



SIFMA BASEL III ENDGAME ROUNDTABLE

April 18, 2024 | Transcript

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

- Good morning. I'm Ken Bentsen, SIFMA's President and CEO. Welcome to today's Roundtable to take a close look at the proposed Basel III Endgame reforms of US Bank capital requirements. This is a follow up to a forum we held last summer just before the rule proposal came out. Today we will focus on reflections on the proposal, its impact on the capital markets and the US economy, and the possible road ahead, so thank you for joining us. As you well know, there's been widespread criticism of the proposal from many stakeholders across all the entire political spectrum, and much of it has come from far outside the financial services industry. In our advocacy, SIFMA has been quite focused on raising awareness about the outsized impact the proposal would have on capital markets activity and the serious knock on effects for the real economy impacting companies including non-financial companies, consumers, and savers who benefit directly or indirectly from bank dealer involvement in US capital markets. The regulators who proposed the package even now have acknowledged that a new approach is in order and have stated that there will be material changes to the proposal. We have a robust and impressive slate of panelists today, but I'm pleased to kick off the morning with an opportunity to hear from one of the key regulators in this process, Federal Reserve Governor Miki Bowman. Governor Bowman has been a member of the Board of Governors of the US Federal Reserve System since she was appointed in November of 2018, and her term runs through 2034. Prior to this, she served as the State Banking Commissioner of Kansas. Governor Bowman, thank you very much for joining us today, and look forward to our conversation.

- It's a pleasure to be here. Thank you for inviting me.

- So to start with, the Basel III Endgame proposal is obviously attracted an unprecedented level of public comment scrutiny from across the political spectrum and from a broad spectrum of groups, including asset managers, pension funds, insurers, and non-financial corporates. Were you and your colleagues surprised to see so much interest in this proposal from such a wide range of stakeholders?

- Well, honestly, I don't think that we should have been surprised. We voted on this matter at a public meeting, and if you go back and watch the meeting, you'll see that a number of the members of our board expressed pretty significant concerns about the proposal and its contents, and the way that it's calibrated,

and what it chose to include, and over calibrate at different levels. So one thing that I think was really interesting is that, after the proposal was introduced and passed by the board, we committed to undertaking a data collection, but the timing was really unique on that. Usually, that data collection happens before a proposal is issued, so it's a little bit like building a house without an architect or without having building plans to guide us in understanding how things would work together and become a final package, but I think one thing that's important to remember is that initially the Basel III proposal or the discussions and negotiations were largely intended to be capital neutral, and so in my mind it was a real surprise to see that, when the proposal came out, it projected approximately 20% increases in total risk weighted assets, but specifically it showed a 16% increase in common equity tier one requirements for all banks that were subject to the proposal and a 19% increase for US G-SIBs and the next largest set of firms, which are category two banks at 750 billion and above, and a 14% increase for intermediate US holding companies for foreign institutions. It's no surprise in my mind after the comments that I made during our initial board meeting that we received significant negative feedback from the public and from commenters throughout our comment period, and even since the close of the comment process back in January of this year, we've continued to hear a number of concerns continue to be raised and even in the public sphere, which is quite unusual for capital rules, which are extremely complicated. But going back to our comments that we've received, out of about 350 comments, 97% of those were negative, and in my mind, I think a lot of that stakeholder feedback reflects the fact that a lot of the impacts from the calibration of some of these requirements are likely unintended and that it would reverberate across the financial system and among bank customers who are borrowers and users of banking products like derivatives, who I don't think that there was an expectation that those markets would be as impacted or even impacted at all.

- So that's very interesting, and maybe to dig in that a little bit deeper, in some of your prior remarks on the Endgame proposal, you spoke about the potential adverse consequences. You were just getting into that of enacting capital increases of this magnitude. From your perspective, what are the most important consequences for the capital markets, the broader economy, and financial stability of getting this calibration wrong, as again, you're just pointing this out, you know, in one instance, talking about derivatives or other securities products that are impacted?

- Well, as you know, the US has very deep equity and debt markets and we offer products and services that support all kinds of businesses and households, and we know that the consequences of over calibration is that everyone who relies on these products and services will be impacted in some way, and frankly, these are predictable adverse consequences, and I'll just go through a couple of them. One is higher costs and less availability of these products and services, and frankly, we know as following the implementation of Dodd-Frank, that banks will adjust in light of these capital requirements likely by increasing the cost of services or deciding that they no longer want to participate or offer these services anymore. Also another impact is increased concentration and reduced competition, so I think what we'll

see is an even greater emphasis on scale that will lead some institutions to more concentration in some services and likely exit some products and services as well, but we know just based on recent banking stresses, that concentrations can intensify risks, so in my mind, increasing concentration could not only lead to higher costs, but it could also lead to reduced resilience, and I mentioned already that I think that the more activities that we're pushing out of the banking system, the less transparency we have to understanding what our financial stability risks might be. And I think that as a result of some of the calibrations of some of these activities, we may see some of those activities shift out of the banking system and into non-bank providers, and I'm not sure again whether or not we know if this is going to lead to enhancement of financial stability or present additional risks, but what we need to ask ourselves is whether the proposal in and of itself enhances safety and soundness or if it could potentially erode financial stability. So one thing that has, that I've mentioned a number of times in talking about the proposal is that our proposals and our regulations need to be based on data analysis, and frankly we need to acknowledge the trade-offs and the consequences of whatever proposal we might be putting out. So one example of that is operational risk, which certainly shows how over calibration can work against safety and soundness. So in some firm's efforts to diversify business lines, which is something that supervisors have encouraged over time to ensure that less risky activities like generating fee income from wealth management activities is better activity to diversify your risks and imposing higher capital charges on those kinds of activities doesn't seem to be in line with that diversification strategy, so.

- Yeah, that's a great point, and in particular, when you think about wealth management, is not only is it very stable fee income business, it's also it is very much a growing business in the US even though we have the most developed wealth management sector in the globe, I would say, but it's still a growth business because there are more people seeking advice and the like and it seems unintended that you would want to penalize that in some way, but I want to shift a couple things you said. You talked about unintended consequences, lack of data, you know, inappropriate calibration. Inappropriate's my word. Maybe focusing a little bit more on capital markets and you point out the depth and breadth of the US capital markets which we think is a good thing and the envy of the world. The US capital markets fund three quarters of commercial activity in the US, which is the inverse of if you look at Europe or Asia.

- That's right.

- We, at SIFMA, along with our colleagues at ISDA did our own calibration because there wasn't a QIS that had been done on this, and so we did our own QIS, and what we found was that with respect to capital markets products, the fundamental review of the trading book proposal as well as the CVA would increase risk weight asset capital to 129% on various bank trading activities, and that just seems unbelievably high. I mean, do you think this type of calibration is appropriate when you're thinking about things of whether it's derivatives or securitization, which is such a critical funding tool for both consumers and the commercial sector or securities financing transactions for that matter?

- Absolutely, well I think this is something that I've taken a close look at, and I agree with you that I think that the proposal's impact on these capital markets activities really seems divorced from the risk that's posed by these activities. And when the proposals was introduced, as you noted with the percentage of increases that revisions to the market risk rule alone would increase risk weighted assets from \$430 billion to \$760 billion for banks in categories one and two and from 130 to 220 billion for categories three and four. But it didn't, the proposal itself, didn't answer a core question for me, which is whether an increase of the size coupled with the many other proposals for capital and prudential requirements justified the risks of the activities. So you mentioned a couple of things that I think are really important for us to take a close look at. What is the credit valuation adjustment that would increase capital for all derivatives activities, and frankly I'm concerned coming from an agricultural area where derivatives are often relied upon for underwriting for agricultural loans that this could have significant impacts on whether the firms continue to offer these kinds of services or at what price, what cost they might be available in the market. Another one is minimum haircuts for securities financing transactions. So this is another area where market activities like stock borrowing and lending could be significantly impaired. But who would this affect, right? Among others is that pension funds and asset managers who have the potential then to have follow on effects with their beneficiaries and their account holders. Another issue is the treatment of securitizations. So I'm concerned that some elements of the rules will have a perverse impact on increasing capital requirements on less risky assets, and you know, we really need to think about the calibration and the balance of all of these things. But the treatment of securitizations by imposing higher risk weight on risk reducing securitizations really are, they're intended to assist with balancing underlying risks, and I'm not sure that the proposal strikes that right balance.

- So sort of digging into that, you know, what we believe one of the most important sources of over calibration of the capital requirements is the interplay between the proposals and the stress capital buffer. And, for example, you know, similar risk arising from bank's capital markets activities are capitalized, once under the fundamental review of the trading book component, and then separately through the global market shock component of the SCB. This is sometimes called double counting of risks. Some don't like that, but it does have that impact or sequential counting perhaps, but with the result being significant over calibration of the capital requirements. What are your views on this, and do you think the Fed should take action to address this significant over calibration prior to implementing the the Basel III Endgame proposal?

- Well, of the many things that need to be addressed in the proposal before it finds its next form, which I hope is a re proposal, I think there is some debate about whether this is actually double counting or if it's just over calibration, but I think maybe this discussion misses the point. The market risk rule and the global market shock and stress testing, which factors into the stress capital buffer, they're intended to measure baseline and tail risks, so it's pretty clear that we need to think about the aggregate calibration

and whether it's too high, and I think there are strong indications that this aggregate calibration is too high, so we should address that, and it needs to be addressed in whatever the final version of the rule is.

- And you know, the effects of the proposal are also likely to be compounded by two other outstanding proposals, the proposal to amend the G-SIB surcharge to include, you know, client clear derivatives in the G-SIB score calculation, and a separate proposal to revise and extend long-term debt requirements for large banks. Do you have any thoughts or concerns about these proposals and then given the complex interaction between all of the capital proposals, do you think that the agencies should wait to finalize them until the full impacts of the Basel III Endgame rule are better understood?

- Well, one, I think it's critically important that we understand the impacts of all of the regulations that are currently under consideration, whether they've already been published for comment or whether they're still, you know, in a drafting stage. I think we have about 5,000 pages of regulations that have already been introduced, with more I think in the pipeline, and I think without fully understanding how each of those in their final version will impact the banking system as a whole, I think it's really dangerous for us to be thinking about each one of these in a silo. So just to address the G-SIB surcharge and the long-term debt proposals, I have concerns about both of them. With the long-term debt proposal in particular, I published a comment, I don't believe we talked about this one in an open board meeting, but I did, while I voted for it to be published, I did express some significant concerns, and I think, for the most part, those have to do with the fact that we're including banks over 100 billion dollars in assets in significantly expensive requirements, not just with Basel, but with long-term debt and with many other changes that we're looking at making to the regulatory framework. And until we really understand the aggregate of all of these impacts, it's impossible to have a complete and thorough view about what those impacts are going to be, and whether or not a bank that is between 100 and 250 billion in assets is a viable entity going forward, so I don't think the intention of publishing rules is to exclude a certain category of banks from being able to operate in an environment that is conducive to continuing banking activities, so this is a pretty significant concern that underlies all of the ways that I approach and look at our regulatory decision making and environment, but I'll talk a little bit about the G-SIB proposal and again, I think it's going to exacerbate the market impacts of the changes that are made in the Basel proposal. So at the time that we discussed this one, I noted that some of the changes to the G-SIB surcharge could be helpful, like reducing the increment of G-SIB surcharges to 10 basis points from the current 50 basis point approach, but I'm concerned about the unintended consequences again of the G-SIB surcharge rules, like the potential impact on market liquidity, and the inclusion of client clear derivatives in the G-SIB score calculation, I think, is a good example of that, and it's fair to assume that this could be an adverse impact for G-SIBs, particularly with the proposed shift away from the year end measurement of certain metrics that factor into the G-SIB scores. And just going a little bit deeper into the long-term debt proposal, again, it's going to impose additional costs on non-G-SIB banks with the cost and probably the availability of services that they may be able to provide once this is in place if it does get finalized in its current form.

And I'd note that the calibration itself of the long-term debt requirement as proposed is not independent of capital chart changes. So to understand the entirety of the implications in the aggregate calibrations, we can't move forward in a piecemeal way with changes to Basel III Endgame or any of these other proposals and expect that that's going to have an outcome that we could anticipate. So again, I think it's helpful to think about all of these proposals in terms of their aggregate or their cumulative effect, one, to understand the actual impact on capital and funding requirements, and two, to understand the consequences of all of these related regulatory reforms, not to beat a dead horse, but again, I think that's probably one of the most critical concerns that I have is that we don't understand how all of these things will work together and what their aggregate impact will be once they're finalized.

- So, maybe sort of wrapping it all up, I mean, you know, you've been through a lot in a very short period of time in underscoring the magnitude of the multiple rules as well as the existing framework and the interaction and perhaps the lack of considering all of the interactions and what the outcome will be and all. What do you see as the next steps for the Basel proposal, and for that matter, the long-term debt going forward? Obviously, your colleague Chair Powell or colleagues as well as Vice Chair Barr have signaled that there'll be, you know, "broad and material changes made to the proposal to ensure that there's broad support for the final rule." I believe Chair Powell even said a re proposal was not off the table. You know, could that possibly be something that we certainly think that would make sense, particularly given everything you just said about having to consider all these factors, and should we expect the agencies to publish the QIS that they're going through also for public comment?

- Well, I'll start with the QIS, I do believe that we are planning to publish the QIS for public comment, and frankly I look forward to that. I know that there will be some very revealing information that will be helpful and that would have been more helpful had we had the opportunity to see that either in conjunction with that initial proposal, or prior to its publication, but, you know, I think that's one thing that will be extremely enlightening for the members of the board once we have an opportunity to see what that analysis shows, but also to help inform what the future of this proposal could look like or should look like based on that. And I'm sure the comments that we'll receive throughout that process will be very enlightening as well, so I am heartened by the fact that there is a plan to publish that QIS proposal, but I also see a path forward for this proposal and, you know, not all policy makers agree all the time. We know that there are trade-offs for decision making and policy and that we all have different views about, you know, what the right levels of calibration or what should be included or addressed in a proposed regulation, but really it's about striking the right balance, and I don't see that there are insurmountable obstacles to achieving a more effective or efficient set of Basel capital reforms here in the US, but I agree with the assessment that Chair Powell noted that this proposal, the way it stands now, requires broad and material changes, and so hopefully this morning I've made it pretty clear about a number of the areas where I see that there's a over calibration and where there's a need to address several areas, and those are just a few of what I've mentioned over the past several months and really nearly a year now since we had that open board

meeting last July. But I think as long as we're willing to carefully review and revise and take account of all of the comments that we've received, I mean they are extensive and clearly they are very informative and enlightening to us in that process that we really should have had the benefit of at least understanding some of those unintended consequences prior to the publication of this proposal and voting on it, but at least we have the benefit of that now. I think, I did note that we're going to be publishing that QIS and I think that's an excellent next step and hopefully that'll help us understand more fully some of those unintended consequences that I mentioned earlier, especially on derivatives and the calibration of fee income for fee-based activities, but I think that any proposal that does end up coming to fruition or coming out of this process is something that can achieve broad consensus among our board members. Again, I noted at the very beginning that, during our initial board meeting, a number of our board members mentioned issues with that proposal, so I think it's appropriate that we would see some changes and that we would have the opportunity to fully support, or at least mostly support whatever that looks like at the end of the day. I think the important thing here is that and the Federal Reserve has a great reputation for its credibility, and if we want rules that continue to be durable throughout political cycles, throughout economic cycles, we have to do our homework, prepare proposals that make sense, that don't have unintended consequences or at least address those unintended consequences and bring something together to at least our board that can be broadly supported. So I look forward to that and I hope that the next step is a re proposal.

- Well, Governor Bowman, thank you so much for spending time with us today. We know you have a very busy schedule, and we really appreciate getting your insights, and with that I'm going to pass this on to my colleague, SIFMA's Chief Operating Officer, Joe Seidel, to tee up the rest of the day's program.

- Thanks so much for the opportunity to speak with you this morning.

- Thank you Ken, and thank you Governor Bowman. That was an excellent way to set the table for the rest of our Roundtable discussion. As Ken noted, the US policy makers who proposed the Basel III Endgame package now acknowledge that they have more work to do, and have stated that they plan to make material changes to the current proposal. Why? Because it is overwhelmingly clear the proposal goes unnecessarily far and the negative consequences will be severe. US bank capital standards are already extraordinarily robust by historical standards, and in terms of overall levels and quality of capital, these levels appropriately balance financial stability with economic growth. The US proposal would, however, dramatically hike bank capital requirements even further. While this complex proposal will have significant effects across the economy, one of the lesser discussed components would potentially have the most far reaching impacts, and that is what we will focus on today. As SIFMA called out in our multiple comment letters submitted earlier this year, the proposed increases in capital, specifically for banking organization's capital markets activities under the Fundamental Review of the Trading Book, FRTB, and the Credit Valuation Adjustment, CVA, are far greater than stated in the proposal, and are not

commensurate with the underlying risks. In fact, the latest industry Quantitative Impact Study estimates the capital for large banks trading activities would increase by 129% over their currently historically high levels, leading to negative impacts on the ability of large banks to provide a range of capital market services to their clients. Given that the US capital markets provide 75% of the financing for the real economy, and given the vital role large banks play in intermediating these markets, such dramatic capital increases will likely impair market liquidity and vibrancy. This will result in serious knock on effects on the real economy impacting companies, consumers, and savers who benefit directly or indirectly from bank involvement in US capital markets and further hurting US economic growth. Indeed we are seeing this negative impact occurring already as many firms begin to price the expected changes into certain long dated instruments and have, in other instances, indicated an intention to scale back specific business lines. Regulators have not fully accounted for these capital market impacts because, in our view, they did not conduct the necessary, robust analysis in advance of issuing the proposal. As I mentioned, the regulators have said they plan to make changes, but what will those be? What aspects will be changed? The devil is in the details. In reality, the most prudent path ahead would be for the agencies to withdraw the proposal and re-propose the entire rule for public comment. Any re proposal should contain a robust holistic review of the entire capital framework and an economic analysis demonstrating the benefits and costs of the proposed changes. More specifically, SIFMA would recommend the following Top 10 changes be made to the rule. Number one, overlap with stress tests and other prudential requirements. There should be a comprehensive evaluation of how the proposal would interact and overlap with other prudential requirements, particularly the stress testing framework as well as the G-SIB surcharge and long-term debt requirements. Number two, the interaction between the global market shock and the FRTB. Regulators should address over recapitalization of market risk between these two frameworks by, for example, applying the FRTB to the trading portfolio on a post GMS shock basis. They should also only apply the stress capital buffer's annual stress test to the US standardized approach to avoid overcapitalizing the CVA and operational risk measures, which are already captured under the alternative expanded risk-based approach. Diversification under both the FRTB's internal models and standardized approaches, regulators should give greater credit for diversification and hedging activities to better align with actual risk exposures and reward good risk management practices. NMRF and PLAT. In the FRTB portion of the proposal, adjustments should be made to lessen the impact of Non model-able Risk Factors, NMRF, and the P&L Loss Attribution, PLAT test, so that more firms are incentivized to adopt the internal models approach, which better reflect firm's risk profile. Number five, Credit Valuation Adjustment. Client clear derivatives should be excluded from the CVA scope in a manner similar to the approach taken in other jurisdictions, and risk weight should be adjusted to reflect the different levels of regulation that a bank's financial counterparties are subject to. Number six, securitizations. The proposed framework for securitization should be adjusted to avoid undue negative impacts on a wide range of asset-backed securitized products that businesses and households rely on to finance their activities including mortgages and credit cards. Number seven, securities financing transactions. In line with the approach taken by every other major jurisdiction, the US should not adopt the SFT for higher cut

framework, as doing so would've significant adverse effects on the critical securities borrowing and lending markets. Number eight, investment grade counterparties and collateral. Regulators should remove the public listing requirements which assign lower risk wage to counterparties to avoid unduly penalizing credit worthy counterparties that do not have public listed lease securities such as pension funds and municipal issuers. They should also recognize the risk mitigation benefits of safe collateral to better reflect counterparty credit risks. Number nine, regulators should revise the proposed operational risk framework, including the treatment of capital markets fee-based services to appropriately incentivize sound risk management practices and diversified business models. And number 10, the implementation guide timeline. The agencies should provide an appropriate amount of time to implement the final Basel framework, at least 18 months from completion of the final rule. These are items that are top of mind here at SIFMA, and today's panel should give policymakers additional food for thought as they reanalyze their approach. So turning then to our program today, first we will ask our participants for their overall reflections on the Basel III Endgame proposal and evaluate its impact on US capital markets and the end users and the broader economy. Then, in our second panel, we will move to a deeper dive on the proposal's capital markets components including the Fundamental Review of the Trading Book, Credit Valuation Adjustment, and the framework for haircuts on securities financing transactions. We'll identify some of the challenges with these aspects of the proposal and potential solutions. We will end with the discussion of the proposed interactions with other components of the capital framework, particularly the supervisory stress test, G-SIB surcharge and resolution related capital requirements, as well as an evaluation of the road ahead for the proposal. And now let's get started. Please join me in welcoming Jelena McWilliams, Managing Partner of the Washington DC office and Head of the Financial Institutions Group at Cravath, Swaine, and Moore. As you all know, Jelena is also a former chairman of the FDIC. Jelena, thank you for joining us today and leading our first discussion.

- Great.

- Over to you.

- Thank you so much. Thank you Joe and it's a pleasure to be here again with you today and thank you for the opportunity to moderate another panel. I thought I was going to be fired after last summer's events as a moderator. but somehow you couldn't find anybody better, so I obliged. I think it's important that we touch upon a few basic points about the NPR that came out from the Federal Reserve on the Basel III Endgame mainly because it is very unusual for the Federal Reserve, and I'll say this as a former staff attorney of the Fed who had to review thousands of comment letters to have received such a large percentage of letters that have negatively reflected upon the proposed rulemaking. I still believe in the Fed as an institution, and I still believe that the Federal Reserve Board of Governors is one of the last bastions of good economic analysis in the United States government, and from that perspective, I would have preferred to have seen perhaps the proposal come out as an advance notice of proposed

rulemaking rolled out at the same time as the Quantitative Impact Study, which the Federal Reserve is more than capable of conducting in a very thoughtful, and I would say, professional manner. Since that didn't happen, we're faced with a proposal that has 97.5% of negative feedback from the public and that is a pretty staggering number for a Federal Reserve proposed rulemaking, and I think it is through that lens that we should take the proposal and the comments very seriously and reflect upon the good, bad, and the ugly, and hopefully proceed in a manner that both preserves the Federal Reserve's good standing as I mentioned, as the foremost bastion of good economic analysis and sensible rulemaking in the United States government, but also to reflect upon the cause benefit that any kind of a rule of this magnitude will impact and have on, not just the banks and you know, the rule primarily impacts banks because it'll increase capital requirements exponentially on different banking organizations, but I do think we need to focus on the end impact on end users, the capital markets and how the transactions generally will be impacted in the lending space in the United States. And from that perspective, the United States is very uniquely situated in that 75% of equity and debt financing in the US takes place through US capital markets for non financial institutions, and this impact, while not on its face clearly impacting that type of lending, it will unquestionably have adverse consequences on the overall lending in the United States. So from that perspective, I welcome this first panel which will focus on the end user's capital markets, products, and segments as well as the impact on economic growth and financial stability, and I will say that one of the more interesting things about this panel this morning is that we have three Randys. So as I'm moderating this panel, there are no three Randys that I would want to have on this panel more than Randy Quarles, Randy Kroszner Randy Guynn. For the ease of navigating the panel, which is why I think I got this job of a moderator, there will be an RQ, RK, and RG references, so bear with me because your name tags may not say that. So we will start with RQ, Mr. Quarles. Randy, have you been surprised by the breadth and depth of reactions to the Basel proposal? What stands out the most to you from the proposal? Where do you think the regulators got it right? Where did they get it wrong? If so, and both in terms of substance and process, and you did publicly address the idea of a re proposal recently, so I would love to get your thoughts on that and how likely is the Federal Reserve to move in that direction?

- Super. Well thank you. Thanks, Jelena. Thanks Joe for having me here. I mean I look around, and not withstanding the superabundance of Brandys as well, it's just this is like the Justice League of bank regulation. This is a very distinguished group to be part of, so I'm really, so I'm pleased to be here. How I been surprised by the breadth and depth of the reaction? Well let me give a Fed-like response, yes and no. I've been gone for two and a half years, but I've still got the touch. So at one level, yes, I mean the reaction is unprecedented as you indicated. I mean the banks have rarely been so united and in your face with the regulators and the disorienting agreement between banks and various anti-bank pressure groups with concerns about the effect of the proposal on the broader economy is also close to unprecedented. On the other hand, the proposal was so weakly supported by analysis, so weakly endorsed even by the Fed board that put it forward for comment, two full throated dissents and a couple of, "I don't know, but I guess it won't hurt to see what people say", that one could hardly say that the reaction was surprising. It

certainly wasn't unmerited. So where did they get it right? Well, I mean most basically I believe they got it right in seeking to implement Basel III. So back in my day there were those who wanted me to disavow the Basel III Endgame or renegotiate it. Chief among those were the French interestingly, but it is neat and right for a comprehensive capital framework to have elements that address a variety of principle risks, such as trading risk. Operational risk is a little more controversial conceptually It's harder to calibrate practically, but it's part of the agreement. It can be implemented in a reasonable way, and following through on these international agreements is a force multiplier for the United States. And these bodies, they are not like the UN. We have enormous sway in these bodies. We usually get our way, so it is in our long-term interest to implement the agreements that come out of them if we can do so sensibly, and since we're the 800 pound gorilla, we usually can. So, that's where they got it right. Where did they get it wrong? Well, first the aggregate amount of capital as Governor Bowman was saying this morning. The proposal raises the aggregate level of capital across the system by 20 or 30%. That's not consistent with various estimates of the optimal level of capital for the industry. It's not consistent with the Basel agreement on these issues, which was to implement the Endgame without a material increase in capital. It is not consistent with recent experience, certainly not the few bank failures last spring, which were liquidity rather than capital related, and nothing in this Basel III proposal would've affected anything that happened last spring anyway. And it is possible to implement the Endgame without this dramatic increase in overall capital levels. I know because Jelena and I had a draft proposal on the shelf when I left the Fed that would've done exactly that. Second, there wasn't sufficient attention paid to the effect on end users of certain elements of the proposal. The overly broad scope of the minimum securities financing transactions, haircuts, for example, that results in pension funds and insurance companies being treated the same way as hedge funds. Third, more attention should be paid, by which I mean some attention should be paid to the interaction of this framework with the stress testing framework. I am a big defender of both frameworks. We should have a clear through the cycle set of minimum capital requirements and we should have a regular process of stress testing, but especially now that the stress test result in an actual capital requirement with the advent of the stress capital buffer, the system has to be considered as a whole to avoid unintended consequences. For example, the way the operational risk assessment of the proposal would work with CCAR results in excessive capital levels without any logical justification. And finally, again, as Governor Bowman said, and as I'm sure there will be more technical analysis of during the discussion today, the operational risk component over penalizes fee-based, less risky businesses such as wealth management. We created a set of capital incentives 15 years ago to move people to less risky businesses, and now we are penalizing them for having done exactly that. These recalibrations should be made because they're in the public interest, not because they are in the banking industry's interest. I mean, I do believe that, you know, the government shouldn't gratuitously persecute categories of its citizens, but that seems to be a controversial view. So let's set it aside and simply say, "What is in the public interest?" And if it is not in the public interest to have a capital framework that will push risky activities out of the banking sector into other parts of the system where they may be less supported by capital or into other parts of the world where they would certainly be less well managed. And finally, yes, I

don't think this proposal can be changed enough to make it workable without it being changed enough to require reproposal under the Administrative Procedure Act. So it's not so much is it wise, I don't think they can do what is wise without doing what it will legally require them to do.

- Yeah, and you and I had ample discussions about that when we were at the Fed, whether or not the final rules were a natural outgrowth of the proposed rule makings. All right, so we'll, Randy one, you're done. We'll go to Randy G. We'll go, you'll just have to be Randy two for today. And Jonathan, and I'll ask this question, what has stood out to you about the reactions to the proposal to date, particularly in terms of the commentary on the trading book components of the proposal? And in your view, does the proposal align with your original objectives of the Basel III International Standards, which were to promote consistency and comparability in capital requirements across jurisdictions?

- Okay, so let me answer that in a way that doesn't repeat too much what Governor Bowman or former Vice Chair Randy Quarles said. I do think, but you know, I will just say I think like them, and like most people, it was quite surprising to see so much dissent at the Federal Reserve. That was unprecedented in my experience, and also so much dissent in the public comments and that those comments, you know, seem to be fairly spontaneous and very well thought out. I think what I would like to talk about is the thing that is being pushed toward but hasn't really been done is really looking at all the proposals because the Basel III Endgame wasn't issued by itself. It was issued as part of a package of proposals that included the Basel III Endgame, which obviously would significantly increase the capital requirements and also the long-term debt requirement and the G-SIB surcharge resolution planning requirements. The only thing that was sort of significant that was left out was information about the stress testing, which is also, I think, critical here. I think it's, you know, since capital liquidity requirements are designed to reduce the probability of failure and long-term debt and resolution planning is an attempt to reduce the consequences of a failure if it actually occurs nevertheless, it's very important that the proposal be viewed as one big package and to get the overall calibration right, and to do a cost benefit analysis really on an aggregate basis. They can't really be seen, you can sort of evaluate them individually, but you also need to evaluate them collectively. The other point that I think I would make is that I noticed that, you know, a lot of the criticisms of the Basel III Endgame have focused on credit risk, 'cause those are the criticisms that are easiest for the public to understand, very easy to understand when, you know, the cost of loans go up, or the availability of credit goes down. It seems much more abstract to most people to talk about the increase of capital on capital market activities, but in some ways, the easiest way to get a sense is it's a 77% or estimate a 77% increase in capital on a particular sector that the public doesn't understand very well, but should, because our capital markets really are the best markets of that type in the world. They're absolutely essential for the smooth operation of our economy, the cost and availability of credit equity and other financing, and if you impose a, effectively, I mean, as Governor Waller said, if you impose a higher capital grant, you're effectively imposing the equivalent of an excise tax, and when you impose effectively the equivalent of an excise tax, you will have less of it. You will have less market making, you will have

less capital market activity, or it will get pushed to the unregulated sector or offshore. That's just, there's no debate about that, and we need to decide as a matter of what's in the public interest, whether that's really in the public interest or where the right balance should be struck.

- [Jelena] Jonathan?

- Thank you, so obviously I enthusiastically agree with the comments from the two Randys, but I'll try to add a few unique observations as well. You know, obviously the breadth of interested parties on this has been extraordinary, but I would also note kind of the willingness to really kind of respectfully kind of criticize and push back on the agency's over a sustained period of time has been notable. You know, and that's not the usual, I think, regulatory capital dynamic, and even in other instances where I think we've seen some shortcomings on the agencies, you know, I think notably kind of the supervision following the March bank failures or leading up to the March bank failures and then kind of the relatively unserious introspection that went on at the agencies themselves, I mean, I think this is markedly different in the sense that, not just industry, but more broadly the public has really sustained kind of criticism and pressure in a constructive way on the agencies to kind of get it right, so I think that's notable in terms of reaction. More specifically, you know, when it comes to regulatory capital, I think generally, you know, people kind of view it as a bit of an exercise, a mathematical exercise an exercise in quantitative risk, but of course, on some level, as others have observed, it's really about trade-offs, right, being made, and it's not as precise as perhaps the formulas would suggest. And I think there's kind of historically been an understanding that, look, you know, the agencies are well intended, have lots of really competent people who work very hard, and they'll do their best and then they'll kind of reflect it, and put it from industry, and they'll, you know, more or less, right's probably not the correct word, but they'll come out with something that makes sense and it's informed by, you know, the benefit of kind of the larger public input. To me, that's not what's happened here, right? I feel like this is kind of a emperor has no clothes moment, right, where, you know, the whole kind of regulatory capital framework is based on this assumption that folks will do their best. Yes, there's some arbitrariness inherent in what they're doing, but it will informed arbitrariness, but that doesn't seem, again, what's happened here, and in fact what's happened here is literally kind of numbers pulled out of thin air in a lot of places, including on the training book side, right? So just to rattle off a few of, you know, some of my favorites and those include, you know, assumptions, unjustified assumptions around liquidity horizons 10, 20, 40 days, you know, very granular risk weight distinctions, like whether a commodity is liquid or combustible, you know, the consequences of failing the profit and loss attribution test or PLAT, which I guess is the acronym now, and my personal favorite, which I would argue is even perhaps more arbitrary than, and this is for you, Jelena, the cosmological constant is the row factor associated with the market risk model framework. So it's just becoming kind of more and more transparent that a lot of these numbers are just kind of pulled out of thin air, and so I think that's kind of upsetting kind of the delicate dance that has historically occurred with respect to kind of setting regulatory capital. We use terms like calibration and over calibrated, and that suggests again, a

level of mathematical precision, which I think doesn't always exist. You know, just a couple other comments. You know, I think in past kind of regulatory capital discussions, you know, this is different too, the reaction has been different because I think the public writ large has maintained a level of cohesion in terms of their response and criticisms. You know, this hasn't become a situation where different participants, or affected parties, stakeholders kind of looking at it on a relative basis comparing and contrasting, "Well, you know, what does it do to my competitor versus me". You know, that dynamic doesn't seem to have existed here, so again, I think this is notable in that the reactions are uniform and sustained over time here. You know, others have already noted kind of the reactions from the agencies themselves, including some notable principle level dissents. I would just, I guess observe that I think this is actually a healthier dynamic for ultimately I think for the agencies and for the policy outcomes, right? I mean, you know, I think there's been perhaps too much of a willingness to defer to agency judgment on, again, what is, at the end of the day, not always a mathematical formula, right? There are really kind of political trade-offs that need to be made here that impact the real economy, and they haven't always been done with the benefit of public input, and I think the reactions here suggest that that's not going to continue. There's going to be a lot more public input to be brought to bear. And so, you know, from my perspective, I think this presents, to kind of conclude on a more positive note, I think this, you know, presents a real opportunity to kind of get regulatory capital back on a more intelligible and rational kind of, you know, framework going forward, right? I mean, if you look at what regulatory capital was in 1988 when Basel began, it's utterly unrecognizable, right? The last 36 years and what we've seen flow from that is a one way ratchet up always more complexity to the point where even very, you know, intelligent policy makers have difficulty penetrating and holding regulators to account around whether or not they're making the right trade-offs. So to me, this is just a wonderful opportunity to, you know, look at that holistically, again, not just within limited to the confines of the Basel III proposal, but more broadly, and try to really kind of discipline the agencies around this and rightsize it, and then, you know, just to conclude on your question on the, is this consistent with kind of the Basel goals? You know, I think clearly it is not, and you know, just the scope, for example, of the application of the market risk capital rules to, you know, relatively small banks really raises questions about like, "What's going on here," right? I mean, Basel was originally about internationally active banks. You know, the US has deviated on many levels, and the US I think at times can't decide whether it's following kind of an American exceptionalism practice with respect to Basel, or whether it's trying to follow it more precisely, so whether it's consistency, comparability, you know, obviously the US has over time increasingly, you know, deviated from Basel in lots of ways. Others have already noted, you know, deviated on the capital neutrality. It's deviated in terms of scope, and again, I think these really raise questions too, and I think this, again, on the positive presents really unique opportunity to consider, you know, what is and should be our relationship to Basel going forward.

- Thank you both, and if I take nothing else from that cosmological constant will stick with me, and I'll try to put it in another speech. All right, thank you. So we'll go from one former Chief Counsel of the OCC to another. Julie, you have had a long and distinguished tenure as a General Counsel at the OCC, and so

it'll be great to get your feedback on whether or not this proposal, particularly its capital markets components, represent a departure from prior rulemakings, similar rulemakings by the agencies, and in particular, do you think that the proposal appropriately addresses the most pressing risks in the banking sector?

- Jelena, thank you, and happy to be part of this very illustrious group this morning. I was reflecting, getting ready for this that, in my tenure in various capacities as a regulator, I probably had been through all of the iterations of Basel up until this one, and just a couple of observations. The scope of this Endgame proposal really is unprecedented compared to what we've seen in the past and certainly Basel, the 2008 10 changes were not simple, but what we're looking at now are a combination of enlarged scope bringing more banking organizations within or under the umbrella of the new rules and raising some good issues, which folks have already noted about, you know, do some of these really make sense when you start with banks of 100 billion in size? So enlarged scope, the changes in the measures for calculating risk weighted assets are just mind boggling, and I think, you know, very challenging for even very sophisticated folks to be able to explain and understand what they're doing, so the complexity of the adjustments that are being made. And so we're talking about changes with credit risk securitizations, the CVA calculation, equity risk ratings, operational risk, market risk, just across the board of the risk categories. There is a, as folks have noted, I think more of an issue of connections or unclear connections between different provisions of the Endgame proposal, and unintended consequences that are being fleshed out now of some of the elements of the proposal. The other thing that has struck me is how dependent many of these provisions are really to an unprecedented degree on extensive data sets and reliant on some very complex and sophisticated analytics and calibrations, and it's amazing to me, and I say this as a former regulator, that all of this was done without putting out a QIS or without providing information about where did all of this come from? Where are we getting this number? Where are we getting this floor? What's the basis for the characterization of some of the key components that are in the proposal? And Jonathan had a great short list of sort of crazy items, and there are plenty more, but it's, and Governor Bowman has said that a QIS is going to be published for comment, but that's not the order in which you're supposed to do things when you do regulations that are very dependent on data and analytics and the key calibrations that you have to be able to support. And I'd say this is one issue that is actually a very interesting one in the emergence of challenges to regulators and regulatory proposals, and so not limited to the capital proposal, and that is that what we're seeing in litigation against agencies, and I would include the CFPB in this grouping, is that litigation challenges both authority to do particular provisions, but also the lack of data to support the provisions that are being proposed, and so it's really a growth of an emergence of a new way to challenge agency rulemaking that we're seeing taking shape, and this is a really an enormous example of it. Now, to your question of, do I think the proposal appropriately addresses the most promising risks in the banking sector? I mean, I don't know why there needs to be such a gigantic increase in the market risk capital calculation. We just, we don't know what the basis of that is, and with respect to operational risk and the treatment of fee income there, the

elements of the proposal and the increase in capital that would flow from what are generally regarded as relatively low risk type of activities seems to be just illogical, and is this something that was really needed here? The last point I'll make, and this is not in the capital market space, but to me is sort of reflective of maybe a fundamental, this is off base type of reaction to the proposal as to whether it is really addressing the issues that the industry faces, and that's with respect to mortgages. So let's look, today we've got basically six types of residential real estate loans. There are risk rates that range from 20% for certain guaranteed loans, 50% certain prudently underwritten current mortgages, and then other mortgages are at 100 or 150%. The proposal would replace this six category system with a framework containing 18 categories of mortgages. Now, somebody please tell me what it is that has happened in the industry in the last 10 or 15 years that requires having 18 categories of mortgages with calibrated risk weights for those 18. So does this proposal address the key issues the industry has faced? I would vote no, and I would also endorse, and I think Randy Quarles said is that the failures that occurred last spring were liquidity failures. They weren't capital failures. These banks were well capitalized, and so in a way, this is sort of a misfire by the agencies on what are more pressing supervisory and risk management issues that in the current market environments the banking organizations are facing. So, Jelena back to you.

- Thank you Julie. It is time that we go to another Randy, so we're going to turn our attention to Randy Kroszner, Governor Kroszner. I was his Fed staffer when he was the Governor before you, Randy, so maybe he's the original one. You've written about the potential consequences, both intended and unintended of the Basel Endgame proposal, and I will complain that your American banker Op-Ed prints on a four size font,

- [Randy Kroszner] Well, expand upon it.

- Well, you will have to expand upon it in the next few minutes. How do you see the proposal affecting the markets and the broader US economy, and in particular, how would you distinguish the trading book components of the proposal and how it influences credit provisions for business and consumers?

- Great, well thank you very much for being here, and just as we have Basel III, we now have Randy three. I've never been in that situation before, so it just seems perfect here to have Basel III and Randy three. Yeah, I had tried to look at the proposal and as colleagues have said here already, there's a lot going on in the proposal, and unfortunately there isn't enough of the kind of cost benefit analysis, careful analysis that I usually associate with putting out such a complicated proposal and very much agree with the kinds of things that have been said that we need to have more analysis of that. That's kind of a very important part of the paper that I wrote, and the op-ed that I wrote. You really need to have some reasonable cost benefit analysis to do that. Other countries have done it, so it's not like it's impossible to do that. You know, can you get it down to, you know, the granular level? No, and so that's not what we need to do. I don't think we have to say, "Well, we've gotten the standard error down so tight, we know

exactly what's going to happen." There are always potentially some unintended consequences of regulation and that that's fine. We can never get all that that perfect, but it doesn't seem that there was a framework for trying to think through that, and what would be valuable is to just, even if there's not the full quantitative analysis, and Governor Bowman said we will have more of a quantitative analysis that'll only be on parts of it, but just sort of think through what are the potential consequences? What are the questions we need to ask for end users, for the economy, and that doesn't really seem to be in there, and it doesn't, as I said, at least from my perspective, we don't need to have the full answer to each of those before we can go ahead and move ahead with regulation. We would never move ahead with regulation, and I'm not saying that we shouldn't have regulation. I mean, a strong and solid capital base is incredibly important. I was at the Fed during the global financial crisis and so know that when capital is not sufficient, that's a real problem for individual institutions and for the economy as a whole, but fortunately we've moved a lot since then. The capital requirements have gone up very substantially. The amount of capital that banks are holding in most cases is as a substantial cushion above that minimum level, which I think market forces are pushing 'em to do that. I think market forces realize there's a lot more risk out there before, and so it's appropriate for there to be a much thicker capital cushion against particular risks. But then exactly as others have said, we want to kind of calibrate those against the risks that are out there, and at least the proposal so far I don't think doesn't really do much of a job of trying to do that. It's sort of a very long list of things, but without sort of the careful analysis of what could go wrong and, you know, when you start and so we have to realize we're at a much different capital position today than we were back 15 years ago, and so from that position, what are the potential unintended consequences? What might come of this? And so exactly as others have said, you know, when you do an economic analysis of these things, if you are increasing the cost of doing business, either there's going to be less of that business done or it's going to be more expensive or a combination of both. You know, looking at some of the issues related to the fundamental review of the trading book and the other parts as Governor Bowman mentioned, you know, this may make it more difficult for ranchers and farmers and others in agriculture to do their hedging. There might be fewer options available, might be more expensive, and it doesn't seem like the proposal really took that kind of thing into account, and there are trade-offs in that. Certainly, you know, robust and solid banking system is extremely important, but that's not the only piece we want to think, one, about overall financial stability, and as Governor Bowman mentioned many times, and as you know, something that is very much a part of what I had done in my analysis is that we've seen a lot of banking activities go outside of the banking system because capital has gone up. And to some extent that's perfectly fine. Not everything should be in the banking industry, but we have to think about what makes sense to keep in, and what makes sense to put out, and that's why you need to do the analysis. Banks can be very valuable in certain situations when they provide credit. There have been some analyses both the US Treasury or co-authors from the US Treasury as well as from the Bank for International Settlements and looking at times of volatility or crises, and it seems that banks are more likely to kind of stick with the borrowers rather than pull back and also then provide funding in the recovery phase, and so banks relative to non-banks. And that's something to take into account because

that's a part of thinking about financial stability, not just narrowly thinking about the bank capital base, but generally about, you know, all of the interconnections and also about how we can make sure that intermediation occurs both in normal and in stress times as effectively as possible, so if there is a negative shock that comes, we can recover from that. And so one of the bigger picture macro concerns I have is, could this have an impact on investment? And if it's raising the costs and lowering the availability of credit and in particular to groups that may be more focused on the banking system, do we then get less activity there, less investment? Without investment you don't get productivity growth. Without productivity growth you don't get growth of GDP, and so you really need to have that. And so that's one of the very big picture concerns that I have. Also, when you're just pushing things out into the areas where we don't have as much of a line of sight, it just becomes much more difficult to know what the financial stability consequences are of that. That's not saying, as I said, just because something has moved out of the banking system into another area that is not a prima facie argument against it, but we do have to think about, you know, since we don't know about those areas as much, what are the potential risks? At least list those out there and as much as possible try to get a way of getting your arms around that, at least thinking about what the potential risks could be. And I worry that by some of these rules will have the unintended consequences of taking the bank's role as shock absorbers and as market makers and reducing that role. I mean we've seen increasing incidences of flash crashes and such, and part of that is because banks have had to hold a lot more capital, haven't been doing as much market making. There's a legitimate question about, you know, what's the right trade off of how much market making should they be doing? What are the other activities they should be doing? But clearly there are potential costs to that and we need to take that into account. I just, I haven't seen that analysis, and I would hope in the next iteration, whether it's a formal reproposal or not, that would be a fundamental part of it, really thinking about those bigger picture questions for financial stability, those bigger questions for end users and not just the end users themselves, but also what that means for investment, productivity, and economic growth.

- Thank you, Randy. The Randys can rest now for a little while and we're going to turn over to Darrell from that other school across the bay from the one that would have me as a student. Darrell, how do you see the proposal as well as the G-SIB surcharge proposal affecting the liquidity provisions in key funding markets over both the short and longer term? And it'll be particularly great if you could let us know your views on the likely impact on the US Treasury markets, which have clearly experienced episodically liquidity challenges in recent years, and I think that may be an understatement.

- Thanks so much, Jelena, and you're always welcome at Stanford.

- You know, can I just say like when I was applying too, I lived in Stockton, California and I was down to \$50 to my name and this application to Stanford was \$60, application to Berkeley was 40, so you were \$10 too expensive for me, but we'll just leave it at that

- They priced you out of the market.

- [Jelena] Talk about market forces at work, right?

- Let me try to address your questions head on, Jelena. So this is always about a trade off between resilience of the banking system and the provision of credit and market liquidity, and I think I'm an outlier in the room in that I'm not disappointed to see overall risk weighted assets go up and risk-based capital buffers increase, and I want to explain why, and I also want to give credit to SIFMA for including all perspectives at the table, at least including mine, 'cause I'm very grateful to be here. So what about the impact on provision of liquidity in capital markets? Well, consistent with most or all of the comments here, I think, initially it's not going to be a positive impact. It's going to be an adverse impact on the provision of liquidity. And why is that? Well, as banks strive to meet higher capital requirements, the cost to their shareholders of expanding their balance sheets to accommodate their customers is going to go up, and banks are going to appropriately decline certain activities that don't meet return to shareholder hurdles. And so no controversy there. I think everybody's got that right. So why am I okay with it? Well, despite the trade-off effects, I think actually ultimately it's going to turn out pretty well for market liquidity, and let me explain why. In fact, I actually asked my PhD students to address this on their final exam in December and they, most of them got it right, so let me explain.

- [Randy Quarles] And the others are headed to New York.

- So what happens once all of this has been achieved and the Fed has nipped and tucked and adjusted to meet the various criticisms that you've all addressed and made the proposal more rational in general, in many details? Well, once risk-based capital is higher, funding costs for banks will be lower. I mean, creditors are not ignorant of the fact that safer banks are less likely to cause losses to creditors and they're going to charge lower funding spreads TLAC spreads will be lower. Equity market investors will demand lower expected return on equity as leverage risk adjusted goes down, so these are principles of Finance 101. Is it just a textbook idea? Well, I don't think so. If you look cross-sectionally over the largest banks, it's a bank with a fortress balance sheet that has lower costs of funding and is able to better compete to offer capital market activities to its customers. It's a bank with a fortress balance sheet that has not only lower funding costs but also lower costs of equity capital. If you look on the issue of gold plating and how this will cause US banks to be at a disadvantage relative to, let's say Europe's largest banks, well we can look backwards and we can see what happened in the last decade as the largest European G-SIBs basically were forced to give up a lot of their swap businesses because their cost of funding, those much higher margin requirements, prohibited them from being able to compete with the US banks whose funding costs were lower. The swaps traders directly consider funding value adjustments when they decide how much swap market provision they want to provide, so whether you look across US

banks or you look internationally, gold plating isn't all bad. It means that US banks in the long run will be better able to compete in capital markets and we'll offer more liquid markets. It doesn't mean that everything in this proposal is great. I mean, let's take the operational risk requirements, and as Governor Waller pointed out in his remarks, when he voted against this proposal, he noted that this implies roughly a \$2 trillion increase in implied balance sheets with respect to capital requirements, and it's not well connected in the proposal to the actual risks, that it's basically proportionate to risk weighted assets and there's not much in up risk that's directly connected, at least in evidence, to credit risk and market risk. So why am I not disappointed? Well, in fact, I already told you I think higher risk-based capital buffers are good and this is just simply going to raise risk-based capital buffers and in fact, its bluntness has this advantage that it's not penalizing any particular line of business much more than any other line. It's not selectively causing market liquidity to decline. Let's take another example, which is the overlap between the global market shock in the systemic capital buffer on the one hand and the new fundamental rule of the trading book requirements, which do address the same kinds of risks. Well, as Governor Bowman noted in her remarks, overlap is not really the issue. It's really are you covering risks in the tail with the sufficient amount of capital? And again, you already know my view, larger risk-based capital buffers are good. Let me turn to the second part of your question, Jelena, which is, what about the impact on treasury markets? Well, consistent with what I just said, I think initially it's going to be bad news. I think initially as banks strive to meet our capital requirements, they're not going to be able to expand their balance sheets in a COVID March, 2020 like event as much as they actually did, which was substantial. Eventually their balance sheets were full and they were not able to provide more liquidity to markets, and that means that once these new Basel III Endgame proposals suitably adjusted, if they require a lot more risk-based capital, then initially banks are going to, it won't take as large a shock to cause banks to basically stop providing liquidity to the treasury market and the markets could become dysfunctional even more easily in a shock of that size. So again, why am I not disappointed? Well, in the long run the treasury market is going to be much, much bigger. Banks are going to be well capitalized. They'll have lower funding costs for their treasury market activities, including the related derivatives activities and they'll be able to better deal with a major shock to market resilience. Moreover, because you're dialing up risk weighted asset based capital requirements, the supplementary leverage ratio, which is, in my view, very distortionary and adverse to the provision of liquidity in treasury markets, which is a safe activity and gets the same capital requirement under SLR or ESLR as a risky real estate loan. The SLR requirement will recede in terms of its binding this relative to risk-based capital requirements and we'll get more rational provision of liquidity in treasury markets. Better to get this all done in the next few years than wait until the treasury market has doubled in size, which isn't going to take that long. Next year alone, the government is projecting a 7% fiscal deficit. Treasury market is expanding very rapidly relative to dealer balance sheets, and if they're going to have to meet higher risk-based capital requirements, which do impinge on treasury market liquidity initially, then those higher risk-based capital requirements should be achieved before the treasury market doubles so that bank holding companies will be better able to provide liquidity to that market. So again, I think I'm an outlier here, but I feel pretty confident that once these adjustments that you're all

discussing have been made, higher risk weighted assets, more risk-based capital requirements will end up being a good thing for market liquidity and the competitiveness of the US banking system. Thank you.

- Thank you, Darrell, are you sure you're not from that other school across the bay? All right, we'll turn to Tom. Where's Tom? Oh, Tom is on camera. All right. Hi Tom. See how much fun you're missing in person. Tom, how would the Basel Endgame proposal impact the ability of corporate end users to raise capital and hedge risks? And in particular, what steps could the regulators take to mitigate potentially adverse impacts on the firms you represent?

- Yes, thanks very much, and I really want to thank the other Roundtable participants for referring to the effects on end users because I think that the regulators really missed that in developing these proposals. I've spent my career in US-based multinational manufacturing companies, and my colleagues on the operating side manage the supply chain that sources raw material, manages the risks of energy and other pricing and we hedge those risks for them in the corporate treasury, so we manage the financial supply chain and in reference to one of the earlier comments about the effect of these proposals being like an excise tax, certainly we can understand that if there were an excise tax on a raw material, my colleagues on the operating side would need to find some kind of an offset to preserve profitability. They would need to cut some other costs or they would need to raise prices, and the same thing happens on our financial supply chain. These proposals will certainly raise our costs, and we will have to find offsets or shrink the business that is being supported. So one of the other things that's somewhat inexplicable is how the US regulators put us at such a disadvantage against our foreign competition. When you look at the Basel III Endgame rules being applied in the European Union as an example, they preserved the exemptions that we won in this country with bipartisan support to exempt end user derivative trades from mandatory margining and central clearing, and on the European side, with the Basel III Endgame rules, they similarly have exempted end user derivatives from the CVA requirement for their unmargined derivative trades, and yet here we're subjecting our companies to those extra charges that distinctly puts us at a disadvantage vis-a-vis our European competitors. So I think that the regulators have often disregarded the effects on end users and having to offset these price increases that their rules will bring about. Let me give you one direct example that I'm sure everybody can understand. When we have daily borrowing requirements because we collect from customers, we concentrate that cash in our depository institutions and we send it out the door to pay our suppliers, our employees, and our shareholders, and to meet the day-to-day fluctuations, we're borrowing. For the large companies, they're borrowing in the commercial paper market, but ever since some of the disruptions occurred in the commercial paper market, we're having to back up our commercial paper issuance with committed credit lines, and so there are two pricing elements to a committed line of credit. One of course is the spread for borrowing over the index of SOFR in today's market, but there's also an explicit charge for the commitment of capital, and there will be a direct measurable increase in that charge, which the large companies borrowing in the commercial paper market will have to bear. But let's say we're not a large company in the commercial paper market

and instead are utilizing our credit line for day-to-day borrowing, in that case, there aren't two different pricing structures, one for the G-SIB lenders and one for the non-G-SIB lenders. All boats are going to rise on the same tide, and the fact that G-SIBs are going to be hit with cost increases from the regulators mean that there's got to be a market clearing price for them, and so all the other banks, even the ones that are too small to be directly affected by these rules, if they're in our credit agreement and many of us have as many as 20 or 30 banks in that credit agreement, they're going to receive the market clearing price that the G-SIB has to receive for being the leader in that bank. So I just would urge the regulators and we had a chance to meet with four of Governor Bowman's colleagues on Friday at the Fed board members and express these sentiments, and so finally, I support the recommendation others have made for a withdrawal of these rules and a complete rewrite that affect some of these fundamental problems. Thank you.

- Thank you very much, Tom. We'll turn to Michael from BlackRock. Hi Michael. How will these changes to bank capital requirements, particularly the trading book components of the reforms as well as the G-SIB surcharge proposal impact the asset management industry and investors more generally, and what do you see as the potential knock on effect for everyday American's retirement and other capital markets investments?

- Great. Well thank you for the question, and thank you for the opportunity to discuss the Basel III proposal with sort of an impact assessment from the lens of an asset manager. And so what is that lens to start? BlackRock as an asset manager is a fiduciary. We don't invest or trade on our own behalf. Instead we manage money on behalf of our underlying clients to help them, or the people they serve, achieve their financial goals, you know, saving for a home, child's education, retirement, and when we think about the Basel III implications, it's really not the impacts on the asset management industry. You know, we're not directly subject to any of the capital requirements on banks, but we are concerned about the implications ultimately for our underlying clients, and that's due to the market implications that many of the panelists here today have already spoken about. And so what I'd like to highlight are really two categories of issues. One is the overall impact of excessive capital levels on the price and capacity for intermediation generally, and then we'd also like to talk a little bit about the idiosyncratic impacts of some elements of the proposals and the G-SIB surcharge proposal in particular on markets for ETFs and derivatives clearing, and also elements of the proposal that could have uneven implications for different categories of asset manager client. So with respect to the overall capital levels, you know, we have, of course, aligned interests with regulators in making sure that the financial system in the US and the banking system in particular is sound and secure and we have strong risk management professionals that look at the credit risk of the counterparties we face, but they don't just look at the credit risk of counterparties on an individual basis. They're also considering the diversification of those counterparties, the concentration risk of too much business with any single counterparty as well as the liquidity risk in stress environments that could impact our client's portfolios. And so when we're considering that narrow

question around capital in the context of resilience, I think we agree with many of the comments made today that the reforms put in place by global financial regulators following the global financial crisis have made the banking sector materially safer; however, we're not convinced that simply putting more capital on its own into the system is really the right target for enhancing safety and soundness by itself. Rather, we think that the rules need to be carefully targeted so that you are incentivizing good risk management behavior with those capital rules, and that you're aligning the capital requirements in an appropriate way with risk and that you're not having an outsized impact on any one, you know, business line or client category that sort of isn't rational relative to risk. We also think that these rules need to be, you know, appropriately calibrated in their aggregate so they don't set capital levels so high that intermediation capacity itself is unduly harmed. And so what are the the impacts of these issues ultimately for our clients? Well, our clients rely on bank intermediaries to achieve their investment goals. We, on their behalf, face banks as trading counterparties when we go to buy or sell a bond in the market. We use banks as counterparties for securities financing transactions. We also rely on banks for access to markets, and one of the areas that we rely on that is access to derivatives clearing markets. So, you know, are the levels appropriately calibrated overall? Well, you know, I think that the number of the stats given today suggests that the proposal will have a dramatic increase on capital requirements, and we know from our own experience when capital requirements have increased in the past, that ultimately the costs that we pay for intermediation and the total intermediation capacity goes down, and capital is really at the heart of the conversations we have with our counterparties when we're seeking to negotiate fees, when we're seeking to increase the capacity of services on behalf of our clients. We know that capital isn't some sort of abstract principle. It's something that has a tangible impact on the overall costs for our clients. So ultimately, you know, the costs are borne by our end investors, right, because they face the actual costs of bid as spreads and financing fees on their portfolios. Now to the second area that we wanted to talk about around, you know, the idiosyncratic impacts. One area that we're particularly concerned about is the impact on clear derivatives markets, and we rely on banks to access clearing houses through generally bank affiliated clearing brokers. And we use these clear derivatives markets ultimately to hedge credit and interest rate risks in our client portfolios. Now, the G-SIB surcharge proposal would materially increase the cost of banks providing agency clearing services by including agency clearing and the inner connectedness and the complexity categories of the G-SIB surcharge score calculation. Now, promoting clearing of derivatives has been a policy priority for regulators since the global financial crisis and for very good reason. You know, I worked in our legal team when we went through Dodd-Frank implementation and the whole industry went through an effort to unwind, you know, complex bilateral contracts and replace them with standardized, net-able contracts cleared at a CCP, and these contracts are then subject to centralized risk management at a CCP that poses initial and variation margin amongst other tools to mitigate credit and counterparty risk. You know, frankly it just doesn't make sense for policymakers to disincentivize clearing by imposing capital requirements that will materially increase those costs, and the estimates are that the Basel III Endgame proposal, along with the G-SIB surcharge punitive impact could increase capital requirements by about 80% for these businesses, and

that's a large enough amount that it would be passed on to end users. But we also have concerns, not just about cost, but about the systemic risk implications. If banks exit the agency clearing market, we are concerned that that could further concentrate risk among a smaller pool of clearing brokers, which could undermine, you know, key default management tools like porting in the event of a default, or leave market participants on the sidelines unable to hedge risk if they don't have sufficient access to these markets. Now the other area of the G-SIB surcharge calculation that hasn't maybe been getting as much attention is also the implications for markets for exchange traded funds. So exchange traded funds offer low cost and convenient ways for market participants to access a variety of different investment strategies. ETFs have made it easier and more affordable for almost all types of investors to allocate their capital and manage their risk, and ETFs due to their liquidity where they both have access to primary market liquidity and the ability to redeem shares directly through APs as well as secondary market liquidity and all markets on exchanges have shown to be extremely resilient during times of market stress, which is why many investment managers turn to them to hedge and manage risk in times of market volatility. But also over 16 million American households invest in markets using ETFs, so this isn't sort of a niche, you know, issue. Now, unfortunately, the capital rules in place today penalize market making and ETFs by treating them with more punitive capital treatment than the actual underlying assets they hold, and the G-SIB surcharge proposal exacerbates this uneven treatment by labeling ETFs as financial institutions, essentially capturing them in the interconnectedness component of the GSIB surcharge calculation. You know, the end result is likely going to be less intermediation by banks, leading to wider transaction costs for end investors and for no particular public benefit as that punitive treatment of ETFs is not aligned really with the risks they present, which are the risks of the underlying assets which they hold. And then finally, I do want to flag a point that Joseph raised in the introduction around potential uneven treatment for different types of clients of asset managers. And actually one of the things that we think is highly rational about the Basel III proposal is the idea that there should be differentiation of risk weighting by different client types, right? If you're facing a client that's low credit risk, that should be accounted for versus a transaction with a client with a higher credit risk. Now the flaw in the proposal is that it puts forward the public listing of a company as the litmus test for its credit worthiness, and we think that, and we know from our own experience that we have numerous clients that are subject to a high degree of regulatory oversight, transparency in terms of their financials and you know, often with liquidity and leverage requirements that simply don't have listed securities. And so why implement a regime that kind of unfairly increases costs for those classes of investors, mutual funds, pension plans, certain insurance companies relative to other clients. So we'd urge, and I think many of comment letters have put forward alternative proposals for addressing this uneven treatment. So in conclusion, returning to the question, you know, what are the implications for retirees? Well, yeah, we definitely think that's at the heart of BlackRock more than half the assets that we manage are for retirement. We help about 35 million Americans invest for life after work, which amounts to about a quarter of the country's workers. And higher transaction costs and fees over time erode the hard earned savings of our clients, and ultimately policies that disincentivize the hedging of risk using derivatives or ETFs also inject more risk than is

necessary into portfolios and into the system as a whole. Now we believe these are unintended consequences, and we hope like Darrell indicated that many of these would ultimately be addressed by a final proposal, and we'll continue to work with regulators to engage on behalf of our clients to improve outcomes for both our clients and markets as a whole.

- Wonderful, thank you Michael. Susan, we'll pose the same question for you. How do you see the proposal impacting investors in the markets more generally? In addition, given your role heading up Muni trading for Alliance Bernstein, what impacts do you see from the Basel III proposal on that market, please?

- Thank you, Jelena and SIFMA for giving us the opportunity to speak here. I'm going to echo a lot of what Michael said about how we see this impacting our end clients as an asset manager, that is where our focus is on these rules. So our ability to serve these clients and hedge risks on their behalf depends on our ability to access critical services provided by the banking organizations in a cost effective way. These services include market making activities, derivatives products, custody and security settlement, fund administration, treasury and collateral management services, and securities brokerage and execution services. And US banks are our largest trading partners and liquidity providers across most of our business lines, and as fiduciaries on behalf of our end clients, we have a responsibility to those clients to access key markets during both high and low volatility regimes to meet client liquidity needs and investment objectives. Like a lot of the people who've spoken already today, we worry that the ripple effects across the banking business will force all banks and others to reconsider allocations to capital intensive businesses. The impact of this move may result in reduced competition, concentration risks, higher fees, and lower liquidity for our clients. One example focusing on, you know, derivatives clearing and futures clearing. In particular, we are seeing that as likely to come under increasing stress if the proposal goes through as written. Clearing has increased the stability of the financial system for end users of cleared derivatives products, and these are our clients as an asset manager, insurance companies, pension funds, retirements, retail investors. We are concerned that these imposed frictions will lead to higher fees and that some futures clearing merchants exit the business as a result of that further concentrating the risk, as Michael pointed out, and there's only a handful that currently account for the vast majority of these transactions, so further concentration just increases risk in periods of stress. Now, specific to the municipal market, it's worth noting that the main investor in the municipals market is US retail, and our concern around the proposal as it relates to municipals is around increased costs passed on to the end investor as well as access to liquidity in those periods of volatility. During those volatile periods, you tend to see municipal investors, because it's a crowded market in a very similar type of investor, they tend to behave in a very similar way. So when liquidity is needed, there is not always that other side of the trade, and so we need to rely on liquidity from the banks predominantly, and over the past few years, we've seen an overall reduction in balance sheet as it relates to higher costs. We've seen major players in the municipals market exit altogether. So as that trend continues, we see risks in the

form of this proposal in the overall higher transaction costs that will be passed on to our end clients, friction in day-to-day activity and our ability to serve those clients' needs, and our ability to help them achieve what they're trying to do in a period of a heightened volatility. Overall, we recommend that the rules in general be reconsidered and ideally rewritten. We definitely see a lot of value in providing stability in the financial markets and we just have concerns around how this will impact our end clients. Thank you very much for letting me speak.

- Thank you Susan, very much, and we're at the tail end of the first panel. Before we turn to the second panel, which will have no Randy's but will be superiorly moderated by my dear colleague Jonathan Gould. I wanted to see if the participants from the first panel would like to take a minute or two to offer some closing remarks or additional thoughts to the questions asked. And don't make me do a Socratic method. Well, you don't need to all rush at the same time.

- I have a question. Can I ask a question?

- No, next. Go ahead.

- So for Darrell, and as I've known this is your view forever. Many people who my respect have exactly the same view, so, but is there no optimal level of capital in your framework? I mean, if one pill is good and two pills are better, is swallowing the whole bottle always best?

- No, because a lot of the liabilities of the largest banks are actually providing direct services beyond the credit. So for example, deposits, banks offer deposit services to their clients, so you can't, if you put enough pills in the bottle, you drive deposits to zero, and that's not good. Similarly, swaps, swap liabilities are a very substantial portion of the liabilities of the G-SIBs. You wouldn't want to drive those out because they're very valuable hedging services. So up to a point, a few more pills in the bottle would be good, but then you don't want to put too many because you start impinging on the services that liabilities provide to the customers of the largest banks.

- So your view is there can be too much capital for a bank to be a bank as opposed to a pool of assets, but we just aren't there yet.

- I don't think we're there yet. I mean it's not as though we haven't seen any banks ever collapse.

- Darrell, don't mind Randy's question. His wife went to Stanford. This is personal. Did I hear a question, Joe?

- Yeah, so from a SIFMA perspective, and we very much appreciate your view quite frankly and very thrilled to have you here, and I guess, you know, quoting the famous economist that, you know, "In the long run we're all dead," right? And a lot of people may be alongside the tracks in this as we get to the long run. Are you concerned at all, 'cause I think in this industry, and I can only probably speak anecdotally, but you know, as we've seen regulatory change over the last 15 or 20 years, we definitely see many faces and firms around the SIFMA and the old SIA board table go away, and so it's very hard, and some would say markets have become more concentrated and it's very hard to sort of see where that capacity comes back. We've had a series of, whether it be financial disruptions or regulatory interactions that have caused people to leave marketplaces, prices to change and so on, and that capacity doesn't come back. There's some economic theory that, "Oh, the small guys will come in." The small guys never come in. They can't get over the infrastructure hurdles to build. So how do you deal with that interim step as you move into the long term and when you get to the long term, will you have the same capacity and the same dynamics that you had before the disruption started?

- That's a question, Joseph, and it does concern me that concentration risk may be exacerbated as only the richest and as most well capitalized banks are able to deal with this transition and the less well capitalized banks might drop a significant marked amount of their services. An example that concerns me, for example, is the central clearing of treasuries, which I'm all in favor of because it's going to use dealer balance sheets more effectively, but what it might do is cause those dealers to have higher funding costs to pull back from central clearing. So you have this kind of paradox, which is, if everyone were meeting all of these higher capital requirements already, we wouldn't have such a concern about concentration, but in the transition it might be exacerbated, and I think that's why the regulators will probably want to think very carefully about the transition and how to tailor these capital requirements so that there does remain a vital amount of competition in capital markets.

- Randy K?

- [Randy Kroszner] But how do you do that?

- [Darrell Duffie] I mean, it's easy.

- You know, I'm very sympathetic as you can see from my remarks, it was just trying to get the, you know, thinking about the tradeoffs, getting the trade-offs right, and I'm not opposed to higher capital on things that are, are riskier if, for some reason there's an externality, and the markets aren't pushing them to do that, so I'm totally on board with that, but I agree that what you said as sort of an idea, but I think it's very hard to get there. I mean, so how would you think about that trade off to make sure to maintain the kind of the robustness of the overall market and and market participants but achieve what you want to achieve?

- Well, I think some of you have already mentioned some of the fixes that are needed that might help address that, like Michael for example, and Randy and others have mentioned that the counterparty capital requirements associated with derivatives are not effectively allowing banks with higher funding costs to manage their clients. And Michael mentioned specifically the issue of concentration risk that might be addressed by tailoring or adjusting those CVA requirements so as not to penalize the ability of a bank to provide clearing services to multiple clients. So that's just one example, but you know, it's not going to be simple, but .

- All right, even though you're from Stanford, I'm going to save you by calling an end to this first panel. It is it 11:05. We're going to return for panel two in 15 minutes at 11:20, and I cannot guarantee you how entertaining the discussion will be, but it will for sure be educational and it will take a deeper dive on these topics, so thank you and we'll take a short break.

- Welcome back. We will now turn to our next panel of the day, a deeper dive on the capital markets components of the proposal, identifying challenges and potential solutions, which will be moderated by Jonathan Gould. Jonathan is currently a partner at Jones Day and previously served as a Senior Deputy Comptroller and Chief Counsel of the Office of the Comptroller of Currency. Jonathan, over to you.

- Thank you very much Joe, and we're going to be continuing our string of unbroken and spirited discussion sessions thanks to a group of great panelists. I won't introduce them individually, but I encourage you to look on the SIFMA websites for their illustrious biographies. So as Joe mentioned, we're going to start with an overview of some of the concerns raised in the capital markets area, particularly around the FRTB, securities financing transactions, credit valuation adjustment and OP risk. First off, we're going to get a sense of the size and scale of the impact on markets, participants, and users in the real economy, particularly in the absence of the regulators doing this work that the public has really had to step up as noted to provide this typically kind of conditioned precedent to a compliant rulemaking process and inform the output of the rulemaking. Then we'll talk about the fixes that could be made to address some of these potential issues with the proposal in the capital market space. That's the good news. I think that there are fixes that can be made, but I would just caveat that by saying and suggesting that the the last panel will address this more broadly is that there are overarching structural complications with the proposal that need to be addressed too, and some of these overarching structural flaws really transcend the four corners of the actual Basel III Endgame proposal. So without further ado, let's kind of start off, and Dylan, I'd like to ask you a question about kind of the market impact. 'cause I know you focused on this. So you and your colleagues at Oliver Wyman have worked to assess the impact of the proposed changes on the wholesale banking business model. How will wholesale or dealer banks be affected, and what types of business lines would be most heavily impacted? More generally, how could these changes impact credit provision in the real economy?

- Thanks, Jonathan. It's obviously a broad and big question, and just by way of background, I lead our corporate and institutional banking advisory practice, so the lens that we look at this through is really around how this will impact the CIB business, which is the broad sweep of wholesale banking businesses. So we actually maintain a bit of a database that looks back at the last 10 or 12 years of data around capital and capital use through the RWA lens of all the major dealers, and just looked through the overall economics of those businesses. And so what we did very simply was we took the rule set or the proposed rules and some of the estimated impacts from that and applied it to that data set to look at what the impact would be for a specific business, which the agencies didn't really look at that specifically. They looked more broadly at risk stripe and then the overall bank, and I think it sort of stands to reason that when you think about the composition of a CIB business, which generally is going to skew more towards market risk, more towards CVA, that the uplifts are going to be more dramatic for a CIB business, and that's indeed what we found. So for CIB businesses overall, we saw an uplift in our RWA on the order of 35%, some cases a little bit higher. If you look at the overall impact on G-SIBs, it was more like 24% at the bank level, so you can see some of the differential there. There's two interesting takeaways from this. One is like what's going on under the hood of that 35%? So you start to see some pretty big variations and I'll come on to talk to that as well, but also the big gap that you end up having between other jurisdictions and the way that they apply these rules. So we also have this data that it's not just US banks that we look at. We also look at European banks. We look at banks outside of Europe as well, but we felt like Europe had the biggest sample sets. We looked at the comparison between US and European banks and actually if you look at Basel III, the equivalent Basel III Endgame for them, you're only talking about, you know, 13, 14, 15% uplift for those institutions. So you see this huge differential between the impact on US players and then European players, which we think has some competitive impact but also has, you know, kind of an existential impact on some of the activities that take place there. I mentioned before that the product level impact is really where the action is, and I think if you scan through this and think about how different businesses are set up and the types of RWA that they consume, you can start to see where the big impacts start to play out. And so you have businesses like cash equities that could have a doubling of their RWA under these these rules, and that's simply because it's only operational risk. It's only market risk that's in play, and those uplifts were in the, you know, very, very high double digits overall. So when you start to apply that, I think you could logically say, "Okay, the regulators targeted a few businesses. They said we want these businesses to hold higher levels of RWA," but it is sort of a networked system, and I think that's an important consideration to take into here because if you look at the banks CIB businesses and then beyond, you know, kind of the G-SIB CIB business is the relief valve that they have, the way that they will actually be able to reduce the pressure on overall RWA is through the big consumers of RWA today, and that's actually on the market side. That's prime services. That's rates and businesses. On the more traditional side, that's the corporate lending and even commercial lending businesses when you start to get into the US regional banks. So I think there's very limited sympathy in the discussions that we've had with regulators and other market participants around the unit economics of CIB businesses. No one seems to really care and I guess that's just the state of play in the

market, but there's been a lot more sympathy and a lot more interest in the discussion about how might this affect the direct credit provision and market liquidity provision activities of those businesses, so that's tended to be more where we focused our attention in, you know, kind of our analysis and the debate. And I think net, when you look at the overall, you know, effectiveness, we expect to see a few things play out in the market. I think one is there will be reduced levels of credit and liquidity provision from these these institutions. It just stands to reason that if you have to hold more capital, and these institutions probably have a limited budget for how much more capital they can put against their activities. They will reduce some of the activity, and then there's a question of does it go away completely, or does it go elsewhere? And we see, you know, certainly some avenues for it to go elsewhere, but those are going to be players in the non-banking sector who have a very different view of providing liquidity through crisis periods, stress periods, and through the recovery to Randy's point earlier. I think there's also the question of just activities that are inherently bank activities which are now going to become more expensive. Those ones are much, much more likely to either go away entirely or to get very concentrated in a small number of banks who can really afford to provide those services. So that's a very quick sweep through what we found in the analysis, but I think, you know, kind of the big takeaways were big differential between CIB businesses and then banking as a whole, and then an even bigger differential between US providers of these services and non-US players.

- Thank you very much for that, Dylan, and your observations too on the differential impact across jurisdictions I think really goes to a question that Jelena was asking in the last session, namely, you know, is this consistent with the goals of Basel around consistency and comparability across jurisdictions? I think we have a, you know, empirical answer to that. Adam, just, you know, moving to you, so PWC has also done work to assess the potential impacts of the proposal on key parts of the capital markets, including securities financing transactions and derivatives trading, and has also looked at the impact of the operational risk framework on capital markets services. Can you talk more about your findings regarding these expected impacts?

- Thank you Jonathan, and thank you SIFMA for having me. I wrote some of the original Basel rules when I was in Basel back in the early 90s, so you can never escape your past, so it's only fitting that I'm here 30 years later still talking about it, so I appreciate the opportunity. I'll tackle operational risks first because it's so consequential, and bear with me, I'm going to give about three minutes to each operational risk, SFTs, and derivatives. It was already mentioned by other panelists that the operational risk increases substantial, I would say gargantuan at about \$2 trillion of risk weighted assets. So it's obviously a huge impact when you inject that into the standardized approach, which for most banks is a binding constraint, so it obviously increases capital requirements substantially. What I want to do is take you into the mechanics of some of the rules because that's where you see the interaction of the mechanics with the calibration, brings forward competitive issues, increase in costs, complexity, and incentives for behavior that will affect how this applies, and gets implemented going forward and what the impacts ultimately are.

So I just want to bear with me as I take you into to some of the complexity of the rule. So the operational risk mechanics, it's a function. The RWA is a function of two components, the business indicator component and the internal loss multiplier. The BIC is a complicated formula that would give any Rube Goldberg machine a run for its money, but essentially it has three sub-components related to net interest income, fee income, and trading revenue that, when combined end up being a very close proxy for size and total revenue. The ILM as it's known, is really a scaler applied to the BIC to increase capital requirements for firms with higher historical operational risk losses, and in the Basel formulation, to scale down requirements for firms with low operational risk loss history relative to their size. So while the application of the BIC is consistent across jurisdictions, the treatment of the ILM varies with implications for the competitiveness potentially of US banks vis-a-vis their European and UK peers. So for example, the UK and the EU both exclude the impact of the ILM by setting its value to one. The US not only includes the ILM but also gold plates the Basel framework by flooring the ILM at one. By applying a floor, the US proposal punishes firms essentially with higher operational loss history, but does not allow for the roughly one third of firms with an ILM that would have been below one to benefit, and these are estimates from ORM, so it's asymmetrical. So as proposed, US banks would have to hold higher operational risks, RWA, than their foreign counterparts generally. And Jonathan, this gets to your point about the level playing field, and their RWA would be sensitive to increases in operational risk in ways that foreign counterparts don't need to consider. So the calibration of the operational risk calculations also raise conceptual soundness issues. In our analysis, we evaluated the historical relationship between observed loss and level of RWA required by the proposal. And based on that analysis, operational risk would require substantially more capital as compared to historical loss levels, including and in stress. Our analysis showed that the proposal requires firms to hold five times more capital than the maximum losses occurred over the most stress two year period observed. And I think that just begs the question, what's the standard that's trying to be achieved here from a calibration standpoint? And it just raises the question, why are banks required to hold so much additional capital relative to the worst historical operational losses? Putting this together, there are some key points for the capital markets. The structure of the operational risk RWA requirements penalizes firms with fee-based businesses that are often lower risk. That's been mentioned before, which runs counter to the goal of having more risk sensitive capital requirements, and this is because the BIC includes service component without a cap or an offset of expenses to fees. And given the inability of the ILM to go below one results in substantial capital charges on lower risk, fee-based businesses such as wealth and investment management. More broadly, the approach is definitionally backward looking, missing forward looking changes to risk profiles or other improvements made to operations so that they're not fully considered. The effect of structural changes in the market, and some have been mentioned today, that tend to reduce operational risk, there's more straight through processing. You have centralized clearing, you have short settlement cycles, they won't be fully factored in. In addition, the increase is on top of the operational risk capital requirements firms hold as part of their stress capital buffer. And I think Randy mentioned this earlier, Randy Q, creating the potential for operational risks to be capitalized in two components of the capital stack. And finally, given

that the BIC is a close proxy for size, the methodology functions as an effective tax on size, which already exists in the form of the G-SIB surcharge. So when the rule is implemented, operational risk capital will be allocated to each business, increasing hurdle rates on all activity, and I think this is what Dylan's getting at, and Darrell mentioned this as well, and these increased costs will be passed on to consumers in US firms, will potentially risk losing market share and especially in globally competitive markets. Let's discuss SFTs, but also consequential for broker dealers is the impact of the Basel Endgame to securities financing, which include repos. Included in the proposal is a haircut floor for certain SFTs, which acts as an effective requirement on margin, and when executing an SFT with an unregulated financial institution, a bank requires the loan to be collateralized, but if the collateral amount exceeds the haircut, then the bank can recognize the collateral value and significantly reduce the exposure amount for purposes of calculating RWA. However, if the haircut minimum is not met, the transaction is treated as unsecured, meaning the entire exposure is risk weighted. Capital requirements could vary by millions of dollars depending on whether an SFT transaction meets or falls below the haircut threshold. Additionally, our banks are faced with several operational challenges to solve, defining which counterparties are in scope as unregulated financial institutions. The proposal refers vaguely to non-bank financial entities, hedge funds and private equity, but ultimately banks would need to come to an internal determination on the population of UFI. Managing exemptions, the proposal offers three types of exemptions that managing these would require banks to rely on representations made by the UFI or requiring the UFI to agree to certain contractual terms or the bank would need to maintain sufficient written documentation regarding the purpose of the transaction without any clear guidance on what is or what is not sufficient. And there's a monitoring of netting sets. We know that netting is an important part of managing your counterparty exposure and risk-based capital. If in scope transactions are bundled within netting sets, the proposal requires the haircut floor to be applied at the portfolio level. Complicated stuff and really complicated for the banks to start to go in and break apart those netting sets. The implications for capital markets here again, the EU and the UK banks are not going to be subject to a haircut floor requirement. These transactions potentially could migrate to other firms if they're not required to charge additional margin to meet the haircut minimum. Also, the operational complexities may lead to concentration of counterparties if banks decide these requirements are too onerous or costly to implement. A bank's infrastructure would likely require significant investments to improve margin management, documentation practices and governance as well as a full review and monitoring of netting sets that may contain in scope transactions. Taken together, these considerations could lead to a reduction in SFT financing by US firms, and this raises a general policy question, does it benefit the US financial stability for these financial transactions to be booked in other jurisdictions? Finally, let me get to derivatives. For derivatives, the proposed rule significantly increases the market risk capital and CVA requirements for trading positions. I'll leave aside FRTB and focus mostly on CVA. Similar to SFTs, these capital increases can be more directly tied back to individual transactions rather than something like the operational requirements that apply across the bank and so can be expected to have more direct impacts on transaction pricing. The proposed rule itself estimated the impact, the changes to increase risk weighted assets by approximately

\$700 billion, again, a huge number, and roughly speaking that that equates to a need for approximately \$80 billion in additional capital across the banking sector. We have a forthcoming paper that we'll be releasing soon, and we use publicly available data to try to estimate how these additional capital requirements could impact the cost of derivatives. Inherently that analysis requires certain assumptions, but at a macro level it indicates that, for a corporate looking to hedge the variability of interest rates on a billion dollars of borrowings, costs could increase in the order of a million dollars a year. And Tom, I think earlier highlighted this type of effect, and with trillions of dollars of corporate debt outstanding, you can see how the cost would rack up. When we think about the global perspective, similar to SFTs, there's a competitive disadvantage compared to the EU implementation of the rules. The proposed rule does not contain the EU's exemption for calculating CVA capital on exposures against non-financial users and pension funds, which will bring transaction by those parties into scope for US banks. The proposed rule also does not contain the US exemption for calculating CVA capital on client clear trades which Michael and Susan mentioned, which is ironic given the regulatory push post the global financial crisis to move the majority of derivative transactions onto clearing to reduce systemic risk. As a result of the push, about 80% of interest rates swaps are now cleared. The EU implementation also provides firms with a two year longer runway to implement at least now increasing the time to build up the incremental capital required and the glide path for EU firms ends at a more beneficial point with their capital requirement floored at 72.5% of the standardized approach, rather than the US, a 100%. The bottom line is that to maintain returns under these increased capital requirements, US banks will need to recover approximately \$10 billion in costs annually, and these costs will likely end up being borne by non-financial end users, pensions funds, and other marketplace participants on top of their existing burdens, costs which their competitors in other jurisdictions may not have to incur, that significant impact. That's real.

- Yeah, thank you for that. I mean, it sounds like really our problems can be solved. We just introduce a few new scalars, particularly if they're denoted by Greek letters. No further problems.

- All all kidding aside though, I think going inside the mechanics and apologies if it's boring, with capital geeks like that stuff, but it shows you what the levers are to pull and where the rule can be adjusted to address competitive imbalance, adjust over calibration, so you really need to go into the depths to see that and it gives the, the US regulators a path.

- So we're going to turn a little bit to hear from some of the market participants here who you know, are really well situated to talk about impact and then also to discuss, you know, potential solutions. So starting with David, how would the proposal impact the securitizations markets and by extension, how could it affect the provision of credit in the real economy, including mortgages, credit cards, auto loans, and small business financing, and what changes could be made to mitigate the potential negative impacts on these markets?

- Yeah, thank you for the question Jonathan. This is a critically important issue because, as currently proposed, the rules will have a direct impact on the cost consumers pay for mortgage, auto, and other credit as well as the cost many US corporations pay for credit. Just to frame the issue, the Fed's household debt and credit report for the fourth quarter of 2023, pegged total household debt at \$17.5 trillion in the United States comprised primarily of mortgage, auto, student loan, and credit card. The majority of housing debt is financed through MBS, and the proportion of non-agency mortgages that are largely held by non-bank originators, but actually financed back on bank balance sheets using securitization structure. Similarly for autos, credit cards and private credit student loans, much of this paper is originated by non-banks today, but again, financed either through ABS, or in warehouse lending facilities, what we call loans and securitization, provided by banks using securitization structure. Many commercial exposures such as rental car, fleet leasing, and aircraft leasing also rely significantly on securitization markets, and bank balance sheets using securitization to finance assets, and these businesses also touch the US consumer. Securitization offers originators of all of these assets an efficient means of financing, which is critically important to the cost consumers pay for the underlying loans. This efficiency is at least in part a function of the conservatism with which securitization, bank lending, and rated bonds are structured, which allows banks to lend or hold the paper efficiently, albeit with already conservative levels of capital today. The Basel Endgame rules will dramatically change this, increasing capital requirements for banks for the same risk they hold today, in some cases, two to three times or more, and asset-backed securities and mortgage-backed securities can be multiples of this, which will lead to increased cost for funding and ultimately to increase costs for the rates that US consumers pay. To put it simply, if an auto lender can finance their loans at treasuries plus 150 today, but in a future state, it costs that same auto lender treasuries plus 300 for financing, it follows that the cost of that auto loan to the consumer will have to increase. The Basel III Endgame rules for securitization as currently proposed will lead to this outcome, increasing the cost of credit and potentially decreasing the availability of credit to US consumers and businesses. While there are a number of changes to the calculation that are also important, the primary change that will lead to increased capital for banks holding securitized exposures is the increase in what's called the P factor from 0.5 to 1.0. This is an input into the securitization standardized approach or SECSA, which is the only approach that US banks will have under Basel III to calculate risk weighted assets for securitization exposures. International banks will still have the option to use external or internal ratings based approaches. The P factor is essentially the capital add-on or capital penalty assessed on banks for holding assets in securitized form. To use a simple example, today if a bank held student loans on their balance sheet that required \$10 of capital, the 0.5 P factor means that if we took those loans and just put them into a securitization trust, and the bank held all the pieces, the bank would actually have to hold \$15 of capital, 50% more on that same portfolio of loans. Doubling the P factor to one means that same bank will now have to hold \$20 of capital or two times the amount of capital they currently hold today. This can have a dramatic effect on the amount of capital banks will need to hold against securitization exposures, and this is on top of already conservative capital levels for the risk given the impact of SEG, SCB, and G-SIB, among others on the largest banks. In some cases this

can result in capital in excess of the market value of the exposure. In addition, because the G-SIB add-on is based on a bank's RWA footprint, the largest banks face an incremental penalty as the increased securitization RWA footprint on these exposures will also lead to incremental G-SIB capital for the same risk banks hold today. Banks generally participate as holders of securitization exposures in three ways. Bank affiliated broker dealers provide liquidity by making markets in ABS, MBS, and CMBS. Bank Portfolio Managers and Chief Investment Offices purchase these bonds for portfolio and banks provide liquidity in the form of warehouse lines to non-bank originators of consumer and commercial assets, using securitization structure to legally isolate the assets from the bankruptcy risk of the originator. In all three forms banks will, in many cases, require more capital against the same exposures. This will likely lead to increased bank lending rates and bank investors requiring higher returns or possibly more concerning, a significant decrease in bank provided liquidity to this very important market. Because the standardized approach is not risk sensitive to the underlying asset, it also may result in some perverse outcomes. As an example, if we look at bank securitization financing and the same will hold true for securities, but there are nuances there given the application of the rules to thickness of tranche sizes in securitizations. In general, the amount of securitization financing relative to the amount of the underlying collateral or the loans is sized based on, among other things, the expected losses of that portfolio of loans. Banks set the amount of excess collateral they require based on a multiple of the expected loss on the underlying loans in order to protect against any underperformance. Logically, banks are willing to lend at a higher advance rate against portfolios of loans that are expected to suffer lower losses and a lower advance rate against portfolios of loans that are expected to suffer higher losses. For example, a bank might lend 87% against a pool of prime auto loans expected to suffer low losses and 75% against a pool of near prime or subprime auto loans expected to suffer higher losses. Because the standardized approach is a blunt instrument and doesn't look at the risk of the underlying assets, it would actually require the bank to hold more capital on the loan against prime assets even though these would be considered "less risky". It only looks at how much excess collateral you have. As an example, based on typical advance rates today, a bank loan against both prime and subprime collateral would be at the 20% RWA floor given the relative advance rates. On the proposed rules, the RWA and thus the capital required for a loan against prime auto loans would more than double while the RWA for subprime loans actually would decrease to 15% given the relative advance rates. This could create perverse incentives where banks seek opportunities to lend against higher loss collateral because the capital footprint is less, and the return on that capital is higher. It will also lead banks to require some combination of more collateral and higher pricing to finance prime assets, which will increase the cost to consumers. Currently the doubling of the P factor with no change in advance rates can, in many instances, lead to two to three times the amount of capital for banks financing, mortgages, auto and other asset classes. There's a nuance in the calculation for securities related to how thick or thin the bond tranche is, but it will lead to the same outcome. One counter to all of this that has been widely publicized is that the rules have actually reduced the RWA on many retail exposures, which in some cases they have. Certain categories of lower LTD mortgages and retail exposures like consumer loans do have a lower RWA under the new rules when they sit on a bank's

balance sheet although, as Julie Williams highlighted earlier, the level of complexity with respect to the categories for mortgages has increased significantly; however, the doubling of the P factor more than offsets this reduction once the loans are put into a securitization. The capital rules as they currently exist have already pushed a significant portion of consumer and commercial lending into the non-bank market; however, as I said earlier, these non-banks continue to rely on banks to provide financing and this financing comes in the form of securitization. This will likely further push mortgage and other consumer lending into the non-regulated or less regulated non-bank markets where non-banks already provide nearly 80% of agency mortgages to Americans. It also creates a significant disparity between the US rules as proposed and the much lighter RWA footprint securitization has in European markets, unleveling the playing field. These are critically important issues created by the super gold plating of the Basel proposal by US regulators. There is no quantitative analysis that we have seen showing risk on securitized exposures has been increasing, requiring more capital. On the contrary, markets actually function quite well today with quantifiable known risks and sophisticated banks and investors were able to assess and price that risk. There's one related point that I'd like to highlight also, which is related to synthetic risk transfer. This is important because if done properly, this could be an effective tool for banks to recycle their capital in an efficient way by syndicating risk to sophisticated investors, which achieves two things that I believe should be supported. It reduces risk that banks hold on their own balance sheets, and it allows banks to free up capital which they can use to facilitate additional lending. I believe the regulators have an opportunity as part of this exercise to clarify the rules and create a well-defined pathway for banks to achieve both of these things.

- Thank you very much David, and I think I saw some head nodding from the colleague sitting next to you, so maybe turn to Andrew. Let's talk about some of the specific product types that might be most affected by the FRTB, CVA, and SFT portions of the proposal. What products do you see as most likely to be affected by the proposed changes, and what do you see as the likely knock on impacts of these changes on American businesses and consumers?

- I'll open by acknowledging I was nodding a lot during David's remarks, and I think that actually David's remarks are a really nice setup for the broader conversation we're trying to have today in that David really bore down deeply in a specific kind of product and service that's offered by large banks in talking about the knock on implications for end user pricing and market access, and I'll talk a little bit more generally, but I think the same principles apply. I'd also like to acknowledge Adam's reference to the levers in the capital framework as well as Randy Quarles' references to there being possibly too many pills in the bottle and the metaphors, but we'll talk about the levers and pills, I think, in the course of my remarks today. I would start with kind of the foundational principle that's been alluded to a few times this morning, including by Randy Guynn and his remarks on the first panel, which is that banks are transmission entities in the economy, and so if you think on the credit side that is the banking book side for loans, it's relatively intuitive and simple to think about how that effect works for a loan, for example. So for a loan

the bank would look at its cost of equity, its cost of deposits, and the relative credit worthiness of the borrower as David also alluded to, and come up with a formulative factor, what is the interest rate to be charged? On the trading book side, there's a very similar analysis, but it's a little bit harder to get to but it's still there, which is simply what is the cost to the bank from an equity perspective of making markets in the capital markets, and that has implications for all sorts of products and services. For example, providing interest rate hedges to corporates, particularly where they're impacted by CVA charges for example. An example I'll talk about in a little bit more detail today is making markets in corporate debt, and so for example, if FRTB had the structural effect of penalizing a certain category of corporate debt issuer, that would have knock on implications for the relative market liquidity, and then of course there's all sorts of investor access fact patterns, particularly for pension funds and other asset managers with real money. Joe, in his opening remarks at the start of the day talked about the 75% projected increase that's excluding ops risk and CVA, but just focusing on FRTB. So when you think about all this, these broad effects, they're certainly out there. I talk about kind of what are the consequences in terms of where this goes, and broadly speaking, I think when you raise capital requirements in the trading book, there are three possible outcomes, and I'm honestly just summarizing remarks that have been made earlier today, so this isn't very original, but I think maybe enumerating them one, two, three is helpful for just clarity and kind of confirming. So effect number one is an increase in cost. That's what David was talking about in his example. If you have the effect of raising requirements for certain trading book activities, there's a transmission effect that results in higher costs for end users and consumers. The second effect or potential effect is investors simply don't invest or don't hedge their risks, and so the relative cost of taking out insurance or taking an interest rate hedge is an economic calculation, and if you simply get to a point where it's no longer economic to make that risk mitigating or investing decision, you'll simply forego it. The third, which has also been alluded to this morning, is the possibility that more activity migrates from the banking sector to the non-banking sector. As Professor Kroszner alluded to earlier today, there's already a bank/non-bank effect that we see in the marketplace and competition is a healthy thing, but there could be shadow banking consequences or lack of regulatory supervision where you have more and more activity, perhaps unintentionally in some cases migrating from the banking sector to the non-bank sector. And then in answering your question, Jonathan, now to the specific areas FRTB, CVA, and SFTs, it's helpful again to kind of remind our audience today around what we're talking about with this nomenclature. I'm going to build off of Adam's sort of expert explanation of some of these things. FRTB is just a shorthand though for market risk, and so when you think about holding the inventory or holding a position, what is the risk of something going up or down in its market value? I'm going to allude in a in a minute here to corporate bond inventory as as an indicator of that. And so where you raise capital requirements by 75% on a projected basis for trading book market risk activities, you're simply creating less capacity in the system to support overall making of markets or trading book activity. CVA, or Credit Valuation Adjustment is something that applies to derivatives but particularly is relevant for longer dated on margin derivatives, and has particular relevance for end users such as at the BlackRock or Alliance Bernstein comments that were raised earlier this morning. And then finally the SFT framework refers to

Securities Financing Transactions, and the haircut floor that Adam referred to earlier also, and I think it's important to frame the relevance of the SFT haircut floor and that it's mostly focused, by design focused on under collateralized transactions. In practice, it basically just applies to the stock borrow market, and so I'll circle back to this, but the stock borrow market is of course very relevant for pensions and for other lenders of securities that are out there in the marketplace. On FRTB, now I want to circle back to the impact on the corporate bond market and how non modelable risk factors, which is not a term that you probably want to use in your daily personal life, but I'll use it here, and how that sort of applies in practice. And so non modelable risk factors, or in the business what we call NMRFs, are charges that apply in the model-based calculation that are designed to pick up risks where you don't have adequate modeling capacity, and logically that makes total sense. If you have a model-based calculation that incorporates data elements to be able to produce a model-based number, then it makes sense that you might want to have an add-on for conservatism. Naturally, however, to borrow Randy Quarles' metaphor, the question is how many pills in the bottle do you put into the formula to make sure that this is well calibrated? And so you could take an example of corporate bonds, if you are one of the largest issuers of corporate bonds, there's going to be lots of data in the marketplace about how your bonds trade. As a result of that, it's unlikely that there are going to be NMRF charges applied to the corporate bonds and that example because there's all sorts of data points that are out there to assemble in the model-based calculation. By contrast, if you have a smaller issuer that has a less robust volume of bonds, and by definition a smaller corporate is going to have a smaller volume of bonds, it's more likely that NMRFs are going to kick in. The logic of the proposal is there's less data on that smaller issuer, so I should apply higher NMRF charges. One of the problems that we've seen in the proforma analytics though is that the NMRF charges for smaller corporate issuers overwhelm the actual calculation, so you end up with a scenario where the non-model part, I mean supposedly model calculation is the largest part of the overall formula and that seems illogical intuitively, but it also has the effect of penalizing smaller corporates in the economy and their access to the debt market. And again, that's something that wasn't explored in the preamble to the proposed rule, but is an area that I think is worth kind of unpacking by the agencies. For anyone who's interested, the Morgan Stanley comment letter has some proforma analytics, which I'd refer to on the agency's websites. I've cited corporate bonds as simply an illustrative example. As David alluded to, student, auto, mortgage, small business loans, which are supported by securitizations are directly impacted by all of this. Corporate's management of interest rate risk and global cash flows, and so if you have a large multinational operating in different jurisdictions, their ability to manage interest rate risk as well as FX risk is impacted by FRTB and CVA. And then finally, pensions investments including how they engage in securities lending activities for SFTs, ALM risk management and then their investment portfolios are impacted by a combination of FRTB, CVA, and the SFT haircut floor. The impacts are wide ranging across products and impact nearly every aspect of our economy.

- So just to telegraph to our listeners here, we're now getting to the point where we're going to, in our next question, solve all the regulator's problems by just telling, you know, how do we fix this? So, Andrew,

sticking with you, in brief, could you outline please the key changes that need to be made to the FRTB, CVA, and SFT components of the proposal to mitigate some of the adverse impacts we've discussed today?

- I'm going to underscore the Jonathan put in brief in the framing of the question, so I'll try to comply with his request as best I'm able to. I would break the question into three parts. Question one, what analysis should be considered? Question two, how does this end game proposal fit within the larger framework of prudential regulation? And question three, what are the specific technical issues that should be considered for change? On the first question, what analysis should be considered? A number of people today have talked about the importance of the QIS data, how there probably should have been a QIS survey before coming out with the proposal, and I would echo that, but I would add to it that it's equally important for there to be analysis on the second order impacts for the economy. So again, as David summarized, I think very eloquently, when you look at the impact for an end user for an auto loan or a home mortgage, that's an important societal question, and how you weigh the risks of credit risk in the economy and the stability of the banking sector versus the provision of affordable credit is an important question. So in terms of what analysis is required, I would suggest that it need not just be limited to putting out an accumulation of bank QIS data in saying please comment, but that there should be a second layer of more sophisticated economic consideration for the impact for end users and overall financial stability, including some of the issues that I talked about earlier on the potential migration of activity out of the banking sector or investors foregoing investments or hedging activities. Second, as has also been alluded to this morning, what are the impacts, or how does this fit within the larger framework of prudential regulation? Two of the Randys highlighted this earlier, so I'm not going to speak about it in great detail, but I'll add one one thought on top of what they've already said, which is the CCAR policy statements that there are two CCAR policy statements. They were adopted by the board, I think most recently amended in 2019, and so one might argue that if you're putting the RWA framework out for comment with material revisions, the CCAR policy statement should also be put out for comment. And that doesn't necessarily prejudice the board toward taking a specific course of action, but it at least allows for procedurally a open lens consideration of how the CCAR framework and the RWA framework might evolve in tandem, particularly in areas like the global market shock and FRTB, where there are similar types of risks that are implicated by each of the two frameworks. The third part of trying to answer your question briefly, Jonathan, what specific areas for technical change? I'll start with FRTB first and I'll kind of break it into three sub parts. The first of those is my favorite MRF acronym, and there, I think I gave the example earlier of corporate bonds and how smaller issuers would be disadvantaged relative to larger issuers. There's been a lot of smart thinking across the industry on this problem, how to solve for MRFs and so one idea would be to distinguish the better data quality MRFs from the less data quality rich MRFs. You could draw some distinctions and you could find different ways of mapping them so that you're more accurately capturing the underlying market risks of the position as opposed to having a structural penalty against smaller issuers just to have a penalty against smaller issuers. The second part

of the FRTB reforms that should be considered is the Profit Loss Attribution Test. Jonathan, I think you had said earlier that it's known as PLAT. Sometimes we call it P-LAT. It doesn't really matter, but the point of PLAT, which I'll call it here, is it's a screening test to decide whether the model is fit for purpose and eligible to continue as a model. If you don't pass PLAT, you have to use a standardized approach, and I'll make two observations about this. The first is there hasn't been US specific market evidence assembled to validate whether PLAT is well suited for US markets and US banks, and so that's an important question, just whether we're empirically doing it the right way. The second though goes to incentives, and so it's optional whether or not large US banks invest in internal models and part of that investment decision is whether they think that the models will be able to pass PLAT through the cycle, receive initial approval, so on and so forth. There was an article in the Financial Times just yesterday indicating that the major Japanese banks have all uniformly decided not to go with IMA, and I think that should be a cause for concern in the US implementation of these rules. Having diversity of models is a good thing. You want banks to think about how to develop and apply their models given their specific risk portfolios as opposed to just relying on a standardized global framework, so I think either not applying PLAT or validating PLAT or adjusting the incentives around PLAT is clearly an area. The third area within FRTB to focus on is diversification. The standardized approach is basically built on a logical premise that you should look at asset class by asset class, and then simply add up the total to get to a number for market risk. And here what it ignores is the fact that there are inter asset correlations so that credit and equity for example, might move in tandem in different ways. The pre-financial crisis market risk standard was probably over generous in assuming a greater degree of diversification than proved out in practice, but going to zero diversification is the pendulum going too far, and that's something where, to borrow your expression Jonathan, the cosmological constant could be maybe rethought and redeveloped with empirical evidence to calibrate it correctly. I'll try to be brief in wrapping up. On CVA, I'll simply refer to the excellent letter submitted by the Coalition for Derivatives End Users, which really makes the argument and assembles the evidence for how corporate end users use derivatives for hedging, and that kind of lays out the arguments for how to think about aligning the CVA framework with requirements for margin exemptions and how it's used by asset managers and corporates. And then lastly on SFTs, it's been alluded to a few times this morning. The SFTs haircut floor has not been proposed to be implemented in other jurisdictions, and what's interesting about it is when you look at the math behind it, most of the transactions that appear to be caught are securities borrowed transactions. The US agencies proposed an exemption for securities borrowing transactions, and it's been alluded to by some of the other commenters. It's a bit unclear how it would be applied in practice, but this begs a basic question. If the intention is to exempt securities borrowing transactions from the SFT haircut floor, then why have the SFT haircut floor, because that's the principle transaction that's going to be caught. On the other hand, it's not really clear that there's evidence that would validate that the SFT haircut floor is going to pick up something else meaningful that needs to be solved for. And my final comment, which I'll make this time for real in terms of being a final comment, Jonathan, is I think in whatever happens next in terms of resolving the rule making, it is important to ask a foundational question, what is the problem to solve for?

And I think in the proposal from last summer, it wasn't clear what is the specific problem that the proposed 1,000 page proposal was designed to actually solve for, and so when they're doing that baseline economic analysis and impact analysis, it should be grounded in a clear statement of the problem that needs to be addressed by the rulemaking.

- Thank you very much Andrew, and thank you to our other great panelists. You know, having identified and solved many of the problems associated with Basel III Endgame proposal, I think it would be appropriate now for us to take a break, and we'll return around 12:20 PM Eastern time for the exciting finale, where we'll be addressing even broader issues in the capital framework more generally. Thank you.

- Back again and thank you for remaining for our final panel of the day, a discussion of the Basel Endgame's interaction with other components of the capital framework and an evaluation of the road ahead, which will again be moderated by Jelena McWilliams. So Jelena.

- Thank you, Joe, and I'll just call these the three Randys and formerly OCC people panel. The rest of us are just visiting for a few minutes. So this last session is going to focus on the ways in which the Basel framework interacts with other elements of the US capital framework, particularly the global market shock component of the stress testing regime as well as its potential interactions with the G-SIB surcharge and long-term debt proposals. We've touched briefly upon all of those aspects in the prior panels, but we're going to take a deeper dive on that. We're going to take a look at the impacts of these interactions on aggregate capital levels and on the capital markets and economy more generally, as well as on potential solutions that could reduce adverse impacts. And I'm really excited about the participant's views on where do we go from here, what do we expect in terms of the timeline, likely changes, a possibility of a rule reproposal, et cetera. So with that, I will not turn to the Randy's. I will go to John and then Kevin. Hello. Can you help us understand how the Basel Endgame and G-SIB surcharge proposals interact with the other elements of the capital framework, in particular the interaction and overlap between the proposal and the stress testing process, and specifically what steps should the regulators take to address the over calibration of capital requirements that results from this interaction with the stress testing process? And I cannot think of better people to answer that than putting you two on the spot.

- Well, thank you very much and Kevin and I both serve on SIFMA's prudential committee. David, very happy to be here and participate. Let me answer your question by breaking in two parts. First, let's speak about the importance of stress testing and in fact its evolution, and then let's look at the interaction between the stress testing and the bottomline game. And Andrew, in our earlier panel was able to cover some of these things, but if you look at and think about it from the point of view of the financial crisis going forward, the policy objectives that were put in place, the original of G7 communiques, if you look at it in both Pittsburgh and , those things have been achieved, and what do I mean by that? Well, first of all, for

US G-SIBs, leverage is down, capital is up and the quality of capital is up, and stress testing is a way of life, and if you go back to the original, the first stress test, I remember that Secretary Geithner had spoken about the fact that the importance of that test was that the markets were able to be settled and that the efforts to begin the repair of our financial system could begin. And in fact, I think from my point of view that stress testing is an integral and extraordinarily important part of maintaining stability in our system and has been one of the most important things, to improve since that crisis. Now we've had 14 years of experience of it, and the question remains here is what has really been the evolution and particularly when one considers that financial institutions, particularly G-SIBs, have evolved substantially. So the question is, what's been the evolution of the stress testing? Now, for institutions like mine at Goldman Sachs, but the others represented, we have faced a number of major stresses, real live shocks if you will. We have faced a pandemic, we have faced a Ukraine war, we have faced the regional bank terminal, we've faced inflation, you know, spiking, we've faced the most recent conflict in the Middle East between Israel and the terrorist elements, so we have a body of experiences. So when I look at the stress test and the question of its role, I have to always look and say the global market shock, is it consistent and has it been true to its own definition, which was that it would be hypothetical, but that it had to be plausible, and for me, I would say that there are certain things that just don't make it plausible. First of all, in the terms of the global market shock itself, for any of the practitioners in here, we know that financial shocks, that if you calibrate 'em to the worst, in terms of historic losses, that they occur over basically a six month period. We've got enough evidence to really see exactly where that happens, and yet in this global market shock, all of this happens in one day, so you're forced, and that doesn't seem very plausible to me in terms of experience. The second thing is that I think that you look at is what is the nature of the transparency and then the implicit volatility that comes with not being transparent in terms of the models. Now this is something that's been debated. I've listened to this debate going on for 14 years here, one way or the other, but in the end of the day, you just have to look and say you have something that's taking place of which you, the regulatory body control completely, every scenario you control the test itself. So why isn't there more transparency into exactly what the fundamental body of the models are. By the way, models that have very, very little public input that's ever taken place there, and so if you look over the course of this transformations that have happened among financial institutions, why isn't there more public input into that discussion? And I think Vice Chairman Quarles have had described this in terms of, you know, you think about it or I could expand on what he said. If you think about students taking a coursework, you're going to share the curriculum with them, 'cause that's the whole point to bring them along and you control the test. They can't game it off of that, so I've never understood that fundamental argument, and the other thing which I would say is that, you know, if you look in the past, there can be more volatility because CCAR implied losses can change 30 to 40% year over year, which can increase capital requirements substantially. And so I think that issue of being able to have more transparency in models and input is very important to it. And then, you know, as I said at the outset, the institutions are well capitalized, and everybody has said it, you know, in every sort of place that they're well capitalized. So if the institutions are all well capitalized, this goes back to Andrew's point and Andrew, I noted that

your letter that you submitted you have to ask yourself the question, you know, why are you doing this? And at least for me, and having been in the public sector myself when I was at the Treasury, I still to this day take things and try to understand it from what is the public policy goal? What are we trying to achieve by something? And I'm not certain that I can look at this and then determine what we're trying to achieve overall by the Basel III being applied, because my point is we still have issues to do and deal with here as it relates to the stress tests, which are critically important, and I don't think it's necessary because those stress tests are taken care of a great deal of issues, which leads to your specific question, which is where is the overlap? This has also been a subject of debate and discussion with the suggestions that there is no overlap. Well, if anybody looks at this carefully, of course there is overlap because the global market shock, and if you look at the proposed fundamental review of the trading book, the overlap are heavy. They are exactly that because both of them capture the risk of losses. A bank could face, in a severe market downturn, both capture losses for market risk, both estimate losses that are based on extreme tail events, both are calibrated to similar historic losses, and both limit recognition of credit risk mitigation and also portfolio diversification. Now separately, I think what happens also with this rule, it doesn't recognize all the other things that have evolved along in other rule making that has taken place particularly in credit. Now I think the proposal unfortunately simply ignores this interaction, and I think it results in a significant double counts of market and operational and it's already been expressed in earlier panel CVA risks. Now Kevin and I have been spending a lot of time on these matters. Let me turn it over to him because you know, you can look at even the operational risks of factors and see what I'm talking about.

- Thanks John, and Jelena, your question really highlights the need to assess the impact of the proposal more broadly, taking into account all components of the regulatory capital framework. And when you listen just to today, we've touched upon many of those components. Obviously the Basel III Endgame was key to that, the stress capital buffer. John, talking about how that interacts with the stress testing regime. Obviously the G-SIB surcharge is the key component reflected in your question. Randy Guynn highlighted earlier the TLAC, or the Total Loss Absorbing Capacity requirements. Professor Duffie highlighted this supplemental leverage ratio, and again, so assessing all of those components into understanding a regime is not easy. You know, someone who has also been in a private sector, I recognize the challenges, but with that said, having kind of a robust comment process, you know, with a clear cost benefit analysis that tries to factor in the impact of all of those component changes and many of which are moving and looking at that and again, highlighting many of the comments from the other panelists, how that affects counterparties, borrowers, pension funds, and other users of financial services. Again, not easy, but I think it's critically important to make certain you look at things holistically. And one of the things I'm hoping try to do today is try to not get into the weeds, but looking at the decisions of the organization of the framework itself. And again, I think one of the key drivers of the impact of the Basel III Endgame in looking at this holistically as well is the overlap of the risk capture, both in Basel III, stress capital buffer and G-SIB surcharge. I mean obviously the other components of the capital regime may have to wait for another day or another panel, but again, should be trying to focus this attention a little bit.

And I think this overlap is most evident in the interplay of the Fed stress test that John was highlighting and therefore input into the SEB with the regulatory treatment of trading and counterparty risk as well as opposite. And let me just simply state this as straightforward as I can, looking at market risk and CVA risk, I mean those risks are capitalized twice. I mean through the fundamental view of the trading book and the Standardized Approach to Counterparty Credit Risk, SA-CCR, and second, through this stress testing framework and the global market shock, that John just highlighted. Op risk is a similar application or a double count or overlap by looking at the application of a op risk loss assessment both in the ERBA to the new standardized approach to operational risk, and second, through the stress testing regime, including the treatment of PPRs, or Pre-Provision Net Revenues. Again, this is, if you take nothing from this sessions today, this is a complicated regime, but let me try to kind of tease this out a little bit to kind of compare the current regulatory regime to the proposal to see where the changes have had and what the impact of those changes are. The current capital regime, and again focusing narrowly on things like stress capital buffer only apply the stress capital buffer to the standardized approach, which captures credit risk and market risk. Importantly again, the current capital regime also includes the incorporation, the results of stress test through the SEB. As John was highlighting, the current regime does present overlaps treatment of market risk RWAs in the global market chart that John was highlighting. The Basel III endgame alters that regime and arguably expands the double count. It applies the SEB not just to credit and market as the current regime, but applies it to all four risk types, credit, market, CVA, and operational risk, and again, as I said, broadening the overlap impact, you know, to CVA and OP risk. Just focus on op risk again in the shortness of time and just make certain there's some degree of granularity, and I won't go into the specifics of the op risk that Adam did. I won't talk about ILM or other things, but again, when you're looking at the current framework, does capitalize op risk by incorporating expenses stemming from the op loss events, from severely adverse scenarios in the stress test. And again, that applies to the SEB. The ERBA framework within the new regime includes a new standardized approach to op risk where historical operational losses are a key element of the ERBA charge, and as Adam was talking about, even as it relates to the application of the ILM. And again, there, there will be a glossary provided later for all the acronyms I just used, but again, viewed very practically this overlap of op risk has a dramatic effect on the capital treatment. Based on industry analysis of the proposal op risk changes are the single largest source of capital increases under proposal. And again, if you're applying that into double count, that has even a more exacerbating result. In the preamble to the NPR, the banking agencies estimated that common equity tier one for the largest banks would increase by 19%, and RWAs were increased by 24%, just for the largest banks relative to the standardized approach. Based on industry analysis in a more holistic assessment, including the impact of other components of the capital framework, the industry QIS estimated the capital would increase by 30%. RWA is up by 33%. And as was discussed earlier, the impact on capital markets is multiples of that, 'cause again, recognizing the kind of broader impact. One of the things in coming back to the beginning and using kind of Andrew's point, I will summarize now, when you're looking at the broader application of the SEB, that was not adequately explained in the preamble to the NPR, and I think the industry would've benefited from the

analysis as to what is the basis of the expansion of the application to a broader array of risk types. And again, I think that would've made a much more informed notice and comment process, and I obviously understand the agency's rationale, but again, to me when you are looking at what this is and maybe cutting to the chase a little bit, retaining the current rules application of the SEB to just a standardized approach and not the ERBA would have a significant impact on addressing the overlap as relates to the op risk in CVA. It doesn't address John's point about the impact on this global market shock, but again, I think there are things you can do to look at the organization of the rule itself, not the details that Adam talked about. That in and of itself could have a significant impact on overall calibration and overall double count, but let me stop there.

- Yeah, I think an absolute summary of this is that we have a significant important exercise, which is the stress test, which produces a very conservative outcome. I've suggested in certain places implausible, but accept that into it, but at the same time what has occurred is significant market reforms, clearing, margin, TLAC, counterparty limits, the G-SIB surcharge, which already address core concerns that were evidenced from the financial crisis for sure. And so if the goal here is to try to do some form of harmonizing practices across jurisdictions, I don't think it meets that design goal.

- Thank you. Thank you both. Dylan, we'll turn to you. Can you help us understand why it is important to address the over calibration of the capital requirements, particularly for wholesale banking businesses?

- Sure, I can, and I'll try to keep the remarks brief. I'll take a cue from Andrew earlier. I think-

- [Jelena] Somehow, Andrew, you made it into our third panel.

- I think, if we take a big step back, I think people have talked about a lot of the technical provisions and the rules, a lot of the overlaps that exist between the stress testing regime and some of these newly proposed capital rules. I think that's been covered in some depth. I just want to take a step back and talk a little bit about the economics of CIB businesses in the market today and how they've performed through some recent stress. So one of the things that we took a step back and looked at was like, there's been a dramatic transformation of what a CIB business looks like over the past 10 years, 10, 12 years since Dodd-Frank really was embedded into the rule set, and those businesses are much better capitalized and they've performed much better through stress as you can see through the performance through the pandemic. I think also they're not exactly generating spectacular returns. Nobody is like celebrating in the streets about the returns being generated by CIB businesses today. They do feel like they're much more secure, safe businesses and performing a lot better in the market overall. And I think if you start to look at all the various different constraints, all the different sets of rules that are coming down the pipeline right now for these businesses, they're trying to manage all of those different pieces and do it in a way where they end up with acceptable economics at the end of the day, not spectacular economics as we said

before. And this set of rules in particular seems to have a number of different areas where it's just moving either counter to or overlapping with other things that are coming down the pipeline. I promise not to talk too much about technical points, but I think CVA in particular, the whole industry in the wake of RKO's moving towards dynamic margining done within daily windows, and yet we have a 10 day margin period of risk, which seems to be very contradictory to what is happening in terms of risk management practices in the industry and just sort of ignores that. And I think, you take that as one example. There's probably 55 other examples that we could lob in there and it has this piling on effect, and I think ultimately what is going to happen if you look at all the different products that are offered today within the CIB landscape is some activity is just frankly going to stop. The economics of it are going to become unattractive and it won't happen anymore. It may also become too expensive for end users, and that's another way of making it stop. I think some activity will become heavily, heavily concentrated in just a handful of the largest institutions who can continue to afford to provide this business and view it as part of a much broader franchise, and then I think the biggest concern probably from a policy standpoint is how much of this activity is going to move into the non-banking sector. And I think there's little appreciation for how diverse a set of players there who are operating in that space. So you have the liquid trading firms, the proprietary trading firms, which sometimes get talked about. You have the, you know, alternative credit, alternative asset management firms that also get some airtime. The commodities trading shops never get talked about, and they basically dominate that whole space of the capital markets today. And I think as you continue to push more and more of this, we'll move outside into a space of the market where it's just uncertain how they'll perform and how they'll support the market through stress, and I think from a policy standpoint, in thinking about the structure of the capital markets business, that's probably the number one, you know, concern that I would hope that the regulators have in mind as they think about how to refine these rules and how to repropose them.

- Great, thank you so much. Randy Q., if you were still in your old seat at the Fed by that fireplace, you know, how would you be thinking about these interactions, not just between the Basel Endgame proposal and the stress test, but also its interaction with the outstanding G-SIB's surcharge and long-term debt proposals? And specifically, do you think that we need to step back and conduct a holistic assessment of the broader capital framework before finalizing these proposals?

- I mean, I think the short answer is it's hard for me to see how you could go final without something like that. I mean, if you're looking at something as consequential as implementing the Basel III Endgame, you have to consider the whole system. You know, you have to consider all parts of the regulatory framework. I mean, we've talked about the Basel framework and its interaction with the stress test. You know, there's the G-SIB surcharge, which I think is, you know, significantly affected by this. We promised we would reconsider the G-SIB surcharge every five years. We not only haven't changed it, we haven't even brought it up to look at, and I think, you know, and so you have to consider the whole framework as opposed to everything piecemeal and saying, "Well, everything is just fine by itself" without considering

what the effects of the interaction are. You have to consider all parts of the financial system, as Dylan was just mentioning. I think that's very important. The effects on the banking, suppose you do all of that analysis and the effects on the banking system it turns out are just fine. Darrell Duffie tells us they are just fine, and I have a great respect for Darrell Duffie, but what does that mean for, okay, well the effects on the banking system are just fine. What's does it mean for what activity has migrated into other parts of the financial system in ways that might not be ultimately good for the banking system, because there's feedback requirements good for the overall financial system because of what might happen in this less regulated and less visible part of the financial system? You have to consider the effects on the end users as to which there was very little consideration given with this proposal. You have to consider the global financial system and what we might be pushing out of the United States into other parts of the world. So I don't think how you can really determine what the right answer is with respect to this particular regulatory proposal without having done that entire consideration. And second, that consideration really has to be a detailed and database analysis as opposed to simply considering the issue and saying, "This feels right in light of this issue." And that now, you know, that detailed database analysis is hard. I can understand that. I mean, the discussion we've been having this morning demonstrates that, you know, it's possible that this system has just become too complicated. We may have created our own three body problem and there is simply no way to understand when it is safe to rehydrate the masses. But we are where we are and the only way to address where we are is through that detailed database analysis, no matter how hard it is. And finally, I'd say we have to consider all input from all sources, which was I think a significant flaw in the process around this, which is if we're going to have, I'm not a constitutional lawyer, I'm a private equity investor in the hierarchy of scoring of constitutional lawyers, private equity investors are just one step above real estate developers, but I do think that in our, you know, that in our constitutional system, if you're going to have entities like the bank regulatory bodies like the Federal Reserve and the other bank regulators, their job in putting forth regulations has to be to assimilate the views of a great range of constituencies and not just to implement their ideas of what would be best. A Congress can do that. People who are democratically elected can do that. Directly democratically accountable can do that. These insulated agencies simply, it's not their job to figure out what they think is best and do that. Their job is to assimilate all of this input and implement that, and that is part of what's going on in this process, and I hope results in changes to the proposal, but it would've been better if that had happened before the proposal was made.

- I'm pretty sure they won't give you all feedback after that. Randy K., would you like to add anything to?

- I think these issues of thinking about the whole is just super, super important. That's what I had talked about before and I think that it's a little bit of looking under the lampposts, so what we keep doing is sort of dialing things up on the banks and as I said before, it was super important that we dramatically increase capital from where we were earlier before the global financial crisis. No doubt about that. And, and I don't think we know exactly where the optimal level of capital is, but we've made a lot of progress

and certainly the banking system has shown more resiliency. It just seems on the margin that the focus should be on some of these other areas where we've pushed a lot of activities outside of the banking industry to these other areas to sort of Dylan's point. This is something I also talked about in the paper that I had written. We don't know enough. Now it may be that there isn't much risk in those other areas, but we don't know that. There may be a lot more risk, and particularly when you push things out from an area where you kind of understood it reasonably well, then you put it into this other area. Some people may be good players in that area, some people may not be such good players in that area, and it just seems on the margin that's where it would be worthwhile to be doing further exploration rather than just keep going along on one particular dimension. If you think about unintended consequences, it's always that if you just keep pushing more and more on one particular lever, there's going to be more and more incentive to get around that either from the institutions themselves, the market participants or just goes elsewhere. And so it seems that what you really want to do is focus on the particular risks of what is the risk of this particular activity and look at, let's say market making, look at who are the players, you know, making markets and what are they doing and who might come in if we change these rules in this way or that way. You can't do that perfectly for sure, but it seems like that strikes me as now first order, given that we have moved capital up where if we hadn't, then moving up capital for the banks is certainly first order. The next step seems like we really want to think about the system as a whole rather than just focusing on the particular lever that we have, which is bank capital.

- All right, you're not getting either. Okay, so we will, it pains me slightly as a former Fed and FDIC person to turn this over now to OCC. For discussion, we have Gene Ludwig joining us now. Gene, as a former fellow bank regulator at that other agency, what is your view on these proposals, and how do you view the cost and benefits of them? What steps should the current crop of regulators take to ensure that capital and prudential regulation more generally is appropriately tailored to the risks and challenges faced by the industry today? And then more specifically, your thoughts on the interconnectedness between prudential and market regulations?

- Well, Jelena, nice to be with you today and this distinguished panel. My own view is this ought to be put off or put in the closet. This proposal is not, you know, appropriate for this period of time if it's ever appropriate. I don't think it adds any value to the wellbeing of the financial institutions. Indeed, I think it's contrary. It will make them less profitable. People seem to forget that actually earning money makes an institution safer. There, as many said, enough capital. If there wasn't capital, we could address that, but that's not the issue. There are serious issues that the regulatory mechanism needs to address. There is a liquidity challenge caused by the internet. We saw that with SVB. Dealing with the internet has not been something that has been particularly addressed by the agencies. Frankly, the whole SVB situation is a reflection to my mind of a failure to assess adequately tail risk, and as a general proposition, particularly in a modern context where we have these tremendous changes going on in society, technological changes, AI is upon us, and there are important changes. There are good changes actually, but they

need to be assessed in a risk framework. I don't see that there's anything gained by adding more capital at this point to the financial, to the banking system. If we want to really address risk, I think there is a, and it was raised by the panelists, a serious anomaly created by the banks, which are heavily, heavily regulated and the non-banks, which are not regulated virtually at all. Those are the issues to improve safety and soundness we ought to be addressing, and there are, after all this time, very serious questions in terms of how we write regulation, whether we are achieving the goals that we set out to achieve in the regulatory process. So anyway, I could go on and on, but the fact of the matter is, spending all this time and effort on a capital proposal, which had it been in place, would've made absolutely no difference to SVB to First Republic, or to Signature, seems to me to be inappropriate at this time.

- Thank you Gene, and staying with the OCC. Oh, you're not getting Randy's either. So sticking with the OCC Julie, back to you from the first panel. I'll ask the same question, very similar question from you. Do you see the proposals as making the banking system safer? Do you think they will strike the right balance between costs and benefits? And more generally, are these proposals the optimal solution, focusing on the right set of risks facing the industry?

- Thank you. I think there are two really sort of loaded words in what you were asking, one is cost and the other is benefits that we are really in a very poor position to address. So costs, we've talked about over the course of the session, the absence of any quantitative impact analysis. So we do not have good data to know what this is going to cost dollars, and as I said before, back in my regulator days, that was one of the fundamental things that we would think about in connection with a rulemaking. And one of the things that we were very sensitive to with respect to the vulnerabilities of rulemaking to challenge in litigation, so we're number one, in a situation where there are defects in the cost information that we have. And another facet of that is we've had a great discussion about unintended consequences of the proposal, and so you've got direct and indirect costs, neither of which really have been satisfactorily outed and discussed in connection with the proposal, and then the other term, benefits. When I think about benefits, I usually say, "Well, what's the problem that we're trying to fix?" Or, as Randy Quarles, just said, "What's the risk here?" And we could go through a little exercise with respect to all of the areas that are getting increased and more complicated capital requirements and ask, "Is this an area where we have safety and soundness risk in the banking system?" You know, "Is this an area where we need new enhanced capital requirements? Is capital a solution to certain issues that we see?" And what, unfortunately, this proposal is sort of maybe the culmination, maybe we haven't seen the last of capital proposals, but of a multi-decade trend to try to sort of micromanage different types of risk through capital regulation, and I would just throw out the word here, another loaded word, supervision. Now aren't there aspects here of safety and soundness in the system that you don't want to try to tackle through micromanaging capital regulations and incredibly complicated capital regulations, but where you want to have basic building blocks and that supervisors have a job to do here to uphold safety and soundness, and I just, there

doesn't seem to be any integration of that concept in what we're talking about in terms of these extensive proposals. So that's my soapbox.

- Well Julie, as you say, I don't mean to interrupt here, but as you said, the supervision aspect of this, I think it reminds me of something that Alan Greenspan said some time ago, which I thought was thoughtful. And he said, "Look, if you're going to super capitalize the banking system, the trade-off might be to eliminate supervision." In other words, you can have an effective financial system where you both add excessive capital and you they have to live with supervision. Now, I think Greenspan said that as a matter of a kind of rhetorical question, just to make one think, a rhetorical statement, and I do think that supervision plays a role that can't be replaced by capital, even if you had capital at 50% or whatever the devil it would be, but your point is very well taken that there are things that ought to be done with the system that would make it safer, but at this moment, excessive capital is not one of them.

- [Jelena] No, Julie, go, I'm sorry.

- When you look at the experience of last spring, as some of the panelists have already noted, that was not a capital issue. That was a liquidity funding issue. And are we seeing a proposed rule to deal with liquidity. to maybe modernize liquidity regulations? Nope.

- Oh, Julie, you just gave them an idea. So there's that. So to quote Andrew Nash, in closing very quickly, I would like the former regulators on the call and Randy Guynn, you're going to be an honorary regulator for this question, to basically cover how do we see the rule finalization process playing out? What do we think is going to be the timing of the rule, and what is the likelihood of the reproposal Julie touched upon the legal challenges? So I'll be curious to get your thoughts on that as well. So we'll start with Randy Q.

- Well, so I'm sort of looking at how do I see the rule of finalization process playing out? That's also very difficult to say. I mean we've had a few, a number of public statements from the Fed that we should expect a final rule that has been materially amended, but we haven't had those public statements from some of the other regulators for a long period of time. A custom has developed that the regulators coordinate this. It's not required by law, but it would require a lot of overcoming both inertia and good practice. I mean the financial industry very much wants their regulators to coordinate these as opposed to have a whole bunch of different regulatory frameworks they have to comply with when, you know, Randy Guynn and I started our careers in the William Howard Taft Administration, the rules were different across all of the regulators. It's only been over the last 20 years or so that that has become a rule. Would they, if they can't get agreement, would they finalize separate rules? I have no idea. Would they just wait and not finalize it at all if they can't get agreement? I don't know. So what does that mean about timing? I don't know. Are we likely to see a reproposal of the rule? I don't know.

- You don't know. I got it.

- But I do feel very strongly that it is not possible to adjust the proposal sufficiently to be workable without having it adjusted enough that it does need to be re-proposed under the Administrative Procedures Act.

- Thank you Randy. Randy G, I will pull you from the Taft Administration to present time, and what are your thoughts on this?

- Okay, so I'm not going to disagree with anything Randy Quarles or Randy Q, the other Randy, or whatever said on reproposal. I think there's a pretty good chance that it will be re-proposed, but let me talk about cost and benefits to pick up on something that Julie mentioned and cumulative impact, and looking at this, you know, the Basel III Endgame was at least proposed. It may not have been sort of described as a package with other proposals, but it was proposed contemporaneously with a long-term debt proposal and resolution planning proposals, and you really have to look at those as a package because they're all designed to interact and to accomplish similar goals. In fact, if you wanted to look at the full package, you'd probably want to add stress testing to that package and you'd want to add liquidity rules to that package, and you really need to look at the cost and benefits of that entire package to get a full picture, and it's very difficult to do each one of them in isolation because they interact so much with each other. I want to make one point, people always talk about long-term debt, but it's actually deeply subordinated long-term debt. It's very similar to tier two capital, and therefore despite the euphemisms like total loss absorbing capacity, you know, or gone concern losses or incapacity, which you know, causes most people's minds to close and their eyes to glaze over. I mean it's just a double capital proposal, and you see this in the calibration because the method is called capital refill, which is basically two times going concern capital equals total loss absorbing debt or total capital, so it may not be double equity capital, but it's definitely double capital, and so it's very expensive. In fact, what surprised me early on in the process is how there was so much opposition to the Basel III Endgame and fairly light criticism of the double capital requirement, the proposed double capital requirement for the non GSIB LBOs. And also in the resolution planning process, there are kind of supervisory capital liquidity requirements get imposed. They may not be rules, but you know, in order to have a credible resolution plan, you have to have a certain amount of beginning capital. You have to have projection models that project your capital liquidity resources, that project your capital liquidity needs if you trigger your plan, and then you actually have to have triggers so that the plan is actually triggered before it's too late. It is triggered when an institution reaches its point of non viability, another, you know, real grabber out there in a term PON V, but again, these things all play together in terms of calibration of capital liquidity and how they work, and I know it's sort of a big lift to ask the banking regulators to say please do a quantitative impact of all those things together when just the three proposals I mentioned, not to mention the ones that should have been on the list probably are, you know, 2000 or 2,500 pages, but that's really their job, and that's the only way that you can really do an honest and effective cost benefit analysis.

- Thank you Randy, and we'll go to the people formerly known as OCC. Jonathan?

- So just taking a step back briefly, I mean the whole timing is odd, right? I mean for the agencies to choose now given current and pending judicial developments around the administrative state to engage in kind of a rulemaking unmoored from rationale and substantive data is interesting. In terms of your specific question. I mean I think what they choose to do with respect to the quantitative impact study, I think that will influence the timing of any re proposal. You know, whether they do that separately, wrap it in. Third, and this I think goes to related to a point Randy was making, there are only so many people at these agencies to do all this stuff, right? I mean at the end of the day it boils down to the same kind of set of people either making decisions or doing a lot of the work, and that is a finite resource at the agencies. And then finally, I mean the Fed chairman has said that, you know, he would like to see I think, I'm trying to think of the terms, you know, broad based, and so, you know, based on that it seemed, and based on some of the legal constraints around what you can do in terms of logical outgrowth from, you know, proposed rule to find a rule, it seems to me that a re proposal of some sort is likely.

- All right. Gene?

- Well, I'm hopeful that they will think better of it and, you know, put this on the shelf and go on to other matters that really do require a lot of attention, which I've mentioned. I fear however, that there will be kind of institutional pressure to re-propose and I would be surprised if they, you know, come out with anything that isn't a re proposal, but I would think that that's more likely than not, and I would bet that it would be at the earliest, you know, into this fall, late fall, and probably more likely next year, but we'll have to see. As I say, I'm hopeful that given, you know, a little bit of time to reflect on this and the huge public outcry against it, that it will just be put on hold for an indefinite period of time.

- Thank you, and Julie, I think you should have the last word on this.

- Well, I'm going to sort of double down on something that several folks have said and that is, in order to address the sorts of issues that we've been discussing today, I think a re proposal is necessary, required. If they tried to go ahead without doing a re proposal, I would be happy to take odds with anybody that would want to do a bet on whether there would be litigation and who would win. So, how about that?

- Thank you so much. And with that, I would like everyone to know that we ran trains on time on panel one and three, and it's time now to turn it over to you, Joe. Thank you for the opportunity. I'm sure all the participants are incredibly grateful for the opportunity to voice their opinions and to you for hosting us.

- Oh, thank you. Thank you for moderating and Jonathan, and this now concludes our Basel Endgame Roundtable. Thank you all for joining us and thanks again to our engaged members, phenomenal panelists, and moderators for their contributions to this event. We'd also like to take a minute to thank the SIFMA staff for their efforts in putting this Roundtable together. This includes Carter, Peter Ryan and Guowei Zhang in our Prudential group, Wes Alvez from our IT division, Anna Ballarin and Christin Chacula from our Conference and Events group, and Monica Ilyevsky, Lindsay Gilbride, and Katrina Cavalli from our Communications and Marketing team. As we talked about today, substantial changes to the US capital framework via implementation of the Basel Endgame will have significant impacts on banks, non-banks, and end users, as well as on the US capital markets and the broader US economy's financial stability. The importance of getting the balance of costs and benefits right was clearly underscored today, and I am hopeful US policy makers have taken notice of the broad ranging concerns and issues raised today, and are in fact making material changes ultimately to the current proposals. I encourage all of you to stay engaged with us on this topic. Your participation is essential to our mission of preserving efficient, effective, and resilient capital markets. As we learn more from regulators on what is next on the existing proposal, we will continue to advocate at SIFMA for a thoughtful consideration of how the Basel III Endgame will impact capital markets and the broader economy. We look forward to continuing this conversation, and thank you again for joining us.