Minutes of the Financial Stability Oversight Council

November 7, 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)
Heath P. Tarbert, 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)
Rodney Hood, 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) (by telephone)

GUESTS:

Department of the Treasury (Treasury)
Justin Muzinich, Deputy Secretary of the Treasury
Brian Callanan, General Counsel
Brian Morrissey, Deputy General Counsel
Bimal Patel, Assistant Secretary for Financial Institutions
Howard Adler, Deputy Assistant Secretary for the Council
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

Board of Governors of the Federal Reserve System
Michael Gibson, Director, Division of Supervision and Regulation

Federal Deposit Insurance Corporation
Travis Hill, Deputy to the Chairman for Policy

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

Commodity Futures Trading Commission
Jaime Klima, Chief of Staff

Consumer Financial Protection Bureau
Christopher Mufarrige, Senior Advisor

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

Comptroller of the Currency
Steven Key, Associate Deputy Comptroller for Bank Supervision Policy

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 (by telephone)

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

Federal Insurance Office
Kevin Meehan, Senior Insurance Regulatory Policy Analyst

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

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
Kameron Hillstrom, Counsel, North American Securities Administrators Association

PRESENTERS:

Proposed Interpretive Guidance on Nonbank Financial Company Designations
- *Howard Adler, Deputy Assistant Secretary for the Council, Treasury*

- *Stephen Ledbetter, Director of Policy, Office of the Financial Stability Oversight Council, and Executive Director of the Council, Treasury (available for questions)*
- *Eric Froman, Assistant General Counsel (Banking and Finance), Treasury (available for questions)*

Cloud Service Providers
- *Ray Diggs, Deputy Associate Director for Risk, Federal Reserve*
- *Kevin Greenfield, Director for Bank Information Technology, OCC*
- *Martin Henning, Deputy Director, Operational Risk, FDIC*
- *Brian Callanan, General Counsel, Treasury*
- *Edward Kraus, Senior Financial Policy Analyst, Federal Reserve (available for questions)*
- *Neha Contractor, Manager, Federal Reserve (available for questions)*

Current Expected Credit Losses (CECL)
- *Sydney Menefee, Deputy Comptroller and Chief Accountant, OCC*
- *Ben Ranish, Senior Economist, Federal Reserve*
- *Robert Storch, Chief Accountant, FDIC*
- *Sarah Chae, Senior Accounting Policy Analyst, Federal Reserve (available for questions)*

2019 Annual Report
- *Stephen Ledbetter, Director of Policy, Office of the Financial Stability Oversight Council, and Executive Director of the Council, Treasury*
- *James Bohn, Senior Professional, Federal Reserve Bank of Boston*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 3:33 P.M.

The Chairperson began by outlining the meeting agenda, which had previously been distributed to the members together with other materials. The agenda for the executive session of the meeting included (1) the Council's proposed interpretive guidance on nonbank financial company designations; (2) cloud service providers; (3) the current expected credit losses accounting methodology; (4) the Council's 2019 annual report; (5) a vote on approving the appointment of the Executive Director of the Council; and (6) a vote on the minutes of the Council's meeting on September 4, 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 under section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Council approved the proposed interpretive guidance on March 6, 2019. The Chairperson turned to Howard Adler, Deputy Assistant Secretary for the Council at Treasury, for the presentation.

Mr. Adler explained that staff were working to finalize the interpretive guidance. He described the primary changes to the proposal in the current draft of the final interpretive guidance. In particular, he described revisions in the current draft of the final interpretive guidance related to the Council's analysis and procedures in the proposed activities-based approach and in its evaluation of nonbank financial companies for potential designation under section 113 of the Dodd-Frank Act.

2. Cloud Service Providers

The Chairperson then introduced the next agenda item, financial institutions' use of cloud service providers. He stated that he had received a number of questions about potential risks posed by financial institutions' use of third-party cloud service providers. He noted that some commenters had recommended that the Council consider designating certain cloud service providers as systemically important financial market utilities (FMUs). Before turning to the presentation, the Chairperson asked Brian Callanan, General Counsel at Treasury, to provide an analysis of the Council's authorities and whether cloud service providers are FMUs.

Mr. Callanan began by explaining that section 804 of the Dodd-Frank Act gives the Council the authority to designate any FMU that it determines is, or is likely to become, systemically important. He explained the statutory definition of "financial market utility," which encompasses any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person. He then described his analysis of cloud service providers under this definition. He concluded that while new cloud service provider business models could emerge over time, no cloud service provider had been identified that would currently qualify as an FMU under the plain meaning of the statute.

The Chairperson then introduced Ray Diggs, Deputy Associate Director for Risk at the Federal Reserve, and Kevin Greenfield, Director for Bank Information Technology at the OCC, for the presentation.

Mr. Greenfield began by describing banks' current usage of cloud service providers. He noted that a limited number of banks had moved critical services to the cloud, but that there was wider adoption of cloud-based services for less-critical functions, such as document archiving and human resources systems. He then described several different types of cloud deployments and cloud service models. He noted that his presentation was focused on public cloud environments, in which computing resources are available in a shared environment, accessible by multiple customers of the cloud service provider.

Mr. Greenfield then described banking agencies' authorities for oversight of public cloud service providers. He noted that under the Bank Service Company Act, federal banking regulators can examine the performance of covered services provided by third parties to the same extent as if such services were performed by the serviced financial institution. He explained that in supervising banks' critical service providers, regulators consider the types of services provided; the services' criticality to the banks; the number of banks being serviced; and the size of those banks. He explained that the banking agencies' interagency supervision program for technology service providers has been in place for over 30 years. He noted that this oversight, including on-site examinations, supports regulators' mission of bank supervision and safety and soundness.

Members of the Council then asked questions and had a discussion, including regarding banks' adoption of public cloud services and banking agencies' authorities to supervise and examine cloud service providers.

3. Current Expected Credit Losses

The Chairperson then introduced the next agenda item, the current expected credit losses (CECL) accounting methodology. He stated that the Council had discussed this issue at its meeting in December 2018. The Chairperson noted that he had recently received a letter from members of Congress regarding CECL. He then introduced Sydney Menefee, Deputy Comptroller and Chief Accountant at the OCC; Ben Ranish, Senior Economist at the Federal Reserve; and Robert Storch, Chief Accountant at the FDIC, for the presentation.

Ms. Menefee began by stating that she would provide an update on the transition to CECL. She stated that CECL was an accounting change from an incurred-loss methodology to an expected-loss methodology. She noted that the incurred-loss methodology, which requires firms to recognize credit losses when losses are probable, had been criticized as resulting in loan losses that were "too little, too late." She stated that CECL, in contrast, requires entities to recognize expected credit losses. She noted that the Financial Accounting Standards Board (FASB) had issued CECL in 2016 after eight years of deliberations. She explained that CECL applies to all entities, regardless of their size or industry. She stated that most SEC registrants must adopt CECL in 2020, and that most others will adopt CECL in 2023. She also noted that the banking agencies were allowing a transition period to phase in CECL's day-one effect on regulatory capital at banking organizations. She then noted that, based on certain banks' recent public disclosures, the impact of CECL on those firms' allowances would range from an increase of 115 percent to a decrease of 14 percent. She stated that none of those firms would be near their regulatory capital minimums due to the day-one impact of CECL. She also noted that legislation had been introduced in Congress to require further study of CECL before its implementation. She noted that Federal Reserve staff had conducted several studies of CECL.

Mr. Ranish then described research that had been conducted by economists, companies, and trade associations on the economic impact CECL will have. He stated that studies have found that CECL will generally accelerate loss provisioning, but that the studies disagree on the impact of the change because of their different assumptions regarding how lenders will react to CECL. He stated that CECL could have a procyclical or anticyclical impact, depending on how various factors trade off in practice and how CECL is implemented. He stated that for these reasons, conducting further new research may be of limited benefit. He noted that the banking agencies had adopted a three-year phase-in period for CECL's impact on regulatory capital ratios and a two-year commitment to maintain the current modeling framework in the Federal Reserve's stress tests.

Ms. Menefee then described CECL's potential impact on access to credit. She stated that no banks had indicated that they were changing their lending mix due to CECL. She stated that she expected the aggregate impact of CECL to be moderate, but that it could be significant at certain individual institutions. She then described the OCC's assessments of CECL's impact on individual OCC-regulated financial institutions.

Mr. Storch then noted that CECL allows companies to develop their own loss-estimation methods. He stated that community financial institutions will not need to engage in complex modeling or retain third-party service providers to apply CECL. He also noted that institutions other than SEC registrants have until 2023 to adopt CECL. He stated that regulators and the FASB are continuing their outreach to the public regarding CECL.

Members of the Council then asked questions and had a discussion. Among other issues, Council members discussed the estimated impact CECL will have on reserves at various financial institutions; types of financial products and financial institutions, including community banks, on which CECL will have a greater or lesser impact; CECL's impact on banks' earnings and capital; and consistency between CECL and the accounting methodology under the International Financial Reporting Standards.

The Chairperson asked the OFR to review existing research on CECL and to report back to the Council with a summary of that literature.

4. 2019 Annual Report

The Chairperson then introduced the next agenda item, the Council's 2019 annual report. He introduced Stephen Ledbetter, Director of Policy in the Office of the Financial Stability Oversight Council and Executive Director of the Council at Treasury, and James Bohn, Senior Professional at the Federal Reserve Bank of Boston.

Mr. Ledbetter summarized the structure of the annual report, noting certain topics that would be addressed in the report as recommendations of the Council or as potential emerging threats and vulnerabilities. Mr. Bohn then noted several topics in the report. Mr. Ledbetter then described the timeline for completing the draft of the annual report and preparing it for approval by the Council.

5. Approval of Appointment of Council Executive Director

The Chairperson then introduced the next agenda item, the approval of the appointment of a new Executive Director of the Council. The Chairperson noted that the Council's Executive Director serves as a principal advisor to Treasury officials on the work of the Council and the Council's committees and coordinates with Council members and their staffs. He explained that the Executive Director also provides general leadership over the work of the Council and the Council's committees in the absence of Treasury's Deputy Assistant Secretary for the Council or during periods of transition.

The Chairperson presented to the Council the following resolution approving the appointment of Stephen Ledbetter as Executive Director of the Council.

WHEREAS, Section XXX.3 of the Rules of Organization of the Financial Stability Oversight Council (Bylaws) establishes the position of Executive Director of the Financial Stability Oversight Council (Council), whose duties are to advise and assist the Council in carrying out its responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act, assist in providing general direction with respect to the administration of the Council's actions, assist in directing the activities of staff, and perform such other duties as the Chairperson may require;

WHEREAS, Section XXX.3(a)(2)(A) of the Bylaws authorizes the Chairperson to designate an individual to serve as Executive Director of the Council, subject to the Council approving by a majority vote of the voting members then serving the appointment of an individual to serve as Executive Director; and

WHEREAS, in order to assist in the conduct of business by the Council, the Chairperson recommends that the Council approve the appointment of Stephen Ledbetter to serve as Executive Director of the Council.

NOW, THEREFORE, BE IT RESOLVED, that the Council hereby approves the appointment of Stephen Ledbetter to serve as Executive Director of the Council, to serve until such time as he resigns or his appointment is terminated as Executive Director of the Council, he is no longer serving as an employee of the Department of the Treasury, or the Council approves the appointment of a new Executive Director of the Council, whichever occurs first.

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

6. Resolution Approving the Minutes of the Meeting Held on September 4, 2019

BE IT RESOLVED, by the Financial Stability Oversight Council (the "Council"), that the minutes attached hereto of the meeting held on September 4, 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 4:29 P.M.