Contents

Preface — VII

1	The Cost of Bank Balance Sheet Space —— 1
1.1	The setting —— 2
1.2	Debt overhang has risen —— 3
1.3	Liquidity provision by dealers —— 7
1.4	Modigliani-Miller, debt overhang, and asset substitution — 9
1.5	Impact on swap markets —— 9
1.6	Strategic implications for dealers —— 10
1.7	Asset pricing implications —— 11
1.8	The leverage-ratio rule —— 12
1.9	European versus US banks —— 13
1.10	Competition and price transparency —— 13
1.11	The stability-liquidity efficient frontier —— 14
2	Leverage Rule Distortions —— 17
2.1	Leverage rule distortions —— 17
2.2	Repo intermediation under the SLR —— 19
2.3	SLR degrades monetary-policy passthrough —— 26
2.4	Repo crunches in 2019 and 2020: Not caused by balance-sheet
	constraints —— 28
3	Funding Cost Frictions —— 30
3.1	An illustrative example: T-bill investment —— 30
3.2	Post-crisis increases in dealer funding costs —— 30
3.3	A model of dealer funding costs —— 32
3.4	CIP arbitrage could harm shareholders —— 34
3.5	Regulatory capital and the cross-currency basis —— 36
4	Market Design Implications —— 39
4.1	Opaque bilateral trade is inefficient —— 39
4.2	Multilateral trade platforms —— 40
4.3	Size discovery —— 41
4.4	Multilateral trade facilities —— 43
4.5	Post-trade price transparency —— 44
4.6	Central clearing —— 47
4.7	Compression trading —— 50
5	When the Fed Rescued the Treasury Market —— 52
5.1	Still a safe haven? —— 53



X — Contents

5.2	Treasury markets became dysfunctional —— 56	
J.Z	ileasury iliarkets became dysiunctional —— 30	3

- Treasury markets became dysfunctional —— 56

 Upgrading the US Treasury market with central clearing —— 64 5.3
- Summary of lessons learned 71 5.4

Bibliography — 75