



SIFMA BASEL III ENDGAME ROUNDTABLE

July 12, 2023 | Transcript

<https://events.sifma.org/basel-iii-roundtable>

- Good morning. I'm Joe Seidel, Chief Operating Officer of SIFMA. I would like to welcome everybody today and before we begin, I would also like to thank my colleagues, Carter McDowell, Peter Ryan and Guowei Zhang, as well as our CEO Ken Bentsen, for their leadership in developing this program today. I would like to also thank our moderators, Jelena McWilliams and Jonathan Gould, and all of our participants in the audience for joining us today. We're gathered here today for what I expect will be a robust conversation around a quickly moving and increasingly urgent topic, "The Basel III Endgame." It's forthcoming implementation in the U.S. and its potential substantial impacts on the capital markets in the U.S. economy. At SIFMA, as the primary trade group for the investment industry, we are particularly interested in the impact these changes will have on the trading book, on market-based risk management tools, and on the overwhelming amount of global financing done through the U.S. capital markets. As we begin the discussion, we should take a brief step back to recall how we got to where we are today. After the global financial crisis, the Basel Committee on Banking Supervision, as well as other standard setters, such as the Financial Stability Board and the National Authorities, instituted a series of wholesale reforms to the pre-crisis prudential regulatory framework to increase both the quality and quantity of capital in the banking system, as well as a whole suite of other prudential regulations designed to enhance bank resiliency. These reforms resulted in a sweeping set of revisions, including heightened risk-based requirements for trading, lending and derivatives activities, new leverage-based capital requirements, new capital requirements for globally systemically important banks, and the introduction of stress testing capital requirements, including the global market shock here in the United States, amongst many other reforms that go above and beyond both the minimum Basel standards and the policies that other major jurisdictions have adopted. Today, U.S. Bank capital levels are extraordinarily robust, both in terms of overall levels of quality of capital and quantity. In recent years, in fact, a recent comprehensive PwC survey found that bank capital levels in the U.S. banking system are in fact currently optimal, meaning they are at levels that appropriately balance financial stability with economic growth. However, global regulators remain concerned that the current Basel III capital standards result in excessive variability in the way risk-based capital requirements are calculated across banks. To this end, the Basel Committee finalized revisions to its risk-based capital standards in 2019, commonly referred to as, "Basel III," "The Basel III Endgame." These aim to promote greater standardization and thus, comparability across risk-based capital requirements. Since then, national regulators have been working to implement the Basel III Endgame package with proposals issued in both the EU and the EUK. Some jurisdictions have already

finalized their rules. The U.S. federal banking agencies have jointly reaffirmed their commitment to implement the Basel III Endgame package, and we expect the U.S. notice of proposed rulemaking implementing the reforms to be published in relatively short order. The Basel III Endgames will significantly overhaul the current risk-based capital framework in the U.S. It is expected to raise overall U.S. capital levels by more than 20% and capital for banks trading book activities by almost 60%. That ultimately means less capital will be available at a higher price to provide financing to the real economy. U.S. regulators have indicated their intent to propose these significantly higher capital requirements for the largest U.S. banks following a holistic review that has been conducted by the Federal Reserve staff. However, without public input and without any written work product available for public review. Why does this matter? The U.S. capital markets are critical to U.S. economic activity, funding three quarters of equity and debt financing for commercial corporations and facilitating prudent business risk management by end users. Banks play a critical role in the capital markets, facilitating capital formation, end user hedging needs, and ensuring liquidity in these markets. The G-SIBs collectively have over 90% of U.S. market share of core capital markets activities affecting commercial businesses and consumers. The expected large increases in trading book capital will likely result in affected banks raising costs and reducing their capital markets activities. This will lead to reduction in the products and services they offer and lead to a loss of capacity in many key markets. There is no guarantee that this loss market capacity will be made up by other market participants. The consequences will likely be higher funding and hedging costs, as well as reduced market access for end users, as highlighted in a letter submitted to the banking agencies last week by the Coalition for Derivatives End-Users. It will likely result in reduced market liquidity during times of stress with potentially broader consequences for financial stability. In addition, it is also important to note that Basel III Endgame will affect certain capital market activities more than others. The areas that we estimate will be hardest hit include securitization products trading, securities underwriting, equity investments in funds, securities borrowing by banks and derivatives, wherever these impacts will be felt in the near term, regardless of whether a phase-in period is included in any final rule as markets and investors will expect financial firms to come into compliance as soon as possible. We are here today to talk about what policymakers can and should do to avoid these unnecessary consequences, and I'll leave the vast majority of the substance to our respected experts joining us today. But before I do, we would like to make one last final appeal for some degree of transparency from U.S. policy makers. The Federal Reserve's holistic review exercise should be made public in conjunction with the publication of the rule proposal in our view. Both should be subject to public comment, allowing sufficient time for external stakeholders to perform quantitative impact studies and provide those analyses to the agencies. Publishing the holistic review in conjunction with the MPR would lead several benefits, we think. It would allow a broader audience to evaluate how capital and other prudential requirements have performed since the last financial crisis. It would provide the Federal Reserve with an opportunity to explain why the Basel III Endgame capital increases are needed at this time and what the cost of doing so would be for specific markets and sectors. Crucially, it would allow for a better understanding of the Basel III Endgame package interacts with other elements of the prudential framework and whether

recalibrating existing requirements may be appropriate. These interactions include the significant duplication between the FRTB portion of the Basel III Endgame and the GMS component of the stress testing process. Public input would also help the Federal Reserve and other agencies to identify an optimal level of capital that balances micro and macro prudential safety. Today, we will attempt to tackle some of these issues and concerns from a diverse set of views. We have regulatory views from both the prudential and capital markets perspectives, industry experts and academic research. We will start with a panel moderated by, Jelena McWilliams, covering a review of post-crisis prudential reforms and evaluation of the Basel III Endgame. The next panel will discuss the impacts of the Basel Endgame on end users, the capital markets and the U.S. economy. And we will end with the session looking to get a deeper sense of the interaction between the Basel Endgame and other elements of the U.S. capital framework and potential reforms. And with that, let's get going. Please join me in welcoming Jelena McWilliams, Managing Partner of the Washington, D.C. office and head of the Financial Institution's group practice at Cravath, Swaine & Moore. She's also former Chairman of the Federal Deposit Insurance Corporation. Jelena, thank you for joining us today and for leading our discussion. Over to you.

- Thank you so much.

- Thank you Joe, and thank you all for being here today with us. I'll just take a couple of minutes to say why I think this discussion today is really timely. As we know, Vice Chairman Barr has given his much anticipated speech on bank capital a couple of days ago, and we know that a lot of movement in this holistic review of capital is afoot. And while we don't have the proposal in our hands yet, and as bank regulators will always tell you, "The devil is in the detail," the truth of the matter is that there has been a lot in this speech given by Vice Chairman Barr, that we can have a, I would say, educated conversation about where we think we're going. And from my personal perspective, I think it's just worth noting that over my tenure at two regulatory agencies and the Senate Banking Committee and as a general counsel of a large bank, it seems like three things remain consistent every time regulators change the capital levels. One is, it always is in response to some kind of a crisis or event in the banking system and we always try to cure that. And quite often, regulators use those events to justify the imposition of the new capital levels, which I think is also available in Mr. Barr's speech. It was the failure of the three large banks to justify increasing the capital levels in the banking system, including for banks over a hundred billion dollars. What I'm hopeful that the Fed will do is actually do a quantitative impact study. They're long overdue. This was one of my main points in 2012, the Fed relied on the QIS from the Basel Committee at the time, and it was based on 229 banks, only 14 of which were U.S. based banks. And the capital levels that they looked at were based as of December 31st, 2009, perhaps one of the worst points in the balance sheets for the banking industry. And that's how we got that Basel III reforms in 2012 on capital

liquidity. And now, we're going to have more changes. And I think that is long overdue to actually undertake a domestic QIS, including for the Basel III Endgame. The second thing that I find always happens is that the fundamental question or what is the optimal capital level, is actually not a partisan one. I don't think it matters on what color jersey you wear. I have never heard a regulator say, "We should have a weak regulatory capital standards." That has never happened. If it has, please send me the speech. And so, when we think about what is the optimal capital level, I wish there were a magic formula. I asked very smart staff at the FDIC and the Fed, what is the number? And it all goes with, "It depends." And where we may have some disagreements is what trade-offs as regulators we would be willing to make to make the capital levels go up or down. And Randy Quarles, the former Vice Chairman for Supervision of the Federal Reserve, will speak later. And I know we have had a number of discussions during our tenure at the Fed and the FDIC exactly on this topic, "What is the optimal level?" We analyzed the system and the accuracy of capital in the system and we didn't think that the system was under capitalized. As a result of that, we thought that we will make some capital changes. They're going to be very targeted and specific and narrow, and we're going to be overall capital neutral. So some banks will get higher capital levels, some lower, but overall we didn't think the system was under capitalized. And that was based on the empirical data from the Fed and the FDIC at the time. So I'm hoping that the proposal, when it comes out, will provide the same kind of analysis that Randy and I used to engage in to understand what the capital levels are. And lastly, they always say, "The rules are going to be implemented at X date." That date always looks far in the future. And nonetheless, you kind of look at your clock and it's like tomorrow. And as a result of that, I think that the market, the analysts and the market experts are already starting to position banks and other institutions based on this new anticipated rules. So it'll be good to understand exactly what's going to be promulgated by the Fed and the impact on the credit availability, not just in the banking system, but capital markets in general. And with that, because I know we're on a tight timeline, I'm going to turn to our first questions. And since, Randy, I called on you already, I will start with you. And so, the Basel III Endgame reforms represent a significant shift in the way risk-based bank capital requirements are calculated and will have a wide range of impacts on the U.S. capital markets and broader economy. Can you explain what the original objectives of the Endgame reforms were and how they build upon or differ from other post-crisis changes and capital rules? More specifically, do you think that the Endgame reforms, particularly the trading book reforms, are likely to achieve those objectives?

- Thanks Jelena. So let just make a few comments in response to that, and I hope this is a roundtable discussion around all of these topics. I do think that we are, at the first highest level, I think that we are in danger of forgetting what was the objective of the post-crisis capital reforms at the highest level, which was, you needed to have a system in which any bank could fail. It was not to have a system in which no bank could or would fail. And as you look at the evolution of the implementation of capital reforms, and

particularly the discussion of the implementation of the Basel Endgame and the Holistic Capital Review, I think we've lost sight of that fact. We seem to be seeking to create a system in which no bank can fail. And that will almost inevitably be an inefficient system, an inefficient system looking only within the context of the banking system. Certainly an inefficient system looking in the larger context of the financial system of which the banking system is a part and of the real economy of which the financial system, the financial system exists to serve. So that's the first comment that I would make. And as we looked at this question of implementing the Basel Endgame reforms, I do think that the two principle elements of the Basel Endgame, a sort of specifically calculated capital charge for trading risk and specifically calculated capital charge for operational risk, that's conceptually sound, that makes sense in the context of an overall capital framework. You should have incentives against these various risks, but it should always be considered within the context of, "What is an aggregate capital level that is efficient? And that is calibrated to create a system in which any bank can fail, not in which no bank can fail." And, so when we looked at the implementation while I was at the Fed, there was, on the shelf, a plan that essentially implemented these two provisions at an appropriate calibration that would not have been too high, but was higher than the capital that the affected firms were currently holding against those sorts of risks. But in which the aggregate level of capital in the system would remain just about constant because we thought we were at an efficient level of capital. And which no bank would have, no large bank would have lost, would've reduced their capital, but no large bank would've had a significant increase in capital. It would've affected the incentives by fine tuning the elements of the capital framework. That's possible to do. It requires acknowledging, which the Fed has said in the past, it would acknowledge. It does not seem, given current public statements, that it's going to do, but it would require acknowledging that some of the current calibration of the capital system was done, the so-called, "gold-plating," in the initial instance, precisely because we didn't have these last elements of the total framework. And therefore, the inevitable, logical corollary is that when you do implement the last elements of the total framework, you should revisit those earlier up calibrations and calibrate them downwards so that you've got a framework again that is at an aggregate efficient level. It's clear that the Fed is not going to do that. Our calculation was that if we did nothing to recalibrate the rest of the system and simply implemented the two elements of the Basel, those two core elements of the Basel Endgame, you would increase capital by about 20% in the system. Well, they've been saying they're going to increase capital in the system by about 20%. So it appears that they're not going to do any material recalibration and simply implement those provisions at the high end of the logical scale of their calibration. And, that is, that is not remaining mindful of the fundamental reason for a capital system to begin with. It's moving too far down the scale of trying to ensure that no bank can fail. It will restrict the ability of the financial system to, of the banking system to provide, to fulfill its role in the rest of the financial system and restrict the ability of the financial system to provide support to the real economy. It's a mistake.

- Thank you Randy. Perhaps we'll turn over to Adam Gilbert at PwC. The other Randy. I was going to say Randy #2, but I'm not sure I should say that. And Steve Strongin. So I'll start with you, Adam. Where's Adam? Right there. I couldn't see you. You and your colleagues at PwC recently released a report that reviewed the post-crisis regulatory reforms and examined the academic literature around the optimal level of bank capital in the system. I can tell you, it's a airplane carry-on weight. If you do single page. Tell us more about the report's findings and whether capital levels for the largest U.S. institutions are in fact close, near optimal levels. And how did you come up with the optimal levels? And where were you when I needed you?

- Thank you, Jelena. Yes, our report has two parts. The first is, as you mentioned, it's a thorough inventory and discussion of the reforms made since the great financial crisis. And that's important because those reforms should factor in to the analysis and discussion about what the right level or optimal level capital really is. And so, we encourage people to really read that and review it and digest it, because it's important to understand how the guardrails in the system have changed, how safety and soundness has evolved, and how financial stability has evolved. So that's an important component of our study. The second part is where we conducted an exploratory analysis across key academic and regulatory literature. And the analysis focused really on 6 papers, although we reviewed 25 of them. And the 6 we chose were selected based on the criteria that they estimated optimal capital, so that was critical, were authored by key regulators, standard setting bodies, or academics, so there was credibility. And it attempted, they attempted to consider some of the post, great financial crisis regulatory regime elements, such as TLAC and liquidity requirements. Now it's important, I'm emphasizing, "Attempted to," and I'll come back to that later. And they also included impacts for the non financial sector as well. So... Conclusion of the outcome? We took an average of the range of outcomes of these studies and concluded that the papers imply the optimal level capital is approximately 15 and half percent of Tier 1 capital, which is close to where firms are today. We took a measure at the end of last year, where we had the most thorough data when we wrote this, which is around 15.2% for the 33 banks that undertake CCAR. So most of the papers analyzed, as I said, Tier 1, rather than CET1, and there's a reason for that. It's due to the latter's introduction in 2015 and the need to have a longer time series for model calibration. So nonetheless, we created an implied optimal CET level based on the studies, which is estimated to be around 13.8%. And here again, the figure aligns with the actual average of banks CET1 ratios as of the end of last year, which was around 13.2%. So very much in line with where banks are today. Let me explain a little bit about how the research, how the literature gets there. 'Cause I think it's important to understand that context and background. The papers typically analyze optimal capital levels by measuring the marginal benefits against the marginal cost of increasing capital requirements. And the marginal benefit is taken to be less frequent and less severe crises in the commercial banking sector, and therefore a more resilient system. The marginal cost is considered in terms of reduced economic growth

and higher funding costs for banks, which is ultimately passed on through increased borrowing costs, reduced lending volumes, and potentially investments as well. It's worth noting that most of the literature we reviewed does not take into consideration all post-crisis reforms, most notably TLAC. And as a result, these studies may also be overstating the marginal benefits of higher capital requirements and underestimating the marginal cost. And I think that's a real takeaway from our analysis. So with this framework in mind, researchers tend to focus on two impact channels. The impacts to financial stability, where higher capital requirements reduce commercial banking leverage and reduce the probability and cost of a financial crisis and the impacts to the supply of credit where higher capital requirements increase bank funding costs, which in turn increases lending rates, reduces loan volumes, and ultimately, can reduce economic growth. If there's some disagreement in the literature regarding the impact of certain factors, and I think this is worthy of discussion. The predominant view is that increasing capital requirements results increased cost of funds. However, two papers proposed these requirements may result in actually lower cost of funds and increased lending volumes. This would be driven by deposit scarcity, driving up consumer demand for deposits, which in turn allows banks to reduce the rate offered on deposits and bring down their weighted average cost of capital. Additionally, if the Fed paper notes that the current models do not consider the reduction in risk premia on bank equity and debt that may result from a safer banking system brought about by higher capital requirements, the reduction in risk premia would then offset the increased cost of capital expected to occur as a result of raising capital requirements. The FRB paper also notes that the corporate bonds, as an alternative funding source for borrowers, is not considered by the research. And consideration of this funding source may potentially reduce the impact of an increase in bank lending rates on non-bank corporate funding costs. The studies also do not contemplate all existing regulation implemented since the financial crisis. For example, enhanced regulation around liquidity requirements and recovery and resolution planning can lower the marginal benefit and marginal costs of increasing capital requirements. Where studies considered these regulatory factors, the reduction in marginal benefits is material because these regulations have been found to substantially reduce the probability of the crisis. Additionally, enhanced risk management capabilities and prudential standards can result in more efficient capital allocation and vendor management of risk, reducing the optimal, the need for, the optimal capital level needed. In addition to disagreements on factor directionality, the papers do not thoroughly examine all relevant factors. The factors omitted by some papers include non-bank financing, trading book and market liquidity, liquidity requirements, improve risk management capabilities, and prudential standards for large banks, and advancements in market standards. Generally, these factors are anticipated to lower optimal capital level estimates because the factors may reduce the same risk to financial stability that higher capital would address. That's a really, really important point. For instance, increasing more capital requirements may increase the size of the non-bank financial sector and while in expansion of the non-bank finance sector benefits economic growth by supplying additional credit and promoting effective competition, driving down borrowing costs, this may be partially offset by an increased probability in cost of a crisis. The potential increase in probability of a crisis would be driven by greater leverage and less regulated, and less

transparent financial intermediaries. And the potential increase in costs would be due to resiliency of the credit supply being reduced. And finally, improvements in market standards, like the Volcker rule and clearing standards can reduce overall risk in the financial system, potentially reducing the marginal benefit of increased capital requirements. Overall, the existing body of literature and optimal capital is vast, and conclusions regarding what is optimal vary due to differences in approach and assumptions. But when considering increase in capital levels, it's important to not only examine the optimal levels of capital discussed in the literature, but also to consider the limitations of the analysis, such as the partial inclusion of post-crisis regulatory reforms and the complex interaction between bank capital requirements, the size of the non-bank sector, and the cost of credit and financial stability.

- Thank you.

- Well, that's a lot. Let me pause a bit.

- That was less weight than what I have to print and carry in my luggage.

- Abbreviated version for you, Jelena.

- Thank you for that. So Randy G., Randy G. You have spent a lot of time discussing capital and liquidity regulations over the years. I know from my early days at the Federal Reserve, you have always been at the table as one of the utmost legal authorities on the issue. When we talk about optimal levels of capital, what comes to mind for you? And how are you proceeding the speech that just came out from Vice Chairman Barr?

- Thanks Jelena. So I think I have two points I'd like to make that really consistent with PwC's report, but comments more on Vice Chair Barr's report on SVB in his recent speech and Steve Strongin, in particular, recognized one of these points that was made 10 years ago. First is, that no reasonable amount of capital will make a bank invulnerable to failure, which is Randy Quarles' point. If it's managers make disastrous decisions about interest rate risk or other risks that result in the destruction of substantial portion of their assets, and the market suddenly learns or comes to believe that I think it came to believe with SVB, that the bank was balance sheet insolvent on a market-to-market basis. And so, the deposits

run because it's rational to run in that situation. Second point is, that no bank's resolution plan, this is the one that Steve Strongin is gonna recognize, will help the FDIC in an actual failure situation to stem contagion unless the FDIC uses that plan to develop and publish its own presumptive path for resolving the particular bank, convinces the market that its presumptive path is credible, and resolves the bank in accordance with its own announced presumptive path, absent extraordinary circumstances. And I think the reason that's important is otherwise, I think the FDIC appears to be flatfooted sometimes as I think it appeared at SVB, because while SVB had a plan, it hadn't been integrated into the FDIC's own resolution plans.

- Thank you Randy. And I can tell you for a fact that the FDIC wasn't flatfooted when I was there, it was in 3-inch heels. I'm just curious, Steve, if you can provide maybe, a couple of perspectives on this as well.

- Very happy to, particularly given, Randy sort of set me up to do this, but the... I wanna step back for a second and note that I think Adam did a magnificent job of explaining the conceptual framework for optimal capital that we have allowed ourselves to buy into.

- Mm-hmm .

- Okay.

- And it makes it all sound far more rational than in truth, it actually is. And I want to go back to something Randy said and just explain the conceptual cret that all of that language allows. So my history at the Fed started with cleaning up the S&L crisis. So I remember definitions of these words way before some of the others. The notion of, "Contagion," here and how it changed is an object lesson in how we allow ourselves to get trapped by language. "Contagion," used to mean that good banks were tarred by bad bank behavior, and we needed to fix that. In the most recent crisis we had a situation where, a bad bank tarred the other bad banks, and all the good banks were fine, right? CNBC was able to give you a list of all the banks where unrealized losses created problems, right? And all the others were fine and everybody knew where to run to. This was an example of exactly how the system's supposed to work, right? The fact that a regulator blood pressure went up is not a sign of failure, okay? The fact that no one had trouble finding a good bank is a sign of success, right? So the system actually worked perfectly, but we somehow had allowed the word, "Contagion," to shift from good banks being tarred by bad banks to

bad banks being tarred by other bad banks. That's actually called, "Transparency." That's how the system's supposed to work, right? And somehow we became so allergic to failure, but we let all the words get redefined. So we still had a problem, right? This was the problem we spent 20 years trying to solve. It got solved. We didn't like one tiny aspect of what that solution looked like, which is other bad banks were discovered. That's actually, from a standpoint of a capital market answer, a really good outcome. At some point in this process we have to declare success. One of the things, as a former researcher on Wall Street, one looks for opportunities to make low risk projections. I project there will be a Basel 3.5.

- Could I make a quick comment, Jelena? Picking up on Steve's point about buying into the framework of the optimal, calculation of optimal capital. Again, I think there have been some significant advances in the work of PwC that Adam has done and described for us that are very helpful. When you look at the huge range of existing studies that are out there, they're useful in providing a disciplined way to think about it. But what you are fundamentally thinking about, the key assumption in each is, "What are the losses you're trying to protect against?" So the Bank of England assumes that you're protecting against losses that were about the same as the great financial crisis and they come up with a range of capital that's lower, right? It's, I think, at the midpoint is about 10. The Fed assumes that you're protecting against losses. The Fed study you're protecting against losses that are, I think, 50% larger than the great financial crisis; some increase. And they come up with a range of minimum required capital that's about 50% higher. It's like 12 to 15. Neel Kashkari in Minneapolis assumes that you have to protect against the earth getting hit by an asteroid. The losses are many times the great financial crisis and it turns out you need many times as much capital to protect against those losses. But all of those studies are simply saying, "If this is the sort of thing you like, you will like this sort of thing." They don't actually tell you what the choice ought to be for what are the amount of losses you need to protect against. And that's kind of hidden in the blinding-by-science of all of these studies.

- Thank you Randy, and thank you for giving us a soundbite this early in the conversation. Sheara, we'll turn over to you. Can you tell us more about how the post-crisis capital reforms have reshaped the capital markets, from your perspective, of U.S. banks and what their broader impacts have been on the U.S. capital?

- Sure, happy to. And I wanna thank you for hosting this panel today. I wanna thank SIFMA for taking the time to put this group together to focus on such an important and a relevant topic right now. When we think about the largest banks in the U.S. and all of the post-financial crisis reforms that Adam's paper referenced, the three that really had the biggest impact on raising the capital requirements for the largest

banks in the country was Basel III, the original, or the OG Basel III, G-SIB and the CCAR-SCCB framework. And as a result of all of that, we've seen capital levels at the largest banks. And I'm generally referring to the G-SIB'S double and for the capital markets focus banks, and looking at my friend across the table, more than triple. And so, when you think about, "What has capital done to the banks?" Every decision of significance that's made at any of these institutions is all done through the lens of capital. If we're gonna look to acquire something, we think about what it's gonna do to our capital front footprint. When we look to dispose of something, it's about the capital footprint. Specifically, within Goldman Sachs, we've been very public about the fact that we're de-risking our on balance sheet private equity. That's in part because it has a pretty volatile earnings profile that shareholders are not pleased with. But the primary reason is in the stress capital buffer, private equity consistently gets shocked near 70% and it's just too expensive of an asset to hold from a capital perspective. And so, capital is what drives all of the strategic decisions that the G-SIBs are making. And as a result of all of that, the G-SIBs are, as we've all mentioned, much safer and stronger than they were and much more resilient. And we've been able to observe that over the past several years as we've seen, not just a hypothetical, severely adverse scenario that we've participate in every year, and sometimes twice, but in some ways more importantly, real life stress tests. And so, with 2020 and the onset of the pandemic, we all saw RWAs across market risk balloon quite dramatically, as markets were really volatile and bar and stress bar acted the way they're meant to act. And during that time, the banks still stood ready to lend to the most troubled sectors. Similarly, in 2022, different issue. With the onset of the Russia-Ukraine war, you saw commodity prices very volatile, affected not only market risk RWAs, but credit risk RWAs, mostly notably from uncollateralized derivatives. And despite that, the banks stood ready to provide capital markets activities mostly in emerging markets, as various countries look ahead to their exposure there. And then most recently, as we've referenced earlier with the regional banking crisis, where the G-SIBs were really a source of strength. So not only do we pass a hypothetical stress test, but again, I would argue more importantly, we pass these multiple and divergent real life stress tests. When we think about, to your question about capital markets, specifically, and you look at Basel III, CCAR and G-SIB, they all have capital markets sitting right in the crosshairs. And you can start with the global market shock within the CCAR stress test as the most obvious. For those less familiar, it's an instantaneous shock on the entirety of your trading book position. And for the likes of the capital market, but banks, it represents north of 50% of our stress capital buffers, with Goldman being close to 60%. And so, there, you've got capital markets activities squarely in the crosshairs of the stress capital buffers. But it's not just there, it's also in the market risk RWA framework, which looks at bar and stress bar, which there is admittedly some duplication there, some of which will be adjusted for in FRTB. But there too, you've got capital markets in the crosshairs, and even something like G-SIB, which is the, "Global Systemically Important Bank," surcharge, which you don't think about as capital markets focused. Three of the indicators have capital markets driving the impact, which include things like trading securities, derivatives and short-term wholesale funding. And so, capital markets in the existing framework, is squarely in the crosshairs of the regulatory regime. And so, why does it matter? It matters, and some of the panelists mentioned this

earlier. The capital markets that exist in the United States is a huge advantage to the United States and it's the primary way in which economics are facilitated in the United States. SIFMA published a statistic that, if you look at the global equity market cap of the world, the U.S. is 40%, with the next nearest market being only 11. And as was referenced earlier, corporations are huge reliers on capital markets, on its depth and on its liquidity in order to not only hedge their interest rate and currency and commodity risk, but I would argue, more importantly, as a bank, as an output and a funding source for them. In the United States, 75% of corporate debt is funded via the bond market. The equivalent in Europe is only 25%. And so, capital markets is a distinct advantage for the United States, and to the extent you raise capital requirements to the large banks, or to all banks, that cost gets passed through into the capital markets. And you've seen that directly with SACR. SACR, the most recent thing to be implemented at the beginning of 2022, which is really the first part of the Basel III Endgame. If you look at, as an example, short-dated cross-currency swaps, the cost of what it costs clients to do those hedges back in '21 and '20, is nearly five times higher, because the RWAs associated with them are higher and the banks are therefore charging more for that type of activity. And as was referenced in the opening remarks, you don't have to take my word for it, you can read the letter issued by the Coalition of Derivatives End-Users, which includes a lot of the household names that we all rely on today, like, "Microsoft," and, "Hilton Hotels," and the energy companies and the airlines, who they, themselves, have talked about how their cost of increase as a result of SACR and in addition, how their expectation, based upon what they know about the Basel III Endgame, is that costs are gonna go up there as well. And so, then when you think about the Basel III Endgame, and I know that's gonna be covered more in a later panel, one of its primary purpose was to address the discrepancy between the U.S. "Gold-plated," rules that Vice Chairman Quarles referenced earlier, and what was being implemented around the globe. And if you look at U.S. versus Europe, the U.S. has method 2 in G-SIB versus method 1, the U.S. has the SCB, which requires banks to carry every single day their peak-to-trough capital requirements. No other jurisdiction has that in your regulatory minimums. Also, no other jurisdiction has it where the regulators calculate it themselves independent of the banks. And even in the RWA framework, existing, there's discrepancies between what's done in the U.S. and Europe. For informational sake at Goldman, we ran in the recently completed Basel Endgame for Europe. If we were bound by that, what would happen to our current capital requirements? And they would meaningfully decline from where we are today, let alone the 20% increase that Vice Chairman Barr's referenced in his speech this week. And so, when you look at the Basel III Endgame, it will only exacerbate, not just the U.S. versus Europe discrepancy, but it's got capital markets once again its crosshairs, whether it's secured borrowing, known as the, "SFT haircut floor," which is going to become much more expensive. And that will directly impact pensions and insurance companies and mutual funds who use that market in order to increase their returns. And notably, no other jurisdiction that has implemented Basel III Endgame has implemented that portion of the rule. Or if you look at things like CVA, where end users, both financial and non-financial, have been carved out by other jurisdictions, it doesn't appear that's what's gonna happen here. And even in the fundamental review of the trading book or the market risk rules, there too, it seems as though the implementation of what's gonna be put in place

here is at a level more severe than the rest of the globe. And I recognize, in Vice Chairman Barr's speech earlier, he talked about the double counting between Basel III Endgame and CCAR, and the fact that they're really capitalizing for different things. But I would just highlight that if you take a lot of different instruments, particularly securitized product, and you run them through the Basel III Endgame, when you add Basel III Endgame RWAs, plus CCAR, you actually capitalize for more than the caring value of the instrument. So if I have a triple-B rated CLO, I'm actually carrying more capital than the market value or the caring value of the instrument. Said another way, if I market to zero, I get to release capital. And so, it may not be a double count, but there's certainly calibration further, to your comments earlier, that needs to be done with the onset of the Basel III Endgame.

- Great. Thank you so much, Sheara. And you know what? You mentioned something that I think may be purposely lost on some people that is that the real stress test was the pandemic and the economic shutdowns. And while you were speaking, I just looked up, and the CT one levels at the G-SIBS at the end of Q3 in 2018 were at 12.9% and three years later, Q3 2021, they were at 14.5. So even the 6 quarters of the pandemic, 6 quarters of the pre-pandemic, the capital levels ended up rising to a level where I think some of the Adam's studies have found to be optimal as well. Turning to the future now. As Vice Chair Barr stated in his speech on Monday, the U.S. prudential agencies will be issuing their proposal implementing the Basel Endgame reforms in the very near future. What are the key issues that the regulators will need to decide on in the U.S. proposal? Where might they diverge from or "Gold-plate," the Basel standards, the timeline, phase-in. And I would like to turn the floor over to my former colleague, Jonathan Gould. And I'm hoping that others, Randy Gynn, and others will participate as well in this next segment.

- Thank you very much, Jelena. So agencies have a lot of discretion, as you all well know, and that means they have a lot of key decisions to make. That discretion comes from at least three sources. One, Congress frankly provides few explicit constraints on agency discretion. Yes, there are some things that the Collins Amendment and the prohibitions on using external credit ratings, which can complicate the regulator's job, but generally speaking, gives the agencies a pretty free hand in terms of guidance. Two, Basel itself, explicitly allows for national supervisory discretion in a lot of areas. Of course, Basel is not legally binding in any way on U.S. regulators. And so, that's obviously not, they're not limited to making decisions where there's explicitly permitted discretion. And the third point I'd just like to make about the outside about discretion is that Basel III is just one part of the U.S. capital edifice. And many key issues that the regulators are gonna have to resolve relate to other elements of the U.S. capital framework, rather than explicit options permitted them in the Basel framework. And a few of those elements of course are prescribed by law, like the Collins Amendment for example. But most are regulatory creations, like the

unique U.S. G-SIB surcharge methodology in the stress capital buffer. We're gonna talk about more on this later in subsequent part of the roundtable. But I make this point now just to note that it's, a lot of the U.S. "Gold-plating," occurs with respect to these non-Basel elements. So I'm gonna cover RWA methodologies for credit risk, market risk, CBA risk and operational risk, and a few other odds and ends. This is not an exhausted list. One of the challenges I think in dealing with Basel III is just the aggregate impact of all the minutia and trying to understand the interaction between the various details and whether, individually or in the aggregate, how this is gonna impact the relative and absolute cost of various financial services and products. We're helped a little bit today in that Vice Chair Barr gave us some color earlier this week, as others have mentioned, on where the agencies are likely to come out. Some of these issues, but obviously, and I certainly hope there'll be a lot of public endpoint and that will be reflected in whatever the final outcome is. So the first key question I think is, the scope of application. Again, Vice Chair Barr stated earlier this week that Basel III is gonna apply to all banks over a hundred billion, but the mechanics in details are not a hundred percent clear. So let's turn to what that means in the context of specific risk types. So starting with credit risk. I think a threshold question is, "To what extent U.S. regulators are gonna permit internal models and under what conditions, if at all?" Now, generally speaking, there's been a desire to increase risk sensitivity in Basel III. But notwithstanding that desire, regulators are skeptical of internal models generally, and more particularly, more specifically, as V.C. Barr stated earlier this week, U.S. regulators apparently are poised to eliminate the use of internal models for calculating credit risk RWAs entirely. Now alternatively, U.S. regulators could actually limit the use of internal models to certain asset classes or they could permit their use, but only subject to certain input floors that constrain the range of RWA outputs. So setting aside this important question about the use of internal models and on credit risk RWAs, the U.S. has often deviated from standardized risk weights for credit exposures and could well do so again. To just cite a few classes or buckets of exposure where the U.S. might deviate, Basel has introduced new exposure classes, such as commercial real estate or retail exposures and specialized lending. And the U.S. will have to decide, for example, whether to adopt Basel's risk weights for real estate's exposures based on LTV bans. We also don't know what the U.S. will do on retail exposures. And then on corporate exposures, will the U.S. align the investment grade definition with industry practices, or will they retain the positive requirement that the bar must be listed on an exchange to qualify as investment grade? The treatment of unused commitments is also not clear. Will the U.S. decrease the credit conversion factor or set it to zero for unused, unconditionally, cancelable commitments or do something else? As Sheara alluded to earlier on securities finance transactions, like reverse repos, the U.S. will have to decide whether it will break with Basel and join the all the other nations in declining to implement minimum haircut floors on collateral for these transactions with non-bank counterparts. And finally, on credit risk, we also don't know what the U.S. will do with the Basel concept of simple, transparent and comparable or STC securitizations. On market risk, I think the initial question again is one of application. Will it apply as, I think, Vice Chair Barr suggested, to entities based on a straight asset test, those over a hundred billion? Will it be more consistent with the way their current market, capital market risk capital applies, which is a function of trading assets and liability. As with credit

rate risk, regulators are gonna have to decide to what extent they're comfortable letting firms use their Internal Models Approach to calculate market risk. Based on the Vice Chairman's speech from earlier this week, it appears that they're going to be allowed to use internal models by trading desk, provided the data is sufficiently robust. But assuming the Internal Models Approach is still a possibility under market risk, at least for some firms, regulators will still need to set the parameters for it's use. How hard will it be to obtain supervisory approval by trading desk? And will it frankly be worth it at the end of the day, in terms of capital reduction? They also need to decide whether the new approach will replace the current market risk approach, or merely be another parallel exercise. All this is gonna drive incentives for continued refinement of internal models, or not, as the case may be. Finally on CVA, or, "Credit Valuation Adjustment Risk," question is, whether it'll be included in the standardized approach and applied to a broader set of banks than it currently does, which appears to be the case. Although, I don't believe that Vice Chair Barr addressed that directly in his speech earlier this week, there's also some interaction between the standardized approach for counterparty credit risk and concerns that the CVA risk will undo some of the benefit commercial end users provided in SACR, along the lines of what Sheara was mentioning earlier. On operational risk, like CVA risk, they're gonna have to decide to what firms it will apply. Again, Vice Chair Barr seems to be saying it'll apply to all firms, a hundred billion plus, so category 4 and up. And that the Standardized Measurement Approach would replace the current Internal Models Approach. But they're gonna have to address the calculation methodology, that SMA approach. Specifically, they're gonna have to address, I think, the services component which addresses the treatment of fee-based activities. The issue is that the so-called, "Business Indicator Formula," penalizes the services component by not allowing an expense offset or capping it. This is different from the treatment for interest income component. Regulators could choose to limit the impact of the services component on overall op risk charge as well. Another issue in op risk that they will need to address, I think is the internal loss multiplier. This is meant to be a mechanism to count for historical losses of the specific bank. If they set it greater than one, it increases RWA. And less than one it decreases, but they could also choose to disregard historical losses as a factor and set the internal loss multiplier to one so it has no impact at all. This is permitted under Basel III, and it's what the EU and the UK have done, I believe. But Vice Chair Barr, again in his speech earlier this week, hinted that the U.S. will use their internal loss multiplier to adjust the operational risk charge upwards only. Like the market risk changes, the op risk changes appear poised to make capital markets activities more expensive on both, an absolute and relative basis. Let me just say a brief word about output floors and transition periods, and I know others wanna talk about this topic too. So as mentioned, regulators are generally uncomfortable with risk-weighted assets, calculated solely on the basis of banks own internal models. One way to address this is through output floors, which limit RWA reduction achieved by using internal models to a percentage of RWAs as calculated using the standardized approach. But U.S. regulators are gonna need to consider how and whether to apply this output floor, including in the context of the Collins Amendment. So even though it seems that U.S. regulator attorney's intent on eliminating a lot of the Internal Models Approach, they seem to be permitting it under the market risk. So they're gonna have to factor that into

and how to think about the output floors, at least in that context. Finally, obviously Basel III set transition periods for its implementation, which basically went out the window as soon as COVID hit. And we talked about how, notwithstanding a transition, apparently, kind of delayed phase-in is down, others pointed out, markets will expect firms to meet it now. So that is something too, that I think the regulators will have to consider. Let me wrap up there 'cause I know others...

- Oh, that's perfect, thank you so much. And since we have Sheara, you said, "The OG for Basel III," we'll call Randy Quarles, "The OG." So I can just say, "Randy," for the other Randy. Randy, if you had any comments to this, we have a couple of minutes on this specific aspect.

- So if I got the, "Randy," correct, how you were referring.

- You did, you did! You're not, "The OG," so I'm sorry about that.

- Okay.

- So I think Jonathan had a very comprehensive list of issues. I think two other issues that I can imagine the regulators needing to decide or thinking about is whether to agree with Vice Chair Barr's recommendation that the AOCI be extended only to firms that have a hundred billion dollars of assets or more. I can imagine some regulators saying that the AOCI should actually be extended to smaller firms on the theory that they have less sophisticated interest rate risk models than the larger firms. The other thing that I can imagine some debate on or issues that need to be decided is whether the regulators agree with Vice Chairman Barr's recommendation not to adjust the enhanced SLR to avoid adverse effects on the Treasury market. I could imagine other Fed governors, the FOMC, or even Treasury Secretary Yellen, not necessarily agreeing with that recommendation, which is something that's been floating around for a long time. So those are two issues. There are others as well, but I think Jonathan did a very good job listing a lot of them.

- Thank you Randy. And we can go to break, unless somebody wants to make closing comments for the first roundtable today. Well I have ruled with an iron fist. Thank you so much for on time. We'll take a 5-minute break and we'll be back.

- Welcome back and welcome back for... And for our next panel, we're going to be moving to the impacts of the Basel Endgame on end-users of the capital markets and the U.S. economy, once again moderated by Jelena McWilliams. And I turn it over to Jelena. Thank you.

- Thank you so much, Joe. And so, we're moving on to our second panel. And I'll just dive into our questions right away. I'll start. Steve, I'll start with you. What are your views on the Basel Endgame reforms and its likely impacts on the U.S. capital markets? And do you see the reforms having broader impacts on financial stability and economic growth?

- Of course. So I think the first thing you have to do to ask.

- There no academic answers. We just...

- That's right.

- You gotta give us a little bit more.

- Yeah. No problem at all. So the first thing you have to do is remove yourself from this optimal capital bank capital structure, right? If you think hard about everything that Adam and others have just said, it's very clear it's about bank safety, opposed to some nebulous impact somewhere else. If you're trying to understand the impact on end users, it's much more useful to think of these as simple excise taxes on activities. Right? This is basically a tax. And by the way, since this is the fifth round of taxes, this is no longer a theoretic exercise. If you don't see it in the economy now, it's probably not gonna happen with the next round of laws. Right? And so, all we really have to do is ask, "What did we already do to the system that we're gonna intensify?" So the first thing is, we've moved a ton of activity out of the public markets into the private markets, right? We are at roughly all time lows, in terms of public capital, as a percent of the economy. The private capital markets have grown tremendously. I think the single fastest growing job title on LinkedIn is, "Private Credit." That wasn't even a thing when I started out. Okay. So we've basically taken all that transparency out of the system, and we have moved it into the private

capital frame. If you look in detail, we have taken the banks out of activity after activity. So for instance, if you look at trading on the New York Stock Exchange today, banks for rounding error, right? It's now high frequency shops are doing most of that trading. The thing that's probably most pernicious is the sort of structure of homogenization. So if you ask, "What are banks good at, relative to the markets?" It's custom solutions. And so, what happens when you continue to raise the bank excise tax, is you make it harder for users who need custom solutions and easier for ones who can take the generic stuff off the shelf. So if you're a mutual fund trading stocks and it's a high frequency shop, you're okay. But if you actually need a custom, structured solution because you have a special problem, you're gonna pay a really high price for it. And so, what we've essentially done is we are homogenizing the economy, right? The regulators have a notion of what a bank is. Every year, banks look more and more like that picture in their head. They have a notion of what a loan book should look like. And every year the loan books look more like that. In every reform they look more like that. Is that a good thing or a bad thing? Now it's actually fundamentally a really terrible thing, but it's a subtle thing in the context of the way we do statistics. When you have diversity, you have lots of little problems, but not many big problems. When you homogenize everything, you get much fewer problems, But when you get 'em, they're really big. So for instance, when I first was at the Fed, we had a local housing crisis every couple of years, right? We determined the problem was, we had local housing markets. So what did we do? We created securitization in national banks so that we could have a national housing problem. Right? So we basically, by homogenizing the risk, have fewer problems, but when we have them, they're gonna be a lot bigger. The internal models is a great example of this, right? Internal models are different. That's the problem. Somebody might have a low model. So let's do a homogenize and force 'em all to the same thing. Well, then they're all gonna make the same mistake when it turns out to be a mistake. And so, the real core is, we're basically forcing the economy to be less creative, less custom, less thoughtful. We're less tolerant of the special needs business and forcing everybody into the homogenous solutions. It looks okay on paper. I sat through a SIFMA meeting, actually, a couple years ago, where the president of the New York Fed, who was a former colleague of mine, said, "These reforms had increased liquidity in the credit markets." I think the room just broke out laughing, right? But he had hard numbers to back 'em up. Why? Because all of the low liquidity stuff had totally exited the market. And the only thing that was left was high liquidity trading. The more we do that, the less resilient the economy is, the less creative the economy is, and the more we all look the same. This is something we should deeply, deeply, deeply distrust, but we've created such marvelous, intellectual frameworks to justify it, we just keep walking down this road. As Randy just said is, "Every regulator gets to tighten the screw a little bit more to demonstrate they care." And every time they do that, we get a more homogenous, less creative economy. And we congratulate ourselves because we've reduced risk and we've been prudentially careful.

- It's the wrong answer to the wrong problem. And yet we just keep repeating the exercise over and over and over again.

- Thank you so much. I too like the market economy. Um, so... We'll turn over to Mark Flannery and Craig Lewis. Mark and Craig, what impacts could the Basel Endgame have on capital markets funding for investors and end users? And do you see these reforms interacting or compounding the effects of the myriad market structure and disclosure reforms that the Securities and Exchange Commission has proposed over the last two years? So if you can share some views on financial stability and the economy overall, I guess we can start with you, Mark.

- Okay, thank you. Thank you all. I apologize for not being there in person. Something came up after I agreed to come and it made it impossible to leave home here, but I'd much rather be up there with the rest of you, even if it is hot. Now, most of today's comments and discussions and thoughts have to do with the Endgame reforms and what sort of marginal changes are gonna be imposed on the banking system. Which costs will go up? By how much? What'll be the ultimate effects? But I wanna go back to the beginning and think about maybe a little bit the way Steve just did. And think a little bit about the basic underlying system and ask, "How were the system's critical capital ratios computed?" Not, "Are they right or wrong?" But conceptually, "How are they computed? And how do those ratios affect bank stability?" Now, Adam Gilbert this morning, gave an impressive summary of a very long PwC report that summarized, that studied 20 papers trying to estimate the fair or adequate capital ratio. And the basic idea underlying all of these papers, more or less, is that you set up a portfolio of some particular risk. And then you put some capital into it, finance the rest with debt, and you let the losses occur in some sort of random way. And you say, "How often is that bit of capital sufficient to avoid an insolvency?" And I think at one point the rule was, you had to have less than a 1% chance of a bank failing in order to have the capital standard be, or the capital ratio be considered adequate. The crucial point underlying this exercise is that a dollar of capital can absorb a dollar of losses. And if you just set up a brand new enterprise with new capital, new assets, then that works perfectly well. But let's let some time pass and let's think what happens to the value of the book capital that is reported, and that's gonna be a problem. So I'm gonna have two conceptual shortcomings about the current regulatory system that I want to talk about. And the first one has to do with the fact that I think we have a flawed measure of risk-bearing capacity, sometimes substantially flawed. So as I said, the experiment to set up adequate capital or identify adequate capital, assumes that a dollar of equity can absorb a dollar of losses. But starting from the situation where we have a fair value of equity capital equal to the adequate capital rate, over the year when things are going badly, especially the accounting is gonna lag behind that, and sometimes atrociously. And so, when we get to a year out, we're gonna be looking at a book capital ratio where it is not at all clear that that book

capital, a dollar of book capital, can absorb a dollar of losses. Now, it could go either way, it could go up or down. But the problems arise when it goes down and the decisions, the supervisory decisions about the bank, are based on a measure of book capital as if the book capital really permitted the absorption of that much loss. Now, we all have seen repeatedly, starting most recently in great financial crisis, a tendency for troubled banks to have a book capital ratio that vastly overstates the fair value of that capital. Recently, the Swiss had provided us a more modern example, where last September, I just happened to have the number for last September, Credit Suisse reported a common equity Tier 1 ratio of 12.6%. Pretty good. At the same time, the equities market value was 1.5%. So we had 12.6, 1.5, and 1.5, being the market value, is a whole lot closer to the fair value of that stuff than the book value because Credit Suisse had been suffering losses and unrealized losses for years. Now as a result, this happened in Switzerland, it happened, I think in our case too, with Silicon Valley, you have a really high capital ratio that we have agreed, means something. And that delays the implementation of strong supervision. Because the bank simply says, "How can you be angry with me? I've got a really high capital ratio and you defined the capital ratio." There's a question about whether the regulators absolutely must accept that capital ratio. Silicon Valley Bank, we had a similar case, the CET1 ratio, recently, was 15.3. But when a colleague and I adjusted that for unbooked securities and loan value losses, that ratio became less than 3, went from 15 to less than 3. The CAMEL's rating was 2 through August 17th last year. And a recent op-ed piece in a major national newspaper said about Silicon Valley, "Calls for increased capital and liquidity, inevitably follow bank failures, but Silicon Valley Bank had plenty of both." Now I don't think that less than 3% capital is plenty of capital. And so, I would disagree with the authors about whether the losses unbooked, secure, unbooked losses were a big effect or a small effect. But I think in the case of Silicon Valley, they're reporting a big book capital ratio, also slowed down the supervisory intervention. So my first point is that we're looking at a measure of risk bearing that is probably flawed and it is probably flawed the most for banks that have the need for the most capital. The second point is one that a couple of people have commented on, including Adam, which is, if we squeeze business out of the banks, business is gonna go somewhere and we don't know where. And in the beginning, people didn't even worry about that very much. They might observe it, they didn't worry about it. But now people are getting serious about saying, "If we squeeze this risk somewhere else and that somewhere else is not regulated, not only don't we know what the risks are in a financial system sense, but we don't know if they are safer or less safe outside of the banking system." So we are gonna get some substitution out. The cost of the services, capital market services, will rise, but we don't know whether the quality of execution, the cost of execution, the risk associated with execution will change. So one of the things that means is, that if you look at the experiments that the PwC study described, those guys looked simply at failure probabilities in the banking system. They didn't worry about what was gonna happen to the failure probabilities elsewhere. But if we think, "If," we think, that moving risks outside the banking system makes them more salient, makes them more likely to affect the financial system, then we have got capital ratios in the banking system that are too high because the calculation has left out the cost of pushing risk into less regulated areas. So I think that's an important thing to think about, and certainly the substitution is

important and will continue. So finally, the last thing I'd say is that, every time I hear a bank regulator say, "We have made the bank safer and therefore, we have improved financial stability," I think about this shifting of risk and I smile a little bit because what we can say is, perhaps, "We've made the banking system safer, but we really don't know what we've done to the financial system overall. The financial system could be riskier than when we started. And we're only, I think, getting serious about looking into that now." So thank you very much.

- Thank you so much, Mark. And Craig, what are your thoughts on that?

- Thank you, Jelena. Well, being the third economist who gets a chance to comment on what's going on, you're gonna hear a little bit of redundancy, but I think one of the key features of the Basel III Endgame is really, it's designed to increase the amount of capital that banks have to hold. And one of the things that happens when banks hold more capital is, they're able to make fewer loans, right? And so, this seems to have a direct implication about capital formation in the economy and what's gonna happen. I did find it interesting. There was a speech by Martin Gruenberg, where he said that, "With this Basel III Endgame, you're going to see, not only the cost of equity at banks go down, but you'll see the cost of debt go down." And this strikes me as something that is completely thought illogical that if you were to, but you shouldn't be focusing on the individual cost capital. You should be focusing on the weighted average cost of capital. And there's no reason to expect that the weighted average cost of capital will go down. I think, if anything, it's likely to go up, because when you restrict the amount of lending that a bank can make or you force 'em to hold more capital, there are incentives to think about, "How are we going to earn a return? So how do we adjust our loan portfolio? Do we raise borrowing rates to people we make loans to? Do we seek more risky loans than we have in the past?" Some way to try to get a higher return on equity to keep shareholders happy. So even though there is this resiliency component to it, you raise capital, you clearly make it less likely that there'll be a bank run, for example, in the next crisis. But to Mark's point, if you restrict your ability to loan in the banking sector, people still need funds. Risk allocation still has to take place in the economy. It's going to go to less regulated, non-bank financial companies. And when it goes to non-bank financial companies, you have a situation where there isn't prudential regulation. There may be some disclosure based regulation around it, but at the end of the day, it is going to be something that you lose transparency around. So prudential regulators don't have the same ability to do this. And at one level, you have to ask yourself, well, there's competition, as Mark mentioned, a lot of substitution effect will go on. But if these non-bank financial companies were competing effectively with banks, they would've already been taking more market share from the bank. So I do believe that when you this happens, you'll see more emphasis on non-bank financial company intermediation. Now one of the things that I guess I'll differentiate a little bit and add some substance and new color to this is, I think the FSOC

anticipates this, right? And if you'll notice, they have recently decided, they made a proposal to amend their interpretive guidance around how to designate somebody as systemically important. And the attempts that they've had in the original guidance were basically, you had to do a cost benefit analysis. I consider that to be an integral part of any regulation. When I was at the SEC, one of the things that I was asked to do by Chairman Shapiro was to completely revise and rethink how the SEC conducted cost benefit analysis on its rules. And so, I think that's an important part. One of the other things that came out of that guidance was an activity-based approach, where what you would allow before you made any designations, you would give the regulator that had the primary regulatory authority the opportunity to weigh in and make the first decision about how an entity should be regulated. What has the FSOC proposed to do? They proposed to eliminate cost benefit analysis, right? They've argued that cost benefit, this comes from the proposal, "Cost benefit analysis is not useful and it's not appropriate." They've also argued that it's one of the things that they had to do under the existing guidance was, you had to estimate the future financial crisis. And they said, "That's infeasible." And they also believe it's infeasible to estimate the likelihood of how likely you are to be in a crisis. I get it, that all those are challenging things to try to estimate, but I don't think it excuses a financial regulator from actually having to articulate why it believes a financial entity is potentially systemically important. So what will be the ultimate solution to this? I believe that what will happen is if you are designated as being financially significant or systemically important, you'll be asked to hold capital buffers, right? And who are non-bank financial companies? They're mutual funds, they're private equity firms, they're hedge funds, they're insurance companies. How much capital should you have to hold? Some of these business models don't even accommodate capital, right? They're pooled investment vehicles. There's no notion for there to be a capital buffer. So when I was at the commission, and I believe this is really the Treasury and the Fed's chance to push back on some of the regulation that really disliked about money market fund reform, that effectively they lost the argument. When I was the chief economist, the debate was, or that the, I thought the predetermined regulatory solution was capital buffers. And I pushed back on that when I was chief economist and argued that these are pool investment products. You should regulate them like you do every other mutual fund. And made, I hoped and I thought, was a compelling case for why we should go to floating nav, as opposed to capital buffers. The biggest reason you do that is because, if you hold a capital buffer in a world where people price risk, the people who contribute capital to a buffer demand a return for that. And if you're expected to absorb the losses in a money market fund, then you demand all the excess return. And in effect, you convert all money market funds to the shareholders into government funds, right? The same thing will happen here. If you start to force firms to hold capital, the capital providers, the people who provide the buffer, will demand the return to those buffers and it will leave the shareholders in mutual funds, people who put money into hedge fund vehicles, they will be taking risk return trade-offs that they don't want. You'll be taking the risk out of those investment positions. And I think at the end of the day, you make all those vehicles much less attractive than they are today. So I think that if you see this moving in the way that the regulators have in mind, you're gonna transition, you're gonna take capital out of the banking system, you're gonna push it into non-bank financial companies. But at the end of the day, if the

response is to be able to say, "We think you're systemically important," not because you actually did any rigorous analysis, but because you believe they're systemically important, you end up with a lot of knock-on effects that I think are going to impair capital formation of economy.

- Thank you. Thank you both. We'll turn over the discussion to a little bit more focused on the trading book changes and we'll go with Debbie Toennies.

- I think it's worth clarifying one thing that Mark said, 'cause I think it goes to why you need to think about the displacement, and SVB provides an excellent example. The Fed, in its infinite wisdom of disliking large banks, basically said you can't, left this hole where a large bank that wasn't a SIFI couldn't be bought by a SIFI until they suspended the rules. As a result, they had to wait until SVB became a crisis to suspend the rules to allow it to be purchased. So when you move stuff out of the banks, or when you have it in the mid-sized banks, you essentially need a bigger crisis to resolve it because the regulators need a bigger headline to justify suspending their own rules. So that we talk about this like this is difficult to calculate and capital to prevent, but the fact is, we create messes much faster in this process by making resolution hard, right?

- Mm-hmm .

- The whole, "We're gonna prevent the crisis in the first place," there's a notion in here that if we make resolution difficult, that will give regulators better incentives to prevent. That's insane, but it is what we've built into the system. And SVB's a wonderful example about it. The almost, probably, no one will ever know the counterfactual, but the entire cost to the taxpayer for that could have been avoided if they'd been willing to sell it to a SIFI 6 months earlier. Right? But they couldn't 'cause they had to suspend the rules.

- Or 6 days earlier.

- Huh? 6 days earlier.

- Or 6 days earlier.

- The night before. Anyway. Alright, thank you Steve so much for that. So we'll turn to Debbie Toennies at J.P. Morgan Chase. Hi Debbie. And maybe we can bring the discussion back to some of the trading book changes. In your opinion, what types of products and markets do you see being most affected? And how might these changes affect market liquidity and pricing for end users, please?

- Sure. Thanks Jelena. And let me start out by saying that the views expressed today are my own and not necessarily those J.P. Morgan. I think to start out, as Sheara mentioned in the earlier panel, capital markets are at the crosshairs of regulations, both existing and the Basel III Endgame. Let's start with a rule that's actually been finalized, which is a little easier question to answer. So the standardized approach to counterparty credit risk, which was finalized and put into effect, has resulted in an increased capital for SFTs and derivatives for the market. Here, the end result has been higher pricing for clients of these transactions. So again, it's SFTs and derivatives. You're gonna hear this kind of go through all these rules. These are heavily affected markets. There has been a little bit of more collateralization of exposures, which is a good thing for the markets, but largely speaking, the largest effective SOCR was an increase in pricing to end users. Now if we switch over to the other rules, we're anxiously awaiting a USMPR. And so, I'm not going to guess at what that will have included in it, specifically on market risk rules, although we do have the benefit of Vice Chair of Supervision Barr's comments last week, where he indicated that we could expect largely, globally compliant rules with higher capital. This makes some sense when we think about what the EU and the UK have done with the Basel standards for their market rules as well. So assuming that those rules largely, are aligned with the Basel standards, let's take them one at a time. CVA... I expect there will be an increase in capital in particular with the elimination of the advanced approach. In addition, as Sheara mentioned earlier, the exemption that is granted in the EU and will play a role in how OTC derivatives are traded across the globe. Now, while this exemption has occurred for some time now, it now appears to be a permanent difference. And I can tell you from our traders' perspective, the original exclusion in the EU was viewed as a temporary basis. And so, it didn't fully affect how these things traded. But this is different now because it is a more permanent change. Now, I'm not saying that jurisdictions should not have capital on pension funds and sovereigns in corporates, but it will drive how these things trade. If you have less capital in the EU than you do in other jurisdictions, one outcome will be that the trading will go to the place where you have less capital and better pricing. Now having said that, the U.S. markets in particular are much more liquid and active than the EU markets. So I'm not sure whether how much of that will happen, but it'll be some combination, I expect, of transactions moving over to the EU and/or pricing in other markets increasing again. Here, we've got anything with a counterparty, SFTs and derivatives. So then let's move on to SFT haircuts.

Now, Sheara again mentioned, that this has not been implemented in other jurisdictions, and I guess it is my view that is not a permanent solution in other jurisdictions. So it is unclear to me whether the USMPR is going to have anything on SFT haircuts. If it does though, then secured financing transactions, repurchase agreements, reverse repurchase agreements, and securities lending transactions will all be negatively affected. If we think about the impact on markets, we're gonna have more collateral being sucked up in the system, which will hurt liquidity overall in those markets where that collateral is. It would also have a significant impact if implemented again, as Basel originally envisaged debt, for high quality assets. Think of the U.S. Treasury market that highly relies on the repo market for funding in those markets. So something to pay very close attention to, I think there in terms of that rule. And finally, to discuss, "The Fundamental Review of the Trading Book," or, "FRTB." Assuming again, that this is largely aligned with the Basel standards, the first question is, "What are banks gonna do with regard to the Internal Models Approach versus the standardized approach? And it's too soon to tell now, because it'll depend on the details of what's in the USMPR, but if we kind of just back up and look at it at a high level, even without knowing that, the most effective products are likely to be OTC derivatives. You've got yield curves spread options that are typically used by insurance companies that will be heavily impacted, exotics and hybrid derivatives, emerging markets, where you've got interest rate in FX products, where non-modellable risk factors will be very high. And if you switch to a standardized approach to avoid those, you end up with broken hedges and lack of diversification. So I think either way, they're going to be higher. Equity investment in funds is another one that will be significantly impacted. Securitization markets has already been mentioned in an earlier panel. Also, we'll see a significant increase when we get to fundamental review of trading book, combining the p-value increase in the banking book calculations for securitization with the add-on for the standardized approach under FRTB. And finally, correlation trading portfolios are gonna be heavily hit by the fundamental review of trading books should they be consistent with Basel. Now I know that correlation trading portfolios have been being downsized by banks for years, but this will basically eliminate. So I think in terms of all of these increased capital, it's either going to be an increase in pricing for these clients to access these products and/or broker dealers and banks deciding it just doesn't make sense to offer these products anymore in the market.

- Great, thank you so much, Debbie. We'll turn the discussion to the corporate end users. And Tom, we'll discuss a little bit your expertise here. How do you see the Basel Endgame reforms impacting the ability of corporate end users to raise capital and hedge risk? And if you do see that happening, what do you see the consequences being for the firms that you represent?

- Yeah, thanks, Jelena. I've been involved in this since that global financial crisis started trying to convince regulators that when they push on one side of the balloon, it comes out on the other side, and that's us.

We directly bear these costs and so... I've spent my career in U.S. based, multinational manufacturing companies. My colleagues on the operating side are managing their supply chain, sourcing materials, sending that into the manufacturing process, and having it come out the other end to be stockpiled and sold to customers. And in corporate Treasury, we're managing our own supply chain with financial intermediaries as the elements of that. We're coming in, collecting cash from customers, concentrating that cash and then sending it out the other door to pay suppliers, employees, lenders and shareholders. And to the extent there are extra costs on those flows, that's gotta be offset somewhere. And it's this offset that the regulators have really almost consistently tried to ignore. But believe me, our cost of capital is the same as many financial institutions calculate. It's based on the volatility of our results. And so, we're entering into interest rate swaps, commodity swaps, energy swaps, foreign exchange trades, in order to reduce the volatility of our results and those swaps require capital to be set aside by our swap counterparties. And to the extent we're not hedging because the costs are too high, that increases the volatility of our results and thereby increases our cost of capital. And so, these costs really do need to be controlled. And, you know, directly, for instance, when we collect this cash from our customers and send it out the other door to suppliers and lenders and others, it's rare on any given day that the inflows and the outflows offset each other. And so, we have to have committed credit in place in order to meet the shortfall that we would have to borrow. And we have to have relationships with financial intermediaries to invest any excess to get an adequate return on that and... Again, in order to have committed credit and we pay explicitly a commitment fee for the bank's commitment of capital to us. And that commitment fee, I can tell you, from having heard this from bankers dozens of times, is directly dependent on their cost of holding that capital aside to meet our needs when it's uncertain. And they'll have to provide it, perhaps, at a time like happened during the COVID crisis, when everybody else was also calling up their lenders and asking for money. And so, when the capital costs get imposed on banks, they increase it not only through higher spreads to us, but directly through higher commitment fees. As I said, I've been, for my career, Treasurer at a U.S. base, at all U.S. based multinationals and vis-a-vis European competitors. We've consistently been at a disadvantage with these capital requirements. There've been explicit carve-outs for end users in Europe, both for derivatives and now I believe for this next round of capital increases that are not, to my knowledge, being considered adequately for U.S. borrowers and U.S. derivative end users. And so, we've really got to look at that and see, do we want to disadvantage American industry, vis-a-vis foreign competition through an imbalance in these regulations? I would argue, on the contrary, that we need to pay very close attention to it. And what's wrong with even giving us an advantage, at least to catch up on where we've been since 2010 or so? We had bipartisan recognition and all the work that I did and many of you here did for implementing the Dodd-Frank regulations. And we had explicit carve-outs for margining end users not having to provide excessive margin or even mandatory central clearing. And similar kinds of rules need to be given for end users in connection with this next round. So again, for us, financial markets are just like any other supply chain. If we have costs imposed on our acquisition of raw materials, we've gotta offset those costs. If we've got costs imposed on our financial institutions that

they're passing on to us, we in turn have to pass those on or offset them, or take them from somebody. And so, I would just urge regulators to be mindful of that as they proceed to this next round.

- Thank you.

- Great, thanks so much, Tom.

- We'll, turn the discussion to the asset management industry. Michael, we'll turn to you. How will these changes to bank capital requirements impact the asset management industry, and investors more generally? And what do you see as the potential knock-on effect for everyday Americans' retirements and other capital market investments?

- Thank you for the question and the opportunity to represent investors on this important issue. And just to set the stage, BlackRock is of course an asset manager. And as an asset manager, we are a fiduciary rather than an asset owner. We don't trade on our own behalf, and instead we manage money on behalf of end clients. And these are clients who have hired us to help them achieve their own financial goals, whether that's saving money for retirement, saving money to buy a house, or finance their child's education. And so, bank capital rules, obviously, don't impact us directly. So why are we here today and why do we care? Well, I think that I'm gonna echo a lot of statements that others have made today that Joe pointed out in the introduction that Sheara and Debbie have made, that banks play a critical role in the capital markets. And asset managers and the investors we represent, really rely on banks to provide the capital market services we require to achieve our clients' financial goals. And so, that includes everything as simple as finding a counterparty to buy or sell a bond to, to receiving financing or making, engaging in financing transactions on behalf of our clients to using derivative products to manage risk in our clients' portfolios so that we can help them achieve their goals with less interest rate exposure or foreign exchange exposure. And so, it's quite simple that if the cost of capital goes up, if capital becomes more scarce, naturally the costs of engaging any of these transactions for our end clients go up as well. But to maybe take one step back, of course, we have an interest in maintaining a secure, safe banking system. And so, we're not here to comment on any particular component of the proposed, or to-be-proposed capital regime. We're really supportive, of course, of well-regulated and well capitalized banks. But we do want to draw attention to that fundamental trade-off that to the extent that there are increased capital requirements that does impact end users. And we can speak to that with some experience. So you don't just have to take the word of Debbie and Sheara, in terms of how these clients are impacted. We

are living that impact, right? And we have had that experience of how capital rules, post-global financial crisis have impacted our firm and our clients. And to step back, we're no longer in a world where we have 16 full-service, global banks that can provide all the services we need, right? What we've experienced is consolidation where the big have gotten bigger and now we're closer to like five full-service entities that we can transact with. And the smaller entities have become much more niche players trying to find the specific business lines where they can generate sufficient returns, right, to support the allocation of capital to them. And so, at the end of the day, what does this mean to our clients? Well, we have a less competitive ecosystem where the cost of trading have gone up, but not only is trading more expensive, there's concentration risk that our clients are exposed to because of this marketing. And so, from an end user perspective, we're very focused on getting the right calibration of rules that are protecting liquidity in the market, which is also a potential source of risk to the system, right? If there's jammed up pipes, not sufficient capacity, that is another source of systemic risk that regulators do need to think about. So to conclude, we are here and work very closely with our bank partners to manage these risks to get them the best possible price when we trade. We work very closely with our bank counterparts to try and figure out how to mitigate our capital input, how to clear and use various instruments to mitigate our capital footprint. But there's only so much we can do and we are beholden to the greater ecosystem, which is why we're here today.

- Great. Thank you so much, Michael. So I'll open it up for others if folks want to comment on either the potential impacts of the Endgame reforms, the phase-in period, potentially, that the regulators may give. What's appropriate? What's not? This is your opportunity to comment before we go into the less exciting panels when I stop, when I stop moderating, so... Randy, please.

- Well, I'm happy to make a comment on the phase-in period, which I think has been held out by the regulators as, "Don't worry. This will have no immediate effects. It will not be an exacerbation of recessionary potential of the economy over the course of next year," which is great. I think, if you're in an airplane that's sort of headed towards the Rocky Mountains. And you're over Kansas and you lose hydraulic control, you don't say, "I got time." So the notion of a phase-in period is it will not be relevant at all. As soon as it's clear where the Rocky Mountains are and that the plane is headed there, everyone will immediately begin taking steps. And so, you can have all the phase-in periods that you want consequential.

- I would double down on your comments.

- Hold on, Sheara.

- Oh, I'm sorry.

- That just redefines the Basel Endgame, so...

- Yeah, I agree with that. But I would double down on your comments. And was meeting with the team that Steve ran when he was at Goldman Sachs yesterday. And we were talking about the phase-in and they said, "How are you thinking about the phase-in?" And I said to them, "The real question is, how are you thinking about the phase-in?" Because to the extent that the expectation of shareholders and analysts is that there is no phase-in and they want the banks to have the hydraulic fuel, or whatever the reference was that you were making, on board, which is what they did for G-SIB, it's what they did for SEB, it's what they did for the original Basel III, such that you really had to be there at time zero, not time phase-in, that then the banks would be forced to really start to build the capital in advance of that.

- Any other comments?

- Maybe one point that we'd make, because we've heard the risks associated with shifting activity out of banks. And so, I think we just want to be careful to, in terms of how we describe non-bank entities, as like this boogeyman or something like that. I think it's important for us to remember that not all entities are alike and really, this is not an issue of not unregulated, but differently regulated. And they're differently regulated because they have very different business models, right? You have investors who are not depositors, but who are there willing to take an investment loss if there's a decrease in the value of the assets that those entities are buying. And so, as we are thinking about the issues of appropriate calibration of bank regulation, I think we also need to think about, the appropriate calibration of regulation, much of which is already in place if you manage a mutual fund or money market fund and think about all of the liquidity rules, disclosure requirements, et cetera, they have to comply with. There's already quite a bit and there's more being done in that area. And we just wanna make sure that is calibrated to the correct business model. And Craig, I think you made some excellent points on that.

- There were some comments sort of like, "Non-bank banks." In theory, you could regulate like banks, but true non-banks, that's never gonna work, and I think people miss the true implication of that. So I was a Fed staffer for the '87 stock market crash. We spent the next two days on the phones with banks, getting them to loan to all of the various parts of the ecosystem because the banks were something Fed knew how to liquify, right? When we have that next crisis that isn't a banking crisis, when the banks get those calls, they're gonna be call forwarded to outside counsel to say, "No." Right? 'Cause given the current rules with the SLR and other things, there's no way the banks can provide that. So how we stabilize the next non-bank crisis, right, is gonna be a real question mark. We don't have the tools to do it, right? The Fed has now set up a particular facility to deal with money market funds, which will be nice if the next crisis is the money market funds. But if it's not, we don't know how they're gonna do it. Neither do they. And that's a real problem. One of the things we forget about banking crises is we actually know how to manage them. We may not like managing them, but we know how. If we have to manage a non-bank crisis, we may be completely outta luck.

- Right. Anybody else? Well with that, we are going to finish the second most exciting roundtable panel of the day before we move to the third and last one with Jonathan Gould, who's the moderator, who will be equally enthusiastic about the topic. And we'll go for a 10-minute break and come back at 5 after. Thank you.

- Welcome back. Welcome back everybody. And for our next and remaining final panel of the day. Final panel of the day would be interactions between the Basel Endgame and other elements of the U.S. capital framework, which we're gonna have moderated by Jonathan Gould. Jonathan is currently a partner at Jones Day. And previously served as the Senior Deputy Comptroller and Chief Counsel of the Office of the Comptroller of the Currency. So welcome again, Jonathan, and over to you.

- Thank you very much Joe. So let me just start with some expectations management. Indeed, this will be an exciting panel. But also, in contrary to its name, this is not in fact the Endgame. As Steve had earlier said, "If the past 35 years of Basel history is prologue to its future, we will indeed have Basel 3.5, 4 and 5, and so on." But that's actually not what I'm referring to when I say this is not the Endgame. What I mean is, that the U.S. capital framework has a number of other critical elements that interact in sometimes confounding ways with the Basel framework. And the U.S. deviates from Basel in a number of areas. These other elements of the U.S. capital framework tend to amplify some underlying issues of the Basel III regime and to introduce entirely new ones into the mix, not always contemplated by Basel. Ultimately, these elements make the overall system more dynamic and complex to understand. This in turn, raises

the risk of unintended consequences, introduces capital redundancies, frustrates the ability of stakeholders to understand the net effect of the changes, as well as to provide meaningful feedback on it, hinders accountability, and creates challenges when managing through crises. Some of these other elements of the U.S. capital framework are driven by U.S. statute like the Collins Amendment, while others are mere regulatory creations. They include capital add-ons, such as distress capital buffer and G-SIB surcharges, as well as stress testing assumptions and scenarios. On capital add-ons, the stress capital buffer varies depending upon stress test results, but is always more than its Basel analog, the capital conservation buffer, and sits top to standardize RWA minimum. The G-SIB surcharges are calculated based on a methodology that differs from Basel. On stress testing assumptions and scenarios, the assumptions themselves can drive results. So the operating losses that impact pre-provision net revenue projections and regular scenarios like the global market shock that apply to some, but not all firms. And how should we even think about the possibility of multiple scenarios going forward, much less reverse stress testing? Capital levels are then, in some sense, set indirectly through regulators, models and assumptions, and those models of course are not disclosed to the public. Stress testing together with the stress capital buffer results in capital requirements that are unknowable in advance and vary from year to year. Other elements include leverage ratios and buffers, as well as interactions between capital requirements at bank subsidiaries and their holding companies. These rates raise questions about how leverage buffers, like the ESLR, should be calculated and calibrated. For example, what should be included in the denominator of leverage ratios? Central bank reserves? Treasuries? On this final panel, we are gonna hear from a number of banks and other experts on how these elements of the U.S. capital framework complicate and for a number of capital markets related activities actually increase capital requirements beyond Basel III's nominal parameters with potentially harmful consequences to our economy. We're gonna conclude with the discussion of what to do about all this. So starting off, let's start with the trading book capital changes. So that's the fundamental review of the trading book and the market risk capitals that flow from it, the CVA, and the securities financing transaction haircut floor. And trying to understand again, how these interact with existing U.S. capital rules, including the U.S. stress testing requirements. Let me to turn first to Andrew. Can you explain how these different capital requirements overlap with one another?

- I'm happy to try to. I also would maybe take a page out of your notebook there and talk about where we are in the cycle of things. I was briefing some colleagues internally on these upcoming reforms. And one of my colleagues said, "Slow down, this is neither the end, nor a game." And so, that's another way to look at this. I think my role in the discussion today is maybe, more to provide a flavor for the issues that are being talked about among the big banks, and provide more of an industry kind of viewpoint, generically, as opposed to one from my institution. And I think, helpfully, also on Monday of this week, Vice Chairman Barr delivered a speech in which he actually alluded specifically to this issue. And so, I

think, given that we're only two days after that speech, maybe we take this as an opportunity to try to unpack what the Vice Chairman's comments were, where they might be motivated by, and where we might go with it. So I think, to look at your question that you asked just now, I think there's three moving pieces that we should talk about discreetly and then how they fit together. The first of those is, "What is the change in the market risk RWA framework by itself?" The second element is, "What is the global market shock and kind of what purpose does that serve?" And the third is, "What is the existing interplay of the global market shock with the market risk regime, and how do we see that changing possibly in the future?" Which again, is the issue that the Vice Chairman was referring to. So the first part of that is the world we have today, or that, I'm sorry. The first part of it is the market risk framework as it exists. So we're expecting, as part of this Basel III Endgame proposal, to move into this fundamental review of the trading book that you also referred to. I think in the opening comments from Joe Seidel, this morning, he talked about the expected quantitative impact. I'm not gonna comment on that other than to say, as has been acknowledged in a number of studies and by regulators, the general effect of FRTB is to increase market risk RWAs on a variety of products in the trading book. So that's the market risk RWA piece. The second part of it is the global market shock. The global market shock is a so-called, "Exogenous shock." And so, you take your end-of-year RWAs, starting for the CCAR process, and there's a series of stress assumptions about if something bad happened in the marketplace, instantaneously, what are the losses that would occur? And so, it sits on top of the RWA framework. As a result of the stress capital buffer, we integrate those two things together. So if you're looking at a trading desk or a trading product and trying to assign what is the capitalization required and thereby the P&L or the profitability expectations that it has to meet, you're going to look at each of the RWA framework and the GMS losses together as being two components of an overall holistic capital framework, which takes us to the third part of this, which is, "Well, what is the interplay of these two things?" And so, I would maybe take us back in time 10 years ago. And in 2013, the Federal Reserve did two things around that time. The first thing was, it implemented the existing market risk rule, which we sometimes call, "Basel 2.5." And the second thing is, it adopted the CCAR policy statement. The CCAR policy statement in turn describes the parameters of what GMS is meant to do in its policy objectives. Subsequently, in 2019, when the Basel Committee finalized for a second time, FRTB, it published an explanatory note saying, "Well, well why are we doing this? Why are we updating the market risk framework?" And in that Basel note, they said, "There are a number of known weaknesses with Basel 2.5, problems we have to solve for." And those problems include, liquidity horizons that we know that in the existing market risk framework, it assumes a 10-day liquidity horizon. And it also, because of the VAR assumptions, also assumes, err, excludes certain tail events or extreme events. You go and you look back at what GMS does, GMS takes a longer liquidity horizon for a number of trading products. And it also assumes that more extreme tail events could occur in the trading book. So another way to think about this is, if you go back in time to 2013, when this framework was originally constructed after the 2008 financial crisis, that the GMS, in some sense, addressed the known weaknesses or deficiencies of the existing Basel 2.5 regime and was a way of complimenting that or working together to reach a harmonious capitalization for the trading book. When

you fast forward to FRTB, FRTB offers solutions within the RWA framework for those known deficiencies in that Basel explanatory note. At the global level, Basel was saying, "We're adopting FRTB because we know that there are these weaknesses in Basel 2.5. We know that liquidity horizon assumptions are a problem. We know that tail events are a problem, there are other issues." And I think that the comments by the Vice Chairman on Monday, were alluding to this tension. So if you're updating the market risk framework to deal with these known weaknesses or known shortcomings of a legacy Basel 2.5 market risk regime, should you be re-looking at the way that CCAR combines together as part of the stress capital buffer? And I think that's the question. I don't think it's gonna be a simple 100% double-count kind of question. I wouldn't frame it that way. But thinking very deliberately about the changes going forth in the market risk regime RWA framework, together with the changes that might be warranted and should be part of the discussion for CCAR, I think that's the issue that the Vice Chairman was seeing up in Monday's speech.

- Thank you. Kevin, do you wanna comment on that a little bit?

- Yeah, no, I think Andrew characterized the issues well. And I think in focusing just on, I believe your third point, the interplay between the GMS and the FRTB, If I can throw in any more acronyms, I will. But again, I think when you look at the two methodologies, I think their assessment methodologies, as you indicated, are not identical, but they're both designed to assess a bank's resilience to severe market stresses, using similar design features and similar calibration elements. That's why, to me, I think I would welcome the review of this interplay between the GMS and the FRTB to ensure that they are serving complimentary roles, as Vice Chair Barr indicated in his speech, kind of in assessing our overall capital requirements. 'Cause again, they are designed to address similar objectives using somewhat different methodologies, but again, significant, similar calibration elements.

- Thank you for that. And you kind of highlight too, the fact that you've got kind of multiple locations for this various kind of interplays, right? You've got regulation, you've got guidance, all interacting, making it I think a lot harder for us, as either market participants or just an informed public to weigh in in an informed fashion. Let me just, I don't know if Randy Quarles or Randy Guynn or others have any thoughts they wanna add on the kind of the trading book capital change before moving onto operation.

- Well, this is maybe a little Randy Quarles, a little bit to the side, but related to the points that we've been making here as to how the two interact. It's very related to the point you were just making, Jonathan,

about the stress testing process. Some of that is regulations, some of that is guidance, points that others have made about the models are not public. And I, I do think that the, particularly the increase in aggregate capital levels that we have been told is coming now throws heavily into relief the stress testing process itself. And while I strongly agree with the concept of stress testing, and it's not polite to say, but the cleverest people in the government are the staff of the Fed and the cleverest people at the Fed are the folks who run the stress test. They do a terrific job. But I have become very convinced that the way the stress test is conducted now is a violation of the Administrative Procedure Act. It is illegal. And so, that doesn't mean you can't run a stress test. There are ways to do it that are, that can comply with the law, but it is illegal. And I worry now, with the further interaction of the improperly, illegally run stress test with the extreme upward calibration of the, through the cycle capital requirements, that may be more than illegal. It may be an excessive delegation of authority to the Federal Reserve. It may be unconstitutional, given some of the recent Supreme Court decisions. I think that's something that the banking industry really should take on and the banking industry representatives. I think it's a real problem.

- Thank you for that. As the law firm that had something to do with the West Virginia EPA, . Randy Guynn, any other thoughts before we turn to the operational risk side of things?

- Okay. I'm probably just gonna give a simplified summary of what's actually been said in a much more sophisticated way, by Andrew and Kevin and others and that is, really, that it just seems logical that since the market capital rules do reflect some stress measures and the global market shock is clearly a stress measure and it has a direct impact on the stress capital buffer, it seems logical to make sure, to look carefully, to make sure, that the two of them are not requiring capital for the same risk under stress conditions. I think that's just a simple way of describing I think what a lot of the more sophisticated comments were about.

- Thank you very much, Randy. So switching gears from market risk to operational risk. And one of the things I've read about is, concerns again about, maybe if not double counting, concerns about capital redundancy there too, particularly as it relates to some of the capital market's related activities. So I'm gonna ask Kevin maybe to start here. But can you provide us a little background on how these reforms will change the way banks calculate their operational risk charges? And discuss the potential implications, particularly, for firms with capital markets focused businesses?

- Sure. And I guess kind of like Andrew, I may need to go back in time a little bit. I promise not to divulge, go too deep into this process to provide some context on the operational recharge, where we came from, where we're going, and then I'll highlight a number of issues at the industry. We'll particularly focus on in both, what is proposed in a rule and how it's implemented. But under the Basel standards that were changed by the Basel Endgame, the Basel II standards, the Basel Committee provided three bases to calculate operational risk, two standardized approaches, and one model-based advanced methodology exercising national discretion, that you indicated, Jonathan, banks, agencies are permitted to do. The U.S. only adopted the model-based, advanced measurement approach, indicating that the standardized approach would not be implemented in the U.S. A key element of the Basel III Endgame process, as it relates to op risk, is that they're abandoning the three methodologies and adopting one standardized approach. And again, so in essence from the U.S. perspective, they're going from an advanced measurement approach, model-based methodology to a standardized methodology. And with any standardized approach, as this group has discussed today, you automatically have simplifying assumptions and other things to make it broadly relevant within a regulatory regime. One of the, let me try and I'll try to be very, very succinct in describing what this new op risk Standardized Measurement Approach is. And it's, and again, in any design of any standardized methodology, something like op risk, which pejoratively is and this is, Basel never wants this framed this way, but it's everything but credit and market, is operational risk. And designing a capital regime to cover that is difficult. Essentially, what it does, however is, it's the capital charge under the standardized measurement approach is based on financial statement proxies for operational risk using income and expense items. And Jonathan, you alluded to one of the components or three components, I won't get into it, but again, it strives to articulate a methodology using existing standards, existing financial statement metrics. That basic indicator component is then scaled up by individual banks' operational loss history through what is framed as the internal loss multiplier. And again, I think that... And again, I didn't do justice to the proposal, but I think you'll get a sense of what the key components are. I think there are at least three issues that immediately come to mind in looking at that process, both generally and how it'll be implemented in the U.S. One is, and I think Jonathan, you alluded to it already, is the substantive provisions of the SMA. And again, I think there's been a number of studies that highlighted some of the potential adverse impacts, and what you referred to as, "The services component," as potentially, having an undue impact on certain business activities, particularly, as it relates to non-interest income related activities and products. I think it clearly, I think when you're looking at, and again, assessing that the proposal in the U.S., and again what was alluded to, and again, going back to Vice Chair Barr's comments of having a robust notice and comment process with a robust kind of economic impact analysis, is continued to look at the potential adverse, unintended impacts of the current structuring of the SMA, particularly, as it relates to non-interest income related businesses and activities. The second item, again, relates to the item I mentioned before, the capital scale up. Essentially, what it's doing in this context is taking a look at individual bank's 10-year average historical operational losses. And when you're looking at it, generally, and particularly in the U.S. perspective, that is, the severity component of that history is litigation related expenses reflecting kind of

litigious nature of the U.S. Essentially, what you do in that context is you scale up their risk indicator approach by individual banks, can have internal loss multiplier op risk history. That is a key component in assessing the overall calibration of the op risk regime. And again, it's also useful to look at what other national authorities are doing in the implementation of the Standardized Measurement Approach. Many setting the internal loss multiplier at one, essentially scaling back, neutering perhaps, the impact of internal op losses in the calculation of the Standardized Measurement Approach. And again, for determining again, this is an area of national discretion. It arguably is not, "Gold-plating," by definition, but it will still clearly affect the relative level playing field positions of U.S. banks relative to others in determining the amount of up risk capital individual banks need to hold. The third piece goes back, again, to DFAST CCAR stress testing. And again, currently, within the existing stress testing process, the regulators do consider the ability of banks to withstand operational risk-related losses in assessing the CCAR DFAST. And ultimately, as you're saying Randy, into this stress capital buffer. Again, I think when you're looking at potential areas, and again going back, I promise for the last time, to Vice Chair Barr's speech where he, again, he indicated a potential review of the interplay between the operational loss elements within the Standardized Measurement Approach and the stress test treatment of operational losses. And again, to ensure that they are also serving complimentary roles, and whether in fact there is a overlap between what is calculated and what risks are assessed through the internal loss assessment process of the standardized approach and CCAR's assessment of banks' ability and resilience to operational losses. But let me stop there. I dunno if Andrew...

- I think it was a great summary, Kevin. I would just have two thoughts to add on top. So my first thought is what I call, "The architecture question," which dovetails with what Kevin was just summarizing. The architecture question is, "How do you put the pieces together?" In the existing framework, operational risk is not included in the RWA subject to CCAR and SCB. So if you assume, which is just an assumption, but if you assume that in the future operational risk becomes part of CCAR and SCB, it puts for the first time a novel question on the table. When I was summarizing earlier the interplay of market risk and GMS, that's been a known issue for a long time. The Fed has had to struggle with how to make that work, how to make the pieces fit together. But it truly is a novel question that's never been considered before. Do you need to adjust PP&R? How do you account for the way operational risk charges work? The second observation I have also keys off of Kevin's summary just now, which is, "Why is this hard?" And I think, as Kevin eloquently put it, operational risk is stuff that's not credit risk or not market risk. If you have credit risk and market risk, you can take a hypothetical portfolio, a hypothetical loan or a derivative, and you can put it into a calculator and it will tell you a capital requirement. And you can go and look across different jurisdictions and say, "It's higher or lower here," or, "Here's, quantitatively, how we assess it." Operational risk is, it's a more difficult concept to get your arms around because it picks up revenues from credit card businesses, custody bank businesses, wealth management franchises, asset management activities. And

all of those categories of things will then have differential business models in different parts of the world, different legal regimes, different regulatory standards. So it's a much harder thing to get your arms around to figure out how to calibrate it correctly. Not that we shouldn't try to figure out too, but it's just inherently a lot harder as a result of that. And so, when the Vice Chairman, on Monday, was talking about that interplay of PP&R, for example, and ops risk as being an area of focus, I think a lot of that maybe, again, I think at the industry level as we talk about it, it's, "What is the U.S. application of this that we need to think through to make it logically a compliment to the system here?"

- Ok, thank you.

- If I can add one other point into Andrew's architecture point, is the introduction, for the first time, of a standardized approach to operational risk does complicate regulatory regime, especially for CCAR. 'Cause again, CCAR is making use of the standardized approach, which apparently does not include op risk. Now it will. And again, looking at scope of application, if you're applying this to banks down to a hundred billion, again, who have not been subject to this capital charge before, at least in a over discrete operational risk capital charge, it does introduce other design features that again, whether they're interplay with the Collins Amendment, all of the features that I think the U.S. regulators are gonna need to address, I think the industry will be very curious about as to how they resolve that, the introduction of a new risk metric as a standardized approach.

- It sounds like some of these problems though are problems, to some extent, of our own making. Just how we will we attempt to resolve them, will be the major question here. Moving from market risk and operational risk, wanna ask Randy Guynn about other possible interactions. We talked about the market risk and the operational risk interaction with stress testing regime. What about other possible interactions, such as with the G-SIB surcharge, leverage requirements, like the supplementary leverage ratio or the ESLR? What have we missed?

- Well, it does seem to me logical that, as minimum capital requirements are increased because of the Basel Endgame, it seems only logical to revisit the calibration of the G-SIB surcharge. And obviously, Vice Chair Barr's comment suggests he's really only looking at nonsubstantive changes at the G-SIB surcharge, except changing the increments from the actual surcharge percentages from 50 basis points to 10 basis points. One issue that was talked about a number of years ago that I think should be revisited, I'm not confident that the current Federal Reserve would do so, but I think it actually should be and that

is... They should implement the Basel Endgame in a way that creates incentives for greater resolvability by giving carrots in the form of a reduced G-SIB surcharge, for instance. To the extent that the G-SIB shows that it's resolvable, it's got sufficient long-term debt or other gone concerned capital to make the plan feasible that will allow it to be resolved in a way that doesn't foster contagion and require a government bailout. There ought to be a reflection of that in a reduction of the G-SIB surcharge. I know that that is consistent at least with some of the comments that Steve Strongin made earlier today, which was that this recent turmoil in the banks were several bad banks, but the good banks actually were very resilient as they were during the COVID-19 pandemic and so forth. And really, that ought to be taken into account in revisiting a calibration of a G-SIB surcharge.

- Thank you very much, Randy. Let me just open it up to the rest of the roundtable participants. Any other elements we should be particularly focused on or concerned about?

- Yeah, I do think that the calibration of the supplemental leverage ratio and the SLR is a much bigger issue than Vice Chairman Barr has indicated that he believes it to be. I've been very hopeful that in his appointment sort of on a, "Only Nixon could go to China basis," that that recalibration, which can be done either by turning down the numerator, which would probably be very controversial. It's the correct way to do it, but it would be very controversial. But you can take reserves and treasuries out of the denominator, solve the pressure on the Treasury market that's caused by the SLR, and that would be politically very doable. Lael Brainard has supported that for a long time, even though it's technically Basel noncompliant. It would be embarrassing for the United States to do that because we pounded the table that you would not be able to remove sovereign securities from the denominator because we didn't want the Europeans bailing out the feckless French. And so, but... But we can do that. And it should be done and it's politically doable. And I was very disappointed that it's not going to. And it will have ongoing negative consequences for the Treasury market, which is something the government should care about.

- Any other thoughts before we get into kind of, which we've naturally moved into from the discussion of the specific other elements to the broader call to action, if you will. If we were wearing our hats as, if we were the regulators for a day, what would we do? I'm sorry, go ahead.

- I think the number one thing, and Randy just said this, and I think it should be repeated as often as you can, none of these rules look at resolvability in a way that reduces the other burden. That makes no sense. Right? If you could resolve this painlessly and instantly, you should require zero capital. Now,

obviously we're not going to get there, but forgetting that is misunderstanding the whole nature of capital, right? It is about resolvability, it is not about the prevention of error. And until you base it in resolvability, you have no frame to think about it. And yet none of these rules talk about resolvability.

- So that sounds like one potential reform we recommend to the current set of regulators. Are there other reforms, whether to the U.S. capital framework, which we've been mostly focused on, but more broadly speaking, to the post-crisis prudential framework that we would recommend to regulators that we think kind of achieve the right balance among economic fairness, economic growth, financial stability?

- Can I ask that question a different way? And this is a general observation. You all, and I'm a former veteran of this, are in a knife fight on the rules, but you're also in an air war about the purpose of the rules. And everyone's gotten very good at the knife fight, but you're gonna lose, 'cause no regulator is ever going to announce they've softened the rules in any form or shape. And every crisis will get something tightened, right? Somewhat randomly, and often, not even related to the crisis. God knows how your current crisis generated the changes you're about to see, but it's going to, right? I think you need to spend more time on the air war, and I think that's gonna require embracing things outside the comfort zone of the discussion, like the role of banks in climate, and the role of banks in income inequality, and the role of banks... 'Cause if you don't have, if you don't have a defined public impact that's a positive, there is no reason to not endlessly tighten the screws. And particularly, if you think about the arguments that you've been making about fairness and so forth. If you try and make it to someone who doesn't know all the acronyms, they're not gonna have a clue what you're arguing. So if you're gonna expand the argument, I think you need to reengage in the air war.

- I would just add too, I think there's some question as to who should be making some of these decisions. These are really important trade offs that are being made. Question is, "Is it appropriate for banking agencies to make these without further input Congress, frankly?" But let me throw it up. Jelena, you have thoughts on?

- Sure, I do.

- I have thoughts on everything. Yeah, you may not like what I have it on, but joking. So from my perspective, I think that the intrinsic question on, "What's the optimal level of capital?" needs to be flipped

here and put back on the regulator as, "Why is the current level of capital not?" Right? And just because a bank or two banks or three banks failed that have very intrinsic problems, doesn't justify increasing the capital level. So I'm hoping that what's in this proposal is going to create the nexus between, and I don't mean just correlation, I mean causation, why the capital levels are inadequate, where we need to spring into this Basel III Endgame. And by the way, this is a Marvel exercise. It will be like 14 Endgames. The characters just keep dying and resurrecting again. The, so... And I think what we have lost the picture of here is the role of supervisors. You know. And I think, Randy, when you and I were in our former posts, the issue is not that you apply a blanket approach to everybody just because everybody's called a, "Bank." Right? You have different, you have gradations. And it almost seems to me, what we have heard in the speech on Monday, is that like one-set-fits-all, versus one-approach-fits-all, versus a more bespoke approach to maybe, some banks should have 15, 16% capital, maybe some banks should have 10. Maybe their business models are just completely different and their risk models and appetite for risk are completely different. And I do think that some of the, I'm afraid that some of what was in the speech on Monday. Again, I don't wanna, impute anything to Vice Chairman Barr or I don't wanna put words in his mouth, but what is the role of supervisors in all of this, right? You think everybody should have, all the banks above a hundred billion, two plus percent increase in the capital. Well, why should X bank have that versus maybe, that one should have one, maybe this one should have three. So I think there's some nuances that, I always say, "The easiest thing for a regulator is to apply a blunt tool to everybody because you can just sit back and not think about it and wade through air. Who's going to hold you accountable, right? But the truth of the matter, there's a cost to that and I think we're going to learn what that cost is.

- Thank you. And maybe building up your comments, but even coming back to where Adam let us off today. In the discussion of the optimal level of capital, one of the conclusions that was drawn is that you need to look more holistically at the other elements of resilience. And in assessing what is the right level of capital or even what is the calibration of the G-SIB surcharge? Now would include things we haven't talked about, like, "Total Loss-Absorbing Capacity," like TLAC. It would include the finalization of liquidity standards, the stress testing both in capital and liquidity that the U.S. has demonstrated as a key part of their supervisory process, the enhancements of resolution planning protocols, finalization of liquidity, all those other issues. I think when you look at that more holistically, you realize there is a full panoply of options and tools that are available to supervisors and sometimes, capital is not the right most effective tool. There may well be other tools for which to be more fine tuned in addressing the issues that have been identified.

- So I would very much emphasize that. Obviously, this discussion has been about the Endgame and the capital framework. But I do think that, particularly, the recent events in the banking system have

highlighted flaws in how we have been thinking about liquidity provision to the banks. And since the great financial crisis, the Fed really has emphasized that banks must self-insure their own liquidity, that you have to have high quality liquid assets that are on your books, that are sufficient to meet your expected liquidity needs over the course of the next 30 days, and slightly different types of assets for liquidity over a year. And that is really an abdication, or a forgetting, if not an abdication, of the reason the Federal Reserve was created. It's why we call it the, "Federal Reserve," instead of the, "Central Bank of the United States." It was created to be a central pool of liquidity that could be directed to individual banks or to banks in a region that had liquidity needs that were under stress when that wasn't widespread. And since the great financial crisis, the Fed has said to banks in calculating illiquidity resilience, "You may not take into account your ability to borrow from the Fed." And that was the reason that Silicon Valley Bank was not prepared to borrow from the Fed and is scrambling on the last day of its existence to try to put collateral at the Fed in order to be able to borrow from the discount window because it had been told, "Yeah, you can go ahead and do that, but you'll get no credit for it in determining whether you are prepared to withstand a run." And that is just completely upside down from how the Fed should be thinking about the liquidity of the system. Yes, banks should have important liquidity reserves, but the Fed must be prepared to provide that liquidity in thinking about both the regulation and the supervision of the liquidity resilience of banks. And that is something that I don't think they are rethinking. I think they are in fact doubling down on the notion that you must self-insure your liquidity in a world where your liquidity needs may now be much greater, because what we had thought were stable deposits are in fact, perhaps, much more likely to run than history had taught us, which means, your liquidity needs are now very large and you're going to need to meet them all internally. I think that will be a much bigger challenge for the banking system, even than some of these capital consequences that we have talked about.

- So let me, if I could just add something here, and this is repeated a little bit. But let me build on and just reemphasize what Steve said earlier, which is I think there's, I have always thought there was an inextricable link between resolution planning and capital levels, and there needs to be. And one of the things that we hear from, actually from Vice Chair Barr, is, "Well, because SVB failed, we need more capital." See? This shows that we can't really predict or... Did anybody have any idea what the FDIC was going to do? Did the FDIC have an idea what it was gonna do in resolving SVB? How connected is what the FDIC actually did with what SVB's plan was? I, personally, have no idea what the connection was, but I think that there needs to be a connection. And I think, again, to repeat what I said earlier and actually to, to actually say, "Don't leave it to the regulators." I think congress needs to require the FDIC to develop and publish its own plans for resolve... Any bank that is required to submit a resolution plan, the FDIC should be required to publish its own plan or presumptive path for resolving that bank and it can build on the resolution plan that the bank has submitted, but it needs to be the FDIC's. And the Congress needs to hold the FDIC accountable for the credibility and feasibility of those plans and needs to require the FDIC

to resolve the banks in accordance with those plans, absent extraordinary, unexpected circumstances, and hold the FDIC accountable for failure to do so. Why? Because one of the biggest problems during a financial crisis or even a mini turmoil, like we recently experienced is, no one has any idea what's going to happen, what the FDIC is going to do, and therefore, they panic and run. And the only way to moderate some of that panic is to have a lot more legal certainty, or a lot more certainty, practical certainty, about what the FDIC is going to do in a particular situation. Again, I don't think the FDIC hands have to be handcuffed. It should continue to have flexibility to adjust the circumstances, but there needs to be a lot more transparency about what they plan to do with respect to a particular large bank that might fail.

- Jelena, I think you were gonna...

- Yeah, no, I was just going to add 22nd comment. Increasing capital by 20% by, I'm sorry, 2%, is not going to prevent a failure of a bank that experiences as large of a deposit plan on a percentage basis as Silicon Valley Bank did that Wednesday and Thursday. So if we're solving for what happened with Silicon Valley Bank, there are other issues to be solved. And I just think that we need to be honest what we're solving for. If we just want more capital in the system, just say so, right? But don't find, we... I always am cautious from the Senate Banking Committee days and my time at the Fed and the FDIC, I'm always cautious of that creating that nexus where nexus doesn't exist because we lull people into believing that this will solve the problem, when in fact it doesn't.

- Well, it sounds like part of what we're saying here, to sum up some of these different reforms is that we've been told there was a holistic capital review and we're hopeful that we'll get to see, in some form or another, what that actual holistic capital review was. But I think we're making the broader point too, that there needs to be a holistic review of all post-crisis reform, post 2008 crisis reforms. Are they actually working? We talked about liquidity, we talked about the link between resolvability and capital and the need to address that. Mechanically, how do we achieve a better outcome here? How do we not wind up with a opaque, holistic capital review or another opaque? Well we've, yes, we've taken it away, we've done our review, comprehensively, of all prudential standards and they're still finding something we need to dial them up. Right? So how do we get a different outcome this time? How do we get a more, both from a process different outcome, but also hopefully a substantively different outcome? And yes, I too, as a former staffer, would love to see Congress weigh and more on these issues. Cause again, I think these are political trade-offs involved in a lot of these, and I think they're less appropriately made in a regulatory agency than they are with elected officials. But I just wonder if people have any thoughts about how we might, what is, how do we mechanically?

- As a former Fed staffer, the notion the Fed is gonna write the review you want is somewhere between zero and zero probability, right? Regardless of the rule you give, right? Or they ought to fire the lead on the report, instantly. Right? If you don't find a way of getting that report done somewhere outside of the supervising agency, you're not gonna get the report you need.

- Have a judicial system form.

- And Jonathan, I'll say, Congress did hold regulators accountable in the Regulatory Flexibility Act, Administrative Procedure Act, Uniform, whatever they wanted apply to the OCC, et cetera. And yet, if you wanna do a cost benefit analysis and understand the impact of these rules, then Basel III, the Fed for example, should have done a comprehensive analysis of all the Basel III rules and not just do a piecemeal. Because once you separate these rules into piecemeal approaches, you may determine that the impact is not major because it impacts 6 banks. But the truth of the matter is when you put 'em all together. So Congress, basically, can mandate something. It doesn't mean that the regulators are going to promulgate that exactly in the way that Congress intended.

- The accountability and liquidity that Randy mentioned are hand in hand. Part of the reason the Fed wrote the liquidity rules the way they wrote them, is because of the level of criticism they got for the use of discount window during the financial crisis. And were actively concerned that should they include it, they would lose the right to use the discount window in a crisis. And so, making them more accountable doesn't make their behavior better as a automatic outcome. That was a good example of it making it worse, notably worse.

- So one other point I just wanna note, and then I think we're getting towards the end here of our call for reforms, but I just wanna follow up on a point that, both I think, Jelena and Randy made, which is really the importance of supervision as a compliment regulation. In fact, one of the things that I would urge regulators to consider if they are inclined to look back over the last 15 years and the edifice they've created is that at times, the regulatory tools become blinding, right? They use those almost in lieu of supervision and there's no excuse for good supervision. There's no excuse for having examiners, who are trained, spot issues who actually go into banks and kick the tires. You can't mindlessly rely upon a tool because the tool by its very nature, has design limitations. It's like trying to examine the Washington

Monument using a microscope, a magnifying glass, and not recognizing, it's this big white obelisk at the end of the day, right? The tools are driving outcomes and I think there has been a, in the 15 years since the 2008 crisis, it's just, I fear, an over reliance on tools at the expense of real supervision. And I think that needs to be reoriented sooner rather than later. So I just wanted to comment.

- In what sense do you mean that? Because I mean, as a bank examiner, SVB was appropriately reviewed. It was found to be inadequate. It was suggested it improve. Right? So the report wasn't wrong, right? They just didn't close it or sell it, right? And they couldn't sell it because they weren't allowed to sell it without suspending the rule. Who was gonna buy it? Right? In other words, they built themselves a trap, but that was not the bank examiner didn't do their job. Right? It was the bank examiner did his job and then they didn't have a road to fix it.

- So that's a possible interpretation of what happened with supervision. But I do think that there's, there's an inevitable drift in the supervisory culture away from sort of emphasizing what's most important. And I think when you look at the materials that the Fed, quite laudably, made public in connection with their supervision of SVB, you see that there was a lack of prioritization of what was actually important. There was a raft of supervisory instructions that the bank was given, most of which had to do with how they onboarded customers and how they managed their third party vendors and what they were do, how many SARs they filed and all worthy and, and the work of the Lord, but not prioritized in any way and indeed, prioritized against the things that really matter and an endless timeframe for the bank to address.

- But I said, and this goes back to the comments that you and Randy, both Randy's, have made about resolution. They had no path to resolution.

- Oh, I completely agree with that. I completely agree that all of this would've been much different if the FDIC had acted with more dispatch in resolving the thing.

- Right. I mean, purchase and assumption was, in the old primitive days before we had all these tools, would've went, "Oh, there's a problem selling." Right? If that had been done, this would have gone away.

- Yes.

- Right? And the part of this that's, to me, most amazing, is how easy and how public the information was that they needed to be sold.

- So if I can maybe comment on that. Because I also found it puzzling that it was, I think July of '22 that there were some analyst reports coming out about the credit issue, risk issues in portfolio at Silicon Valley Bank. Then you had a blog write about it also weeks in advance. There was information out there. And what puzzled me quite a bit was when the FDIC's Chairman and the Vice Chairman Super testified, and they were asked, "When did you hear about the liquidity issues at Silicon Valley Bank?" One said, "Thursday morning," one said, "Thursday evening." So the fact that you could have gone on Twitter and seen that all of these tweets are going around for 48 hours prior. So there's definitely, and again, this is the capital discussion, so I don't wanna go into some of this, but the realtime information and the ability to get realtime information on the bank is...

- No, but this is the confusion they wanted, right? So the capital, the lack of capital was completely public. And you could have basically done a FactSet search lead subtraction list and you would've gotten the banks that were in trouble, right? You had to do no work to do this, right? You had to have a FactSet account. Okay? Then there's a question of, "When did the market believe that there was enough of a problem that they might be closed, that they had to remove deposits?" Right? That's the point Randy brought about the FDIC itself being unpredictable, right? That was when the market began to worry the FDIC was going to do this badly. That wasn't a question about SVB, that was a question about the FDIC.

- Mm-hmm .

- Right?

- And... I actually was, I remember being in the gym and the person next to me had a bunch of accounts at First Republic and was trying to figure out when he needed to move them, based on what the FDIC was going to do. There was no uncertainty about the banks. There were lots of uncertainty about the regulators.

- Well, I would say,

- Lemme... it doesn't, but it actually does not surprise me at all, which is again, part of the issue that has to be addressed on the regulator and supervisory side of the system that they did not hear about this until it was essentially over. Because that is...

- They knew the capital wasn't there, right? They didn't know there was gonna be a run.

- Well, you know, the, I don't believe that they, I think they have said that they were informed about the issues with SVB. I mean, yes, they could have.

- They said, "When did you learn about the issues?"

- About the issues regarding SVB. They were informed about it the night before, the night that everything was happening. And that rings absolutely true to me because one of the issues that has to be addressed was supervision, at least at the Fed, I think across the banking regulators, is that there is a view. There's a famous story from the Vietnam War of Robert McNamara and his deputy secretary being down at a time when there was a blockade, I think it was a blockade of something during the Vietnam War. And they're down in the engine room with the admirals and the chief and saying, "Well, why aren't we doing this? Why aren't we doing that? Shouldn't we be doing this?" And the admiral said, "Mr. Secretary, you and your deputy go back to your office and the Navy will run the blockade." And that is very much the view of the supervisory system with respect to any sort of oversight, which is, "Mr. Vice Chairman, Mr. Chairman of the FDIC, you go back to your office and the supervisors will supervise the banks." And I think that level of accountability has to improve.

- Yeah, let me just add this from the perspective, this is from the perspective being on the outside looking in. But the outside was a pretty important outside, in the sense that my colleagues and I probably advised, probably had a hundred calls between Friday morning and Sunday night of the weekend when Silicon Valley Bank was put into receivership. And everybody that we talked to, almost everybody were depositors. Some were other creditors and other constituents. But the question was, "What is the FDIC gonna do?" And we are pretty sophisticated and we, as a law firm, and we couldn't really tell them. And

then the other sort of theme was, there does not seem to be a sense of urgency among the FDIC resolution staff to actually get a deal done over the weekend. And that was my impression. That may have been an incorrect impression because I was looking from the outside in. And maybe those who were on the inside would say, "No, no, no. We were very, there was a real sense of urgency," but it just wasn't perceived on the outside that there was a sense of urgency that weekend.

- Well, maybe just given the time here, let me insert myself as the moderator here and say, I think this panel is definitely outperforming expectations. We clearly have a lot of unsolicited advice for the regulators which we hope they'll take. I think we could embark on our own comprehensive deep dive and review of the post 2008 crisis on our own, probably over the course of next week. But let me thank all of the wonderful panelists for participating and SIFMA for hosting and turn it over to Joe.

- Thank you. Thank you, thank you. And now, this concludes our roundtable today. Thank you all for joining, and thanks again for our engaged members, our phenomenal panelists, and moderators for their contributions to the event. As we've talked about today, substantial changes to the U.S. capital framework via implementation of the Basel Endgame will have a significant impact on banks, on commercial corporations and end users, as well as on the U.S. capital markets and the broader U.S. economy and financial stability. The importance of getting the balance of cost and benefits rights was clearly underscored today. And I'm hopeful U.S. policy makers will take notice of the broad ranging concerns and issues that have been raised. I encourage you all to stay engaged on the topic. Your participation is essential to helping us preserve efficient, effective, and resilient capital markets. As we learn more from regulators and see the actual proposals in the coming weeks, we will continue to advocate for thoughtful consideration of how the Basel III Endgame will interact with existing components of the U.S. capital framework, as well as potential reforms for the broader prudential framework, appropriately balancing financial stability with economic growth. We also hope participants and the audience will consider joining us for a second roundtable, where we can continue the discussion we were having on the topic and tackling the details of the NPR tentatively scheduled for the fall. We would hope to have that. So in concluding, I would like to thank some of our SIFMA staff who've been involved in the production, Ana Ballarin, Kristin Chachula, Monica Ilyevsky, Lindsey Gilbride, Wes Alves and Ken Morrison, our director here, for all their work today. And we look forward to continuing this conversation. And thank you again for joining us today. Thank you.