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RETHINKING HOME/HOST SUPERVISORY ROLES IN THE AGE OF INTERNATIONAL RING-FENCING

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P R O C E E D I N G S

MS. SAHNI: Well, thank you everyone. We're going to go ahead and get started now. So, first let me welcome you to the panel on Rethinking Home/Host Supervisory Roles in the Age of International Ring-fencing. We have a very distinguished panel lined up for this discussion; so, I'll introduce them briefly; and then we'll launch right into our discussion.

My introductions will be, by necessity, very brief; so, I commend you to the full bios in the program because it doesn't do them justice here.

First, to my right, we have Wilson Ervin, a Vice Chairman at Credit Suisse and former Lead and Chief Risk Officer. He's well-known for his work on Too Big to Fail and Bail-In; and was recently recognized by *Risk Magazine* with a Lifetime Achievement Award for his leadership in this area.

Next, we have Andrew Gracie, currently a Senior Advisor at Deloitte. He's well-known to many of us for having served for many years as the Executive Director of Resolution at the Bank of England. He's also chaired the FSB Cross-Border Crisis Management

Committee; and has played a central role in the negotiation of the TLAC Term Sheet.

To his right is Bill Nelson, Chief Economist at the Bank Policy Institute; and prior to joining the Clearing House was deputy director of the Division of Monetary Affairs at the Federal Reserve Board. He's attended FOMC meetings and regularly briefed the Board and the FOMC. He was a member of the LISC Committee and the CLAR Steering Committee, and has chaired a number of BIS working groups on liquidity regulation.

To his right, we have my partner and friend, Barney Reynolds, the Global Head of the Financial Services Industry Group at Shearman & Sterling. Aside from being an expert on UK and EU financial services regulations, he's advised banks; financial market infrastructures and governments; and has been heavily involved in the development of enhanced equivalence. He's published draft treaty and legislative text, and created and developed a model adopted by the UK Government for its future relationship with EU.

And last, but not least, at the end, we're joined by Brent Hoyer, a Managing Director at Chain

Bridge Partners. Prior to Chain Bridge, he was with the FDIC for 25 years where he served as a deputy director in the Division of Risk Management Supervision. As deputy director, he was responsible for resolution planning for the largest most systemically important financial institutions and for advising FDIC Board members on these issues.

So, we have quite a bit of gravitas and serious thinking on this panel. I'm Reena Sahni. I'm a Partner at Shearman & Sterling in the Financial Institutions Group; and I'm very thrilled to be here, and welcome you to this panel.

So a few words before we get started. I think, by my count, this is about the fourth year we're now discussing some variation on the topic of the future of global banking, and how and why regulation is impacting the global business model. But, I think, this continues to be an important and central topic, both because of the intended and unintended consequences of regulation; the impact of changes in business models on accessibility to capital; and some of the real world flick on economic consequences; and we'll hear much more about those from this panel.

So, most recently, the FSB's published a report on market fragmentation, and more recently published an update. IOSCA's published a report from its task force on cross-broader regulation, and how to enhance cross-border cooperation; and the BIS just published a working paper on fragmentation in the global financial markets. So, obviously, the dialogue in this area continues to be robust; and this is the group that's been contributing to that effort and, I hope, continues to do so today.

So, we're structuring this to talk a little bit about some of the issues and some of the problems; and then, hopefully, leave you with some discussion about some of potential solutions to the problems identified. If you have questions, feel free to send them in thru the App. We'll ask them as we go along, or reserve some time at the end, as well.

So, with that, just to begin, I think we'll start with framing the question. Maybe, Wilson, if you can start us off by explaining what the issue is that we're facing with market fragmentation and, more importantly, why it's relevant?

MR. ERVIN: Sure; thanks, Reena; and thank you all for coming. I was talking before with Adam Gilbert about rock concerts. You normally start off with a big upbeat hit, but I'm going to try and bring you down a little bit early (laughter); try and make you sad; but, hopefully, we will fix that by the end of the panel.

We think ring-fencing and home host roles in fragmentation, those are kind of nuance; they're a little bit complex. I've tried to explain, for example, to my dad why these things are important, and he kind of shakes his head. But, I think, these are among the most important issues of our day. As we look at the, sort of the, post-reform era. If you think of the 10 years after the crisis as a core of the reform era, we're now in sort of a next phase.

I think that fragmentation and home/host relations are one of the reasons why bank ROEs are depressed in many parts of the world, especially outside of the U.S. And, unfortunately, I think, unless we do something, they will be at the center of the next big bank crisis. I hope that crisis is far away; but unless we fix some things, I think, fragmentation will be at the center of it.

So, what do I mean by this? If you look back 10 years -- there's actually be some remarkable achievements -- in Pittsburg, the G20, which was pretty new at that point, and the FSB was new, set out a bold crisis reform program to increase capital; fix ODC markets; and then too-big-to-fail -- pretty big goals -- and when you step back after 10 years, you have to sort of tip your hat. They did a lot on all those issues. We can quibble about all of the execution, but it was a very coordinated effort and, I think, achieved some big things.

But there are some termites in this achievement; and they are hungry termites. Those termites are the growing list of legal entity requirements that trap capital liquidity and destroy the ability to move that to where it's useable. If you can't use money to solve a problem in the United Kingdom or Japan because it's trapped in the U.S. or Zurich, then the risk of a subsidiary failure starts to grow even if your bank overall is okay. And if a subsidiary fails far away, the risk could blow back to other countries, I think, in the modern world with the Internet, is very, very high.

We've tried to model this for a simplified bank; and we estimate that in a heavily ring-fenced model bank, one with four equally sized subsidiaries -- so, sort of theoretical -- but if you run that with plausible statistics, we believe the risk of failure goes up by 5 to 15 times. That is -- if you think about the impact of making a firm 10 times more likely to fail than it would be otherwise for the same amount of lending to the economy and the same amount of capital that feels like a very big policy mistake. Or, put another way, it's taking a big part of the extra capital and liquidity we built up over the last 10 years, which has been hard to do. It's a big achievement. It's measured in the hundreds of billions to trillions. It's like taking a third or half of that and feeding it to the termites.

The species of termites varies a little bit by region. The European termite is characterized by chronically low ROE, which, I think, hurts their resilience; no mergers; slow capital formation; slow growth in the real economy. It also exacerbates negative interest rates in the north, which has been a big political issue and hurts savers. It's led to a situation in the (inaudible) has made the euro area both vulnerable to systemic shocks and unable to cushion the real economy. He estimates the European financial system -- the U.S. financial system can cushion about 70 percent of a shock because it's got diversified -- it's got the bank union here, we have interstate banking, which we didn't have 25 years ago -- and we have good capital markets. In Europe they can only cushion about 25 percent of a shock, which is why places like Italy still have a lower GDP now than they did in 2008.

My hope that the current banking initiative by Finance Minister Scholz from Germany works because the European system right now is kind of halfway; it's a pretty fragmented system still. They've got some of the components of bank union, but they're only halfway; and halfway is a dangerous place to be when the next storm hits.

The U.S. has a more robust banking market.

The banks here, when you look at global ROEs, global health are in about good shape as any market in the world; but there are termites here too; and those termites are built into the logic of Title I plans that the more you ring-fence abroad, the closest a Title I cliff-edge comes. And it's plausible if ring-fencing continues to increase that even health U.S. banks, in the next downturn, could be pulled very close to that cliff edge; and it'd be a terrible policy mistake, I think, to do an unnecessary resolution of a U.S. big bank just because we built too much ring-fencing into the system and we've created a lot of this machinery that could create that risk.

In Asia, the termites are reducing the ability for some of these high-savings regions to deplore their capital efficiently and deplore deposits sufficiently; and pushing is going to take high risks in some markets; and that could also be a regulatory own goal to some extent.

So, the termites, they vary in size and shape but they're all eating well, unfortunately. With the advent of the IPU in Europe with a potential for Brexit, which separates the biggest financial market from the rest of Europe, and the possible expansion of bank liberal requirements around the world. It looks like they've got reservations for a lot of other good meals going forward.

One policymaker said at a recent event that ring-fencing was not "unbearable today"; but what I'd like to do is to summarize it this way. You could have said this very same thing about capital regulation or too big to fail in 2006. Those weren't unbearable in 2006, but they also weren't ready for prime time. And, unfortunately, I think, we're in the same place where respect to home/host relations and fragmentation.

At prudential, standards don't really matter until the skies go from blue to grey, and then they're everything. So, we're going to talk about some solutions later and try to bring up, but my goal for the last few minutes is to try and bring you down and make sure that the extent of this problem is well understood. I think this is a very serious one, and unless we grasp the problem, I think it'll be very hard to shake off the complacency here. So, apologies for the bug metaphors.

(Laughter) Hopefully, that doesn't lose you any sleep; but it is something I think that -- I think most of the people on the panel see this as a potentially very serious policy issue underlying some of the shiny reforms and something we need to tackle.

MS. SAHNI: Thanks, Wilson. I think, moving from bug metaphors, maybe to a little bit of canary in the coal mine; Bill can you talk a little bit about where recent developments is sort of a manifestation, again, of what Wilson's been talking about in terms of some of the regulatory requirements and, maybe unintended consequences, and how that's being manifest in the real economy?

MR. NELSON: Sure; happy to. So, I imagine most everyone in this room knows, in the mid-September there was a pretty serious volatility in money markets, particularly in REPO markets. Now, before getting into the details, I should note that problems in REPO markets are really -- REPO markets are really an international bank phenomena to a great extent. So, 13 -- as of October -- 13 of the 16 primary dealers that directly face money funds who are the big REPO lenders and were high enough rated to directly face the money funds and borrow from them, were foreign; and all of the non-primary dealers that directly borrow from money funds were foreign.

And, moreover, a big chunk of the institutions that borrowed from -- that weren't highly enough rated -- still borrowed a lot in REPO markets, and so, had to borrow, intermediate through the primary dealers were Japanese institutions. So, troubles in REPO markets are reflective of issues in foreign institutions and vice versa.

So, on September 16th, it was corporate tax day based on historical norms, about $100 billion of money flowed from institutional-only government money funds into the Treasury's account. The Treasury keeps all of that money at the Fed now rather than keeping it back in the commercial banking system, removing what would have been sort of an offset to these troubles. At the same time, the Treasury settled about, on net, $56 billion or $54 billion worth of coupon securities.

Now the movement of money out of money funds reduced the supply of REPO financing significantly. And the net new issuance of corporate securities increased the demand for financing because those securities had to be financed. And, not surprisingly, when a reduction in supply met an increase in demand, REPO rates rose sharply. Where they had been, at about 2 percent, they traded then, on the 16th and on the 17th, anywhere from 5, 8, or even 10 percent.

Now, while the approximate causes of the REPO turmoil are pretty clear, there were also some important questions raised by the events, and the answers to those questions, intimately involve, actually, foreign institutions. So, one question is banks are sitting on these huge piles of cash, of deposits at the Federal Reserve, faced with these high rates. Why weren't they willing to substitute those reserves into reverse REPO? And the second question is well if they insisted on holding that cash, why weren't they willing to intermediate; why weren't they willing to go borrow where it was cheaper, like in the Fed Funds Market, and lend where it was expensive back in the REPO market? So, let me take you to those questions in turn.

So, in terms of why banks weren't willing to substitute their reserves for reversed REPO, there the story is, I think, to a large extent about liquidity regulations but also just about caution. Banks are much more cautious now about how they manage their cash; in part because they now manage their cash so that they have a 100 percent certainty that they will never ever have to end up at the discount window again. There's always been a stigma associated with borrowing from the discount window; but the stigma became especially acute during the crisis; and that was especially true for foreign institutions. Foreign institutions, as I'll discuss actually again, or maybe the next time around, borrowed heavily from the discount window in the crisis, but the borrowing was completely appropriate and it was, as intended, the discount window to the used, and the borrowing was all paid back.

Nevertheless, recently, when the Federal Reserve announced that it wanted to get comment back on the idea it might impose LCN, liquidity requirements on branches, one of the reasons that it cited was the borrowing by branches in the crisis. So, that sends a pretty strong message to the banks that you really shouldn't borrow, even though our regs say you should borrow.

One officer from a foreign institution working here told me, he said when he joined the institution, he was told that if he were to ever from the discount window, there'd be two phone calls. There'd be a call from the New York Fed to their CEO to find out what happened; then there'd be a call from his HR to him to tell him to pack up his desk because he needed to find a new job. So, with incentives like that people have to hold a lot of cash, and they're not going to be willing to substitute out of that cash.

Now, another issue is the messages provided by supervisors to banks that even though the LCR and other liquidity regs treat treasuries and cash equally, but they really did prefer that they held cash; and partly that's because deposits at the Fed are the most liquid asset. That part of the story is less, I think, specific to FBO, so I'll just skip over that.

But the other issue, the other question I think is critical for thinking about what we might face if fragmentation continues. This issue of why weren't banks willing to intermediate. Why weren't REPO people, people active in the REPO market, willing to go out and borrow and where it was cheap and land where it was dear; after all that's how the financial system is supposed to work. That's how shocks to supply and demand are supposed to be equilibrated, avoiding these big shocks to prices.

Well, what we've heard talking to a lot of market participants and reading a lot of commentary is that capital requirements have gotten so high; and, particularly, requirements on very low risk or no risk things caused by leverage ratio requirements that banks now, and, moreover, that they're very complex, especially for international institutions where they have to comply with domestic requirements, and with U.S. requirements, and their home/host requirements. It's very complex. Banks are not able to reallocate quickly when events happen. They allocate their capital very carefully; their REPO activities have a specific amount of balance sheet that they're allocated; and just because rates are 10 percent today and there's a lot of money to be made, doesn't mean they're able to sort of get a hunting license and go out and meet that need.

Now, that can be fairly frightening because, you know, this is a very benign time. People are not concerned about each other's credit conditions, but we still had very severe dislocation and lingering continued problems in REPO markets at a not crazy dislocation largely because banks, I think, in large part, are not willing to intermediate; and that is precisely the concern. If you can't move your capital, as Wilson said, from, you know, from Zurich to the U.S., you know, you can't redeploy your capital within your organization, and institutions can't respond flexibly and quickly to the kind of dislocations that lead to financial volatility.

MS. SAHNI: Great.

MR. ERVIN: By the way, Bill is being modest here, but I think you wrote papers predicting this event within the *Fortnight*, a month before. So, this was not an unforeseeable event; this is one at least a few people were able to foresee and to understand these supply/demand dynamics. I think we're all surprised by how fast and how hard it moved; and that to me was sort of the surprise of the fragility that it exposed in, or the lack of flexibility that we built into the modern system.

MS. SAHNI: Great; thank you. I guess just moving to those, you know, and possibly other side of the coin, Barney, clearly a different view of market fragmentation could be taken from the UK in the context of Brexit. Can you speak to that ringfencing from the perspective of the UK and how does that put pressure, in particular, on the need for additional cooperation and coordination among regulators?

MR. REYNOLDS: Yes; so starting with termites (laughter), I'd add something to Wilson's description of the European termite. So, the European termite is self-limiting in a sense because of the euro and the fact that many of the factors that Wilson cited are features of the euro because it's got most single sovereign backing it because it applies a fiction in the regulation capital architect show which treats the member state government bonds as sovereign when they're not, and that then riddles itself through to the financial system through the insurance regulation capital rules, the bank regulation capital rules, the ECB collateral, what they take as collateral, and so on; all the way through the system.

So that termite is leading to like (inaudible) as Wilson rightly is saying. I think there are other reasons for it as well, but that's a key reason for it; in my view, at the core of it, i.e., it's some of the heavy lifting in creating a currency has been done, but not the difficult bit. The difficult bit is actually creating a country that stands behind the currency, and that is politically unachievable; and Scholz, the Finance Minister of Germany, when he sort of floated ideas for creating this banking union, as its termed, there was nibbling around the edges. It was trying to stop Italy buying so many Italian Government bonds, and so that does not fix the fundamental flaw of no single sovereign backer and the regulation capital regime, basically, are treating the whole system as sovereign when it's not.

So, that termite not only leads to low growth within the eurozone, and it sort of then, consequentially, leads to the regulation capital regime, as I explained, being constructed in a way it has across the EU as a whole, that termite in a way is partly what's driving what one might see as ring-fencing in a sense that it needs to be a retrenchment away from that source of risk anyway. This is nothing to do with Brexit; and were it to being the case that Brexit didn't happen, under the David Cameron attempt to deal, and preferably involved in advising the UK Treasury on MAPS in the context of the financial services deal, one of the key elements was trying to isolate the UK from the European risk, but that failed for a whole lot of political reasons.

So, then there needs to be some sort of retrenchment to global capital pools managed by a sovereign, the only one in the European times and, of course, being in the UK. Just probably for those who aren't following the press closely on Brexit, the timetable on that is -- and there may not be very many of those in the room, but just in case there are some -- the timetable is there's an election December 12th. Looks like, currently, that Boris Johnson is going to win and to continue with the Brexit project. There will be a sort of cycle phase I deal which isn't really a deal at all, it's just sort of a transitional state.; with nothing, if (inaudible) to anyone in this room, in terms of the VSUs that addresses the real deal, as it were, would be at the end all 2020, which will contain something of financial services. And the two options for Europe in the way because it's any deal needs to be two way, is that the global markets will either need to retrench to the traditional model where the customers come to the market for reasons of liquidity, (inaudible) and so on; or if the eurozone wants to continue to treat Brexit to that liquidity without having to establish presence, there still have to be some sort of announced equivalence arrangement on the basis that I've set out and drafted treaty text, and so.

I think we'll go to that point, and I think there won't, therefore, be sort of a dire retrenchment in terms of ring-fencing in the UK. There is ring-fencing in the UK in the context of retail banking, but that's very minimal and that, in fact, liberalizes the wholesale markets from a retail problem that would otherwise exist and allows the regulators to focus on systemic risk in wholesale markets without worrying about domestic retail banking and payments.

And so, I see that likely to be the case that, in fact, there'll be re-globalization, at least in the European time zone, of finance. Whether we can sort out the European eurozone termite is a different matter. I think that is something which is politically flawed in the sense that it doesn't look like the German taxpayers are happy to bailout the Italian, you know, consumers, or whatever. I mean once one extends that logic, it looks like it’s a fundamentally flawed proposition, but in the short term it's possible to keep the show on the road, as it were, in terms of global capital funds and booking, at least in the UK, for the next 10, 15, 20 years while we see which way that goes either consolidating into a state, which I think is unlikely but possible, or breaking apart into different sub-units, which is more likely.

MS. SAHNI: Thanks, Barney. I think we want to come back to this point about enhanced equivalence and what that really entails; but maybe before we do that, moving from sort of the market impact and the macro level, Andrew, if you could talk a little bit about what's been the impact on firms from, effectively, this kind of market fragmentation and ring-fencing, and what the real impact of having to sort of sign for these alternative scenarios has been on the financial institutions?

MR. GRACIE: Sure. So, ring-fencing is, of course, a, you know, loaded motive term; but it's absolutely clear that there's a tension between international agreements on resource requirements for international banking groups and local regulation. Authorities rock up in Basel; shake hands on what capital and liquidity international banks need to operate safely; and then they also agree in the FSB resolution strategies for all GSIPS -- and nearly all GSIPS are treated as a single part of entry -- the understanding is amongst the home and host authorities that they can't actually allow those groups to fail as a set of distinct legal entities, but because of the independencies within the groups, they need to be resolved group-wide under a common plan; but when they do that, they then pivot, retreat to their respective corners, if you will, and regulate the legal entities within their jurisdictions as if they were stand alone. You know, there's no observable modulation in the results requirements that legal entities and individual jurisdictions face.

For all that, there are these international agreements framing what applies to groups. The consequence of this is that it sucks resources down into legal entities. A one-way journey, typically; and reduces disparities that's available at the top of the group. And rather, as Wilson outlined, probably reduces the overall resilience, increases the PED of international groups; and the more so where interaffiliate exposures are significant so that you end up with the sum of requirements for the individual legal entities being pushed up above what the consolidated resource requirements would be. So, shake hands on an international agreement for banks to operate safely, but that in practice end up with higher requirements because some of the parts of local regulation of subsidiaries.

Now, in a way, why is this coming to the floor now? It's kind of a sign of the maturity, the implementation of the post-crisis agenda; and host have -- definitely, post-crisis -- taken setting requirements for local entities probably more seriously than they did pre-crisis. And it could get worse as jurisdictions set additional other requirements or add-on Pillar 2 requirements for capital. And to date, there's been a tendency for authorities to take each other's requirements as a given rather than amongst them to face up to this resource contention. So, an example of that is that in Title I resolution plans, firms are expected to model the liquidity they would need to see through the resolution plan; and in the assumptions they are required to use in preparing this estimate of resolution liquidity need, they have to assume that the post-requirements are fulfilled at all legal entities, including branches.

And the consequence of this is that the RLN -- everything needs an acronym (laughter) -- in some cases lies above what the LCR require with the implication that, in principal, banks might be filing for bankruptcy when their aged (inaudible) still intact, which seems added to Wilson's list of policy mistakes, I guess.

The conservatism and inherent fragmentation in this, and this disconnect between international standards and the complex of local regulatory requirements really needs to be addressed by authorities. It's striking that we're on our third or fourth iteration -- I don’t off the (inaudible), that depends on counting -- and it's still the case where distribution of capital within banking groups isn't addressed internationally.

On the resolution side, there was an attempt to face up to this in the TLAC standard with internal TLAC provision which said that resources should be downstreamed at a discount to what the entity would be holding on a solo basis; but a tendency in jurisdictions to hard code these requirements at the top of the available range. So, in the U.S., the federals says that FBOs must old 90 percent of what the IFC would have held on a stand-alone basis; and low and behold, Europe copies that; and so IPUs will have to hold 90 percent of what the IPU would have held on a stand-alone basis, when the original range is 75 to 90; so, let's set a requirement at the maximum possible.

But more fundamentally, there's no recognition, if there is a recognition of some of the past issues on the (inaudible) concern side in TLAC space, there's no recognition of some of the parts, issues in capital. There's a little relief, perhaps, in some buffer requirements that subs of foreign banks don't need to hold; but the majority of requirements have to be fulfilled in full. And this is a concern as the focus moves from capital into liquidity because, you know, there is an articulation between going and gone concern requirements of solvency, there's nothing around liquidity. And then, from a (inaudible) perspective, there's a lot of interest in setting far more quantity requirements for branches, whatever logic that has, when you're talking about a single legal entity which needs to be solvent and liquid in its entirety.

So, against that backdrop, it's surely to be welcomed that the FSB has actually embarked on this exercise on looking at market fragmentation, and fragmentation more generally; and, hopefully, you know, they will step up and make an effort at addressing some of these issues.

MR. ERVIN: Maybe just to step in on a couple of the comments that Andrew made, which is this coming to the floor now. So, although the Fed has chosen an official range in the 75 to 90 -- I think it ends up being 89 and change -- but the U.S. also has, I think, 24 overlapping requirements, and that when you apply that at the subsidiary level you can often get odd results; and so, the effective requirement in the U.S. for the big U.S. subsidiaries ends up averaging about 130 percent of the Basel requirement. In fact, the foreign entities here, generally win the highest TLAC ratios -- interesting -- of any of the entities in the market; and that's one of the reasons why they, particularly the broker/dealer entities here have shrunk by between 55 and 75 percent over the last 8 years.

One of things I'm worried about in Europe is as we build the IPU machinery on the continent and, potentially -- I don't know what the UK response post-Brexit will be for some of that machinery -- I'm worried you'll see similar things probably through the lens of Pillar 2 requirements where you get super equivalence even at the sub level. Andrew and other colleagues at the Fed and elsewhere did, I think, very good work in the TLAC standard, trying to build in some discounts; but, I think, some of the local supervisors have fought against those discounts; and today, unfortunately, the localists have won.

MR. REYNOLDS: I'm not sure the UK is wedded to the IPU concepts for your first Brexit. The first Brexit is a liberalization opportunity on that front.

MR. ERVIN: The Singapore of the Atlantic?

MR. REYNOLDS: We'll see.

MS. SAHNI: Well, so we've heard sort of some of the concerns or termites, as Wilson has phrased it, in the maceration of the, you know, that post-financial crisis reform agenda, I guess, Brent, if you can speak to, you know, the perspective of somebody who was there, the formulation, the regulations, you know, what was intended; is this really sort of a necessary and intended consequence; or, you know, is there some more balance that can be struck around some of these concerns?

MR. NELSON: Sure. I have nothing on termites, sorry. (Laughter) I didn't get the memo on the buy analogy; so, I'll see if I can weave that in; but, yes, as someone that was actively involved in all things resolution planning here in the U.S. from the rule guidance to, ultimately, the feedback, this was something we grappled with on a very routine basis on how do we think about the information that we're ultimately sending out to the industry to work on and how do we think about, from our own perspective; and so, really the two drivers of this risk issue, in my mind, and what we thought about there as we were working through it, were, first and foremost, you know, there's been a great deal of effort, as everybody recognizes on this panel, across the various regimes, we have the framework. There's been pretty reasonable transparency on it, and I'd say some thoughtful processes, but at the end of the day, they're untested. It's very difficult for any kind of supervisor to get comfort, assurance -- that would be the word most people will use these days -- around how that's going to play out and how that's going to openly impact them; and that's driving that. Little side note: As a long-term supervisor -- I know no one wants to hear this that's why strong capital and liquidity regimes give me great comfort and help me sleep at night; so, that aside; I know it's a different panel -- the real driver of this though, which Andrew and others have already spoke to, is when you sit back and you think about these are national frameworks for a global firm and no one really started off thinking about it from that standpoint; and I know that's a pretty basic element here, but each of the governing bodies that were task with setting down and coming up with the rules of the road thought about their national interest, their preferences, their people, their businesses, their depositors, and so on, their economy.

If you take the U.S. rule, take any Fed examiner, take any FDIC examiner that was involved with Title I and Title II put them into a room and say you have to draft me a small paragraph about what the objective is; and I guarantee you, 100 percent of them will say stability of the U.S. economy. That doesn't seem very global; and so, that challenge, that friction, will always be there and it has to be addressed.

Now, I don't want to disregard some great efforts that have occurred on the international front.

There've been some good cooperative meetings; there's been good agreements; but at the end of the day those individual jurisdictions still are going to be bound by those guardrails and those statutes that were put up. So, that's really the drivers of it. We were thoughtful at the time. I still use we, it's hard to (inaudible) 25 years; but as the Federal Reserve and the FDIC were working through guidance -- I know they'll probably be some complaints about several of the things we recreated. Andrew had talked about RLN and the acronym; I remember being in the room the day that we created that acronym, so apologies for that. We didn't call it termite though, so I guess that's (laughter) (inaudible).

But as we evolved along with the industry and as, when you think about the foreign banking guidance that went out on the Title I, that was the last big piece of guidance that I put out, we were much more thoughtful from a liquidity standpoint and giving deference to the various regimes in that it didn't require full prepositioning. You can go back and look at that particular guidance -- I remember working on this quite extensively -- it provided the option of prepositioning or a mechanism that demonstrate getting that from the parent. So, there was some thought going into that but, nonetheless, concerns, as you can imagine, from the various constituents in thinking through that.

So, look, those are the drivers of the issues no matter what the underlying aspects are, and those are, ultimately, whether this panel talks about it or others, have to be the things that are thought about from a solution standpoint of how folks are going to get comfortable.

More importantly, and thinking about it more practically, if you're a banker out there and you're dealing with this on an international front, you step back and go, okay, well, hold on, what do I do; how do I deal with that Brent? You just told me that one, you know, no one's tested the strategy, so I can't wait around for that to occur; and two, the national jurisdictions really maybe aren't coming together quite as aggressively as they can to help us out and I can't solve either one of those.

So, while the agencies are working through their effort from an assurance standpoint, you should be working from a firm standpoint. This is something that I communicated when I was at the FDIC and I continue to work with firms on it to this day is that it's really setting down with each of the host jurisdictions, having a coordinated program cross your organization that really hits it from three areas: your strategy; your information; and, more importantly, it's already come up no this panel, is capabilities -- the strategy you guys know.

The information aspect -- if you think about what, ultimately, is going to drive ring-fencing at the end of the day is just a lack of information; a lack of, you know, certainty about what's going on; and so, the more you can start to coordinate with those jurisdictions now what information are they going to want. It's not just going to be your, you know, home jurisdiction. John, who was on the prior panel, the U.S. regulators are going to be all over that home firm like ants -- there you go, I brought it in; like ants on an anthill (laughter) -- at the time of; but what are you providing to all the other jurisdictions out there to give them comfort; to give them that roadmap so that they know that this is playing out the way you expect it to be across the continuum.

So, I'd encourage you to be working with that now for that firm-specific assurance; and another component of that is just an understanding. I mean, really, this comes down to financial resources, right. At the end of the day, this is what this is all about; and it's your capability to measure that at a very granular level, in a very fluid way; and so having that conversation now about your capabilities to do that and demonstrate, that's going to be helpful. Yeah, your operational and legal impediments, and how you can handle that from a structural standpoint are important; you want to give them those assurances as well.

The last piece I would indicate that if you're not already having these conversations with your host jurisdictions would be around any kind of business-as-usual program to show that look this remains operable despite what's going on from attestation to testing, to simulations

The last piece I would say, which Andrew did in a very nice and political way. I can never speak as eloquently as he did on this, is that if you step back and go Brent, I'm already doing that in the CMGs, and you didn't hear anything I said or Andrew said, the CMGs just really aren't the effective place, haven't really been the effective venue to really have those dialogues and really present that information as, I guess, we had hoped they would be.

So, that's how I would speak to it from a risk standpoint, what's driving it; and then, more practically, if I'm sitting in your seat what would I be doing today while the agencies work through those challenges.

MS. SAHNI: That's very helpful. I think that's a perfect segue to sort of where we want to go with Wilson's, and Wilson's rock concert analogy, you know, starting low and building up to the crescendo of the solutions. So, if we can sort of pivot to solutions. Again, maybe I'll start with you Wilson, you know, if you can talk a little bit about hey, where do we go from here, right? So, you know, of a speed project, what's happening there; kind of what's the next step and start making this work better?

MR. ERVIN: Great. And I apologize. This will not be free bird or stairway to heaven (laughter), so you knew that coming here today. So, one issue that's come on the scene lately, both in the U.S. context, and global context has been branch liquidity. And kind of superbly I had sort of an old model in my old head of branch liquidity is part and parcel of a single legal entity and, typically, while there would be some measurement at the local level, not that many restrictions on where you hold liquidity, where you hold solvency. And as I looked at how the world has evolved since the crisis, there's some good information provided by some colleagues at both my bank and other banks, we found out that platonic ideal of the branch has been steadily eroding; that people, almost half the countries of the world now have a pseudo solvency requirements for branches, which is strange for a single legal entity to have parts of it, have their own solvency rules, and even a higher number for liquidity requirements.

I thought it was actually very constructive that when Randy Quarrels was thinking about this issue for the United States, he said we need to bring this to the FSB. We need to kind of get in front of this at a global level. I think that's the right way to solve that.

Now, why is this important? I think this is, actually, one of the stranger owned goals from a prudential and a resilience standpoint. If you're running a single legal entity and trying to make sure that single legal entity is as strong as possible -- I'm agreeing with Brent that strong capital and strong liquidity are important -- let's take that as a given; but if you slice those things up into small buckets, the risk that you may have -- if I'm the Lima supervisor and I say I want to see a lot of cash here in Lima -- that's going to make it harder for that bank to make sure it can make all of its payment obligations (inaudible) on a cloudy day. And if Frankfort, or Zurich, or New York, and London jump into that, all of a sudden the amount of free cash, flexible cash, that's available for the bank, overall, will decline.

And so, the risks, actually, even to the Lima branch, because it's part of that same legal entity by trapping cash in my own country, I've made it more risky for me to have that bank in my country. The risk of it failing has gone up. Now, I attribute some of this to sort of post-crisis traumatic syndrome. If you're a supervisor, wanting to see cash on a barrel in your own country is a sort of natural reflex; but I'd argue it's sort of a category mistake. It's not understanding the nature of the problem and, in fact, it's making your own problem a little bit worse.

Now, there are other reasons why you might have rules for how branches operate in your country, but if you want to promote global resilience, I think it's very important to be thoughtful and come to more of an international view of how we think about liquidity in branches and how we make sure that we're not making banks more fragile by doing so.

MS. SAHNI: I guess you've described this in the past as sort of the home/host prisoner dilemma, right -- everybody acting in their own interests sort of makes everyone else worse off than they would be otherwise.

MR ERVIN: Yeah. This was, actually, even worse in branches because you don't even make yourself locally better off if other people don't copy. That's true for subsidiaries; for branches I'd say it's more counterproductive, it's an own goal.

MS. SAHNI: Yeah. I guess the question then is it a matter of increased information sharing; there has to be more trust among regulators; or where does that take you in terms of the next step to make people aware of where, you know, their interests actually lie here?

MR. ERVIN: I think there's probably a couple of things. I think part of it is stepping back to understand what is the purpose of the legal entity system. If you build strong capital, strong TLAC, strong liquidity, what's the smartest way to allocate that? You then get into the questions of how do you get the information, the CMGs that were brought up earlier, how do you get both colleges and CMGs to understand how that would be used both in peace times and if things got scary?

MR. GRACIE: That's the point I want to expand on a bit because, you know, where are we. In a way where we are is host of doing backward induction from failure and making sure that they've got their arms around resources, (inaudible) to protect themselves. But it isn't logical, certainly not logical for branches. I'd argue it's not really logical for subs either. I use to look out at the window at the Bank of England with every last global investment bank having a sub in London, and half the balance sheets of those entities were interaffiliate claims. It was preposterous to believe that as an entity that could survive or move ahead on its own.

Part of the backward induction from failure by host is, as well, revealed preference, huge investment in requiring firms to prepare for cooperation failing. So, the FSB trumpets how many SP resolution strategies are great for GSIPS; but then the U.S. requires FBOs to prepare local bankruptcy plans, and the PRA in the UK requires these investment bank subs of global investment banks to prepare a solvent wind down plan, which is entirely local. And I guess, you know, I should take some responsibility here; obviously, (inaudible) (laughter); but being on the other side of the fence now, I'm going to turn around and waive a monitoring finger at them and say, you know, they really do need to do better at following through on what they've collectively agreed is the right way to (inaudible) to fail; it's the right way to make the global financial system safe. And that really does mean that CMGs and also supervisory colleges, which, frankly, have been not very accountable; have been talking shops to a large extent, need to step up and work much more intensely together to bring clarity as to how within these groups which the people around the table agree are single point of entry, how resources are preposition; how the resources are utilized, so where losses are incurred or where there are outflows, how those are repaired; and then where does point of non-viability lie for the group; how does that interact at legal entity level; and what are the resources and how are they used in resolution.

Actually, I think there's a role there for firms to play, frankly, because it took nearly, you know, a decade to get Basel 3 or Basel 4 -- and as I alluded to earlier, nothing on distribution of resources within an international banking groups within that -- so, the idea that there's going to be a tablet down from the mountain which is going to bring peace and harmony any time soon is vain.

But, maybe echoing a bit what Brent was describing, if firm's can articulate as part of their eye lamp, their eye camp from a home/host perspective, how things work all the way along the continuum from BIU, through stress, and to recovery, and to resolution; actually, you may have a better shot of getting the home and the host authorities that you're confronted with towards some kind of agreement. But as it is, if one rings one's hands and says passively, you know, these requirements are terrible, some of the (inaudible) is terrible, I think it may just get worse rather than better. So, I'd take destiny in your own hands (laughter).

MS. SAHNI: I supposed that in that vein, Barney, you've, obviously, written a lot about enhanced equivalence, how do you think that works as a potential solution to some of these fragmentation or ring-fencing concerns?

MR. REYNOLDS: So, I think, I completely agree with Andrew's some proposed way forward. I think what Brexit provides as an opportunity is for the legal pinnings of this more trusting relationship for the two main global financial centers to be encapsulated in more than a MAU in some sort of provide a legal architecture that provide some level of certainty. And the basis for that, I think, is in some form or other going a little bit further than what the U.S. already has in terms of (inaudible) to compliance, but involves some sort of element of mutual respect of laws. And the UK within the EU was the pilot for the concept of equivalence where if laws (inaudible), they can be recognized; and I think, for the reasons I mentioned earlier, I think the UK and the EU will end up in some sort of an arrangement like that which would allow the UK, in fact, to repatriate some much needed autonomy to make the sort of decisions that entries outlining and, I think, the UK should make. And the prize, I think, which is very much achievable, and I don't think it means much movement on the U.S. side, is to stitch together the U.S./UK markets in an architecture a little bit of sort of underpinning, that allows for that leap, particularly by the UK I'd say more so than the U.S. I don't see the U.S. as making such a great leap for it. I mean the U.S. has stipulated the 90 percent requirement, I would hope that it's prepared to come down a bit on that for the UK.

But I think the prize would be, actually, to create the fabric that would allow for that trust to take route; and I think it's imminently achievable. I think the sort of sands are shifting, the EU is shifting towards that; it's a smaller pool of capital in the EU less lucrative markets to do the deal with. I think the UK's focus should be, and the U.S. focus should be in relations to each other.

MS. SAHNI: Great. Bill, you mentioned in terms of the REPO markets, you know, some of this seems to come back to potential central bank cooperation. I don't know if that's something that you see as a potential solution or sort of, you know, two difficult to actually accomplish and that there are other sort of more interim solutions.

MR. NELSON: No, I think it's absolutely an important part of the solution, and maybe not be something that can be achieved directly, but, I mean immediately, but it can be something that can be built towards over time. So, yesterday, BPI published a working paper that I wrote on central bank cooperation as replacement for fragmentation. The paper's basis thesis is that central banks had an understanding before the crisis about how lender of last resort lending would be handled when it involved an international institution. That understanding was strained to some extent, broke down to some extent, during the crisis; and that, as a consequence, no longer confident on how these things would be handled by the home central bank. That was one of the key reasons that gave rise to the host central banks, and the host jurisdictions insisting on a lot prepositioning of liquidity.

So just to go through it quickly -- so, an international bank will borrow quite frequently from the home central bank and the host central bank, and this sounds a little alarming but it's not at all because borrowing from the central bank is a very normal thing, it's a normal part of monetary policy operations; and the vast majority of those things have nothing to do with the condition of the institution. But sometimes, you know, the borrowing does have to do with the institution even if you're lending to a solvent institution, there might be questions about its solvency or it might be facing liquidity strains. Sometimes those things happen when they start out as a lending that's a monetary policy operation. But in those situations, there needs to be coordination between the -- often the initial lending is at the host central bank. These things can come up fast; the liquidity need can be there; the collateral can be there; so, there's cooperation and coordination needed because, ultimately, the information about the solvency of the institution is in the home jurisdiction as well as the decisions to be made about resolving or closing the institution.

Now there was an informal understanding about how these needs would be handled between central banks, going all the way back to the 70s and, you know, it dates to this sort of the formation of the Basel Committee which happened in the wake of the Harris failure of the Harris Stock Bank, and other liquidity problems, AFAC problems that happened because of that and, basically, the understanding is that the host central bank will meet the liquidity need in the first instance, but relatively quickly the home central bank will come in and take over; and, ultimately, liquidity needs the responsibility of the home central bank which, again, has the expertise to judge the solvency of the global institution.

That understanding was strained during the crisis and in its aftermath for a couple of reasons. So, as I mentioned earlier, a lot of foreign institutions did borrow from the discount lender, as well as the other liquidity facilities that the Federal Reserve opened, that was all, in fact, understandable and not in any way sort of alarming because foreign branches and agencies of banks they are very reliant on wholesale funding. They don't have a deposit base, and the financial crisis was a crisis in wholesale funding markets; but there were two banks that took a long time to repay those loans. So, rather than, you know, almost once the Fed, you know, was done with its war footing and started to close things down and wanted to get back into sort of very short-term lending, it took a very long time, months and months, for a couple of the foreign institutions, for the foreign jurisdictions, to sort of take over the responsibility for the lending to those foreign institutions.

Now on the European side, the ECB actually made losses on a loan that it made to a Lehman subsidiary. Now, they, ultimately, were able to realize on the collateral and not make losses; but they had booked losses for a long time; and there was a lot of bitterness over the fact that the Federal Reserve didn't make any losses on Lehman, but the ECB had. But if you can't trust the other central bank to take over; if you have to consider the possibility when you're making a loan to a foreign institution that you may be in some sense stuck with that loan; then you need to have that institution preposition a lot of liquidity, and even capital, before you're comfortable making that loan. And those are important reasons why IHEs were reformed and why there's discussion about branch liquidity requirements.

But if you can go back to greater cooperation across central banks, then you can also go back to less fragmentation. You can get, as it were, more growth, and the same amount of stability, or more growth and more stability because you're operating more efficiently; you're operating on the growth stability frontier, not as Wilson pointed out, you know, sort of inside of that frontier, making a lot of inefficient decisions.

Now, this is importantly about the fact that liquidity regulations are about time. So liquidity regulations are designed to buy you time. So, 30 days, the LCR buys you 30 days. If you know that things will be taken over by the home institution quickly, you don't need to trap as much liquidity in the host jurisdiction. Now, I see I'm out of time, but I'm going to quickly go through a few things that could be done in order to encourage cooperation.

So, first of all, there could be clear understandings about the division of responsibilities between home and host central banks. So, there's been a lot of work on that. Andrew and I worked on these issues together, but there could be a lot further to be done. Central banks could develop the ability to take collateral for one another on other's behalf. And there are some beginning capabilities that way, and that capability has been done in the past; but often when a host central bank makes a loan the collateral is in the host jurisdiction, and for the home central bank to take it over, there has to be a handoff of that collateral.

The Fed could provide more certainty about the international swap lines. This is really a problem about dollars in the Fed. If you're a global institution and you have to take over a dollar loan, I mean if you're a home central bank and you have to take over a loan to one of your institutions, in dollars, well, you don't have the luxury of being able to create dollars like the Fed does; so, having confidence that you can get those dollars when needed can really change your perspective on your ability to engage in sort of cooperation.

And lastly, institutions need to, I think, share more information. Central banks need to share more information about their views of the solvency of their international institution. One way that you can get trapped, different central banks have different views about what is a solvent institution. So, you could lend to an institution that passes your solvency test, but if the home central bank says in our view they're not solvent -- it's kind of what happened in the financial crisis -- then you can end up back in a situation. So, greater information sharing about condition can also help.

MS. SAHNI: Great; thanks. Well, as you mentioned, our time is up; so, Brent I'll give you the last word and then we'll let people off to their drinks.

MR. HOYER: I will be very, very quick. Let's do it this way because you had asked what solutions relative to what we were talking about from a national regime or a global firm, as well as what possible regulations could adjust; and not admitting to any mistakes in the regulations which I had an involvement with (laughter), but looking back, specifically, to the U.S. to Title I and the framework that was established around RLAP and RLN relative to excess resources and entities not being able to flow across -- and look, I think, that's something that's already being revisited and that's something I would think about differently today, and that would have a material impact, quite frankly, and I would follow more along the free flow of funds line and friction-based analysis that was put into the FBO Guidance, that'd be one.

As far as the solutions to the national regime, these would be difficult, they'd be hard; but, practically, if you were restarting this, this is how I would do it. One, it has to be governed by agreements, plain and simple. Some people would say treaties; some people would say agreements; and whenever you say treaties, people just pretty much give up and go home; but if you're looking at it from the standpoint of each firm that truly is a global firm, and needing that type of plan, you would approach it that way across those material jurisdictions.

And then, secondly, it would be a global plan as we've talked about it. It wouldn't just be this U.S. plan, or EU plan, or different framework; those jurisdictions that signed on would look at it from a global plan. The firms have all identified all identified, whether you call them critical operations or critical functions, and the associated services that support those across all those regimes; and so to establish a global plan, I think, would be much more appealing to many CEOs and CFOs that place resources at a complete 100 percent friction in every jurisdiction they operate in. That was fast (laughter).

MS. SAHNI: Great; thank you very much; and thank you, the panel. (Applause)

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