CFA Institute®
Systemic Risk Council

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SRC Members

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 relating 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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Welcome to the 2023 Annual Report of CFA Institute Systemic Risk Council (the Council or SRC). Since 2013, the Council has offered an independent, noncommercial voice to assess significant financial and economic disruptions and to make recommendations for building a more robust process for systemic risk oversight in the US, Europe, and elsewhere. The Council provides an expert and unvarnished assessment of the readiness of global regulatory institutions to deal with evolving systemic vulnerabilities. In addition, our members advocate through comment letters and media commentary for improvements in the detection, monitoring, and response to ever-emerging threats to economic stability.

The past two decades have seen an unprecedented number of major financial disruptions, which have tested the resiliency of our global financial systems. This past year brought yet another episode when three US regional banks failed, resulting in the authorities having to invoke emergency measures to stem contagion across the broader financial system. Notably, this was the first time we have witnessed the full speed of runs that can be generated by social media and financial market apps. We saw our traditional tools for market order and resilience quickly outpaced. Banking systems also faced particular challenges in Switzerland and in the UK.

We began 2023 with concerns about potential disruptions as the global economy began to unwind from unprecedented fiscal and monetary stimulus. The policy challenges seemed immense and the risk of breakage in the system seemed high. Despite elevated recession risks, geopolitical stress, and a flash banking crisis, the vision of a miracle soft landing remains intact. Just how miraculous 2023 turned out for economies and markets, despite consensus naysayers, is an economic lesson for the ages. From a systemic risk standpoint, trying to predict the extent and timing of economic disruption is fascinating, but being prepared for another crisis remains a necessity. This is why regulators spent a good portion of 2023 continuing to shore up a global financial system that remains vulnerable. They are working hard to keep pace with emerging fintech applications and products.

The Council spent considerable time commenting on: improving disclosure and transparency from nonbank financial intermediaries; bolstering long-term debt buffers issued by large banks; and implementing the final phase of Basel III. Combined, these measures move us towards a more robust regulatory capital framework relating to credit, market, and operational risks.

Thank you for reviewing our 2023 annual report. We look back on the key challenges and issues of the year, and at the same time offer some thoughts on the year ahead. We welcome your support, comments, and inquiries.

Visit us today at www.systemicriskcouncil.org.

— Kurt N. Schacht, Executive Director

LETTER FROM THE CO-CHAIRS

Dear Readers,

This past year marked the 10-year anniversary of the CFA Institute Systemic Risk Council. It was a year filled with a range of systemic risk disturbances, regulatory changes, and technology developments that have challenged regulators and markets around the world. As co-chairs of the Systemic Risk Council, we first offer our many thanks to Council members for their continuing efforts and contributions to our collective activities this past year. We have hosted a regular series of discussions and presentations from key regulators, economists, and other stakeholders tracking what has been a very active year for both prudential regulation and securities market regulation, with emphasis on transparency, investor protection, and bolstering economic stability. We faced another serious challenge to banking stability in the United States in March 2023 with the social media–fueled runs at Silicon Valley Bank and Signature Bank. In all, the systemic risk developments and challenges of 2023 were the greatest since the COVID pandemic.

Soft landing: What has surprised most observers of the economy and markets, including us, has been the benign effects and reaction to the great inflation unwind. The long and variable lag that major shifts in monetary policy have on the economy, which Milton Friedman described to a joint session of Congress in 1959, seem to be potentially longer and more variable than anyone imagined a year ago. Predictions of recession and market declines have given way to a growing opinion that we may actually see the elusive soft landing come to pass. Whatever the outcome, 2024 is likely to be the test as to whether economic growth, tight labor markets, wage growth, and lower inflation can peacefully coexist. Professor Friedman would have enjoyed calling the play-by-play.

Thought-leaders: In 2023, the Council held informative meetings with presentations from a range of economic, regulatory, and systemic risk officials, including Gary Gensler, SEC chair; John Berrigan, director-general for financial stability, financial services, and the Capital Markets Union of the European Commission (EC); Martin J. Gruenberg, chair of the FDIC board of directors; José Manuel Campa, chair of the European Banking Authority (EBA); and, Michael Barr, vice chair for supervision of the board of governors of the Federal Reserve System. These discussions not only allow for deeper understanding and analysis of the key systemic issues from these authorities but also provide the opportunity for us to promote and elevate our views on these critical areas.

Comment letters: The Council also issued detailed comment letters this year to explain our views on several important regulatory proposals to bolster economic stability. The SRC has heard repeatedly from global regulators that nonbank financial intermediaries (NBFIs) pose an ever-increasing challenge to systemic risk. The SRC provided detailed comments and support for a new analytic framework proposed by US regulators for determining and measuring potential financial stability risks of these NBFIs. The proposals focused on requiring greater disclosures from such firms so that regulators can better assess the level of interconnectedness, whether there is excess leverage, and the adequacy of liquidity risk management practices at such firms. Perhaps the most important systemic risk proposals of the year related to the so-called Basel III endgame, which implements long-overdue global agreements on strengthening regulatory capital rules for large banking organizations.

2024 priorities: Through the turbulent regulatory and economic twists and turns of 2023, several key issues developed as matters of building systemic concern. In 2024, the SRC will continue to advocate for action in the following areas in which improvements in detecting, monitoring, and responsiveness are needed to meet these evolving threats to financial stability:

- **NBFIs:** Faster action on global regulatory concerns about opaque private markets with hidden leverage exposures and uncertain counterparty interconnectedness.
- **Ukraine:** Systemic implications of an increasingly aggressive Russian war on Ukraine.
- **Artificial intelligence (AI):** AI advancements and their implications for financial stability.
- **Cyber risk:** Ever-increasing aggressiveness and sophistication of cybersecurity hazards.
- **Expanding climate risks:** Climate change and its implications for systemic risk.
- **Complacency:** Global Financial Crisis reforms were conceived and implemented by policy leaders to prevent recurrence of systemic risks of a different era. The SRC will continue to encourage regulators to focus on today's large structural shifts in risk and staying ahead of the curve.
- **Response time:** Keeping pace includes the new dangers of social media–induced runs amidst potentially obsolete processes and technology that hinders the agility and speed of regulatory response.

Thank you for reviewing the CFA Institute Systemic Risk Council 2023 Annual Report. The Council remains focused on keeping our commitment to addressing regulatory and structural issues relating to global systemic risk and to providing a strong, independent voice for reforms that anticipate and mitigate financial instability.

Sincerely,

Simon Johnson, SRC Co-Chair and former IMF Chief Economist

Erkki Liikanen, SRC Co-Chair and Chair of the IFRS Foundation

2023 KEY SYSTEMIC RISK ISSUES IN REVIEW

Key activities and actions in 2023: After a year filled with dynamic ups and downs, we provide a review of matters of systemic importance and key actions and perspectives from the Council.

Support for Completing the Work of Basel III

SRC support: The path forward for Basel III implementation in the United States has been a contentious one over the past year. Despite the growing criticism among industry advocates, the SRC laid out detailed arguments in support of the proposed rules that were issued jointly by the Federal Reserve System, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) in early 2023. The Basel III international standards represent a comprehensive regulatory framework aimed at addressing systemic risk gaps in large banking organizations, particularly in market and operational risk areas. As noted in our recent comment letter, the SRC emphasizes three key reasons for its backing: (1) a long-overdue change to address gaps in systemic risk and improve the economic preparedness following recent financial crises; (2) noting that industry claims of sufficient capitalization in the banking system overlook the extensive public support provided through systemwide mechanisms as recent as march 2023; and (3) the need for consistent, global coordination and a simpler, standardized approach to risk weighting across banking organizations.

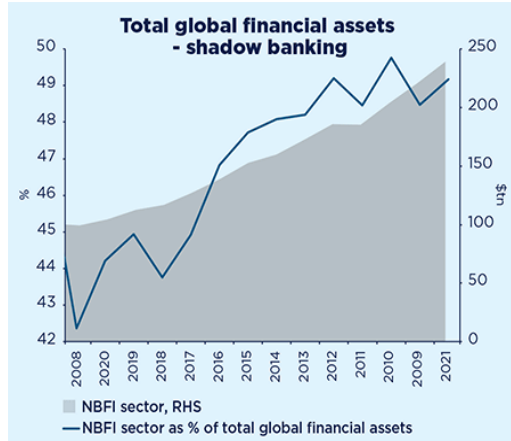
Industry criticisms: Over this past year, industry pushback of the proposal has become more intense, which prompted the regulatory agencies to extend the deadline for comments. Critics of the proposal, including many banks, trade associations, and politicians, have raised concerns primarily centered on whether the proposed increase in capital requirements and compliance costs within the banking industry are even needed. They often point to Dodd–Frank reforms they say have weathered all recent financial disruptions as being adequate. These same industry stakeholders also argue that the measures will limit banks' capacity to participate in key financial markets, thereby disadvantaging banks operating in the United States and having negative impacts on economic growth in the US market.

In sum: The SRC believes the Basel III proposals are an important last step in ensuring implementation of global agreements to ensure large banking organizations are appropriately capitalized to better withstand all manner of economic disruption. Basel III's focus on maintaining and further calibrating regulatory capital along with improving global coordination on systemic risk management are crucial elements for global economic stability in the decade ahead.

Swift Action on the Financial Stability Oversight Council's NBFI Proposals

SRC support: The SRC has taken a proactive stance in supporting the Financial Stability Oversight Council's (FSOC) recent proposals aimed at enhancing the oversight and regulation of NBFIs, as stated in our comment letter issued on 19 July 2023 to US Treasury Secretary Janet Yellen.

Focus on transparency: The SRC applauded the proposed new frameworks that focus on assessing and improving transparency surrounding the growing financial risks associated with NBFIs and their activities. Notably, the SRC urged the FSOC to further refine the process for nonbank designations, ensuring timely and comprehensive assessments of the size, complexity, and interconnectedness of NBFI risks. The SRC encouraged stronger requirements and specific actions for systemic risk reviews, emphasizing that designated NBFIs should be directed to implement corrective steps promptly when their actions jeopardize financial stability.



Source: Amundi Institute on Jurisdictions' 2022 submissions (national sector balance sheet and other data) and 2021 submission for Russia; FSB calculations. Data is as of 29 May 2023.NBFI: non-bank financial institutions.

Global coordination: The SRC's concerns about the NBFI sector align with broader challenges faced by standard-setting bodies globally, as noted by thought-leaders, Gary Gensler, chair of SEC, and José Manuel Campa, chair of the EBA, who presented to our group. Despite some progress in addressing NBFI risks, uniform action, authority, and enforcement remain lacking on a global level. The SRC advocates for prompt action to establish a comprehensive framework for enhanced NBFI oversight, emphasizing transparency, interconnectedness, hidden leverage, resolution capabilities, and liquidity preparedness.

SEC's Move to Reduce Open-End Fund Liquidity Risk Implications

In February, the SRC issued its comment letter in support of the SEC's proposed rule on Open-End Fund Liquidity Risk Management Programs and Swing Pricing. This regulatory effort aligns with the SRC's persistent advocacy since 2015 for a comprehensive examination of open-end and money market mutual funds to mitigate potential systemic risks. The SRC expressed support for the proposed enhancements to liquidity risk management, including changes to liquidity classifications, minimum requirements for portfolio investments, and more detailed reporting disclosures. Moreover, the SRC endorsed the idea of mandatory swing pricing for all funds to address potential issues surrounding investors' daily redemption of shares.

Enhancements to the SEC's Covered Clearing Agency Resiliency Plans

In a letter sent on 30 August 2023, the SRC extended its support to the SEC's proposed Covered Clearing Agency (CCA) Resilience and Recovery and Wind-Down Plans. With its support, the SRC proposed refinements to significantly strengthen resiliency against a CCA's failure. The SRC advocated for changes to counteract both operational and financial risks, with a focus on imposing losses on financial obligations before operational liabilities. The SRC outlined specific actions and procedures to guide the SEC in addressing the growing risks to financial stability posed by CCAs.

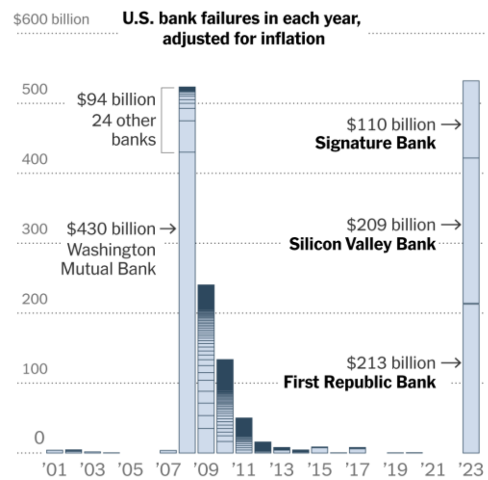
Long-Term Debt Standards

In December, the SRC issued a comment letter expressing its support for the joint proposal by the OCC, the Federal Reserve Board (FRB), and the FDIC. The proposal calls for large depository institution holding companies and insured depository institutions with total consolidated assets of $100 billion or more to issue and maintain a minimum amount of long-term debt (LTD). This move aligns these banking organizations with the standards applicable to global systemically important banks to mitigate systemic risks and foster confidence in the banking system. The SRC believes the benefits, including protecting the Deposit Insurance Fund and maintaining financial stability, far outweigh the modest costs associated with the rule.

Lessons Learned from 2023 US Bank Failures

Lessons and insight: The three bank failures in March 2023—Silicon Valley Bank, Signature Bank, and First Republic Bank—provide valuable insight into the challenges facing the banking industry. During 2023, the SRC was fortunate to meet (via video) with numerous industry and regulatory leaders to discuss key systemic risk issues, including in the US banking sector.

Regulatory action: According to FDIC Chair Martin Gruenberg, these failures shared common characteristics, serving as a cautionary tale for the industry. A toxic combination of poor management, rapid growth, heavy reliance on uninsured deposits, unrealized losses on securities, and minimal LTD were identified as key contributors to the failures. Chair Gruenberg highlighted the importance of creating remedies and policies to strengthen the industry's stability, including increasing large bank's capital requirements and LTD requirements and more stringent supervision of large regional banks, including a reexamination of risk-based deposit insurance pricing, to address the liquidity risks.



Source: NextBigFuture.com

Needed reforms: The SRC was also joined by Dr. Elke König, former chair of the European Union Single Resolution Board (SRB), who provided insight into the recent banking failures and the need for recalibrating regulations. Given the recent interest rate hikes, liquidity management challenges, and hold-to-maturity (HTM) valuation effects, she discussed potential reforms, including expanding deposit insurance, recalibrating total loss-absorbing capacity (TLAC), implementing more robust liquidity stress-testing, and enhancing global cooperation.

Reviewing accounting rules: In the aftermath of the bank disruptions, regulators, including the Federal Reserve Bank, are closely examining the effects of HTM accounting rules on banks' capital and liquidity. The concern revolves around whether many large banks are able to mask stresses to their capital and liquidity by holding assets at their original cost rather than reflecting current fair values. Prudential authorities are reviewing how bank regulators addressed these issues in the context of the recent regional bank failures.

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