

SYMPOSIUM ON BUILDING THE
FINANCIAL SYSTEM OF THE 21ST CENTURY:
AN AGENDA FOR EUROPE AND THE UNITED STATES
The Weill Center, Armonk, NY • MARCH 27-29, 2014



AGENDA (AS OF MARCH 25)

THURSDAY, MARCH 27

5:35 p.m. and 5:50 p.m. *Renaissance Guests – Bus to the Weill Center; meet in front of the Renaissance Hotel*

6:00-6:45 p.m. COCKTAIL RECEPTION *Main Lobby*

6:45-6:55 p.m. GREETINGS *Dining Room*

- **HAL SCOTT**, Nomura Professor and Director, Program on International Financial Systems, Harvard Law School
- **KAREL LANNOO**, Chief Executive Officer, Centre for European Policy Studies

6:55-8:15 p.m. DINNER *Dining Room*

8:20-8:55 p.m. KEYNOTE ADDRESS *Dining Room*

DANIEL TARULLO, Governor, U.S. Federal Reserve Board

Introduced by: **Hal Scott**, Nomura Professor and Director, Program on International Financial Systems, Harvard Law School

8:55-10:00 p.m. AFTER-DINNER COCKTAILS *Main Lobby*

9:05 P.M. , 9:35 P.M. , & 10:00 P.M. *Renaissance Guests – Bus back to hotel; meet in Main Lobby of Weill*

FRIDAY, MARCH 28

6:55 a.m. – 7:40 a.m. *Renaissance Guests – Buses to the Weill Center- Meet in front of Renaissance Hotel*

7:15-8:00 a.m. BREAKFAST BUFFET *Dining Room*

**Panelists, Facilitators, and Reporters sit at reserved tables.*

8:00-9:30 a.m. BREAKFAST PANEL DISCUSSION *Dining Room*

SIFI design: setting the scene for insurance companies, asset management firms and other non-financial industries

- **BARBARA NOVICK**, Vice Chairman, BlackRock
- **BRANDON BECKER**, Executive Vice President and Chief Legal Officer, TIAA-CREF
- **JACQUES BUSQUET**, Managing Director, Chief Risk Officer, Natixis North America LLC
- **ARTHUR LINDO**, Senior Associate Director, Division of Banking Supervision & Regulation, Board of Governors of the Federal Reserve System

Moderated by: **Hal Scott**, Nomura Professor and Director, PIFS, Harvard Law School

9:50-10:10 a.m. PANEL SESSION

Room H

The Too Big To Fail Doctrine: assessing developments for Bank Structural Reforms, Recovery and Resolution Procedures

- **GREG BAER**, Managing Director and General Counsel for Corporate and Regulatory Law, JPMorgan Chase
- **ANTONIO GARCIA DEL RIEGO**, Managing Director, Banco Santander

10:15-11:45 a.m. SMALL GROUP SESSIONS

<u>Group</u>	<u>Room</u>	<u>Facilitator</u>	<u>Reporter</u>
1	Room H	Alan Houmann	Eric Morgan de Rivery
2	Room F	Richard Kaye	Simon Gleeson
3	Room J	Paul Saltzman	Patrick Kenadjian
4	Room A	Daniel Trinder	Bill Grimes
5	Room B	Heath Tarbert	Diego Valiente
6	Dining Room 2	Bernard de Longevialle	Edward Nalbantian

11:50-1:20 p.m. LUNCHEON KEYNOTE ADDRESS

Dining Room

- **ANDREAS DOMBRET**, Member of the Executive Board, Deutsche Bundesbank
Introduced by: **Karel Lannoo**, Chief Executive Officer, Centre for European Policy Studies

1:30-1:50 p.m. PANEL SESSION

Room H

Bringing coherence to Transatlantic rulemaking. Which Way Forward?

- **SHARON BOWLES**, MEP, Chair, Economic and Monetary Affairs Committee, European Parliament
- **MARK SOBEL**, Deputy Assistant Secretary for International Monetary and Financial Policy, U.S. Department of the Treasury

1:55-3:30 p.m. SMALL GROUP SESSIONS

<u>Group</u>	<u>Room</u>	<u>Facilitator</u>	<u>Reporter</u>
1	Room H	Hal Scott	Eric Morgan de Rivery
2	Room F	Karel Lannoo	Simon Gleeson
3	Room J	Peter Skinner	Patrick Kenadjian
4	Room A	Nick Collier	Bill Grimes
5	Room B	Nick Reinhardt	Diego Valiente
6	Dining Room 2	Dan Waldman	Edward Nalbantian

- 3:35 p.m. and 3:45 p.m. *Renaissance Guests* – Bus back to hotel; meet in Weill Main Lobby
- 3:35-6:15 p.m. FREE TIME/ REPORTERS MEETING *Room F*
- 5:45 p.m. and 5:55 p.m. *Renaissance Guests* – Bus to the Weill Center; meet in front of the Renaissance Hotel
- 6:20-6:50 p.m. KEYNOTE ADDRESS *Room H*
- **BRIAN LEACH**, Head of Franchise Risk and Strategy, Citi
Introduced by: **Hal Scott**, Nomura Professor and Director, Program on International Financial Systems, Harvard Law School
- 6:55-7:30 p.m. COCKTAIL RECEPTION *Main Lobby*
- 7:35-9:30 p.m. DINNER AND KEYNOTE ADDRESS *Dining Room*
- **YVES MERSCH**, Member of the Executive Board, European Central Bank
Introduced by: **Karel Lannoo**, Chief Executive Officer, Centre for European Policy Studies
- 9:30-10:30 p.m. AFTER-DINNER COCKTAILS *Main Lobby*
- 9:35 P.M. , 10:00 P.M. , & 10:30 P.M. *Renaissance Guests* – Bus back to hotel; meet in Main Lobby of Weill

SATURDAY, MARCH 29

- 7:15 a.m. - 7:55 a.m. *Renaissance Guests* – Bus to the Weill Center- Meet in front of Renaissance with your luggage
- 7:30-8:30 a.m. BREAKFAST BUFFET *Dining Room*
*Chairs and Reporters sit at reserved tables
- 8:40-9:55 a.m. PRESENTATION AND DISCUSSION *Room H*
- Different tools or different rules? Assessing the Consistency of EU derivatives and trading rules with Dodd-Frank**
- **KIM TAYLOR**, President, CME Clearing
 - **BRIAN BUSSEY**, Associate Director, Derivatives Policy and Trading Practices, U.S. Securities and Exchange Commission
 - **CHRIS BATES**, Partner, Clifford Chance
 - Moderated by: **Yalman Onaran**, Senior Writer, Bloomberg
- 10:00-10:15 a.m. REFRESHMENT BREAK
- 10:15-11:15 a.m. PRESENTATION & DISCUSSION *Room H*
- The Too Big To Fail Doctrine: assessing developments for Bank Structural Reforms, Recovery and Resolution Procedures**

- **EMILIANO TORNESE**, Financial Stability, DG Internal Market and Services, European Commission
- **MICHAEL KRIMMINGER**, Partner, Cleary Gottlieb Steen & Hamilton LLP

11:15-12:15 p.m. PRESENTATION & DISCUSSION

Room H

Bringing coherence to Transatlantic rulemaking. Which Way Forward?

- **EDOUARD-FRANÇOIS DE LENCQUESAING**, CEO, European Institute of Financial Regulation (EIFR)
- **RACHEL LOMAX**, Chair, International Regulatory Strategy Group, City of London

12:15-12:50 p.m. CLOSING BUFFET LUNCH

Dining Room

12:50 P.M. *Buses from the Weill Center to JFK and Grand Central Station*

SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM
OF THE 21ST CENTURY: AN AGENDA FOR EUROPE AND THE US
THE WEILL CENTER, ARMONK, NY • MARCH 27-29, 2014

DRAFT AGENDA AS OF MARCH 18



2014 Symposium on Building the Financial System of the Twenty- First Century: An Agenda for Europe and the United States

The eleventh Europe-US Symposium was held in Armonk, New York from March 27-29, 2014. Sessions addressed the designation and regulation of non-banks as systemically important financial institutions (SIFIs), developments in managing issues of “too big to fail,” transatlantic regulatory coherence, and the consistency of US and EU rules regarding derivatives trading. Participants acknowledged progress in planning and capabilities for dealing with future SIFI failures, as well as the establishment of the EU’s Single Resolution Mechanism, as important steps forward in financial regulation. However, they expressed concerns about other effects of post-crisis regulation, including the fragmentation of derivatives markets, moves toward ring-fencing in the banking sector, ongoing difficulties of transatlantic regulatory cooperation, SIFI designation of non-banks such as asset management companies, and increased costs of regulatory compliance. There were also questions about the effects of post-crisis regulation on the real economy in the form of impacts on the lending practices of banks and on the hedging strategies of end-users of derivatives.

Session 1:

SIFI Design: Setting the Scene for Insurance Companies, Asset Management Firms and Other Non-Financial Industries

Session 1 addressed the issue of designating and regulating non-banks as SIFIs, with a particular focus on asset management companies. A number of participants expressed concern that the effort to regulate asset managers as SIFIs was misplaced, and raised questions about the assumptions underlying recent regulatory initiatives.

“Systemic Importance” and the Asset Management Sector

A number of participants critiqued the anticipated SIFI designation of asset management companies. The concerns fell into three categories: misplaced attention to financial institutions rather than specific products or markets, excessive focus on size as an indicator of systemic importance, and uncertainty about the impact and costs of SIFI designation for firms.

Several participants raised the question of whether it was appropriate to regulate asset managers as SIFIs at all. They argued that asset management firms are fundamentally different from other financial institutions such as banks, brokers, and insurance companies in that they operate entirely as agents of their clients and do not lend or borrow, access the discount window, or act as counterparties to transactions. Since they are agents, any herd behavior is the result of client decisions, and not attributable to the asset management firm itself. Moreover, several participants argued, resolution of an asset management firm would look different from resolution of a bank, as the fund holding company could easily be resolved while the funds were kept intact. Instead of increasing regulation at the firm level, these participants advocated focusing on product-level regulation—for example, for money market funds.

A number of participants also expressed concern over what they saw as a preoccupation on the part of regulators with size when it came to SIFI designation. Although it was pointed out that FSOC had outlined multiple categories and indicators to determine whether a given financial institution was systemically important, these participants felt that size tended to trump other considerations. While they agreed that this might make sense in banking, they argued that such a focus was misplaced in the asset management sector. For example, it was noted that many of the largest funds were index funds, which were likely to pose little if any danger of herding or liquidity freeze-ups, and which typically had no leverage. It was also pointed out that asset managers catering to individual investors, especially those managing retirement funds, were often countercyclical in their investing practices. It was argued that subjecting such firms to bank-like capital requirements might therefore actually increase systemic risk.

Third, many participants expressed concern about the potential for increased costs of compliance. They questioned whether the benefits in terms of system stability (which many expected to be slight or perhaps even non-existent) justified the costs to asset managers not only of compliance but also of possibly having to change their business models or approaches to risk management. It was noted that the DC Court of Appeals had become increasingly concerned with the lack of cost-benefit analysis in a number of new financial regulations.

Not all participants felt that SIFI designation and regulation of asset managers were misplaced, however. Some participants pointed to what they saw as real systemic risks that could be generated by the asset management sector. These included issues related to money market funds (especially those catering to institutional clients), as well as the involvement of many asset funds as major players in derivatives, asset-backed securities, commercial paper, and other financial markets that had seized up in the financial crisis and thus contributed to contagion. And while these participants acknowledged that size alone should not be determinative, they argued that, for any given level of risk and leverage, larger funds were more likely to have a systemic impact than smaller ones. (Others strongly disagreed with this assessment. They reiterated that point that asset managers act as agents, argued that investor herding would therefore remain a problem even if there were no large asset management firms involved.)

Despite the concerns expressed by a number of participants about the effects of SIFI regulation on non-banks, others argued that regulators clearly understood that one-size-fits-all was not appropriate for non-banks. Although regulation would include common factors and seek comparability across financial institutions—including with regard to capital and liquidity rules, scrutiny of risk management, and creation of resolution plans—they were confident that these would look very different depending on the characteristics and business models of a given financial institution.

Finally, some participants suggested that the issue of SIFI designation in the asset management sector was primarily an issue for US firms. They noted that most large EU-based asset managers were controlled by banks or insurance companies, and thus many would automatically be subject to SIFI regulation if their parent companies were so designated. European financial institutions would therefore likely be less concerned about SIFI designation of asset managers than about broader regulatory initiatives. Meanwhile, leverage ratios might have bigger effects on European banks than on US ones, as European banks were seen as more likely to manage corporate clients' medium and long-term credit on their own balance sheets, with relatively few shadow banking players to which the assets could be transferred

Alternatives to SIFI Designation

Critics of designating asset managers as SIFIs called instead for a two-pronged approach to reducing the systemic risks in the sector. First, they advocated improving the market environment through the implementation of central clearing for most derivatives, rigorous capital rules for central clearing parties (CCPs), and stricter and more uniform reporting requirements. Some participants expressed significant concerns about

concentration risk in CCPs, arguing that many were insufficiently capitalized to make good in the event of a major financial institution failure. They urged regulators to focus there rather than on the fund industry. (Others disagreed, arguing that the new capital standards for CCPs would be sufficient in nearly any imaginable crisis.) They also called for stress testing of CCPs and ensuring that the waterfall would operate as intended.

There was a general consensus in favor of rigorous reporting requirements, but some participants expressed disappointment with the current state of play. Participants noted that different jurisdictions, including the US and EU, were dictating differing, albeit overlapping, reporting requirements. They saw this not only as leading to unnecessary costs for market participants, but also as a problem for regulators, who would not be able to aggregate trading data across borders.

Second, they called for product-level regulation, as noted above. Money market funds were seen as a likely target of enhanced regulation, although there was little discussion of specifics. Some participants also agreed that systemic risk considerations might call for consideration of subscription and redemption rules, pricing rules, and leverage or liquidity rules on at least some types of funds. They stressed, however, that such regulation should be based on clear cost-benefit analysis.

Uncertainties Regarding SIFI Regulation of Non-Banks

Participants agreed that a variety of uncertainties remained concerning both designation and regulation of non-bank SIFIs. While most of the discussion in Session 1 focused on asset managers, they noted that there remained uncertainty even in how SIFI regulation would work in the insurance sector, despite the fact that a number of insurers had already been designated national or global SIFIs. Regulators were much further from making decisions about regulation of asset management. Meanwhile, insurance firms designated as G-SIFIs also had widely varying business models (not only life vs. property and casualty, but also traditional vs. non-traditional insurance products), complicating the effort to produce one-size-fits-all regulation; the asset management sector was seen as even more diverse in that respect.

Despite the uncertainties related to SIFI designation and regulation of non-banks, participants raised several specific concerns about how it might be operationalized. One concern was the opaqueness of the process of SIFI designation. It was argued that some financial institutions may wish to structure their business models so as to avoid enhanced regulation as a SIFI, but as of now there was no way of knowing what the threshold was. Others were less worried about opaqueness. They argued that, although public statements were opaque, discussions between regulators and designated SIFIs were much more clear and concrete.

Several participants also raised the concern that SIFI designation and regulation could actually lead to more market volatility and systemic risk. One way in which this might occur is if fears of SIFI regulation of asset managers or shadow banking were to lead investors to shift funds away from SIFI-designated firms, or if asset management ended up breaking up so as to drop below size thresholds for SIFI designation. In that case, a

number of participants argued that risk would not be reduced, but rather just shifted to less regulated players or markets.

Some participants suggested that guidance by the prudential regulator could also increase volatility. They noted that regulators often ask questions of major market participants about their holdings, and suggested that asset managers often take such questions as guidance to change their portfolio composition. In the case of a designated SIFI, they argued, they would be even more sensitive out of concern that they might get in trouble if they did not heed such guidance. This might lead to more herd behavior. Other participants were skeptical of this argument. They argued that prudential regulators had an obligation to make sure that financial institutions had thought through the implications of their holdings, and that questions raised by regulators could only contribute to effective risk management.

In the end, some participants thought that SIFI designation and regulation of asset managers and other non-banks was likely unavoidable. But they also thought that no one knew what such regulation would entail. Thus, the challenge for both regulators and industry would be to create rules that enhanced market stability at a reasonable cost.

Session 2: The Too Big To Fail Doctrine: Assessing Developments for Bank Structural Reforms, Recovery and Resolution Procedures

Session 2 addressed policies aimed at ending the problem of “too big to fail.” Participants discussed the extent of progress to date, as well as tasks still left undone. There was considerable debate about how major financial institutions would be resolved in the event of failure, with particular attention to loss-absorbing capital, single vs. multiple point of entry models, and whether national regulators would cooperate in the event of a failure of a global financial institution or resort to ring-fencing

Status of Efforts to Eliminate Too Big to Fail

In the wake of the global financial crisis, one of the central commitments of G20 policymakers was to end the problem of financial institutions that were “too big to fail.” Major policy initiatives including the Dodd-Frank Act and the EU’s Single Resolution Mechanism aimed at creating resolution mechanisms for financial institutions that would not involve injections of public money. There was considerable discussion in Session 2 of the extent to which that goal had been achieved.

While few participants were prepared to say that post-crisis financial regulation had eliminated too-big-to-fail, there was an overall sense of cautious optimism that the problem had been significantly reduced and that the system had become safer, at least for banks. (Some participants expressed more pointed concerns regarding CCPs and other non-banks, but the discussion focused on banks.)

Participants pointed to a number of important advances that they saw as reducing the problem of TBTF in the banking sector. One key element was more stringent capital and liquidity requirements for all internationally-active banks, with higher requirements for SIFIs and G-SIFIs. Although some participants worried about the cost of such heightened capital and liquidity requirements for both individual banks and credit provision to the real economy, they agreed that higher amounts of regulatory and loss-absorbing capital would make banks not only less likely to fail but also less likely to require injections of public funds if they did.

Participants were also generally positive about the development of resolution plans among SIFIs. Not all believed that the resolution plans would be followed as written, but most participants agreed that having financial institutions and their regulators testing failure scenarios was itself a good thing—as one participant quoted Dwight Eisenhower, “Plans are worthless, but planning is everything.” A similar argument was made for the benefits of stress tests, although some participants expressed skepticism about the rigor of ECB stress tests to date.

Despite these advances, participants pointed to a number of tasks still left undone. A primary concern in this regard was the progress of regulatory cooperation. Participants

did recognize some advances in this regard. In particular, they saw the establishment of the EU's single resolution mechanism as a big step forward for managing TBTF and ensuring cooperation within the EU. Still, some pointed out that the fund's target level would not be fully reached for another eight years.

In any event, outside of the EU, international regulatory cooperation remained an unfinished project, despite years of ongoing discussions among regulators from the US, EU, Japan, and other jurisdictions. Participants acknowledged developments in resolution planning across jurisdictions, in particular case-specific dialogue and planning based on SIFIs' resolution plans, as a major improvement compared to the pre-crisis period. However, there was considerable disagreement about whether plans and agreements would be followed in the event of a major financial institution failure. Some participants argued that the trust that had developed among regulators would ensure effective cooperation. Others were skeptical, arguing that the prospects of committing large amounts of public money to bail out foreign depositors or creditors would likely be a political bridge too far regardless of the quality of resolution planning and cooperation agreements. These participants felt that ring-fencing or "pre-positioning" of capital was likely to become the default norm, even if international regulators signed off on a SIFI's global resolution plan.

Participants pointed to other ongoing uncertainties as well. In particular, a number of participants noted the newness of resolution planning, as well as evolving standards and expectations of regulators and markets. Several pointed to the Fed's recent review of resolution plans as suggesting uncertainty about expectations. They expected that resolution plans would continue to evolve in coming years, which would likely require considerable management time and attention. Some participants also wondered whether banks' strategies had actually caught up with planning regarding structure and operations. They argued that in many cases, resolution plans would require changes in where capital would be held in a given financial institution, as well as how risk would be managed throughout the institution. At least in some cases, it appeared that resolution plans were already leading to pre-positioning of capital or liquidity, in the expectation that ring-fencing would occur in the event of an actual failure of the financial institution or of a local subsidiary.

Role of Capital and Liquidity under Basel III

Capital requirements for banks were, as in previous Symposiums, a matter of considerable discussion. Participants agreed that the extensive new capital requirements were likely to reduce the threat of bank failures as well as their cost. There were, however, questions as to whether regulators had stipulated sufficient (or excessive) loss-absorbing capital, and where that capital should be deployed.

One of the major effects of Basel III was the principle that all senior debt was now bailable as global loss-absorbing capital (GLAC) in the event of a bank failure. When added to regulatory capital (including SIFI surcharges) and hybrid capital, one participant estimated that GLAC in global SIFIs amounted to around twenty percent of total assets. Thus, many participants felt that the failure of a major financial institution would be

unlikely to require a bailout using public funds. Overall, most participants appeared to agree that systemic stability was improved by the increases in GLAC, as well as the establishment of countercyclical buffers.

Some participants expressed skepticism about whether bailin-able debt could actually be mobilized effectively in the event of a crisis. If the goal was to declare a bank insolvent over the weekend, then reopen on Monday, they argued that the increase in capital at the holding company level would not automatically make liquidity available at foreign subsidiaries to prevent a run. Others were more sanguine, arguing that the guarantee of sufficient loss-absorbency would prevent runs, and if necessary central banks could supply liquidity either directly (if the bank were seen to be still solvent) or via a national resolution authority. As in a number of other discussions at the Symposium, at least some of this conversation reflected differences of opinion as to whether national resolution authorities or central banks would be willing to provide money that might be used to bail out foreigners.

While most participants agreed that Basel III requirements would improve the resolution of major financial institutions and reduce systemic risk, they also raised significant concerns about the costs of the new requirements. It was acknowledged that these costs were difficult to quantify and not politically salient. Leaving aside the costs to banks, several participants made the case that the requirements would lead to a reduction in credit available to a variety of potential borrowers. Due to Basel III risk-weighting rules, major banks would have to take higher capital charges for non-prime mortgage lending and SME lending than smaller banks (which followed the standardized model), so they were already withdrawing from those markets in the US, leaving them to local banks and the shadow banking sector. It was argued that lower credit availability and higher rates would result for such borrowers, with negative impacts on economic growth and inequality.

The effects of other aspects of the new regime were also discussed. A number of participants criticized the imposition of a leverage ratio as a binding constraint for banks. Because the Supplementary Leverage Ratio treats all assets as equal, it was argued that large banks were trimming all their low-risk assets, including repos and government bonds, possibly reducing their own liquidity, as well as liquidity in the markets for such instruments. Combined with the reduction of lending to high-risk borrowers driven by capital rules, this would also leave large banks competing for a narrowing band of assets worth holding, reducing profitability and increasing concentration risk.

This discussion informed the ongoing debate over how GSIB designation affects banks' incentives. Many participants continued to hold the view that such designation was attractive to banks, as clients and creditors would tend to equate it with an implicit government guarantee that the bank was too big to fail, thus attracting clients and lowering the cost of capital. Those who accepted the too-big-to-fail argument also expected that GSIB designation would be an incentive for risk-taking. Others pointed to the heightened costs of compliance and the narrowing of markets as reasons why major banks would prefer to not to be designated as SIFIs. Moreover, they argued that Basel III

capital rules significantly reduced the scope for risk-taking, whatever the funding advantages of SIFI designation might be. Opponents of this line of reasoning pointed out that no SIFI-designated financial institutions had chosen to break themselves up so as to no longer be subject to SIFI regulation.

Approaches to Resolution

While the effects of Basel III regulation on banks and systemic stability was a matter of deep interest to many participants, the bulk of the discussion in Session 2 was focused on the issue of resolution of failed financial institutions. Participants discussed at length the merits of single point of entry (SPOE) and multiple point of entry (MPOE) approaches to resolving multinational financial institutions. While some participants preferred one approach over the other on principle, most felt that it depended on characteristics of banks or resolution authorities.

Many participants appeared to prefer the single point of entry approach for globally active financial institutions. In particular, it was seen as well-suited to the US holding company model, as well as groups headed by a single bank, in which the holding company and its subsidiaries have clear legal obligations to each other. Thus, holding company creditors would be the ones to suffer in a failure. Advocates of SPOE argued that it would reduce moral hazard and improve internal governance, while reducing systemic risk by ensuring that subsidiaries around the world would continue as going concerns. It was noted that markets have already responded to this model by downgrading the credit ratings of US holding companies, while upgrading those of subsidiaries' bonds.

Not surprisingly, SPOE was seen to be preferred by US regulators, following the initiative of the FDIC, as well as by UK regulators. It was also argued that SPOE would allow for rational resolution, in which creditors would be treated equally across borders, and national resolution authorities would have clear expectations about what they and their foreign counterparts would be expected to do.

Even those who preferred the SPOE model recognized potential limitations, however. Most importantly, they agreed that it would only work well if the waterfall were to cascade as planned. In practice, many participants were skeptical that this would occur, as they argued that national regulators would have incentives to ring-fence in order to prevent transfer of funds to foreign subsidiaries, so as to make sure there was enough money to deal with their own domestic banks. In other words, they argued, SPOE at the international level necessarily relied on trust among regulators. Several pointed to Lehman Brothers as an example of why regulators should not trust each others' promises or good intentions when push came to shove. Some also noted that, despite the stated preference of US and UK regulators for SPOE, in practice there was already considerable evidence of ring-fencing in both countries.

Finally, some participants argued that SPOE would work best in the event of a single, idiosyncratic bank failure, where regulators did not fear contagion. The increased GLAC should also be reassuring to regulators who might fear that their home depositors or

creditors would be disadvantaged by following the waterfall and resolution plan. However, in the event of a systemic crisis, they felt that SPOE's benefits were more questionable.

Multiple point of entry, in contrast, was seen as most appropriate to highly distributed banking models, which were more characteristic of some European banks. In banks where subsidiaries operated largely independently, and were not supported by a holding company, the MPOE model would allow each subsidiary to be treated separately. This could allow most subsidiaries to continue operating as going concerns, with national authorities dealing with resolution of problem units.

Participants pointed to two potential problems of MPOE resolution. First, it reduced incentives for international cooperation in the resolution (and even resolution planning) of multinational financial institutions. Some participants actually saw this as a good thing, arguing that in a major banking failure international cooperation might well break down anyway, so it was better to plan for an orderly resolution that did not depend on trust. Second, it was argued that MPOE resolution planning would inevitably lead to pre-positioning of capital and liquidity in subsidiaries, preventing them from being deployed throughout the financial institutions' global operations. They worried that this would reduce the efficiency of capital and liquidity allocation in normal times, while also reducing the likelihood that a troubled subsidiary would be bailed out by the parent company or bank (or vice versa).

Given the mixed opinions about SPOE and MPOE, some participants argued that decisions about which resolution approach to follow should be made on a bank-by-bank basis, rather than by national regulators as a blanket rule—i.e., that diversity might be better than monoculture. It was not clear that this would be legally possible in many jurisdictions, however. In any event, many participants predicted that that MPOE would become the default setting in a world in which regulators could not trust their international counterparts to allow capital and liquidity to flow from their countries to a failing subsidiary or holding company. In other words, MPOE was seen to be the only practical way to handle resolution in a ring-fenced world.

Regulator Responses to Failure

Regardless of the intent of resolution plans or the merits of SPOE vs. MPOE, many participants felt that regulators were already working on the expectation that they could not trust their foreign counterparts to allow money to flow out of the country in the event of a major bank failure. In practice, this meant a proliferation of ring-fencing regulations, even if they were not always pitched as such. As an example, participants pointed to the Fed's recent decision to require pre-positioning of capital in an intermediate holding company for foreign banks' operations in the US. Although US rules still called for SPOE resolution and international collaboration in the event of a bank failure, many participants anticipated that the new rule would facilitate ring-fencing; at the least, it appeared premised on an expectation that foreign resolution authorities would not allow banks or holding companies in their home jurisdictions to provide funds to their US subsidiaries.

On a more optimistic note, participants agreed that the tools available to regulators and resolution authorities had significantly increased. Central banks in the US and EU had demonstrated their ability to provide liquidity to financial institutions in an emergency, although the classic problem of distinguishing a solvency from a liquidity crisis remained as challenging as ever. US authorities had improved their ability to manage failures of diversified financial institutions with holding company structures, and had been able to test some of the new tools in managing the bankruptcies of the GSEs. One caution, however, was new restrictions on authorities' freedom of action—a major example was the Dodd-Frank Act 13(3) restriction on emergency liquidity provision by the Fed. In the EU, participants pointed to a host of improved resolution mechanisms, culminating in the Banking Union and Single Resolution Mechanism. Although the EU system was seen as still nascent, many participants saw the EU as moving toward a resolution system that was as robust and effective as that of the US. Others were less sanguine about how it would work in practice, but agreed that the legal and financial infrastructure for handling bank failures in the EU had improved dramatically.

Session 3: Bringing Coherence to Transatlantic Rulemaking: Which Way Forward?

Session 3 addressed the issue of how to enhance coherence of transatlantic rulemaking. Despite broad agreement on global standards, participants saw significant divergence in some areas, threatening fragmentation of global markets. There was considerable discussion of ways in which transatlantic cooperation could be improved, including debate over the benefits of technical cooperation at the working level vs. inclusion of financial services in the Transatlantic Trade and Investment Partnership (TTIP).

Status of Transatlantic Regulatory Cooperation

Participants offered varying assessments of the status of transatlantic regulatory cooperation. A number of participants highlighted serious gaps in regulatory coherence (“harmonization” was seen as not feasible, due to differences in legal systems and financial structures). They saw some of these gaps as extremely consequential to specific markets. This was particularly true of regulation of derivatives and of trading and execution facilities (addressed in detail in Session 4, below).

Other participants argued that there had actually been significant progress in terms of transatlantic regulatory cooperation and coherence. They pointed out that, prior to the global financial crisis, financial regulatory cooperation had actually been quite limited; this was exacerbated by fragmentation and variation within the EU. In the aftermath of the crisis, the G20 and new FSB had contributed to global regulatory coherence through the expansion of global financial regulatory standards as well as shared principles of regulation of multinational financial institutions (particularly G-SIBs and other G-SIFIs). A number of participants also described much more extensive regulatory dialogue at the transatlantic level; while some participants criticized technical cooperation for being post-hoc, others spoke of considerable discussions between US, EU and other regulators as an integral part of Dodd-Frank and EMIR rulemaking processes.

There was considerable discussion of global standards. Some participants expressed cynicism about the effects of new global standards, arguing that despite the rhetoric of global cooperation, in fact many jurisdictions had gone their own ways. Even where a single standard was implemented globally, other regulations could render the effects very different depending on the jurisdiction. Some participants pointed to the Basel III leverage ratio. Despite being precisely defined relative to assets, IFRS and GAAP accounting principles led to significant differences in valuation of assets, and very different leverage ratios for an identical balance sheet.

Others were more positive about the effects of global standards. While acknowledging that national implementation meant that rules were not being fully harmonized across borders, they saw significant regulatory convergence. Several also emphasized that global standards should be understood as minimum standards, and that different countries could choose to go beyond them—one example was capital standards, where countries like

Switzerland had imposed much higher requirements in recognition of the scale of major Swiss financial institutions relative to the country's GDP. The Fed's decision to require some foreign banks to create intermediate holding companies was noted as another example of going beyond Basel to improve financial system stability, although a number of participants argued that the move was more of an effort at ring-fencing rather than a prudential measure. Finally, even if global standards did not necessarily lead to full convergence, many participants lauded the principle of non-discriminatory treatment.

For a number of participants, it was simply too early to judge the effectiveness of regulatory cooperation. While they agreed that significant gaps remained, they pointed out that the scope and pace of regulatory change in both the EU and US had been enormous, and that rulemaking was an ongoing process. They expressed hope that, over time, transatlantic consultation could lead to much greater regulatory coherence.

Effects of Regulatory Divergence

Some participants questioned whether transatlantic regulatory divergence was necessarily a bad thing. They pointed out that it reflected the preferences of differing national systems, and that moreover it allowed for testing of alternative policies and approaches to common (and sometimes different) problems. Some pointed to the US implementation of the Volcker Rule as an object lesson for other countries, expressing hope that the eventual EU legislation to come out of the Liikanen Report and Barnier proposal would have less of a negative effect on EU banks' business models.

Others argued that regulatory divergence was not as great in substance as often portrayed. They felt that transatlantic regulatory cooperation could bridge the specific gaps, as long as they were conducted in a spirit of reciprocity and good faith. Several saw "coherence," which they defined as equivalence plus access, as a strategy that made much more sense than line-by-line regulatory convergence.

However, most participants were concerned about the potential dangers of divergence. A major concern was that diverging rules would lead to fragmentation. In some cases, similar but overlapping rules could actually make certain activities impossible. An example was US and EU rules about clearinghouse membership, which could prevent transatlantic derivatives clearing unless regulators could come to an agreement about substituted compliance. Perhaps a larger concern was that, faced with differing rules across jurisdictions, financial institutions would be forced either by regulators or market pressures to comply with the strictest rules from each jurisdiction. (This issue was discussed in detail in Session 4, as it pertained to CCPs.) This could raise financial institutions' costs considerably, and possibly even dissuade them from entering foreign markets, which would exacerbate problems of market fragmentation.

Differing rules could also provide opportunities for regulatory arbitrage. While some participants were skeptical that a regulatory race to the bottom would result, others noted that costs were likely to vary between jurisdictions if the rules differed and that businesses that had a choice would gravitate to the lower-cost market.

Venues for Transatlantic Cooperation

Participants saw the development of multiple channels for regulatory cooperation and dialogue over the recent years as a positive contribution to promoting regulatory coherence. These included the FSB and other global regulatory bodies, transatlantic dialogue as typified by the US-EU Financial Markets Regulatory Dialogue (FMRD), and possibly the proposed Transatlantic Trade and Investment Partnership (TTIP). There was considerable discussion about what cooperation venues offered the most promise.

Some participants felt that regulatory cooperation should be managed at the global level. With financial institutions and markets outside the US and EU growing in importance, argued that global standards ought to be debated globally. The imprimatur of FSB or other global regulatory body would contribute to the legitimacy of decisions as well as address those markets' needs. Some participants felt that the FSB itself should be taking a leading role in promoting regulatory coherence, perhaps through providing authoritative evaluation and benchmarking of countries' financial regulation. Others argued that the most important issues at play were often technical in nature and that it would be better to keep discussions closer to the working level through IOSCO, the Basel Committee, or other bodies.

Other participants were skeptical of the usefulness of global regulatory bodies in promoting regulatory coherence. They argued that these bodies were often unwieldy and slow-moving. Moreover, a number of participants questioned the benefits of broadening dialogue to the global level, pointing out that in some cases, such as derivatives, the US and EU constituted the bulk of global markets.

These participants argued that it was therefore important to improve and expand transatlantic regulatory cooperation in order to move forward more effectively and expeditiously. One model for cooperation advocated by a number of participants was the FMRD. They argued that many of the key issues were technical in nature, that discrepancies could in many cases be addressed through administrative rulemaking rather than having to go through legislation, and that regulatory agencies were also typically able to make decisions regarding substituted compliance. Other participants were more skeptical, however. Some criticized FMRD as being focused on *ex post* technical consultations after legislatures had already made decisions; even with good intentions, they felt, regulators would not be able to bridge large gaps. Several participants, with direct knowledge of transatlantic regulatory dialogue, responded that US and EU regulators were actually involved in extensive *ex ante* consultations as they did their rulemaking, with the goal of trying to minimize negative impact on international transactions and foreign financial institutions. Still, even advocates agreed that in some cases, post-crisis legislation in the US and EU had led to gaps that were too large to bridge through technical consultation, especially since that legislation often limited regulators' discretion.

Some participants saw TTIP as a solution to those problems. They argued that the time had come to move from the peer review model embodied by FMRD to one of formal enforceability. Advocates of the TTIP approach saw formal enforceability as essential to

ensure reciprocity and to move beyond a reliance on “trust” among regulators. They also argued that a formal commitment by national leaders would be essential to surmount some of the regulatory gaps and problems of non-cooperation among regulatory agencies; embedding financial cooperation within a major initiative like TTIP would provide that kind of commitment at the top. Other participants were more skeptical. They worried that financial services did not fit comfortably into the trade agreement model—they argued that, whereas trade agreements tended to be highly prescriptive, legalistic, and difficult to amend, financial services regulation required much more flexibility in their terms and discretion in enforcement. Thus, they worried that including financial regulation in TTIP would prevent regulators from responding quickly to changes in financial markets. Some participants countered that TTIP’s financial services chapter would not be as prescriptive as a typical trade agreement. Rather, they saw it as an opportunity to build trust among regulators by creating effective surveillance and consultation processes. In any event, there remained considerable uncertainty as to whether financial services would be included given EU support and US opposition. There was also uncertainty about what the financial services chapter might look like if it were to be included, so it was extremely difficult to assess its possible effectiveness.

Obstacles and Alternatives

Much of the discussion in Session 3 focused on issues of technical cooperation, but participants also recognized that technical issues could not be divorced from politics. Many identified politics as a major obstacle to regulatory coherence.

A number of participants argued that the electoral politics did not support a regulatory coherence agenda in either the US or the EU. While financial institutions might see efforts to reduce market fragmentation and overlaps or conflicts between rules as being of obvious interest to policymakers, voters felt differently. With voter sentiment strongly against the big banks and derivatives market players that had sparked the crisis and were then supported by public money, these participants argued that there was limited legislative impetus to change the situation.

Even apart from populist politics, a number of participants argued that major players in the transatlantic dialogue held different core interests, based on their own financial systems and institutions. Among the major EU countries, the UK was seen as an outlier in terms of its preferences for financial regulation and supervision, based on the longstanding prominence of London in global financial markets. In contrast, other EU members were more willing to clip the wings of financial markets through means such as the financial transaction tax and restrictions on high-frequency trading. And while much of EU policymaking focused on the needs of a bank-focused financial system, the US system assumed much more reliance on market-based finance. The complexity and fragmentation of US and EU policymaking processes and representative democracy further complicated efforts to improve regulatory coherence in financial services.

In this context, many participants saw the differential timing of US and EU decision making as a result and cause of the political contestation. With the passage of the Dodd-Frank Act, EU governments saw the US as having stepped away from its G20

commitment to global cooperation and instead trying to establish first mover advantage. EU rulemaking was considerably slower, but EU governments were determined not to simply accept US solutions as global *faits accomplis*. Thus, even as US regulators and financial institutions were becoming locked into the Dodd-Frank framework, the EU was consciously choosing not to follow that framework entirely. This dynamic was seen as detracting from transatlantic regulatory coherence.

Finally, some participants pointed out that the lack of an institutionalized process of regulatory cooperation left cooperation at the mercy of individual personalities, as well as the fragmented regulatory systems of the US and EU. Participants agreed that agency heads varied considerably in their commitment to the idea of transatlantic cooperation and willingness to compromise in order to achieve it.

Despite concerns about the difficult politics of regulatory cooperation in financial services, however, a number of participants were more optimistic that differences would be ironed out or that at least substituted compliance would smooth over the rough edges. They argued that it was still much too early to declare transatlantic cooperation a failure and expressed hope for the future of regulatory coherence.

Alternatives to Transatlantic Regulatory Coherence

While participants continued to urge political leaders and regulators to promote regulatory cooperation and coherence, they also addressed the question of what would happen if those efforts failed. Most predicted that in that event, the global financial system would be characterized by ring-fencing and fragmentation. The business models of global financial institutions would be severely compromised.

Others suggested that a failure of transatlantic regulatory cooperation would decrease the relevance of the US and EU in setting global standards and in global financial markets in general. They argued that Asian jurisdictions including Hong Kong, Singapore, and Shanghai might well create their own regional systems of cooperation. While they were still not dominant players in global derivatives and debt markets, these participants argued that the US and EU would not retain their dominant positions if they could not cooperate. Others were skeptical about the likelihood of cooperation among Asian jurisdictions driving an alternative that would outstrip US-EU models of financial regulation, arguing that incentives for Asian regional cooperation were weak.

Finally, some participants asked whether there might be constructive alternatives to cooperation and coherence. Few were willing to accept that fragmentation was an attractive state of affairs, but it was suggested that regulators could at least try to agree on a minimalist level of cooperation that centered on transparency and an *ex ante* division of labor between regulators in different jurisdictions.

Session 4: Different Tools or Different Rules? Assessing the Consistency of EU Derivatives and Trading Rules with Dodd-Frank

In Session 4, participants discussed US and EU treatment of derivatives trading. Given the global nature of derivatives markets, the discussion addressed concerns that differences between the regulatory regimes might lead to market segmentation, which in turn could raise hedging costs for end-users as well as opportunities for financial institutions. A number of participants highlighted commonalities in terms of approaches and tools, which offered some grounds for optimism that differences between the EU and US could be surmounted through the use of substituted compliance. Still, participants called for regulators to show greater urgency in resolving the challenges of substituted compliance.

Principles of Derivatives Regulation

While global derivatives markets were to a considerable extent unregulated prior to 2008, the financial crisis raised significant concerns about the role of OTC derivatives in transmitting and exacerbating the crisis. Accordingly, regulation of derivatives trading and markets was a key element of the G20 financial reform agenda. Although the timing and many of the specifics diverged, both the US and EU based their new derivatives regulation upon the G20's principles, including mandatory central clearing, exchange trading, and trade reporting.

Several participants argued that there are many fewer differences than might be expected, given the profusion of new rules and revised regulatory framework on both sides of the Atlantic. They saw considerable commonality between the EU and US in terms of tools, concepts, and approaches across many of the key elements of derivatives regulation, including mandatory clearing, margining concept, reporting rules, risk mitigation, CCP regulation, trading rules, and transparency. They also pointed to similar ideas with regard to substituted compliance.

In managing cross-border transactions, participants agreed that a key principle should be deference to home country regulation. They also argued that equivalence determinations for foreign country regulatory regimes should be made on basis of outcome rather than on line-by-line similarity. Moreover, they agreed that regulators should not use equivalence determinations as a means of gaining competitive advantage or as a protectionist barrier. While regulatory arbitrage is a real issue for regulators, the point was made that arbitrage is driven by overall costs and benefits rather than by single line-items. Participants also recognized that perfect standardization across jurisdictions would not be feasible, due to differences in regulatory structures.

Finally, there was a consensus among participants that regulation of derivatives should focus on non-financial end-users' needs and costs. A number of participants expressed

frustration that policy initiatives had grown from a desire to police these previously unregulated markets, whereas the economic rationale for derivatives was often overlooked in the regulatory dialogue. While some reforms were seen to be beneficial to end-users—particularly those related to reducing counterparty risk—they worried about other effects of regulatory reform, including market segmentation and rising costs for bespoke derivatives.

Regulatory Divergence between US and EU

While participants saw a number of commonalities in principle and practice between US and EU, they also highlighted a number of important differences. Some were seen as significant challenges to reconstituting global derivatives markets, which participants agreed would require significant home country deference (or substituted compliance) as well as restraint on extraterritoriality of derivatives regulation.

Several participants pointed out that the timing of derivatives regulatory reforms in the two jurisdictions had created frictions. The ambitious timetable for US legislators and regulators meant that US rules did not reflect EU concerns; although rulemaking may have benefited to some extent from the US experience (e.g., leveraging US work on risk mitigation), significant differences remain. These were exacerbated by restrictions on the flexibility of regulatory agencies to bridge differences in a discretionary manner—for the US, legislation reduced regulators’ discretion considerably, while EU regulators were unable to modify rules or issue no-action letters in response to changing situations. Moreover, the EU system was still not fully in place, including key implementation issues such as decisions whether to recognize non-EU CCPs.

Both the US and EU were seen by participants as acting extraterritorially. US rules on broker-dealer registration were put forward as a prime example of extraterritoriality. Some participants raised the concern that, even if transatlantic mutual recognition of CCPs could be achieved, different rules of US and EU CCPs would create problems. Although regulators on both sides of the Atlantic will follow G20 principles, the specifics have led to complications, as the US and EU rules are conservative in different ways—the EU has been conservative on margining, using a two-day standard, while the US uses a one-day standard but with more conservative liquidity rules. Meanwhile, US rules on customer gross margining (developed partly in response to MF Global’s loss of clients’ funds) would make it more than twice as costly to margin a futures contract in the US than in the EU; however, other rules would raise the relative cost for EU market participants. Participants recognized that putting together a risk management regime includes many components; however, they worried that while the two approaches might be comparable in effect, having differing rules would inevitably create significant costs and complications. A major concern for CCPs was that they might end up being held to the strictest standards for both jurisdictions, or what one participant termed the “max of the max.” In addition to raising costs for CCPs (and ultimately end-users) and reducing opportunities for innovation, some participants worried that this could create a massive model risk problem in which all CCPs were effectively constrained to follow the same practices.

A number of participants expressed frustration over the continuing uncertainty regarding EU rules and decisions regarding CCPs. If a non-EU CCP is not recognized under the ESMA regime, it will not be a qualified CCP for Basel purposes and CCP members will face higher capital requirements for exposures to that CCP. In practice, these participants argued, that will mean that EU firms will not be clients or members of non-EU CCPs. With a December 2014 deadline for ESMA recognition, and legislation still not in place, they worried that the clock was running out. This issue was seen by a number of participants as critical to whether derivatives markets would be global or fragmented.

Participants also pointed to a number of other specific differences, several of which were unlikely to be bridged due to their embeddedness in differing regulatory and bankruptcy regimes. These included customer segregation (required for EU CCPs, but impossible in the US because of the bankruptcy code's pro rata distribution principle). Rules on rehypothecation also differed. EU rules would allow only limited rehypothecation in margining on uncleared derivatives; in some countries, such as Germany, it was expected that rehypothecation would be so restricted as to be useless. In contrast, the US bankruptcy code is designed to allow rehypothecation, but the principles developed in the Working Group on Margin Requirements (WGMR) would significantly restrict the ability to use it in practice.

Participants urged regulators to try to surmount the various specific differences by following the principle of mutual recognition based on the broad comparability of the systems. Several expressed hope that ongoing regulatory dialogue, particularly the WGMR, could lead to common standards for the US and EU (although acknowledging that non-US, non-EU players would continue to face challenges). However, they recognized significant obstacles and including limited flexibility, timing (e.g., the EU system was still not in place, making US deference to home country regulation difficult). Finally, it was noted that implementation a substantial sticking point in US-EU mutual recognition. US regulators were adamant that substituted compliance was not only about rules but also implementation, and thus were unlikely to recognize home country regulation in a number of the peripheral EU countries; however, the EU demanded that recognition be extended to all EU countries in order for the EU to accept US home country regulation.

Costs of Market Fragmentation and Extraterritoriality

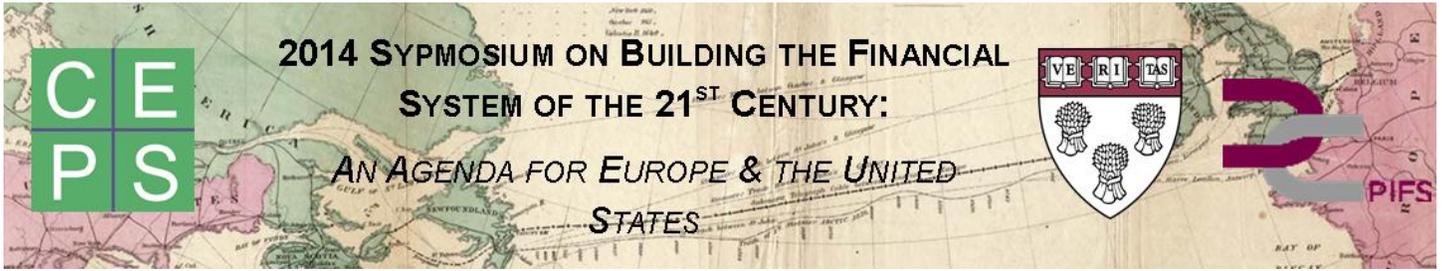
Participants raised serious concerns about the effects of regulatory non-cooperation on derivatives markets and end-users. Many market participants had global hedging needs, but without harmonization or much more extensive substituted compliance, they would have to try to do so through segmented markets. This would likely result in higher transaction costs and lower liquidity, making hedging strategies much more costly or in some cases even infeasible.

One participant declared that end-users were "reeling from the lack of harmonization." Lack of clarity and consistency in rules and rushed deadlines were seen as another major problem for market participants who needed to understand the legal and financial

implications of business decisions in an environment of significant uncertainty. Moreover, they raised concerns about the costs of compliance with new rules. For end-users, EMIR reporting rules were seen as a particular problem—for example, to have to report every intra-group FX swap would be a huge burden that would not even provide useful information to regulators.

Several participants noted that US trading restrictions had already had a profound impact on transatlantic trading. They argued that EU actions could segment markets even more. In particular, they pointed to the December 2014 deadline for ESMA recognition of non-EU CCPs, arguing that CCPs and market participants would be making long-lasting decisions about trading venues long before then. Even if the rule were fixed, they argued that damage was already being done, as market players were already making investment decisions and there would be costs to changing yet again where they do business. Participants agreed that there was a much greater consciousness than before among non-EU, non-US market participants about the nationality of the parties that they were trading with or the platforms they were trading on, which was further contributing to fragmentation.

Finally, there were questions raised as to whether collateral shortages would arise, although there were no clear answers provided. One participant noted that EMIR rules would in theory require reclassification and remargining of every existing contract, and cautioned that, “We shouldn’t underestimate the scale of effort that will be required to do this by December 1.”



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