Minutes of the Financial Stability Oversight Council

June 11, 2021

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)
Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation (FDIC)
Gary Gensler, Chair, Securities and Exchange Commission (SEC)
Rostin Behnam, Acting Chairman, Commodity Futures Trading Commission (CFTC)
David Uejio, Acting Director, Consumer Financial Protection Bureau (CFPB)
Mark Calabria, Director, Federal Housing Finance Agency (FHFA)
Michael J. Hsu, Acting Comptroller of the Currency, Office of the Comptroller of the Currency (OCC)
Todd Harper, Chairman, National Credit Union Administration (NCUA)
Thomas E. Workman, Independent Member with Insurance Expertise
Dino Falaschetti, 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)
Charles G. Cooper, Commissioner, Texas Department of Banking (non-voting member)
Eric Cioppa, Superintendent, Maine Bureau of Insurance (non-voting member)
Melanie Lubin, Securities Commissioner, Maryland Office of the Attorney General, Securities Division (non-voting member)

GUESTS:

<u>Department of the Treasury (Treasury)</u>
Eric Froman, Assistant General Counsel (Banking and Finance)
Stephen Ledbetter, Director of Policy, Office of the Financial Stability Oversight Council, and Executive Director of the Council

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

<u>Federal Deposit Insurance Corporation</u>
Travis Hill, Deputy to the Chairman for Policy

<u>Securities and Exchange Commission</u>
Amanda Fischer, Senior Counselor

<u>Commodity Futures Trading Commission</u>
David Gillers, Chief of Staff

Consumer Financial Protection Bureau
Ashwin Vasan, Advisor to the Director

Comptroller of the Currency
Blake Paulson, Senior Deputy Comptroller and Chief Operating Officer

National Credit Union Administration
Andrew Leventis, Chief Economist

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

Federal Reserve Bank of New York
John Williams, President and Chief Executive Officer
Richard Crump, Vice President, Capital Markets Function

Office of Financial Research
Sriram Rajan, Associate Director

Federal Insurance Office
Andrew Shaw, Senior Policy Advisor

Texas Department of Banking
Michael Townsley, Policy Counsel, Conference of State Bank Supervisors

Maine Bureau of Insurance
Mark Sagat, Assistant Director, Financial Policy and Legislation, National Association of Insurance Commissioners (NAIC)

Maryland Office of the Attorney General, Securities Division
Vincent Martinez, General Counsel, North American Securities Administrators Association

PRESENTERS:

Money Market Fund Reform
- *Sarah ten Siethoff, Acting Director, Division of Investment Management, SEC*
- *Angela Mokodean, Branch Chief, Division of Investment Management, SEC*

Update on Council Priorities
- *Stephen Ledbetter, Director of Policy, Office of the Financial Stability Oversight Council, and Executive Director of the Council, Treasury*
- *Josh Frost, Deputy Assistant Secretary for Financial Markets, Treasury (available for questions)*

LIBOR Transition

- *Randal Quarles, Vice Chairman for Supervision, Federal Reserve*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 2:01 P.M. The Chairperson began by welcoming two new members of the Council: Gary Gensler, Chair of the SEC, and Michael Hsu, Acting Comptroller of the Currency. The Chairperson then outlined the meeting agenda, which had previously been distributed to the members together with other materials. The agenda for the executive session included (1) money market fund (MMF) reform and (2) an update on the Council's priorities.

1. MMF Reform

The Chairperson turned to the first agenda item, MMF reform. The Chairperson noted that during the open session of the Council meeting, the Council would vote on a public statement regarding MMF reform. The Chairperson also noted that the topic of MMF reform was highlighted in a report issued in December 2020 by the President's Working Group on Financial Markets (PWG). The Chairperson then introduced Sarah ten Siethoff, Acting Director of the Division of Investment Management at the SEC, and Angela Mokodean, Branch Chief of the Division of Investment Management at the SEC, to provide a presentation on public comments submitted to the SEC in response to its request for comment on potential reforms to improve the resilience of MMFs.

Ms. ten Siethoff began by noting that the SEC had requested public comment on the reform options described in the PWG report. She noted that during the SEC's comment period, which closed on April 12, 2021, the agency had received approximately 50 comment letters from a diverse group of commenters. She discussed the comments received regarding a number of topics related to MMF reform, including proposals for reforming the current rule that allows a prime or tax-exempt MMF to impose a redemption gate or liquidity fee if its weekly liquid asset threshold drops below 30 percent; changing the conditions for imposing redemption gates; imposing "minimum balance at risk" requirements, under which a portion of each shareholder's recent balance in a MMF would be available only with a time delay and could be first in line to absorb any losses; changing the requirements related to liquidity management, including daily and weekly liquid asset requirements; introducing countercyclical weekly liquid asset requirements, which would allow MMFs' minimum weekly liquid assets to decline under certain circumstances; and requiring all prime and tax-exempt MMFs to use a floating net asset value. Ms. ten Siethoff discussed the range of comments regarding each of these reform proposals.

Ms. Mokodean then described comments received by the SEC on other potential reform options, including swing pricing, in which a fund's net asset value would be "swung" down when net redemptions exceed a threshold; requiring MMFs to hold capital buffers; requiring prime and tax-exempt MMFs to be members of a private liquidity exchange bank that would provide a liquidity backstop during stressed periods; and requirements for fund sponsors to provide support to MMFs in certain circumstances. She noted the diversity of commenter views on the potential reforms. She also noted that some commenters supported other types of reforms, such as reforms to the structure of the commercial paper market or changes to banking or dealer requirements.

Members of the Council then asked questions and had a discussion on various topics, including engagement with the Financial Stability Board on MMF reform; exposures of government MMFs to government-sponsored enterprises; and the need to address structural vulnerabilities in the MMF sector and in short-term wholesale funding markets. The Chairperson stated that the Council would revisit this topic as the SEC evaluates potential next steps.

2. Update on Council Priorities

The Chairperson then introduced the next agenda item, an update on the Council's priorities. The Chairperson noted that during the previous Council meeting, she had highlighted three priorities for the Council: vulnerabilities in nonbank financial intermediation, climate change, and Treasury market resiliency. The Chairperson introduced Stephen Ledbetter, Director of Policy for the Office of the Financial Stability Oversight Council and Executive Director of the Council.

Mr. Ledbetter described recent staff work in connection with each of these Council priorities, including the re-establishment of the Council's Hedge Fund Working Group; preliminary planning for a working group to assess risks to financial stability that may arise from liquidity and redemption features in open-end funds; and interagency discussions in response to the President's May 20, 2021, Executive Order on Climate-Related Financial Risk. He also described staff assessments of Treasury market resilience, which he noted was being led by the Inter-Agency Working Group on Treasury Market Surveillance.

Members of the Council then had a discussion, including regarding Council member agency efforts to address climate-related risks, and other Council priorities, such as cybersecurity risks, the growth of nonfinancial corporate credit, and the evolving role of digital assets.

The Chairperson adjourned the executive session of the meeting at approximately 2:48 P.M.

Open Session

The Chairperson called the open session of the meeting of the Council to order at approximately 3:00 P.M. The Chairperson began by welcoming the two new Council members since the previous Council meeting, Chair Gensler and Acting Comptroller Hsu.

The Chairperson then outlined the agenda for the open session, which included (1) a discussion of MMF reform and a vote on a public statement by the Council regarding this topic, (2) an update on the LIBOR transition, and (3) a vote on the minutes of the Council's meeting on March 31, 2021.

1. MMF Reform

The Chairperson turned to the first agenda item, MMF reform and a vote on a public statement by the Council regarding this topic. The Chairperson stated that the Council statement on MMF reform highlighted the importance of this issue to the stability of the U.S. financial system. She noted that the early stages of the COVID-19 pandemic again demonstrated that structural vulnerabilities in these funds have the potential to create or amplify financial instability. She stated that extreme policy interventions by the Federal Reserve and Treasury had been required to restore market functioning and mitigate market stress. She said that regulators had developed potential policy options to address MMF vulnerabilities and that SEC staff had briefed the Council in the executive session regarding the public comments the SEC had received on the policy options. She expressed support for the SEC's engagement on this critical issue, and noted that the Council would continue to monitor reform efforts going forward. The Chairperson then invited other Council members to comment.

Chair Gensler began by stating that he supported the Council's mission to identify and respond to financial stability risk and to better promote market discipline. He noted that financial stability was part of his remit as Chair of the SEC.

Chair Gensler stated in the spring of 2020, the U.S. economy had experienced system-wide issues affecting short-term funding markets, including MMFs, commercial paper, certificates of deposit, and the Treasury repurchase agreement (repo) market. He stated that the economy had also experienced challenges in the Treasury repo market in the fall of 2019.

Chair Gensler then turned to MMFs, which he said are an important part of U.S. markets and a source of wholesale funding for many issuers. He noted that the SEC sought to address structural issues in MMFs through reforms adopted in 2010 and 2014. Chair Gensler stated that, based on the events of last spring, the SEC, the Council, and the PWG had engaged in a review of how regulators can make further progress to enhance the resiliency of these funds. He stated that these events brought a focus to prime MMFs and their interrelationship with investments in commercial paper and certificates of deposit. Chair Gensler stated that commercial paper and certificates of deposit have limited liquidity in good times, and virtually disappeared during the stress in Spring 2020. He stated that it was important to ensure the resiliency of MMFs. He noted that he had directed SEC staff to examine these issues in coordination with other federal agencies, and to provide recommendations to the SEC's commissioners for purposes of considering further reforms.

Jerome Powell, Chair of the Federal Reserve, stated that the pandemic made clear the importance of short-term funding markets to the stability of the financial system. He noted that as the pandemic caused disruption across the globe, the resulting dash for cash stressed short-term funding markets. Chair Powell stated that rapid redemptions of MMFs resulted from, and in turn exacerbated, these liquidity pressures. He said that the Federal Reserve had responded by establishing the Money Market Mutual Fund Liquidity Facility with approval and credit protection from Treasury. He noted that the turmoil subsided, conditions in short-term funding markets improved, and access to credit increased as market conditions and economic activity improved. Chair Powell stated that regulators now had an opportunity to consider appropriate reforms of MMFs, given their ability to impact businesses, state and local governments, and the public. He stated that the Federal Reserve supported the progress on efforts to further safeguard the financial system.

Mark Calabria, Director of the FHFA, stated that he supported the work of the SEC on this issue. He stated that while the PWG had been focused on prime MMF reform, it was also important to consider risks in government MMFs. He noted that government MMFs had large exposures to the entities regulated by the FHFA, specifically Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Director Calabria stated that in light of the potential risk posed by this interconnectedness, the FHFA supported the Council's monitoring of MMFs, and encouraged efforts to address the vulnerability of government MMFs to potential losses from disruptions in the housing agency debt market.

Todd Harper, Chairman of the NCUA, stated that since the creation of the Council, MMFs had been a perennial issue on the Council's agenda. He stated that while regulators had made progress over the last decade, the events of 2020 demonstrated why the Council and the primary regulator should continue to develop regulation in this area to address lingering structural problems. Chairman Harper stated that in mitigating risks to protect the broader financial system, the Council needs to recognize the strengths and weaknesses of each of the different types of MMFs. He said that the public statement by the Council on MMFs, as well as the SEC's renewed engagement with stakeholders, were important steps toward increasing the stability and resiliency of the U.S. financial system.

The Chairperson then presented to the Council the following resolution approving the Council's statement regarding MMF reform:

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; monitoring financial regulatory proposals and developments, and making recommendations in such areas that will enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets; recommending to the Council member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies; and identifying gaps in regulation that could pose risks to U.S. financial stability; and

WHEREAS, the President's Working Group on Financial Markets (PWG) released a report entitled "Overview of Recent Events and Potential Reform Options for Money Market Funds" (PWG Report) in December 2020; and

WHEREAS, the Securities and Exchange Commission (SEC) published a request for public comment on the potential policy measures identified in the PWG Report; and

WHEREAS, the staffs of Council members and their agencies have prepared the "Financial Stability Oversight Council Statement on Money Market Fund Reform" attached hereto (the Statement).

NOW, THEREFORE, BE IT RESOLVED, that the Council hereby approves the Statement and authorizes the Chairperson, or her designee, to cause the Statement 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.

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 Statement 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. LIBOR Transition

The Chairperson then introduced the second agenda item, an update on the upcoming LIBOR transition. She introduced Randal Quarles, Vice Chairman for Supervision at the Federal Reserve, for a presentation regarding this topic.

Mr. Quarles stated that for almost a decade, the financial stability risks posed by LIBOR had been high on the agenda of the Council, many of the Council member agencies, and the Financial Stability Board (FSB). He said that despite years of work to transition away from LIBOR, LIBOR's record of manipulation, and the intention of the panel banks to stop participating in the production of LIBOR, some market participants were not taking timely steps to prepare for the imminent end of LIBOR.

Mr. Quarles stated that the United Kingdom's Financial Conduct Authority, which regulates LIBOR, and the ICE Benchmark Administration (IBA), which administers LIBOR, had stated that IBA would no longer have the necessary panel bank submissions to continue to publish any non-dollar LIBOR tenors, or one-week or two-month U.S. dollar LIBOR, after December 31, 2021. He also stated that the IBA would no longer have the necessary panel bank submissions to continue publishing the remaining U.S. dollar LIBOR tenors after June 30, 2023.

Mr. Quarles stated that, recognizing this reality, the Federal Reserve had issued a supervisory letter, stating that continued use of LIBOR in new contracts after 2021 would create safety and soundness concerns, and highlighting the importance of ending the issuance of new LIBOR contracts as soon as practicable, and in any event by December 31, 2021. He said that the U.S. dollar LIBOR quotes that will be available from January 2022 until June 2023 will only be appropriate for legacy contracts. He noted that use of the quotes for new products would create safety and soundness risks, and the Federal Reserve would supervise firms accordingly.

Mr. Quarles stated that there is no path forward for LIBOR after the end of this year. He said that market participants should expect to see liquidity and trading volumes falling for LIBOR instruments as the year-end deadline approaches, and the Federal Reserve expects them to plan accordingly. He noted that while more remains to be done, key players were making important progress. He stated that the Alternative Reference Rates Committee (ARRC), the private sector body leading the transition in the United States, had indicated it would soon be in a position to recommend term rates for the Secured Overnight Financing Rate (SOFR). He stated that with the encouragement and leadership of the CFTC, interdealer derivative markets were expected in late July 2021 to switch from primarily pricing based on LIBOR to pricing that refers to SOFR (so-called "SOFR-first" pricing).

Mr. Quarles stated that, based on experience in the United Kingdom, when this change in quotation conventions takes place in July, it should accelerate the transition. He noted that this would be the last key prerequisite for a SOFR term rate, and that the Federal Reserve encouraged this move. He said that at the same time, the Federal Reserve welcomed efforts in Congress to craft federal legislation that would provide a workable fallback for legacy contracts that lack one. He noted that throughout this transition, the official sector had stressed that lenders and borrowers were free to choose the rate they wish to use to replace LIBOR on newly originated loans, but they should make that decision with a full understanding of what it entails.

Mr. Quarles stated that market participants should ensure that they understand how their chosen reference rate was constructed. He noted that they must be aware of any fragilities associated with that rate and the markets that underlie it. He stated that, most importantly, they must use strong contractual fallback provisions, should their chosen rate be unavailable in the future for any reason. He then stated that market participants need to be confident that they would emerge from the LIBOR transition with a more stable financial system, which would require reference rates for derivatives and capital markets products that are determined in a stable structure. Mr. Quarles stated that the broad range of private sector market participants that constitute the ARRC constructed and chose SOFR as their preferred rate because of this stable structure. He noted that it rests on one of the deepest and most liquid markets in the world, and is therefore likely to remain available even when other financial markets are disrupted. He stated that it is transparently calculated, engendering market confidence. He also noted that within weeks, there would be a term rate based on SOFR supporting the pricing of a range of market products. He stated that, for all these reasons, the ARRC did not recommend rates other than SOFR in capital markets or for derivatives, and market participants should not expect such rates to be widely available.

Mr. Quarles stated that for non-capital markets products, the Federal Reserve's supervisory guidance noted that lenders and borrowers are free to choose among rates that meet their needs, but there are benefits of SOFR for these products, and thus (particularly with the development of term rates) SOFR would play a role in these markets as well. He noted that all Council members are charged with safeguarding the stability of the financial system. He stated that shepherding the LIBOR transition was a key element of their responsibilities in that regard, and a key inflection point in that transition had arisen. He noted that LIBOR would be gone in fewer than 30 weeks.

Mr. Quarles stated that financial firms did not have the luxury to burn time, reinventing the wheel on the pricing of capital markets products and derivatives, when the work of the private-sector experts on the ARRC had described a clear transition path. He stated in conclusion that with the CFTC-sponsored change to a SOFR-first quoting convention, and with the imminent availability of term SOFR, there was no reason for any firm to delay moving its derivatives and capital markets products to SOFR in line with the ARRC's recommendations.

The Chairperson stated that the Council had first discussed the importance of reference rate reform in 2012 and that a great deal of progress had been made since then. She stated that the ARRC had worked to identify and address transition issues, including analysis of potential alternative rates and the recommendation to use SOFR. She noted that SOFR provides a robust rate suitable for use in most products, with underlying transactions volumes that are unmatched by other LIBOR alternatives.

The Chairperson stated that the ARRC had also addressed other issues, including drafting clear and effective contractual fallbacks to alternative rates upon LIBOR's cessation, facilitating the development of SOFR derivative markets, developing conventions for the use of SOFR across asset classes, and proposing legislation, which New York State recently enacted, to help transition certain legacy contracts. She noted that, despite this progress, a critical juncture had arrived, and more must be done to facilitate an orderly transition. She stated that with the U.S. dollar LIBOR cessation dates fully known, many participants were actively evaluating their options and undertaking the work to transition contracts.

The Chairperson stated that while important progress was being made in some segments of the market, other segments, including business loans, were well behind where they should be at this stage in the transition. She stated that the decisions made now around the selection of alternative rates would determine whether some of LIBOR's shortcomings may be replicated through the use of alternative rates that lack sufficient underlying transaction volumes. She expressed her concern about the recent use, and potential future growth in use, of these rates and derivatives, where the volume of derivatives contracts referencing these alternative rates could quickly outnumber the transaction volumes underlying the reference rate, which would leave it vulnerable to manipulation and disruption, one of the primary issues with LIBOR.

The Chairperson acknowledged the desire of some market participants for a forward-looking SOFR term rate, as it would provide a useful additional tool in the transition away from LIBOR. She encouraged market participants to act promptly to support the switch in derivatives from LIBOR to SOFR this summer, as suggested by the CFTC's Interest Rate Benchmark Reform Subcommittee (the CFTC Benchmark Subcommittee) and the ARRC. The Chairperson stated that it is important for term SOFR to be grounded in a deep SOFR derivatives market and to be used in a way that does not diminish that activity. She said that action by market participants now would allow the ARRC to recommend a term SOFR rate soon.

The Chairperson stated that the most critical step in the transition was the move to a truly robust alternative rate like SOFR, which could mitigate the need for future transitions. She concluded by stating that a failure to adopt robust alternative rates would leave market participants continuing to face the same risks and challenges they currently face. The Chairperson then invited other Council members to comment.

Chair Powell stated that a critical phase of the LIBOR transition had arrived. He noted that December 31 was approaching and that planning by market participants would need to accelerate. He expressed his support for the comments of Mr. Quarles. He stated that in order to meet the year-end deadline, regulators and market participants would have to work together across both the public and private sectors. He noted that the lessons of LIBOR provided an opportunity to learn from the past and to use that knowledge to help safeguard the future. He noted that Mr. Quarles emphasized the importance of adopting SOFR in derivative and capital markets and thereby avoiding broad systemic risks. Chair Powell stated that the path ahead was clear and there was no longer an excuse for procrastination.

Chair Powell stated that the announcement of a term rate had overcome the last hurdle to adopting SOFR widely across all markets. He stated that although Council members represent different institutions, they are bound to the common goal of financial stability. He said that, over the past decade, Council members had worked to create a safer, sounder financial system. He stated that the past 16 months had revealed the benefits of a system that is stronger, more liquid and better capitalized. He noted that the security of the financial system had been critical to softening the pandemic's blow. Chair Powell concluded by stating that the end of LIBOR cannot and should not pose a threat to the solid foundation that regulators had helped build.

Chair Gensler then described the origins of LIBOR, noting that it had emerged in the early 1970s to enable banks to make loans with floating rates. He noted that an outstanding question at the time was what rate banks should reference. He stated that by the 1980s, banks had coalesced around the idea of using the unsecured rate at which banks were making loans to one another in London. He noted that LIBOR became so popular that it was embedded in hundreds of trillions of dollars of financial contracts around the world, including loans, derivatives, mortgages, and even supplier arrangements. However, he said there was a fundamental problem: in good times, there was very little lending of unsecured term loans between and among banks, and in stress times, even that small market disappeared. Chair Gensler stated that long before the 2008 crisis, that market had largely dried up, and banks were not making term loans to other banks without getting some collateral in return. He stated that this had created a structure that resembled an inverted pyramid, in which a massive market, today about $220 trillion, but then even larger, was referencing a small market at the tip of the inverted pyramid. He noted that there were very few underlying transactions in this market structure, and the individuals responsible for determining this benchmark tended to use their own judgment in setting it.

Chair Gensler said that this market structure presented an additional challenge. He noted that LIBOR was easy to game, partly because of the inverted pyramid. He said that when he served as Chairman of the CFTC, agency staff uncovered many cases of manipulative conduct by large banks, and even interdealer brokers. He noted that in 2013, the Council called for U.S. regulators to take action promoting a smooth and orderly transition to alternative benchmarks with consideration given to issues of stability. He noted that, eight years later, regulators were focused on this goal. He stated that the ARRC and other committees had done a significant amount of work. He noted that the FSB had echoed these views the previous week, stating that "benchmarks which are used extensively must be especially robust."

Chair Gensler said that he had several concerns about one rate that a number of commercial banks were advocating as a replacement for LIBOR: the Bloomberg Short-Term Bank Yield Index, popularly known as BSBY. He stated that BSBY had many of the same flaws as LIBOR. He noted that both benchmarks were based upon unsecured term bank-to-bank lending. He stated that term BSBY, whether one-month or 12-month, was underpinned primarily by trades and commercial paper and certificates of deposits issued by about 30 banks.

Chair Gensler stated that although the median trading volume underlying three-month BSBY was single-digit billions per day, six- and 12-month BSBY was even lower. He stated that BSBY therefore could reintroduce the risk of such an inverted pyramid, in which multiple trillions of dollars would be based on a small amount of trading. He stated that when a benchmark was mismatched in this manner, there was a significant economic incentive to manipulate it. He noted that this was why SOFR, which is based on a nearly trillion-dollar market daily, was a preferable alternative rate.

Chair Gensler stated that the markets underpinning BSBY were not only thin in good times, but virtually disappear in a crisis. He noted that in Spring 2020, the primary commercial paper lending market had evaporated for about five weeks during the stress period of the pandemic. He noted the lack of resiliency of prime MMFs, particularly in stress times and because of commercial paper and certificates of deposit. He stated that in the wake of the European debt crisis and the U.S. financial crisis, the International Organization of Securities Commissions (IOSCO) had issued a report on the hygiene of benchmarks like LIBOR. He noted that IOSCO had determined that it was necessary to establish a benchmark quote that reflects the credible market for an interest measured by that benchmark. Chair Gensler stated that BSBY did not meet that standard and was not especially robust. He stated that BSBY presented a risk to financial stability and financial resiliency. He concluded by expressing his concern that a financial crisis would reveal the flaws of BSBY.

Rostin Behnam, Acting Chairman of the CFTC, stated that market regulators must not allow market participants to continue down LIBOR's road to obsolescence when a sustainable path was in sight. He expressed his support for the view of other Council members that shepherding the LIBOR transition was a key element of safeguarding the stability of the financial system.

Acting Chairman Behnam stated that it had been over a decade since the first allegations of benchmark manipulations surfaced, and nine years since the CFTC began imposing sanctions for LIBOR-related misconduct, resulting in the collection of more than $3.3 billion. He noted that Governor Andrew Bailey, former chief executive of the United Kingdom's Financial Conduct Authority, had acknowledged that despite significant improvements to LIBOR, the goal of anchoring LIBOR's submissions and rates to the greatest extent possible to actual transactions could not be achieved.

Acting Chairman Behnam stated that the Federal Reserve estimated that more than $200 trillion in outstanding volume of U.S. dollar LIBOR contracts were benchmarked to a rate generated by $1 billion of transactions per day. He said that three-month LIBOR, the standard reference rate in the derivatives markets, was linked to less than $1 billion of borrowing among the largest banks. He noted that on many days, that number dropped below $100 million. He stated that this situation had not changed in the last four years. He said that the skewed proportionality underlying LIBOR continued to raise serious concerns about market integrity, financial conduct risks, and financial stability risks. He stated that regulatory authorities had relied on broad market participation and the global cooperative and consultative efforts by committees like the ARRC, and were ready to facilitate transition efforts by helping to avoid market dislocations.

Acting Chairman Behnam stated that in July 2018, he had convened the CFTC's Market Risk Advisory Committee to focus on benchmark reform. He noted that soon after, the CFTC voted to establish the CFTC Benchmark Subcommittee to provide reports and recommendations regarding efforts to transition U.S. dollar derivatives and related contracts to SOFR. He said that this subcommittee had focused on collaborating with the ARRC on market development initiatives, with a view to supplementing and supporting those efforts.

Acting Chairman Behnam stated that the first major effort of the CFTC Benchmark Subcommittee related to plain-English disclosures that market participants could use to inform clients and counterparties with which they were transacting in derivatives referencing LIBOR and similar rates about the implications of using such products. He said that the second significant effort was a tabletop exercise with respect to the SOFR discounting switch by central counterparties (CCPs). He noted that the CCP discounting shift in October 2020 was an important event positively correlated with a noticeable uptake in SOFR-based derivatives trading. He said that the third major effort of the CFTC Benchmark Subcommittee was its recommendation of the SOFR-first transition initiative, similar to the initiative led by the United Kingdom's Financial Conduct Authority and the Bank of England. He stated that this was a best practice aimed at prioritizing interdealer trading in SOFR over LIBOR.

Acting Chairman Behnam stated that, as a part of the initiative, the CFTC Benchmark Subcommittee had recommended that interdealer brokers change U.S. dollar linear swap trading conventions to SOFR on July 26, 2021. He stated that after this date, the interdealer market should replace trading of LIBOR linear swaps with trading of SOFR linear swaps. He noted that while LIBOR would be expected to be accessible as a basis to SOFR after this date, the screens for LIBOR linear swaps would remain visible only for informational purposes until October 22, 2021, when they would go dark.

Acting Chairman Behnam stated that the CFTC Benchmark Subcommittee believed its recommendations were especially prudent given the most recent FSB and IOSCO statements on LIBOR transition, which were consistent with and supportive of the interagency guidance from U.S. banking regulators that banks cease entering into new contracts that reference LIBOR after December 31, 2021. He said there was broad consensus among market participants, not only the dealer banks, of the urgency to shift away from LIBOR. He noted that the June 2 announcements by the FSB and IOSCO regarding the LIBOR transition were timed to ensure that market participants, trading platforms, and other service providers had sufficient time to prepare for the July 26 event. He stated that market participants must move on with a rate that was based on sustained and robust transactions. He noted that the daily transactions volume underlying SOFR often exceeded $1 trillion, and it had never been less than $700 billion.

Acting Chairman Behnam stated that SOFR reflected activity undertaken by diverse types of institutions. He stated that to avoid the conduct and stability risks that emerge when LIBOR became disconnected from actual activity, market participants must rely on a benchmark that is both representative of transactions and proportional to the depth and breadth of the products that rely on it. He noted that SOFR demonstrates that fitness for the derivatives markets. He concluded by stating that complacency was no longer an option, and as regulators were collectively acting to ensure a smooth transition to SOFR, market participants should now switch from LIBOR.

Director Calabria stated that the FHFA had consistently made clear to the entities it regulates that LIBOR was going away. He said that as it relates to families and households, the mortgage market may be the most important financial market using LIBOR, which in the past had widely supported adjustable-rate mortgages. He noted that Fannie Mae issued the first SOFR-based debt in July 2018, and Freddie Mac and the Federal Home Loan Banks followed soon thereafter. He also noted that the Federal Home Loan Banks were the largest issuers of SOFR-based floating debt.

Michael Hsu, Acting Comptroller of the OCC, stated that an important juncture in the LIBOR transition had arrived. He stated that this issue raised important financial stability implications for the Council and the financial system. He noted that financial stability was a critical interest of all stakeholders, irrespective of their size and market participation. He stated that SOFR was a robust replacement rate that had been carefully developed, and said that it would be reliably produced in a wide range of market conditions. He stated that the widespread adoption of SOFR in derivatives and other markets would promote financial stability for all participants in the financial system. He stated that SOFR enjoyed broad applicability and had a proven track record. He said that the OCC expected every bank, regardless of size, to demonstrate that its replacement rate selections were appropriate for the bank’s products, funding needs, and operational capacities. He emphasized the importance of banks considering the strength of the fallback provisions they employ. He stated that it was imperative that banks continue careful planning for the LIBOR transition, and noted that OCC examiners would continue to work with banks to ensure their preparedness.

Jelena McWilliams, Chairman of the FDIC, expressed her support for the comments of Mr. Quarles, noting that the FDIC continued to focus on the LIBOR transition and to assess institutions’ practices and plans to adopt a replacement rate and address legacy contracts before December 31, 2021. She stated that FDIC-supervised institutions were generally on target to meet this goal. She said that most FDIC-supervised institutions did not have material LIBOR exposures. She stated that those that did tended to be banks with total assets exceeding $10 billion and larger community banks that engaged in commercial lending or derivative activities. She noted that these institutions had generally developed appropriate plans to move away from LIBOR and had stopped, or were on track to stop, issuing new contracts using LIBOR by year-end. Chairman McWilliams reaffirmed that the FDIC did not endorse any particular alternative reference rate. She said that from a supervisory perspective, the FDIC was focused on the selection of a replacement rate, appropriate fallback language for legacy contracts, technology capabilities for processing a new benchmark rate with various tenors, customer communication, and consumer protection.

Todd Harper, Chairman of the NCUA, stated that the cessation of LIBOR was a concern not only for large financial institutions, but also for federally insured credit unions of all sizes. He noted that the credit union industry had exposure to LIBOR-related loans, like adjustable-rate mortgages, and to derivatives. He said that these risks were often concentrated in a few institutions. He noted that the failure of a credit union to prepare for LIBOR transition could undermine its safety and soundness and could also pose legal, operational, and consumer financial protection risks. Chairman Harper said that, accordingly, the NCUA had established the transition away from LIBOR as a supervisory priority. He said that the NCUA had advised federally insured credit unions to identify and implement appropriate alternatives to LIBOR as soon as possible. He noted that NCUA examiners were closely evaluating the plans of credit unions. He said that the NCUA would continue these efforts within the agency and in its work on the Federal Financial Institutions Examination Council over the next year.

Eric Cioppa, Superintendent of the Maine Bureau of Insurance, stated that state insurance regulators believed it was important that insurance companies transition to a LIBOR alternative as expeditiously as possible given the upcoming deadline. He said that insurance regulators, through the NAIC, were monitoring the insurance sector's transition from LIBOR, and that the NAIC was an *ex officio* member of the ARRC. He stated that insurance regulators were focused on three areas that may have the most potential impact to the insurance sector: life insurance reserving, investments in swaps, and statutory accounting. He noted that over the previous year and a half, state insurance regulators had taken regulatory actions to facilitate the sector's transition, including making changes to the NAIC's valuation manual and statutory accounting principles and guidance. He concluded by stating that they would continue to monitor the sector's efforts and take any appropriate regulatory actions to facilitate insurance companies' transition away from LIBOR.

3. Resolution Approving the Minutes of the Meeting Held on March 31, 2021

BE IT RESOLVED, by the Financial Stability Oversight Council (the "Council"), that the minutes attached hereto of the meeting held on March 31, 2021 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.