Minutes of the Financial Stability Oversight Council

March 31, 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)
Allison Herren Lee, Acting 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)
Blake Paulson, 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:

Department of the Treasury (Treasury)
Wally Adeyemo, Deputy Secretary
Nellie Liang, Counselor to the Secretary
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
Eric Juzenas, Chief Counsel

Commodity Futures Trading Commission
David Gillers, Chief of Staff

Consumer Financial Protection Bureau
Ashwin Vasan, Advisor to the Director

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

Comptroller of the Currency
Jonathan Fink, Assistant Chief Counsel

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

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

PRESENTERS:

Hedge Fund Activities
- *Ted Berg, Senior Financial Analyst, OFR*
- *Ron Alquist, Researcher, OFR*
- *Ram Yamarthy, Researcher, OFR*
- *Jay Kahn, Researcher, OFR (available for questions)*

Open End-Funds

- *Sarah ten Siethoff, Acting Director, Division of Investment Management, SEC*
- *Timothy Husson, Associate Director, Division of Investment Management, SEC*

Climate Change and Its Potential Financial Stability Implications

- *Elizabeth Kiser, Associate Director of Research and Statistics, Federal Reserve*
- *Andreas Lehnert, Director, Division of Financial Stability, Federal Reserve (available for questions)*

Executive Session

The Chairperson called the executive session of the meeting of the Council to order at approximately 2:02 P.M. The Chairperson expressed her support for the Council's mission and stated that she looked forward to working with the Council members to address issues affecting the stability of the financial system. She noted that this was the first Council meeting for several members. Those Council members then highlighted their priorities at their respective agencies, which included safety and soundness issues, risks related to climate change, responses to the coronavirus pandemic, and racial equity.

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) hedge fund activities and (2) open-end mutual funds.

The Chairperson then described new areas that she expected the Council to focus on over the coming year. First, she noted that nonbank financial intermediation can amplify market stresses, and she called for the Council to reestablish its Hedge Fund Working Group, to improve data sharing and risk identification and to strengthen the financial system. Second, she noted the disruption to the Treasury securities market in 2020 and underscored the need for an interagency review regarding the factors that contributed to those stresses. Third, she noted that climate change poses risks to U.S. financial stability and to the U.S. economy, and highlighted the Council's role to coordinate regulators, examine the risks, and resolve financial stability issues relating to climate change.

1. Hedge Fund Activities

The Chairperson then introduced the first agenda item, hedge fund activities. She asked Randal Quarles, Vice Chairman for Supervision at the Federal Reserve, to provide an update on bank supervisory issues related to recent market developments associated with Archegos Capital Management. Vice Chairman Quarles described the circumstances that had led to the company's default and the actions taken by prime brokerages in response to those developments. Allison Herren Lee, Acting Chair of the SEC, then provided additional information regarding Archegos, including further detail regarding the firm's investments and the SEC's coordination with other regulators.

Following these remarks, the Chairperson introduced Ted Berg, Senior Financial Analyst at the OFR; Ron Alquist, Researcher at the OFR; and Ram Yamarthy, Researcher at the OFR.

Mr. Berg began by stating that hedge funds entered 2020 with higher than historical leverage. He noted that while there were no major hedge fund collapses in 2020, hedge funds can amplify or contribute to threats to financial stability. He described hedge fund deleveraging during the crisis, noting that this may have amplified price declines in certain markets. He stated that like other market participants, the industry had likely benefited from the extraordinary policy interventions to stabilize markets. He noted that some very large funds have high leverage and are highly interconnected with financial markets and banks.

Mr. Alquist then described the size of the hedge fund industry, based on gross and net assets, and cited industry concentration among the largest funds. He described recent hedge fund returns, noting a sharp decline in March 2020 that was followed by a sharp recovery in April 2020. He also noted that outflows from hedge funds had been significant in the first quarter of 2020.

Mr. Yamarthy then provided information on hedge fund launches and closures. He also described trends in hedge funds' gross notional exposure since the end of 2019, highlighting reductions in exposures to various asset classes. He stated that some reductions in exposures to U.S. Treasury securities may have been due to hedge funds withdrawing from a specific bond basis trade.

Mr. Berg then discussed hedge fund borrowing in greater detail. He noted that lenders to hedge funds face risks even if such lending is secured, because if a large fund, or many funds, suddenly failed, each counterparty may attempt to sell the collateral in unison, and the value of the collateral could decline materially, imposing losses on counterparties. He also noted that large exposures obtained via leverage can disrupt financial markets when forced sales arise from margin calls or an inability to roll over financing. Finally, Mr. Berg discussed large banks' exposures to hedge funds through lending and the significance of these exposures relative to bank assets. Mr. Berg concluded by noting the importance of the SEC's Form PF.

Members of the Council then asked questions and had a discussion, including regarding the exposures of prime brokerages to hedge funds. The Chairperson noted that the Council's Hedge Fund Working Group would be reestablished and that she had asked staff to develop a workplan.

2. Open-End Funds

The Chairperson then introduced the next agenda item, open-end mutual funds. She introduced Sarah ten Siethoff, Acting Director of the Division of Investment Management at the SEC, and Timothy Husson, Associate Director of the Division of Investment Management at the SEC.

Before the presentation commenced, Acting Chair Lee noted that the SEC staff's presentation was based on newly available data.

Mr. Husson then began by stating that the SEC has a more detailed view than previously regarding open-end fund liquidity. He noted that open-end funds offer daily liquidity to investors, regardless of investment strategy. He stated that the SEC did not previously have comprehensive data on how open-end funds manage liquidity needs. He stated that while fund liquidity risk management involves a complex mixture of factors, empirical analysis of fund liquidity risk may now be more feasible with data obtained through new regulatory filings.

Ms. ten Siethoff then noted that in 2016, the SEC had adopted liquidity risk management rules, which include requirements for a mandatory liquidity risk management program; enhanced reporting and disclosure on Form N-LIQUID, N-CEN and N-PORT; and swing pricing.

Mr. Husson stated that the first quarter of 2020 had presented a liquidity stress test, especially in fixed income markets. He noted that redemptions from bond funds had been historically large, and that credit risk was not the driving factor. He described redemptions by sector and asset class, based on information reported to the SEC, such as on Form N-LIQUID. Mr. Husson stated that Form N-PORT provides information on which tools open-end funds use to manage liquidity. He stated that the additional reporting to the SEC under the liquidity risk management rules enables the SEC to perform a more granular analysis than was possible before.

Ms. ten Siethoff then noted that the SEC had enabled open-end funds to use swing pricing, but she noted that it had not been used due to operational hurdles.

Mr. Husson then described the tools open-end funds use to manage liquidity, such as lines of credit, cash balances, and asset sales.

Members of the Council then asked questions and had a discussion, including on ways to further improve the understanding of open-end funds' vulnerabilities, risks to other parts of the financial system, and impact on markets and the economy during the first quarter of 2020. It was noted that open-ended funds had experienced stress in early 2020 and that actions by the Federal Reserve and other agencies had helped alleviate market stresses. The Chairperson asked interagency staff to assess potential financial stability risks associated with open-end funds, focusing on liquidity risks.

The Chairperson adjourned the executive session of the meeting at approximately 3:07 P.M.

Open Session

The Chairperson called the open session of the meeting of the Council to order at approximately 3:20 P.M.

The Chairperson began the meeting by stating that almost exactly one year ago, the pandemic's outbreak caused significant stress in the economy and in the financial system. She stated that investors, in response to the deep uncertainty, sought safety in the form of cash and short-term government securities. She noted that bond markets became illiquid, and stated that without the swift actions of the Federal Reserve, Treasury, Congress, and others, those stresses could have led to an even greater economic contraction.

The Chairperson stated that the U.S. economy was digging out of a deep hole, but that the hole could have been even deeper. She stated that increased capital and liquidity requirements imposed after the 2008 financial crisis helped banks weather the pandemic-induced crisis. She noted that the fact that extreme policy interventions were still required to support market functioning should serve as a clear reminder that U.S. regulators had to do more to address vulnerabilities in the financial system. She then highlighted three ways for the Council to begin doing that.

First, the Chairperson stated that the Council should examine vulnerabilities in nonbank financial intermediation. She noted that in March 2020, there was evidence of how these vulnerabilities can amplify the existing stress in the financial system. The Chairperson stated that it was encouraging that regulators were considering reform options for money market mutual funds, and stated that she supported the SEC's efforts to strengthen short-term funding markets. She noted that open-end mutual funds offer investments with greater liquidity than their underlying assets. She stated that while these investment funds play a critical role in financing the economy, this practice should be reviewed. She noted that the SEC was studying the performance of open-end mutual funds during the March 2020 market turmoil, and that SEC staff had briefed the Council on their initial analysis in the executive session of the Council meeting. The Chairperson stated that she had asked for an interagency assessment to determine if additional measures should be taken to address this financial stability vulnerability, and if so, to develop recommendations for the Council.

The Chairperson stated that the Council was also briefed in the executive session by the OFR regarding the performance of hedge funds through the COVID-19 crisis. She noted that the pandemic showed that leverage of some hedge funds can amplify stresses. She stated that the Council previously had a Hedge Fund Working Group, and that the group had been reestablished so that the Council can better share data, identify risks, and work to strengthen the financial system.

The Chairperson stated that the second area where regulators need to address vulnerabilities is the U.S. Treasury securities market. The Chairperson stated that a deep and liquid Treasury market is essential for a strong U.S. economy and critical to the entire financial system. She stated that this market supports the U.S. dollar as the world's reserve currency and is the benchmark for asset classes globally. She stated that last year's disruption of the Treasury market warrants a broad, interagency effort. The Chairperson stated that the Council needs to better understand the factors that contributed to an increase in the demand for liquidity by investors, and a reduction in the supply of liquidity by dealers and principal trading firms. She stated that regulators must also make the Treasury securities market more resilient.

Third, the Chairperson stated that regulators must look ahead at emerging risks, particularly climate change. The Chairperson stated that climate change is an existential threat to the environment and poses a tremendous risk to U.S. financial stability. She stated that the U.S. financial system must be prepared for the market and credit risks of climate-related events. The Chairperson stated that the United States must also be prepared for a rapid transition to a net-zero carbon economy, which also creates potential challenges for financial institutions and markets. She noted that the Council has an important role to play, helping to coordinate regulators' collective efforts to improve the measurement and management of climate-related risks in the financial system.

The Chairperson stated that the three areas that she highlighted were major challenges that would require the Council's collective efforts. She noted that these were not the only challenges to financial stability the country faced and that regulators must continue to identify and address other vulnerabilities, such as cybersecurity risks, the growth of nonfinancial corporate credit, the importance of large banks and central counterparties in the financial system, the evolving role of digital assets, and others.

1. Climate Change and Its Potential Financial Stability Implications

The Chairperson then turned to the first agenda item, climate change and its potential financial stability implications. The Chairperson introduced Elizabeth Kiser, Associate Director of Research and Statistics at the Federal Reserve, for the presentation.

Ms. Kiser stated that she would describe the Federal Reserve's framework for analyzing the financial stability implications of climate change. She stated that the Federal Reserve was considering the effects of climate change in the context of its mandates of full employment, price stability, financial stability, and the supervision of financial institutions. She noted that financial stability refers to the ability of the financial system to absorb, rather than amplify, negative shocks. She stated that when the financial system amplifies a negative shock, both employment and inflation can fall far below optimal levels. She noted that for this reason, the Federal Reserve analyzes and monitors the resilience of the financial system to a wide range of potential shocks. She stated that the risks associated with climate change have the potential to be an important factor in the financial system's resilience, and for that reason Federal Reserve staff had begun to analyze its potential effects on financial institutions and markets. She noted that the Federal Reserve was still in the early stages of its analysis of the impact of risks arising from climate change on financial institutions, markets, and the system's overall resilience. She stated that the Federal Reserve had an initial framework for fitting these risks into its monitoring of financial stability. She noted that this framework was published in the Federal Reserve's *Financial Stability Report* issued in November 2020.

Ms. Kiser stated that climate change refers to the trend toward higher average global temperatures and accompanying environmental shifts such as rising sea levels and more severe weather events. She stated that economic and financial risks from climate change can arise from the acute and chronic hazards from a hotter planet, such as severe weather events; the potential impact of measures to mitigate these effects, including government policies and technological developments; and shifts in the perceptions of investors and consumers. She noted that these risks may be amplified by the financial system because the risks may be mispriced and institutions may have leveraged exposures to the risks. She stated that climate risks add a new layer of economic and financial uncertainty to a broad range of financial institutions and markets. She stated that different sectors of the economy, geographic regions, and the markets for assets linked to those sectors and regions face new risks that may diverge from historical patterns. She noted that these risks may already be manifest in some sectors and regions. She stated that as markets come to understand both the risks and the exposures of a range of assets, market prices could shift abruptly.

Ms. Kiser noted that an example of how climate change could increase financial stability risks was through real estate exposures. She stated that some residential and commercial properties will be exposed to damage from increased and more severe hurricanes, wildfires, or rising sea levels. She noted that losses will be borne by the owners of these properties and by institutions holding assets linked to them, such as mortgage-backed securities. She also noted that given the uncertain timing and severity of future climate-related losses and the associated opacity of asset exposures, investors in real estate-linked assets may react abruptly to new information about a region's exposure to climate-related financial risks. She stated that the resulting price changes could be amplified by financial and nonfinancial leverage, funding risks, and the interconnections among affected market participants. She said that greater transparency through improved measurement and disclosure could improve the pricing of climate risks, thereby reducing the likelihood of abrupt changes in the prices of climate-related assets.

Ms. Kiser stated that it was important that regulators understand how resilient financial institutions and markets are to climate-related risks. She noted that continued research into the interconnections between the climate, the economy, and the financial sector could strengthen knowledge of transmission, clarify linkages and exposures, and facilitate more efficient pricing of risk. She stated that the Federal Reserve was undertaking research and analysis related to climate risks in a number of areas. She noted that Federal Reserve staff had written papers about the effects of extreme weather events on retail expenditures, and changes in housing market values from potential sea level rise. She stated that staff were also learning from colleagues at other U.S. regulatory agencies, international authorities, academic institutions, and from market participants. She emphasized that this work was at an early stage.

Ms. Kiser noted that, to identify and assess the risks to the safety and soundness of supervised firms from climate change, and to promote their resilience to those risks, the Federal Reserve recently created a Supervision Climate Committee. She stated that, as a complement to this work, to understand the implications of climate risks for the broader financial system, the Federal Reserve also recently created an additional staff group, the Financial Stability Climate Committee.

Following Ms. Kiser's presentation, the Chairperson asked Ms. Kiser for examples of the data and methodology challenges associated with evaluating the potential financial stability risks of climate change. Ms. Kiser stated that there are a number of challenges associated with data and methodology on this topic. She stated that one of the key challenges was to translate climate-related risks into economic risks, financial risks, and risks to financial stability, and to understand the linkages among those issues across the financial system. She noted that there was considerable uncertainty regarding the time horizon and the likelihood of the various possible physical outcomes, and uncertainty around the policies that could be undertaken to mitigate or adapt to the effects of those changes. Ms. Kiser stated that the geographic and sectoral differences in climate-related risks are also substantial. She noted that climate-related risks and policies may differ across geographic areas, sectors, asset classes and institution types. She stated that the availability of data along these dimensions was limited in many respects, particularly in linking these issues together. She noted that the modeling of climate risks was also complex. Finally, she stated that there could be different exposures to participants in different parts of the financial system, as well as linkages through financial instruments or contracts that could transmit risks.

The Chairperson stated that the potential risks that climate change poses to financial stability would be a focus of the Council. She noted that Treasury was establishing a climate hub to focus on the opportunities for climate finance to support the transition to a net-zero economy. The Chairperson then invited other Council members to describe their agencies' actions to evaluate risks arising from climate change.

Jerome Powell, Chair of the Federal Reserve, stated that climate change was an important issue, and society's response to the challenges presented by climate change laid with elected representatives. He stated that while climate policy was not the province of the Federal Reserve, climate change came into its work, to the extent that it had material implications for the pursuit of its existing responsibilities, particularly for supervision and regulation of financial institutions, and for financial stability. Chairman Powell stated that the Federal Reserve was in the early stages of assessing these potential links. He stated that the Federal Reserve had recently established a Supervision Climate Committee, which brought together senior staff from across the Federal Reserve System to assess and ensure the resilience of supervised firms. He stated that the Federal Reserve was also investing in research and analysis on the means by which climate change may affect the banking sector over time. He noted that the Supervision Climate Committee would also work with large institutions to better understand how they assess climate risks and incorporate them into their risk management frameworks. Chairman Powell stated that it would tailor its approach and devote resources to the firms that face the most risk.

Chairman Powell stated that this engagement was in its early days, and that the Federal Reserve was committed to a robust and open dialogue. He stated that the Federal Reserve also had work underway to integrate climate change into its financial stability framework. He noted that a changing climate may have many effects, which may be amplified by the financial system. He stated that the Federal Reserve's new Financial Stability Climate Committee was dedicated to researching the potential vulnerabilities of financial markets and institutions, both from the consequences of climate change and the policies designed to mitigate its effects. Chairman Powell stated that one of the goals of the Federal Reserve was to make climate change part of its regular financial stability framework. He noted that a benefit to this adjustment was the ability to update the public on this work. He stated that climate change may affect many of the institutions and markets overseen by Council members. He noted that updating analysis and risk assessment was critical to maintaining a safe and sound financial system.

Todd Harper, Chairman of the NCUA, then stated that the data about extreme weather events and climate risk were clear. He stated that climate change was accelerating and that the number and costs of climate-related natural disasters was rising, often impacting disadvantaged communities the hardest. He noted that according to the National Oceanic and Atmospheric Administration, the U.S. had 22 separate billion-dollar weather and climate disasters in 2020. Chairman Harper stated that these disasters caused $95 billion in damage. He stated that markets were responding, with financial services companies adjusting their business plans and committing to achieve net-zero carbon emissions.

Chairman Harper stated that the Council should focus on the financial risks related to climate change and that each Council member needed to manage that risk within their regulatory and supervisory frameworks. He stated that he wanted to ensure that the NCUA's regulated institutions remain resilient against all material risks, including the financial risks posed by climate change. He noted that regulators must consider not only the macroeconomic impact of climate change, but also the microeconomic context. Chairman Harper stated that climate change would affect the value of collateral like homes and commercial properties, especially in areas affected by extreme weather, and vehicles, as the U.S. transitions to electric and hybrid vehicles. He stated that a credit union's field of membership is often tied to a business like an oil refinery or a community linked to farming. He noted that the movement to renewable energy and changes in weather patterns would affect their operations and their members. Chairman Harper stated that to remain resilient, such credit unions must consider adjusting their fields of membership or altering their lending portfolios. He concluded by stating that the Council should quantify and determine the impact of climate change on the financial system, so that Council members can take action to lessen the risk for the institutions they oversee.

Mark Calabria, Director of the FHFA, called attention to the importance of homes and real estate in the climate change discussion. He stated that there may be no sector of the financial system more exposed to the potential of climate change than mortgage finance, given its close connection to the housing market. He stated that the FHFA was working to ensure that it was accounting for these risks, in its prudential supervision of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. Director Calabria stated that the FHFA had developed a framework for its regulated entities to respond to the impact of natural disasters, given their potential to harm borrowers and renters. He noted that the forbearance framework that the FHFA used in response to COVID-19 was built upon the agency's longstanding response to natural disasters. Director Calabria stated that the FHFA was focused on strengthening its capabilities to identify and assess the current and future exposure of its regulated entities to climate and natural disaster risk. He stated that the FHFA was exploring ways to potentially enhance its supervisory and regulatory framework. He noted that the FHFA had brought together climate risk experts and researchers at the agency's biannual economic research summit, and that the FHFA had recently hired two environmental economists.

Director Calabria stated that in November 2020, the FHFA finalized a regulatory capital framework for Fannie Mae and Freddie Mac that recognized that the potential risks from climate change were difficult to quantify but potentially material to Fannie Mae and Freddie Mac. He stated that loss-absorbing capital, particularly in the form of common equity, was the strongest protection for financial institutions against any negative shock, including those from natural disasters. Director Calabria stated that the FHFA's priority was therefore building capital at its regulated entities. He noted that the FHFA had established an agency-wide working group and had recently released a request for information on climate and natural disaster risk management at its regulated entities.

Blake Paulson, Acting Comptroller of the Currency, stated that the financial stability impact of climate change could benefit from collaboration with stakeholders, including market participants, Council member agencies, and international standard-setting bodies. He stated that several agencies were charged with responsibility for addressing climate change. He noted that the OCC was focused on the safety, soundness, and fairness of its regulated entities. Acting Comptroller

Paulson stated that the OCC's role was to ensure that those financial institutions understand the risks they face and have robust risk management to control and monitor the risks and their impacts. He noted that those risks can arise in many ways, including contexts related to climate change, either because of physical conditions or climate-related transitions.

Acting Comptroller Paulson stated that the OCC was developing its knowledge of the risks in this area by engaging with stakeholders. He stated that the OCC's National Risk Committee oversees its internal work on this subject. He stated that the agency was active domestically and internationally on issues related to climate change, such as through the Task Force on Climate-related Financial Risks established by the Basel Committee on Banking Supervision. He stated that the group had taken stock of member initiatives on climate-related financial risks, cataloguing them for member organizations to benefit from one another's experience. Acting Comptroller Paulson stated that domestic and international collaboration was also critical to avoid risks of regulatory fragmentation and maximize regulators' resources and the effect of their efforts. He stated that internationally active national banks and federal savings associations were reviewing requirements applicable to their activities overseas.

Acting Chair Lee stated that the SEC supported the Council's prioritization of climate change and its potential impacts on financial stability. She stated that the SEC had taken a number of recent steps to promote consistent, comparable, and reliable disclosure on climate risks and opportunities, to ensure efficient pricing and allocation of capital. She then highlighted a few of those efforts. Acting Chair Lee stated that the SEC recently announced that SEC staff would enhance its focus on current climate-related disclosures under the SEC's 2010 climate guidance for public companies. She stated that SEC staff would also review the 2010 guidance to consider how it can be modernized to accommodate the shifting landscape on climate disclosure. She noted that the SEC recently solicited public comment on climate disclosure, which she stated would help inform a potential update to the SEC's disclosure framework as it relates to climate change, should the SEC decide to do so. She noted that, in addition, the SEC had enhanced its examination and enforcement efforts regarding compliance with existing regulatory requirements as they apply to climate disclosure and also the implementation of environmental, social, and governance (ESG) investment strategies. She stated that the SEC was considering issues around shareholder proposals and fund building as they relate to climate risks and opportunities in ESG.

Rostin Behnam, Acting Chairman of the CFTC, stated that the CFTC had conducted a significant amount of analysis over the past several years on climate-related financial market risk. He noted that the CFTC's Market Risk Advisory Committee published a report in September of 2020, entitled *Managing Climate Risk in the U.S. Financial System*, which could inform the Council's future deliberations on this topic. He stated that among the 53 policy recommendations in the report, one of the first was that the Council incorporate climate risk into its mandate. Chairman Behnam noted that the CFTC had announced the formation of a Climate Risk Unit, which would focus on the role of derivatives and understanding pricing and addressing climate-related risk in transitioning to a low-carbon economy.

Jelena McWilliams, Chairman of the FDIC, stated that while the issue of the potential impact of climate on the financial sector seemed to be gaining momentum among domestic and international regulatory bodies, FDIC supervisors had long expected financial institutions to consider and appropriately address potential climate risks that could arise in their operating environment as a meaningful safety and soundness concern. She noted that these risks included physical risks associated with extreme weather events, such as hurricanes, floods, storms, tornados, drought, and fires. She stated that the FDIC also expected institutions to mitigate the risks associated with adverse climate or weather-related events that are common to specific locations or particular areas of the country. She stated that such activities can include ensuring the institution and its borrowers have appropriate insurance coverage, adjusting borrowers' cash flow estimates based on reduced agricultural yields or adverse business conditions, and complying with applicable rules, regulations, and building codes.

Chairman McWilliams stated that FDIC economists and financial analysts conduct internal analysis of a range of factors that affect economic and banking conditions, including the potential implications of changing environmental conditions. She noted that several FDIC regional risk committees include environmental factors in their regular analysis, such as drought in the western states. She stated that the FDIC would continue to monitor the impact of climate and other emerging risks on the financial industry, and would continue to engage with other regulatory bodies, domestic and international, on how best to address such risks.

Eric Cioppa, Superintendent, Maine Bureau of Insurance, stated that he appreciated seeing climate change placed at the forefront of the Council's agenda. He stated that a key priority for state insurance regulators was monitoring and addressing how climate risks can impact the insurance sector. He noted that as with other financial sectors, the insurance sector was exposed to potential risks on the asset side of the balance sheet through their investments and also on the liability side through the risks insurance companies underwrite. He noted that property and casualty insurers and reinsurers face risks associated with the increase in extreme weather events and changes to weather patterns resulting from climate change that could impact the extent of claim payouts. Superintendent Cioppa stated that all insurers face potential investment volatility associated with the transition to a low-carbon economy. He stated that although insurance can mitigate the effects of climate change, the sector's ability to do so could be offset by increasing claims that negatively impact insurers' financial condition, which in turn will affect the availability and affordability of coverage to consumers. He stated that insurance regulators were keenly aware of the challenges that climate change can pose to the sector. He noted that in 2020, state insurance regulators, through the National Association of Insurance Commissioners (NAIC), had formed a task force on climate-related risk and resiliency issues. Superintendent Cioppa stated that this work was focused on five areas.

First, he stated that state insurance regulators had a workstream focused on solvency, which was examining the potential solvency impact of insurers' exposures, including investments, to climate-related risks. He noted that this workstream would consider enhancements to regulator solvency tools, to analyze and address an insurance company's potential financial exposure to both the physical and transition impacts of climate change. Second, he noted that state insurance regulators had established a workstream on climate risk disclosure, which was considering modifications to the current NAIC Climate Risk Disclosure Survey to promote uniformity in reporting requirements. He stated that this workstream was considering modifications to the survey to better align with the Task Force on Climate-related Financial Disclosures, established by the Financial Stability Board. Third, Superintendent Cioppa noted that state insurance regulators had established a workstream on pre-disaster mitigation, charged with participating in stakeholder educational efforts on coverage gaps and pre-disaster mitigation related to climate risks, and incentivizing insurer recognition of enhanced building codes in underwriting and rating. He stated that climate resiliency initiatives such as building code enhancements and infrastructure improvements were critical to forestall the impacts of climate change to insurance companies and the policyholders they serve. He noted that many of these projects need to be implemented at the state and local level. Fourth, he noted that state insurance regulators had established a workstream on innovation, which was considering solutions to climate risk and resiliency directed at reducing, managing, and mitigating climate risk while closing insurance gaps in coverage for consumers. Finally, Superintendent Cioppa noted that state insurance regulators had established a workstream focusing on the increasing use of technology to better assess and evaluate climate risk exposure. The workstream was considering predictive modeling tools, primarily catastrophe models used for wildfire, hurricane, flood, and earthquake perils, among other perils.

Superintendent Cioppa noted that while this work would not yield results overnight, state insurance regulators hoped their work would enhance the strength of the sector and help protect insurance consumers from some of the effects of climate change. He remarked that state insurance regulators looked forward to working with other federal and state regulators as they monitor the impacts that climate change would have on the sectors they regulate and on U.S. financial stability. He also encouraged regulators, the Administration, and Congress to focus on providing support to climate resiliency initiatives in state and local communities to help fortify those at particular risk of the effects of climate change, reduce risks to the financial sector, including insurers, and enhance U.S. financial stability.

Steven Seitz, Director of FIO, stated that he supported the Council's focus on climate change issues. He stated that FIO was working on this issue with colleagues within Treasury, across the federal government, with state insurance regulators, and with international colleagues, including at the International Association of Insurance Supervisors. He noted that in March 2021, FIO had joined the United Nations Sustainable Insurance Forum, which was a signal of FIO's commitment in this area.

David Uejio, Acting Director of the CFPB, expressed his support for the Council's focus on climate change, and noted that he was particularly focused on humanizing the potential negative effects of climate change on the financial lives of American consumers. He stated that he was encouraged by the focus on real estate and housing in the Federal Reserve's presentation. He stated that he had made housing insecurity a top priority of the CFPB. He noted that the CFPB was beginning to evaluate how climate risk might impact consumers. He stated that it may lead to population migration, noting that over 13 million Americans may migrate due to flood risk. He stated that this could stress municipal infrastructure and destroy family wealth. He noted that the CFPB was also concerned that climate change would widen existing inequalities. He stated that financially vulnerable consumers, such as low-income consumers, generally face higher risk of seeing their income decline due to natural disasters. He noted that as such disasters grow more frequent, these consumers encounter greater risk. He stated that this would exacerbate racial and economic inequity and heighten risks to homeownership stability. He noted that formerly redlined areas have $107 billion worth of home space and flood risk, 25% more than non-historically redlined areas.

Thomas Workman, the Council's independent member with insurance expertise, expressed his interest in assisting the Council members in their work on climate-related risks.

The Chairperson concluded by reiterating the importance of the Council addressing financial stability threats, and noted that a resilient financial system is key to fostering widespread economic prosperity.

The Chairperson adjourned the meeting at approximately 4:04 P.M.