

## Minutes of the Financial Stability Oversight Council

February 4, 2022

### 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, Chairman, Commodity Futures Trading Commission (CFTC)  
Rohit Chopra, 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  
Laurie Schaffer, Principal Deputy General Counsel  
Sandra Lee, Deputy Assistant Secretary for the Council  
Eric Froman, Assistant General Counsel (Banking and Finance)

#### Board of Governors of the Federal Reserve System

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  
Gregg Gelzinis, 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  
Richard Crump, Vice President, Capital Markets Function

Office of Financial Research  
Michael Passante, Chief Counsel

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:

*Hedge Fund Working Group Update*

- *Ron Alquist, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury*
- *Jay Kahn, Senior Economist, OFR*
- *Andrew McKenna, Assistant Vice President, Federal Reserve Bank of New York*
- *Danny Barth, Senior Economist, Division of Financial Stability, Federal Reserve (available for questions)*
- *Phillip Monin, Economist, Division of Monetary Affairs, Federal Reserve (available for questions)*

- *Mike Neus, Private Funds Fellow, Division of Investment Management, SEC (available for questions)*
- *Alexei Orlov, Supervisory Economist, Office of the Chief Economist, CFTC (available for questions)*
- *Alexandra Somers, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury (available for questions)*

#### *Open-end Fund Working Group Update*

- *Fang Cai, Chief, Division of Financial Stability, Federal Reserve*
- *Kelsey Pristach, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury*
- *Michelle Beck, Risk Management Fellow, Division of Investment Management, SEC (available for questions)*
- *Emilie O'Malley, Policy Analyst, Office of the Financial Stability Oversight Council, Treasury (available for questions)*
- *Adam Minson, Lead, Financial Sector Risk, Federal Reserve Bank of New York (available for questions)*
- *Sarah ten Siethoff, Associate Director, Division of Investment Management, SEC (available for questions)*

#### *SEC Proposed Rule on Money Market Funds*

- *William Birdthistle, Director, Division of Investment Management, SEC*
- *Sarah ten Siethoff, Associate Director, Division of Investment Management, SEC*

#### *Council Priorities Update*

- *Sandra Lee, Deputy Assistant Secretary for the Council, Treasury*

#### *Nonbank Financial Intermediation*

- *William Birdthistle, Director, Division of Investment Management, SEC*
- *Kelsey Pristach, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury*
- *Alexandra Somers, Senior Policy Advisor, Office of the Financial Stability Oversight Council, Treasury*
- *Sarah ten Siethoff, Associate Director, Division of Investment Management, SEC (available for questions)*

### **Executive Session**

The Chairperson called the executive session of the meeting of the Council to order at approximately 10:00 A.M. The Council convened by videoconference. The Chairperson began by congratulating Rostin Behnam on his confirmation as chairman of the CFTC. She also noted that this was the last Council meeting for Jelena McWilliams, Chairman of the FDIC, and thanked her for her service. 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) an update on the Council's Hedge Fund Working Group, (2) an

update on the Council's Open-end Fund Working Group, (3) a presentation on the SEC's proposed rule on money market funds, and (4) an update on the Council's priorities.

## 1. Hedge Fund Working Group Update

The Chairperson turned to the first agenda item, an update from staff on the Council's Hedge Fund Working Group, which was reestablished in March 2021. She introduced Ron Alquist, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury; Jay Kahn, Senior Economist at the OFR; and Andrew McKenna, Assistant Vice President at the Federal Reserve Bank of New York.

Mr. Alquist stated that the presenters would summarize the progress of the 2021 Hedge Fund Working Group. He said the working group includes staff from Treasury, the Federal Reserve, the Federal Reserve Bank of New York, the SEC, the CFTC, and the OFR. He stated that the working group built on the efforts in 2016 of the Council's Hedge Fund Working Group, which identified two potential financial stability risks from hedge funds: market disruptions from forced liquidations of leveraged positions, and transmission of stress to large or highly interconnected counterparties. He stated that in 2021 the working group had also assessed issues related to financial intermediation.

Mr. Alquist then described the main channels through which hedge funds can create risks to financial stability and transmit shocks to the financial system: the liquidation of leveraged positions, counterparty risks, and financial intermediation.

Mr. Kahn then described the dislocations that occurred in the Treasury market in March 2020. He stated that prior to the COVID-19 pandemic, hedge fund gross exposures to Treasuries increased by \$960 billion over a two-year period, of which approximately \$700 billion was likely attributable to the cash-futures basis trade. He noted that there had also previously been a substantial increase in hedge funds' borrowing under repurchase agreements (repo). He described hedge funds' deleveraging and reductions in exposures to Treasuries in March 2020. He described the leverage of hedge fund basis traders and their sales of Treasuries. He stated that as volatility in Treasury markets widened the cash-futures basis spread in March 2020, basis traders took significant losses. He noted that the corresponding increase in margin requirements on Treasury futures raised funding costs for the basis trade, potentially leading some funds to liquidate positions. He stated the potential that hedge fund sales could have become more disruptive to Treasury markets without the Federal Reserve's extraordinary interventions.

Mr. Kahn stated that hedge funds were a significant source of liquidations during the March 2020 disruptions. He stated that work to enhance the resilience of the Treasury market should account for the role played by hedge funds in this market, balancing the plausible efficiency gains from this arbitrage capital against the plausible risk that funds can amplify Treasury market stress.

Mr. McKenna then described the working group's analysis of the failure of Archegos Capital Management. He noted that although Archegos was a family office rather than a hedge fund, it implemented leveraged strategies similar to those used by hedge funds. He noted that the value

of Archegos's portfolio peaked at over \$160 billion in March 2021. He said that Archegos's default was triggered by declines in the prices of certain stocks in its portfolio, resulting in over \$10 billion in counterparty credit losses across multiple large financial institutions. He said that Archegos's concentrated positions meant that counterparties could not liquidate positions in a timely manner without affecting prices. He said that Archegos's failure revealed that several of its counterparties had inadequate counterparty credit risk management practices and margin practices. He also noted that prime broker static margining practices and the use of total return swaps allowed Archegos to grow rapidly and take on excessive leverage and concentration.

Mr. McKenna said that the failure of a large, highly leveraged private investment vehicle can lead to significant losses at large, interconnected financial institutions. He noted that losses can be amplified if positions are highly concentrated and opaque. He said that counterparty risk management practices at large financial institutions may not be sufficiently robust. He noted that the Council and its member agencies have limited insight into family offices, and that counterparties and regulators had limited insight into the buildup of risks in Archegos's portfolio.

Mr. Alquist then stated that staff were seeking to coordinate with the Inter-Agency Working Group on Treasury Market Surveillance (IAWG) on the role of hedge funds in Treasury markets; improve data availability; develop an interagency hedge fund risk monitoring framework; and study options to address risks to financial stability related to hedge funds.

Council members then asked questions and had a discussion regarding gaps in member agencies' data regarding hedge funds and private funds, and potential approaches to address those data gaps.

## 2. Open-end Fund Working Group Update

The Chairperson then introduced the next agenda item, an update from staff on the Council's Open-end Fund Working Group. She turned to Kelsey Pristach, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury, and Fang Cai, Chief of the Division of Financial Stability at the Federal Reserve.

Ms. Pristach stated that in March 2021, the Council established a staff working group to assess the risks to financial stability that may arise from the liquidity and redemption features in open-end funds. She said that the Open-end Fund Working Group, which includes staff from Treasury, the Federal Reserve System, the SEC, the CFTC and the OFR, had reviewed studies and evidence on the role of open-end funds in the March 2020 financial market disruptions. Ms. Pristach stated that staff considered the statement the Council issued on April 18, 2016, regarding asset management products and activities, which she said described two primary features of pooled investment vehicles that raise financial stability concerns. She said the first feature involved liquidity transformation. She said that open-end funds provide liquidity transformation by allowing frequent, daily redemptions by investors while potentially investing in less-liquid assets. She noted that during a stress event, the price of assets held by these funds may fall rapidly if large redemptions occur, as the investment vehicle may incur significant costs to sell these less-liquid holdings. She said the second feature involved first-mover advantage, and she noted that redemption options and pricing methods offered by pooled investment

vehicles may create a potential first-mover advantage if the costs of meeting investor redemptions are borne by remaining investors in the fund.

Ms. Cai stated that the working group examined information regarding liquidity transformation by open-end funds in March 2020. Ms. Cai stated that open-end funds faced historically large waves of investor redemptions in March 2020, particularly fixed-income funds. She noted the potential that the redemptions at open-end funds could have become even greater or more sustained absent emergency official-sector interventions.

Ms. Cai described liquidations of Treasury securities, municipal bonds, corporate debt, and other debt instruments by open-end funds in the first quarter of 2020. She noted that the impacts of open-end funds' selling activity may have been amplified by poor liquidity in debt markets in March 2020. Ms. Cai then described the liquidity management tools employed by open-end funds during March 2020. She stated that open-end funds managed the outsized redemptions largely by liquidating assets to replenish or build cash, prioritizing the selling of assets considered to be the most liquid. She noted that bond mutual funds, for example, primarily began by liquidating U.S. Treasury securities. She noted that no U.S. funds used swing pricing. Ms. Cai said that official-sector and academic studies indicated that liquidity transformation contributed to redemptions at open-end funds.

Ms. Pristach stated that the working group considered whether market stress was attributable to factors other than open-end funds, and examined evidence for markets in which open-end funds are significant investors. She noted that open-end funds were one of many types of investors attempting to sell assets in March 2020. She stated that in U.S. corporate and municipal debt markets, official-sector sources found that dealers were unwilling or unable to increase their intermediation to fully meet the demands of open-end funds and other investors to liquidate these assets. She noted that dealers did not materially add to the selling pressures in these markets. She said that, by contrast, broker-dealers did increase intermediation in U.S. Treasury securities, although she noted that this was insufficient to meet the demand of mutual funds, foreign official institutions, hedge funds, and others. Ms. Pristach noted that while ETFs faced significant outflows during March 2020, ETFs may have characteristics that support resiliency and reduce liquidity transformation during periods of stress.

Ms. Pristach said that official-sector and independent sources had found that open-end funds contributed to the disruptions in U.S. bond markets in March 2020, including the stress in Treasury markets, and she noted risks from liquidity transformation.

Ms. Pristach said that Treasury, municipal debt, and U.S. corporate debt markets were stressed in March 2020 due to investor asset liquidations and limited private intermediation. She noted that the stress in these markets ultimately required official-sector emergency interventions. She stated that U.S. open-end funds were among the largest recorded sellers of U.S. Treasuries, U.S. municipal bonds, and possibly U.S. corporate debt during March 2020. She noted they were not the sole or primary cause of market stress, and said that there was no single, primary cause. However, she stated that the size of their asset liquidations indicates that they contributed to this stress. She said that the large volume of asset liquidations by fixed-income mutual funds was driven by investor redemptions, caused by various factors.

Council members then discussed potential regulatory actions by the SEC related to open-end funds.

### 3. SEC Proposed Rule on Money Market Funds

The Chairperson then turned to the next agenda item, the SEC's proposed rule on money market funds (MMFs). She introduced William Birdthistle, Director of the Division of Investment Management at the SEC, and Sarah ten Siethoff, Associate Director of the Division of Investment Management at the SEC.

Mr. Birdthistle said the impetus for the SEC proposal began with the events of March 2020, when the COVID-19 pandemic led investors to reallocate their assets into cash and short-term government securities. He noted that prime and tax-exempt MMFs had experienced significant outflows, while government MMFs saw inflows in March 2020 of over \$800 billion. He noted that the President's Working Group on Financial Markets (PWG) had issued a report on MMFs in December 2020, and the SEC had issued a request for comment on the reform options presented in the PWG report in February 2021. He noted that the SEC had proposed amendments to certain SEC rules governing MMFs in December 2021.

Ms. ten Siethoff then described the SEC's proposal on MMFs. She noted that the proposal would increase daily liquid asset and weekly liquid asset requirements to 25 percent and 50 percent, respectively. She noted that an MMF may currently impose a liquidity fee or a redemption gate if the fund's weekly liquid assets fall below 30 percent, subject to a board determination. She said the proposal would remove these fee and gate provisions to eliminate an incentive for preemptive redemptions.

Ms. ten Siethoff stated that the proposal would require institutional prime and institutional tax-exempt MMFs to adopt swing pricing policies and procedures to adjust a fund's net asset value (NAV) per share by a swing factor when the fund has net redemptions, with the result that the transaction price would effectively pass on costs stemming from shareholder flows out of the fund to redeeming shareholders.

She then stated that the proposal provided that stable NAV MMFs must convert to a floating share price if future market conditions result in negative fund yields. She noted that to transact in the fund's shares, financial intermediaries would also need to have the capacity to redeem and sell the fund's shares at prices that do not correspond to a stable price per share. Finally, she described proposed amendments to SEC reporting requirements. She stated that among other proposed changes, monthly reports on Form N-MFP would include additional information about the composition and concentration of MMF shareholders; the amount of portfolio securities a prime MMF sold or disposed of each month; the frequency and size of swing pricing adjustments; and repo, such as whether the repo is centrally cleared or settled on a triparty platform. She stated that the proposal would also introduce a new reporting requirement when an MMF's liquidity falls below half of the 25 percent daily liquid asset or 50 percent weekly liquid asset minimum liquidity requirements.

Council members then had a discussion regarding vulnerabilities of MMFs.

#### 4. Council Priorities Update

The Chairperson then turned to the next agenda item, an update on the Council's priorities. She introduced Sandra Lee, Deputy Assistant Secretary for the Council at Treasury.

Ms. Lee stated that in 2021, the Council made progress on its three identified priorities: climate-related financial risks, nonbank financial intermediation, and Treasury market resiliency. She said that for 2022, Council staff proposed adding digital assets as a fourth priority.

Ms. Lee said that, with respect to nonbank financial intermediation, the Hedge Fund Working Group would continue to coordinate with the IAWG on the role of hedge funds in the Treasury market, and would work to improve data, establish a risk-monitoring framework, and identify potential policy options. She said that the Open-end Fund Working Group would continue its analysis on potential risks to financial stability posed by open-end funds. She said that, with respect to Treasury market resiliency, the Council would continue to support the efforts of the IAWG, including by leveraging the analysis produced by the Hedge Fund and Open-end Fund Working Groups. With regard to climate-related financial risk, she noted that following the publication of the Council's climate report in October 2021, the Council established the Climate-Related Financial Risk Committee in December 2021 to advance the recommendations set forth in the report. Finally, she noted that digital assets are a rapidly evolving part of the financial landscape and stated that Council members and their staffs were working to deepen their understanding of how digital assets were impacting the financial system.

Council members then had a discussion regarding Council priorities.

The Chairperson adjourned the executive session of the meeting at approximately 11:11 A.M.

#### **Open Session**

The Chairperson called the open session of the meeting of the Council to order at approximately 11:21 A.M. The Chairperson began by noting that this was Chairman McWilliams' last Council meeting and thanked her for her service. The Chairperson outlined the agenda for the open session, which included (1) an update on nonbank financial intermediation and a vote on a public statement by the Council regarding this topic, and (2) a vote on the minutes of the Council's meeting on December 17, 2021.

##### 1. Nonbank Financial Intermediation

The Chairperson turned to the first agenda item, the Council's work on nonbank financial intermediation. She said that at her first Council meeting in 2021, she identified vulnerabilities in nonbank financial intermediation as a key area of focus for the Council. She stated that the market stress in March 2020 demonstrated how vulnerabilities in nonbank financial intermediation, especially with hedge funds, open-end funds, and MMFs, can amplify existing stresses in the financial system. She noted that over the past year, Council member agencies had



made significant progress towards assessing and addressing these risks.

The Chairperson then turned to the presentations on nonbank financial intermediation. She introduced Alexandra Somers, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury; Kelsey Pristach, Senior Policy Advisor in the Office of the Financial Stability Oversight Council at Treasury; William Birdthistle, Director of the Division of Investment Management at the SEC; and Sarah ten Siethoff, Associate Director of the Division of Investment Management at the SEC.

Ms. Somers said that in March 2021, the Council reestablished its Hedge Fund Working Group, which was originally created in early 2016. She said the working group was tasked with updating the Council's assessment of potential risks to financial stability from hedge funds, their activities, and their interconnections with other market participants. She said that today she would update the Council on the working group's progress and on its next steps.

Ms. Somers stated that the working group, which includes representatives from Treasury, the Federal Reserve, the Federal Reserve Bank of New York, the SEC, the CFTC, and the OFR, reviewed the analysis conducted by the original Hedge Fund Working Group. She noted that the earlier analysis identified two channels through which hedge funds' use of leverage could pose financial stability risks: first, by causing or contributing to market disruptions through forced asset liquidations; and second, by transmitting risks to counterparties that are large, highly interconnected financial institutions.

Ms. Somers stated that the current working group also considered an additional channel: that a reduction in hedge fund intermediation could, under certain conditions, potentially impair market functioning. She said that working group staff applied this framework to analyze two case studies: hedge funds' role in the March 2020 Treasury market turmoil, and the March 2021 failure of Archegos Capital Management. She noted that although Archegos was a family office rather than a hedge fund, its investment strategies were similar to those of many hedge funds, and its failure illustrated how leveraged investment managers can transmit stress to other parts of the financial system.

Ms. Somers said that the working group first examined hedge funds' role in the March 2020 Treasury market dislocations. She stated that the events of that period, coupled with the increasingly prominent role of leveraged funds in Treasury markets, underscored the importance of assessing hedge funds' impact on market functioning during stress periods.

Ms. Somers said that after reviewing a range of quantitative and qualitative evidence, staff found that hedge funds materially contributed to the Treasury market dysfunction, although they were not the sole cause. She noted that hedge funds were among the largest liquidators of Treasury securities, alongside U.S. open-end funds and foreign investors. She stated that, at the same time, hedge funds liquidated substantial Treasury futures positions, which contributed to the disruptive widening of the cash-futures basis. She noted that a significant share of these liquidations was attributable to funds unwinding highly leveraged basis trade positions, although she noted that this was not the sole cause of hedge fund liquidations. She said that these conclusions were consistent with the IAWG's "Recent Disruptions and Potential Reforms in the

U.S. Treasury Market: A Staff Progress Report” issued in November 2021, along with qualitative evidence obtained from market participants during and after the March 2020 stress.

Ms. Somers said that the availability of granular data regarding hedge fund activities in the U.S. Treasury market continued to be a challenge. She noted that assessing the sufficiency of existing data was a central part of the Hedge Fund Working Group’s efforts in 2016, and the reestablished working group also identified several areas to improve availability of data on hedge fund activities. She said that improvements that would particularly enhance regulators’ insight into hedge funds’ market activities include more detailed reporting on hedge funds’ exposures and regular data collection on uncleared bilateral repo, which is the primary source of Treasury financing for hedge funds.

Ms. Somers said that the working group then reviewed the March 2021 failure of Archegos Capital Management. She said that the working group analyzed the failure of Archegos because its trading strategies and prime brokerage relationships were similar to those maintained by some hedge funds. She noted that the Council’s 2021 annual report contained a detailed discussion of the events leading up to Archegos’s failure.

Ms. Somers said that a main conclusion of the working group was that Archegos’s failure revealed shortcomings in the counterparty risk management practices and margin models sometimes employed at global financial institutions. She noted that in light of those failures, the Federal Reserve issued a letter reiterating its supervisory expectations on sound counterparty credit risk management practices and was continuing to review the weaknesses identified. She said that the Archegos episode also highlighted gaps in transparency related to the use of security-based swaps. She noted that the SEC’s post-trade transparency rules, which require security-based swap transaction data to be reported to a swap data depository, had gone into effect following the failure of Archegos. She stated that the event also highlighted the official sector’s limited visibility into family offices.

Ms. Somers said that for 2022, working group staff had identified four areas for further work: first, coordinating with the IAWG in examining the important role hedge funds play in the Treasury market and their implications for market resiliency; second, considering initiatives to improve data on hedge funds and the markets in which they operate; third, establishing an interagency risk monitoring system to identify potential emerging financial stability risks posed by hedge funds; and finally, considering options to mitigate the risks identified in the two case studies previously discussed.

Ms. Somers then turned to Ms. Pristach to provide an update on the Council’s analysis of open-end funds.

Ms. Pristach stated that the Open-end Fund Working Group was established by the Council in 2021. She said that the working group was asked to assess potential risks to U.S. financial stability arising from open-end funds, particularly from their liquidity and redemption features. She noted that the working group includes staff from the Treasury, the Federal Reserve System, the SEC, the CFTC, and the OFR.

Ms. Pristach stated that the Council had long recognized that open-end funds play a critical intermediary role in the U.S. economy by promoting economic growth through efficient capital formation. She said that the Council, in its 2016 “Update on Review of Asset Management Products and Activities,” identified two channels by which open-end funds may give rise to financial stability concerns: liquidity transformation and first-mover advantage.

Ms. Pristach stated that the events of the early pandemic period demonstrated how crucial it was to address these financial stability concerns. She noted that market turmoil caused by the pandemic in March 2020 created pressure on open-end funds. She said that over the past year, the working group analyzed how these funds were affected by redemptions and, in turn, how they impacted broader markets. She said the working group drew conclusions from a review of official-sector, academic, and industry analysis and incorporated the data, research, and analysis of the working group members.

Ms. Pristach stated that, as the Council described in its two most recent annual reports, U.S. fixed-income mutual funds faced historic levels of investor redemptions in March 2020. She said that open-end funds employed various liquidity management strategies in order to have cash available to meet redemption requests. She said that during the early pandemic period, fund managers liquidated assets to meet redemptions and generally prioritized selling their funds’ most liquid assets. She noted that, as a result, open-end funds sold sizable amounts of fixed-income securities into stressed markets. She said that U.S. open-end funds were among the largest recorded sellers of U.S. Treasuries, U.S. municipal bonds, and possibly U.S. corporate debt during this period.

Ms. Pristach stated that asset sales alone do not necessarily indicate a potential risk to financial stability. She noted that when funds sell assets to meet redemptions more quickly than expected, however, they may incur significant costs. She said that these costs may further impair performance and put downward pressure on the prices of the underlying assets, potentially prompting further fund outflows and spillovers that may lead to broader market stress.

Ms. Pristach stated that some official-sector reports and academic studies presented evidence that liquidity transformation may have, directly or indirectly, driven some portion of the open-end funds’ redemption activity. She said that, in particular, these studies identified patterns of redemptions that correlated with portfolio liquidity and liquidity transformation. She noted that some industry sources had questioned the importance of liquidity transformation in March 2020 and the severity of the event. She said that they expressed the view that open-end funds performed reasonably well through the crisis, as evidenced by their ability to honor redemptions. She said that the working group noted, however, that redemptions might have become even larger or more sustained absent emergency official-sector interventions.

Ms. Pristach stated that overall, the findings of the working group supported the Council’s continued focus on open-end funds. She said that open-end funds were not the sole or primary cause of market stress, and noted that there was no single, primary cause. She said that the size of their asset liquidations, however, indicated that they were one of the significant contributors to this stress. Ms. Pristach stated that the working group’s analysis also suggested that as open-end funds’ footprint in less-liquid assets increases, they become more likely to impact the market for

these assets during periods of heavy redemptions. Ms. Pristach stated that the Open-end Fund Working Group would continue to share information and develop its analysis regarding the potential risks to financial stability that may arise from the liquidity transformation of open-end funds. Ms. Pristach then turned to Mr. Birdthistle to discuss the SEC's proposed reforms regarding MMFs.

Mr. Birdthistle stated that the events that precipitated the SEC's proposal to reform the rules governing MMFs occurred in March 2020, when economic concerns about the impact of the pandemic led investors to shift their holdings rapidly to cash and short-term government securities, creating significant stress in short-term funding markets. He said that during this period, institutional prime MMFs experienced significant redemptions contributing to that stress.

Mr. Birdthistle noted that, following intervention by the Federal Reserve, these redemption pressures subsided, and short-term funding markets stabilized. He stated that in response to these events, in December 2021, the SEC voted to propose reforms to the rules that govern MMFs. He stated that the proposed reforms had four principal elements: increased daily and weekly liquidity requirements for all MMFs; the removal of provisions that allow liquidity fees and redemption gates if a prime MMF's liquidity falls below a specified threshold; a swing pricing requirement for institutional prime MMFs; and a proposed requirement that stable net asset value MMFs use a floating NAV to handle any negative interest rate environment, should one occur. He said that the primary goals of the SEC reforms were to eliminate both the incentives for preemptive runs at MMFs and any first-mover advantage investors may have; to enhance the resilience of MMFs during periods of stress and to changing market conditions; and to require investors to bear the costs of their redemption activity more fairly.

Following the presentations, the Chairperson stated that Council member agencies had undertaken a considerable amount of analysis to advance their understanding of the financial stability risks posed by nonbank financial intermediaries, which was reflected in the preceding presentations. She said that member agencies were taking important steps to address these risks, but there was more work to be done, and this topic would continue to be a priority for the Council. She said that today the Council would vote on issuing a public statement to reaffirm its commitment to addressing these vulnerabilities. The Chairperson then called on other Council members for comments.

Gary Gensler, Chair of the SEC, stated that the fund industry gives retail and institutional investors an opportunity to pool their assets together, receive investment advice, and attain diversification and efficiency. He said that these pooled assets had become a significant part of the market. He noted that MMFs hold approximately \$5 trillion in assets under management, while open-end bond funds and hedge funds each hold approximately \$9 trillion. He said that the nature, scale and interconnectedness of these fund sectors, however, also pose issues of financial stability. He said that this concern was not based solely on financial economic theory, but also upon the lessons of the past. He provided several historical examples of risks manifesting in these sectors, including the 2008 financial crisis, the start of the COVID-19 crisis in March 2020, and the failure of hedge fund Long-Term Capital Management in 1998.

Chair Gensler stated that MMFs and open-end bond funds have a potential liquidity mismatch, as identified between, on the one hand, investors' ability to redeem daily, and on the other hand, the fund's securities that may have lower liquidity. He said that while this might not be a significant concern in normal markets, in stressed times, these fund liquidity mismatches can raise systemic issues. He stated that hedge funds can also present financial resiliency issues through leverage and derivative positions. He said that the SEC has a responsibility to help protect financial stability, as part of the SEC's mandate to maintain fair, orderly, and efficient markets. He said that he had asked SEC staff for recommendations designed to bolster resiliency across these areas. He noted that the SEC had recently voted on proposed amendments to SEC rules on MMFs. He said that, with respect to open-end bond funds, he had asked SEC staff whether the SEC could consider amendments designed to improve fund liquidity rules, or whether the SEC could enhance fund liquidity, pricing, and resiliency for possible future stress events through other reforms.

Chair Gensler said that, with respect to hedge funds, the SEC voted in January 2022 to propose amendments to Form PF, a form first adopted after the financial crisis. He said that the SEC now had 10 years of experience with Form PF, which he noted provides important information about private funds to the SEC and other Council member agencies. He said that the proposed Form PF amendments, if implemented, would give the SEC current reporting on certain events of hedge funds and private funds. He noted that he had asked SEC staff to work with the CFTC to consider whether the periodic reports for hedge funds should be updated. He noted that in November 2021, the SEC proposed a rule to require public reporting of large securities-based swap positions. He said that total return swaps, a type of security-based swap, contributed to the transmission of risk during the failure of Archegos. He said that he supported the Council's statement on nonbank financial intermediation and welcomed other Council members' input on the SEC's ongoing consideration of how it can enhance resiliency in these fund sectors.

Jerome Powell, Chair of the Federal Reserve, said that he welcomed the Council's progress on its work to evaluate and address risks posed by hedge funds, MMFs, and open-end funds. He said that, with regard to hedge funds, efforts to establish a risk monitoring framework, promote communication among regulatory authorities, and improve the quality and availability of data would augment the ability to evaluate the potential risks to U.S. financial stability posed by these funds. He also expressed support for the SEC's recently proposed amendments related to MMFs. He stated that these amendments, if adopted, could meaningfully reduce structural vulnerabilities in MMFs. In addition, he said that, as indicated at the outset of the pandemic, open-end mutual funds, especially those invested in fixed-income securities, can also amplify liquidity strains in the event of large-scale investor redemptions during times of stress. Chair Powell said in conclusion that he welcomed continued analysis and consideration of the vulnerabilities associated with these funds.

Michael Hsu, Acting Comptroller of the Currency, emphasized the importance of remaining vigilant about identifying and managing financial stability risks arising from nonbank financial institutions. He said that the OCC supported the initiatives described in the staff presentations, including work that member agencies were undertaking to address gaps in the availability of data related to hedge funds. He also commended the SEC for continuing to engage on the topic of the

resilience of open-end funds during stressed market conditions and for its efforts to reform MMFs and strengthen short-term funding markets.

Dino Falaschetti, Director of the OFR, stated that data gaps can prevent financial regulators from identifying and addressing risks to financial stability, and noted that regulators may need to fill gaps by collecting new data from firms or markets to form a more complete picture. He said that the Council's Hedge Fund Working Group, among others, identified gaps in data on uncleared bilateral repo. He stated that the OFR, consistent with its statutory mandate to support the Council with data and research insights, was laying the groundwork to address this data need through a pilot data collection. He said that the OFR anticipated beginning a rulemaking process to establish a permanent collection once it has gathered sufficient information from the pilot.

Todd Harper, Chairman of the NCUA, stated that while the investment instruments highlighted at the meeting had different structures, investor profiles, trading strategies, and regulatory requirements, each played a significant role in generating financial market stress at the onset of the COVID-19 pandemic. He noted that emergency actions by the Federal Reserve and other parts of the government calmed markets, diminished uncertainty, and prevented a broader crisis within the financial system. He stated that he supported the Council's continued monitoring of risks in this area, as well as efforts to bolster market resilience and improve transparency through additional disclosures to market participants.

The Chairperson then presented to the Council the following resolution approving the Council's statement regarding nonbank financial intermediation:

*WHEREAS, the duties of the Financial Stability Oversight Council (Council) under section 112 of the Dodd-Frank Wall Street Reform and Consumer Protection Act include monitoring the financial services marketplace in order to identify potential threats to U.S. financial stability; monitoring financial regulatory proposals and developments, and making recommendations in such areas that will enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets; recommending to the Council member agencies general supervisory priorities and principles reflecting the outcome of discussions among the member agencies; and identifying gaps in regulation that could pose risks to U.S. financial stability; and*

*WHEREAS, in response to the stress in March 2020 in short-term funding markets, the Council has made it a priority to evaluate and address the risks to U.S. financial stability posed by three types of nonbank financial institutions: hedge funds, open-end funds, and money market funds; and*

*WHEREAS, in 2021, the Council reestablished its Hedge Fund Working Group, an interagency staff-level working group, to update the Council's assessment of potential risks to U.S. financial stability from hedge funds, their activities, and their interconnections with other market participants; and*

*WHEREAS, in 2021, the Council also established the Open-end Fund Working Group, an interagency staff-level working group, to assess potential risks to U.S. financial stability arising from open-end funds, particularly their liquidity and redemption features.*

*WHEREAS, in December 2021, the Securities and Exchange Commission (SEC) issued for public comment a proposed rule on money market fund reforms; and*

*WHEREAS, the staffs of Council members and their agencies have prepared the “Financial Stability Oversight Council Statement on Nonbank Financial Intermediation” attached hereto (the Statement).*

*NOW, THEREFORE, BE IT RESOLVED, that the Council hereby approves the Statement and authorizes the Chairperson, or her designee, to cause the Statement to be published on the Council’s website, in a form and manner acceptable to the Chairperson, or her designee, and to otherwise make it available to the public as the Chairperson, or her designee, deems appropriate.*

*BE IT FURTHER RESOLVED, that the Council hereby delegates authority to the Chairperson, or her designee, to make technical, nonsubstantive, or conforming changes to the text of the Statement, and to take such other actions and issue such other documents incidental and related to the foregoing as the Chairperson, or her designee, deems necessary or appropriate to fulfill the Council’s objectives in connection with its publication.*

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

## 2. Resolution Approving the Minutes of the Meeting Held on December 17, 2021

*BE IT RESOLVED, by the Financial Stability Oversight Council (the “Council”), that the minutes attached hereto of the meeting held on December 17, 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 11:46 A.M.