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FEDERAL RESERVE BOARD SUPERVISION VICE CHAIR

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P R O C E E D I N G S

MS. AARONSON: Good morning everyone. And welcome to Brookings.

My name is Stephanie Aaronson, and I'm the Vice President and Director of the Economic Studies Program here at Brookings. Although to be honest, I've only been in the role for three weeks. In fact, you all are the first audience I've had the pleasure of welcoming to Brookings in this new capacity. And so, I'm very grateful to each of you for showing up here this morning.

We are here today to discuss the current state of financial regulation, and to hear from the person perhaps best situated to share the latest developments, Federal Reserve Vice Chairman for Supervision, Randy Quarles.

Before joining Brookings I, too, was at the Federal Reserve providing analysis to policymakers on the U.S. economy and labor markets in particular.

So, I recognize how critical a stable financial system is to our economy and to all who participate in it. In that role I had the pleasure of interacting with Vice Chairman Quarles on a few occasions. And I'm grateful that he was able to stop by this morning and share his valuable perspective.

Quarles was confirmed as Vice Chairman for Supervision a little more than a year ago, and just six months later Congress passed new legislation to adjust several aspects of the Post-Financial Crisis Financial Regulatory Framework created by Dodd-Frank.

Vice Chairman Quarles continues to play a vital role in the implementation of those regulatory changes, which is one of the many reasons I look forward to his remarks today.

Vice Chairman Quarles brings to the Federal Reserve Board decades of experience as a Banking Lawyer in both the public and private sectors. Directly prior to his appointment to the Board, he was the Founding and Managing Director of the Cynosure Group, and before that, a Partner at the Carlyle Group in Washington.

He also spent several years at the Treasury Department, first as Assistant Secretary for International -- first as Assistant Secretary of the Treasury for International Affairs, and later as Under Secretary of the Treasury for Domestic Finance.

Given the interconnectedness of the global financial system, his experience in both domestic and international affairs is surely invaluable to his work at the Federal Reserve today.

I'll close with a little bit of information on today's program. We'll begin of course with prepared remarks from Vice Chairman Quarles. Following his remarks he'll be joined on stage for a moderated Q&A with Brookings' Senior Fellow, Martin Baily. Vice Chairman Quarles will also take questions from the audience. To conclude we'll hear from a panel of experts moderated by Brookings' Fellow, Aaron Klein.

With that, I'd like welcome Vice Chairman Quarles to the stage. Thank you for being with us here today! (Applause)

MR. QUARLES: Thanks Stephanie. And thanks to Brookings for inviting me to speak today. It's an honor and a pleasure to speak to this distinguished audience. I'm very pleased that people would want to show up for such a wonky topic.

And obviously Brookings' scholars in this area are extremely distinguished. They include Former Chairs, Vice Chairs, senior leaders of the Federal Reserve, many others, some of whom are in this audience who did the hard, foundational work of developing and implementing many of the new post-crisis measures, including stress testing, which is what I want to talk to you about today, some of the changes we're proposing to make in stress testing.

And under those circumstances, my showing up at Brookings and discussing changes to our stress testing regime could sound uncomfortably close to the serene arrogance of Alfonso X of Castile, who famously said that "Had I been present at the creation, I would have given some useful hints for the better ordering of the universe."

My thoughts today, however, are not a call to rewrite Genesis, (laughter) but rather a recognition that our stress testing regime, like the banking and financial system that it evaluates, will and should evolve as we continue to learn from experience in the management of this tool. And in the best traditions of the Federal Reserve, this evolution should be grounded in rigorous analysis of the data, and a commitment to continual improvement of our methods.

So in my remarks today, I'll begin with what's been successful about the stress tests and why those elements should remain. I'll spend some time discussing some of the changes we have proposed for our stress testing program, and how we are now thinking about moving forward with those changes.

After that, I'll discuss the tension between, on the one hand, providing additional information to the affected firms while, on the other hand, ensuring that the tests remain effective. And finally, I will close with some thoughts on the qualitative element of our Stress Testing Program.

The adjustments that I'll discuss are intended to increase both the transparency and the efficiency of the stress testing regime. Enhanced transparency goes to the very core of democratic accountability and to the rights of all U.S. citizens, including the management and shareholders of the institutions that are subject to the stress tests, to understand the requirements to which they are subject, and it also helps to ensure the continued credibility of our regime.

So let me begin with a short discussion of the core elements of our stress testing program. So as most of you know, one of the most visible aspects of our stress testing program is that the firms and the public receive an independent view of the capital adequacy of the largest banks. The results are based on our own models and provide a consistent yardstick to measure resiliency across the banking system.

But the stress test that's conducted by the Fed is only one part of our stress testing regime. Just as important, in our view, we require each firm to run its own stress test, using its own models and a stressful scenario that reflects the firm's assessment of its idiosyncratic risks and key vulnerabilities.

Underpinning a firm's stress test is the firm's ability to identify and measure risks under both normal and stressful conditions and the strength of the firm's internal processes around that assessment, and we use our supervisory process to ensure that the firms' stress testing practices employ sound methodologies.

So the combination of the Fed's common yardstick, the firm's own stress tests, and supervisory oversight over the firms' practices has resulted in a meaningful increase in the post-stress resiliency of large financial institutions. All of these core components will remain in place.

In addition, the changes I'll talk about today are not intended to materially alter the overall level of capital in the system or the stringency of the regime. A healthy U.S. economy relies on a strong, well-capitalized banking system that can weather stressful events and continue lending to households and businesses.

The U.S. banking organizations subject to the 2018 Comprehensive Capital Analysis and Review, or CCAR, which is the Fed's evaluation of capital adequacy for large holding companies, have increased the dollar amount of their common tier 1 capital from around $500 billion in 2009 to more than $1.2 trillion as of the second quarter of this year, have more than doubled CET1 risk-based capital ratios from approximately 5 percent to over 12 percent over the same period.

But while the regime has been successful overall, in my view, I believe it's prudent to review all of our practices to ensure that they are as efficient and transparent as possible and that they remain appropriate in light of changes in the industry that have been achieved.

For instance, as firms become more resilient they may no longer need to build capital to support their current level of risk taking, but rather move into the mode of retaining the capital they've already built. Firms have also significantly improved their risk management from before the crisis, providing room to adjust our approach to assessing their practices.

And finally, as we make changes to our regime, the issue of volatility in the stress test results becomes more pronounced. As I'll discuss, we are considering how to balance the need to preserve the dynamism in stress testing with the need to ensure that firms have sufficient notice regarding the capital requirements to which they are held.

Now, many of you in this room are familiar with the Federal Reserve's proposal to integrate the stress test with the regulatory capital rule, known as the Stress Capital Buffer, or SCB, and if you're not, then you're not maybe you're on the plane. (Laughter)

But I believe the SCB proposal represents an important milestone as we enter the next chapter of our stress testing regime. But for those who aren't quite as familiar with the SCB, let me provide a little background about how our capital rule currently works, and how it would be modified by the SCB.

So as devoted readers of our capital rules may know, our Regulatory Capital Rule includes both minimum capital requirements and a buffer that sits on top of those minimum requirements. The buffer serves as an early warning to a firm and to its supervisors, and it requires the firm to reduce its capital distributions as the firm approaches the minimum requirements, as it leads through the buffer down to the minimum.

Under the current capital rules, all firms are subject to a fixed buffer requirement of 2.5 percent of risk-weighted assets, and the largest firms are also subject to a global systemically important bank surcharge and a potential countercyclical capital buffer.

For large firms, the SCB would replace the fixed 2.5 percent risk-based buffer with a firm-specific buffer the size of which would vary from firm to firm based on the firm's stress test results. In this way, we are integrating the automatic restrictions on capital distributions in the current capital rule with the output of the most dynamic tool we have for assessing risk, the stress test, to create a more robust and dynamic but also simpler regulatory capital regime.

The SCB would also result in a more transparent and simplified system of regulatory capital requirements, because a firm will be held to a single, integrated capital regime.

Now, when we made our SCB proposal last April, we had aimed to make the SCB final for the 2019 stress test cycle. But the comments we received have been extensive, they've been thoughtful, and they've raised issues that require a carefully considered response. I don't believe those issues will ultimately prevent us from implementing the SCB, but they've flagged certain elements of the regime that could benefit from further refinement.

Accordingly, I expect we'll adopt a final rule in the near future that will settle the basic framework of the SCB but re-propose certain elements. And to enable this process to run its course, I expect that the first SCB would not go into effect before the earliest 2020.

For 2019, I expect CCAR will remain in place for firms with over 250 billion in assets or that are otherwise complex; but we'll consider whether we could move forward with any aspects of the SCB proposal for CCAR 2019, such as assumptions related to balance sheet growth.

And again, for people who are familiar with the proposal, you know what some of the assumptions about the content of the stress test in addition to the form of the stress tests that were included in that proposal, and we need to consider whether there are any of those questions of content that could be included in the current stress test even though the SCB won't be effective for that cycle.

I will also ask the Board to exempt firms with less than 250 billion in assets from the CCAR quantitative assessment and supervisory stress testing in 2019 in light of the every-other-year cycle contemplated in the Tailoring Proposal that the Board approved two weeks ago.

Returning to the SCB proposal, I want to give you a sense of some of the comments we received and our approach to addressing those concerns. The issue that's foremost on my mind is the volatility of the stress test results. One concern that was frequently expressed is that the results of the supervisory stress test can lead to capital requirements that change significantly from year to year, which limits a firm's ability to manage its capital effectively.

Some amount of volatility is necessary to preserve the dynamism of the stress test, by nature the stress test will differ year-over-year based on macroeconomic conditions, contemporary understanding of salient risks in the economy, and in addition, the stress test results are sensitive to changes in a firm's balance sheet, which means that a firm's capital requirements will evolve as the firm's activities and exposure evolve.

But I do think there's an important balance to be struck between preserving this dynamism and ensuring that firms have sufficient notice regarding the capital requirements to which they're held.

In the first years after the financial crisis the banking system was dramatically ramping up the total amount of capital in the system, this volatility was less of a management problem until we reached a reasonably full capitalization every year, every bank needed to increase its capital; and if one year that increment was a little higher or a little lower than the previous year, that was simply a modest difference of velocity, not direction.

At the current juncture, however, both our system as a whole and each of the largest banks in that system are fully meeting their capital requirements. Chairman Powell and I have both said on more than one occasions, the amount of capital in the system is just not right.

In these circumstances, having a highly variable capital requirement presents a significant management challenge. So, we're considering ways of preserving the dynamism of stress testing while reducing its volatility, and we plan to seek comment on a proposal in this area in the not-too-distant future, and that's not too distant in real time not Fed time. (Laughter)

In addition, we are also exploring ways of improving our approach to measuring risks in the trading book. Firms' trading books are dynamic and complex, firms hold both long and short positions, many have noted that a single market shock doesn't adequately capture the risks in firms' trading book.

Those are sensible comments, we are exploring ways to incorporate multiple market shocks in the stress test without adding volatility to the results, and without increasing the compliance burden, which as you can imagine, the Venn diagrams there overlap over a relatively small area, but that's what we're trying to accomplish.

We are also considering adjusting another element of the SCB proposal in order to provide more notice to firms. Currently, and both how we currently run the stress test and in the SCB proposal, as we originally put if forward, a firm must decide whether to increase or decrease its planned dividends and share repurchases for the upcoming year without the knowledge of a key constraint, which is the results of the stress test.

In other words, we require a firm to give us a formal plan for dividends and stock repurchases without knowing what its effective capital requirement is. If it guesses wrong, it could be publicly shamed for failing the stress test if its dividends are too high relative to capital, or it could be penalized in the markets for inadequate distribution of income if its dividends are too low relative to capital.

Now, admittedly, at first blush this structure could appear to be pointless and obdurate cruelty, but the reason behind the practice was initially perfectly sensible. It reflected the view that firms should think rigorously about their capital uses and needs in developing their capital distribution plans, rather than rely primarily on the results of the supervisory stress test to guide those plans.

But now that we've all had several years' experience with this system, firms have told us that they would be able to engage in more thoughtful capital planning if they had knowledge of that year's stress test results before making final their distribution plans for the upcoming year. I'm very sympathetic to their concerns, and I'll ask the Board to adjust the operation of the rule so that firms know their SCB before they decide on their planned distributions for the coming year.

This adjustment in sequencing will also help firms manage volatility in the SCB. Obviously we expect firms to continue to maintain robust stress testing practices and to use those results to inform their capital distribution plans, and we'll continue to use our supervisory process to reinforce this expectation.

The comments that we received also highlighted an issue with how the capital buffers operate today, and that's amplified by the inherent volatility of the SCB. So as I noted earlier, a firm operating in its capital buffer is required to reduce its capital distributions so that it can build capital over time.

Now, by design, the buffer was intended to apply increasingly stringent limitations as the firm's capital ratios decline. So it's supposed to be moving along a continuum, but in that current world in which a healthy and profitable banking system is seeking to maintain its capital levels rather than continue to increase them, a bank can appropriately and safely tend to distribute much or all of its income in a given year. It's in maintenance mode as opposed to increase mode.

But in that case, given the way that the capital buffer rules are described, the minute you get into the buffer, you would have to completely cease all of your distributions as opposed to having a gradual ramping down, even if the changes in your capital levels are quite minor.

So we are considering adjustments that would make the rules more consistent with the graduated intent of the structure. And we'll work with the other banking agencies to consider how best to effect this change.

There are two additional elements of the SCB proposal that I think would benefit from modification. First, the SCB proposal would have included four quarters of dividends in a firm's SCB in recognition of the fact that firms experience market pressure to hold dividends constant, even under stress.

But in my view, and this view is shared by many regulators around the world who have similarly stringent expectations and regulatory structures, there may be ways of encouraging greater reliance on less sticky repurchases while providing more flexibility in the regime, and we are exploring alternatives. And finally, the SCB proposal would have included a post-stress leverage requirement.

Now, the Federal Reserve has long maintained -- so I don't want to overstress that -- we've long maintained we haven't always maintained -- (laughter) -- we haven't always maintained, I don't want to sound too much like we have always been at war with East Asia. But we have long maintained that leverage requirements are intended to -- are important elements of our capital regime, but they're intended to serve as a backstop to the risk-based capital requirements.

By definition, they are not intended to be risk-sensitive. So, I'm concerned that explicitly assigning a leverage buffer requirement to a firm on the basis of risk-sensitive, post-stress estimates runs afoul of the intellectual underpinnings of the leverage ratio. So, I would advocate removing this element of the stress capital buffer regime.

It's not removing the leverage ratio, the leverage ratio is including the enhanced supplementary leverage requirements, and would remain a critical part of our regulatory capital regime, and we'll maintain a supervisory expectation that firms have sufficient capital to meet all minimum regulatory requirements, including the leverage backstop.

Together, the adjustments we are contemplating to the SCB offer promise in improving the efficiency, coherence, and transparency of the regulatory capital regime while maintaining the overall level of capital in the system and the core principles of the regime that have proven successful.

That being said, we welcome a continued dialogue with the public as we implement these changes, and through that implementation, we'll ensure that we maintain the incentives for effective stress testing practices that exist today.

Now, transparency of the stress test and its inputs and outputs is key to the credibility of the test, and there are several initiatives underway to provide additional transparency regarding the supervisory stress test models and the scenario design process. We think that the adjustments that are under development strike the right balance of advancing transparency, while maintaining incentives for firms to think critically about their own risks.

So I expect that soon you will see the Federal Reserve -- and again, soon in real time not Fed time -- you'll see the Federal Reserve issue a policy statement describing governing principles around the supervisory stress testing process. As a part of that statement, I would expect a commitment to disclose additional detail on the supervisory stress test models and results, and to publish portfolios of hypothetical loans and associated loss rates.

I expect that we'll begin providing some of this additional detail starting in early 2019, and that these changes will allow firms to benchmark the results of their own models against those of the supervisory models. But our commitment to transparency does not end there.

We are currently considering options to provide additional transparency regarding scenarios and the design of the scenarios, and I expect that the Board will seek comment on the advisability of, and possible approaches to, gathering the public's input on scenarios and on the salient risks that are facing the banking system in each year.

Such a proposal may also provide additional details about the scenario design features that underpin each year's scenarios, and a range of other enhancements.

Additional transparency regarding the stress test scenarios serves multiple purposes: it provides additional due process to affected participants, and as a former lawyer, I couldn't underscore enough how important that is in any governmental process, but it also provides additional sources of insight, including from academics and thought leaders, like many of you in this room, that could be used to inform a given year's scenario.

Increased transparency could also enable us to be more nimble in our scenario design to the extent that we uncover through external input new salient risks that we haven't previously considered.

As we develop proposals, a key consideration is to ensure that we maintain incentives for firms to conduct their own stress tests rigorously and thoughtfully. Firms have indicated that additional disclosure about models would not affect their own stress tests, and we expect them to make good on that representation, as the Federal Reserve's stress test is not and cannot be a full picture of a firm's resiliency in light of its idiosyncratic risks.

For example, there is some risk that firms will use knowledge from additional transparency about the stress test to engage in transactions that are solely designed to reduce losses in the test, but that don't truly reduce risk in their portfolios.

As supervisors, however, this is something we can guard against through the regular examination process, and we'll closely monitor changes in firms' portfolios and take appropriate actions to ensure that firms are holding sufficient capital, and have sufficient controls and governance in light of the risk characteristics of their activities.

Before I close, I would like to say a few words about the role of the qualitative objection in our new chapter of stress testing. As originally conceived, and again, if this isn't familiar to anyone in the audience, by now you are scrambling to figure out how we can land at the nearest intermediate point and you can get on the right plane. But as originally conceived CCAR had both a quantitative component, based on the supervisory stress test, and a qualitative component based on the Federal Reserve's assessment of a firm's stress testing practices.

In 2017, the Federal Reserve eliminated the qualitative objection as part of CCAR for large but noncomplex firms, in part because of improvements in risk management at these firms. That's not an elimination of our concern over their practices with regard to their internal stress testing and capital management, but by incorporating supervisory stress testing into the regulatory capital regime and introducing an automatic penalty if a firm falls below its SCB-derived capital requirement, the SCB proposal will eliminate the quantitative objection from CCAR.

The natural next question is: has the CCAR qualitative objection for the largest firms also run its course? In my view, the time has come to normalize the CCAR qualitative assessment by removing the public objection tool, and continuing to evaluate firms' stress testing practices through normal supervision.

In such an environment, firms would remain subject to the same supervisory expectations, examiners would continue to conduct rigorous horizontal and firm-specific assessments of a firm's capital positions and capital planning, tailored to the risk profile of the firm. While much of the examination work would center on a firm's capital plan submissions, examination work would continue on a year-round basis for the large firms, taking into account the firm's management of other financial risks.

The evaluation of the firm's capital position and capital planning would culminate in a rating of the firm's capital position and planning, and firms with deficient practices would receive supervisory findings through the examination process, and would be at risk of a ratings downgrade or enforcement action if those deficiencies were sufficiently material, we would simply remove the public shaming element of the qualitative objection.

So, in conclusion, as we begin the next chapter in stress testing, my objective is to ensure the continued credibility of the program by increasing its transparency, its simplicity and its stability while maintaining the strength of the supervisory and internal stress testing elements that are central to the program today.

These adjustments will be coupled with our continued commitment to strong supervision, and our expectations to financial institutions ensure they are managing their risks and holding sufficient capital to continue operations through times of stress.

So, thank you again very much for having me here today on this wonky topic, and I'm looking forward to our discussion. (Applause)

MR. BAILY: Thank you so much. That was terrific. I've got to hold the mic there. Thank you. And my phone will probably go off in a minute too, but never mind.

So thank you so much. As you are well aware, you've gotten some comments and criticisms coming from folks who think that the changes that you're making in financial regulation have not gone far enough, and so we're not doing what the President wanted to do, which was to increase the amount of lending, encourage economic growth.

And then you've gotten criticisms from folks who think you've gone too far, that you shouldn't be loosening regulations, that Dodd-Frank should be kept in place, and nothing change. So, I'm going to ask questions that sort of come at you from both directions, if that's okay.

So the capital rules that banks are facing, so this is sort of the direction. Have you done enough to try to improve or make regulation more efficient and encourage economic growth?

So, the capital and liquidity rules that banks face, have been extremely complex, and the description you gave have changed it to the stress test indicate maybe some simplification, but it still sounded like a very complicated regime.

And I know that John Dugan, when we were working at the Bipartisan Policy Center, he used to complain there were nine different capital ratios that he had to look at with the leverage ratios, then there was the liquidity you have to look at as well. So, are you thinking you're on a path, or have you done enough to kind of simplify the capital regime so banks can operate more efficiently?

MR. QUARLES: So, I think we have proposed a lot, our own count actually is that in the current regime banks are subject to 24 separate capital measures, and with --

MR. BAILY: More than nine.

MR. QUARLES: Exactly. More than nine, and with the SCB proposal that we put forward that would reduce the number to 12, which is still more than nine. But it's a move in the right direction, and I think a significant simplification of the regime. And most of the comments that we received have acknowledged that.

Now, I think that at any moment we shouldn't consider -- you know, the job of the Fed should never be to consider its work over, but rather to continue to think about, well, how can we continue to improve the efficiency of the regime? But I think that those are significant steps towards improved efficiency.

MR. BAILY: Let me ask you to comment on the Volcker Rule, so that's something that's been -- it's in the law so, you know, it's there, it's something that the banks have had a hard time with, it's something that regulators had a hard time sort of setting up, I think there is sentiment too in the Federal Reserve to simplify the Volcker Rule.

So, could you give me comment on that? I don't think we want to go back to the days when you had huge, risky trading floors with inadequate capital and we know where that went. But are there proposals, or how do you see the Volcker Rule playing out? And do you think it's actually damaging, for example as has been claimed, issuance by a smaller company, smaller bond issues because of the presence of the Volcker Rule making it more difficult for institutions to make markets?

MR. QUARLES: So to take the last part first, I do think that there have been effects on markets from the Volcker Rule. You know, they're difficult to quantify precisely, but there is, you know, I think universal sentiment among market participants that the Volcker Rule has effective liquidity in some markets, and I think that's probably true.

Reasonable people can differ about the extent of that. I think that there's universal agreement that the rule, as it currently exists, is too complicated, it's too complicated from the point of view of supervisory enforcement, it's too complicated from the point of view of firm compliance, and I think that it is totally sensible, and for that matter, does Paul Volcker, to have a much simpler approach to implementing both the letter and the spirit of the Volcker Rule provision in the Dodd-Frank Act.

So, I think that's eminently doable because as I said, there's universal agreement on that, the five relevant agencies are working together to process the comments, very thoughtful comments that we received, and responsive proposal that was put out earlier this year, and so I expect that that process will come to a successful conclusion.

MR. BAILY: In that, when you announce the tailoring process there were some comments, maybe some complaints that you weren't doing anything for the GSIBs, if the goal is to try to ease regulation to make money more available for businesses, as

Willie Sutton said, you go where the money is, and that's, you know, to a large extent that's the GSIBs.

So if the capital requirements are about the same, the TLAC requirements for those banks are about the same, maybe we're going to simplify the stress test a little bit, but have you done enough to make sure that large banks are able to play the role that's needed in order for a growing economy to have access to funds?

MR. QUARLES: So, we are continuing to look at the -- you know, at the framework that affects a lot of banks. As I've said, our objective is not to materially change their capital requirements. There are a lot of things that are in the works, Basel III implementation, for example that would -- other things being equal -- result in material increases in their capital requirements.

I think we have to think through how we think about that in light of an overall view that this is a system in which the capital level is just about right. But with respect to the criticism of the Tailoring Proposal that came out last week, didn’t do anything -- or maybe it's two weeks ago now -- how time flies -- didn’t do anything for the largest banks.

Well, that was focused on implementing Crapo, which didn’t do anything for the largest banks, not Crapo the man, but Crapo the Bill.

MR. BAILY: The bill, okay.

MR. QUARLES: And required a huge amount of Fed resources, and I don't want to necessarily over stress this, but I think we put out that implementation proposal, if it is not the fastest implementation of a major piece of regulation in the history of the Federal Reserve, it is certainly among the fastest two or three which required significant devotion of resources to that effort.

And now that that proposal is out there, and we're processing comments, we'll determine resources to thinking about other parts of the system.

MR. BAILY: Let me sort of cross the street now, and sort of, say, raise some of the concerns that have come from the folks that think maybe you're doing too much. So, one of the most common things that I hear, and I'm sure that you hear, is to say, look, we have a very hot economy, people are reaching for yields, that maybe even beyond full employment, this is a boom time, this is a time when we should be tightening the screws a little bit on the banks, on the financial institutions, not easing the rules. So we want it -- it's really sort of the macroprudential approach. So could you comment on that reaction to the proposal?

MR. QUARLES: So to that I'd say a couple of things, one, you know, to the view that we are relaxing in the face of a boom, I really don't view the regulatory proposals that we have put forward, those that we are thinking about, those that I talked about today as relaxation.

I think that what we're doing is recalibrating in light of experience the post crisis regulatory regime in order to achieve the same objectives. There's no one that's ever been on the Federal Reserve Board, no one in the financial regulatory leadership frankly that disagrees with the fundamental objectives of a post-crisis regulation, which is to have more capital, more liquidity in the banking system to have a safer and sounder system.

But we also need to look at that framework through the lens of efficiency, because we have a strong public interest. It's not just a question of, you know, the banks feeling overburdened, but we have a strong public interest in the efficiency of the operation of that system, and its support for the real economy wherever we are in the economic cycle.

So that's the first thing I would say, is that I do think that when looked at fairly what we are doing is sort of, I think, very justified recalibration as opposed to relaxation of the regime.

But the second thing I would say is that we are, with respect to what people most frequently talk about is, you know, at this point in the cycle shouldn't we be pushing against the cycle as the countercyclical capital buffer.

And we have a very clear framework that we have talked about for implementing, for turning on the countercyclical capital buffer which refers to an assessment of overall financial vulnerability. So, the countercyclical capital buffer as it was discussed internationally, as it has been implemented both internationally and in the U.S., is a financial stability tool, not a sort of macroeconomic dampener, if you will.

And is designed to be in our framework quite explicitly we say, we are designed to turn it on when we think that financial stability risks are meaningfully above normal.

Now, quarterly at the Fed -- I mean, constantly the institution is assessing financial stability, but we have a formal quarterly process in which the Board reviews with the staff, our current assessment of financial stability risks. And our assessment currently is as we have said, is that those risks are moderate.

There are certain areas where you have clearly elevated risks, valuation pressures in certain asset classes, certain sectors where there's elevated leverage, but overall, the very strong position of the financial sector, the low leverage in the financial sector, the high liquidity in the financial sector, the adjustment of household balance sheets, all of that feeds into an overall assessment that our financial stability risks are moderate currently, and therefore in our disciplined and methodical framework, you would not turn on the countercyclical capital buffer.

There are regimes around the world that are rethinking this notion, and saying, well, maybe the countercyclical capital buffer could be used more appropriately as kind a macroeconomic dampener, as opposed to purely a financial stability flywheel, if you will.

But we haven't done the work here, we haven't gone through that process here in order to do that, and so I think as we think about using that tool, we need to do that in a disciplined way, and our current discipline is to thoroughly evaluate financial stability risk, to view as a financial stability tool, and in those circumstances, you wouldn't turn it on.

MR. BAILY: So, in your judgment, and I understand that the banks that you supervise and regulate are in good shape, so to speak. That they've got the capital, they've got the liquidity, and so you're not seeing red flashing signs going on even though the economy is strong?

MR. QUARLES: So, we're not. I'm very mindful that in my Nomination Hearing similar statements that I have made earlier in my life, were brought to my attention again. (Laughter)

MR. BAILY: They do that in the confirmation process, don't they? Yes.

MR. QUARLES: But no, we're not. In fact we're going to be releasing later today a Supervision Report with a very comprehensive assessment of the current state of the banking industry, and all the data would show that it's a very healthy industry.

MR. BAILY: All right. So let's go outside the regulatory perimeter for a minute. I mean, one of the concerns about Dodd-Frank was that it would strengthen the institutions that are subject to Fed supervision or careful supervision, but there are institutions that are not as -- that you don't see into, and that you don't necessarily regulate in the same way that maybe have some other regulator.

And I hear concerns about leverage allowance, for example, coming out of non-bank institutions. They're concerned about asset managers that may be reaching for yield, and taking unnecessary risks. And I also note that the FSOC has basically decided that no non-bank should be included in Federal Reserve supervision.

So, are you comfortable with where the regulatory perimeter is? Or do you fear some -- perhaps something that would happen outside of that perimeter that would, in the end, impact financial stability in the banks?

MR. QUARLES: I think that's an interesting question. We, you know, at the Federal Reserve we regulate the banking sector, and absent designation have limited responsibility and visibility into other parts of the financial sector obviously. But we do have some visibility, and what really is the -- if you think about what the real risk is, it's whether some of these other structures that are holding these assets, how leveraged are they.

And we do have visibility into that, from the fact that the leverage will tend to come from the regulated banking sector, and that's something that we are always monitoring. Again, currently we don't view that as raising significant risks, but we are always monitoring that.

I would refine a little bit your statement. The FSOC has said that no non-banking institution would be, you know, would be designated and placed under regulation by the Fed. I mean the FSOC is focusing on a designation by activity, if you will.

MR. BAILY: Right.

MR. QUARLES: So, we're focusing on what activities are there, which is a tricky thing to do, but is in fact being, you know, quite diligently and quite rigorously pursued by the FSOC, and I think conceptually, is it's probably even more accurate than the previous entity designation approach, because conceptually, that's what we ought to be concerned about.

It's, are there activities that can be conducted by any institution, whether it's a bank or a purple panda that could be affecting financial stability? And if so, it's those activities that we ought to be looking at, and that's what the FSOC is trying to do.

MR. BAILY: Okay. I've always agreed with that, that it's sort of activities you'd like to regulate. It's actually hard to do, because the activities occur within institutions.

MR. QUARLES: Yes.

MR. BAILY: So what's your control over that activity, it's through the institution, right? So, I've got lots of questions I'd love to ask, but I think I'm going to ask two more and then throw it open.

So, the resolution process, I've always been enthusiastic about the development of the single-point-of-entry approach, the creation to TLAC, unsecured long-term debt as a buffer in the event that a bank gets into trouble, and the process that I think the FDIC has put in place to resolve large institution.

But I think the question about that is, well, what if we had a really bad crisis, the kind of crisis the kind of crisis we had before, hopefully we won't for the next hundred years, but maybe we could. So, we could imagine that a couple of GSIBs were in trouble going down, maybe a couple of other banks, two or three other banks.

Could we manage to resolve all three, four, five institutions at the same time without there have been a big crisis? Or are we going to end up looking like the previous crisis? In other words, do you think this resolution process is really strong enough to withstand a big crisis that could hit some time in the future?

MR. QUARLES: I think the best answer to that, at least that I have, the most honest answer that I have, is that I view -- you know, the too-big-to-fail project, if you will, as ensuring the policymakers have more options in the event of the next instance of very widespread stress.

And I think that the post-crisis regulatory regime has done that. I think the work that's been done on resolution has done that. So, if you do face a period of widespread stress, I think that policymakers will have more options, which options they choose, what they choose to do will depend on the circumstances of time, and the policymakers of the time.

I also think that what we have done with respect to resolution significantly put off, you know, reduces the likelihood that you have kind of these -- the need to resolve many institutions.

MR. BAILY: Yes. Yes.

MR. QUARLES: One of the reasons that many institutions were resolved even in the last crisis was the uncertainty as to how you could resolve even one. And I do think that our ability -- or the much greater clarity we have into how we could resolve even a very large institution, even if it were only singular, reduces the risk that you will then have to resolve three, if it's clear how you can resolve one.

MR. BAILY: Okay. All right! For my last question, I want to go back, since your speech was about the stress test, I'd like to go back to that. And you mentioned the increase in transparency around the stress test. Now, I must admit, I was surprised when the stress tests were put out, that there was so little transparency, and I know the banks sort of felt they were, you know, walking into a minefield.

They didn't know what was coming. When I talk to folks, I remember a conversation with the regulators at the Fed in New York, their view was that we don't want to give away the exam questions before the student takes the exam, because then the exam wouldn't be worth anything anymore.

So, you've decided that you want to increase transparency, so say a little bit more about how you’ve done that in such a way that it makes it easier for the banks, but at the same time, presumably, you're not just giving away the exam.

MR. QUARLES: So, for me, the question about giving away the exam, I will admit that I've always been a little skeptical of that, about the ability of the firms to gain. For me that part of the criticism, or the support for opacity, it's really not a question of giving the banks the test questions, as opposed to, are we going to give them the textbook.

But I do think that there is a genuine concern about the so-called mono model problem, which is that to the extent that it is absolutely clear what the Federal Reserve's stress tests are going to show, what the models are, there's an almost irresistible incentive. I mean, it's just going to happen, because that will ultimately govern that that's what the banks will do on their own, thinking about their internal risks will erode to some extent.

I don't think that they -- you know, it's not like the "will of Landru" from the old Star Trek, and they're only doing what the Fed says, but -- (Laughter)

MR. BAILY: I missed that episode. It's all right. (Laughter)

MR. QUARLES: I can do them all, but --

SPEAKER: Good for you.

SPEAKER: The next time.

MR. QUARLES: But nonetheless there would be that erosion and, you know, and as said in my speech, the Fed does not have it exactly right. No one is going to have -- that complex of a model -- is going to have it exactly right. There's going to be judgments, there's going to be mistakes, there's going to be idiosyncrasies, and if there is one model to rule them all, all of the risks in the system will congregate around those fault lines.

So, I think that's a real concern. Now, opacity is only a half-way measure in dealing with that concern, because one of the reasons why there's less noise about transparency than there was even a year ago when I arrived at the Fed is that the banks are reverse-engineering. I mean, every time you have an iteration of the stress test, it's easier to say, oh, that's what happened, that's what they're thinking.

And so ultimately that mono model problem doesn’t disappear simply because we are opaque about the models. So I think we have to do more thinking about that. But that's why we are proposing more transparency, because I think that's a matter of due process.

I think we get more comments from folks in this room about, you know, how can you improve the test, to ensure that it remains dynamic and useful. I'm less worried, as I said, about the gaming issue, and we need to continue to work on the mono model issue.

MR. BAILY: Thank you. I'm going to ask some questions from the audience. Could you please identify yourself? Could you make it a short question, and not a speech, and hopefully relevant to the topic of this event. So, we have one at the back, yes. Please identify yourself.

MR. TENNEY: My name is Mark Tenney --

MR. BAILY: Oh, wait. We do need a mic.

MR. TENNEY: Thank you, ma'am. Yes. My name is Mark Tenney. I'm involved with capital and asset adequacy work in life insurance industry, and I helped calibrate the Economic Scenario Generator used to set capital and reserves for life insurance companies. Currently the economy generator which is required for reserves is unable to create scenarios that start at 0 go to 5 and back to 0 in short-term rates, and has trouble keeping rates close to zero for long periods of time.

Just to give you a little bit of information for those not familiar. Life insurance companies do ten thousand scenarios at monthly intervals --

MR. BAILY: We need a question in there, yes.

MR. TENNEY: Okay. So the question is, the inability of the Academy Generator to produce what I call the Larry Summers scenario, short rates go from 0 to 5 and back to 0, or to produce long periods of low rates, you know, do you consider that a systemic risk? And do you think that they need to improve their generator to include those scenarios?

MR. QUARLES: So I haven't considered that question up to now.

MR. BAILY: I was going to say I'm glad you're answering that question, and not me. (Laughter)

MR. QUARLES: But I would say that, as we think about stress testing, and my own view about stress testing is that it should -- you know, you should have the ability in the creation of scenarios to design a variety of different shocks. And some of them should be quite unexpected shocks. There's a question as to then, what do you do with the information that you get, but the point of stress testing is to shock the system in ways that might not otherwise be expected, that aren't day-to-day.

In the 2018 stress test we included an actual steepening of the yield curve even in light of a significant sort of macroeconomic event, which is not what one would normally expect to happen, but which could happen. There were reasons to think that this might be an environment in which it might be particularly -- you know, that unusual thing might be somewhat more usual than others.

So, how would the system evolve and resolve to that? And I think that those sorts of unexpected shocks, they're something that a good stress-testing regime ought to have the ability to incorporate, and not to do.

MR. BAILY: Yes? We need a mic on this side here.

MS. LONG: Hi. Heather Long from *The Washington Pos*t. Are you concerned at all about the slowdown in the housing sector? I get notes that say it's a canary in the coal mine for the broader economy, and maybe even for banks and bank lending. I'm curious what you think.

MR. QUARLES: Okay. So, one thing I should probably have made clear at the outset, but we just had our FOMC Meeting yesterday, and our blackout policy extends for one day after the meeting to -- I guess to prevent us all from stampeding over each other out of the room. (Laughter)

So, I actually can't comment on sort of macroeconomic, or questions that would affect monetary policy today. I'm sorry about that. Ordinarily the meeting is over on Wednesday, and I think when we set time for this --

MR. BAILY: When we set this time, yeah.

MR. QUARLES: -- it was precisely because the meeting would be over, and then because of the election, although we have known when the election was. But in any event -- (Laughter)

MR. BAILY: We were just happy without a date at all, that was a long struggle. Okay. A question here, and then I'll go to the back.

MR. DATE: Good morning. Raj Date from Fenway Summer. Vice Chair Quarles, thank you for being here. I marvel at your ability to render these hyper-technical issues in ways that are very slightly less hyper-technical (laughter). So, thank you.

If you'd asked me 10 years ago, which you did not, but 20 years ago I would thought that if we had both higher and more transparent levels of risk resilience in the system, that one, yes, depressingly would see lower returns on equity, but simultaneously one would see lower costs of equity, because investors would sensibly, you know, expect less volatility. Is that true; and (b) happening? And if not, what do you think about why not?

MR. QUARLES: So, I think -- that's an interesting question. I think that we're -- I think that it hasn't really been true up to now, but I think that's because they're in the -- sort of increasing capitalization of the system, but there's an increasing awareness of investors, or different view of investors as to what capital is necessary in order to make an institution safe.

And therefore, a different point at which you reach the area where increasing capitalization will in fact result in a sort of decrease in the ability of the system to provide credit and economic growth.

And so I think up to now we're only just entering that area. We've been building capital in the system up to now, in a general sense, and I think a correct sense that -- you know, that there was always more to come and appropriately so, and each increment would, in fact, make the system safer without a particular cost in its ability to provide credit.

Now I think we're operating in the regime, in the region of that continuum where additional -- additions to capital that may make the system safer but they will come at a cost that's the more normal regime where we thought we were operating before, and we simply had misjudged what a safe level of capital was. And so now operating that system I think we'll see that effect operated in a more traditional way.

MR. BAILY: We had a question at the back.

MR. MILLS: Thank you, Governor Quarles. Edward Mills, Raymond James. I had a question about CCIL. There's a big push right now for there to be cost-benefit analysis on the standard, something that you seem to have supported previously. A lot of concerns about making sure there's a harmonization between the accounting standard and regulatory capital rules, to make sure that there's not a extra accounting of capital and not a negative procyclical impact of the rule.

Could you give us an update as to how you view the need for a cost-benefit analysis? And how the Fed and other regulators could harmonize the standard with existing capital rules?

MR. QUARLES: So, I think, and I think we've -- I think we'd proposed this, and if we haven't proposed this, we'll propose it shortly, in real time. But that from the regulatory point of view we will phase in the use of CCIL in our regulatory capital calculations that will give -- and we'll phase it in both with respect to the spot capital regime, and with respect to the stress testing capital regime.

And that will give us time to evaluate what the effect of CCIL is going to be, because I agree with you. There's a lot more -- we've gotten a lot of data, a lot of it is conflicting as to both what the day-one effect of CCIL is going to be. And there's less controversy I think, less disagreement about what the effect of CCIL will be in times of stress, that it will be procyclical, and therefore how do you address that it's particularly important for a stress test, it's also particularly important if there were any actual stress.

But our view is that by phasing this in, by allowing a long time before it's fully effective, we will be able to do this further study to understand exactly what the implications are, and therefore how we ought to respond.

MR. BAILY: We're running over time. I'll take one more question here. And we need a mic. It's coming.

MR. SUTTON: Hi. Brent Sutton from the University of British Columbia. Where do we stand on the Incentive Compensation Rules? The second set were issued in 2016, I think they're in limbo at the moment. And secondly, is it possible that you could use the joint guidelines that have already been issued as a way of meeting the requirements under 956 of the Dodd-Frank Act?

MR. QUARLES: So, the Incentive Compensation Rules, we've received a number of comments about the proposals that are out, there are a lot technical issues with them. However, we are very much mindful of the incentive compensation principles that underlie that provision of Dodd-Frank and that underlie the regulatory proposals in our regulatory -- in our regular supervisory engagement with the firms.

So, that is something that we take into account, we look at firms' compensation practices when we do our regular examinations, it's not something that -- you know, I think I said this to Senator Menendez, this has not fallen behind the refrigerator and been forgotten about. Our press people don't like me to use that phrase, and I just used it again. (Laughter)

MR. BAILY: Take it away (crosstalk). Go for it.

MR. QUARLES: So, you know, I mean we are focused on that and our engagement with the firms. Turning it into a rule, you know, has raised a number of technical complexities we're continuing to work on that, but it is not -- while that rule is still being thought about -- it's not something that we're not doing in our supervision and regulation of firms.

MR. BAILY: Thank you. Please join me in thanking Vice Chairman Quarles. I hope you enjoyed it. (Applause) Thank you so much. Fantastic! (Applause)

We have a panel, please, a very distinguished panel, I think it will be a lot of fun. So, please stick around.

(Recess)

MR. KLEIN: As my fellow panelists get seated, and before we begin, and I will introduce each of them. I'd also like to state Davis Polk and Sullivan & Cromwell -- firms where two of our panelists are currently employed -- provide generous support to the economic studies that makes the work we do possible. I'd like to reiterate Brookings' commitment to independence, and underscore that the views expressed today are solely those of the speakers.

That brings me to introducing this distinguished panel. I'll start immediately to my left and work down. Rodgin Cohen is best described, the best introduction I've heard of Rodgin is: he's the Counsel to the situation. Rodgin is one of the foremost banking experts in the country, Senior Partner at Sullivan & Cromwell.

Kathleen Day is a Professor at Johns Hopkins University. She's had a distinguished career as a Journalist, as a Consumer Advocate, and is somebody who has covered multiple financial crises and written lengthy books including a new one forthcoming --

MS. DAY: January, Yale University Press.

MR. KLEIN: -- that will help us better understand the commonalities between the various financial crises that many of us in this room have lived through.

Chris Brummer is hot off the press at Georgetown University where he conducted, I think the -- certainly Washington's preeminent FinTech Week, but perhaps the nation's preeminent FinTech Week. And I appreciate you joining us and being able to shift gears from the future of technology to the current regulatory structure.

MR. BRUMMER: Sure.

MR. KLEIN: Randy Guynn is the person who probably has spent the most time thinking about how to solve the failure element of too big to fail, both from a policy perspective and from an institution, real-real world perspective. There's nobody I've ever met who understands living wills, the TLAC capital regime, and the intellectual structure behind that better than Randy, who runs the Davis Polk practice in this, and thinks deeply and holistically about these issues.

So with that, knowing who are the panelists, I want to try to do something that is rarely done, which is I want the panel to react to the speech, and what Governor Quarles said. And in that way, I would like you to just hold your comments. I think Governor Quarles' committed to the Fed introducing one policy statement, seeking three notices, having multiple changes in regulation, all in real time, not Fed time.

But let's start by just reacting to the substance within Governor Quarles' statements on stage, and we'll broaden it out in a little bit. But, Rodgin, what was your takeaway?

MR. COHEN: My takeaway was that the commentators who have said this is a do-nothing Federal Reserve, are about 180-degrees off the mark. You can hear what is coming, I think the Vice Chairman was very clear about what real time means, and he started with a biblical reference, and I've always thought the Feds sort of work in biblical time. You know, everybody lived to 500 years, and so you had all that time.

But I think he's very committed, and I think what you've heard is that the basic building blocks of the post-2008 regime will remain intact, but it's time to take a look at all the extraneous accouchements that have been built in, and see whether they are really are necessary and really work.

MS. DAY: Okay. Well, are you going to take mine longer?

MR. KLEIN: No. I'm just focused --

MS. DAY: Just what he said today. To translate it in the vernaculars: things are great, the check is in the mail. This is what people said right before a long-term capital, right before the meltdown. We have as much complexity. It's a new bunch of alphabet soup with, you know, FSOCs and all these things, but I think there's a lot of confidence that history might challenge.

MR. KLEIN: Chris?

MR. BRUMMER: I viewed really, the remarks as a continuation of a process that was initiated. And I think it is, by all accounts, a much more ambitious process than many people first had anticipated. To move the regulatory pendulum in a direction that will ask for more flexibility for sure, but it's being operationalized in a highly technical manner that does create certain real questions as to the long-term robustness of our response mechanisms should the economy start to slow.

MR. GUYNN: So, it's interesting. Three guiding principles that has guided what Vice Chairman Quarles has done in the Federal Reserve over the last few -- over the last year or so, has really been like Quarles which is: transparency, simplicity, and efficiency. And I thought the speech today was interesting because it was very transparent.

One of the things that I've learned over the process of seeing so many rules be proposed and implemented, implementing Dodd-Frank and things, is that it tends to be a static process where you have a proposal, you submit a bunch of comment letters, you hear nothing, and then you see the Final Rule come out.

What I've learned of that process is a better process would be much of a give and take over a period of time. And what I thought was really refreshing in Vice Chairman Quarles' speech today, is how he actually talked about a number of the comments and how they're thinking about them, as opposed to it being a black box.

And I think that that's really positive. I think having much more of a dynamic comment process so that we actually get to the right results is better than what I think I think I've seen a bit more in the past in other areas.

MR. KLEIN: Let me pull on that string a little bit, because, and I think the Fed can be commended in great detail for embracing huge increases in transparency in monetary policy over the last 25 years. And there was a theme, I agree with you, of an increase in transparency throughout his speech until he got to the very end, when on the qualitative remarks the comment was: we're going to pull back the public element of it creating less transparency, and handle things in a confidential manner. Did anybody see that as a tension between the broad themes?

MR. GUYNN: Well, it's interesting, I guess what I would say as opposed to commenting on, you know, was that a pullback by him, I'm not sure. That certainly is a characteristic of a supervisory process. I personally think the supervisory process should be more transparent, I'm not sure it can be as transparent as a matter of reality as monetary policy, but I think it can be a lot more transparent than it is now.

I think if you went back in history, and one of my partners, Mactier, has written a piece on this, the scope of information that was considered to be confidential supervisory information was much more limited than it is today. I think the perimeter of confidential supervisory information is much too broad, and I would like to see more transparency.

I guess I think that Vice Chairman Quarles and the General Counsel, Mark Van Der Weide, are proponents of more transparency, but it takes time to have that be realized.

MR. COHEN: You know, Aaron, I think we're talking about really two different but related terms here, one is transparency, and the other, which I think Randy very much was focusing on as well, is meaningful dialogue. And dialogue, you listen to one another, you just don't talk at each other. And I think what you are hearing from the Vice Chairman is the opportunity for the meaningful dialogue.

And I will express my views that I do not think meaningful dialogue translates into regulatory capture, it really does mean listening.

MS. DAY: Just one thing I hadn't thought of until this moment when the comment period was brought up. Lately there's been some question about whether the comment process, how you're going to preserve the integrity of it. There's been *The Wall Street Journal* that has a review that some of the things from the FCC, some of the SEC comments, I think some of the regulatory comments to the Fed have been fake, and Astro turf, and no agency has really pursued that. So, it's great to have a dialogue, I just hope it's not with bots, and it's real people. Yeah.

MR. BRUMMER: You know, I think that there are different kinds of transparency, I think I would also applaud the Governor and the -- to the extent to which you have any public official who's willing to engage the public about the thinking behind those decisions. There is always this tension of course, when you want to introduce transparency in the other aspects of administrative policymaking, such as, for example, the transparency with the metrics behind your stress testing.

You know, one of the things that I've written about, and we call it the Trilemma, usually with FinTech for the innovation and the difficulty of writing rules for financial innovation, but I think here it's also applicable, is that there is usually, we already talk about a trilemmas is with economists, but for regulators there's often a trilemma between clear rules, market integrity, and financial innovation, that you can get two but not all three.

That you can get clear rules and market integrity, but it usually comes in the form of prohibitions that can impact financial innovation. You can have market integrity and financial innovation, but sometimes that will come at the cost of complexity, and then you'd have financial innovation and clear rules, but then sometimes that will come at the cost of market integrity.

And here you see attempting approaches to accommodate that trilemma in administrative rulemaking, right? Both in terms of the dialogue process with the public, and an attempt to change the way in which the stress tests themselves are operationalized from and *ex ante* perspective.

Now the question is, you know, again historically speaking, you can only get two of the three, but maybe as to how you stand between those poles depending on the toolbox, and how you design the tools which can engage and involve public engagement, or it can literally, you can have changes in the regulatory rulemaking process and the way in which you designed different stress testing scenarios, and how much the rule book, or the textbook, or the rule, or the lecture that you want to provide in advance.

And you can sort of move the dial, but sometimes there's a tradeoff involved, and part of the conversation that will no doubt come from his remarks will be just how far, in one direction, are they pushing in terms of those tradeoffs.

MR. KLEIN: So, let's broaden the conversation a bit beyond just what Governor Quarles said today, but a whole suite of changes that have gone on since the passage of Dodd-Frank and the crisis, moving towards regulation and now, fine-tuning or pulling some of it back.

The Fed had a giant sweeping proposal with four new tiers that came out, it was the subject of some dissent, which is rare among the Federal Reserve Voting Governors. But let's track to the broader set of new changes going on at the Fed. Rodgin, what's your take?

MR. COHEN: Well, I'll go back, Aaron, to what we were talking about a few minutes. This is not designed, the suite of changes, and there are a number of them, not only the Tailoring, but the adoption of the proposal on the new LFI Rating System, and could have very substantial ramifications.

Again, its approach, it is around the edges of what is being done. You heard the Vice Chairman say we're not going to change the basic capital standards. I see little prospect of a change in the basic liquidity standards, but it's not surprising that there are going to be flaws and errors and 10 years of regulation, or that the circumstances of change sufficiently. And I think what we're seeing is a relatively comprehensive response to what has occurred in the last 10 years

MR. KLEIN: Kathleen?

MS. DAY: Can I do the big -- he knows I've been waiting to say this. So, I think that these comments all have to be taken in more general -- the general comments of what's been going on at the OCC and the FDIC, and if you put all these things together, I'm old enough, I think probably older than anyone on here, I've heard all this before. And if I had a nickel for every time I heard transparency, simplicity and efficiency, and the other two, and this is when I reach for my wallet, is when I hear, financial innovation and consumer choice. When you hear those two words reach for your wallet, atypically.

So, I just would like to take all the things, or some of the main things that have happened with all the regulators, because they do act in concert, and give them the broad category. So, now we have preemption with the OCC's and new FinTech charter, and if you read through all the lines, what it's really meant to do, is clear out the hurdles of being able to go into different states.

So, now we have preemption, one of the ingredients for the last crisis. Now you have the lower of capital standards, weakening of the Volcker Rule although -- and I'm not saying none of these things should be changed at all, but you're rating them a little bit, there you go, cheap credit can easily become easy credit, overly leveraged, a problem.

Then you have deteriorating standards. You have the OCC saying, oh, let's get -- the banks were not only going to say you can do it, but we encourage you to do payday lending, and you have the Consumer Financial Protection Bureau at the same time saying, and guess what, we're going to lower underwriting standards. No more assessing a person's ability to repay if you can go into their bank account and take your money back, even it puts them in financial ruin, so be it.

So now you have this deteriorating standard, and with the lowering also of the capital rules, you have more self-regulation, and we know how well that went before. And then there's amnesia, the amnesia; Otting at OCC called the bank, he's supposed to regulate his customers. Again, reach for your wallet when you hear things like that, because the customer is the U.S. taxpayer and the U.S. public.

And finally -- I won't go into the Fiduciary Rule, but that's another bee in my bonnet -- I just want to say, in doing my most recent book, I really came to understand, the Founding Fathers did not include the word "bank" or "corporation" in the Constitution, because they were such divisive issues, and they're still divisive issues.

But one thing I think we have forgotten is when you have a Federal charter, and you have Federal deposit insurance, it is a privilege, and with that privilege comes an obligation of regulators who extend that privilege to these organizations on behalf of the public and taxpayer, to make sure they remember who their customer is, and they go in and regulate with that in mind.

And I understand the need not to over-regulate, I will admit this now, I would never have admitted it before, I was actually -- I joined the Libertarian Party at one point, I don't want regulatory overreach. I'm not there anymore because I don't want to have to pay a toll every one mile on the road, but I'm not quite that far, those were my younger days.

But I really do think this idea of having incorporation, and the privileges that the government bestows by giving it to you. And deposit insurance comes with an increased obligation, and I think the regulators forget that. We're all embroiled in those alphabet soups, and FSOC, and SIFI, I mean, ugh, look at the big picture. So, there, I've stopped. I won't say anymore.

MR. BRUMMER: So that was a lot, and you're -- I'll start this way. I think that, you know, if you're just going to stay for the moment with the Fed, I think what I think is a particularly salient point, that's already been discussed, is that these are not choices made in a vacuum, right. That they are instead following up on other kinds of choices.

So, you can have decisions relating to lowering certain kinds of capital charges, you also have the removal of some liquidity requirements for your financial assets, for some small or medium-sized banks, which is a choice. You can always ask yourself, well, you know: are the current standards too stringent? Should they be weakened and be made more appropriate, or should they be eliminated altogether.

And there are certain kinds of choices that are made amongst that -- along that particular spectrum. And for some of the banks it was, you know, to remove altogether, just as with, say, a countercyclical buffer, something that was discussed, we are certainly in times of plenty, and there are choice to be made.

You know, when you go about an analysis and you ask yourself looking at the data, is the provision of credit, the rate at which credit is being provided, is it outstripping your GDP growth, right? As a general matter that's deemed to be a source of some financial instability, or can pretend a future source of financial instability, and depending on what you country you are and under what kinds of circumstances can you implement.

I don't want, want a Fiat, but you know, these are all important choices that collectively can have an impact on the degree to which regulators, not only will be able to respond to a crisis, but can prevent that crisis in the future.

Now, the only one thing I would push back a bit on is that -- and I do think that all of the financial regulators are looking to operationalize rules that they believe are either more efficient, or looking at rules that they think are too burdensome for the provision of financial services.

Now, that being said, you know, when you look at say the OCC Charter, is that a question of preemption, or the state regulators who don't like the OCC, the FinTech Charter, no doubt about it, aren't necessarily preempted from trying to compete with it, but it does raise interesting questions that the OCC and other banking regulators, and even other financial and capital markets regulators, are trying to deal with.

But that itself is trying to -- the agenda behind some of these efforts involve questions that I think are worthy of real attention, like financial inclusion, capital access and the like, particularly when you look at incumbent players in the market and their ability to service underbanked and the unbanked, as well as obviously some of your more traditional financial market participants.

I talked much longer than I had intended to, but there was a lot --

MS. DAY: Can I make just one more --

MR. KLEIN: Just one moment --

MS. DAY: Go ahead. All right, and I'd like to make two comments.

MR. KLEIN: We'll get back.

MR. GUYNN: So, I'm going to stick to the original question which is the Tailoring Proposal by the Federal Reserve that recently came out, and by three regulators on cap and liquidity. It's interesting because you see reactions on both sides of this one, so at least at the extremes they're very unhappy people. So, on the one hand there are tweets that say it's a tragic mistake, it's going to allow what Kathleen is talking about in terms of under-capitalized banks, and under-liquefied banks.

On the other extreme there are those -- I'm not sure I've heard this since that came out -- but at least before there were letters from Congress saying you should exempt completely the banks between 100 and $250 billion in assets the way -- and that's what Congress intended by the Economic Growth Act.

Instead what the Fed has done is that it's taking sort of the middle approach, and when you actually look at what has happened, I mean, you’ve still got four categories, for those of you who haven't read it, there's four categories, and the GSIBs are in the top category, very large banks that have cross-border operations that are in the second category, than banks between 100 and 200 -- I'm sorry, then another category, and then the last one is between 100 and 250 billion in assets that don't have certain other factors.

And if you actually look, and they’ve got a nice chart at the back, that basically, you'll see that most of the capital and liquidity and stress testing still applies to the largest banks, and to the extent they’ve been, some of them have been eliminated for the smaller banks, there's still internal stress testing and liquidity, there's still a lot of -- their capital requirements that are there.

So, in many ways it's almost designed to make the people on the extremes unhappy either way it goes, because it is sort of an incremental modest approach. But I think it's useful in thinking about where the Fed has come out on those proposals, and obviously people will comment on those things.

Where did the $50 billion -- where did the magical $50-billion threshold come from to begin with? Was it based on some kind of empirical status that this was a division between systemic and non-systemic? No. I think it was sort of pulled out of the air. In fact, I think it was actually designed to be fairly low, so that the idea was that the Fed would in fact tailor among institutions about $50 billion, it's just the Fed never really tailored a whole lot until now. So, it's interesting to see though.

MR. KLEIN: So that having been there when the magic 50-number was created, from my memory, I believe the number was purposefully set too low because of concerns about moral hazard. There's a giant concern that prove to be well overstated that the market would see any institution over 50 as having a too-big-to-fail *promoteur*, and it would gain a comparative funding advantage.

And if you set the number so low that it became obvious that the government would allow institutions over that number to fail, the market would be fooled and unclear who would benefit from the *imprimatur* of moral hazard that I believe was well -- it turned out to be over-founded -- overblown. But I do want to push back a little bit, and to the panel.

So, I view the Fed is creating three tiers, a tier of GSIBs, a tier of large regionals that are over 250 and below 700, and then the 100 to 250.

SPEAKER: That's right.

MR. KLEIN: It created a fourth tier which was one institution, which was Fed-speak because we don't want to actually name one institution, so we call Northern Trust tier two, so we're not singling out Northern Trust, they just happen to be the only entity in tier two.

One of the concerns given in the dissent on this, was that the law only addressed one- to 250, and the Fed's tailoring which is consistent with other aspects of Dodd-Frank but was not part of S.2155, dealt with the changes to institutions over this new magic number of 250, which maybe is pulled from the same air as 50, just differently.

How did you see -- did that surprise you, and do you think the Fed's decision to grant them relief is in the long run the best interest of the economy? Chris?

MR. BRUMMER: I want to piggyback off that question I think to ask Randy's thoughts on that combined with the stress testing. You know, if you move from a one to two-year window, what does that do? Not so much from the standpoint of disciplining mechanism for the supervised, but from the surveillance perspective of the regulator itself, in terms of its own internal information gathering and surveilance?

MR. GUYNN: So, let me just try to answer at least outside Aaron's implicit question, and then let me try to answer that one. I actually think the Fed and Dodd-Frank has always had the authority to do the tailoring of this.

MR. BRUMMER: That's right.

MR. GUYNN: I don't think it required the Economic Growth Act to actually say it can do it. So the fact of the Economic Growth Act, you know, raises the traditional threshold from 50 to 100, and then has another threshold between 100 and 250, precludes the Fed from saying, well, we'll do further tailoring, which is what they've done with the -- and I think there's basically three categories, and then there's GSIB light category, or at least global light.

And I think that that's actually, that's something the Fed probably should have done a long time ago, was to tailor more. I'm just not sure that they could do it, they were working so hard on getting the basics down, that I think it's now the time to sort of look at tailoring.

So even though the Economic Growth Act came out and set those thresholds, I think they're probably looking at it more holistically than say (inaudible). And I think actually looking at risk factors as opposed to only size. In other words, asset size is actually a good idea. I'm not sure I agree that the five risk factors they come up with including size are necessarily the right ones, or equally weighted the way they are in this proposal, but I think it's actually the right way of going about it. I think it's more sophisticated than just size thresholds.

MR. COHEN: I was just going to say, you know, it's a question always of where you draw lines, and if you look at the banks in that category, are they closer to the GSIBs or closer to the regionals in the next tier down? I think it's very clear it's the latter not the former. So some modest form of tailoring for that group seemed perfectly appropriate. And I agree 100 percent with Randy that the Fed has clear legal authority to take that action.

Again, if we were talking about taking that group and really reducing capital requirements, or reducing the liquidity requirements, that could be a whole different analysis, but that's not what we're talking about here.

MR. KLEIN: Let me ask a different question about where you draw the line, which the treatment of foreign banks. They seem to have been -- the lines to be drawing a very different line on foreign banks than it has historically in the United States. And Chris, do you see a global implication there? Is this America first in banking? (Laughter)

MR. BRUMMER: Well, you know, whether or not you look at banking, or whether or not you look at derivatives as well, there's always been a propensity. I mean whether or not you look at the risk weighting for sovereign assets, you know, there's always been certain kinds of advantages that have been given to domestic financial institutions even when it comes to the operationalization of your banking regulations. In light of G20 and FSP, and Basel Committee rules, standards and best practices, certainly you would expect that this would have the impact of incentivizing local banking in a way that would have a disparately negative impact on foreign banks.

But do I view this as so beyond or out of sync with certain -- past aspects of banking regulation? No. Now, is it contrary to some of the principles of cross-border coordination and standard setting that were embraced particularly in the wake of the financial crisis? I'd say, yes. So, I'm not a lawyer, it depends, yes.

MR. KLEIN: Any thoughts on the treatment of foreign bank in the new regime?

MR. COHEN: You know, the Fed has said that they're going to come out quickly, I didn't hear quite the real time that Randy was talking about, but I think the foreign banking community, with some justification, believes that it is being -- and I'll use the word -- discriminated against by the entire American regulatory and law enforcement regime. It is not just the Fed. But this is a series of enforcement actions, which, to the foreign banks seem more severe.

As a regulatory matter you can almost look at one more biblical reference, original sin was the IHC, and the IHC was supposed to make foreign banks comparable to U.S. banks in terms of regulation, but now the U.S. regionals are being -- their regulatory scheme is being changed to some extent, but IHC, there's still nothing there, and it goes, for example, to how they're going to deal with directors, it's just a number of issues that are coming together, and it is creating real animosity among the foreign banking community.

MR. GUYNN: From the FBO's I think what they see is, they're being treated on a global basis now, and so for instance, they're compared to GSIBs if they're a large institution. Historically I think the way the Fed had devised regulation it's usually focused on U.S. operations, and so from perspective they look at themselves and they say, our U.S. operations are a lot more like regional banks than they are like GSIBs, and that's how we ought to be compared to them.

So there's a tension between, do we compare them at a global level based on their global operations, or do we compare them, for regulatory purposes, on a local level? And at least their perspective is, these are regional bank corporations and ought to be compared on a local level.

MR. KLEIN: So, it sounds like then, Trumpism is winning a little bit. Let me go from the rest of the world and --

MR. BRUMMER: I mean, you know, it is interesting, right. I mean, because we've had iterations of this conversation in this room, you know, but just under very, very different guises. So, you know, when it comes to capitalization, and whether or not you're going to force international companies to place all their assets in any particular jurisdiction under its rules.

The plan, people could have argued then that that was, you know, an "America first" program, right, because you want to make sure that locally there's enough assets and you can grab whatever you need in cases of financial stress, right? Okay. In this particular instance you can make similar kinds of comments, and I think it depends on the historical context, and that's why I think my answer was, it depends, because it's not unusual for the United States or any other country, or jurisdiction to impose rules and regulations that have a disparate impact.

And the international community can, in some cases rightly identify that treatment as not being consistent with its international either commitments or principles that they embraced elsewhere.

MR. COHEN: You know, if I could, there's such -- I'm sorry --

MR. KLEIN: Yes.

MR. COHEN: To continue, it's such a great question, and it's a burning issue. I think it's actually coincidental with the America first, it just has happened, as

Chris pointed out, the IHC was developed by Governor Tarullo not by this current Board. But you can see from the foreign bank perspective why they see this as a (crosstalk) of a global approach.

MR. KLEIN: So, I want to pick up on a banking pun of disparate impact, and transition a little bit to American consumers. In the financial crisis --

MR. BRUMMER: I don't see how you're going to do this.

MR. KLEIN: The concept on disparate impact on the regulatory treatments that affect certain groups of people more or worse than others, and while leaving Dodd-Frank the Federal Reserve's financial regulatory authorities were expanded significantly. The one area where the Federal Reserve saw a transfer of authorities was in consumer protection, which had frequently been neglected, not just at the Fed but across Federal banking regulators.

Congress created a new agency tasked with doing that, the CFPB, put in charge of series of forceful single, independent agency heads -- one former Head is sitting in the room right now. Under this administration the President's Chief Budget Officer has been placed in charge of that, and has gone about taking a much sharper course correction than I think any of the other bank regulators --

MS. DAY: A course correction, or is it veering off the road?

MR. KLEIN: Well, one could say it's a -- it's a good question, Kathleen. Let me ask you then, following up on that, you’ve seen these crises before, you used the term, reach for your wallet, which I think is shorthand for consumers ought to be afraid. Holistically speaking, is there a connection in financial stability perspective between the new White House-led CFPB's perspective on consumer regulation and what's going on in terms of fine-tuning and calibrating other bank capital standards?

MS. DAY: So, this has succeeded in making this really wonky. It's not a wonky subject especially when you have a crisis. He is going to have to -- "he" meaning the Speaker, Quarles, is going to have to preside over a system, and within that system are these FDIC insured institutions.

We struck a bargain, you have the taxpayers on the hook, and that with deregulation, Graham-Leach-Bliley, which just formalized deregulation, you then put that safety net over everything. And I guess in real times of crisis -- you know, we used to let investment banks go under, but it stopped when you really think about the affiliation with FDIC-insured institutions, which I'm fine with.

I don't think it was a problem undoing Glass-Steagall, but there's a lack of oversight, of policing, and I would like -- first of all I would just like to say this, I would hope we would never have to have used the phrase "nonbank bank" again, but here we are with the ridiculous, you know, Mr. Otting who considers the banks as customers.

But the ability to repay, was going out of the CFPB, is extremely pernicious, they are saying, we do not have -- we can give loans again, go ahead, give loans again to consumers without assessing their ability to repay. That was always a code for, you can abuse them at your leisure. And let's not forget, and this is something Bernanke really stressed after the last crisis, that you imperil consumers at your risk, they account for 67 cents of every dime of every dime spent in the economy, and what we discovered is they didn’t need more credit at the end of that crisis, they needed less debt. They had been abused.

You need to have common sense. If you are lending people money without assessing their ability to repay it, I always tell my students, believe it or not, these are the very things that toxic subprime did. Why are we there again? What are they thinking? (Laughter)

MR. BRUMMER: (Inaudible) at Chris --

MS. DAY: No. I'm looking that way, and this way.

MR. BRUMMER: Okay, okay. I think that there are definitely ways in which, you know, you can expand access to credit as well as the other vital financial services. Whether that be insurance, even health care, and that the way that you do it is important. I do want to note that when you look at the housing crisis, you know, loans were extended to people who couldn't pay, and there was --

MS. DAY: On terms they couldn't repay.

MR. BRUMMER: On terms that they couldn't repay.

MS. DAY: That they didn't understand, and were purposely, they were misled about.

MR. BRUMMER: Right, but I'm trying to say that the incentive behind it was that, you know, you looked around and houses were --

MS. DAY: No. That was always (crosstalk) --

MR. BRUMMER: Kathleen, Kathleen --

MS. DAY: -- they were trying to increase housing.

MR. KLEIN: Kathleen, Kathleen, let Chris --

MS. DAY: Okay.

MR. BRUMMER: I think that there was largely a desire that you look at minority communities, and you want to make sure that they can participate in GDP growth, and economic growth to the same extent of their counterparts, because houses are -- at least historically, have been financial assets that allowed for the creation of wealth. That's not a controversial statement that I'm saying, and I think that many people particularly -- not just frankly on The Hill, but others would look at one's house as their primary family asset.

Now, you know, the way in which you can encourage that, can come about in different ways. And one of the things, you know, if you were trying to responsibly think through financial inclusion and a wider participation in the financial economy, there are ways to do it, and I personally disagree with a lot of things that are happening over at the CFPB, including their policing of discrimination policies and what's happening with their office over at the CFPB.

That being said, I'm someone who, I teach law, you know, and I like to look at institutions, I like to look at things in their particularity, and if you're going to create and generate wider financial inclusion, you may want to think about alternative data, the kind of incumbent data that's been generally used to facilitate the provision of credit which has had a disparate impact on women, small businesses, as well as minorities, and you can think through how you want to -- which was really one of the original ideas behind Project Catalyst, and some of the others, CFPB goals, as designed by others.

Speakers have come through here including one of your Senior Fellows, Michael Barr, and to think through, well, how do you trigger and lever other kinds of tools in a responsible way? And I do believe that, as with many things in financial regulatory policy, when you have people who are -- and I'm not talking about any one in particular, but as a general phenomenon, when you have in the regulatory agency folks who are on the frontlines of political battles, that can lead to a polarization of the debate, where sometimes, you know, it's better to look at the end goal, and to achieve the kinds of outcomes that I think that you're very -- and that we're all very passionately interested in, and in achieving.

But I do think that, yeah, the CFPB's approach has been more aggressive ostensibly than some of the other financial regulators and I, personally, would explore other kinds of options to achieve the kinds of ends for which the Agency was originally devised and created.

MR. KLEIN: So, I'm going to turn to the audience for their questions now, and given Rodgin and Randy the opportunity if they want to weigh in, whether or not a series of new consumer abuses could potentially lead to a repeat of what we saw before with a sleepier CFPB?

MR. COHEN: You know, the answer I think in part. First of all, could consumer abuses lead to a financial crisis? Here I agree 100 percent with the Kathleen. The evidence is there, it could, there's no question about it. But whatever the CFPB's position may be, the bank regulatory agencies were not stripped of their authority to examine these institutions, and they are examining them as fully and as comprehensively in the consumer area, as they were two or three years ago, five years ago. So, I think there is -- what Congress did was create a double level of protection.

MR. KLEIN: All right. Who in the audience has a question? Right there!

QUESTIONER: My question relates to, the Fed's approach to --

SPEAKER: The mic -- we're not hearing you -- does it have a green light on it?

QUESTIONER: Okay, sorry. So the Fed's stress testing and the Basel, it's based on, you'd get some accounting number of out the balance sheet, and when you adjust it, and then you multiply it by a ratio, like 8 percent for capital, or 10.5 percent. And then for the stress test they increased some of these numbers based on judgment, but you're still getting -- you're still taking a balance sheet item and multiplying it by some ratio that doesn’t change the market conditions.

So the 8 percent capital for banks, like insurance companies, if interest rates are really low, that's bad for their business. If the yield-curve becomes highly inverted, that's usually bad. But that doesn’t change these ratios, at least as far as the Basel --

MR. KLEIN: What's the -- the question is?

QUESTIONER: Okay. Whereas the life insurance industry does 10,000 scenarios of stochastic of monthly cash flows, and that actually sets the capital number. And so for me, my question really is, this has been going on for 30 years, why is the banking methodology so primitive compared to life insurance?

MR. GUYNN: I have no basis for knowing whether it is or isn't.

MS. DAY: May be they have state regulators, I don't know.

MR. KLEIN: I think with insurance and banking, you're dealing with apples and oranges in terms of -- well, a bank you give them your money and they -- a bank gives you their money, and you promise to repay them. With a life insurance company, you give them your money, and they promise to repay your heirs. By definition you'll never -- they're not going to repay you. And so I think you have to look at that difference.

We have a question over there, Allen?

QUESTIONER: Well, actually I have an answer.

MR. KLEIN: Well, hold on now. No, no, we're not answering -- other audience questions XXXSIC MEANT AUDIENCE ANSWERS??XXX, we're giving the audience a chance to question the panel.

QUESTIONER: okay. I'll rephrase it as a question. (Laughter) Data in the insurance world is far better than data in the banking world. Anyone who is objective observer of the banking world understands that the central problem with data, is it hobbles the ability to do analysis. And so the question is, given that there are now open source, free data standards for financial instruments being created, why have the regulators not adopted this to enable the type of assessments that the insurance industry does?

MR. KLEIN: A data standard question.

MR. COHEN: I really am going to plead the same fifth, or actually it's the eleventh, ignorance on this issue. You know, I think that life insurers and banks are not the same animals, they may be both animals, but they're not the same. To Aaron's point, who pays whom, but also life insurers have very long-dated liabilities and long-dated assets. That's not where banks are.

So, having different systems doesn’t mean that there's something inherently fallacious in one or the other. I fully agree, if there are opportunities to use better data, it should be used wherever you are, whatever type of animal you are, but the animals are just, I don't think the same.

MR. KLEIN: Dennis?

MR. KELLEHER: Hi. Dennis Kelleher of Better Markets. I hate to break with the theme here, and ask a question related to what you're talking about. But two points, one is on the threshold, whether it's 50 billion or 100 billion, or you pick your number, let's remember that there's almost -- a little shy of 6,000 banks in the United States, if the threshold is at 50 billion there's only about 40 banks in the United States with more than $50 billion in assets. This is not and insuperable or huge class of banks for the Fed or any of the regulators to deal with.

And even at 50 billion, and Better Markets actually put out, because this has been debated for so long, a fact sheet under 165, the Fed had full authority to tailor above $50 billion in every type of prudential standard that was to be applied, similarly for the stress test. So the issue was not that they couldn’t do it, and in fact the argument -- and we showed that they did do it before.

The question now is, whether or not it's appropriate based on an individualized risk assessment of the banks. And the question for you that I have is whether or not you think they get there closer on an individualized risk assessment based on actual activity? Size was always the threshold question, not the substantive analysis.

And the second point I wanted to just get your thoughts on, it's on FBOs. I mean, let's remember that foreign banks receives trillions of dollars from the U.S. Government. Frankly, you know, the Fed substituted U.S. taxpayers for German taxpayers to bail out Deutsche Bank U.S. operations, and then Deutsche Bank and Barclays, as you both know, reorganized themselves to avoid the capital rules, which is what forced the Fed's hand on the FBO Rule.

So, I agree completely, Rog, that there's a lot of discrimination, or I should say apparent discrimination particularly on the law enforcement side, a little bit less clear. So the question is, doesn't the United States have a self interest, if we're going to pay the bill, shouldn't we make sure, that in fact the bill next time for the foreign entities are going to be ideally as low as the bill will be for U.S. entities?

MR. KLEIN: All right, two questions.

MS. DAY: My answer, yes.

MR. KLEIN: That was the answer to question two.

MS. DAY: That was the answer; yes, to question two.

MR. KLEIN: Question one, individualized risk assessment versus categorical assessment. Randy?

MS. DAY: Well I was --

MR. KLEIN: Wait, hold on --

MR. GUYNN: I'm happy. So it's interesting because we actually look at the Tailoring Proposal, and that's my label for it; they do actually have an alternative possibility which is they've got the -- they've got the categories the way they've defined it now, and they've actually talked about having another approach that seems more close to what you're talking in terms of risk base, or a multifactor, individualized assessment, kind of the way the GSIBs are done, the GSIB surcharge.

That strikes me as if, interestingly -- maybe one of these trends you're talking about because it might be more precise, but it may be more complicated and complex as well, and there is some value to simplicity. I think I want to get your original point, which is I think part of the problem, part of the real push for these new thresholds and raising thresholds from 50 to 100 is the fact that the Fed over the past eight years didn't actually tailor things.

And so you found a bank with $52 billion in assets that was subject to virtually the same CCAR stress testing requirements as the largest U.S. GSIB. And that didn't make a whole lot of sense, and that really irritated the heck out of a lot of the smaller banks. And so they've gone and complained to their, you know, Members of Congress, and Senate, and so forth.

And so I think that was probably a retrospective mistake, probably should have tailored things more in a -- and I saw this also on the living wills, I mean idea that some of the smaller institutions were required to do living wills with the same kind of guidelines, part of the problem there was that the original guidelines, the regulators were kind of in the dark, feeling their way, trying to figure out what guidelines should we have.

And so there's a lot of experimentation, that's one thing -- that's one thing to have that kind of experimentation with the banks with very large resources, it's another thing to have that experimentation take place with the smaller banks, whereas, was really a heavy burden relative to their size. So I think that -- I think tailoring is a good idea. It should have been done a long time ago.

MR. BRUMMER: I have a quick response though. I would say to the FBO and the question of the German taxpayers. You know, we're just in an environment where I'm increasingly mindful of the implications of this urge here, but even when you look at the fact that, yes, either there were swap lines, and through other varying assistance provided by the United States in the wake of the financial crisis.

You know, I would urge that we not forget why many of these countries were in troubles in the first place, because they were taking other wonderful exports from the United States including U.S. blue jeans and credit default swaps, which impaired the balance sheets of different institutions who were themselves -- you know, their balance sheets were intertwined with those of sovereign governance, and obviously because of the strategic place of the U.S. dollar in the international financial system, they needed a line of credit.

But, you know, it wasn’t a one-sided relationship, and the reason why many sovereign governments were finding themselves in financial stress, was not entirely due to what they did themselves. We live in an interconnected world, we live in an international economy and -- you know, that's that.

MS. DAY: But once again, the regulators weren't keeping track of the risk, instead of using derivatives, and collateralized debt to mitigate risk, they were allowing these banks, foreign and domestic, to use them in a way that amplified it. So again, they fell down on the job. The question should be, how do we get regulators to do their job? And that's to protect the public and the taxpayer.

MS. TERRY: Hi. Sabrina Terry with UnidosUS, formerly the National Council of La Raza. I have a question that may be a bit tangential, but it's linking back to the discussion around access to credit, or increasing access to credit and capital. The OCC has proposed modernization of the Community Reinvestment Act. I would love the panel's feedback on how those proposed modernizations may or may not lead to disparate impact for traditionally underserved communities, and if there are areas that are lacking within the proposed rulemaking they should be addressed or at least should be assessed in their -- you know, the process?

MS. DAY: CRA, as the legislation banks love to hate and hate to love, but they do like it privately, they think it's worked pretty well, and that's what they will tell you privately, and for three decades I've heard them say that.

But we don't know what the proposals are, but again, I am anxious about what the proposals will be to change it, because again we're hearing about consumer choice, innovation, access to credit, all the buzzwords that were being used for the housing crisis, when in fact -- and we are opening doors to homeownership, when in fact 9 out of 10 of the mortgage-backed security, of the mortgages underpinning the toxic mortgage-backed securities went to people who already had a home, including, disproportionately, in the Black and Hispanic communities.

And because the house is the number one way that people move up the economic ladder in this country, by causing so many people who had a home, putting them into a bad mortgage, causing them to lose their home that effect is going to be felt in the economy for decades, those people. So, I think the devil is in the -- we haven't seen the details of what they're going to do, but I'm worried.

MR. BRUMMER: So, two things, and I'll get to the CRA in just a second, because it's particularly important as applied to set something like the FinTech Charter, where, for example, if you go and talk to members of the CBC it will be of enormous importance for Maxine Waters and others.

You know, to what degree are you going to make sure that the CRA and both its principles are formed, or in some way or another are operationalized in a world in which you are engaged in online lending, and where it's much more difficult to discern and identify the geographic boundaries of both the credit provider or the lending entity, and the ultimate customer of those services, right?

And that's going to be a question that I think particularly given the election is going -- there's going to be a lot of attention to that, and frankly, four people who are traditionally concerned about access to capital, in particular for minority communities, the question has always been, if people are really interested in access to capital, and financial inclusion, and frankly having a much more balanced growth of the American economy, then you have to make sure that everybody, that everybody is involved and is participating.

And that's going to be question, it's going to rise, when it came to the earlier issues relating to the housing, there was goodwill I think behind a lot of people who wanted to make sure that everyone was able to participate in the American dream, but the rules that are developed by regulators to achieve that don't always get those results.

And the question that will be posed here with the OCC, and I think we're largely intersecting is, you know, how do you lay out those CRA rules -- as I understand them I think that they've been -- that they're in the process of getting comments on the CRA proposal that's just been released, and many of us will be providing those comments.

MR. COHEN: Could I just very quickly. I think I ascribe fully to this point Chris is making. The debilitating impact of economic inequality is we need to deal with, there are so many ramifications, but a modernization of CRA could be very helpful. CRA is now 40 years older, and it's still based on a branch model, bricks and mortar.

MR. BRUMMER: That's right.

MR. COHEN: That's not where so much of financial services is today, and we need the agencies to get in a room, sit down, this should be a very high priority, because it could be so helpful in the area of economic inequality.

MR. KLEIN: So, I t could also be very harmful.

MS. DAY: Yes.

MR. KLEIN: It's interesting that only the OCC has moved forward. There is a finite amount of regulatory bandwidth at the Fed, and Vice Chairman Quarles laid out a pretty aggressive and real-time agenda, did not mention CRA nor did the Fed go along with it. But I've long held that the single best thing the Fed could do to help address income inequality is move to a real-time payment system.

That the 60 percent of Americans who live paycheck to paycheck, who get huge check cashing overdraft fees, when your check clears, is the matter between billions of -- in the aggregate billions of dollars are needing a payday loan. For the 14 percent of us who always have money, never touch the zero lower bound in our bank account, we frankly don't care, and we're oblivious to the large economic consequences of a payment system that I think is state of the art from United Kingdom of 1853, that the U.K. got real-time payments in 2007 when the first iPhone came out. I got an iPhone 10-XR yesterday; and a check that, if I deposited it today in the bank, may be available on Wednesday or Thursday next week.

Rodgin, the Feds come out with a proposal here, a request for thoughts, they're holding town halls across the country 10 years after other central banks adopted the same technology. What do you think is going to go on here?

MR. COHEN: Well, I am concerned, and as you started out to avoid any misperceptions of conflicts of interest we represent the Clearing House which has an RTPS up and running --

MR. KLEIN: Real-Time Payment System.

MR. COHEN: -- up and running, and frankly, I don't think it is useful for the Fed to be going out, they had their faster payment systems taskforce what, three or four years ago. What would really be useful is to support where they're going to regulate it, they'll be able to fully, in every way including true ubiquity in the sense that the small banks that Dennis referred to, the 6,000 which did not develop the system, have access on full and fair terms.

That's where I think the Feds should be going, because I agree it is a real issue that needs to be dealt with and we've waited too long.

MR. BRUMMER: Only because --

MR. KLEIN: The last word.

MR. BRUMMER: Well, only because I actually thought that I was, you know, going to be talking about crypto assets to some extent. You know, there's this very interesting question of central bank digital currencies. And we were at the IMF just last week, and it's a question as to how can you operationalize some of the financial inclusion faster payments, more mature -- costs and more competition with the traditional banking sector through, if not innovations with -- from everything scaling, or from the scale of accounts with central banks to central bank digital currencies. And I agree it's very important. Now let everyone go home.

MR. KLEIN: Great! Thank you all very much, we appreciate that. Join me in thanking the panelists. (Applause)

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I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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