

QUARTERLY SYSTEMIC RISK REPORT

Spring 2024

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CFA Institute Systemic Risk Council (SRC or the Council) is a private sector, nonpartisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues related to global systemic risk, with a particular focus on the United States and Europe. It was formed to provide a strong, independent voice for reforms that are necessary to protect the public from financial instability. The goal is to help ensure a financial system in which we can all have confidence.

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We hope you had a good start to 2024, a first quarter packed with activities and issues involving the Systemic Risk realm, including global debates and gyrations around inflation, interest rates, and monetary policy. The CFA Institute Systemic Risk Council (SRC or the Council) continues to provide an independent lens and voice on global systemic risk issues. This edition of the Quarterly Systemic Risk Report highlights recent activities and ongoing challenges affecting global markets, systemic risk regulators and provides updates on key priorities for improving and maintaining economic stability.

We begin by mourning the passing in March of our dear friend, mentor, and one of the founders of the Council, Ira Millstein. We update our discussions and concerns over the ongoing war in Ukraine and the importance of its outcomes to economic stability and social order. We had the opportunity to review issues surrounding the access and use of the Fed Discount Window and emergency lending facilities with banking industry experts. The Council has continued its efforts to support regulatory agencies' proposals to enhance long-term debt requirements and global efforts to complete the work of Basel III implementation, despite rising political and industry opposition. Lastly, the Council was updated by leaders of EU and US regulatory agencies on the mounting concerns surrounding nonbank financial intermediaries (NBFIs) in the global financial system.

We wish you all a happy and profitable spring! As always, we welcome your comments and suggestions for future topics and issues to cover.

– Kurt N. Schacht, Executive Director

SRC UPDATES

IN MEMORIAM: IRA M. MILLSTEIN

CFA Institute Systemic Risk Council mourns the passing of founding member and legal adviser, Ira Millstein. Among his many contributions to public life around the globe, Ira was a motivating force in the creation of the CFA Institute Systemic Risk Council, where he served as a member and chief legal adviser for more than 10 years. Ira helped conceptualize our Council as a private sector, non-partisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues relating to global systemic risk.



Ira M. Millstein

Simon Johnson and Erkki Liikanen, co-chairs of the SRC said, "Ira was a leader in so many areas of law, corporate governance, and public service that to serve with him on the Council has been a great privilege. To have his active help and backing in the creation of this organization has been a blessing. He represented everything the SRC stands for and exists to promote. Our deepest condolences to Ira's family." Find here, the [SRC's full statement](#).

THOUGHT-LEADER PRESENTATIONS ON SYSTEMIC RISK

REVITALIZING THE FED DISCOUNT WINDOW: CONVERSATION WITH WILLIAM NELSON, CHIEF ECONOMIST OF THE BANK POLICY INSTITUTE

29 March SRC meeting: William Nelson, Chief Economist of the Bank Policy Institute (BPI), presented to the SRC themes from his recent [testimony](#) before the US House Financial Services Subcommittee on Financial Institutions and Monetary Policy. Nelson, who previously worked for 24 years at the Federal Reserve Board, discussed the issues surrounding the Fed Discount Window and emergency lending. The Federal Reserve System is a lender of last resort to provide banks with a safe place to keep reserves and extend collateralized loans, ensuring economic stability during financial stresses.



William Nelson, Chief Economist, BPI

Lender of last resort: While originally designed to adjust the aggregate level of reserve balances using cash or repo open-market operations, discount window loans are the Fed's frontline tool to address banking system strains and financial crises. These loans are now collateralized advances, generally extendable for up to four months, and must be secured to the satisfaction of the lending reserve bank. Nelson discussed with the Council the lingering stigma associated with borrowing from the discount window, which has been exacerbated since the global financial crisis (GFC). Despite being a vital monetary policy and financial stability tool, borrowing from the discount window is too often viewed unfavorably by bank management, resulting in an unwillingness to utilize a well- designed mechanism to foster liquidity and stability of the banking industry.

Reducing stigma: Nelson emphasized the need to reduce this stigma and highlighted various proposals to encourage banks to maintain discount window borrowing capacity. They include the requirement for banks to have discount window borrowing capacity combined with reserves that exceed potential outflows under severe liquidity stress and the potential implementation of committed collateralized lines of credit to incentivize banks to reduce liquidity risk. Nelson emphasized the importance of changing the narrative around discount window usage among the public, Congress, bank examiners, and investors to dispel the notion that access signals bank distress. Failing to do so will continue to sideline an important protection for economic stability.

UNDERSTANDING THE IMPACTS OF THE RUSSIA-UKRAINE WAR: A CONVERSATION WITH PROFESSOR YURIY GORODNICHENKO OF THE UNIVERSITY OF CALIFORNIA, BERKELEY



Yuriy Gorodnichenko, University of California, Berkeley

23 February SRC meeting: Professor Yuriy Gorodnichenko of the University of California, Berkeley, addressed the Council on the systemic risks of the ongoing Russia-Ukraine war, now two years into the conflict. He emphasized the heightened geopolitical risks, societal disorder, and commodity market uncertainties that go beyond battlefield impacts to the broader European Union as it is challenged internally with immigration, safety, and economic issues because of the war.

EU challenges: The EU's public finances are strained by the refugee crisis which has resulted in an enormous influx of immigrants. Most member countries lack both the monetary and infrastructure resources to manage this influx, happening at the same time as urgent calls to increase defense-related spending in light of threats to regional stability. Likewise, the war has only begun to disrupt commodity supply chains, especially in regard to energy and grain markets.

The Black Sea's trade routes, crucial for global oil and wheat exports, are in constant danger of attack. What's more, Russia controls a significant portion of these commodity exports, making energy prices and food security precarious.

Ongoing concern: Professor Gorodnichenko also discussed the impact of western sanctions on Russia, potential commodity shocks, and the global implications of freezing or seizing Russia's Central Bank assets. He concluded by likening the conflict's danger to the run up of World War II and underscored the crucial need for ongoing support to Ukraine and its citizens.

NAVIGATING EU FINANCIAL CHALLENGES: A CONVERSATION WITH JOHN BERRIGAN, DIRECTOR-GENERAL, FINANCIAL STABILITY AT THE EUROPEAN COMMISSION

26 January SRC meeting: As we opened 2024, we welcomed a return visit to the SRC by John Berrigan, Director-General for Financial Stability at the European Commission, who discussed his views and concerns for the EU's financial landscape in the year ahead. The overarching themes of his presentation revolved around the EU's continuing resilience in the face of economic challenges, the tightening of financial regulations under Basel III, the ongoing evolution of the bank resolution framework, and the critical role and concerns surrounding nonbank financial intermediaries (NBFI) in the EU financial system.



John Berrigan, Director-General for Financial Stability, European Commission

EU challenges: Berrigan emphasized the EU's initiative-taking approach to adapting and implementing regulations, particularly with the finalization of stricter Basel III guidelines. He also addressed the need for a unified bank resolution process across the EU and the importance of understanding the interconnectedness of NBFI with regulated banks. Additionally, the presentation shed light on the EU's evolving stance on green policies and the focus on implementing consistent environmental, social, and governance (ESG) disclosure standards. He noted the continuing evolution around digital finance and crypto markets and the need to identify and monitor any challenges they might pose to financial stability. Finally, Berrigan further highlighted the challenges and considerations related to artificial intelligence (AI) in financial markets and the ongoing debate around centralized EU financial supervision.

SYSTEMIC RISK IN THE NEWS

SRC MEMBERS WEIGH IN ON SYSTEMIC RISK ISSUES

Expert voices weigh in on key news and issues: Our members are in the news—and making news—on important financial issues.

- ["Beware the Banking Industry's Diversionary Tactics on Basel"](#) (*American Banker*, 16 April 2024): CFA Institute Managing Director Paul Andrews takes exception with the complaints of the US banking industry and their lobbyists casting the Basel III process as a threat to US economic prosperity and competitiveness.
- ["Will the Widespread Adoption of AI for Investments Present Risks to Economic Stability?"](#) (*Institutional Investor*, 18 March, 2024): CFA Institute Managing Director Paul Andrews writes that the economy could benefit if regulators had dynamic and tested contingency plans for AI-induced runs.
- ["Jeremy Grantham Says Outlook for U.S. Stocks is as Poor as Ever. Sees Initial AI Bubble Eventually Bursting"](#) (*CNBC*, 12 March 2024): Jeremy Grantham predicts a daunting stock market outlook.
- ["It's Time to Rethink the FDIC Approach to Bank Rescues"](#) (*Financial Times*, 11 March 2024): Former FDIC Chair Sheila Bair suggests that the FDIC should have more flexibility rather than being compelled to choose the "least cost" option.
- ["SRC Co-Chair Erkki Liikanen Reappointed to Serve as Chair of the IFRS Foundation Trustees until September 2027"](#) (IFRS Foundation, 4 March 2024): SRC Co-chair Erkki Liikanen will serve a third term as chair of the IFRS Foundation Trustees, ensuring continuity and stability in the organization's leadership as it institutionalizes the International Sustainability Standards Board's work and strengthens the International Accounting Standards Board's IFRS Accounting Standards.
- ["The Great Recession's Unsung Hero"](#) (*Business Insider*, 4 March 2024): A profile of Brooksley Born, who as the chair of the US Commodity Futures Trading Commission warned that the GFC was coming.
- ["Bank Failures Are Looming. Let's Make Sure Executives Have Skin in the Game"](#) (*Washington Post*, 20 February 2024): Sheila Bair and Charles Goodhart comment on the 2023 bank failures and challenges faced by the US banking industry.
- ["Lender of Last Resort: Issues with the Fed Discount Window and Emergency"](#) (Financial Services Committee, 14 February 2024): SRC Co-chair Simon Johnson testifies on Capitol Hill before the Subcommittee on Financial Institutions and Monetary Policy of the Financial Services Committee, United States House of Representatives.
- ["SPACs: Will They Rise Again?"](#) (*NASDAQ*, 14 February 2024): CFA Institute Managing Director Paul Andrews discusses the Securities and Exchange Commission's approved final rules regarding special purpose acquisition companies.

SYSTEMIC RISK REPORTS & UPDATES

In case you missed it: Following is a selection of other recent important news and reports on systemic risk.

- ["Private Credit's Growth Raises Potential for Systemic Risk, IMF Says"](#) (*Wall Street Journal*, 8 April 2024): The rapid growth of private credit has raised concern at the International Monetary Fund about potential risks.
- ["The Evolution of Banking in the 21st Century"](#) (Brookings Institution, 27 March 2024): In the wake of the recent US bank failures, the authors look at trends over the past quarter-century, including the substantial growth of uninsured deposits and the migration of business lending to nonbanks.
- ["European Fund Group Warns of "Systemic" Risk from US Settlement Reform"](#) (*Financial Times*, March 14, 2024): Looming changes to the time it takes to settle trades on Wall Street pose a "systemic" risk to currency markets, European asset managers have warned.
- ["Why Seizing Russian Assets to Fund Ukraine Is Fraught"](#) (*Bloomberg*, 11 March 2024): A discussion on whether Russian assets should be seized to help Ukraine and why some allies are wary.
- ["EU Warned of Rising Risk of Systemic Financial Shocks from Continent Warming"](#) (*Financial Times*, 10 March 2024): The EU is at "higher and higher" risk of systemic financial shocks from climate change, the head of Europe's environment agency has warned.
- ["A Year After Silicon Valley Bank's Collapse, the Rules Are Still Catching Up"](#) (*Wall Street Journal*, 9 March 2024): New proposed regulations will not address some of the root causes of regional banking malaise.
- ["CRE and Systemic Risk"](#) (*Financial Times*, 27 February 2024): Smaller regional banks may cut back on lending because of commercial real estate pressures.

SYSTEMIC RISK COUNCIL MEMBERS

Chair: [Simon Johnson](#)

SRC Co-Chair and former IMF Chief Economist

Chair: [Erkki Liikanen](#)

SRC Co-Chair and Chair of the IFRS Foundation Board of Trustees

Senior Adviser: [Sheila C. Bair](#)

Founding Chair of Systemic Risk Council and former FDIC Chair

Senior Adviser: [Jean-Claude Trichet](#)

Former President of the European Central Bank

Members:

Paul P. Andrews

Managing Director, Research, Advocacy, and Standards, CFA Institute; former Secretary General of the International Organization of Securities Commissions (IOSCO)

Brooksley Born

Former US Commodity Futures Trading Commission Chair

Sharon Bowles

Former Member of European Parliament and former Chair of the Parliament's Economic and Monetary Affairs Committee

Bill Bradley

Former US Senator (D-NJ)

Marina Brogi

Full Professor of Banking and Capital Markets at Sapienza University of Rome and a former member of the Securities and Markets Stakeholder Group at the European Securities and Markets Authority (ESMA)

Andreas Raymond Dombret

Former member of executive board, Deutsche Bundesbank, founding member of the Supervisory Board of the European Central Bank, and board member of the Bank of International Settlements

William Donaldson

Former US SEC Chair

José Manuel González-Páramo

Former member of the executive board of the European Central Bank (ECB), member of the Executive Board of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), and member of the executive board of the Bank of Spain

Jeremy Grantham

Co-founder and Chief Investment Strategist, Grantham Mayo Van Otterloo (GMO)

Richard Herring

Jacob Safra Professor of International Banking, Wharton School of the University of Pennsylvania

René Karsenti

Senior Adviser to the International Capital Market Association (ICMA)

Elke König

Former Chair of the Single Resolution Board (SRB)

Ira Millstein

Senior Partner, Weil Gotshal & Manges LLP

John S. Reed

Former Chair and CEO, Citicorp and Citibank

Christina Romer

Professor of the Graduate School at the University of California, Berkeley