15th Anniversary Lehman Collapse Conference

Wednesday, September 13, 2023, 9:30am – 5pm

PANEL DISCUSSION: What Has Changed/Not Changed from Bear Stearns/Lehman Brothers to SVB/First Republic?

Shayna Olesiuk, Better Markets
Thank you, Martin. That was terrific. Hi, everyone. I'm Shayna Olesiuk, the Director of Banking Policy at Better Markets. We have an all-star cast for our first panel. It's going to explore what's changed or not changed from Bear Stearns and Lehman Brothers in 2008, to the collapse of Silicon Valley Bank, and First Republic Bank in 2023. We are very fortunate to have Deborah Solomon, as the moderator for this panel. She has had a long and storied career in journalism. Deborah has been the economics editor at the New York Times for more than six years now. Before that, she was a longtime award-winning economic policy reporter and news editor at The Wall Street Journal. She led the journals coverage of Washington's response to the 2008 financial crisis and was a finalist along with several colleagues for the 2009 Pulitzer Prize. Her reporting focused on corporate misconduct, the 2008 crash, financial regulation, the SEC, and much more. Her full bio and all the participants bios are on the Better Markets website. Deborah, over to you.

Deborah Solomon, The New York Times
Thank you so much for that nice introduction. And, I feel very privileged to be with this all-star cast. I wish we had all been together 15 years ago because it would have made my job easier. So, I'll do a quick intro. I think Dennis Keller had mentioned who everybody is, but just to give a short introduction to our panel, we've got Bill Cohan, who I'm sure many of you are familiar with. He was a longtime senior investment banker at some of the biggest banks on Wall Street including Lazard, Merrill, JP Morgan. He's written several books, bestsellers including House of Cards, which is about the downfall of Bear Stearns, he wrote a book about Goldman Sachs as well, and the Last Tycoons, which is the secret history of Lazard. A lot of you probably read him for a long time in Vanity Fair, but he has recently switched over to PUC a digital news and opinion organization that he helped co-found where he continues to write very lively pieces about Wall Street.

So, Bill will be joining us, as well as we have Jeremy Kress, who we're very privileged to have. He's an Assistant Professor of Law at the University of Michigan. And he was at the Fed for a long time. He focuses on systemic risk. He knows everything about SIFIs and Basel and can probably talk our ear off again about the Basel III endgame, so we're very privileged to have him as well.

Frank Partnoy, who is now at University of Berkeley. Knew him for a long time at San Diego. He has obviously been very prolific in writing about Wall Street, and has authored dozens of pieces, maybe more than dozens for some of the biggest publications. Has appeared on lots of shows including 60 minutes and the Daily Show with Jon Stewart. I forget what it's called now, because we've had so many hosts.

And now we've got Jennifer Taub, who is probably one of the best-known people for understanding the mortgage market meltdown in 2008. She's an advocate, and she focuses on explaining to people all the intricacies of Wall Street and why they matter, and how understand what's happening in the real world and how it affects you. She's also very focused on white collar crime. And she wrote a book in 2020, which is about following the money.

So, I'm very proud to be on a panel with all of you. And I guess what, we're going to start with some 10-minute presentations from each of our panelists, and then we'll jump into questions. So Bill, I'm going to hand it off to you.

William Cohan, Writer
Well, thank you, Deborah, for the kind introduction. And thank you Dennis for having me and thank you to Elizabeth Warren for that inspiring conversation, which reminds me, we haven't come all that far in 15 years and for Martin Wolf, just a masterclass. That was a stunning presentation that he gave us. And we were all privileged to hear that.

In my 10 minutes, which are rapidly deteriorating, I just want to make the point, I think that the system is designed and continues to be designed, the financial system, to allow for failures, to accept failures, bank failures on a regular basis. In our history, of the country, I mean, essentially, we were born out of a financial crisis when we couldn't pay our debts for the Revolutionary War. And pretty much every 10 to 15 to 20 years since then we've had a financial crisis. And I think that when you really step back from it and think about it, it's sort of the price we're willing to pay for the way we've constructed our financial system, which is really a fractional banking system. Which means that we put money in banks, we think that our money is safe in the banks. We think that our money is at the bank when we want to get it out. And pretty much every time we want to go to the bank and get it out, it's there for us. It used to be we had to go to a teller and present various documents and stand and wait. And then the teller would hand us cash. Now, of course, as Paul Volcker once said about the ATM machine, it was the greatest innovation in banking in the 20th century. You know, you go to the ATM machine, you put in a little card, and you put in your code, and outcomes, your cash. And so that's the way it works.

And it works great, until people panic, and everybody wants their money at the same time, or a lot of people want their money at the same time, doesn't even have to be everybody. And when a lot of people want their money at the same time, as we saw with Bear Stearns in March of 2008, or Lehman, in September of 2008. And it wasn't just those two, of course, it was Merrill Lynch, it was Morgan Stanley, was almost Goldman Sachs, it was AIG. It was as I explore in my latest book about GE, it was GE Capital, which, frankly, nobody even paid attention to, even though GE was, you know, one of our biggest and most powerful and important corporations. And as we also know, well, we had a problem with the automobile companies. And of course, then the same thing happened earlier this year with Silicon Valley Bank, with First Republic Bank, and with Signature Bank as Senator Warren was talking about.

And the reason that bank panics result in financial crises is because of the fractional banking system, which is how we've designed our banking system, and how it remains designed, despite Dodd Frank, despite re-regulation, despite the regulations that were put in the Great Depression. In a fractional banking system, the way banks make money is that our money isn't at the bank. It's never been at the bank. And in fact, if the money were at the bank, banks couldn't make money. Because they take our money, and then they lend it out. They take our money, and reward us with at the moment, tiny amounts of interest payment. And if I look at my checking account and my savings account, which are JPMorgan Chase, our biggest bank, I get one basis point of interest on my checking account and a whopping two basis points of interest on my savings account, which means essentially, that number one, JPMorgan Chase doesn't really want my deposits anymore, because if they did, they'd pay me more for them. Okay, that doesn't mean anything. They still have $2 trillion plus, $2 and a half trillion plus, of deposits they're viewed as particularly, one of our safest banks, and they essentially get their raw material for free. Their raw material that they use to make money is our deposits. And they're basically paying us nothing for them. They then turn around and lend that money out to corporations to endowments, to universities, municipalities, individuals, and they capture the spread along with a bunch of fees. And that's essentially one of the main ways banks make money. So, we put our money in, we get a tiny amount of interest from it, at least at the moment. And we think that the money is there. But of course, it's not there.

And everything about a bank is designed to maintain that fiction, that the money, our money is safe. Like, when you go into a bank, or at least in the old days, there were barrel vaulted ceilings, in these big branches that looked so elegant and lovely. And in the corner, you could spy, a huge bank vault, which was just opened a little bit to make you think that your money was tucked away in there, and that if anybody ever got close to that bank vault, that bank vault would shudder and, your money would be safe. But of course, that is all just a major league fiction. It's all designed to create what is essentially a confidence game in our banking system. And once people lose confidence like they did in March of 2008, when Bear Stearns went down in a week, or with Silicon Valley Bank 15 years later, when literally, in 36 hours, people through their iPhones were able to whisk away their deposits out of the company, then banks fail, because by design banks are in the business of borrowing short and lending long. And that works fine until people lose confidence in that system and want their money out. They wanted their money out in Silicon Valley Bank, they took it out in 36 hours, those are short term liabilities that can leave. Deposits are nothing more than short term liabilities that can leave the bank in an instant, as we found out earlier this year, leaving long term assets, these loans of 5 to 7 to 10 years or in the case of Silicon Valley Bank they were long dated Treasury securities that they thought were safe. And what eventually happens is that when you're in the business of borrowing short and lending long, you have created an extremely risky financial system. And what people forget is that Wall Street has always been a very risky place. We're lulled into complacency because the risks don't show up. Except for, once every 10 to 15 to 20 years. And then we have to deal with it. And, as we see over and over again, especially lately, that dealing with it means that the Federal Reserve, the Treasury, the Congress has to come forth and put forth these huge bailout plans. And so, the system is designed to fail. And once every 15 or 20 years, it does fail. And we forget that.

I'll end by just telling people, about my experience, you know, more than 17 years working on Wall Street. I was an M&A banker at Lazard Merrill Lynch and JP Morgan Chase. I had no idea how any of these firms finance themselves, that wasn't my job. My job was to bring in M&A deals, do M&A deals, get fees for M&A deals. I hadn't a clue about how these banks finance themselves or how risky they actually were. And that's the way everybody is who works on Wall Street. There's a very tiny percentage of people who work at banks who really understand how risky they are. Where are our rewards were to bring in fees. And if we did that we got rewarded with big bonuses and people are pretty simple. They do what they're rewarded to do. And on Wall Street, they're rewarded to bring in fees on a daily basis. They are not rewarded to figure out the risks that exist in the financial system or at their individual bank.

Thank you. I look forward to working with the rest of the panel and having this robust discussion.

Deborah Solomon
Thanks. Jeremy?

Jeremy Kress, Michigan Ross School of Business
Thanks, Deborah, and thank you to Better Markets for the opportunity to be here. I'm deeply grateful for all the wonderful work that Better Markets does advocating for appropriate oversight of the financial sector. And especially grateful to Dennis for his idea to host this event today, to commemorate the anniversary that I worry would have gone overlooked, but for the conversations that we're having today.

So, I'm excited to be here in keeping with the theme of the panel. I'm going to gear my remarks toward what has changed since Lehman and Bear Stearns and also what has not changed, or perhaps what has gotten worst since Lehman and Bear Stearns. And in keeping with my expertise, I'll gear my remarks toward the regulatory environment in which financial institutions operate. So, in terms of what's changed, I think on a positive note, we can be confident that the financial system is safer and fairer today than it was in 2008. In large part due to advancements made by Dodd Frank, and Basel III. With no claims toward comprehensiveness, I will identify just four ways in which I think the regulatory environment has improved.

First, bank capital requirements today are meaningfully higher than they were in 2007, 2008. The quality of that capital is higher. So, when banks suffer losses, we can be more confident that their equity buffers are there to sustain those losses. By most estimates, the quantity of capital that big banks like JP Morgan and Citi are holding is roughly two times the amount of capital that they were maintaining pre crisis. So strong advancements in terms of bank capital.

Second, stress tests. The Fed now has a reasonably robust system for evaluating how large banks could perform under severely adverse financial conditions and it can adjust banks capital buffers accordingly.

Thirdly, we have other enhanced prudential standards like liquidity requirements, long term debt requirements, resolution planning or Living Wills. All of these enhanced prudential standards are supposed to make bank failures more manageable, give regulators more time to assess and plan for how to handle a bank failure should one occur.

And fourth and finally, perhaps one of the most meaningful advancements in the last 15 years was the establishment of the Consumer Financial Protection Bureau. We now have the CFPB as a dedicated consumer finance regulator, to prevent both banks and non-banks from exploiting consumers like they did pre-crisis when consumer protection was fragmented and ignored by all the prudential regulators.

So, these are some, I think, very important improvements. That's not to suggest that they're perfect. I think each of the four areas that I mentioned, could all be improved upon. But they're all really significant ways in which we live in a different world today than we did in 2008. Importantly, I want to point out one common theme, which each with each of the four areas that I just mentioned, and that is, all of these advancements are currently under attack by the financial sector and their allies. If the banks get their way, we could see the progress of the past 15 years, erased and reversed.

With bank capital, we're seeing the financial sector putting a whole lot of money and lobbying power behind their stop Basel endgame campaign to prevent the financial regulators from instituting enhancements to the capital regime. On stress testing, we're seeing the banks gear up to judicially challenge stress tests as some sort of violation of the Administrative Procedure Act. We're seeing banks gear up for a potential legal challenge to the enhanced prudential standards as they apply to $250 billion banks. They view this as a violation of the tailoring law that was passed in 2018, also known as the Dodd Frank rollback bill. And just next month on October 3, the CFPB is going to the Supreme Court to defend its very existence against a radical legal challenge to its funding mechanism. So, while we have made really important improvements, it is critical that we not rest on our laurels because even the improvements that we've made today, 15 years later are still under attack. And we're at risk of backsliding if the industry gets its way.

So that's what's changed. Let me talk for a few moments about what has not changed or perhaps what has gotten worse. I don't want to dwell too much on the negatives, but we need some continued improvement in areas that we've not gotten our arms around since 2008. Let me identify three areas. First, building on Bill's comments, non-bank systemic risk. We have gotten nowhere on systemic risk arising from investment banks, insurance companies, other non-banks, money market mutual funds. We often think of the 2008 crisis as a non-bank crisis triggered by Bear Stearns, Lehman Brothers, AIG, Morgan Stanley, Goldman Sachs, and yet here we are 15 years later, and we've done nothing to better regulate non-banks. Dodd Frank did set up the Financial Stability Oversight Council, and FSOC appropriately designated four companies, AIG, MetLife Prudential and GE Capital. That did some good things, GE Capital and AIG simplified themselves, reduced their systemic footprints in order to win D designation. But then we saw MetLife challenge its designation in court and we had a very wrongly decided district court case in MetLife. That released MetLife from its designation, and unfortunately has laid the groundwork for the industry to target FSOC in general. The Biden Administration appropriately is trying to reinvigorate FSOC. But there's still so much work that needs to be done on non-bank systemic risk. And critically, this non-bank problem has gotten worse because we've seen an increasing proportion of financial activity migrate out of the banking system, and to non-banks. So that remains a very significant vulnerability that we need to do a lot more thinking about.

Second area that has not changed or gotten worse is concentration. The 2008 financial crisis was perhaps caused by, at least exacerbated by, very large, very powerful, powerful financial institutions. And yet here we are 15 years later, with even larger and even more powerful financial institutions. JP Morgan, Bank of America, Wells Fargo, they're all two times the size today, as they were before 2008, even after adjusting for inflation. And the number of community banks in the United States has declined from 8400 in 2008 to 4400 today. So, we're seeing increasing concentration. That concentration has harmful consequences on a number of dimensions, including reducing competition, increasing financial stability risks, and posing a threat to democracy itself through the intense concentration of financial power.

Third and final area that hasn't changed or has gotten worse, and related to the second, the Too Big to Fail, and too big to manage problems. Too Big To Fail, too big to manage. I know I'm previewing here, a panel that will happen this afternoon. But in my view, they're both alive and well. On the too big to fail front, you need to look no further than Credit Suisse, which just a few months ago demonstrated that we have more work to do to ensure that mega banks can be wound down safely and without government assistance. And as Silicon Valley and Signature demonstrated in the US, we need to expand our understanding of what we think of as Too Big To Fail. It used to be that we just thought of the GSIBs, the eight global systemically important banks. But we are now appreciating that we have a category of domestic systemically important banks that are sometimes erroneously termed regional banks, but we are finding out that they are in fact systemically important. So that's Too Big To Fail. Too big to manage, remains problematic. Wells Fargo has now been subjected to its asset cap for six years. Wells Fargo is not the only problem according to the Federal Reserve's supervision and regulation report. Exactly half of the large banking organizations with more than $100 billion in assets today are rated to be in not satisfactory supervisory condition. So, we still have a too big to manage problem. And yet, so far, we've been unwilling to impose meaningful consequences to get that problem under control.

So, thank you for the opportunity to present these remarks. I look forward to hearing from Jen and Frank and then having a discussion and debate afterwards.

Deborah Solomon
Thanks, Jeremy. Frank?

Frank Partnoy, Berkely Law School
Thanks so much. And special thanks to Dennis and Better Markets, not only for organizing today, but for their role commenting on various regulations over the last decade or so. And I also want to just call out Steven Hall as being an especially astute commentator I've worked with, particularly over the last year and a half. I set up a nonprofit, co-founded, the International Institute of Law and Finance, and we've worked with Better Markets. And we don't always agree, but we always know that we're going to get an open, interesting, well thought out perspective. And already, I'm excited about today's comments, because they're similar to what Better Markets has been doing over the last 15 years.

And so, when Dennis asked me to do this, and I thought on questions since Lehman, and what's changed and what's not changed, I immediately thought of some big picture issues. And so, what I'd like to do is talk about some big picture, macro bank incentive failure questions that I think in many ways have gotten worse, since Lehman, and then give a little bit of California perspective. I teach at UC Berkeley. And in many ways, this recent banking crisis had a California flavor to it, and then talk a little bit about how some of the market actors and market institutions have changed and also, in many ways are failing us.

So first, with respect to the big picture questions. The way that regulators and academics have long thought about bank failures is to think about market failures and the ways in which markets don't adequately incentivize large financial institutions. And the three buckets that economists and legal academics often think about are moral hazard, taking on increased risk in the presence of insurance, information asymmetry gaps between people within these institutions and people outside of them, ad agency costs, the cost within institutions and within regulators in terms of the people at the top and the people at the bottom. And certainly, with respect to moral hazard, there have been significant changes in the last 15 years. And we don't know the counterfactual of what would have happened if we hadn't provided floor support for financial institutions recently. We can't run the counterfactual. But we do know that what counts as systemic risk is much broader now than it was 15 years ago. So, 13(3), which is the portion of the Federal Reserve Act that permits emergency lending is now the standard toolkit post Lehman. It was the toolkit in the aftermath of the financial crisis. It was the toolkit in March of 2020, when many people thought the financial system would collapse. And the systemic risk exception was a significant part of the toolkit on March 10, in response to the collapse of SVB, and the instrument for regulators to make depositors whole right away. We got a bank term funding program and a $25 billion backstop very quickly because regulators determined that there was this emergency. That there were unusual and exigent circumstances that existed at the time that warranted the approval of this, and I think most people would agree that that the assumption that 13(3) facilities are part of the standard toolkit is something we didn't think about when Lehman collapsed, and that this exception to the idea of what systemic is much, much broader than it was 15 years ago.

Think in terms of big picture, macro issues, that this information asymmetry idea also has changed a bit. The idea that we can look inside an institution and understand its assets, liabilities and risk. In some ways, it's gotten better. We forget the Lehman collapse was followed by an extensive investigation, and many of us read the 2000 + page report in bankruptcy that included morsels like repo 105 and the misrepresentation of values and moving risks off balance sheet and back then we thought we might actually fix this. And I think one of the biggest changes since then, is that we've essentially given up on the kind of granularity and disclosures about assets and liabilities and risk. At least back then we looked at things like collateralized debt obligations and tried to figure out details. Now, I'm not sure all that many people are looking carefully at bank financial statements. And I'll just say, I think the SEC has done a tremendous job here. And I think Chair Gensler and the head of Division of Corporation Finance, Eric Girding deserve a lot of credit for ensuring that we have adequate disclosures. And we had a lot of information about SVB and others well before this crisis, but the problem is a lot of people are not paying attention to it.

And this relates to the moral hazard problem. You don't necessarily pay attention to the details if you know that the financial institution will be backed by a 13(3) facility if things go south. So, I think a lot of the information that was of concern for SVB actually was disclosed. I am worried, just to not pay too glossy a picture, here that there are a lot of risks. And again, this information asymmetry has gotten a lot worse at the larger financial institutions. And I'll just mention collateralized loan obligations, and leveraged loans, which were part of the March 20 backstop. And now we have not only the proliferation of these loans, many of which are not marked to market at financial institutions, but we have ETFs based on CLOs. We have expanded risk taking related to leveraged loans. So, some worries that have gotten worse, some are not as bad.

And then the third category of agency costs is one. Legal academics always think about these kinds of concerns about monitoring and costs and risks within an institution. And as Jeremy says, these banks are much larger now. There have been a lot of improvements in terms of taking proprietary risk, but there still are rogue areas within financial institutions. And because they're much larger, what counts as material, and therefore it needs to be disclosed is also much larger. And so, a lot of people worry about significant risks in areas within large financial institutions that we don't even find out about, that we won't ever find out about because they're not deemed material. So those big pictures are really the main thing I wanted to say.

I'll just spend a couple of minutes talking about the California vibe to SVB. I'm vegan, I was trying to think of a good food analogy for this. I don't know where I would put the avocados or the sprouts. But I will certainly say that the menu of who the depositors were at SVB was very, very different. And the flavor of the collapse for people who were in the Bay Area is very different. The point that Bill made about the speed at which people withdrew was just breathtaking on March 9, with 40 plus billion dollars of withdrawals in one day. And what's interesting, I think is quite different, is that the largest depositors were new names, and we know who those people are. And what's interesting is that the same sort of emergency facilities and concerns were about institutions who were depositors like, Circle Internet Financial Limited, the largest depositor in SVB. Sequoia, with a billion dollars of deposits, and many startup companies, relatively young companies, Altos Labs, a private life science startup backed by Jeff Bezos, which had almost $700 million worth of deposits. And I think one of the things that we should think about when we think about SVB, and First Republic is just the fact that the context is quite different, that the breath, it's not a New York kind of focus. It's not really even international in the same way. And again, many people were aware of this, it's not like this was a secret at the time.

The closing issue I'll just spend a minute, it's not just about regulation and supervision from the government. 15 years ago, it was conceivable that a Lehman could fail. And people in the market private actors actually looked for Lehman’s. They investigated, and there were four categories of groups in particular that have, I think, been gutted in the last 15 years. They used to spend a fair amount of time and have market power. And those are journalists, short sellers, plaintiffs, lawyers, and shareholder activists. And all of those categories, these are people who used to spend a lot of time looking at these issues. Jesse Eisner, the Pulitzer winner for reporting on the crisis, and I did a 9000-word Atlantic cover piece more than a decade ago now basically saying that banks are like paintings, and the people in the markets can't understand them. And people aren't even looking at the details about disclosures, and if we look at those significant market actors, who back then would have spent the time, people like Bill Ackman, for example, who looked in detail at CDOs and MBIA and had a massive spreadsheet that caused my computer to crash wouldn't when I used to hit back 15 years ago, aren't bothering to look at financial institutions. And it's become very difficult to wade through bank 10k. My favorite is Wells Fargo, I keep looking at them and keeping an eye on them. But my closing thought for all of you would be if you haven't read a bank 10k recently, it's worth a read just after our panel or after today's remarks. Just peruse a bank 10k. And tell me you aren't worried about large financial institutions.

Deborah Solomon
Thanks, Frank. Jennifer?

Jennifer Taub, Western New England University
Thanks so much, Deborah. And thank you to Dennis, the whole team here at Better Markets for everything you've done up until now and helping us remember these events from 15 years ago, and I'm honored to be on this panel with all of you. I've read your work, and I learned so much from you. One thing I'd like to add about my background is before I joined academia, back in 2004, I had worked as the head lawyer for fixed income at Fidelity Investments. And so, I was right there, you know, near the repo depth and actually knew what, what short term wholesale funding was as the lifeblood of the financial system well before I completely panicked in September of 2008, when I heard that the overnight

funding markets were freezing up something obviously separate and apart from the $700 billion TARP that was being negotiated. And it made me it made me panic. I will get to that in a moment.

But first, I want to comment and build on in my remarks, what my fellow panelists said. And I'm going to start with something that Bill said that I think is inherent in everything we talked about, which is the fundamental fragility of fractional reserve banking with maturity transformation. And, you know, that's how we talk. But what we're saying is, when deposits can be withdrawn quickly, and whether those are retail deposits or brokered deposits, big chunks of uninsured deposits, such as in Silicon Valley Bank, or during the SNL crisis, or repo funding, as was in the case you know, in 2008, when the money funding banking institutions can leave more quickly than the assets backing that funding can because these are longer term loans or hard to value illiquid securities. When that happens, and it does happen, because that's inherently the nature of banking, there are going to be bank collapses. And the question is what was the promise made to us after the collapse of 2008? And why are we still facing similar risks today, and I'm going to talk abstractly, and then look at some numbers.

And specifically, there's this this quote I go back through from Fed Reserve Chairman Ben Bernanke from 2009. And he said, “It wasn't to help the big firms that we intervened, those companies have turned out to be too big to allow to collapse because when the elephant falls down, all the grass gets crushed, as well.” And then he said, “we really need a new regulatory framework that will make sure that we do not have this problem in the future.” Okay. So, if you unpack that metaphor, I see a number of things that are in that promise. It's a promise of prevention. That somehow those steps will be put in place, whether it's the regulators, or in the case, one would hope as I think, as Frank just mentioned, that the shorts or there'll be some sort of self-regulatory mechanism on Wall Street, but really, that we put something in place where regulators would have more power to prevent these collapses. And some of that could be by either downsizing banks in theory, or making sure that they didn't have as much of the economy in terms of GDP. Or they weren't as highly leveraged, they didn't borrow more to finance their balance sheets that they were funded more with equity, for example. There are all kinds of ways of talking about prevention. Also limiting how much they can take depositors, insured deposits and other deposits and invest them in high-risk investments, including complex derivatives, all that stuff was about prevention.

The next piece, of course, besides prevention, is the idea of intervention. Because these were the debates. Yeah, 13(3) was there to rescue Bear Stearns, but no one wanted let Lehman fail. And so there is this argument that we needed better intervention tools. Then there's also, of course, the making people whole. It's sort of part of intervention. It's something we really did a terrible job of after 2008 in terms of underwater homeowners and letting millions of families lose their home. I think we've gotten better at intervention, as we saw with the COVID crisis, what we did to put money in the system, even directly having, you know, mortgage firms not foreclose on people. There's a lot that we did, so we didn't have a catastrophic failure then.

The last area, and then I'll kind of go through each of these. The last area of concern is accountability. And this is where we have utterly, utterly failed. And, in every way that you can think about, there are other you look at the major bankers who were involved in the financial collapse. And you could say, well, I'm sure if there were crimes, someone would have prosecuted them. I'm not so sure. And I don't want to cross over into defamation, but I will note that there were several senior bankers who ended up in settlements with regulatory agencies related to fraudulent things they said and did. But somehow those weren't made as criminal cases. Other countries managed to do it. We didn't. Only one guy, one sort of senior level bankers that Jesse Eisenberg wrote about did get prosecuted. So, there's a huge problem there. It's perverse incentives, because, you know, at the end of the day, and to quote one of my favorite television series Succession, if it's just a number that the corporation isn't going to pay, and there's not going to be a senior executive or even a sacrificial lamb, to go to prison, there's not a lot of incentive for, for these banks to change their behavior.

I will also then, and I've only got a few minutes left, talk about the prevention tools. What was going on in Silicon Valley Bank that the Fed, the San Francisco Fed, did not notice that their balance sheet did not look good. You may say, Oh, well, it looked healthy in terms of just the numbers in terms of a capital cushion. But in reality, when you're depending that much on such big amounts of uninsured deposits, I'm not sure why they were allowed to grow so quickly, so fast. And it's not just because of the things that we worried about the 2018 rollback in terms in terms of supervision. There could have still been supervision on this institution, as it grew.

In terms of the tools for prevention. Jeremy mentioned this in terms of the size of the banks and this is something I had looked at previously, you can look at the raw balance sheet numbers and you can also look at the top US bank holding companies relative to GDP. In 1995, it was around, you know, under 20%, around 15%. In 2005, it was 50%. And up in 2013, you know, 10 years ago, it was up to 60%. So, I looked at those numbers now. And I went back and looked at 2018 and then today. And in 2018, the top six banking firms which have had 1.5 trillion, collectively on their balance sheet that represented 51% of GDP then, and then right now, as of spring, the number is $14 trillion total for those top six bank holding companies, and it's back up to 55% of GDP, which is over. It's a little lower, as you can see that it was in 2013. But it's still well above the 2005 amounts.

I'm going to jump over leverage for a moment and talk about repo funding. This is another area of concern. Triparty repo alone in 2008 was like $2.7 trillion. It started creeping back up I when I had looked at it recently. I just took a look yesterday, and the numbers are tremendous total outstanding triparty repo is getting like $4.7 trillion. Now, you may say well, that, you know what is the concern there? It's obviously to the extent that we're talking about repos relied upon by the investment banks to finance their balance sheet runs are the concern. On the other hand, for folks who are following this maybe some of this isn't so concerning because money market funds can now go to the Fed as lender of first resort, with their extra cash. So, you have to have to get into the weeds of this. But I will tell you, I have not seen a lot of people focused on this, despite the fact that there was a huge bailout in 2019, of the repo market.

And so, I, unfortunately, have turned my eye away from some of the short term hold self-funding issues, because I've been focused almost exclusively, as Deborah has noted on white collar crime. So, I am glad to be back in the mix here. And maybe I will turn my attention to repo with a laser eye. So, thanks all.

Deborah Solomon
Thanks so much for that. And for all the panelists that was really interesting. You know, listening to what folks have said, one of the things that strikes me is just what hasn't changed and where we are now versus where we were 15 years ago. When we had the regional bank runs and the failures, the

government swooped in, and basically made the depositors whole, and there was barely a peep about it. There was not the kind of outrage that you saw in 2008. I mean, granted, the economic consequences of it were not probably as severe. There was a lot more going on. People were being foreclosed on. The human costs in 2008, were much more pronounced.

But my question is, to Bill's point, he said, the system is designed to accept bank failures on a regular basis. It seems almost like we've internalized moral hazard. That we just accept that this will happen every 15 or 10, or 25 years, and the government will come in and do what it needs to do, which is rescue the depositors, rescue the bank itself, figure out some way to get, the bank to prevent its collapse. Dodd Frank was supposed to prevent that from happening. So, I guess my question is, are we basically just living in a world where we have a de facto government guarantee of the banking system? And does that matter? Jennifer, let me start with you since you were on my screen in front of me right now.

Jennifer Taub
There's two questions, do we have a de facto guarantee and does that matter?

Yes and yes. But, I think the reason why people weren't up in arms, in addition to what you mentioned, which is they weren't being kicked out of their own homes, and they weren't losing their jobs, so sort of hard to sort of piece together. Part of it is because even though I was unhappy that, the government went in and made the uninsured depositors whole, they actually did contain the spread of this. And so, this is, I mean, the question we have to ask is, given the system we have where these entities are actually, you know, too big to manage and Too Big to Fail, what else do we want our regulators to do?

And then I think I want accountability. At least the boards that these enterprises shouldn't be there, and then we should downsize them? I mean, the answer shouldn't be let's let the whole thing fall apart, and people be out on the streets and the financial system collapse again. And then as, as Martin Wolf mentioned, be an opportunity to feed the rise of authoritarian leaders? I mean, no, that can't be the answer. We need to down downsize these institutions and make them more stable. But I think the second piece of it, I think the other reason why people aren't paying so much attention, is look around. Look at what else is going on where the country is in the middle of an existential crisis related to the survival of our democracy. I mean, I know that's sort of like, in the wings, but that's a backdrop here. And we had the COVID crisis. So, I think what would have bothered us, you know, now just seems sort of like a rounding error at this point.

Deborah Solomon
Well, what's your thought, given you're the one who kind of talked about how the system is designed? And it’s rigged this way. Do we basically have any choice but to have a system like this?

William Cohan
I mean, Deborah, I mean, what choice is there? Really, I mean, it's either, you know, save the bank, or, you know, bailout the bank, bailout the depositors, bailout the creditors. You know, give a tip to shareholders, as happened, say, with Credit Suisse, or you know face existential crisis. And because when a bank collapses, you know, there's detritus strewn all across the landscape, you know, from people losing their homes, to people losing their companies, to people losing their cars, you know, things that we literally take for granted. So, it's quite binary it turns out. You know, until Bear Stearns was bailed out in 2008, the Federal Government had never bailed out an investment bank before.

Investment banks were deemed to be risky. Were risky, non-depository institutions, and therefore, if they failed, you know, so be it. But you know, once upon a time, they were also small private partnerships. And there wasn't, you know, systemic risk attached to the failure of an investment bank. But that began to change in 1970, when DOJ went public, against the wishes of the New York Stock Exchange until they changed their rules. And, you know, one firm after another became a public company, got really big, used other people's money, you know, made acquisitions, as Elizabeth Warren was talking about. So now these firms, of course, are SIFIs, systemically important financial institutions, you know. We can't risk them going down the tubes and causing the existential crisis that would inevitably result.

What I'm just riveted by is, you know, where was the San Francisco Fed on Silicon Valley Bank? I mean, obviously, so obviously, their liabilities were short. And they were lending long, even if they were investing in long dated treasuries that they thought was safe. But how could you know, a bank regulator, let alone the CEO of that bank, not be painfully aware of the risk. The huge risk that would have resulted from rising interest rates if you've got a portfolio of Treasury securities that were bought at high prices and low yields? It was obvious that the zero interest rate program, quantitative easing, was going to end after 13 years. I mean, you didn't know exactly when. But it was obvious that this had to end. That you could no longer manipulate interest rates down to zero ad infinitum as much as the market wanted that to happen. How could you be, you know, a highly compensated CEO, Executive CEO of a bank and not understand that that risk was looming out there? How could the regulators at the San Francisco Fed not realize that risk was out there? So, part of it is the way the system is designed to make these blow ups inevitable? And part of it is bank, CEO management risk failure and supervisory failure? And you know, when you have all those things together, you get the blow ups.

Deborah Solomon
I guess I want to talk about that for a minute. It's interesting to me that people always talk about where are the regulators? Okay, so I want to read two quotes. One is from Ben Bernanke in May of 2009. He said, “The events of the past few years have revealed weaknesses in both private sector risk management and in the public sectors oversight of the financial system. It's imperative that we apply the lessons of this experience to strengthen our regulatory system, both at the level of its overall architecture and its daily execution”. So, then we have from the Barr report, “Regulatory standards for SVB were too low. Supervision of SVB did not work with sufficient force and urgency following SVB’s failure. We must strengthen the Federal Reserve's supervision and regulation based on what we've learned.”

Jeremy, are we actually able to regulate for problems? Or do we always just chase the last problem and take our eye off the ball for what might happen next? I mean, to Bill's point, it was in plain sight that interest rates were going up and that if you were betting against them, you were going to have a problem. You know, obviously the report pointed out that there were there were concerns about by the regulators and they didn't necessarily feel emboldened to raise things. And I want to get to the whole rollback and the Randy Quarles piece of this. But Jeremy, I'm just curious, since you have spent so long looking at regulation and regulators, can we regulate the banking system at this point in an effective way?

Jeremy Kress
Yeah. It's a great question, Deborah. And I think the Bernanke quote that you raised and the Barr report, also, appropriately balanced regulation, on the one hand, with supervision on the other. Regulation, just by its very nature, and the requirements to go through APA noticing and comment, will, in some cases, be a blunt instrument that is not very dynamic. And that's why it's important that regulation be complemented by supervision because supervision is the mechanism by which boots on the ground can go in and adapt to evolving circumstances and work with management to address emerging risks.

So, regulation, as you noted, very often has a tendency to fight the last war. I think good through the cycle, appropriate regulation can minimize a lot of risks out of the system. But there's always going to be residual risks that fall through the cracks of regulation. That's part of the job of a financial institution is to optimize performance under legal constraints. And so, supervisory agencies have to have effective supervision in order to respond to those residual risks that regulation simply isn't able to catch. As you noted, there's been some hollowing out of both regulation and supervision over the last six years that undoubtedly contributed to the SVB's collapse. Happy to get into specifics, but I think just to emphasize the point, we've got to have both effective regulation and supervision. Neither one alone will be able to keep the financial system safe.

Deborah Solomon
Thanks. Do you have any thoughts on kind of the ability of regulators and supervisors to prevent these types of crises?

Jeremy Kress
I think from the supervisory standpoint, one of the challenges that we saw with SVB was that the supervisors really had their legs taken out from under that. Given the power dynamics of how finance and supervision works, bank management, have sometimes been able to railroad supervisors. When supervisors raise red flags, supervisors have to have support from their principals who are presidentially appointed Senate confirmed, and when they don't have that support, it's way too easy for banks, executives, board members to ignore feedback that they received from their supervisor. So, I think we saw that supervisors at SVB did flag interest rate risk, perhaps not as early as you might have hoped, but certainly in enough time to do something to address interest rate risk. But for whatever reason, SVB management was not responsive to those concerns. And I think that has something to do with tone at the top with the supervisory agency. So, it's got to be a consistent message from supervisors on the ground all the way up to their, their bosses. And I fear that that wasn't the case in the years leading up to the March 2023 crisis.

Deborah Solomon
Frank. Do you have thoughts on?

Frank Partnoy
Deborah, I think you've hit on a fundamental question about the temporal aspects of regulation and banking. And in many ways, the problem is always going to be looking in the rearview mirror. But it doesn't have to be, right. We can think about regulation of financial institutions in a predictive way. And this is kind of the way that we've moved towards a regulatory state and away from the kind of common law approach, generally speaking, and in the markets is part of this as well. We have a massive

regulatory approach, but we don't have too, and part of the Volcker rule and many criminal law concepts are tied to the Oliver Wendell Holmes notion. You probably didn't think Oliver Wendell Holmes would get presents in this panel. But his notion of the law being a prediction of what a judge will do, and I think one of the challenges is to get inside the minds of people at large financial institutions and have them start thinking about consequences as predictive. So, the mismatch that Bill points to that is endemic between assets and liabilities is something that I think many people were aware of. They were aware of it in the context of bailouts and the likelihood of a 13(3) facility looming, if that turns out that they bet wrong. But the way that Jennifer is, is talking about regulation and enforcement, I think is something that hasn't made its way into financial institutions. Again, thinking about consequences in a predictive way, and trying to imagine okay, if I do this, what will be the consequences in a 1 or 5 years or 10 years? And it's rational, I think, for the managers of financial institutions who know that they have a mismatch between assets and liabilities to take a big yield curve trade. I mean, I was at Morgan Stanley in the 1990s, when something similar happened with an increase in interest rates in 94. And people were well aware of the, the, again, predictive aspects of taking on these risks at some institutions, but not in others. And so, I think what you've pointed to is one of the challenges of both regulation and supervision which is trying to force inside the minds of the people at the institutions, the idea that there will be future consequences.

Deborah Solomon
Right. And we saw, obviously a big change in 2018. With the law that passed through Congress that was supposed to be this tailored approach, you know. Remove some of the Dodd Frank rules for smaller and medium sized banks. It was, you know, there were some obviously, like Senator Warren, who opposed it, but others were more, you know, okay with it. Even Dan Tarullo, you know, had said that he thought some of it was appropriate. In hindsight, we now see that it wasn't just that law, but the interpretation of that law by the Fed that helped fuel some of what happened at SVB.

Now, there's lots of reasons, but if you read the report, the internal report, it's clear that the change in how SVB was treated at once they crossed that $100-billion-dollar threshold was significant because of the changes that then Vice Chair for Supervision Randy Quarles put in place. They crossed that R100-billion-dollar threshold, which was supposed to subject them to more liquidity and regulatory requirements in 2021. But they weren't going to be subjected to those higher capital or liquidity requirements or oversight requirements till 2024. And there was also a culture of feeling that, you know, supervisors were supposed to be a little bit, you know, nice to the banks. A big change from post 2008 when the banks were, you know, what, what did Obama say? Only person between me and the pitchforks. He's the only person between the banks and the pitchforks.

My question, I do have one, is how much do you guys think that the Feds interpretation of what Congress approved in S 1255, you know, destabilized the banking system and undermined Dodd Frank? Sort of the, you know, the idea of Dodd Frank. If not for the biggest banking organizations, just for the overall banking sector. Jeremy, do you want to talk about that? I know you've got to leave soon. So, I want to get your thought.

Jeremy Kress
I would love to talk about that Deborah. Thank you for the question.

I will say you characterized it as the Fed's interpretation of the law. But it is abundantly clear that was the message that Congress was sending, by passing 2155. Although Congress ostensibly left the Fed some discretion to apply enhanced prudential standards to banks with between $100 and $250 billion in assets, it is abundantly clear that every member who voted for that law expected the Fed to raise the threshold to 250. And if the Fed had tried to exercise that discretion, pre SVB, there would have been very strong congressional pushback to regulating the midsize regional banks. The underlying assumption behind S 2155, and the tailoring law, was that banks in that $100 billion to $250 billion range are not and cannot be systemic. We now know that, some of us knew then, everyone knows now that is now false. Things in that range, are systemic and should be regulated appropriately.

I think, you know, sometimes we can get in debates where we're fixated on unique issues having to do with SVB, or unique issues having to do with First Republic. And, you know, the industry wants to argue about oh, SVB was unique, because it had a high concentration of uninsured postures, what have you. I think it's critical for the other side of the debate to point out that, yes, we saw three failures and SVB, First Republic, Signature. But if it were not for the systemic risk exception that the FDIC invoked with the Fed and the Treasury, and very high-ranking government officials, advertising that we stand ready to support other regional banks in similar ways, we very likely would have seen additional failures. So, with the three banks that did fail, that constituted roughly 1/7 or 1/8 of the regional bank population. But absent government support, a much larger portion of that segment of the banking sector would have experienced continued stress. So, I think the verdict on S 2155 is it was wrong from the start. And the Fed can and should exercise its discretion to reregulate that important segment of the banking system.

Deborah Solomon
For Frank or Bill, do you have thoughts on that as well on 2155. How much the tailoring you know, dismantled a key part of Dodd Frank

Frank Partnoy
Jennifer you want to go first, and then I'll go.

Jennifer Taub
Yeah, I mean, I'm one of those people ….. I wrote a piece, I think it was for, might have been for Washington Monthly, or maybe it was, I can't remember where, and it was one of these, I can't believe I'm writing this thing so later, I can point back and say, I told you so. But that doesn't feel very good. To me, it was clear that it was a mistake. To do this, having written the book that Dennis mentioned, *Other People's Houses* was a comparison of the collapse during the savings and loan debacle to the 2008 crisis. And this idea that you have to say either or that either, you know, either it's just a problem of size, or it's a problem of types of balance sheets, and interconnectedness. No, it's all of the above. And so, I do find it frustrating that, that's where things have gone.

As to the distinction that you're drawing, Deborah, between how the Fed may have interpreted the legislation versus what it said. I have never worked inside the Fed. But in terms of regulatory capture, there's no question that if you spend your time working around people, you start to sympathize with them. And, you know, if you don't look like you're going to be understanding of a situation, then people won't speak to you. I mean, there's, you know, I just have to say that, when I think about all of this, I think, again, going back to Succession, about how Shiv, the character on the show, said to someone that it's really just, you know, that it's really all just money and gossip. And by gossip, she means the kind of spin and the kind of interpersonal relationships. And that's a lot of the reasons why we can't get change in Congress to permanently fix the system, so that we have better prevention and reduce the amounts of these interventions is because of all these factors, money, and the political process, and the spin, and the way you have to appeal to folks in the financial sector in order to even have a chance at getting elected in many, many areas.

Frank Partnoy
A couple of points. To two points related to what Jennifer's talking about, which I think is really important.

One is that the line drawing exercise that we're talking about that we'd like for regulation to do, and for regulators to do, is a really difficult one that we're likely to get wrong, especially if we use dollar numbers. If we go back to Lehman, and we think about the granularity of the different banks and non-banks, they were very different. If everyone had the same risk exposure as Goldman Sachs, we wouldn't have had a financial crisis. If everyone had the financial exposure of Citi Group, it would have happened six months earlier. In terms of painting all of the relatively smaller banks with the same brush now, more recently, I think it's right that we separate them into categories by using these kinds of thresholds. But I'm just not sure it's such a good idea.

And the second point is, I think with respect to using systemic risk, it's just too tempting. Once it's in regulation, or regulators are embracing the idea that they can make a determination of the presence of systemic risk in order to trigger a rescue or a bailout, it's the kind of thing where it's, it's an odyssey kind of situation, right? You really want to try your hands somewhat and not say we're constantly be going to systemic risk exception and have that hardwired in. What you'd really rather have is a higher bar. And I think one of the things that gets lost in this discussion is that if we take a step back, that the optimal number of failures, I agree with Bill that there are going to be these failures, but the optimal and need for rescue, but the optimal number shouldn't be zero. We shouldn't be bailing out every single one of these financial institutions. At some point, the systemic risk determination becomes less credible, more implausible. And so, I think we should just keep that in as the expansion of what we call systemic risk continues. I'm not persuaded at all, that there were the same kinds of system wide risks posed by these three financial institutions that are that there were in 2008. I know that's controversial point, but we aren't willing to run the experiment of watching what a financial institution failing would do. And I think that's a big difference from 15 years ago.

William Cohan
Can I just jump in quickly to picking up on what Frank said? I mean, there's been no consequences for poor risk management and poor risk decision making. If you just look at Silicon Valley Bank again, you know because the FDIC decided to bail out all the depositors, not just those who had a $250,000 or less in their accounts. Why should Andreessen Horowitz, which is one of the most sophisticated financial institutions on the planet, put a billion dollars into Silicon Valley Bank in terms of depositing their money, their payroll, whatever it is, their portfolio companies’ money? Why should they suffer no consequences for failing to appreciate what was going on with this short-term borrowing and long term lending. Borrowing short lending long, the classic problem of fractional banking that has been with us forever. Because Andreessen Horowitz, and their like, don't face the consequences of that failure to

understand appreciate that risk. Then there's like child behavior, you know. You don't punish a child or reprimand a child for their bad behavior, they're going to repeat it. And so, without any consequences, you know, obviously, you don't want to have consequences for small depositors. That's why there's FDIC insurance. But for big, sophisticated depositors to get off scot-free without any penalty whatsoever, you're asking for a repetition of the bad behavior over and over again, especially in a system, as we've discussed earlier, that is designed to fail, you know, once every 15 or 20 years.

Deborah Solomon
Well, not only are you, yeah, incentivizing them to do that, but you're incentivizing them to do exactly what they did during SVB, which was to, you know, basically force the government's hand by going on social media, you know, and talking about…a Jason Calacanis saying…your hair should be on fire, and Bill Ackman saying, if the government didn't, insure all deposits there'd be a giant sucking sound of a historic bank run. And, you know, it worked. It basically caused a, you know, mass cascade, I guess. I know, we're going to have a panel later on Too Big to Fail. But I am curious from your point of view, and we've talked about this a little bit about, you know, systemic risk, but, you know, what does Too Big To Fail even mean, now, when you've got high frequency trading, social media, you know, just the destabilizing, you know, impact of being able to withdraw your money in a nanosecond?

I mean, do we need to rethink what systemic risk even is, especially as, you know, the FSOC embarks on another go round at looking at how to designate systemically important financial institutions, the non-banks? You know, I guess I'm just curious. It just seems to me like what we thought of as systemic risk for so long to Frank's point doesn't really apply anymore. So how do you deal with a system in which you basically are, you know, chasing your own tail?

William Cohan
I'm just gonna quickly make a point and then be quiet. But you know, risk doesn't disappear. Just because a regulator moves it out of Wall Street banks, which is what happened with Dodd Frank. You know, basically, Wall Street went from being in the storage business, to the moving business, right. They have to get these loans and assets off their balance sheets as quickly as possible, although they haven't done that yet, with the Twitter loans, which is a whole another topic, but they are forced to do that. Okay, theoretically, by the Fed by the regulators. And maybe they've done that to some extent. But probably not as much as they should or need to. But that doesn't mean the risk disappears. Risk is out there everywhere. And so, you know, the question is, where does it go? It goes into the shadow banking system that exists, you know. It goes into collateralized loan obligations that goes into leverage loans that are held by investors all around the world. And so, we've may have moved through Dodd Frank, the risk out of the left ventricle of capitalism, the Wall Street banks, and they're probably safer than they've ever been. But that doesn't mean the risk just disappears. It just moves around. And therefore, we're asking for the next financial crisis to be originating in a place that we least suspected at the moment,

Deborah Solomon
Jennifer?

Jennifer Taub
Yeah, so it's interesting when you talk about Too Big To Fail, I think many of us associated with the 2008 financial crisis. But actually, it dates back to 1984, with Charlie Knapp, who was the head of American

Savings and Loan, which I believe, had a balance sheet of only, it was remarkable growth, but I think his balance sheet was only $34 billion. And when he testified before Congress, sorry a meeting with regulators, it was a Savings and Loan in June of 1984. And he said, we're Too Big To Fail. If we go down, we'll take the whole system with us. And they ended up arranging for, a bailout of people, think it was associated with Continental Illinois, it was actually this.

But the point is, this idea of Too Big To Fail, you know, was much smaller at $34 billion. Very different than a multi trillion-dollar balance sheet. So, I think the problem with the phrase now is we think it's all about size, and you have to be ginormous, and I think it has a lot more to do with, how the balance sheets are managed, and how the maturity mismatch is done. And I'll just say, you know, we couldn't be doing things differently in the world. I came from, you know, money market mutual funds. They have a very tight maturity mismatch requirement. How long the assets can be, because of the very short-term liabilities a daily or daily weighted average maturity, you know. It's an idea, you know to say that to look at the composition of a bank's liabilities as compared to its assets and look more closely at the nature of and the liquidity of those assets. And particularly, you know, we've talked about the trigger of rising interest rates being what led to the run and the collapse of Silicon Valley Bank. You know, same story, pre-2008. Same story with the SNL. It's not that the folks who run these places don't know, well. Some of them don't know, and don't care. Others do know. And if the IBG YPG, you know, I'll be gone, you'll be gone. Their checks still clear. Their second wives still have, you know, the fur coats, the golf course, still lets them play. You know it's a way of the world now. And I don't want to accept it. I want to shine a light on it. But there we are.

Deborah Solomon
Frank, you have some thoughts on this?

Frank Partnoy
Yes, I completely agree about shining the light. One of the interesting questions about SVB was who was there to even shine the light because it didn't have a chief risk officer for eight months. But in terms of shining light within institutions, I mean, one of the things that we know is that with respect to this yield curve carry trade that Bill was talking about, if they don't do it, they're not going to make any money. So, they're going to be taking on risk of some kind. Question is, let's get disclosure about it. And one of the issues again, looking back to Lehman and what banks were doing then was essentially yes, offloading risk, but offloading it by tossing a boomerang. And the boomerang comes back. And one of the questions that we don't know the answer to right now is the extent to which large institutions are tossing the boomerang that they appear in some ways to have offloaded risks. But remember that large institutions have over a trillion dollars worth of variable interest entities, the same kind of technology that Enron used to move its risks off balance sheet. They have lots and lots of derivatives and swaps still, and we don't have an accurate sense of what mark to market is on many of the loans and other assets that have obviously lost a lot of value, post COVID. So, I think shining that light is really important. But we don't do that. And again, we don't have incentives for people outside of the institutions to spend a lot of time looking at that. Short sellers aren't spending a lot of time on this. Investigative Journalists aren't really incentivized anymore. And Deborah, you've done so much fantastic work. But how many of your colleagues are now working, you know, spending two years working on an expose about the footnotes of a bank's financial statements to the Supreme Court, you know. So, it's really hard for people to shine the light. I think Jennifer's right.

Deborah Solomon
We had a question, actually, from somebody who's watching who wanted you, Frank to expand on that a little bit. Like why are short sellers and activist investors not doing their due diligence. I mean, put aside journalists, you know, that I'm happy to talk about, or if you can, but I just I do find it weird, like that is your job to understand risk. and where do you want to bet against if not invest in right?

Frank Partnoy
Well, short sellers are being threatened with prosecution from the Department of Justice. They're facing very high transaction costs in terms of lending. They're being attacked on Reddit in lots of instances, when they do take short positions. The bar to short selling making money has gotten higher as the cost associated with borrowing shares has increased. So, there are lots of barriers to short sellers. The plaintiff's lawyers make money some of the time, but they also spend 15 years since Lehman working on cases like the case against Goldman Sachs that was appealed, went to the Supreme Court and is now not certified as a class. So, the incentives for the production of this information aren't there in the same way. Activists have been very effective in many other industries, but when they look at banks, it's hard to justify taking on a large position as a shareholder activist to try to get inside the details and get things changed. And as a result, I think this is one industry that's been at least somewhat protected from shareholder activism. So, it's lots of kind of institutional costs that put up barriers to these various actors who might generate information, being successful and making money off of generating that kind of that kind of information.

Deborah Solomon
It's really fascinating. I wish we could spend more time on that. We're running out of time, and I want to talk about the Consumer Financial Protection Bureau. And I know, Jeremy, likely has a lot of thoughts about this. I mean, when you think about this agency, it has been under attack from day one. And those attacks seem to be succeeding. We saw this week, a conservative judge in Texas basically said that they overstepped their authority when they tried to get done, implement some anti-discrimination policies. And we've got, obviously, as you mentioned, this big case coming up before the Supreme Court that could essentially hobble the agency if you know, by limiting the power of independent agencies. You know, Jeremy, what is the going to be the impact of the ramifications of all of these challenges against an agency that was set up to basically protect consumers from you know, bad actors? Right?

Jeremy Kress
So I'm really worried about this, Deborah, because it is a radical legal challenge on a completely novel legal theory dealing with the CFPB's funding. The CFPB, of course, derives its funding from the Federal Reserve Board, in exactly the same way that the Federal Reserve Banks derive their funding from the Federal Reserve Board. So, the consequences of this case is if it comes out as I fear it might, against the CFPB, could have very far reaching consequences. Not just for consumer finance regulation, throwing into question all of the mortgage market regulations, credit card protections, debit card protections the CFPB has passed that could really adversely affect not just consumers, but the financial institutions that rely on those regulations. Some of the CFPB has regulations or safe harbors that many financial institutions rely on when they engage in certain types of consumer finance transactions that financial institutions may pull back from if they no longer have that legal certainty of a CFPB past Safe Harbor. So, there could be wide ranging consequences for consumers. Wide ranging consequences from financial

institutions. I worry about the broader financial stability impacts if the CFPB's work is undermined by the Supreme Court. And we got to worry about the knock-on consequences of what other agencies may come under fire. As I mentioned, the Federal Reserve is funded similarly to the CFPB. The other financial regulators, FDIC, OCC are funded by assessments levied on the institutions they regulate. Those could similarly come under question. So unfortunately, a lot of incoming fire are coming at not only the CFPB, but the other financial agencies all on these administrative law technicalities, not dealing with the substance of what they were doing, but on their governing statutes that I fear for the wide-ranging implications that of what might be coming if the CFPB if the Supreme Court doesn't. Craft it's relating very, very carefully.

Deborah Solomon
Yeah, I mean, I don't know if others have thoughts on that. But the court challenges and the use of the courts is really interesting, especially given what we're seeing now as the banks clearly are gearing up not just the banks, but you know, other trade groups are gearing up, to sue the Fed over the Basel endgame rules. I mean, they sent a letter yesterday that made clear they're going to, you know, use the administrative, the APA basically to say that the Fed is overstepping and didn't actually give enough notice and comment. I mean, I guess, you know, Bill, I'm curious from your point of view. I thought banks like certainty. Why do they keep trying to take, you know, to undo some of the things that have been in place for a while, you know, not, I mean, the Basel endgame stuff, obviously. I understand that they're very concerned about that. But the things like the CFPB, to Jeremy's point. I mean, there are safe harbors in there that they've made loans, you know, using. And if the Supreme Court does rule against them, it could question the legitimacy of a lot of the rules that they've put in place over the past, you know, 10 years since they've been, you know, legislating or regulating. I'm curious, you know, I don't know if you talk to folks, you seem to have a good insight into the banks and what they think about, I mean, what is their view of the CFPB at this point? And why do they want to kind of make it, you know, obsolete.

William Cohan
Does the word hate mean anything? I mean, they say they hate it, they've hated it from the beginning. They fought against it. They don't like the Dodd Frank regulations, they fought against them. You know, mean, you know, Goldman Sachs used to have 70% return on equity back in the days when it was unregulated private partnership, they had very little capital, sure, that made them very risky, but it made them risky to their partners and their shareholders. Now, of course, big public company, 100-billion-dollar market cap, you know. I'm sure they believe they are required to have way more capital than they really need. Their return on equity is quite low. Now, it's not anything like what it used to be, you know. They struggled to get a return on equity up in the teens. And, you know, I'm sure they dislike it. They don't want to have to have more capital tied up. I wrote in my Goldman Book that they alone, saw troubled coming in 2007 and 2008, and did something about it, make huge bets against the mortgage market and make huge profits when the rest of Wall Street was losing money hand over fist may even exacerbated some of those losses that their competitors face.

They don't like regulation. They want to go back to a time where they could make big bets on interest rates, or mortgage rates or whatever it is, and you know, so they're gonna fight against it as best as they can.

Deborah Solomon
Jennifer, Frank, do you have any thoughts or concerns about what's happening with the CFPB? Before we have to close?

Jennifer Taub
I would concur with what Bill said, they haven't liked it. They didn't. Their lawyers didn't put it in the legislation. And they will, you know, it's worth it for them to continue to fight.

Frank Partnoy
I think it's an illustration of how hate is just not productive. That we've become so polarized in so many ways. And I'll just again, say thanks to Better Markets for having a conversation like this, which I hope doesn't involve a lot of hate. We can say nice things about each other and try to have a productive conversation moving forward. I wish people wouldn't do that with respect to that organization.

Deborah Solomon
Well, thank you to everybody for this. I wish we had another hour and I'm sorry that it didn't get to more of the audience questions. Just want to let everybody knows that there will now be a 30-minute lunch break before the afternoon sessions, which will start with a fireside chat with the SEC chair Gary Gensler, which I'm sure will be fascinating. And I want to thank you all for a lively panel in which we talked about both Oliver Wendell Holmes and Succession which you don't normally get in a panel about financial regulation. So, thank you, and I hope you guys enjoy the rest of the conference. Thank you.