

Minutes of the Financial Stability Oversight Council

Held January 21, 2015

PRESENT:

Jacob J. Lew, Secretary of the Treasury and Chairperson of the Financial Stability Oversight Council (Council)
Janet Yellen, Chair, Board of Governors of the Federal Reserve System (Federal Reserve)
Martin J. Gruenberg, Chairperson, Federal Deposit Insurance Corporation (FDIC)
Mary Jo White, Chair, Securities and Exchange Commission (SEC)
Richard Cordray, Director, Consumer Financial Protection Bureau (CFPB)
Melvin Watt, Director, Federal Housing Finance Agency (FHFA)
Thomas J. Curry, Comptroller of the Currency, Office of the Comptroller of the Currency (OCC)
Debbie Matz, Chairman, National Credit Union Administration (NCUA) (by telephone)
Roy Woodall, Independent Member with Insurance Expertise
Richard Berner, Director, Office of Financial Research (OFR), Department of the Treasury (non-voting member)
Michael McRaith, Director, Federal Insurance Office, Department of the Treasury (non-voting member)
John P. Ducrest, Commissioner, Louisiana Office of Financial Institutions (non-voting member)
Adam Hamm, Commissioner, North Dakota Insurance Department (non-voting member)
David Massey, Deputy Securities Administrator, North Carolina Department of the Secretary of State, Securities Division (non-voting member)

NOT PRESENT:

Timothy G. Massad, Chairman, Commodity Futures Trading Commission (CFTC)

GUESTS:

Department of the Treasury

Sarah Bloom Raskin, Deputy Secretary of the Treasury
Matthew Rutherford, Acting Under Secretary for Domestic Finance
Christopher J. Meade, General Counsel
Patrick Pinschmidt, Deputy Assistant Secretary and Executive Director of the Council
Eric M. Thorson, Inspector General and Chairman of the Council of Inspectors General on Financial Oversight

Board of Governors of the Federal Reserve System

Daniel K. Tarullo, Governor

Federal Deposit Insurance Corporation

Jason Cave, Special Advisor to the Chairman for Supervisory Matters

Securities and Exchange Commission

Lona Nallengara, Chief of Staff

Consumer Financial Protection Bureau
Ron Borzekowski, Deputy Assistant Director

Federal Housing Finance Agency
Mario Ugoletti, Special Advisor to the Director

Office of the Comptroller of the Currency
Jennifer Kelly, Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner

National Credit Union Administration
John Worth, Chief Economist (by telephone)

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

Federal Reserve Bank of New York
William Dudley, President and Chief Executive Officer (by telephone)

Office of Financial Research
Patricia Mosser, Deputy Director for Research and Analysis

Louisiana Office of Financial Institutions
James Cooper, Senior Vice President, Conference of State Bank Supervisors

North Dakota Insurance Department
Mark Sagat, Counsel and Manager, Financial Policy and Legislation, National Association of Insurance Commissioners

North Carolina Department of the Secretary of the State, Securities Division
Christopher Staley, Counsel, North American Securities Administrators Association

PRESENTERS:

Market Update: Foreign Exchange Developments

- *Ramin Toloui, Assistant Secretary for International Markets, Treasury*
- *Thomas J. Smith, Interim Director, Division of Swap Dealer and Intermediary Oversight, CFTC (available for questions)*

Leveraged Lending

- *Nellie Liang, Director, Office of Financial Stability Policy and Research, Federal Reserve*
- *Ashish Kumbhat, Division of Monetary Affairs, Federal Reserve (available for questions)*

2015 Annual Report

- *Trent Reasons, Senior Policy Advisor, Treasury*
- *Daniel Beltran, Senior Economist, Federal Reserve*

Other Business

- *Kathleen Hartnett, Deputy Assistant Attorney General, Department of Justice*
- *Eric Froman, Deputy Assistant General Counsel for the Council, Treasury (available for questions)*
- *Deepthy Kishore, Trial Attorney, Department of Justice (available for questions)*

Supplemental Procedures Relating to Nonbank Financial Company Determinations

- *Matthew Rutherford, Acting Under Secretary for Domestic Finance, Treasury*
- *Patrick Pinschmidt, Deputy Assistant Secretary for the Council and Executive Director of the Council, Treasury*

Benchmark Reform Update

- *John Schindler, Assistant Director, Office of Financial Stability Policy and Research, Federal Reserve*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 1:32 P.M. (EST). He began by welcoming Eric Thorson, Treasury's Inspector General and Chairman of the Council of Inspectors General on Financial Oversight, who was invited to observe the meeting. The Chairperson then outlined the meeting agenda, which had previously been distributed to the members together with copies of the resolution and other materials. The agenda for the executive session of the meeting included the following subjects: (1) a market update on foreign exchange developments; (2) leveraged lending; and (3) the Council's 2015 annual report.

1. Market Update: Foreign Exchange Developments

The Chairperson introduced Ramin Toloui, Assistant Secretary for International Finance at Treasury, who presented an update on recent developments related to foreign exchange markets. He described the Swiss National Bank's decision on January 15, 2015, to discontinue its efforts to peg the Swiss franc to the euro. Mr. Toloui discussed the market reaction to the Swiss National Bank's decision, possible vectors for the transmission of stress, and the potential for related market developments in 2015. Following the presentation, members of the Council asked questions and had a discussion.

2. Leveraged Lending Update

The Chairperson then introduced the next agenda item, a presentation on speculative-grade debt markets, including leveraged lending. Nellie Liang, Director of the Federal Reserve's Office of Financial Stability Policy and Research, presented on developments in these markets. She noted the increased issuance of speculative-grade debt and that the quality of new issues has been weak. She also noted that speculative-grade bond spreads are low and the leverage of

speculative-grade nonfinancial businesses is rising. She then discussed potential risks to financial stability relating to these markets. Members of the Council then asked questions on topics including implications of the decline in oil prices, and had a discussion.

3. 2015 Annual Report

The Chairperson introduced Trent Reasons, Senior Policy Advisor at Treasury, and Daniel Beltran, Senior Economist at the Federal Reserve, to present on the next agenda item, the Council's 2015 annual report. They explained that work had begun on developing the report and that the target date for publication was the spring. They stated that they expected the structure to be similar to prior reports and to be based on five substantive sections: (1) macroeconomic environment, (2) financial developments, (3) regulatory developments and Council activities, (4) potential emerging threats, and (5) recommendations. They described potential recommendations and topics for the report, including potential new risk topics and themes they expected to re-emphasize from the 2014 report. Members of the Council then asked questions and had a discussion, including regarding potential topics to be considered in the report.

4. Other Business

Finally, the Chairperson introduced Kathleen Hartnett, Deputy Assistant Attorney General from the Department of Justice. Ms. Hartnett gave a presentation regarding the lawsuit brought by MetLife, Inc. challenging the Council's determination in December 2014 that the company would be subject to Federal Reserve supervision and enhanced prudential standards. Members of the Council asked questions and had a discussion.

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

Open Session

The Chairperson called the open session of the Council meeting to order at approximately 2:59 P.M. (EST). The agenda for the open session of the meeting included: (1) the nonbank financial company designations process; (2) an update on benchmark reform efforts; and (3) consideration of, and a vote on, a resolution approving the minutes of the Council's meeting on December 18, 2014.

1. Nonbank Financial Company Designations Process

The Chairperson introduced the first agenda item, the nonbank financial company designations process. He noted that prior to the financial crisis and the formation of the Council, no single entity was accountable for monitoring and addressing risks to financial stability, but rather each regulator focused on the institutions, functions, or markets under its own purview. He described the Council's authority to designate nonbank financial companies for Federal Reserve supervision and enhanced prudential standards as an important part of the Council's role in bringing together regulators from across the financial system to identify threats to financial stability and take action to address such threats.

The Chairperson stated that the Council does not reach the decision to designate a firm lightly. He noted that the Council reviews a company in extraordinary detail before doing so, including working closely with the company and its regulators, to determine how the firm's material financial distress, if it were to occur, could affect the broader financial system. He observed that the existing process is rigorous and includes extensive engagement and communication with any firm under consideration. At the same time, he stated that the Council, as a young organization, must periodically examine how it conducts its activities. He stated that following last year's enhancements to the Council's governance procedures and transparency policy, the Council proceeded to examine ways to enhance its nonbank financial company designations process and that, at the Council's instruction, staff conducted extensive outreach to stakeholders in the fall of 2014.

The Chairperson noted attempts to roll back financial reform in recent months and stated his opposition to diminishing the Council's ability to address threats to stability, including its authority to designate nonbank financial companies. He then introduced Matthew Rutherford, Acting Under Secretary for Domestic Finance at Treasury and Chairperson of the Council's Deputies Committee, to describe the stakeholder outreach that had been conducted, and Patrick Pinschmidt, Deputy Assistant Secretary and Executive Director of the Council at Treasury, to describe the types of changes the Council is considering.

Acting Under Secretary Rutherford stated that Council staff had worked diligently over the past four months to identify potential enhancements to the Council's nonbank financial company designation process. He explained that staff began a series of conversations with a wide range of stakeholders and also solicited input from Congressional staff and each of the companies then subject to a designation. In total, Mr. Rutherford stated that staff heard the views of 20 different trade groups, companies, consumer advocates, and public interest organizations. He noted that the Government Accountability Office's recent review of the Council's nonbank financial company designations process also informed the staff's work.

Mr. Rutherford then provided a brief summary of the feedback the staff received and described three key themes emerging from the staff's outreach discussions. He stated that companies in the process want to know earlier when they are under consideration and to engage earlier in the process, although some stakeholders argued that earlier engagement would subject the Council and staff to attempts to slow down or hinder the process. Mr. Rutherford stated that there was also broad agreement that the public would benefit from more information on the Council's process and the Council's reasons for designating particular companies. Finally, he stated that staff heard that the Council should better explain its process for its annual reevaluations of designations and enable more engagement in that process, including opportunities to meet with the Council.

Mr. Pinschmidt then detailed the staff recommendations for potential changes to the Council's process. He described recommendations in three categories: (1) engagement with companies under consideration by the Council for potential designation; (2) transparency to the broader public regarding the designations process; and (3) the Council's annual reevaluations of previous designations.

Under the first category of recommendations, Mr. Pinschmidt stated that the Council would notify a company when it comes under active review in Stage 2 of the Council's process for evaluating companies, rather than first notifying a company only when it is advanced to Stage 3. He further explained that, under the recommendations, a company under active review in Stage 2 would have the opportunity to meet with staff representing Council members and member agencies, receive a description of the primary sources of public information staff are reviewing, and provide any relevant information. Under the recommendations, if the Council votes to not advance a company from Stage 2 to Stage 3, the Council would notify the company in writing of the Council's decision. If the Council votes to advance a company from Stage 2 to Stage 3, under the recommendations, staff would meet with the company's representatives at the start of Stage 3 to explain the evaluation process and the framework for the Council's analysis; if the analysis in Stage 2 identified specific aspects of the company's operations or activities as the primary focus for the evaluation, staff would notify the company of those issues. Further, Mr. Pinschmidt noted that under the recommendations, the Council's Deputies Committee would meet with a company in Stage 3. Under the recommendations, the Council would continue to engage with a company's primary financial regulatory agencies, including notifying the regulator when the company comes under active review in Stage 2 and beginning the consultation process with the regulator before any vote to advance the company to Stage 3.

Mr. Pinschmidt stated that under the second category of recommendations, if a company under review by the Council has publicly announced the review, the Council would, on the request of a third party, confirm the status of the company's review. He also stated that, under the recommendations, the Council would continue providing the public with a greater understanding of the Council's analysis supporting any final designation, while continuing to meet its statutory obligation to protect sensitive, confidential information submitted by companies; include more information in its annual reports about its designations work, including the number of companies that have been voted on in Stages 2 and 3; and publish further details explaining how the Council calculates the uniform, quantitative Stage 1 thresholds used to identify nonbank financial companies for review in Stage 2.

For the third category of recommendations, Mr. Pinschmidt stated that when the Council conducts its annual review of a nonbank financial company's designation, the company would have an opportunity to meet with staff to discuss the scope and process for the review and to present information regarding any relevant changes. He also stated that, under the recommendations, if a company contests its designation in an annual review, the Council would vote on whether to rescind the designation and would provide the company with a written explanation if it decides not to rescind the designation. In addition, Mr. Pinschmidt stated that, under the recommendations, the Council would give each designated company an opportunity for an oral hearing before the Council every five years to contest its designation.

The Chairperson expressed his strong support for the recommendations, describing them as good changes that would refine engagement with the companies under review and provide additional transparency to the public. He suggested that the recommendations be formalized for adoption.

Federal Reserve Chair Janet Yellen described the recommendations as a strong set of proposals for enhancing the Council's process for making nonbank financial company designations and

stated that she supported adopting them. She also stated that the Council's goal should be to make the designation process and the rationale for the Council's decisions as transparent as possible while safeguarding confidential firm-specific information. She also observed that the staff proposals meaningfully respond to concerns that financial companies, public interest groups, and members of Congress raised, and also took into account Government Accountability Office recommendations.

Comptroller of the Currency Thomas Curry stated that he believes the current designation process is robust and provides ample opportunities for engagement with firms under consideration but that he also supports the recommendations and ongoing efforts to review and improve the Council's process generally.

SEC Chair Mary Jo White voiced her support for the Council's efforts to enhance transparency and its process for nonbank financial company designations, including the proposals described in the presentation and the continuing study of possible enhancements.

Federal Insurance Office Director Michael McRaith thanked insurance stakeholders, including firms and staff of the National Association of Insurance Commissioners for their engagement with the Council in support of the nonbank financial company designations process discussion and described input from firms and state regulators as tremendously constructive.

CFPB Director Richard Cordray stated he supported the proposals put forward in the meeting. He also stated that he did not believe that these proposals would affect any of the determinations the Council has previously made and that the Council has always based its determinations on an extensive, thorough, careful, and comprehensive record and through an accessible process.

2. Benchmark Reform Update

The Chairperson then introduced John Schindler, Assistant Director of the Federal Reserve's Office of Financial Stability Policy and Research, to provide an update on the efforts by U.S. and foreign regulators to reform interest rate benchmarks, a topic that has been an important area of focus for the Council over the past several years, including in annual reports.

Mr. Schindler described the context for benchmark rate reform, noting the June 2012 revelations that some banks manipulated or attempted to manipulate rates such as the London Interbank Offered Rate (LIBOR), which damaged public confidence in the rates and encouraged some banks to withdraw from reference rate panels. He raised the concern that had many banks withdrawn from the LIBOR panel, it may have been difficult to publish a meaningful rate, drawing into question the ability of about \$300 trillion in LIBOR-based contracts to settle.

Mr. Schindler stated that the Council recommended reference rate reform in its 2013 and 2014 annual reports, including that U.S. and foreign regulators cooperate with international bodies and market participants to reform interest rate benchmarks, including by identifying alternative interest rate benchmarks for potential use by market participants and by promoting an orderly transition to those alternative rates.

Mr. Schindler stated that in 2013, the Financial Stability Board set up an official sector steering group charged with developing reference rate reform recommendations. He stated that the group's key recommendation, released in July 2014, was that there should be multiple, transaction-based reference rates. Mr. Schindler explained that the benefits of this approach would include allowing users to choose a rate that more closely ties to the underlying economic purpose of the transaction; reducing the incentive to manipulate any particular rate; and enhancing stability by having more alternative rates available. He stated that a reformed, strengthened LIBOR would be among those reference rates and that it would continue to include a measure of bank credit risk in it and be a proxy for a bank's cost of funding. He also described other rates that would be risk-free and more appropriate for transactions where credit risk is a very small component or non-existent. Having these new rates alongside a reformed LIBOR, Mr. Schindler stated, would both offer market choice and avoid the problem of replacing LIBOR for existing contracts that reference it.

With respect to strengthening LIBOR, Mr. Schindler stated that administration of the rate had shifted from the British Bankers Association to Intercontinental Exchange Benchmark Administration (IBA). He explained that IBA advocates for using a transactions-based approach to calculating LIBOR, for increasing the number of participating banks on the rate panels, for widening the scope of transactions used to make it more representative of bank funding costs, and for increasing the time frame for considering transactions.

For a risk-free, side-by-side alternative rate, Mr. Schindler stated that the Federal Reserve is sponsoring an alternative reference rate committee consisting of market participants and with support from agencies including Treasury, the CFTC, and foreign agencies. He stated this committee is working to (1) identify best practices for reference rates and rates that meet those best practices; (2) develop an adoption plan for these alternative rates, including a timeline for the plan; and (3) consider contract robustness in the event a reference rate cannot be published. Mr. Schindler also noted the challenges in shifting market practices from a long-standing reference rate and stated that the Federal Reserve and other agencies have been working to address some of those challenges, including the way various accounting standards and tax principles treat the reference rates. He also noted the involvement of market participants, including end users, clearing houses, and exchanges, to ensure incorporation of their views in the alternative reference rate development.

The Chairperson asked how smooth a transition to new benchmarks would be and about Mr. Schindler's confidence in there being a transactional base to inform the benchmarks. In response, Mr. Schindler stated that keeping LIBOR as a reference rate option lessens the transitional hurdle and that involving market participants in the process is an important part of the strategy for encouraging adoption of alternative rates. He described the overhaul of LIBOR to make it more robust.

OFR Director Richard Berner asked Mr. Schindler to describe some of the interest rate benchmarks that have been proposed as potential LIBOR alternatives. Director Berner also commented on the importance of data quality and the use of standards for creating and maintaining reference rates. Mr. Schindler stated that for alternative stand-alone U.S. dollar rates that could exist side-by-side with LIBOR, three rates have been mentioned most

prominently: (1) overnight index swap rates, or a derivative of those; (2) Treasury yields; and (3) general collateral repo rates.

3. Resolution Approving the Minutes of the Meeting held on December 18, 2014.

“BE IT RESOLVED, by the Financial Stability Oversight Council (the “Council”), that the minutes attached hereto of the meeting held on December 18, 2014 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 3:34 P.M. (EST).