Office of Financial Research (OFR), Department of the Treasury (non-voting member)
Steven Seitz, Director, Federal Insurance Office (FIO), Department of the Treasury (non-voting member) (via videoconference)
Adrienne Harris, Superintendent, New York State Department of Financial Services (NYDFS) (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, Acting 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
Michael Barr, Vice Chair for Supervision
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
Corey Frayer, Senior Advisor

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
Jay Gallagher, Senior Deputy Comptroller for Supervision Risk and Analysis

National Credit Union Administration
Catherine Galicia, Chief of Staff

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

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

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
Todd Sells, Director, Financial Regulatory Policy and Data, National Association of Insurance Commissioners (NAIC) (via videoconference)

Maryland Office of the Attorney General, Securities Division
Vincente Martinez, General Counsel, North American Securities Administrators Association (NASAA)

PRESENTERS:

Hedge Funds

- *Alexandra Somers, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury*

- *Ethan Schwartz, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury*
- *Spencer Petitti, Program Manager, Counterparty Credit Risk Supervision, Federal Reserve Bank of New York*
- *Andrew McKenna, Head of Market and Counterparty Credit Risk Supervision, Federal Reserve Bank of New York (available for questions) (via videoconference)*
- *Ted Berg, Senior Financial Analyst, OFR (available for questions)*
- *Adam Minson, Lead, Financial Sector Risk, Federal Reserve Bank of New York (available for questions) (via videoconference)*

Life Insurance Sector

- *Silab Mohanty, Deputy Director of Policy, Office of the Financial Stability Oversight Council, Treasury*
- *Celso Brunetti, Assistant Director, Division of Research and Statistics, Federal Reserve*
- *Alex Hart, Senior Insurance Regulatory Policy Analyst, FIO, Treasury*
- *Eric Kolchinsky, Director, Structured Securities & Capital Markets, NAIC*
- *Dan Daveline, Director, Financial Regulatory Services, NAIC (available for questions)*

Nonbank Mortgage Servicing

- *Sandra Lee, Deputy Assistant Secretary for the Council, Treasury*
- *Karen Pence, Deputy Associate Director, Division of Research and Statistics, Federal Reserve*
- *Anna Mwangi, Senior Financial Analyst, FHFA*
- *Kevin Byers, Senior Director, Consumer Protection & Non-Depository Supervision, CSBS*
- *Gregory Keith, Senior Vice President and Chief Risk Officer, Ginnie Mae*
- *Kaitlin Hildner, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury (available for questions)*

2024 Annual Report

- *Sandra Lee, Deputy Assistant Secretary for the Council, Treasury*
- *Stefan Jacewitz, Assistant Vice President, Federal Reserve Bank of Kansas City*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 9:58 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) hedge funds, (2) the life insurance sector, and (3) nonbank mortgage servicing.

1. Hedge Funds

The Chairperson introduced the first agenda item, an update on hedge funds. She introduced Alexandra Somers, Senior Policy Advisor in the Office of the Financial Stability Oversight

Council at Treasury; Ethan Schwartz, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury; and Spencer Petitti, Program Manager of Counterparty Credit Risk Supervision at the Federal Reserve Bank of New York, for the presentation.

Ms. Somers stated that the Council's Hedge Fund Working Group had provided an update at the December 2023 Council meeting in which the working group noted that financial stability risks emanating from the hedge fund sector had increased. She said that the working group had highlighted in that update an increase in hedge fund exposures and borrowing levels more broadly, and the reemergence of the basis trade specifically, as indicators of increased risks. She said that since that presentation, there had been an increase in the use of cash and derivatives borrowing, a decline in unencumbered cash ratios, and increased leverage. She also highlighted increased concentration among the largest hedge funds. She noted that over the past year there had been continued growth of the cash-futures basis trade, and growth and increased leverage of multi-strategy funds.

Ms. Somers then provided summary information on the growth of the hedge fund sector. She said that the hedge fund industry had continued to grow rapidly, with reported gross assets under management for qualifying hedge funds totaling $9.6 trillion as of the second quarter of 2024, a $1.2 trillion increase from the prior year. She said that gross notional exposures were over $30 trillion, a $6 trillion increase from the second quarter of 2023.

Ms. Somers stated that a key consideration when assessing financial stability risks from hedge funds is determining how much of their growth is organic based on performance and how much is supported by increased borrowing and additional leverage. She said that the recent growth in hedge fund assets had largely been supported by increased borrowing and additional leverage. She stated that repurchase agreement (repo) borrowing levels had surged over the past several quarters, with aggregate repo borrowing reaching a record $2.2 trillion in the second quarter of 2024. She said that prime brokerage borrowing had also seen steady growth, but she said that this growth is consistent with the rising U.S. equity markets. She said that ultimately, this growth in borrowing had led to a material increase in relative value, macro, and multi-strategy leverage metrics. She noted that multi-strategy and macro funds' leverage metrics continued to hit new record highs.

Ms. Somers then provided additional information on borrowing and liquidity trends among the 10 largest hedge funds. She said that these 10 funds, which had reached a combined $1.3 trillion in repo borrowing, tend to receive more favorable financing terms and most are known to be active in the basis trade. She stated that concentration risks had increased further, as the growth of repo borrowing among these 10 funds had outpaced that of other hedge funds. She said that, at the same time, these funds had seen their unencumbered cash levels as a percentage of gross assets decline to historically low levels, as unencumbered cash levels remained stable and gross assets had increased.

Ms. Somers addressed the continued growth of the basis trade, which she said had likely been a main factor driving the rapid growth of repo borrowing. She said that the continued growth of the basis trade had increased the amount of leverage in the Treasury market and represented a financial stability vulnerability. She said that the Treasury cash-futures basis trade arbitrages mispricing when futures trade at a premium to cash Treasuries. She said that the dynamics of this trade are particularly pronounced given asset managers' current preference for futures combined with the increased supply of Treasuries held by the private sector. She stated that under normal market conditions, funds engaged in basis trading increase Treasury market efficiency by translating other asset managers' demand for Treasury futures contracts into demand for Treasury securities, reducing market segmentation and improving market liquidity. She said that the reemergence of the basis trade also increases fragilities in the Treasury market, as the amount of leverage in this trading strategy leaves funds vulnerable to adverse funding shocks (as in September 2019) or a breakdown in historical correlations (as in March 2020). She stated that indicators show that the basis trade was considerably larger than its pre-pandemic peak. She said that hedge funds were expected to remain important intermediaries in the Treasury market, as record high issuance was expected to continue for the foreseeable future.

Ms. Somers also addressed the significant growth over the past several years in multi-strategy funds, which have nearly $3 trillion in gross assets. She said that multi-strategy funds can be structured in a variety of ways, but in general, these funds operate globally, run multiple trading strategies, and invest in a range of asset classes and financial instruments. She stated that under the "pod shop" model, individual portfolio managers run autonomous trading strategies (pods) and compete for centrally allocated capital with tight risk limits. She said that multi-strategy hedge fund leverage metrics had been steadily rising, as the growth of these funds had largely been supported by increased borrowing.

Ms. Somers stated that a breakdown in historical cross-asset correlations could lead to multiple pods simultaneously reaching their internal risk limits, a sharp increase in multi-strategy funds' overall volatility, and a broader deleveraging across multi-strategy funds. She said that deleveraging could exacerbate volatility and further increase correlations, potentially leading to further deleveraging, which she said could impair market functioning. She said that the impact of any deleveraging could be compounded if it occurs in crowded trades.

Mr. Petitti stated that Federal Reserve supervisory staff conducted a review in 2024 of the largest U.S. banks' (G-SIBs) counterparty credit risk management (CCRM) practices for fixed-income financing (FIF) activities, including repo and reverse repo. He noted that FIF includes the provision of financing to hedge funds. He said that this work represented a continuation of important supervisory work on counterparty credit risk undertaken in recent years, and that supervisory staff had identified improvements in U.S. G-SIBs' CCRM practices following prior work. He noted, however, that supervisory staff had identified a range of practices in risk management and risk measurement of FIF activities. He said that Federal Reserve supervisory staff had recently provided feedback to several banks related to repo haircut risk management practices and risk measurement for these activities. He stated that while supervisory feedback would improve risk management practices at banks, there are likely to be limitations in addressing the full extent of financial stability risks through supervisory action alone.

Mr. Petitti described several outcomes from the Federal Reserve's work. First, he noted that U.S. G-SIBs provide a material amount of low or zero haircut reverse repo and repo financing to both hedge fund and non-hedge fund counterparties, and that they also provide a significant amount of gross financing to the largest fixed-income relative value funds. Second, he said that banks typically mitigate this risk by keeping trades short-dated, taking risk-offsetting trades, and managing counterparty credit risk exposure through limits. Third, he discussed weaknesses in banks' haircut risk management standards and challenges banks face in stress testing material FIF exposures.

Fourth, Mr. Petitti discussed how remaining counterparty risk exposure to clients sponsored into the Fixed Income Clearing Corporation (FICC)-sponsored repo program causes sponsors to undertake risk management as if it were an uncleared bilateral repo exposure. He said that it was currently unclear if the practice of not passing through FICC margin requirements to sponsored clients would change following the implementation of central clearing. Fifth, he said that cross-margining and cross-netting between futures and repo activities was limited. He stated that cross-netting is constructed to allow banks to offset gains with a counterparty in one netting set against losses with that same counterparty in another netting set, across legal entities. He said that some banks had restructured contractual agreements with their counterparties in recent years to facilitate cross-netting, but he noted the potential for legal uncertainty in bankruptcy situations. He said that cross-netting was a relatively recent development in the FIF space but has the potential to become more prevalent due to market pressures.

Mr. Schwartz described the Council's annual report recommendations to address risks related to hedge funds, along with additional approaches that could be considered. He said that the annual report notes that the Council supports initiatives by the SEC and other agencies to establish greater transparency in hedge funds, including data-collection improvements for Form PF, and supports the ongoing work of the relevant banking supervisors to improve banks' counterparty credit risk management practices with respect to hedge funds. He said that the annual report recommended that the Council, banking regulators, and market regulators should continue reviewing the findings of the Council's Hedge Fund Working Group and consider whether additional steps should be taken to address identified vulnerabilities. He stated that, in addition to recommendations presented in the annual report, member agency staff had also considered what agency authorities could be used to address risks associated with excessive hedge fund leverage. He noted authorities that the Council and other agencies may have, and said that a number of policy and other considerations would need to be addressed to determine whether the use of any such authorities may be appropriate.

Following the presentation, the Chairperson stated that the Hedge Fund Working Group had consistently produced high-quality analysis since it was reestablished four years ago. She noted that the presentation highlighted the growth in leverage across the sector, and particularly at the largest funds. She said that recent and ongoing reform efforts, such as supervisors' counterparty credit risk management efforts, were intended to address these risks. She noted that significant progress had also been made to enhance the resilience of the Treasury market more broadly. She stated that the Council should continue to monitor these developments and consider whether additional steps should be taken to address identified vulnerabilities.

Council members then asked questions and had a discussion, including regarding the OFR's recent launch of its data collection on non-centrally cleared bilateral repo; the basis trade and other factors contributing to the growth of aggregate hedge fund assets under management; exposures of banks to hedge funds; and potential policy responses to the identified risks.

2. Life Insurance Sector

The Chairperson then turned to the second agenda item, an update on the life insurance sector. She introduced Silab Mohanty, Deputy Director of Policy in the Office of the Financial Stability Oversight Council at Treasury; Celso Brunetti, Assistant Director in the Division of Research and Statistics at the Federal Reserve; Alex Hart, Senior Insurance Regulatory Policy Analyst in FIO; and Eric Kolchinsky, Director of Structured Securities & Capital Markets at the NAIC, for the presentation.

Mr. Mohanty stated that the presentation would highlight developments in the life insurance sector that had been discussed in the Council's annual reports. He said that some of these changes had continued since the 2008 financial crisis and impacted vulnerabilities that have implications for financial stability. He said that presenters would also discuss regulatory initiatives and recommendations in the Council's 2024 annual report to address some of these issues. He stated that structural changes observed in various aspects of the life insurance business model had accelerated during the era of low interest rates in the aftermath of the 2008 financial crisis and had been influenced by the focus on capital optimization, as well as regulatory and tax considerations. He said that the involvement of external institutional capital in the sector had been an important catalyst. He then highlighted certain major changes in the sector. First, with respect to product mix, he noted that the low-interest rate environment had made it challenging to sustain legacy insurance products that provided high returns, such as variable annuities with guaranteed minimum benefits, that created stress during the financial crisis. He stated that life insurers had since shifted to products that are less capital intensive and had adjusted product features to transfer more market risk and longevity risk to policyholders.

Turning to the sector's investment portfolio, Mr. Mohanty stated that holdings of nontraditional assets, such as private credit, structured securities, and alternative investments, had been growing steadily. He said that this drive towards greater investment yields commensurate with more risk had continued even as higher interest rates may have mitigated pressures on profit margins. He said that the involvement of private equity firms and asset managers in the sector, which he noted started around 2009 in the form of strategic alliances or acquisition of blocks of policies, had since evolved to majority ownership of life insurance companies. He said that life insurers had benefited from this trend by freeing up capital and accessing specialized asset management capabilities, while private equity firms had benefited from access to low-cost stable funding. He noted, however, that these changes to the sector's business models may have raised risks. He said that the sector had seen an increased use of reinsurance to transfer risks of both ongoing and legacy business for annuities. He stated that more reinsurance had moved to offshore jurisdictions like Bermuda, which he noted have different regulatory requirements, tax policies, and accounting conventions than the United States. He said that reinsurance arrangements had become more complex with the shift in focus from mortality exposures towards asset performance for annuities. He said that life insurers had been increasingly accessing nontraditional funding sources. He said that these include borrowings from the Federal Home Loan Bank system and accessing the capital markets for institutional spread-based products. He also noted that the life insurance sector does not have a lender of last resort.

Mr. Mohanty stated that the developments just summarized had impacted several vulnerabilities outlined in the Council's analytic framework for financial stability risks. He said that interconnections with the broader financial system had increased through the sector's involvement with private equity, asset managers, institutional investors, offshore reinsurers, and the Federal Home Loan Bank system. He said that complexity and opacity had increased through greater involvement with private and structured investments, offshore contracts, and complex organizational structures. He said that liquidity risks and leverage had increased with changes to the investment portfolio composition and greater reliance on nontraditional liabilities.

Mr. Mohanty then summarized the recommendations in the Council's 2024 annual report to address some of the identified vulnerabilities. He said that the annual report recommended that Council member agencies further evaluate the impact of the identified structural changes in the life insurance sector on financial stability. He stated that the annual report also recommended that insurance regulators strengthen the supervisory framework, consider incentives to reduce regulatory arbitrage, and enhance disclosures on private investments and offshore reinsurance.

Mr. Kolchinsky then stated that while annuities sold by life insurers contributed to stress during the 2008 financial crisis, the shift in product mix towards fixed and indexed annuities may have reduced run risk. He summarized some of the differences between annuities and bank deposits, and certain contractual and tax aspects of annuities that may mitigate certain risks. He stated that higher allocation to alternative assets had increased complexity around credit assessment and valuation. He said that the extensive period of near-zero interest rates had driven the search for alternative sources of investment yield. He stated that the preference for alternative assets had led to growth in structured finance investments. He noted that mortgage loans are not considered alternative assets for insurers due to their asset-liability match with insurer liabilities. He said that more recently, life insurers had focused on private credit as a preferred asset. He said that "private credit" is amorphous and that market participants and regulators had not yet agreed on a common definition. He said that private credit ranges from direct lending to privately placed structured finance. He said that the fact that ratings are typically private, and performance data is not broadly available, reduces transparency. He stated that regulatory concerns regarding private credit center on the lack of transparency and market crowding.

Mr. Kolchinsky stated that increased investments in structured securities had increased complexity and opacity. He said that structured finance had been a growing asset for insurers, and he described certain actions by the NAIC to respond to these risks. He said that private equity ownership growth had impacted investment portfolio compositions. He said that the asset mix for insurers owned by private equity firms was more focused on structured finance than the asset mix for other insurers. He said that regulators had focused more on insurers' investment activities and products that may cause concern than on their ownership structure.

Mr. Hart stated that reinsurance is not a new market development and that it serves an important risk-management function. He noted, however, that over the past few years it had been used in ways that may be increasing counterparty and enterprise risk. He said that at its simplest, reinsurance is third-party insurance for a primary insurer, transferring risk from the primary insurer, or cedent, to the reinsurer. He discussed how reinsurance helps cedents manage risk and capital and protects them from large losses. He also discussed the activities of insurers and reinsurers owned by private equity firms or alternative asset managers. He said that U.S. life insurers were increasingly looking to offshore jurisdictions for reinsurance capacity. He said that over the past several years, new entrant U.S. firms had been more likely to use offshore reinsurance. He stated that this movement of U.S. life insurance reserves was driven in large part by the potentially less stringent regulatory standards in some offshore jurisdictions, which he said may lead to increased capital efficiency. He said that this increased efficiency may also increase risk to the sector. As an example, he said that this movement of U.S. life reserves increases interconnectedness and may raise concerns about tax and regulatory considerations.

Mr. Hart stated that Bermuda had become the most popular offshore reinsurance domicile. He said that Bermuda was also the main domicile for reinsurers established by new entrant firms. He said that Bermuda offers an attractive economic-based capital regime for insurers as well as unique opportunities to raise capital, given that Bermuda's tax regime and established financial infrastructure attracts many institutional investors. He said that this potential concentration highlights concerns about counterparty risk.

Mr. Brunetti then stated that many of the structural changes discussed in the presentation involve life insurers that combine three types of entities: a U.S.-domiciled life insurer, a captive reinsurer in Bermuda, and an asset manager or private equity firm. He said that tax and regulatory arbitrage opportunities are among the motivations of this triangular structure. He said that these structures have increased complexity and opacity, raising concerns in the event of solvency issues. He stated that insurance companies had increased their use of nontraditional liabilities, which include funding agreement-backed securities (FABS), Federal Home Loan Bank system advances, securities lending, and repo transactions. He said that some nontraditional liabilities are not treated as "debt" in statutory accounting and are excluded from certain measures of financial leverage. He said that the vulnerability for nontraditional liabilities is rollover risk, in which institutional investors may withdraw funds. He said that this risk can generate spillovers to short-term funding markets, as well as to the broader financial system, and may lead to policyholder withdrawals. He stated that growth in nontraditional liabilities may also reflect increased concentration, highlighting significant increases in FABS and Federal Home Loan Bank system advances. He said that on the asset side, life insurers were increasing their exposure to risky corporate debt such as bank-originated and private corporate loans, collateralized loan obligations, private placements, and high-yield corporate bonds. He then discussed research on interest rate risk management practices by life insurers, noting that life insurers' stock prices are uncorrelated with 10-year Treasury yields, indicating that life insurers' interest rate risk management is generally effective.

Mr. Kolchinsky described certain regulatory initiatives by state insurance regulators and the NAIC, including increased disclosures, modifications of risk-based capital requirements, additional risk-management requirements related to investments, and a current proposal related to cash-flow testing of material reinsurance agreements.

Following the presentation, the Chairperson stated that the presentation highlighted key vulnerabilities in the life insurance sector that warrant additional focus from a financial stability perspective, particularly growing interconnectedness, complexity, and opacity due to the expanding role of private equity and offshore reinsurance. She noted that the changes in the investment portfolio of the sector, along with its reliance on nontraditional liabilities, can also increase liquidity risk. She encouraged regulators to remain focused not only on the microprudential and consumer risks in this sector, but also on the financial stability risks that the presentation highlighted.

Council members then asked questions and had a discussion, including regarding the risks and mitigants to withdrawals of traditional and nontraditional insurance liabilities; the use of private debt ratings; reinsurance practices; private equity ownership of insurers; and efforts by state insurance regulators to mitigate risks related to the sector.

3. Nonbank Mortgage Servicing

The Chairperson introduced the next agenda item, an update on nonbank mortgaging servicing. She introduced Sandra Lee, Deputy Assistant Secretary for the Council at Treasury; Karen Pence, Deputy Associate Director in the Division of Research and Statistics at the Federal Reserve; Anna Mwangi, Senior Financial Analyst at FHFA; Kevin Byers, Senior Director for Consumer Protection & Non-Depository Supervision at CSBS; and Gregory Keith, Senior Vice President and Chief Risk Officer at Ginnie Mae, for the presentation.

Ms. Lee noted that the Council voted to approve its Report on Nonbank Mortgage Servicing in May 2024. She noted that the report identified vulnerabilities associated with nonbank mortgage servicing, described how these vulnerabilities could undermine financial stability, and included recommendations to address the identified vulnerabilities. She stated that since the publication of the report, staff had continued to meet to review the risks in the sector and that Ginnie Mae recently hosted a summit with industry participants on liquidity. She said that many participants from both industry and the official sector had echoed the findings in the report. She said that the presentation would provide an update on how risks had developed since the Council issued the report, including an update on efforts by federal agencies and states to act on the recommendations in the report.

Ms. Pence stated that nonbank mortgage servicers have liquidity and leverage vulnerabilities, as well as high exposure to mortgage-market shocks, which she said could impair their ability to carry out critical functions. She noted that the nonbank share of agency servicing had continued to rise. She said that nonbank mortgage servicers' profitability had improved but remained strained. She noted that servicing had remained profitable because delinquency rates were low, and most firms had stopped losing money on mortgage originations. She stated that revaluations of mortgage servicing rights weighed on firms' earnings in the third quarter. She also stated that liquidity and leverage had improved. She said that cash levels had remained steady, with rundowns primarily occurring at firms with large cash reserves. She noted that Ginnie Mae issuers with less risk-weighted capital had strengthened their balance sheets. She said that industry strains had led to some consolidation among agency servicers. She stated that the largest nonbank agency servicers had purchased portfolios from weaker nonbank servicers. She said that nonbanks were the four largest holders of servicing rights on agency mortgages, although two banking organizations were the largest servicers overall when portfolio loans are included. She described potential sources of strain, including that delinquency rates on mortgages insured by the Federal Housing Administration were rising, although she said they remained at moderate levels by historical standards. She said that the typical hedge for increased delinquency costs, refinancing revenue, was less effective in the current environment. She stated that mortgage interest rates were considerably above the average rates on outstanding mortgages, limiting the potential for a large refinancing surge.

Ms. Lee stated that the Council's Report on Nonbank Mortgage Servicing included recommendations to state and federal agencies and to Congress to promote safe and sound operations, address liquidity pressures in the event of stress, and ensure continuity of servicing operations. She said that staff from FHFA, CSBS, and Ginnie Mae would highlight recent actions taken that respond to a number of the report's recommendations.

Ms. Mwangi described the FHFA's recent actions to promote safe and sound operations in response to the Council's Report on Nonbank Mortgage Servicing. Describing capital and liquidity plans, she said that the FHFA's Servicer Eligibility 2.0 requirements include a requirement for large nonbanks (those with $50 billion or more in total servicing) to submit, for the first time, annual capital and liquidity plans to the government-sponsored enterprises. She said that the first plans were submitted to the enterprises earlier in 2024. She stated that the enterprises had reviewed the plans and were preparing feedback on how the nonbanks can improve the next submissions. She said that the FHFA was also developing a standard set of preliminary metrics and information to assist staff participating in the Council's Nonbank Mortgage Servicing Task Force to monitor exposures and emerging trends in the sector. She said that the FHFA had completed one onsite review of a residential nonbank seller/servicer in 2024, and she described the FHFA's further efforts and its risk evaluation of multifamily nonbank seller/servicers. She discussed FHFA efforts related to ensuring the continuity of servicing operations in the event of a servicer failure.

Mr. Byers described actions that the states were undertaking. He noted that states continued to move toward adoption of the CSBS "Final Model State Regulatory Prudential Standards for Nonbank Mortgage Servicers," which he said was responsive to a recommendation in the Council's Report on Nonbank Mortgage Servicing. He also noted that states had increased their exam coordination and sharing of supervisory information regarding nonbank mortgage servicers. He described pending work by the CSBS on recovery and resolution.

Mr. Keith described actions being taken by Ginnie Mae. He said that new risk-based capital ratio program requirements would take effect December 31, 2024. He noted that issuers may be provided risk-based capital ratio relief when issuers demonstrate a strong mortgage servicing rights hedging efficacy. He said that, to address liquidity pressures in the reverse mortgage market, Ginnie Mae was actively working to develop a new security type. Regarding continuity of servicing operations, he stated that Ginnie Mae was also implementing mandatory recovery planning requirements for the largest issuers in Ginnie Mae programs, to increase transparency and to facilitate asset transfer if needed in the event of a servicer failure. He noted that Ginnie Mae was also working on addressing cyber risks at servicers.

Ms. Lee called attention to the steps that state and federal agencies had taken to make the sector more resilient. She said that, as noted in the Report on Nonbank Mortgage Servicing, existing authorities are insufficient to adequately and holistically address the identified risks. She said that the report recommended that Congress take legislative action to address structural vulnerabilities. She noted that Congress had not acted on the recommendations outlined in the report. She concluded by noting that this sector had been an area of focus for the Council.

Following the presentation, the Chairperson stated that the Council's Report on Nonbank Mortgage Servicing identified a number of vulnerabilities that could compromise nonbank mortgage companies' ability to carry out their servicing functions and included recommendations to enhance the sector's resilience. She said that Ginnie Mae's upcoming risk-based capital ratio requirement was an important step to help promote safe and sound operations, and she expressed her support for state and federal regulators' focus on recovery and resolution. She stated that it would be important that agencies continue collaborating to closely monitor the sector and to act on the report's recommendations.

Council members then discussed systemic risks in the nonbank mortgage servicing sector, risks from third-party service providers, resolution and recovery challenges, market consolidation, and existing oversight.

The Chairperson adjourned the executive session of the meeting at approximately 11:40 A.M.

Open Session

The Chairperson called the open session of the meeting of the Council to order at approximately 11:47 A.M.

The Chairperson outlined the agenda for the open session, which included (1) a presentation and vote on the Council's 2024 annual report and (2) a vote on the minutes of the Council's meeting on October 18, 2024.

1. 2024 Annual Report

The Chairperson introduced the first agenda item, a presentation and vote on the Council's 2024 annual report. She said that during 2024, the U.S. economy had been marked by a combination of developments that few thought possible. She noted that inflation had declined significantly, the unemployment rate was near historic lows, and economic growth was robust. She said that this was the result of a number of actions taken over the past four years, including the Administration's focus on strengthening the resilience of the U.S. financial system. She stated that a resilient financial system is critical to a strong economy, and she said that, as discussed in the Council's 2024 annual report, the Council had played an important role in increasing the resilience of the U.S. financial system. She said that she would address ongoing progress in three key areas, beginning with the banking sector.

The Chairperson stated that in March of 2023, Council member agencies acted quickly and decisively to prevent contagion from regional banking stress that could have destabilized the U.S. financial system and undermined a historic economic recovery. She said that since then, the Council had provided direction and helped lead coordination among regulators to address core weaknesses the banking stress had revealed. She said that as the annual report indicated, further work is needed to ensure that banks are prepared for liquidity stress, by making sure that they have diverse sources of contingency funding and the capacity to borrow from the Federal Reserve discount window. The Chairperson stated that the Council also remained focused on credit risk in commercial real estate. She said that this risk had become more evident in 2024, and she said that regulators should continue to focus on the ability of the financial industry to address this risk.

She said that the Council had also been addressing emerging risks from significant technological changes. She said that digital assets and artificial intelligence (AI) bring potential benefits such as efficiencies, but also financial risks, cyber risks, and risks from third-party service providers. She stated that the Council continued to call for legislation to create a comprehensive federal prudential framework for stablecoin issuers and for legislation on crypto assets that addresses the risks the Council identified. She said that the Council recommended building further interagency expertise to analyze and monitor potential systemic risks associated with the use of AI in the financial services sector while facilitating innovation. She said that Treasury's report on AI-specific cybersecurity risks, intended to equip financial institutions with information on best practices, was one example of recent progress. She stated that efforts like Treasury's Project Fortress, which brings together more than 1,000 financial institutions to combat cybersecurity risks, are also important.

She noted that that the Council had played an important coordinating role in strengthening the resilience of the U.S. Treasury market, which she said continued to be a top priority. She said that the Council had made progress on increasing the availability and quality of data on Treasury market and repo activity in an effort to improve transparency, and in evaluating the use of leverage that could increase risk to Treasury market liquidity. She noted that Treasury also launched a new buyback program to bolster liquidity. She stated that this work should continue alongside ongoing efforts to implement expanded central clearing of Treasury securities and to improve risk management.

The Chairperson stated that the strengthening of the Council had facilitated progress in these areas. She noted that when she became Chairperson, the Council Secretariat at Treasury had fewer than 10 staff members, and the infrastructure supporting interagency coordination had been significantly reduced. She said that as a result, that the Council was less equipped to identify and respond to risks to the financial system. She described the efforts undertaken to revitalize the Council, which she said included increasing staff, creating more opportunities for agencies to collaborate, and developing new tools, such as the Council's analytic framework for financial stability risk identification, assessment, and response, published in 2023. She stated that the Council had worked to make the U.S. financial system more resilient and the economy stronger. She said that it would be crucial to continue these efforts. She then turned to Sandra Lee, Deputy Assistant Secretary for the Council at Treasury, and Stefan Jacewitz, Assistant Vice President at the Federal Reserve Bank of Kansas City, to present on the Council's 2024 annual report.

Ms. Lee stated that over the past year, the Council had continued its work to identify and address vulnerabilities in the financial system, including advancing efforts to improve the resilience of the Treasury market and to assess risks posed by nonbank financial intermediaries, digital assets, and climate-related financial risk. She noted that earlier in 2024, the Council had released its Report on Nonbank Mortgage Servicing, which documented the important role that nonbank mortgage servicers play in the mortgage market and provided recommendations to enhance their resilience. She said that the Council also reconvened its Financial Market Utilities (FMU) Committee to restart interagency analysis of FMU developments and undertake a review of FMUs currently designated as systemically important by the Council. She stated that the Council also made further progress on a framework to better measure how climate-related financial risks can impact financial institutions.

Ms. Lee said that in addition, the Council took steps to monitor and identify potential systemic risks posed by the rapid and growing use of AI. She stated that the Council had advanced coordination and capacity building on AI across member agencies and hosted a conference on AI and financial stability, which she said provided an opportunity for greater public and private sector engagement to improve the collective understanding of the opportunities and risks posed by AI. She stated that this was the first Council conference in almost a decade and included participants from over 75 organizations. She noted that one of the Council's statutory purposes is to respond to emerging threats to U.S. financial stability. She said that a strong and resilient financial system plays a critical role in supporting a strong economy. She said that over the past four years, the Council and its member agencies had worked to make the financial system more resilient to both exogenous and endogenous risks to the financial system. She said that developing a more holistic view of the financial system was central to the Council's work to address financial stability risks, and requires interagency coordination and information sharing. She stated that the Council had worked to rebuild that capacity and to promote more effective interagency coordination and engagement to develop this more holistic view. She said that the initiatives described in the annual report were representative of that revitalized engagement. She then turned to Stefan Jacewitz, Assistant Vice President at the Federal Reserve Bank of Kansas City, to provide an overview of the risks and vulnerabilities in the Council's 2024 annual report.

Mr. Jacewitz stated that in the 2024 annual report, the Council identified 14 vulnerabilities in the U.S. financial system that may warrant continued monitoring or additional regulatory or legislative action. He said that the annual report also provided specific and actionable recommendations to address each of these vulnerabilities. He noted that the Chairperson had already highlighted vulnerabilities in banking, the Treasury market, cybersecurity, digital assets, and third-party service providers. He stated that he would focus on vulnerabilities in the remaining areas, in the order that they appear in the annual report: commercial real estate, residential real estate, corporate credit, short-term funding markets, climate-related financial risks, investment funds, central counterparties, and the insurance sector.

Mr. Jacewitz turned first to commercial real estate. He said that signs of increasing credit risk in commercial real estate had become more evident in 2024, with slower rent growth, increased borrowing costs, and a continued rise in vacancy rates, chiefly in office properties and to a lesser extent in multifamily properties. He stated that these pressures on borrowers had led to increased loan delinquencies, loan losses, and provisioning for banks. He said that the Council recommended that regulators continue to monitor the financial industry's ability to withstand stress from declining property prices and deteriorating loan quality in commercial real estate. He noted that residential real estate is central to the U.S. financial system. He said that housing prices continued to be high relative to household incomes. He stated that while the low supply of housing had been an important contributor to high prices, the housing market could soften if economic conditions weakened. He said that the Council therefore recommended that supervisors and financial institutions continue to monitor residential real estate exposures and the adequacy of credit loss allowances. He said that nonbank mortgage servicers could face operational and financial pressures in a weaker housing market. He noted that the Council, in its Report on Nonbank Mortgage Servicing, made recommendations to enhance the resilience of the nonbank mortgage servicing sector, drawing on existing authorities of state and federal regulators and encouraging Congress to address the risks identified in the report. He stated that the Council reaffirmed in the annual report the recommendations made in the Report on Nonbank Mortgage Servicing.

Mr. Jacewitz turned next to corporate credit, particularly private credit, which he noted had grown rapidly. He said that this market was an increasingly important source of funding for small and mid-sized firms, which he said are typically more highly leveraged than those in public credit markets. He stated that this growing importance had prompted discussions about potential financial stability risks due to the market's opacity, credit risk, liquidity risk, and increasing interconnectedness with banks, insurance companies, and other institutions. He said that to provide additional insight into any potential risks associated with the rise in private credit, the Council supported enhancing data collection in this market. He noted that some of this work had already begun.

Mr. Jacewitz stated that short-term funding markets also present financial vulnerabilities. He said that while short-term funding markets play a critical role in the financial system, these markets had also experienced heightened volatility during periods of market stress and had historically been vulnerable to runs. He stated that to address these risks, the Council had worked to strengthen the resilience of short-term funding markets and support orderly market functioning during periods of heightened market stress. He said that the Council's review of a broad set of short-term investment vehicles in 2024 found that they share features that can contribute to financial stability risks, including liquidity mismatch and characteristics that may incentivize redemptions during periods of market stress. He stated that the Council would continue to assess and monitor the vulnerabilities from short-term investment vehicles and was ready to consider additional actions as appropriate to address financial stability risks.

Mr. Jacewitz stated that climate change continued to present financial risks, and that the Council had taken steps to better understand climate-related financial stability concerns and transmission channels. He stated that in addition to its work to develop a set of metrics to assess climate-related financial risks, the Council recommended that agencies collaborate to further explore how the intersection of physical risk, real estate, and insurance may affect financial stability.

Mr. Jacewitz stated that the Council had also identified vulnerabilities within several categories of investment funds, including hedge funds, open-end funds, and collective investment funds. He said that the Council supported initiatives by the SEC and other agencies to increase hedge fund transparency. He stated that the Council also supported the ongoing work of banking supervisors to improve banks' counterparty credit risk management practices with respect to hedge funds. He said that the Council and state and federal agencies should also consider what additional steps are needed to address financial stability risks from open-end funds and collective investment funds.

Mr. Jacewitz stated that the report also discussed vulnerabilities related to central counterparties. He said that central counterparties are key nodes within the global financial system and can thus introduce potential hazards to the system. He said that the Council supported the continued efforts of the CFTC, Federal Reserve, and SEC to enhance oversight of the five central counterparties designated by the Council as systemically important FMUs. He said that the Council recommended that these agencies continue to monitor the operational resilience of central counterparties, including the introduction of stress testing for non-default losses.

Mr. Jacewitz stated that the 2024 annual report also discussed vulnerabilities within the insurance market. He said that the United States is the world's single largest insurance market. He said that there had been a long-term shift toward non-traditional assets and liabilities and offshore reinsurance in the insurance industry, especially within the life insurance sector, and he noted that this shift had accelerated over the past year. He said that given the sector's interconnections with the broader financial system, the shift warranted continued attention. He stated that to better understand potential risks, the Council encouraged state insurance authorities and the NAIC to increase disclosure of private market investments and offshore reinsurance in required financial reporting. He said that the Council also encouraged these entities to evaluate the need for enhancements in specific supervisory tools and processes. He stated in conclusion that his remarks, together with those of the Chairperson, had addressed the vulnerabilities highlighted in the Council's 2024 annual report.

Following the presentation, the Chairperson called on other Council members to comment.

Jerome Powell, Chair of the Federal Reserve, stated that incidents of elevated financial stress that threaten economic well-being are a recurring phenomenon. He said that when those events occur, they are typically accompanied by emerging risks that may arise in gaps between the existing authorities of agencies or outside the more regulated financial system. He said that the cross-agency collaboration inherent to the Council helps close such gaps, as illustrated by the annual report. He said that while the financial system remained resilient, the report identified important areas of elevated risk, such as credit weakness in commercial real estate and increasing leverage in private funds and at insurance companies.

Gary Gensler, Chair of the SEC, stated that the Council's purpose is to mitigate the potential for risks in the financial sector to negatively impact everyday Americans. He noted that risk is part of the financial sector, but that it is important for that risk not to spill over to the economy. He noted that the Council was formed in the aftermath of the 2008 financial crisis and that the Council brings together various regulatory perspectives to prevent gaps in financial regulation from causing harm to the public. He noted the scale of the U.S. financial sector, including the capital markets, banking, and credit union sectors. He noted that nonbank financial intermediation is a comparative advantage of the United States, but that it also has risks, and that the SEC and the Council work to promote resiliency. Chair Gensler noted the SEC's adoption of rules contributing to a more resilient financial system. He said that these included the adoption of central clearing in Treasury markets, reforms to the money market fund sector, additional transparency in the private funds market, and a shortened securities settlement cycle. He said that due to regulatory changes, Americans with accounts at broker-dealers and investment advisers would, for the first time, receive notices if their private information is hacked and assistance in protecting themselves from a cyber event.

Chair Gensler stated that because financial markets, technology, and business models are always evolving, the work of the Council is never finished. He stated that the significant leverage in the macro hedge fund sector, and the intersection of that sector with the banking sector through prime brokerage activity, presents risks. He said that it would be important for the Council to continue to monitor this risk, and he stated that recent Treasury market reforms would contribute to this effort. He said that he believed that AI presents opportunities to positively benefit the U.S. economy, although he noted AI presents risks related to concentration and centralization. He stated that risks would increase in the event that several thousand financial firms rely on a small number of base models. He concluded by expressing concerns about crypto assets. He then said that without compliance with existing rules related to disclosure, conflicts, and business conduct, investors in the crypto sector will experience significant harms. He said noncompliance with time-tested securities laws could develop into a systemic concern if it undermines trust and integrity in the broader capital markets. He closed by noting that financial stability risks affect everyday Americans.

Martin Gruenberg, Chairman of the FDIC, stated that, as the report noted, the banking industry continued to show resilience in 2024, following the failure of three large regional banks in the spring of 2023. He noted, however, that the industry continued to report weakness in several loan portfolios, including commercial real estate and credit cards, as well as deterioration in multifamily loans. He said that many banks also remained reliant on uninsured deposits, which he noted carry liquidity risks that contributed to last year's regional bank failures. He stated that he appreciated the annual report's recommendation that the banking agencies finalize a proposal to improve the resilience and resolvability of certain large banks, by requiring them to maintain outstanding long-term debt that can provide additional loss protection for depositors and the Deposit Insurance Fund. He noted that the report also encouraged the banking agencies to complete the Basel III capital reforms to further enhance the resilience of the banking system. He said that the report also noted that risks involving third-party service providers continued to be a financial stability concern. He stated that these providers deliver products and services to financial institutions, and the arrangements they make with banks had become more frequent and complex. He noted that the failure of Synapse, a third-party provider of deposits to banks, had resulted in thousands of depositors being unable to access their accounts, and illustrated the need for banks to maintain adequate controls. He commended the annual report's discussion of the Council's work in 2024 on risks in the nonbank financial sector. He stated that Council members had worked to analyze and address high leverage in the largest hedge funds, and he said that evaluating the connections of hedge funds with the Treasury market and the banking system is important and should be an ongoing Council priority. He said that the Council's Report on Nonbank Mortgage Servicing provided important recommendations to improve the financial stability of mortgage markets. He expressed appreciation for the annual report's attention to the rapid growth and risks of private credit. He stated that that the opaque nature of private credit makes it difficult for regulators to assess risk management practices in the sector and its growing connections to the financial system.

Chairman Gruenberg expressed appreciation for the annual report's support for the allocation of resources for the resolution of central counterparties. He said that these resources are essential to ensure that the resolution authority is able to maintain operational continuity of the critical services these firms provide. He commended the rulemaking by the SEC and the proposed rule by the CFTC to strengthen the recovery and wind-down plans for central counterparties, and he noted their collaborations on these matters with the FDIC.

Michael Hsu, Acting Comptroller of the Currency, expressed his support for the annual report and its recommendations. He noted that the recommendations addressed both traditional and emerging risks, from cybersecurity and commercial real estate risk in the banking system, to the growth of nonbanks like mortgage servicers, hedge funds, and private credit funds, to AI, digital assets, and climate-related financial risks.

Rohit Chopra, Director of the CFPB, noted the role of regulators in addressing how financial institutions monitor and manage risks, and he said that the Council should continue to focus on this area. He noted that one of the purposes of the Council is to promote market discipline, by eliminating expectations that the government will bail out financial institutions. He stated that further efforts would be needed to eliminate this expectation, so that financial institutions incur the costs of their risks.

Rostin Behnam, Chairman of the CFTC, expressed his support for the annual report. He noted that the United States leads the world in the depth, strength, and innovation of its financial markets. He said that the increasingly complex and interconnected nature of the financial system exposes it to risks and vulnerabilities. He said that the annual report identified a number of issues and vulnerabilities that are of significant interest to the CFTC. As an example, he noted that central counterparties represent a significant priority for the CFTC in terms of risk. He said that the CFTC, working with other Council members, continued to monitor central counterparties. He said that the CFTC also continued to focus on cybersecurity, which he said continued to be a significant vulnerability for U.S. markets. He also noted that the first Bitcoin futures contract was listed in 2017 on two exchanges. He stated that this trend would continue, and he noted that there were eight platforms registered with the CFTC and over 18 different tokens being traded. He said that it would be important for Congress and Council member agencies to properly regulate digital assets in order to eliminate or mitigate vulnerabilities.

Sandra Thompson, Director of the FHFA, drew attention to the report's discussion of housing affordability, which she said remained a persistent challenge nationwide. She said that the annual report highlighted the economic challenge presented by the ongoing housing shortage. She said that the imbalance between robust demand for single family housing and inadequate supplies had contributed to an increase in home prices throughout 2024. She said that home prices had risen by more than 50 percent in the last five years. She stated that given the current interest rate environment, many aspiring home buyers had experienced difficulty finding affordable homes. She said that the problems with housing affordability had been exacerbated by changes in the market for homeowners insurance. She said that areas prone to natural disasters are facing significant increases in the price of insurance and decreased availability in the primary insurance market. She stated that even when insurance is still available in these markets, some insurers are raising prices to cover the rising cost of natural disasters, which she said heightens home affordability concerns and strains household balance sheets. She said that ultimately, more and more borrowers would be faced with renewal concerns or difficulty obtaining affordable initial insurance policies when buying a home. She said that the Council would need to engage in cooperation, collaboration, and coordination when addressing the intersection of the housing, insurance, and banking sectors. She expressed her support for the recommendation in the annual report that the FHFA and NCUA be granted examination and enforcement authority over third-party service providers. She stated that the role of third-party service providers had expanded significantly since the Council first made this recommendation in its 2015 annual report. She said that this authority was a critical tool to help the FHFA ensure the safety and soundness of its regulated entities.

Todd Harper, Chairman of the NCUA, called attention to the publication in 2023 of the Council's analytic framework for financial stability risks and interpretive guidance on nonbank financial company determinations. He said that it addressed what he described as deficiencies in the previous Council guidance on nonbank financial company determinations. He said that the 2023 guidance presented clear, balanced, and consistent processes that are consistent with the applicable requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). He then expressed his support for the annual report, which he said highlighted several systemic risks specific to the credit union system. He stated that the NCUA's lack of vendor authority over third parties was a growing regulatory blind spot that has real world implications. He said that the risks had only grown since the Council first recommended in its 2015 annual report that Congress act. He said that late last year, for example, a cyber incident at a core credit union service provider disrupted basic services for credit union members across 40 states. He said that risk frequently grows in the most unregulated shadows of the financial system. He stated that Congress should close this regulatory loophole. He said that the Council's annual report, for the first time, also recognized the need to anticipate and mitigate the likelihood of large credit union failures, especially with system assets heavily concentrated in a few large institutions. He noted that the annual report recommended that the NCUA should both increase the reserves held in the NCUA Share Insurance Fund and be granted additional flexibility in how it manages the fund.

Chairman Harper stated that the NCUA's power to raise reserves was fundamentally constrained under current law, which he said constrained the agency's ability to leverage periods of economic financial strength to prepare for times of upheaval. He said that if Congress raised the equity ratio ceiling, the Board of Directors of the NCUA could act when appropriate to strengthen the resiliency of the Share Insurance Fund and prevent a repeat of the 2008 corporate credit union crisis, which led Congress to pass emergency legislation to protect the credit union system. He also said that the annual report underscored the need to finalize regulatory action on incentive-based compensation in accordance with section 956 of the Dodd-Frank Act. He stated that earlier in 2024, the NCUA and several other agencies had issued a proposed rule to establish disclosure and reporting requirements for incentive-based compensation agreements. He said that it was important for all six agencies subject to section 956 to finalize work on this statutory mandate. He said that financial executives have a responsibility to focus on long-term organizational health and not on short-term personal gains when managing their institutions. He stated that effective rules, rather than unenforceable guidelines, would best enable regulators to protect shareholders, employees, and households. He said that this was an important step to uphold transparency and accountability across the financial system.

Chairman Harper stated that the Council was established to research and monitor the financial system for potential risks and to act when identified vulnerabilities are not sufficiently addressed. He said that the Council's work would be beneficial to people on Main Street by protecting them from the excesses of Wall Street and the risks beyond the perimeter of the current regulatory system. He warned against a repeat of the 2008 financial crisis, when unemployment peaked at above 15 million and 10 million Americans lost their homes. He stated that the Council must remain vigilant against threats to financial stability and be ready to act by actively monitoring all aspects of the financial system, designating nonbank financial companies and FMUs, and breaking apart financial companies that pose a grave threat to the financial system.

Thomas Workman, the Council's independent member with insurance expertise, expressed support for the annual report, particularly its discussion of the insurance sector.

Adrienne Harris, Superintendent of the New York State Department of Financial Services, stated that in 2024, the Council had addressed a number of new and developing risks that were key areas of focus for state regulators, including digital assets, nonbank mortgage servicing, and the use of AI in financial services. She said that this year's report continued to highlight the growing interconnectedness of digital assets and traditional financial institutions. She noted that this year's report updated the Council's previous recommendation and now focused exclusively on the federal role in advancing comprehensive stablecoin regulation. She stated that state banking regulators shared the goal of establishing a national framework to protect consumers across the country, but she noted that there is an important role for states to play in the regulation of innovative financial services. She said that states can act nimbly in response to industry developments, modernizing regulations quickly in an effort to support responsible innovation. She noted the work that New York State and other states had done to establish strong regulation of digital assets. She stated that the NYDFS was the first regulator to provide regulatory clarity in this space, with a rigorous regulatory framework, to protect consumers and create a resilient market for digital assets businesses across New York State. She said that any federal legislation should leverage state and federal expertise, and she said that the states welcomed collaboration with Congress as it develops a strong regulatory framework at the federal level. She said that she appreciated that the annual report reaffirmed the Council's commitment to implement the recommendations in the Council's Report on Nonbank Mortgage Servicing. She said that states, as the primary prudential regulators of nonbank mortgage companies, had been playing a leading role in this area. She said that states had established model prudential standards and adopted new processes and tools to license and examine these institutions on a multi-state basis. She said that given the market's rapid growth, she supported greater collaboration between state regulators and federal agencies to enhance the supervision of nonbank mortgage companies. She said that stronger coordination across all levels of government would better protect homeowners and the housing market. She expressed her appreciation for the Council's work to bring together regulators from different levels of government with various perspectives and experiences. She stated that by continuing to collaborate on these challenges, Council member agencies would be more effective in protecting consumers, maintaining the health of regulated entities, and preserving the stability of the global financial system.

Melanie Lubin, Securities Commissioner in the Securities Division of the Maryland Office of the Attorney General, noted that the annual report included important legislative recommendations relating to the uses of blockchain and distributed ledger technologies. She noted in particular that the report recommended that Congress take action to address perceived gaps in the regulation of certain digital assets. She expressed her belief that Council members had a shared goal of ensuring that the United States has a robust, whole-of-government approach to promoting innovation responsibly in U.S. capital markets. She acknowledged the collaboration between state securities regulators and the CFTC and SEC on a variety of enforcement matters. She said that these collaborative efforts had helped to ensure that investors receive appropriate protections in the financial markets. She stated that information provided by the state securities regulators showed that investigations and enforcement actions remained heavily focused on technology and digital assets. She said that in 2023, states reported opening more than 340 investigations involving digital assets, not including matters involving non-fungible tokens and staking products. She said that the number of reported investigations involving technology and digital assets had increased significantly from the numbers reported in 2022. She said that data indicated that digital assets other than non-fungible tokens and staking products were involved in 50 percent more enforcement actions than the next-highest product. She stated that these state enforcement actions included shutting down not only digital assets frauds targeting local communities, but also larger, unregistered offerings involving investors across many jurisdictions.

Commissioner Lubin stated that despite these enforcement actions and the significant financial losses suffered by retail investors, NASAA was concerned that the recommendation in the annual report did not sufficiently address the need to ensure robust investor protections by maintaining state regulatory authority. She said that in addition to state authority, any federal legislation establishing a framework for digital assets and distributed ledger technologies should maintain longstanding legal principles that have formed the foundation for many antifraud actions. She said that federal legislation relating to the use of blockchain and distributed ledger technologies in securities and commodities markets should maintain a robust role for state securities regulators, particularly in the area of antifraud enforcement. She said that forgoing such authority would harm investors and harm the innovators and companies in need of investment capital. She stated that NASAA would continue to engage with Congress and other stakeholders to ensure that states retain the authority necessary to protect investors and maintain trust in capital markets.

Following the remarks, the Chairperson thanked Council members for their collaboration and engagement over the last four years. She also thanked Ms. Lee and the Council Secretariat staff for their work contributing to analysis and direction that enabled the Council to leave a stronger and more resilient financial system that benefits all Americans.

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

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

WHEREAS, the staffs of the Council members and their agencies prepared the attached 2024 annual report of the Council (2024 Annual Report) pursuant to section 112 of the Dodd-Frank Act, and members of the Council have reviewed and commented on the attached report.

NOW, THEREFORE, BE IT RESOLVED, that the Council hereby approves the 2024 Annual Report and authorizes the Chairperson, or her designee, to take such action as they may deem necessary or appropriate to transmit the 2024 Annual Report to Congress and to release it to the public; and

BE IT FURTHER RESOLVED, that the Council hereby delegates authority to the Chairperson, or her designee, to make technical, nonsubstantive, or conforming changes to the text of the 2024 Annual Report and to take such other actions as they may deem necessary or appropriate to prepare the report for transmittal to Congress and release to the public.

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

2. Resolution Approving the Minutes of the Meeting Held on October 18, 2024

BE IT RESOLVED, by the Financial Stability Oversight Council (Council), that the minutes attached hereto of the meeting held on October 18, 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 12:38 P.M.