Minutes of the Financial Stability Oversight Council

September 9, 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)
Sandra L. Thompson, Acting Director, Federal Housing Finance Agency (FHFA)
Michael J. Hsu, Acting Comptroller of the Currency, Office of the Comptroller of the Currency (OCC)
Todd M. Harper, Chairman, National Credit Union Administration (NCUA)
Thomas E. Workman, Independent Member with Insurance Expertise
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:

Department of the Treasury (Treasury)
Nellie Liang, Under Secretary for Domestic Finance
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
Randal Quarles, Vice Chairman for Supervision
Andreas Lehnert, Director, Division of Financial Stability

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

Securities and Exchange Commission
Amanda Fischer, Senior Counselor

Commodity Futures Trading Commission
David Gillers, Chief of Staff

Consumer Financial Protection Bureau
Ashwin Vasan, Senior Advisor to the Director

Federal Housing Finance Agency
Naa Awaa Tagoe, Acting Deputy Director, Division of Housing Mission and Goals

Comptroller of the Currency
Blake Paulson, Senior Deputy Comptroller for Supervision Risk and Analysis

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
Philip Goodman, Senior Insurance Regulatory Policy Analyst

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

Maine Bureau of Insurance
Ethan Sonnichsen, Managing Director of Government Relations, National Association of Insurance Commissioners

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

PRESENTERS:

Climate Report Update

- *Eric Juzenas, Counselor to the Under Secretary for Domestic Finance, Treasury*
- *Sean Hoskins, Senior Advisor, Office of the Financial Stability Oversight Council, Treasury (available for questions)*

Commercial Real Estate

- *Jeffrey Levine, Senior Trader/Analyst, Markets Group, Federal Reserve Bank of New York*
- *Woojung Park, Senior Associate, Markets Group, Federal Reserve Bank of New York*

2021 Annual Report

- *Stephen Ledbetter, Director of Policy, Office of the Financial Stability Oversight Council, and Executive Director of the Council, Treasury*
- *Jonathan Rose, Senior Economist, Federal Reserve Bank of Chicago*
- *Alexandra Somers, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury (available for questions)*

Fiscal Year 2022 Council Budget

- *Stephen Ledbetter, Director of Policy, Office of the Financial Stability Oversight Council, and Executive Director of the Council, Treasury*
- *Samantha MacInnis, Director of Operations, Office of the Financial Stability Oversight Council, Treasury*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 1:00 P.M. The Council convened by videoconference.

The Chairperson began by highlighting risks related to the debt limit. She noted that the debt limit was reinstated on August 1, 2021. She stated that since then, Treasury had been using extraordinary measures to continue to finance the government, including not investing portions of some federal trust funds. She stated that those measures were only temporary. The Chairperson stated that on September 8, she sent a letter to Congress stating that, absent Congressional action, the most likely outcome was that Treasury's cash and extraordinary measures would be exhausted during the month of October. She said that if the debt limit was not increased or suspended by the time available resources were exhausted, Treasury would be unable to meet its payment obligations for the first time in the nation's history. She stated that this would force the United States to default on its obligations, which posed truly systemic risks to the global economy and financial system. She stated that this issue was particularly urgent at a time when the nation was still working to recover from the effects of the pandemic. She stated that a default would increase borrowing costs for the government and lead to higher interest rates across the economy, given that Treasury securities serve as the benchmark interest rates for a wide range of credit products. She noted that Treasury securities are also a key asset on financial institutions' balance sheets and are widely used as collateral in short-term financing transactions. She stated that a default on Treasury's obligations would be an unnecessary shock that could lead to concerns about the solvency of certain institutions and cause significant stress in markets. The Chairperson emphasized the importance of assessing the potential risks that the ongoing debt limit impasse could have on regulated entities and markets.

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) the

Council's report under the Executive Order on Climate-Related Financial Risk, (2) commercial real estate, (3) the Council's 2021 annual report, (4) a vote on the Council's fiscal year 2022 budget, and (5) a vote on the minutes of the Council's meeting on July 16, 2021.

1. Climate Report Update

The Chairperson then turned to the first agenda item, an update on the Council's report to be issued under the Executive Order on Climate-Related Financial Risk, which was issued on May 20, 2021 (the Climate EO). She introduced Eric Juzenas, Counselor to the Under Secretary for Domestic Finance at Treasury, and Sean Hoskins, Senior Advisor in the Office of the Financial Stability Oversight Council at Treasury.

Mr. Juzenas provided an update on the status of the development of the report and an overview of the potential recommendations to be included in the report. He also described the timeline for drafting the report and anticipated next steps in the interagency review process. He then highlighted key themes expected to be included in the report.

Council members then asked questions and had a discussion about the draft report, including the proposed recommendations, the role of independent regulatory agencies, and relevant impacts on underserved communities.

2. Commercial Real Estate

The Chairperson then introduced the next agenda item, a presentation on commercial real estate (CRE). She noted that while CRE had broadly recovered from its pandemic lows, some market segments remained highly sensitive to the economic effects of the pandemic, and ongoing review of CRE trends was an important part of monitoring financial stability. She then introduced Jeffrey Levine, Senior Trader/Analyst in the Markets Group at the Federal Reserve Bank of New York, and Woojung Park, Senior Associate in the Markets Group at the Federal Reserve Bank of New York.

Mr. Levine stated that he and Mr. Park would provide an overview of trends and risks in CRE markets since the onset of COVID-19. He noted that the presentation was based on information from industry participants and did not include information gathered during the supervision of banks. Mr. Park then described the CRE market. He noted that the $4.9 trillion market for CRE loans represents 16 percent of total U.S. loans outstanding and is a core component of U.S. commercial bank lending. He noted that prior to the pandemic, CRE experienced a multi-year period of price appreciation, with low CRE capitalization rates suggesting elevated valuations. He stated that when the pandemic began, certain segments of CRE experienced immediate negative effects, with retailers and hotels experiencing reduced revenues. Mr. Park noted that this period saw a temporary halt in the issuance of commercial mortgage-backed securities (CMBS) amid significantly reduced liquidity and wider spreads, with overall loan origination volume declining notably.

Mr. Park then addressed CRE conditions through year-end 2020. He stated that a recovery in capital market conditions had occurred by this time, evidenced by improved issuance levels, and a substantial recovery in CRE loan and CMBS spreads. He stated that although non-agency CMBS loan delinquency rates had increased at the beginning of the pandemic (led by hotel and retail loans), rates had stabilized and started to decline by this time. Mr. Park noted that as of year-end 2020, there was a divide across CRE property segments, with investors preferring perceived safer property types. He stated that concerns remained over the future of major cities and central business district properties, and noted that and started to decline higher delinquencies could lead to an uptick in distressed assets, such as hotels and retail.

Addressing trends in CRE markets in 2021, Mr. Park stated that the widespread availability of vaccinations and recovering economic activity had led to improved performance across CRE property sectors. He stated that CRE property sale transaction volumes had remained robust through the first half of 2021, although there was uneven activity across property types. He noted that CRE property prices generally increased in 2021, but that central business district office prices remained a notable exception. Mr. Park then described various CRE financial market indicators in 2021. He noted that some real estate investment trust indexes (notably multifamily residential and industrial indexes) had retraced their 2020 losses, although retail, hotel, and office indicators continued to lag pre-pandemic levels. He said that credit spreads for private-label CMBS had tightened over much of 2021 and were at or near multi-year lows. He stated that underwriting standards, which market participants reported were stronger in 2021 than immediately before the 2007-09 financial crisis, had assisted the recovery process. Mr. Park stated that loan delinquency rates continued to trend lower in 2021, but that delinquencies remained elevated for some subsectors, such as hotels focusing on business travel or conferences.

Mr. Levine then provided a summary of market conditions experienced by CRE credit providers in 2021. He noted that balance sheet lenders, such as banks and insurance companies, were increasing their lending activity, with a focus on safer CRE property types. He stated that in securitized markets, CMBS issuance had seen a record pace. He stated that leveraged non-bank lenders had returned to their level of market engagement before the pandemic and a greater willingness to extend credit to perceived riskier CRE property types. Mr. Levine noted that data as of the second quarter of 2021 shows that net CRE lending by banks had increased since the onset of COVID-19, particularly among regional and community banks, and he stated that some large banks had increased their indirect CRE exposures through warehouse lending lines to non-bank CRE lenders.

Regarding trends in CRE securitization, Mr. Levine stated that the record pace of issuance in single asset, single borrower CMBS and CRE CLOs highlighted the bifurcated credit availability, alongside strong investor demand and other factors, for credit that is perceived to be of good quality. Mr. Levine stated that reach-for-yield investor behavior added demand for CRE CLOs and the robust return of this market has provided a funding source for leveraged CRE lenders. Commenting on trends in non-bank CRE lending, Mr. Levine stated that concerns had arisen during the peak stress periods in 2020 that many non-banks, particularly the smaller firms, were experiencing strains and paused their lending activity. He noted the emergence of new non-bank entrants in 2021, and stated that both large and smaller non-banks had broadly resumed lending activity in 2021. Noting recent optimism in CRE markets, he stated that certain CRE asset classes, such as multifamily and industrial properties, had attracted strong investor interest at increasingly elevated valuations. He stated that spreads on CRE-based products reached multi-year lows in 2021, despite robust issuance volumes.

Mr. Levine then described industry concerns over the future performance of the office sector. He stated that sources of uncertainty included the increased reliance on telework. He noted signs of potential stress, including the underperformance of equity real estate investment trusts with large exposure to offices in the urban cores of major metropolitan areas. Finally, Mr. Levine discussed potential future risks in the CRE market, including potential additional shutdowns triggered by emerging COVID-19 variants; CRE mortgage borrowers' thinner cash cushions compared to before the pandemic; the non-bank lenders with short-term, less-stable funding; high valuations in some CRE sectors supported by highly optimistic future performance forecasts; interest rate risk; and the risk of a drop in office valuations due to teleworking and reduced demand for office space.

Members of the Council then had a discussion, including regarding the importance of monitoring banks' exposures to CRE loans; risks in the CRE market; and trends in the multifamily housing sector.

3. 2021 Annual Report

The Chairperson then introduced the next agenda item, an update on the Council's 2021 annual report.

She turned to Stephen Ledbetter, Director of Policy in the Office of the Financial Stability Oversight Council at Treasury and Executive Director of the Council; Jonathan Rose, Senior Economist at the Federal Reserve Bank of Chicago; and Alexandra Somers, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury.

Mr. Ledbetter described the process for developing the annual report, and provided an update regarding interagency staff deliberations about the report. Mr. Rose then provided an overview of the organization of the report and highlighted certain topics that the report may address.

Council members then asked questions and had a discussion about certain topics that may be included in the report.

4. Fiscal Year 2022 Council Budget

The Chairperson then introduced the next agenda item, the Council's fiscal year 2022 budget. She introduced Stephen Ledbetter, Director of Policy in the Office of the Financial Stability Oversight Council at Treasury and Executive Director of the Council, and Samantha MacInnis, Director of Operations in the Office of the Financial Stability Oversight Council at Treasury, for the presentation.

Mr. Ledbetter and Ms. MacInnis reported on the Council's proposed budget for fiscal year 2022. Treasury had distributed a proposed budget to the Council in accordance with the Council's bylaws. Mr. Ledbetter explained that the Council's budget included two main components: expenses of the Office of the Financial Stability Oversight Council at Treasury and the Office of the Council's Independent Member with Insurance Expertise; and reimbursement of certain FDIC expenses for implementation of Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed fiscal year 2022 budget included $7.56 million for expenses of the Office of the Financial Stability Oversight Council at Treasury and the Office of the Independent Member with Insurance Expertise, and $3.25 million for the reimbursement of FDIC expenses.

Ms. MacInnis explained that the proposed budget called for 23 staff at Treasury supporting the Council, and four employees in the Office of the Independent Member with Insurance Expertise. She noted that compared to the budget approved by the Council for fiscal year 2021, the proposed budget would allow for an additional six full-time-equivalent employees. She also noted that the Council's actual expenses in fiscal year 2021 had come in under budget due to unfilled staff positions and savings on travel.

The Chairperson then presented to the Council the following resolution approving the Council's budget for fiscal year 2022.

BE IT RESOLVED, by the Financial Stability Oversight Council (the "Council"), that the Council's budget for fiscal year 2022 attached hereto is 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.

5. Resolution Approving the Minutes of the Meeting Held on July 16, 2021

BE IT RESOLVED, by the Financial Stability Oversight Council (the "Council"), that the minutes attached hereto of the meeting held on July 16, 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 2:20 P.M.