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THE BASEL III ENDGAME: A CONVERSATION WITH MICHAEL BARR

Tuesday, September 10, 2024

MODERATOR:

DAVID WESSEL, Director - The Hutchins Center on Fiscal and Monetary Policy, Senior Fellow, Economic Studies, Brookings

FEATURING:

MICHAEL S. BARR, Vice Chair for Supervision, Board of Governors of the Federal Reserve System

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WESSEL: Welcome. I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy. Glad to see so many of you here this morning to hear Michael Barr talk about the end of the Basel endgame bank capital. As most of you in the room know, but just in case is a measure of the investment that bank shareholders have in the business, in contrast to deposits are money that the bank has borrowed. Capital does not have to be paid back. A bank that has sufficient capital can cover customers deposits, even if the loans it has made aren't repaid or its investments drop in value. It's a cushion, a buffer that protects the bank from insolvency and thus importantly, reduces the risk that a bank failure can trigger system wide financial instability. If banks have too little capital to absorb the risks they take, they can, in bad time, screw us all. And we have seen that that happened. And it's clear now that many big banks had too little capital going into the global financial crisis in 2007. So the Basel Committee on Bank Supervision issued recommendations to national regulators, which are known as Basel III in July 2023, the Federal Reserve, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, published for comment changes to bank capital rules that were intended to be aligned with Basel III. Hence the Basel III end game, which does sound like a video game I know. Now the banks were, to put it mildly, unhappy it provoked. Banks don't like to have more capital because more capital means less leverage and basically means lower profits. And the banks were rather outspoken about their opposition. There were even TV ads and websites like americanscantaffordit.com and stopthebaselendgame.com. Some members of Congress joined in the criticism. Even among regulators, there was some reluctance. The Federal Reserve Board voted four to two to put the regulations out for comment, but Fed Chair Jay Powell expressed some reservations about the proposal. So both Chair Powell and Vice Chair Michael Barr promised broad and material changes. So today, Michael Barr joins us to preview those changes. Michael has been fed vice chair since July 2022. He was before that, among other things, dean of the Ford School at the University of Michigan. He's written several books and articles on financial regulation and financial inclusion. He served in the Treasury during the Obama administration and was instrumental in in writing Dodd-Frank. He's worked in the White House, the Treasury and the State Department in the Clinton administration. He's a graduate of Yale University and Yale Law School. He was a Rhodes Scholar, and he has in the past been a nonresident fellow at Brookings. After Vice-Chair Barr's remarks, I'm going to join him on stage and ask a few questions and then turn to the audience. Now, important because this event falls within the Fed's blackout period. Michael Barr is not going to talk about interest rates. I was worried that three people or half to audience would leave. So I suggested to Michael that to get around the rules, he should just show up with a football jersey that said either 25 or 50. But as you'll see, he didn't take the suggestion. Michael Barr.

BARR: Thanks very much, David, and thank you to the Brookings Institution for hosting this event. Thanks for all of you for being in the room today. Since I joined the Federal Reserve Board as vice chair for supervision, I have spoken many times about the importance of bank capital to the safety and soundness of banks and the stability of the financial system. It is critical that banks have the capacity to continue lending to households and businesses through times of stress. Bain Capital is a key component of this resilience, and Bain Capital rules help to ensure that banks are holding capital commensurate with the risks of their activities and the risks that they pose to the US financial system. But capital has cost too, as compared to debt. Capital is a more expensive source of funding to the bank. Thus, higher capital requirements can raise the cost of funding to a bank, and the bank can pass higher costs on to households, businesses and clients. Engaged in a range of financial activities. These activities are critical to a well-functioning economy that works for everyone. That's why it's important to get the balance between resiliency and efficiency right. Today, I'll return to these themes in the context of two rules of great public interest. The Basel III endgame proposal and the proposal to adjust the capital surcharge for globally systemically important banks or G-SIBS. A little over a year ago. The board sought comment on these two proposed rules, which would modify risk based capital requirements for large banks. We received a great number of comments on the provisions in the proposal, as well as on the justifications and analysis that underlie those provisions. Since that time, we have had been we have been hard at work analyzing the comments and the data we collected to evaluate the combined impact of these proposals. We have spoken with a wide range of stakeholders, including banks, academics, public interest groups, consumers, businesses, other regulators, Congress and others. And as you would expect in a project both as technical and as consequential as this one, I've had many productive meetings with board colleagues and our fellow bank regulatory agencies, the FDIC and the Office of the Comptroller of the Currency. This process has led us to conclude that broad, immaterial changes to the proposal are warranted. As I've said, there are benefits and costs to increase in capital requirements. The changes we intend to make will bring these two important objectives into better balance. In light of the feedback we have received, the changes to the endgame proposal have been a joint effort with my counterparts at the FDIC and the OCC. I intend to recommend that the board re propose the Basel Endgame and G-SIB surcharge rules. This will provide the public with the opportunity to fully review a number of key, broad and material changes to the original proposals and provide comment. We will accept public comments on any aspect of the Basel endgame and G-SIB surcharge proposals. The changes in the endgame re proposal will cover all major areas of the rule credit risk, operational risk and market risk. Banks with assets between 100 and 250 billion in assets size would no longer be subject to the end changes other than the requirement to recognize unrealized gains and losses of their securities in regulatory capital. These

changes reflect the feedback we have received from the public. Improve the hearing of the proposal and better reflect risks. I will also recommend changes to the G-SIB surcharge proposal to better align the capital surcharge, for example, with its systemic risk profile. Taken together, the reproposals would increase aggregate common equity, tier one capital requirements for the G-SIBs, which are the largest and most complex banks by 9% for other large banks that are not G-SIBs. The impact from the proposal would mainly result from the inclusion of unrealized gains and losses on their securities and regulatory capital, estimated to be equivalent to a 3 to 4% increase in capital requirements over the long run. The remainder of the proposal would increase capital requirements for non G-SIB firms still subject to the rule by about 0.5%. While these proposed changes affect some of the most important aspects of the proposals, the agencies have not made final decisions on any aspect of the proposals, and that includes those are not explicitly addressed in the reproposal. The public should not view any omission of a potential change in these reproposals as an indication that the agencies will finalize a provision as originally proposed. We continue to consider comments already received on the 2023 proposal and we will. Consider these comments, those comments together with any comments submitted on the re proposals as part of any final rulemakings. This is an interim step. Let me reiterate that we are open to comments on any aspect of the proposals. Now I'll turn to the changes. I began with an overview of the changes I will recommend to the capital requirements for credit risk, which protect against the risk that a bank's loans will not be fully repaid. These changes include reducing the risk rates for residential real estate and retail exposures, extending the scope of the reduced risk rate for certain low risk corporate debt and eliminating the minimum haircut for securities financing transactions. First, I intend to recommend that the board lower the proposed risk weights for loans secured by residential real estate and loans to retail customers. The original proposal introduced a more risk sensitive approach for residential real estate and retail exposures, but calibrated them to be higher than the Basel standards to promote domestic competitive equity. The agency has received significant comment on the proposed calibrations. Some commenters argued that the elevated risk weights would overstate the risk for these loans, given their loss history. Others argued that the risk weighting would affect home affordability and home ownership opportunities, particularly for first time homebuyers, minority communities and low and moderate income borrowers, and could reduce the availability and affordability of retail credit. I will recommend that we reduce the calibration for residential real estate exposures so that it is in line with the calibration developed in the Basel process. With this change, all in capital requirements, including for operational and credit risk, will be lower on average than they are currently for mortgages. Up to 90% loan to value and about the same as they are now for mortgages up to 100% loan to value. With respect to loans to retail customers, I intend to recommend that we adopt the Basel standard with two exceptions. First, we

would lower the capital requirements for credit card exposures, where the borrower uses only a small portion of the commitment lines. And second, we would lower the capital requirement for charge cards with no pre-set credit limits. The second proposed change related to credit risk would extend the reduced risk rate for low risk corporate exposures to certain regulated entities that are bank judges to be investment grade and that are not publicly traded. The original proposal provided this preferential treatment only to investment grade corporates that were publicly traded because the financial disclosure requirements for these entities facilitate market participants assessments of their financial condition, which in turn provide additional information for banking organizations to use when assessing these entities credit risk. There were many comments that the preferential treatment should be extended further, including to regulated entities that are also subject to substantial regulatory discipline and substantial transparency requirements. Consistent with our objective of increasing risk sensitivity and capital requirements. I plan to recommend to the Board that we extend the reduced corporate risk rate to regulated entities, including regulated financial institutions that are not banks such as pension funds, certain mutual funds and foreign equivalents that are investment grade but not publicly traded. Third, I intend to recommend that the board not adopt the capital treatment associated with minimum haircut floors for securities financing transactions. The proposal included heightened capital requirements for repo style transactions and eligible margin loans that did not meet minimum margin requirements while consistent with the Basel standard. Several other major jurisdictions have not adopted this approach. Not adopting the minimum haircut floors will allow time to see greater international consensus on this important topic before deciding on whether and how to implement such an approach in the United States. Let me speak next to the treatment of tax credit equity financing exposures. I plan to recommend that we significantly lower the risk rate for tax credit equity funding structures, given the lower inherent risk in these structures compared to many other equity investments. The revised lower risk rate for these exposures of 100% would reflect this lower risk and be consistent with the approach we take for other tax credit investments, such as the low income housing tax credit. Next, let me speak about three changes I intend to recommend for the proposed capital treatment of operational risk, which is the risk of losses from inadequate or failed processes such as from fraud or cyber attack. First, I plan to recommend that we no longer adjust a firm's operational risk charge based on its operational loss history. This change will reduce fluctuations in a bank's operational risk capital requirements over time. Second, I plan to recommend to the board that we calculate fee income on a net basis in calculating its contribution to the operational risk capital requirements. The original proposal would have measured the contribution of fee based activities based on gross revenues instead of net income, which is revenue minus expense. Moving to net income for fee based activities specifically by netting non-interest income and expense except for

operational loss, would produce more consistency in how operational risk is measured across bank activities as interest and trading income and expense are already measured on a net basis under the proposal. This change would also produce more consistent operational risk requirements across banks because the approach is less sensitive to the differences in accounting practices across banks. Third, I plan to recommend to the board that we reduce operational risk capital requirements for investment management activities to reflect the smaller historical operational losses for these activities relative to income. The agency has received comments suggesting that some fee based business lines have incurred meaningfully lower operational losses than other business lines. We have found evidence that investment management has historically experienced noticeably low operational losses relative to income produced. Now I'll speak to the capital treatment for a bank's trading activities and its derivative activities. The end game proposal included a number of important improvements relative to current market risk capital framework, including to incorporate lessons learned from the global financial crisis that have not been sufficiently addressed in the current framework. It would permit firms to use internal models to capture the complex dynamics of most market risks, but would put certain constraints on banks models and provide fallbacks in areas where modeling practices are not adequate. We received numerous comments on ways to improve this part of the proposal. I plan to recommend that we make changes to facilitate banks abilities to use internal models for market risk. For example, the proposal will introduce a multiyear implementation period for the profit and loss attribution tests that are used to confirm that models are working as intended. This extended transition period would allow banks to gain experience with the tests and provide time to improve their systems and processes and address any potential gaps in data and model performance. In addition, the proposal would contain a few additional adjustments to improve incentives for a firm to model its exposures. Moreover, we would clarify that uniform mortgage backed security positions would be treated as having a single obligor, regardless of whether they were issued by Freddie Mac or Fannie Mae. This change will enable firms to recognize hedging across these securities with respect to derivatives activities. I plan to recommend that the board adjust the capital treatment for client cleared derivative activities by reducing the capital required for the client facing leg of a client cleared derivative. This change would better reflect the risks of these transactions, which are highly collateralized and subject to netting and daily margin requirements. This also would avoid disincentives to central clearing. A topic I'll return to later. Let me turn to tiering. The largest, most complex firms should be subject to the most stringent standards in light of the cost that their potential failure would impose on the broader financial system and thus on businesses and households. Under the reproposal, G-SIBs and other internationally active banks would be subject to the most stringent set of requirements, including the new credit risk and operational risk requirements and the revised frameworks for market risk

and CDA frameworks. Capital requirements for large banks that are not G-SIBs can be simpler while still supporting resilience. I am recommending a number of changes to better reflect this principle. For firms with assets between 250 and 700 billion that are not G-SIBs or internationally active, the proposal would apply the new credit risk and operational risk requirements. It would apply the frameworks for market risk and CVA frameworks. Only two firms that engage in significant trading activity. Further, the proposal would revert to the simpler definition of capital. The numerator in the capital ratio for these firms is currently in place, with the exception of applying the requirement to reflect unrealized losses and gains on certain securities and other aspects of accumulated other comprehensive income or AOCI. The proposal would maintain this element to better reflect interest rate risk in capital, a problem that played a major role in last Mark's last March's bank failures. For large banks with assets between 100 and 250 billion. The reproposal would not apply to credit risk and operational risk frameworks of the expanded risk based approach. Maintaining a simpler capital framework for these less complex firms. For these firms, the proposal would also revert to the simpler definition of capital. For these firms that is currently in place, again, with the same exception of applying the requirement to reflect unrealized losses and gains on securities and other aspects of AOCI. As I noted last July, we saw a comment on proposed revisions to the G-SIB surcharge to better reflect the systemic risk of the G-SIB. In particular, the proposal would make adjustments to limit window dressing by requiring banks to report indicators as average values instead of on a point in time basis. It would also reduce cliff effects by calculating a G-SIB capital surcharge in 0.1% increments instead of 0.5% increments. And the proposal would adjust how we measure some systemic indicators to better align them with risk. The goal of the 2023 proposal was to improve the risk sensitivity of the G-SIB surcharge. Commentators provided feedback regarding the proposals potential impact on certain types of activities such as client clearing of derivatives. We are still considering all of these comments, but let me speak just to a few areas where I will recommend making changes to the original proposal. First, I'll speak to the treatment of clear derivatives. The proposal would have increased the extent to which client cleared derivatives, contribute to a bank's gSIB surcharge to promote consistency of the measure. However, commenters argued that the measure might result in higher costs and more volatility for derivative end users and might reduce incentives to provide client access to central clearing. While it is important for our capital rules to be risk sensitive, it is also important that we consider the impact of our rules in the broader market context. Central clearing of derivatives is a critical tool that can help improve transparency and reduce systemic risk. To avoid disincentives for client clearing. I intend to recommend to the board that we not adopt the proposed changes to capital requirements associated with client clearing. Second, let me speak to changes in the search and proposal that I will recommend to keep the measures we use up to date. The US G-SIB surcharge was set nearly nine years

ago, and the growth in the economy since 2015 has meant that G-SIB measures of systemic risk have increased. Even for firms who share of domestic or global economic activity has not increased. The board noted the potential for this effect in the original 2015 GSIB rule. While it did not provide a mechanism to automatically adjust for economic growth at that time, the board stated that it would periodically reevaluate the framework as part of the GSIB re proposal. I intend to recommend that we improve the calculation of the capital surcharge for G-SIBs by reflecting changes in the global banking system. Since the Board adopted the G-SIB surcharge in 2015. In addition for the future, I intend to recommend that we account for effects from inflation and economic growth in the measurement of a systemic risk profile. As a result, a G-SIB surcharge would not change based simply on growth in the economy. The journey to improve capital requirements since the global financial crisis has been a long one, and the Basel III endgame is an important element of this effort. These proposals bring us closer to completing the task. The broader material changes to both proposals that I've outlined today would better balance the benefits and costs. In light of comments received and result in a capital framework that appropriately reflects the risks of bank activities and is tiered to the banking sector. They also bring the proposals broadly in line with what other major jurisdictions are doing. And what does this all mean? A safer and fairer banking system. My goal through my nearly 30 years in this field has been always to help ensure that the banking system can support households and businesses of all types during good times and bad. In addition to the proposals outlined today, we are looking carefully at how our stress test complements the risk based capital rules to help ensure our overall framework supports a resilient and effective banking sector. We are attentive to the interactions across all components of our capital framework as well as the combined burden and benefits. And we take these issues seriously in all of our work. We will continue to seek an approach that helps to ensure financial system resiliency and supports the flow of credit to households and businesses. It's most imperative that we get this right. Thank you very much.

WESSEL: Thank you very much. Michael, you promised it would be all spinach and no appetizer and dessert, and you delivered.

BARR: Yes. It's a spinach only speech.

WESSEL: So I think the big question that comes to mind is, was your first proposal a mistake and you corrected the mistakes or was the opposition for the banks so strong that you were forced to backtrack?

BARR: Well, let me say, David, you know, I have found on a personal level, maybe this has happened to you, too, that that life gives you ample opportunity to learn and relearned the lesson of humility. And this is a tough area. It's a complicated set of areas. The work on this started in 2013, 11 years ago, when the Basel Committee started talking about changes to the market risk component of risk weighted assets. And it's been a long journey. And this is an important part of that journey. I would say when we were working on our 2023 proposal, we had very fresh in mind. The March banking stress. March 2023, banking stress, where we had three of the largest bank failures in US history. And so when we were thinking about the various trade offs and the calibration, how conservative to be, we were quite conservative. And what we got back in the comment process is a lot of commenters said, Yeah, you were very conservative, but you didn't take into account potential enough, potential unintended consequences. You didn't take into account enough the tradeoffs involved in capital. And we we heard those comments. And I think the proposal that we're putting forward soon is really responsive to that, that concern.

WESSEL: Okay. Can you talk a little bit about next steps? You describe this as your recommendation to the board. What happens next?

BARR: So, I expect that given the importance of this proposal, we'll have an open board meeting on it. We should be able to schedule that soon and we'll have a vote on that. The other, as I mentioned, the proposal was joint with the FDIC and the OCC. I'll let them speak to their own processes, but we worked on this jointly together, will then seek comment. So, we'll put this out to the public. We'll have a 60 day comment period. We'll get comments back on the proposal. As I mentioned, we'll take comments on any part of the proposal from 2023 and anything we did or didn't mention in this proposal. We'll take comment on anything and we'll take that comment back and then we'll have to do the work that is required to analyze those those comments. Look at the additional comments we received, which we're still analyzing on the 2023 proposal and then move to a final rule.

WESSEL: So, the usual comment period is 60 days. The banks will probably ask for more time. Was were you rushing to get this out before the election, having to do it?

BARR: No, we're definitely not rushing to finish before the election. You know, we do our work over the long cycle. You know, as I mentioned, this rule process started in 2013. We're going to take the time to get it right.

WESSEL: Okay. So let's talk a little bit about the specifics for the globally systemically important banks. You said that on average, the increase in capital would be about 9%. And as I understand it, apples to apples, that's about half as much of a capital increase as you proposed in in July 2023.

BARR: That's right.

WESSEL: And and also, it seemed to me that there are lots of banks that have business models that are based on they have credit cards or they have wealth management. And they complained that you were they were being asked to put more capital aside than is necessary, given their risks. So you've changed those things?

BARR: We do. We have we have been responsive to comments really across the proposal. So, you know, we heard some concerns about the effect on credit cards and charge cards, as you mentioned.

WESSEL: And that we because how you think about the fact that I have a $20,000 limit on my credit card, but I might pay my bill every month and I don't have any balance.

BARR: Right. Exactly. So when you look at uncommitted credit lines like that, the right answer for how much capital should be held against that is not zero, because we know that banks continue to lend to those customers. And so there's risk associated with that lending. The calibration we had was in looking at the comments too high. And so we brought that calibration down for both uncommitted credit card lines and for charge cards, which really have no preset a credit limit. We've made adjustments to bring those, I think, better in line with the risk that we see in. As in those products.

WESSEL: So if I read this right, and I may not have you've made changes, substantial changes to the amount of capital that banks have to hold against credit risk and substantial changes to the banks that the capital banks have to hold against operational risk. But where you are still asking for substantially more capital is in the market risk. So the banks that will be asked to hold more capital are those that engage in lots of trading activities, is that right? And what's the thinking there?

BARR: That's right, David. So if you looked overall at, you know, at our re- proposal, the overwhelming bulk of the capital increase for G-SIBs is focused in trading related activities. And these are really the activities

that we saw from the global financial crisis we've seen in other circumstances can lead to significant losses. And as to which our current risk based approach does not have sufficient capital. So you'll see in the in the overall framework that those trading related activities are where the bulk of new capital will will be focused.

WESSEL: So there was a lot of criticism from the banks about what and from advocacy groups about what this would do to mortgages. And they said it would make mortgages lending even less attractive than it is now. And you've scaled that back quite a bit, right? What was the thinking there? Yeah.

BARR: So in our original proposal, we had increased the amount of capital required for mortgages for the very largest banks to make them not only to adjust for risk, but to make them equivalent to the capital charge for smaller banks on average. And we've taken that extra element out and we've gone back to the purely risk based approach that was established in the Basel in the Basel process. And as a result of that, four mortgage risk mortgages that are at 90% loan to value or below, we have a somewhat lower risk rate than they have today. And mortgages that are between 90 and 100 will have about the same as they have today. So there should be no negative effect on mortgages at all and and some positive effect on mortgage access.

WESSEL: So one of the questions that I got from somebody online said, why are you going so easy on the banks between 100 and 250, we learned in March that you can turn a lot of do a lot of damage in that size. So what you actually are asking them to hold more capital, right?

BARR: We are, yeah. So, you know, one of the things, again, we're looking at is the costs and benefits, the proposal. So after we made our set of actions, after we made after we looked through and analyzed the set of changes that we were thinking about on the proposal as a whole, and we looked at the capital impact on those firms, the capital that they would be required to hold under the reproposal was about the same as what they're required to hold. Now, other than the unrealized loss issue that I'll get to in just a sack. And so when we looked at that, we said, do we really need them to go through all of the process of creating new systems to comply with this new capital rule when there's no capital impact on on how safe they are? And so that that didn't seem like a tradeoff worth making. So the big exception to that is, you know, one of the lessons we learned from March 2023 is that interest rate risk management is super important and that banks can fail because of poor interest rate risk management. And so we retained the original proposal that we made to include unrealized losses on securities in capital. And over the long run, that will have an effect of increasing

capital for these firms and improving their interest rate risk management. So I think it's a good thing to do and we kept that in the proposal and that's, I think, an important part of the reform that emphasized.

WESSEL: So one of the problems the Silicon Valley Bank had is they had a lot of bonds. The bonds weren't worth what they were because interest rates went up. That what didn't used to be part of the capital account calculation. And under this proposal, that will.

BARR: Exactly, David.

WESSEL: Let me ask you a couple of process questions. So first, do you have reason to believe you have, quote, broad support from your colleagues on the Federal Reserve Board?

BARR: Yeah. So I spent a lot of time working with my colleagues on the board in developing this proposal, and I do expect it will have broad support.

WESSEL: Six votes, seven votes?

BARR: I'm not going to vote for you.

WESSEL: I hope you've done the vote count this time.

BARR: It will have broad support.

WESSEL: And you have a number of other proposals floating around, including one that would require some banks to issue more long term. Term debt. What is the status and timing on that proposal?

BARR: Yeah. So let me say on the long term debt proposal is a proposal that would require a large banks, again, that are not G-SIBs. G-SIBs already have a requirement. But large banks over $100 billion would be required to hold long term debt. And the reason for that is, as we saw in the March 2023 banking stress, when those institutions fail, they can cause problems not only for their own institution but for the broader financial system. We saw contagion from those institutions affecting lots of banks all over the country. And so it's super important that they be resilient. And it's also really important that when they fail, they can be

resolved in an orderly way. And so long term debt does both those things. It helps improve the resiliency of the banking system and helps improve their ability to be resolved.

WESSEL: Because you can just not pay back that debt, because.

BARR: That debt, that debt explicitly is subordinated to all other claims. And so it can be, in effect, converted to new equity for for the bank. And that bank can then either be sold or there's a time to break it apart and sell pieces of it, or it potentially could go back out into the market as a healthy institution. So it's a really critically important effort to improve the resiliency of banks. And what we've done is we issued an advance notice of proposed rule making in 2022. We issued a proposal in 2023 and we expect next to finalize that. We got lots of comments on the long term debt proposal. As with this rule, we're taking all those comments very, very seriously. And as we move to finalize, the rule will be incorporating a number of those comments into the next step, which is which is moving to a final rule.

WESSEL: What's the timing on that? You know.

BARR: I expect it will be in a position to do that, you know, relatively soon in Federal Reserve terms.

WESSEL: And what about we learned a lot about the how archaic the discount window was and some concerns about liquidity. And during the March 2020 thing, where do we stand on looking at those regulations?

BARR: So I think that the discount window performed actually quite well during the during the March bank stress. And we used that to launch the bank term funding program, which banks thousands of banks across the country used quite effectively. But there's still ways that we can improve the operations of the discount window. We have been working on that since March. We made a number of improvements, including things like making it easier to apply online to to get discount window access. We'll continue that process. We're inviting comment from the public on ways that the discount window can be improved. And then in addition to that, one of the really important things that we learned in March 2023 is about banks ability to use the discount window and to be appropriately prepared with the liquidity they need themselves. That was a very, very important lesson in March 2023. There are a number of banks that were not prepared to use the discount window. They hadn't done the work required to pledge collateral. Some of them around the country

didn't have legal agreements in place with the with the Federal Reserve. They hadn't done the basic kind of steps they needed to be prepared. So as a supervisory matter, we've been working with banks to say if the discount window is one of your contingency funding planning ideas, when you get into stress, you need to show us that you are ready to use the discount window. And banks have significantly improved their liquidity preparedness over the last year and a half. From March 2023, for example, to March 2024, banks pledged an additional $1 trillion of loan collateral and securities collateral to the Federal Reserve's discount window that makes the financial system safer. That's a good thing. We are looking and and I've said this in several speeches at ways to develop a proposal, a regulatory proposal on discount window preparedness, on liquidity, risk management, making sure that banks are ready and able to use the liquidity sources that they are relying on and making sure that assumptions about depositor behavior are in line with lived experience. And all of that, I expect, will package together in a proposal again in a in a relatively soon period of time. And we'll invite comment on that. It it'll be the first stage of that proposal for.

WESSEL: Banks be able to use access to the discount window as part of their liquidity plan?

BARR: So. So right now, this gets very technical, very fast. But right now, banks are able to use the discount window as part of their contingency funding planning. And they're able to, if they can demonstrate effective use of the discount window included in their internal liquidity stress test. So that exists already. The kinds of things I'm talking about are requirements that are in conjunction with those.

WESSEL: Let me ask you one more question about Basel before I turn to something else. So I think you mentioned this. Not everything in this recommendation you're making to the board is consistent with Basel.

BARR: That's correct.

WESSEL: Why And what are the implications of that for keeping the collective attempt to raise bank capital standards?

BARR: So, you know, I've said many times when I testify in Congress, you know, if we think that there needs to be an adjustment to an international standard to make it work for US banks in terms of their resiliency, we can make adjustments. So the Basel agreement is not a treaty. It is a jointly developed international regulatory standard. And in the past, the United States has made adjustments to the Basel implementation in

the US, both both up and down. And that that's fine. That is a normal part of the process. You wouldn't want a situation, I don't think, where we had to kind of slavishly follow whatever was agreed to in this global sense. And so we've made adjustments. Other countries have made adjustments, too. I mentioned, you know, the UK and and the European Union made adjustments to their frameworks. Other countries have made adjustments. But the key thing is that, you know, broadly speaking, we're all on the same page and we will be with this set of proposals and in a broad sense will be deviations that we've made. There are different deviations that the Europeans have made or the UK has made. But broadly speaking, we're all on the same page together on this. And I think that is very, very important.

WESSEL: So you don't deviating from Basel, you don't think is the beginning of erosion of the parcel three agreement?

BARR: No, we're quite committed to implementing the Basel III package. Other jurisdictions are as well. We spent a lot of time talking to each other in the international regulatory community, and I think this will in fact, reinvigorate the process that the other jurisdictions want to know that the US is going to finalize Basel III. And we are and this is a demonstrable step in that process to finalize Basel III.

WESSEL: So let me ask you one more question about just the banking system in general, and then I'm going to turn to the audience. So it's conventional for people in your job to say the banking system is sound and stable. And so we posit that everything nobody should run to the bank after the speech. But when you look across the horizon, what are the risks that you are paying the most attention to? Is it commercial real estate? Is it consumer delinquencies? Is it banks preparedness for a big change in interest rates? Where are the risks that you look at?

BARR: Well, first of all, David, let me say that the banking system is sound and resilient. We are.

WESSEL: Trying to preempt that.

BARR: We are and always do look at risks across the system. Commercial real estate is an area that we're watching very carefully. There's not a one size fits all risk assessment about commercial real estate, but some types of commercial real estate. For example, in the office sector, in downtown markets in particular buildings is higher risk than, say, you know, a multifamily property in in the suburbs where you're not seeing

any problems at all. So we try and carefully calibrate that that look and, and understand that CRE risk is heterogeneous. We do expect banks to be managing that risk carefully. The you know, the global pandemic has, you know, changed the nature of work and where we work and how we work. And that has put enormous pressure on some office CRE and other and other issues. But so there's that issue. And then on top of that, in a in a rate environment that has been elevated, it may be difficult for firms to to refinance. So so that's one area. I tell you, a non-financial risk we worry about a lot is cyber risk. We're very attentive to banks being sure that they are not only working on prevention from cyber attack, but also resiliency in the event of successful attack. They're both equally important because we know that that those events occur and they can be successful. So we're, you know, quite focused on cyber is another example. We do in our looking at how banks have been managing their interest rate risk during this period. A number of institutions that I mentioned have unrealized losses and they need to manage through that. It can hurt their earnings. It also can, as we saw in March 2023, lead to insolvency. So those are those are all areas that we're looking at. And some institutions have a combination of credit risk and interest rate risk and also elevated uninsured deposit levels. And that combination presents an additional risk factor that we want to be careful to look at. We're obviously looking at geopolitical risk. We live in a very complicated world and internationally active banks are exposed to those geopolitical risks. They are very focused on managing those risks, and we want to make sure that they're managing those risks. So that just gives you a little flavor for some of the things we're thinking. We're going to.

WESSEL: Take 2 or 3 questions. Do you want to start right? Wait for your mic? So identify yourself and remember. Question is a question, not a speech.

AUDIENCE QUESTION: Katanga Johnson here. Reporter Bloomberg. Thanks so much for sharing today. Two questions, one on substance and then one on process. On substance. I'm just curious whether for banks outside of the G-SIBS, do you anticipate under these revisions that their capital would go up or go down relative to today? And then a second question on on process. I know you won't speak to other agencies than the Fed, but I wonder if you have an expectation as to whether there's broad consensus among all of the principals who would have to vote on the plan. And if not, would the Fed go alone on these revisions? Thank you.

WESSEL: Let me violate my role. One. Those are two questions.

BARR: I'll just take them.

WESSEL: Yeah. Okay.

BARR: So on net, the large banks. Banks over $100 Billion. They're not G-SIBs. We'll see their capital go up after the reproposal is implemented and the overwhelming bulk of that increase will be because of the inclusion of unrealized losses in their capital requirements. The other changes are going to have very modest effects on those institutions in terms of process, like I can only really speak to, you know, my my board. I've spent a lot of time with my board. I believe that this set of re proposals will have broad support on my board and they were developed jointly with the FDIC and the OCC. All three agencies worked hand in glove together to develop these proposals over many, many months. And I'll let I'll let each of the other agencies speak to their own processes.

WESSEL: Over here.

AUDIENCE QUESTION: My name is Hugo Dante with Washington Analysis. This January, you actually had mentioned that you were planning on putting out the quantitative impact study for comment. Do you anticipate that going out with the reproposal?

WESSEL: Thanks. Over here.

AUDIENCE QUESTION: John Hultman with American Banker. This this the Basel proposal is sort of thought of as a response to the Silicon Valley Bank failure and the unpleasantness of March 2023. Maybe that's just timing. Is should we still think of the Basel proposal as a policy response to SVP? Or is it more than that? Less than that or qualified?

WESSEL: Thanks. Gentleman here.

AUDIENCE QUESTION: Hi, Richard Grey from the IF. Thanks for the comments. It was a lot of spinach. We like to give names. Basel 3.1, Basil IV, Basil Endgame. This might be when it's finished the Basil Popeye proposals, but because of all the spinach in there. But just on timing in relation to timing, to the extent you can, when do you hope that the proposals can be the right reproposal can be put on the table? And more

importantly, I guess, implementation date when so when you do do consultations, you nominate an implementation date. The original was July 2025. Unlikely, I think imposible to meet that now with a reproposal that's understood. Do you propose or can you give us some indication of the need, the initial implementation date?

WESSEL: Okay. So why don't we start with is this a response to see a CVB or something broader?

BARR: Yeah. So the Basel process that I mentioned is, is one that started in 2013. And so our proposal that we issued in 2023 was in part a response to the March banking stress, but also in part a response, in large part a response to the global financial crisis. So it's it's been in train for many, many years and it's really finishing the work that started right after the global financial crisis. And as I mentioned, you know, the proposal has really at its heart in terms of increases in capital, increase in capital for the trading activities, trading derivatives, activities of of the largest banks, primarily the the G-SIBs, The changes that are most directly responsive to the March banking stress are those that are related to the inclusion of unrealized losses in the balance sheet and capital treatment for large banks. Banks over 100 billion. So you can think of them as both.

WESSEL: And so can you explain first what a quantitative impact statement is and then answer the question about is there going to be another one?

BARR: So let me go back to the to the 2023 proposal. So in the 2023 proposal, we had impact analysis. That was based on a study that we conducted with the Basel Committee based on the Basel framework and based on balance sheets that were available to us at the time of that study. We included that impact in our original proposal in 2023, we decided to go above and beyond what is required under the Administrative Procedure Act by asking for additional data as part of that proposal. And that's the quantitative impact study or special data collection, as we call it, internally. So that special data collection was designed to be based on the most recent balance sheet of the banks. So that give us more recent data and also be based on the precise contours of our dnpr or notice of proposed rule making. So we get more detailed, more granular data. And that worked. So we got lots of information back from the banks. We had to do a lot of back and forth with them to correct errors or to correct omissions. We got that information back, we cleaned the data, we've analyzed the data and that will be part of the package that I recommend to the board that we put out for comment. So people will be able to see in detail the special data collection not only as it applied to our

original proposal in 2023, but as it relates more importantly to the changes that we're making so people can understand the changes we're making in light of that updated data. And as I promised originally, people can comment on that.

WESSEL: So responsive to the question. Good. Thank you. All right. And timing.

BARR: So timing know, we we are going to put this out for comment. It's a 60 day comment period. We're going to have to analyze those comments. We also need to continue to do the work we've been doing and other other areas of the rule that I didn't mention where we got lots of comment and are working our way through what those might mean for a final rule. So that will take some time. In terms of an implementation date, You know, our original implementation date was notionally based on the idea that banks would have one year between finalizing the rule and beginning implementation, and we would follow that same basic approach here. So whenever it is that we finalize the rule, banks would have a year to begin implementation and then there's a phase in period for all the provisions.

WESSEL: Thanks. And in front. And then there's two in the middle. Sara, can you come down? And the guy with the bow tie.

AUDIENCE QUESTION: Yeah. I wanted to ask. Sorry. My name is Alex Grab from my banker partner with S&P Global. I wanted to ask what extent that the Basel III endgame and game proposal could further be delayed or disrupted Should we switch to a Republican government in our after the election?

AUDIENCE QUESTION: John Sheldon Advancing American freedom. One of our concerns in the previous round of floor comments was that over the past half century we've seen the standardization of banking that has reduced the diversity in the banking sector, different models of banking. We've also seen reduced banking charters throughout that whole time. I'd be curious what your your prognosis is on how Basel endgame would impact that. Will we see kind of continued stagnation of new charters? And how do you think that will affect the stability and resilience of the banking.

WESSEL: Sector as a whole? Great. And a pass to your right.

AUDIENCE QUESTION: I'm from the Japanese Financial Services Agency. I think the proposals you mention today are mainly geared toward US banks. But are you considering any additional regulatory changes for foreign bank organizations?

WESSEL: Okay. All right. So what happens if the Republicans take control?

BARR: So I view my job at the Federal Reserve as not paying any attention at all to elections. I have a job. The Federal Reserve is an independent agency. I have a fixed term of office. I just do my job. So we're not paying attention to the election cycle in terms of any of our work that we do. And I'm not paying attention to it for this purpose.

WESSEL: So your term runs to 2026?

BARR: Correct.

WESSEL: And you're the only American who's not paying attention to the election. The question about diversity in banking models and the reduction in charters.

BARR: So I think that it's really important for the United States, for our economy and for the banking system that we have a wide diversity of kinds of financial institutions in this country, banks and non-banks. We have a really healthy, really vibrant, very competitive financial services sector. And part of that is because we have lots of diversity in the kinds and types of institutions that we have. We have, you know, really small community banks that serve their local community really effectively. We've got regional banks, we've got midsize banks, we have large banks. We have globally systemically important banks. We have banks with very, very different business models across all the different sizes of institutions. And that diversity is really healthy. It's an important value that that that I that I have and hold for for our financial services sector. I don't think that the Basel endgame, either as proposed or as re proposed or as finalized, will have a major impact on any of that.

WESSEL: But seems to me that the re proposal addresses the concerns of some banks with specific business models that felt they were being affected unfairly and the ones who are going to have the most may

have the most criticism are the big banks whose capital is going to go up. So you've you've carved out some of the things in diversity. And then the question about how does this affect international banks?

BARR: Yeah. So we will make a set of changes in the re proposal that that affect foreign banking organizations. And I expect as we move to final, we'll also be looking at that those issues are relatively smaller in terms of their effect on on foreign banks than than domestic institutions. So I don't anticipate that the reproposal will have a significant effect on foreign banking organizations.

AUDIENCE QUESTION: Hi. I'm Aaron Caddell from Global Counsel here in Washington, DC. I want to ask a question about bank merger policy. US banks, particularly regional banks, had a robust period of consolidation of post the end of the prohibition on interstate banking operations, but that has really stagnated. Some people think that there is a policy dynamic related to that, to the point that say First Republic really had no major other regional bank buyers. So it went fell to the hands of JP Morgan, which is a big bank fail became even bigger as a result of that. So this is not just about the Basel in game rule, but do you think that there are particularly given the actions of DOJ and FTC to be involved in this process? Does the Fed have any role in making bank mergers easier or more difficult to do, particularly for the regional banks and whose are covered by your proposal? Thank you.

WESSEL: The woman here.

AUDIENCE QUESTION: Thank you. Hi. My name's Raya from George Washington University. Currently, many museums have different risk weighted asset requirements when it comes to lending through MIGA guarantees and the World Bank. Does any part of the Basel III endgame seek to tighten the phrasing on that to ensure that there is more uniformity?

WESSEL: You already had one. Come on. All right you got it for being persistent.

AUDIENCE QUESTION: This is more just a quick question. So when you put out the puzzle proposal, you also estimated the capital impact for FBOS would be higher than for other category three and four banks. Do you have an estimate what the impact will be for a few years in the repurposed?

WESSEL: Mergers, MIGA, and FBOS.

BARR: So let me do those maybe in reverse order on foreign bank organizations are the special data collection that I mentioned earlier. The information that we got from that special data collection suggested that based on the banks own information, that we had significantly overestimated the effect on foreign banking organizations of the original proposal. And that information will be in the in the special data collection section of this reproposal document. And people will be able to sort through that and see that on on the G-SIBs interactions with international organizations. Those are those are treated similarly for all all of the G-SIBs and they're taken into account when in the way that you would take into account any any counterparty exposure. So that's, I think, not a not a issue that we're addressing in this in this package on bank mergers. You know, I've said many times and I'll say again today, that I think that mergers and acquisitions can be a healthy part of any sector, including the financial services sector. We don't have a policy for mergers and we don't have a policy against mergers. We have a set of statutory factors that we review on financial stability, on competition, on convenience and the age of the community and on financial and managerial factors. And we methodically analyze those factors. That's our that's our job as regulators. So we're not we're not trying to put a thumb on the scale either in favor of mergers or against mergers. Since I've been there, we've had a number of mergers that have gone through the board just fine. And I would expect that we'll have other mergers that that don't go through the board. That's just sort of the nature of what we're supposed to do. We have to review the statutory factors Congress set out for us in terms of why there hasn't been more mergers. I would have put more emphasis on just the state of the banking system and the fact that a number of banks that would like to effectuate mergers have unrealized losses that make it difficult for them to merge with an institution because upon merger, those losses become realized and that that is a much bigger driver of this question than anything else.

WESSEL: Let me ask you one final question. After the March 2023 episode, you wrote a report that was quite critical of the quality of supervision in the Federal Reserve System. How far along are you in fixing those problems? Are you halfway there? 10% of the way there and 90% of the way there.

BARR: Let me just back up and say, you know, I thought it was really important after SPV failed that we do a critical self-assessment of our own work. It's what we ask banks to do if they get themselves into a mess. The first thing we say is do your own self assessment. And so we we took that on. Chair Powell and I decided that would be really important for me to lead that right away. And we're able to produce a really, I think, very, very good report. It was conducted independently by staff who had not been involved in the

supervisory process with respect to SPV from around the Federal Reserve System, both at the board and in the reserve banks. And they did the staff did a I think, just a first rate job on that report, and I'm very grateful to them for that. The the lessons that we took from that were were a few. One is that we want to make sure that supervisors can act with the speed force and agility that is commensurate with the problem that they're facing. There are lots of times where speed, force and agility are not not that important either the problem is not very large or it's not not urgent. But but when it is, you want supervisors to be able to act. And so what I've been emphasizing really since I arrived in July 2022 is that I have the supervisors back. And I think that message is a very important one. We're have been improving our internal processes so that when significant issues arise, we can act faster as a board or as Reserve Bank in taking the step that is required to do that. And we're looking at whether we have the right resource match for the kinds of institutions that may be fast growing or present outside risks, but are not the very largest institutions in the country. And so all of that is in process. I'd say we're making progress on all of those fronts. The work is not done. These are issues that come up in supervision, not just at the Fed, but at other agencies. They have arisen and been discussed over a long period of time. If you go back and look at reports from the global financial crisis, those kinds of issues arose. Then other jurisdictions and other countries have raised these issues. So I don't want to over claim on this is going to be a process that we're working our way through.

WESSEL: So not done.

BARR: Not done.

WESSEL: Right. But then please thank me in joining Vice Chair Barr.