Minutes of the Financial Stability Oversight Council

May 30, 2019

PRESENT:

Steven T. Mnuchin, Secretary of the Treasury and Chairperson of the Financial Stability Oversight Council (Council)
Jerome H. Powell, Chairman, Board of Governors of the Federal Reserve System (Federal Reserve)
Jelena McWilliams, Chairman, Federal Deposit Insurance Corporation (FDIC) (by telephone)
Jay Clayton, Chairman, Securities and Exchange Commission (SEC)
J. Christopher Giancarlo, Chairman, Commodity Futures Trading Commission (CFTC)
Kathleen Kraninger, Director, Consumer Financial Protection Bureau (CFPB)
Mark Calabria, Director, Federal Housing Finance Agency (FHFA)
Joseph Otting, Comptroller of the Currency, Office of the Comptroller of the Currency (OCC) (by telephone)
Rodney Hood, Chairman, National Credit Union Administration (NCUA)
Thomas E. Workman, Independent Member with Insurance Expertise
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) (by telephone)
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:

Department of the Treasury (Treasury)
Brent McIntosh, General Counsel
Heath Tarbert, Acting Under Secretary for International Affairs
Craig Phillips, Counselor to the Secretary
Bimal Patel, Deputy Assistant Secretary for the Council
Eric Froman, Principal Deputy Assistant General Counsel (Banking and Finance) and Executive Director of the Council
Howard Adler, Senior Advisor, Office of Domestic Finance
Stephen Ledbetter, Director of Policy, Office of the Financial Stability Oversight Council

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

Federal Deposit Insurance Corporation
Travis Hill, Senior Advisor to the Chairman

Securities and Exchange Commission
Jeffrey Dinwoodie, Senior Counsel and Policy Advisor for Market and Activities-Based Risk

Commodity Futures Trading Commission
Michael Gill, Chief of Staff

Consumer Financial Protection Bureau
Hallee Morgan, Attorney-Advisor

Federal Housing Finance Agency
Sandra Thompson, Deputy Director, Division of Housing Mission and Goals

Comptroller of the Currency
Robert Phelps, Deputy Comptroller for Supervision Risk Management

National Credit Union Administration
Andrew Leventis, Chief Economist

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

Office of Financial Research (OFR)
Kipp Kranbuhl, Acting Assistant Secretary for Financial Institutions, Treasury
Stacey Schreft, Deputy Director for Research and Analysis

Federal Insurance Office
Kevin Meehan, Senior Insurance Regulatory Policy Analyst

Texas Department of Banking
James Cooper, Senior Vice President for Policy, Conference of State Bank Supervisors

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

Maryland Office of the Attorney General, Securities Division
Christopher Staley, Counsel, North American Securities Administrators Association

PRESENTERS:

Proposed Interpretive Guidance on Nonbank Financial Company Designations
- *Bimal Patel, Deputy Assistant Secretary for the Council, Treasury*
- *Mark Schlegel, Attorney-Advisor, Treasury (available for questions)*

U.S. Nonfinancial Corporate Credit and Leveraged Lending

- *Craig Phillips, Counselor to the Secretary, Treasury*
- *Richard Farber, Senior Advisor, Treasury (available for questions)*

Equity Market Structure

- *Brett Redfearn, Director, Division of Trading and Markets, SEC*
- *Richard Farber, Senior Advisor, Treasury (available for questions)*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 3:04 P.M.

The Chairperson began by welcoming Mark Calabria, the Director of the FHFA, and Rodney Hood, the Chairman of the NCUA, to their first meeting as members of the Council. The Chairperson thanked J. Christopher Giancarlo, Chairman of the CFTC, for his service. The Chairperson also thanked Craig Phillips, Counselor to the Secretary at Treasury, for his work. 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 of the meeting included (1) a presentation on the Council's proposed interpretive guidance on nonbank financial company designations; (2) an update on U.S. nonfinancial corporate credit and leveraged lending; (3) an update on equity market structure; and (4) a vote on the minutes of the Council's meeting on March 6, 2019.

1. Proposed Interpretive Guidance on Nonbank Financial Company Designations

The Chairperson then introduced the first agenda item, a presentation on the Council's proposed interpretive guidance on nonbank financial company designations, which the Council had approved on March 6, 2019. The Chairperson turned to Bimal Patel, Deputy Assistant Secretary for the Council at Treasury.

Mr. Patel stated that the public comment period for the proposed interpretive guidance had closed on May 13. He noted that the Council had received 26 comment letters, and he described the types of commenters, including industry advocacy groups, other advocacy organizations, and financial companies. Mr. Patel stated that 20 of the commenters generally supported the proposed interpretive guidance, including the proposal for the Council to prioritize its work to identify and address potential risks to U.S. financial stability using an activities-based approach (ABA) and the Council's proposed analytical enhancements to the nonbank financial company designation process. Mr. Patel noted that six commenters were generally opposed to the proposal, arguing it would limit the Council's tools for addressing risks to financial stability.

Mr. Patel then highlighted several issues that numerous comment letters had addressed. For example, he described the comments regarding the Council's proposed methodology and process for assessing risks under the ABA; the proposed changes to the Council's nonbank financial company designation process and analysis. He noted that several commenters supported the Council's extensive engagement with existing primary regulatory agencies under the proposal.

Mr. Patel also noted certain areas where commenters had requested further detail, including the Council's approach to voting on transitions in the ABA and designations processes and the Council's definitions of certain terms in the guidance. In addition, he described comments supporting and opposed to the proposed designation "off-ramp" under the guidance. Mr. Patel concluded by stating that staff supporting the Council would work together to review the comment letters and consider potential changes to the guidance, with the goal of publishing final interpretive guidance by the end of 2019.

2. U.S. Nonfinancial Corporate Credit and Leveraged Lending

The Chairperson then introduced the second agenda item, an update on U.S. nonfinancial corporate credit and leveraged lending. He introduced Craig Phillips, Counselor to the Secretary at Treasury, who described recent market developments and highlighted the ongoing collaboration among financial regulators on this topic.

Mr. Phillips noted that the Council had discussed nonfinancial corporate credit and leveraged lending at its previous meeting, on March 6, 2019, and that the President's Working Group on Financial Markets had subsequently discussed this topic. He described banks' exposures to leveraged lending, stating that the exposures were relatively limited and that there did not appear to be significant concentrations. He noted, however, that outstanding leveraged loans are relatively high compared to U.S. gross domestic product, and that further research was needed. He stated that Treasury and other agencies would continue to work together to assess this issue. He also highlighted the importance of assessing risks related to collateralized loan obligations and funds with exposures to leveraged loans. Finally, he noted analytical challenges related to data availability and definitional questions regarding leveraged loans.

3. Equity Market Structure

The Chairperson then introduced the third agenda item, a presentation on equity market structure. He turned to Jay Clayton, Chairman of the SEC, and Brett Redfearn, Director of the Division of Trading and Markets at the SEC, for the presentation.

Mr. Redfearn began by describing key characteristics of current equity markets. He noted factors including extremely high transaction speeds; widespread use of varying algorithmic trading strategies; market fragmentation and complexity; the ownership structure of exchanges; competitive dynamics and pricing structures in various areas, including market access and market data; and increasing market concentration in market making, trading, financing, clearance, and custody. He then highlighted examples of extraordinary market volatility, and he described measures the SEC and other regulators had put in place to address those types of issues. In particular, he described the SEC's Market Access Rule, which generally requires broker-dealers to implement risk-management controls and supervisory procedures that control the access they provide to markets, and Regulation Systems Compliance and Integrity, which generally requires certain SEC-regulated markets and other market utilities to have certain measures in place concerning their systems resiliency and security, provide certain notifications to their members and to the SEC upon the occurrence of systems disruptions and other events, and conduct systems testing, among other things. He also noted other measures the SEC had implemented, including certain restrictions on short sales in certain circumstances; a "limit up–limit down" mechanism adopted by the Financial Industry Regulatory Authority (FINRA) and the securities exchanges that prevents certain trades from occurring outside of specified price bands; and market-wide circuit breakers that have been updated by FINRA and the securities exchanges.

Mr. Redfearn then described the "maker-taker" exchange pricing model. He explained that in this pricing model, exchanges offer rebates to providers of liquidity ("makers" of liquidity) in order attract limit orders and compete for market share, and charge a transaction fee to market participants who trade against resting orders (or "takers" of liquidity). He described several concerns that have been raised related to maker-taker pricing, including whether the SEC's current regulation of exchange pricing models is effective; incentives that lead to potential conflicts of interest; the possibility that rebates could contribute to excessive intermediation; and the potential for increasing complexity and market fragmentation. Mr. Redfearn then described the SEC's transaction fee pilot rulemaking, which is intended to generate data to test the effects of existing exchange pricing models. He stated that data from the pilot program would be used to facilitate an empirical evaluation of existing exchange pricing models and whether they are furthering statutory goals.

Mr. Redfearn then described issues relating to market data and market access. He noted that currently, in U.S. equity markets, the provision of market access and market data is not uniform and could be described broadly as a two-tiered system: proprietary data streams and access services sold by exchanges that are fast, content-rich, and expensive; and public data feeds that are slower and provide less-extensive data. He pointed out concerns that have been raised related to the effectiveness and fairness of this structure, including asymmetric information and access across different types of market participants, additional implicit trading costs for those using inferior services, a potential lack of competition in the provision of these services, and continued cost escalation, which could foster additional consolidation. He noted ways in which data asymmetries can affect retail investors. Mr. Redfearn then stated that the SEC staff is evaluating potential regulatory responses to these market data and access issues. He concluded by noting that the United States has the largest, deepest, most vibrant equity markets in the world, and that regulators must be vigilant, monitor their functioning, and identify ways to improve them.

Members of the Council then asked questions and had a discussion, including regarding potential risks arising from algorithmic trading and concentration; the rapid changes in equity market structure over the last 20 years; the potential for market-making issues in the futures markets; and the importance of ongoing collaboration among regulators on these issues.

4. Other Business

Before concluding the meeting, the Chairperson asked Director Calabria and Chairman Hood about their priorities in their new positions. Director Calabria noted his focus on issues related to housing finance reform, and Chairman Hood highlighted his attention to cybersecurity issues at credit unions.

5. Resolution Approving the Minutes of the Meeting Held on March 6, 2019

BE IT RESOLVED, by the Financial Stability Oversight Council (the "Council"), that the minutes attached hereto of the meeting held on March 6, 2019 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.