Financial Stability Report

Statement by Governor Lael Brainard

I appreciate the staff's outstanding analysis and research in the Financial Stability Report (FSR).[1] I want to note a few points.

The resurgence of fragility and funding stress in the same nonbank financial sectors in the COVID-19 crisis and the Global Financial Crisis highlights the importance of a renewed commitment to financial reform. We saw runs on prime money market funds—which had grown rapidly in the preceding couple of years—as large or larger than those in 2008. We also saw record outflows from open-ended funds that offer daily redemptions against less liquid underlying assets, such as the $1.7 trillion in corporate bonds held by mutual funds in the second quarter. In addition, the March turmoil highlights the importance of exploring reforms in the critically important Treasury market, which could include wider use of central clearing in Treasury cash markets and wider access to platforms that could promote forms of "all to all" trading, as well as innovations such as the recent FIMA repo facilities.[2]

I welcome the introduction of climate into the FSR. Climate change poses important risks to financial stability.[3] A lack of clarity about true exposures to specific climate risks for real and financial assets, coupled with differing assessments about the sizes and timing of these risks, can create vulnerabilities to abrupt repricing events. Acute hazards, such as storms, floods, or wildfires, may cause investors to update their perceptions of the value of real or financial assets suddenly. Chronic hazards, such as slow increases in mean temperatures or sea levels, or a gradual change in investor sentiment about those risks, introduce the possibility of abrupt tipping points or significant swings in sentiment. Supervisors expect banks to have systems in place that appropriately identify, measure, control, and monitor their material risks, which for many banks is likely to extend to climate risks.[4] At present, financial markets face challenges in analyzing and pricing climate risks, and financial models may lack the necessary geographic granularity or appropriate horizons. Increased transparency through improved measurement and more standardized disclosures will be crucial. It is vitally important to move from the recognition that climate change poses significant financial stability risks to the stage where the quantitative implications of those risks are appropriately assessed and addressed.

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1. https://www.federalreserve.gov/publications/files/financial-stability-report-20201109.pdf. Return to text

2. Lorie K. Logan (2020), "Treasury Market Liquidity and Early Lessons from the Pandemic Shock ," Remarks at Brookings-Chicago Booth Task Force on Financial Stability (TFFS) Meeting, Panel on Market Liquidity October 23, 2020. Return to text

3. Lael Brainard (2019), "Why Climate Change Matters for Monetary Policy and Financial Stability," Delivered at The Economics of Climate Change research conference at the Federal Reserve Bank of San Francisco, November 8, 2019. Return to text

4. Kevin J. Stiroh (2020), "Climate Change and Risk Management in Bank Supervision ," Delivered at Risks, Opportunities, and Investment in the Era of Climate Change, Harvard Business School, Boston, Massachusetts, March 4, 2020. Return to text

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