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RECENT BANK FAILURES AND THE FEDERAL REGULATORY RESPONSE

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE RECENT U.S. BANK FAILURES AND THE FEDERAL REGULATORS' RESPONSE

MARCH 28, 2023

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C O N T E N T S

TUESDAY, MARCH 28, 2023

WITNESSES

Additional Material Supplied for the Record

RECENT BANK FAILURES AND THE FEDERAL REGULATORY RESPONSE

TUESDAY, MARCH 28, 2023

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10 a.m., in room 106, Dirksen Senate Office Building, Hon. Sherrod Brown, Chair of the Committee, presiding.

OPENING STATEMENT OF CHAIR SHERROD BROWN

Chair BROWN. The Committee on Banking, Housing, and Urban Affairs will come to order.

Thanks to the New Deal and the hard work of our regulators today, most bank failures, of course never a good thing, are generally not a big deal. But the quick collapses of Silicon Valley Bank and Signature Bank were no ordinary failures.

In less than a day, Silicon Valley Bank customers pulled $42 billion out of the bank, fueled by venture capitalists and their social media accounts. They created the largest and fastest bank run in history. In the following days, Signature Bank lost $17.8 billion.

Regulators—both Republicans and Democrats—came together to prevent the panic from spreading. They increased liquidity, promoted confidence in our banking system, and protected the deposits of customers and small businesses, not, notably, the investments of executives and shareholders.

I spent that weekend on the phone with Ohio small businesses and banks and credit unions. Ohio small business owners simply wanted to make payroll. They did not want to see years of hard work go down the drain because of venture capitalists panicking on Twitter 2,000 miles away. One woman told me she was terrified she would not be able to pay her workers the next week, and I heard that story over and over.

And Ohio banks and credit unions institutions—institutions that are sound and well-capitalized—did not want to see deposits flee their institutions for the biggest Wall Street banks.

For anyone who lived through the Global Financial Crisis, it is impossible not to think of 2008.

Once again, small businesses and workers feared they would pay the price for other people's bad decisions. And we are left with many questions—and justified anger—toward bank executives and boards, toward venture capitalists, toward Federal and State bank regulators, and toward policymakers.

The scene of the crime does not start with the regulators before us. Instead, we must look inside the bank, at the bank CEOs, and at the Trump-era banking regulators, who made it their mission, again, to give Wall Street everything it wanted.

Monday morning quarterbacking aimed only at the actions of regulators this month is as convenient as it is misplaced, coming from those who have never met a Wall Street wish list they did not want to grant.

Many who are the first to scold the regulators for their failures offer ready ears whenever bank CEOs line up at their offices complaining about "out-of-control bank examiners."

Remember some of those complaints at our hearing with Fed Chair Powell over the Fed merely reviewing capital, just 3 days before Silicon Valley Bank failed?

How soon we choose to forget.

When we ask who should have known how the risks were building in these banks, we should start at the source—with the executives.

Silicon Valley Bank almost quadrupled in size over 3 years, and Signature Bank more than doubled in that time.

The principles here are not complicated. Banks should be prudently managed and be mindful of the full scope of risks they face, and should diversify across companies and products.

This Committee must consider how these banks exploded in size, in a way that was clearly unsustainable. Some explanations will focus on complicated-sounding concepts like balance sheet risk, moral hazard, stress tests, and liquidity ratios. Really though, it comes down to more basic concepts: hubris, entitlement, greed. And always, always, always with big paydays at the end, for the executives at the top.

The CEOs' own pay was tied directly to the growth at SVB. At SVB, executive bonuses were pegged to return on equity. So they took more risk by buying assets with higher yields to make higher profits. When those investments started to lose money, they did not back down.

It will not surprise anyone that Silicon Valley Bank went nearly a year without a Chief Risk Officer.

Venture capitalists fueled the bank's growth by forcing the companies they invested in and advised to keep their money at Silicon Valley Bank. And then those same VCs turned around and sparked the bank run by telling the companies to pull their money out, creating more chaos and more panic.

Signature Bank found itself in the middle of Sam Bankman-Fried's crime spree at the crypto exchange FTX. The bank let him open multiple accounts and ignored red flag after red flag.

It is all just a variation on the same theme, the same root cause of most of our economic problems: wealthy elites do anything to make a quick profit and pocket the rewards. And when their risky behavior leads to catastrophic failures, they turn to the Government asking for help, expecting workers and taxpayers to pay the price, and too often workers do.

Even though no taxpayer money is being used to save these depositors, I understand why many Americans are angry—even disgusted—at how quickly the Government mobilized when a bunch of elites in California were demanding it. People have a pretty good sense of whose problems get taken more seriously than others in this town.

Of course we have to prevent systemic threats to the economy. But corporate trade deals are a systemic threat to towns like I grew up in, in Mansfield, Ohio, and across the industrial Midwest. So it is a Wall Street business model that rewards short-term profits over investments in innovation and workers.

And those threats are not only tolerated, they have been actively pushed by the same crowd that this month clamored for the Government to save them. Just as there are no atheists in foxholes, it appears that when there is a bank crash, there are no libertarians in Silicon Valley.

I hope that from now on, those who have no problem with Government intervention to protect their own livelihoods will think a little bit harder about what their warped version of the free market has done to workers in Ohio.

It may be tempting to look at all this and say, we do not need new rules. The real problem was these arrogant executives.

But there will always be arrogant executives. That is exactly why we need strong rules, and public servants with the courage—with the courage and guts—to stand up to bank lobbyists and enforce those rules. The officials sitting before us today know that their predecessors rolled back protections, like capital and liquidity standards, stress tests, brokered deposit limits, and even basic supervision. They greenlighted these banks to grow and grow and grow, too big, too fast.

There are important questions about deposit insurance we must consider—whether the current amount works for everyone, including small businesses whose real goal is make payroll.

We expect bank executives to understand the basic principles of bank management and to know they cannot grow a bank by overconcentrating business in specialized areas and then pay themselves huge bonuses right up until things blow up. That is not being a trusted partner to your customers. It is taking advantage of them.

These executives must answer for their banks' downfalls. I have called on the former CEOs of these failed banks to testify and I thank Ranking Member Scott for joining us in that effort.

But they must also face real consequences for their actions. Right now, none of the executives who ran these banks into the ground are barred from taking other banking jobs, none have had their compensation clawed back, none have paid any fines.

Some executives have decamped to Hawai'i. Others have already gone on to work for other banks. Some simply wandered off into the sunset.

It will surprise no one in Ohio that these bank executives face less accountability than a cashier who miscounts the cashbox.

That is why I will be introducing legislation to strengthen regulators' ability to impose fines and penalties, to clawback bonuses, and to ban executives who caused bank failures from working at another bank ever again.

We also need to look at bank regulators' ability to not only identify risks and problems at banks, but to also be empowered to actually make the banks fix them. Today, my colleagues and I are asking GAO to follow up on a 2019 report where they highlighted communication failures, and the extent to which senior bank management fully addressed identified deficiencies.

I am looking forward to hearing from our financial watchdogs today. We will be watching them to make sure they assess the damage, hold accountable those responsible, and fix what is broken.

Last, I ask my colleagues to work together to make sure that our financial system is stronger after this crisis. Americans have watched the same pattern over and over. A crisis occurs, some of us push for reforms, and if we are lucky, we are able to seize the moment, and actually pass some.

And then the bank lobbyists go to work, and they are so good at their jobs.

Politicians spend the ensuing years rolling back reforms, right up until the next crisis. And that crisis happens because, you guessed it—we rolled back regulations, and this body enabling the regulators to roll them back even further.

And we know who is the first to get help in any crisis. It is little wonder that workers in Ohio and around the country do not trust banks, and do not trust their own Government. It is time we proved them wrong—ignore corporate lobbyists, and put workers and their families first.

Senator Scott.

STATEMENT OF SENATOR TIM SCOTT

Senator SCOTT. Thank you, Mr. Chairman.

Today, we are here to understand just how we found ourselves in the middle of the second- and third-largest bank failures in United States history. Though our questions are nowhere near answered, this is an important first step in providing transparency and accountability necessary to the American taxpayer.

I would like to thank you, Mr. Chairman, for taking the time and working with me to try to bring the bank CEOs into this hearing. I think it is incredibly important that we hear from the folks specifically and uniquely responsible for the failure of these banks, the folks who managed them.

By all accounts, this is a classic tale of negligence, and it started with the banks themselves. Without any question, that is where the buck stops. So it is imperative that we hear straight from the horse's mouth, so to speak, to find out why these banks were so poorly managed and so poorly managed the risks.

Unfortunately, the bank executives are not the only managers we are missing.

The Secretary of the Treasury and the Chairman of the Federal Reserve are also not here to testify. I do not mean to offend the witnesses that are here, but it is hard to believe the Biden administration seriously is concerned about the failure that we are seeing when they themselves are shielding the top official at the Department of Treasury, the same official that briefed the President and invoked the System Risk Exception.

Nor do we have Chairman Powell here. Instead, we have the Vice Chair of Supervision here to use the Committee as a platform to talk about the wrongs under his supervision. As the Federal Reserve has already announced, he is conducting a review to assess any supervisory failures, which is an obvious, inherent conflict of interest and a classic case of the fox guarding the henhouse.

The Fed should focus on its mission and not the climate arena. This is a waste of time, attention, and manpower, all things that could have gone into bank supervision.

Banks, like any other business, must manage their risk and be good stewards for their customers. But unlike other businesses, banks are highly regulated. Sometimes banks even have their regulators sitting in their banks and continually monitoring their risks and activities, as is the case with Silicon Valley Bank.

For the last 2½ weeks, the regulators have consistently described Silicon Valley as unique and highly "idiosyncratic," meaning the warning signs should have been flashing red and SVB should have stood out as what it was, absolutely a problem child. Clear as a bell were the warning signs.

In fact, reports indicate that these warning signs were already flashing, and on March 19, the *New York Times* wrote that "Silicon Valley Bank's risky practices were on the Federal Reserve's radar for more than a year . . ." .

Moreover, Silicon Valley suffered from extreme interest rate risk, due to investments in long-term securities that declined in value because of soaring inflation. Of all our supervisors, the Federal Reserve should have been keenly aware of the impact its interest rate hikes would have on the value of these securities, and it should have been actively working to ensure the banks it supervises were hedging their bets and covering their risk accordingly.

But now we know, based off your testimony, Mr. Barr, that the Fed was aware. In fact, in 2021, your supervisors found deficiencies in the bank's liquidity and its management, resulting in six supervisory findings. Later, in 2022, supervisors then issued three findings related to ineffective board oversight, risk-management weaknesses, and the bank's internal audit function. What were the supervisors thinking?

The law and the regulations are crystal clear. The Federal Reserve can take any supervisory or enforcement action it deems necessary to address unsafe and unsound practices.

Recent reports confirm what we already know. Your priorities and your work with the San Francisco Federal Reserve Bank President, Mary Daly, centered on climate change, an issue wholly unrelated to the Federal Reserve's dual mandate and role as supervisor. Given SVB's social and climate agenda, one must ask if SVB's investments in climate caused the regulators to be a bit more permissive of its risks.

If you cannot stay on mission and enforce the laws as they already are on the books, how can you ask Congress for more authority with a straight face?

To that end, I hope to learn how the Federal Reserve could know about such risky practices for more than a year and fail to take definitive, corrective action. By all accounts, our regulators appear to have been asleep at the wheel.

In addition, I also hope to learn more from the FDIC about the role in the receivership and sale of both SVB and Signature Bank, especially on the auction and bid process.

I am very concerned that private sector offers appear to have been submitted, and yet were denied. If Silicon Valley Bank had been purchased before it failed, the panic and the shock to the market and to market confidence we have seen over the past 2½ weeks may have been avoided.

If Silicon Valley had been purchased over the weekend of March 10, confidence in the marketplace may have sustained Signature Bank and prevented its failure.

The FDIC's bid auction process has been a black hole for Congress and the American people, and we deserve answers.

I know hindsight is 2020, but when you hear rumors that this process was delayed because the White House does not like mergers in any shape, form, or fashion, it makes you wonder what actually is going on. Sometimes, when it looks like a duck, quacks like a duck, it is just a duck.

As I close on this opening statement, three things remain clear to me regarding SVB. First, the bank was rife with mismanagement. Second, there was a clear supervisory failure. Our regulators were simply asleep at the wheel. And finally, President Biden's reckless spending caused this 40-year high in inflation, and the country, as well as the bank, experienced tremendous loss.

Chair BROWN. Thank you, Ranking Member Scott. I will introduce the three witnesses today.

Martin Gruenberg was sworn in as Chair of the Federal Deposit Insurance Corporation Board of Directors in January of 2023. Michael Barr took office as Vice Chair of Supervision of the Board of Governors of the Federal Reserve in July of 2022, for a 4-year term. He serves also as a member, of course, of the Board of Governors. Nellie Liang has been the Under Secretary for Domestic Finance at the U.S. Department of Treasury since July 2021.

Thanks to all of you for joining us, and Mr. Gruenberg, if you would begin. Thank you.

STATEMENT OF MARTIN GRUENBERG, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. GRUENBERG. Thank you, Mr. Chairman. Chairman Brown, Ranking Member Scott, and Members of the Committee, thank you for the opportunity to appear before you today to address the recent bank failures and the Federal regulatory response.

On March 10th, just over 2 weeks ago, Silicon Valley Bank, or SVB, as it is known, with $209 billion in assets at year-end 2022, was closed by the California Department of Financial Protection and Innovation, which appointed the FDIC as receiver. The failure of SVB, following the March 8th announcement by Silvergate Bank that it would voluntarily liquidate, signaled the possibility of a contagion effect on other banks.

On Sunday, March 12th, just 2 days after the failure of SVB, another institution, Signature Bank of New York, with $110 billion in assets at year-end 2022, was closed by the New York State Department of Financial Services, which also appointed the FDIC as receiver. With other institutions experiencing stress, serious concerns arose about a broader economic spillover from these failures.

After careful analysis and deliberation, the Boards of the FDIC and the Federal Reserve voted unanimously to recommend, and the Treasury Secretary, in consultation with the President, determined that the FDIC could use emergency systemic risk authorities under the Federal Deposit Insurance Act to fully protect all depositors in winding down SVB and Signature Bank.

It is worth noting that these two institutions were allowed to fail. Shareholders lost their investment. Unsecured creditors took losses. The boards and the most senior executives were removed. The FDIC has authority to investigate and hold accountable the directors and officers of the banks for the losses they caused and for their misconduct in the management of the institutions. And the FDIC has already commenced these investigations.

Further, any losses to the FDIC's Deposit Insurance Fund as a result of uninsured deposit insurance coverage will be repaid by a special assessment on banks as required by law.

The FDIC has now completed the sale of both bridge banks to acquiring institutions—New York Community Bancorp's Flagstar Bank for Signature, and First Citizens for Silicon Valley Bridge Bank.

My written testimony today describes the events leading up to the failures of SVB and Signature Bank and the facts and circumstances that prompted the decision to utilize the authority in the FDI Act to protect all depositors in those banks following these failures. It further describes the management and disposition of the bridge institutions that were established. It also discusses the FDIC's assessment of the current state of the U.S. financial system, which remains sound despite recent events. In addition, it shares some preliminary lessons learned as we look back on the immediate aftermath of this episode.

In that regard, the FDIC will undertake a comprehensive review of the deposit insurance system and will release a report by May 1, that will include policy options for consideration relating to deposit insurance coverage levels, excess deposit insurance, and the implications for risk-based pricing and deposit insurance fund adequacy. In addition, the FDIC's Chief Risk Officer will undertake a review of the FDIC's supervision of Signature Bank and will also release a report by May 1. Further, the FDIC will issue, in May a proposed rulemaking for the special assessment for public comment.

The two bank failures demonstrate the implications that banks with assets over $100 billion can have for financial stability. The prudential regulation of these institutions merits serious attention, particularly for capital, liquidity, and interest rate risk. Resolution plan requirements for these institutions also merit review, including a long-term debt requirement to facilitate orderly resolution.

Recent efforts to stabilize the banking system and stem potential contagion from the failures of SVB and Signature Bank have ensured that depositors will continue to have access to their savings, that small businesses and other employers can continue to make payrolls, and that other banks—small, medium, and large—can continue to extend credit to borrowers and serve as a source of support. The FDIC continues to monitor developments and is prepared to use all of its authorities as needed.

The FDIC is committed to working cooperatively with our counterparts at the other Federal regulators as well as with policymakers in the Congress to better understand what brought these institutions to failure and what measures can be taken to prevent similar failures in the future.

That concludes my statement, and I would be glad to respond to questions.

Chair BROWN. Thank you, Mr. Gruenberg.

Mr. Barr, you are recognized. Thank you.

STATEMENT OF MICHAEL BARR, VICE CHAIRMAN FOR SUPERVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BARR. Chairman Brown, Ranking Member Scott, other Members of the Committee, thank you for the opportunity to testify today on the Federal Reserve's supervisory and regulatory oversight of Silicon Valley Bank.

Our banking system is sound and resilient, with strong capital and liquidity. The Federal Reserve, working with the Treasury Department and FDIC, took decisive actions to protect the U.S. economy and to strengthen public confidence in the banking system. These actions demonstrate that we are committed to ensuring that all deposits are safe. We will continue to closely monitor conditions in the banking system and are prepared to use all of our tools for any size institution, as needed, to keep the system safe and sound.

At the same time, the events of the last few weeks raise questions about what more can and what more should be done so that isolated banking problems do not undermine confidence in healthy banks and threaten the stability of the banking system as a whole. At the forefront of my mind is the importance of maintaining the strength and diversity of banks of all sizes that serve communities across the country.

SVB failed because the bank's management did not effectively manage its interest rate and liquidity risk, and the bank then suffered a devastating and unexpected run by its uninsured depositors in a period of less than 24 hours.

Immediately following SVB's failure, Chair Powell and I agreed that I should oversee a review of the circumstances leading up to SVB's failure. In this review, we are looking at SVB's growth and management, our supervisory engagement with the bank, and the regulatory requirements that applied to the bank.

The picture that has emerged thus far shows SVB had inadequate risk management and internal controls that struggled to keep pace with the growth of the bank. Supervisors began delivering supervisory warnings near the end of 2021. Our review will consider whether these supervisory warnings were sufficient and whether supervisors had sufficient tools to escalate them. We are also focusing on whether the Federal Reserve's supervision was appropriate for the rapid growth and vulnerabilities of the bank. While the Federal Reserve's framework focuses on size thresholds, size is not always a good proxy for risk, particularly when a bank has a nontraditional business model.

Turning to regulation, we are evaluating whether application of more stringent standards would have prompted the bank to better manage the risks that led to its failure. Staff are also assessing whether SVB would have had higher levels of capital and liquidity under those standards, and whether such higher levels of capital and liquidity could have forestalled the bank's failure or provided further resilience to the bank.

We need to move forward with our work to improve the resilience of the banking system, including the Basel III endgame reforms, a long-term debt requirement for large banks, and enhancements to stress testing with multiple scenarios so that it captures a wider range of risk and uncovers channels for contagion, like those we saw in the recent series of events. We must also explore changes to our liquidity rules and other reforms to improve the resiliency of the financial system. In addition, recent events have shown that we must evolve our understanding of banking in light of changing technologies and emerging risks.

Part of the Federal Reserve's core mission is to promote the safety and soundness of the banks we supervise, as well as the stability of the financial system to help ensure that the system supports a healthy economy for U.S. households, businesses, and communities. Deeply interrogating SVB's failure and probing its broader implications is critical to our responsibility for upholding that mission.

Thank you, and I look forward to your questions.

Chair BROWN. Thank you, Mr. Barr.

Ms. Liang, nice to see you. Thank you for being here.

STATEMENT OF NELLIE LIANG, UNDER SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Ms. LIANG. Thank you. Chairman Brown, Ranking Member Scott, and other Members of the Committee, thank you for inviting me to testify and for the opportunity to speak several times in recent days to share updates from Treasury regarding current events.

The American economy relies on a healthy and diverse banking system, one that includes large, small, and mid-size banks and provides for the financial needs of families, businesses, and local communities.

Nearly 3 weeks ago, problems emerged at two banks with the potential for immediate and significant impacts on the broader banking system and the economy. The situation demanded a swift response. In the days that followed, the Federal Government took decisive actions to strengthen public confidence in the U.S. banking system and to protect the American economy.

On March 9th, depositors of Silicon Valley Bank withdrew $42 billion in deposits in a period of just a few hours. After concluding that significant deposit withdrawals would continue the next day, the California State regulator closed SVB and appointed the FDIC as receiver. Two days later, the New York regulator closed Signature Bank, which also had experienced a depositor run, and appointed the FDIC as receiver.

Treasury worked to assess the effects of these failures on the broader banking system, consulting regularly with the Federal Reserve and FDIC. On Sunday evening, recognizing the urgency of reducing uncertainty for Monday morning, Treasury, the Federal Reserve, and the FDIC announced a number of actions to stem uninsured depositor runs and to prevent significant disruptions to households and businesses.

First, the boards of the FDIC and the Federal Reserve recommended unanimously, and Secretary Yellen approved after consulting with the President, two actions that would enable the FDIC to complete its resolutions of the two banks in a manner that fully protects all of their depositors. These actions ensured that businesses could continue to make payroll and that families could access their funds. Depositors were protected by the Deposit Insurance Fund. Equity holders and bond holders were not protected.

Second, the Federal Reserve created the Bank Term Funding Program, a new facility to provide term funding to all insured depository institutions eligible for primary credit at the discount window, based on their holdings of Treasury and Government agency securities. This program, along with the preexisting discount window, has helped banks meet depositor demands and bolstered liquidity in the banking system.

This two-pronged, targeted approach was necessary to reassure depositors at all banks, and to protect the U.S. banking system and economy. These actions have helped to stabilize deposits throughout the country and provided depositors with confidence that their funds were safe.

In addition to these actions, on March 16th, 11 banks deposited $30 billion into First Republic Bank. The actions of these large and mid-size banks represent a vote of confidence in the banking system and demonstrate the importance of banks of all sizes working to keep our economy strong. Moreover, on March 20th, the deposits and certain assets of Signature Bridge Bank were acquired from the FDIC, and on March 26th, the deposits and certain assets of Silicon Valley Bridge Bank were acquired from the FDIC.

We continue to closely monitor developments across the banking and financial system, and to coordinate with Federal and State regulators. As Secretary Yellen has said, we have used important tools to act quickly to prevent contagion. And they are tools we would use again to ensure that Americans' deposits are safe.

Looking forward, while we do not yet have all the details about the failures of the two banks, we know that the recent developments are very different from those of the Global Financial Crisis. Back then, many financial institutions came under stress because they held low credit-quality assets. This was not at all the catalyst for recent events. Our financial system is significantly stronger than it was 15 years ago. This is in large part due to the postcrisis reforms for stronger capital and liquidity.

As you know, the Federal Reserve announced a review of the failure of SVB and the FDIC a review of Signature Bank. I fully support these reviews and look forward to learning more in order to inform any regulatory and supervisory responses. We must ensure that our bank regulatory policies and supervision are appropriate for the risks and challenges that banks face today.

Thank you to the Committee for its leadership on these important issues and for inviting me here to testify. I look forward to your questions.

Chair BROWN. Thank you, Ms. Liang.

Almost every Member of this Committee will be here today, on both sides of the aisle. Make your answers as brief and as quick as you possibly can. So thank you for that.

In 2019, by votes of 4 to 1 and 5 to 1, now chair of the NEC, Lael Brainard, the only dissenter in every one of those votes, the Fed rolled back stronger rules and was responsible for supervising Silicon Bank. Vice Chair Barr, did the Fed drop the ball because it did not see the risk that was building?

Mr. BARR. Thank you, Chairman Brown, for that question. Fundamentally, the bank failed because its management failed to appropriately address clear interest rate risk and clear liquidity risk. That interest rate risk and liquidity risk was cited, was highlighted by the supervisors of the firm beginning in November of 2021. The Federal Reserve Bank brought forward these problems to the bank, and they failed to address them in a timely way.

That exposure led the firm to be highly vulnerable to a shock, and that shock came on the evening of Wednesday, March 8th, when it very belatedly attempted to adjust its liquidity position and reported losses on its available-for-sale securities. The market reaction to that was quite negative, and that eventually, on Thursday, sparked a depositor run.

Chair BROWN. So some of their practices appear to have violated the basic principles of Banking 101, concentration risk, overreliance on uninsured deposits, inadequate liquidity, poor risk management—the list goes on. How poorly managed was this bank?

Mr. BARR. Supervisors had rated the bank at a very low rating. Normally we would not be describing these matters, confidential matters, but given that the firm failed and triggered a systemic risk determination, I am prepared to talk about that confidential information. The firm was rated a 3 in the Campbell scale, which is "not well-managed," and at the holding company level it was rated "deficient," which is also clearly not well-managed.

Chair BROWN. Thank you.

Chair Gruenberg, I heard from many small businesses over that weekend who had money in SVB and were worried about making payroll in Ohio, making payroll as a result of the failure. I heard from Ohio small banks and credit unions who were worried about deposits leaving their institutions. I know that I am not unique. Many of my colleagues from both sides of the aisle heard those same concerns in their State.

Given the unprecedented scale of the bank run, what would have been the impact on small banks and small businesses across the Nation if you and other regulators had not taken action to protect depositors at SVB and Signature Bank?

Mr. GRUENBERG. Senator, that was our central concern. I think the evidence suggested, from the sequential failures of first Silicon Valley and then Signature, that there was a significant risk of contagion to other institutions, and in fact, over that weekend we were seeing serious stress at other institutions. And I think that and the potential knock-on effects of that contagion is really what led the Federal Reserve board and the FDIC board unanimously to recommend to the Treasury Secretary——

Chair BROWN. But you are saying the actions taken were the least bad option for small businesses and banks across the Nation.

If you had not acted that way, you think there would have been a contagion.

Mr. GRUENBERG. I think there would have been a contagion, and I think we would be in a worse situation today with consequences for the actors in our economic system.

Chair BROWN. Meaning regulators, Republicans, and Democrats all across the board there was agreement on those actions.

Mr. GRUENBERG. Yes.

Chair BROWN. Under Secretary Liang, do you agree with that?

Ms. LIANG. Senator Brown, I do agree with that. I think the actions that were taken have been working to stabilize deposits. Had they not been taken, the runs by uninsured depositors from many small and regional-sized banks and mid-sized banks would have intensified and caused serious problems for small banks' liquidity and their ability to support small businesses.

Chair BROWN. Thank you. And if you can answer this really briefly, because I do not want to go over my 5 minutes. Mr. Gruenberg, the FDIC announced the sale of SVB to First Citizens Bank and Trust from Senator Tillis' North Carolina. It was estimated to have cost the deposit insurance fund approximately $20 billion. How is that cost covered?

Mr. GRUENBERG. Oh, that is required by law, and I indicated in my opening statement the FDIC has to impose an assessment on the banking industry to cover the cost of coverage for any uninsured deposits. And I would note that the law provides the FDIC authority in implementing that assessment to consider the types of entities that benefit from any action or assistance provided. And as I also indicated in my statement, we expect to issue a notice of proposed rulemaking for public comment in May, to implement the assessment.

Chair BROWN. Thank you. I would point out in your testimony and your answer there were no tax dollars, nothing funded through the congressional appropriations process.

Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman. What is the future of regional banking?

Mr. GRUENBERG. I think we have a strong set of regional banks in the United States. And as a general matter, their liquidities remained stable through this episode. And I think it was a good indication, frankly, that in the two failed institutions, in both of those cases the strongest bids we received to acquire those failed institutions were from two other regional banks that had the capability and strategic business interest to acquire them.

So there are a lot of cautionary lessons to be learned from this, Senator. I completely agree with that. And we are going to need to carefully review this episode. But as a general proposition, I think the regional banks in the United States remain a source of strength for the system.

Senator SCOTT. I walked in on the Chairman's comments about the actions that were taken the weekend of March 9th and how important it was and the importance of making sure we get credit for doing something that actually, I thought, could have been avoided, frankly. I thought it could have been avoided if we had someone in the private sector make the decision to buy the bank, buy the assets. Had that been done on Friday, March 10th, I think we could have literally eliminated the fiasco that we saw over the weekend.

Were there folks interested in buying Silicon Valley Bank on Friday?

Mr. GRUENBERG. Senator, just to be clear, before the bank failed, on an open institution basis?

Senator SCOTT. After.

Mr. GRUENBERG. Oh, after the failure, on a closed basis.

Senator SCOTT. Yes.

Mr. GRUENBERG. Oh, we had expressions of interest. Remember, this was a very rushed process, if I may say. The bank failed on Friday morning. The other institution failed over the weekend. We had to set up two bridge institutions to manage those failed banks.

To your point, though, we had expressions of interest. We quickly set up a bidding process that we ran on Sunday. We received two bids. One was not valid because it had not been approved by the board of the bank, and the other, after we evaluated it, indicted that it was more expensive than a liquidation of the institution would have been to the FDIC. So, in effect, we did not have an acceptable bid, and it was really a determination that we made to try to set up two bridge institutions to manage for a short period of time these two failed banks, and then to organize a bidding process, an open bidding process, for both institutions, which we ultimately were able to implement successful. And so Signature Bank, previous weekend, two weekends ago, and then to sell SVB this past weekend.

Senator SCOTT. Are you suggesting that the fact that the board had not approved the offer that was on the table was the primary reason why you turned down that offer?

Mr. GRUENBERG. It was one of the bids. As a matter, we are required, for a bank, to make a valid offer to the board of the bank.

Senator SCOTT. Yes, to approve the offer. That was the primary reason why you did not——

Mr. GRUENBERG. For that bid. The other bid did not have that issue, but the other bid was more costly than liquidation would have been.

Senator SCOTT. So you are suggesting that a private sector engagement would have increased the cost, not decreased the cost.

Mr. GRUENBERG. At that point, I think, in part because it takes a bit of time. This was a substantial institution. It takes some time for a bank to do appropriate due diligence, to evaluate the assets and liabilities, and to make an informed bid for the institution. And I think as a practical matter that was difficult to do given the compressed timeframe over that initial weekend. I think that is why we set up the bridge institutions, to try to put in place quickly an orderly bidding process where any interested party could submit a bid, have an opportunity to do due diligence in order to evaluate the institution, and to make an informed bid. I think we were ultimately able to do that for both of these failed institutions.

Senator SCOTT. I will just say, with my remaining time, that I look forward to the second round of questions. But I will say, without question, that if we would have had a better private sector engagement with quicker action from the Feds, I think we could have avoided the concept that rushed us to a decision, which was a concern of contagion, in part. That could have been avoided if we had had a decision made on Friday, if there were private sector folks willing to make a decision. But we will have an opportunity, hopefully, on the second round.

Chair BROWN. Thank you.

Senator Warner, from Virginia.

Senator WARNER. Thank you, Mr. Chairman, and thank you for having this hearing. It is good to see all of you.

A couple of weeks ago, when we were in a Finance Committee hearing, I asked Secretary Yellen, that I thought it was very important that we try to get all the facts out about what happened here. I very much appreciate, Vice Chairman Barr, you taking on this unenviable task of sorting this out, because I had real questions. Was this a regulatory and bank management failure or was it, as some on my side of the aisle have indicated, was it a statutory failure? If it was a statutory failure and an additional test or activity was needed, I am all for putting it in place.

But my operating premise at this point is if this had been not a $200 billion bank but a $5 billion bank that management's mistakes, not having a risk officer, other items, and failure of basic prudential regulation should have caught this. We had two chief regulators, a State regulator that at some point, Mr. Chairman, I hope we would get in front to where were they, and obviously the San Francisco Fed. So I am going to be very interested in making sure we get to the bottom of this.

I think some of the things you have already pointed out, Vice Chair Barr, is that the bank's business, concentrating in one industry, an industry that I used to be part of, but the fact that there was such a high concentration of counterparty risk. My understanding, 10 depositors alone had about $13 billion of deposits. Again, it seems to me interest rate mismanagement is Banking 101, and again, even at a $5 billion bank they should have been called out.

I also think the speed—I have often cited the fact that the largest bank failure we have seen was WAMU back in the crisis. Sixteen billion dollars left that bank over a 10-day period. In this case, $42 billion, the equivalent of 25 cents on every deposit, went out in 6 hours. I am not sure at that point what regulatory structure could have prevented that. And at least from reports it seems to me that—and I say this as somebody who used to be in the VC industry—some of the very VCs who banked for a long time at SVB may have started this run and demanded all of their ancillary companies all go out at once.

So Vice Chairman Barr, can you take us through, with a little more detail, starting Wednesday night through Friday afternoon, how this happened, how we got here, and what you have seen so far?

Mr. BARR. Thank you very much, Senator. I will start where you did, which is this is a textbook case of bank mismanagement. The risks the bank faced, interest rate risk and liquidity risk, those are bread-and-butter banking issues. The firm was quite aware of those issues. They had been told by regulators investors were talking about problems with interest rate and liquidity risk publicly.

And they did not take the action necessary. They were quite vulnerable to risk, to shocks, and they did not take the actions necessary to meet that.

What happened on Wednesday night is they belatedly attempted to improve their liquidity position, and they did it in a way that spooked investors, that spooked depositors, that spooked the market. Nonetheless, on Thursday morning, things appeared calm, according to the bank's report to supervisors, but later Thursday afternoon deposit outflows started, and by Thursday evening, we learned that more than $42 billion, as you had indicated, had rushed out of the bank. That is an extraordinary pace and scale. Federal Reserve bank staff worked with the bank through the afternoon, evening, and overnight, to try and find enough collateral that the Federal Reserve could continue discount window lending against.

On Friday morning it appeared that it might be possible to meet the outflow that was expected the day before, but that morning the bank let us know that they expected the outflow to be vastly larger, based on client requests and what was in the queue. A total of $100 billion was scheduled to go out the door that day. The bank did not have enough collateral to meet that, and therefore they were not able to actually meet their obligations to pay their depositors over the course of that day, and they were shut down.

Chair BROWN. Senator Crapo is recognized, from Idaho.

Senator CRAPO. Thank you very much, Mr. Chairman.

In your testimony, Mr. Barr, you indicated that you were going to be, in one of the aspects of what you are working on you are going to be looking at whether more stringent standards are needed. And I want to follow up on Senator Warner's questions relating to this argument that has been put out there, I think as part of the blame-shifting game, and there is a lot of that going on right now, that it was a statutory failure.

That brings us to the 2018 reforms, Senate bill 2155. And I just want to read to you a couple of sentences out of Senate bill 2155 with regard to the question of whether that legislation prohibited our Federal regulators, and particularly the Fed, from doing anything they needed to do with regard to applying the appropriate strict standards. And to start out with I will read—what Senate bill 2155 did was to stop a one-size-fits-all system and mandate, by changing the word "may" to "shall," mandate that the Federal Reserve tailor its regulations to the risk and so forth. I want to read the language.

It mandates that the Federal Reserve "differentiate as it tailors, differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities, including financial activities of their subsidiaries, size, and any other risk-related factors that the board of Governors deems appropriate."

And then at the conclusion of the statute, that section of the statute, it makes it crystal clear—and this is the statutory language—"Nothing in Subsection A shall be construed to limit the authority of the board of Governors of the Federal Reserve system in prescribing prudential standards under this section, or any other law to tailor or differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities, including financial activities of their subsidiaries, size, and any other risk-related factors that the board of Governors deems appropriate." And I could go on with multiple times that that language was repeated.

My question to you is, was there any statutory restriction faced by the Federal Board of Reserves as it issued its regulations on tailoring that would have prohibited them from applying the strictest standards they could to address the prudential needs of our banking system?

Mr. BARR. Thank you, Senator Crapo. I agree with you there was substantial discretion under that act for the Federal Reserve to put in place tailoring rules that were different from the tailoring rules that it put in place in 2019. I think there is still, to this day, a substantial discretion in changing those by notice and comment rulemaking. That is one of the areas that we will be looking at in our review, whether there should be appropriate changes.

There are some areas, particularly for smaller firms, firms between $50 and $100 billion, where the act is more prescriptive, but for the firms in the category that we are addressing today there is substantial discretion for the Federal Reserve to change those rules in a way that is supportive of safety and soundness and financial stability.

Senator CRAPO. Thank you, and I appreciate your answer. You said recently that the bank failed—referring to SVB—as the public began to focus on changes in values of securities in the bank's held-to-maturity account. That is correct, right?

My question to you there is, did the standards on that risk that are used for supervision, were those changed at all in Senate bill 2155 in 2018?

Mr. BARR. The standards for capital rules are determined by the bank agencies. The bank agencies made a decision for smaller categories of these large banks to not require the pass-through of AOCI into the capital structure. But that was a decision that is available to be altered by the discretion of the bank agencies.

Senator CRAPO. And it was not mandated by 2155.

Mr. BARR. No, it was not mandated by 2155.

Senator CRAPO. Last question is under the current standards that are applied with regard to capital, was SVB adequately capitalized?

Mr. BARR. Yes. Prior to its failure it was categorized under current capital rules as well capitalized.

Senator CRAPO. All right. Thank you very much.

Chair BROWN. Thank you, Senator Crapo.

Senator Cortez Masto, from Nevada, is recognized.

Senator CORTEZ MASTO. Thank you, Mr. Chair. Thank you, all three of you, for being here.

Vice Chairman Barr, let me start with you. You have talked about how the Federal Reserve is undergoing an investigation to determine whether the Federal Reserve actually failed in this instance. Is the Federal Reserve the appropriate body to conduct this investigation or should we have an independent investigation?

Mr. BARR. Thank you, Senator. It is a terrific question. We describe what we are doing as a review. We are reviewing our own practices. I think it is an important part of risk management to do self-assessment. I think it would be irresponsible and imprudent of us not to do self-assessment. We are going to take that very seriously. We are going to be thorough, we are going to be transparent, and we are going to be far-reaching in that self-assessment.

I also think it is appropriate for outsiders to have independent reviews, and we expect and welcome independent reviews of our actions.

Senator CORTEZ MASTO. And if you uncover, in your investigation, that the Federal Reserve failed here in some of its supervisory roles, will you make that public?

Mr. BARR. Yes. We intend to make our report fully public on May 1st, and that will report will include—normally it is not our practice to include, but that report will include confidential supervisory information such as the exam reports.

Senator CORTEZ MASTO. And in the scope of your review you identify the scope of that review in your written testimony. Is there anything in addition that is not in your written testimony that you will be reviewing here, in that scope?

Mr. BARR. Thank you, Senator. I have asked the staff to be far-reaching. So if they determine that an issue should be in scope, they have full discretion to put that issue in scope and to address it in the review. So there are no limitations on their ability to review how the Federal Reserve conducted its supervision and the regulatory oversight of the firm.

Senator CORTEZ MASTO. Thank you. And then one final thing because there has been a lot of discussion about the previous rollback of some of the regulation in votes in this body just recently. If you find that that change in the law impacted the Federal Reserve's ability to conduct the appropriate test, based on the tiering of the bank's assets, would you be forthcoming with that and say so?

Mr. BARR. Yes. We intend to describe where we think supervisory and regulatory failings occurred. If changing those to make them what we think is the right standard would require an act of Congress, we will say so in that review.

Senator CORTEZ MASTO. And then Chairman Gruenberg, the same to you. You are conducting a scope of the FDIC. Are you comfortable that you can conduct that and be transparent and accountable, or should there be an independent body looking at this?

Mr. GRUENBERG. I think there is room for both. As Michael indicated, I think it is important for each of our agencies to look internally at our supervision of these institutions and draw lessons from it. In our case, we have asked our Chief Risk Officer, who is not directly involved in the supervision process and whose role is to evaluate risk at the FDIC, to undertake this internal review of our supervision of Signature Bank.

Senator CORTEZ MASTO. Thank you. And then there has been a lot of talk in the media about the executive salaries, about the executive bonuses, about the sale of stock. Let me ask the three of you. My first question is what authority do you have to claw back any of those bonuses or the executive pay, or even deal with the sale of the stock? And maybe, Mr. Gruenberg, let us start with you.

Mr. GRUENBERG. Thank you, Senator. You know, as I indicated in my opening statement, the FDIC, for every failed institution, is required to undertake an investigation of the conduct of the members of the board, the management of the institution, as well as professional service providers and other institution-affiliated parties. We have already begun that investigation, and we have significant authority under the law, depending on the findings of the investigation, to impose civil money penalties, restitution, and as well, bar individuals from the business of banking.

So the authorities are substantial and we are going to pursue this as expeditiously as we can. We do not have, under the Federal Deposit Insurance Act, explicit authority for claw back of compensation. We can get to some of that with our other authorities. We have that specific authority under Title II of the Dodd-Frank Act. If you are looking for an additional authority, specific authority under the FDI Act for clawbacks, probably would have some value here.

Senator CORTEZ MASTO. Thank you. Mr. Barr.

Mr. BARR. Thank you. The board does have authority to pursue actions against individuals who engaged in violations of the law, who engage in unsafe or unsound practices, who have engaged in breaches of fiduciary duty. We retain this authority even after a bank fails. And we stand ready to use this authority to the fullest extent, based on the facts and circumstances. And as with Chair Gruenberg, potential consequences include a prohibition from banking, civil money penalties, or the payment of restitution. We intend to use these authorities to the fullest extent we are able.

Senator CORTEZ MASTO. Thank you. Ms. Liang. And I know, with the Chairman's indulgence.

Chair BROWN. Briefly, Ms. Liang.

Ms. LIANG. Yes. I defer to the FDIC and the Federal Reserve on this.

Senator CORTEZ MASTO. Thank you. Thank you, Mr. Chairman.

Chair BROWN. That was brief. Thank you, Under Secretary.

Senator Rounds, of South Dakota, is recognized.

Senator ROUNDS. Thank you, Mr. Chairman. First of all, thank you to all of you for appearing before our Committee today.

Vice Chair Barr, in your testimony you said that in November the Fed supervisors delivered a supervisory finding on interest rate risk management to Silicon Valley Bank. As you know, the communication of supervisory findings must be focused on significant matters that require attention. Matters Requiring Immediate Attention, or MRIAs, are matters of significant importance that the Fed believes need to be resolved right away, including matters that have the potential to pose significant risk to the safety and soundness of the banking organization.

My question, Vice Chair Barr, was managing interest rate risk listed in the MRIA section of the supervisory finding issued to SVB, and if it was not, why not?

Mr. BARR. Senator, we are still reconstructing the supervisory record. We have just started the review. But my understanding is that they were issued a Matter Requiring Immediate Attention based on the inaccuracy of their interest rate risk modeling. Essentially, the risk model was not at all aligned with reality.

Senator ROUNDS. Pretty interesting statement, if it was not aligned with reality.

I recognize that you are going to have a complete report, and I am not going to try to push you too far into this. But I am really curious. What is the timeframe that is expected for a response for an MRIA, one that requires immediate attention?

Mr. BARR. Senator, there is not a fixed amount of time. It depends on the issue, the scope of the issue, the complexity of resolving the issue. So I do not have a way of giving you a firm baseline on the action, but they are expected to be a top priority for management to address. And particularly in the interest rate environment that we are in, and knowing that the firm had been cited previously for other problems with liquidity risk management and interest rate risk management, supervisors would expect that that would take a high priority attention by top management.

The supervisors met with the CFO of the firm in the fall, in October of 2021, to convey the seriousness of the findings directly.

Senator ROUNDS. During this time period, perhaps for as much as 6 months during that previous year, the bank was without a risk management officer. Is that correct?

Mr. BARR. That is my understanding. I think it is terrible risk management, obviously, not to have a CRO at the firm. You need an effective CRO as part of risk management in the firm. And as I indicated previously, the supervisors had told the firm in the summer that they had deficiencies in governance and controls and the management level and at the board level, and that was related to their failure to appropriately manage risk.

Senator ROUNDS. My understanding is that there was a period of time there in which they were without a CFO as well. Is that correct?

Mr. BARR. I do not have the details of that but I am happy to get back to you.

Senator ROUNDS. OK. And I recognize that there is a difference between a matter requiring immediate attention and a matter requiring attention. Can you kind of share with us the difference? I mean, there clearly is a defined difference between a matter of such importance that it requires immediate attention versus one where it requires attention. Can you talk a little bit about what the expectations are between the two?

Mr. BARR. They both really signal that bank management should pay attention to what is in front of them. They are not issued lightly. A matter requiring immediate attention is, as its name suggested, telling managers that they should place a priority on fixing this issue over other issues. But the exercise of the line between the two is a matter of supervisory judgment.

Senator ROUNDS. Just to follow up a little bit, recognizing once again that we will get a full report in the next couple of weeks, but it seems to me that when it turns into an MRIA there is an expectation that the board, or the executive officers, would respond fairly quickly. To your knowledge at this point was that expectation met?

Mr. BARR. Well, I think the fundamental fact is, you know, the firm failed because of its interest rate risk and its liquidity risk, and that is, I think, evidence of the fact that they did not respond strongly enough and promptly enough.

Senator ROUNDS. In other words, with the information that you had and that the regulators had, they were able to determine that there was a problem at the bank, and they directed that there be a response immediately, an immediate response, based upon the data that they were able to gather at that time. That is a reasonable assumption, is it not?

Mr. BARR. I do not know what the timeframe set out in each of the individual orders were, so I am not able to answer your question with precision, and I want to be very careful to be able to do that——

Senator ROUNDS. That is fair.

Mr. BARR. ——and not go beyond the record.

Senator ROUNDS. But we will receive that information when the full report comes out.

Mr. BARR. Yes. On May 1st we will release the full report, and it will include the reports of examination, so people will be able to see what is in the record.

Senator ROUNDS. Very good. Thank you. Thank you, Mr. Chairman.

Chair BROWN. Thank you, Senator Rounds.

Senator Menendez, of New Jersey, is recognized.

Senator MENENDEZ. Thank you, Mr. Chairman.

In 2018, Congress passed a bill which was signed into law by President Trump, that relaxed regulation for institutions like Silicon Valley Bank. That law, which I opposed, exempted those banks from enhanced prudential standards stress tests, raised the threshold at which a bank would be considered systemically important. But even as that law kept Silicon Valley Bank off the list of systemically important institutions, the Fed and the FDIC rightly cited systemic risk to justify their actions to prevent runs on other banks.

So Mr. Barr and Mr. Gruenberg, each of you voted to invoke what is known as the, quote, "systemic risk exception." With a simple yes or no, can you tell me that the situation at Silicon Valley Bank posed systemic risk?

Mr. BARR. Thank you, Senator. I think it is an absolutely crucial question. The invocation of systemic risk exception required judgment as well as incoming data, and our best assessment, the assessment of a unanimous Federal Reserve board, and a unanimous board of the FDIC and the Treasury Secretary was that we were seeing signs of contagion in the banking system that threatened to put at risk depositors and banks across the country. And to make sure that banks could continue to lend in their communities, to make sure that depositors were safe, to make sure that businesses could pay payroll, we thought it was important to invoke that systemic risk determination——

Senator MENENDEZ. Because you felt that Silicon Valley Bank was a systemic risk at that point in time?

Mr. BARR. The judgment was really broadly about the risk that the failures of these institutions and other stresses in the system were posing as a whole, as opposed to a particularly decision only about——

Senator MENENDEZ. But that sounds like a distinction without a difference. If any single bank's failure can cause contagion that threatens the system, then it seems that the bank should be considered systemically important. And so you all need to have an obligation to be clear with us, and with the American people, when you took extraordinary steps to protect uninsured depositors that could very well lead to increased fees charged to banks and ultimately to consumers.

So I think we need to be clear about what is a systemic risk. And so I am looking for a more crystallized version of that. I was here in 2008. I do not want to live through it again.

Do you agree with President Biden's statement 2 weeks ago that Congress should strengthen rules for banks to make it less likely that we will see another failure similar to that of Silicon Valley Bank?

Mr. BARR. Thank you, Senator. I think it is important for us to strengthen capital and liquidity rules. We are working on strengthening them as part of our Basel III reforms and our holistic review of capital, and I think we need to move forward with that. And as both Chair Gruenberg and I suggested, with a long-term debt requirement that would provide an additional cushion in addition to capital for large institutions. That work will need to go through notice and comment rulemaking, there will be transition periods for it, but I think that is really important work for us to do, and I am committed to doing it.

Senator MENENDEZ. Well let me ask you, Mr. Barr. This morning I, along with Senator Rounds and other Members of this Committee, sent a letter to Chairman Powell asking him to explain whether the Fed applied enhanced supervision or prudential standards to Silicon Valley Bank or any similar-sized bank using the Fed's existing authority.

We have also learned from public reporting that Fed supervisors began flagging problems at the SVB as far back as 2021. Now I understand we have a lot more to learn about the facts of what transpired, both with the bank with any management failures, but I expect that we are going to see that all factored in as part of a review.

So as you begin that review, let me ask you, do you agree with Chairman Powell's statement last week that from what we know it is, quote, "clear that we do need to strengthen supervision and regulation"?

Mr. BARR. Yes, I absolutely agree with that.

Senator MENENDEZ. Thank you for that.

Now last, I would love to know, Mr. Gruenberg, about, as we think about should we raise the Federal deposit insurance, what percentage of account holders does that account for, how much is private versus business, and what are the costs that are associated with it. So I will just put that out there for you to submit an answer to the record, because it will take more time than what I have.

But the last point I want to make is, we have seen a flight from regional and community banks to, quote/unquote, "too-big-to-fail" banks. And a concentration of deposits at a select few institutions also brings about its own risks to the financial system. At the end of the day, it seems that we are incentivizing entities to go to too-big-to-fail banks. It only makes it even more consequential in terms of too big to fail. Is that what we want to ultimately achieve in this process?

Mr. BARR. Senator, I think that the goal of the actions that we took are to make sure that we have a thriving and diverse system of banking in the United States, including community banks and regional banks that are the lifeblood of many communities all across the country.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chair BROWN. Thank you, Senator Menendez.

Senator Kennedy, of Louisiana, is recognized.

Senator KENNEDY. Thank you, Mr. Chairman. Thank you all for being here today.

Chairman Barr, the Federal Reserve stress-tested 34 banks in 2022. Is that correct?

Mr. BARR. Senator, I do not have the exact number in front of me, but that sounds correct.

Senator KENNEDY. Well, I have your report. It says 34. And the cutoff was $100 billion. Is that right?

Mr. BARR. Yes.

Senator KENNEDY. OK. You did not stress-test Silicon Valley Bank, did you?

Mr. BARR. No. Under the Federal Reserve board's rules that were put in place for transition into the stress testing, it takes a while for a firm to be considered above the threshold. They need to have a rolling four-quarter average——

Senator KENNEDY. Did you stress test Silicon Valley Bank in 2022?

Mr. BARR. No.

Senator KENNEDY. OK. Silicon Valley Bank had $100 billion, more than $100 billion in assets at the end of 2021, did it not?

Mr. BARR. Senator, as I was explaining, the transition rules in place at the time require a rolling four-quarter average to be above that amount——

Senator KENNEDY. OK.

Mr. BARR. ——and then if the firm happens to be in a year that is not the year that, since it is an every-other-year test, that a test is running, then it waits until the next year. So for Silicon Valley Bank that would have meant 2024 would be its first stress test.

Senator KENNEDY. But the point is you did not test Silicon Valley Bank.

Mr. BARR. We did not apply a stress test to Silicon Valley Bank. It was, of course, using its own stress test——

Senator KENNEDY. Did you have the authority to do it?

Mr. BARR. Under our existing regulations, no. We would have to change our regulations to have that authority.

Senator KENNEDY. Under the Congress' amendment to Dodd-Frank—Senator Crapo talked about it, 2155, Section 252.3—is it not a fact that we gave the Federal Reserve the authority to stress test Silicon Valley Bank?

Mr. BARR. Under that legislation the Federal Reserve could have put in place a rule defining the word "periodic"——

Senator KENNEDY. But you did not.

Mr. BARR. ——in a different way than was done.

Senator KENNEDY. Right. But did not, did you?

Mr. BARR. The Federal Reserve did not do that.

Senator KENNEDY. OK. If you had stress tested—well, let me put it this way. If you had stress tested Silicon Valley Bank in 2022, it would not have made any difference, would it?

Mr. BARR. I do not know the answer to that question.

Senator KENNEDY. Well, you did not test for Silicon Valley Bank's problem. I have read your report. You stress-tested these 34 banks for falling GDP, spike in unemployment, and defaults on commercial real estate. Is that not correct?

Mr. BARR. Yes. In a typical adverse scenario for banks, we are testing falling interest rates——

Senator KENNEDY. But that was not our problem in 2022.

Mr. BARR. I completely agree with you.

Senator KENNEDY. That is not our problem today. The problem is inflation-high interest rate and loss value in Government bonds, is it not?

Mr. BARR. I completely agree with you.

Senator KENNEDY. So you stress-tested in 2022 for the wrong thing.

Mr. BARR. The stress test is not the primary way that the Federal Reserve or other regulators test for interest rate risk.

Senator KENNEDY. But you stress-tested for the wrong thing.

Mr. BARR. As I said, Senator, I agree with you that it would be useful to test for hiring rising interest rates. That is why, in our alternative scenario, multiple scenario that we put in place for this year's stress test, we do that. These decisions were made before I arrived, but I agree with you that it would be better to do that.

Senator KENNEDY. But it is like somebody going in for a test for COVID and getting a test for cholera, is it not?

Mr. BARR. I do not know enough about either of those tests to know.

Senator KENNEDY. Yeah. Well, they are different.

So all this business about, well, the amendment to Dodd-Frank kept them from stress-testing. The way I see it, you chose not to stress-test, and if you had stress-tested Silicon Valley Bank you would not have caught the problem.

Mr. BARR. As I said, Senator, I agree with you that the statute requires periodic stress-testing. The Federal Reserve made a decision about how to implement that in 2019.

Senator KENNEDY. Right.

Mr. BARR. That resulted in SVB not being tested until, plan to be tested until 2024. But as I said, the stress test requirements——

Senator KENNEDY. You knew from the—I am sorry to cut you off but the Chairman is going to cut me off in a second—but you knew, the Federal Reserve knew well in advance that Silicon Valley Bank had a problem with holding too much of its money in interest rate sensitive long Government bonds, did it not?

Mr. BARR. I think the investing public and the Federal Reserve which cited it for interest rate risk problems knew that it had interest rate risk. But nobody anticipated the bank——

Senator KENNEDY. But the Federal Reserve did not do anything about it, did it?

Mr. BARR. I am sorry. I could not hear you.

Senator KENNEDY. The Federal Reserve did not do anything about it, did it?

Mr. BARR. I disagree with that, Senator, respectfully. The Federal Reserve did cite these problems to the bank and required them to take action. Bank management failed to act on those.

Senator KENNEDY. You did not follow up, did you?

Chair BROWN. The Senator's time has expired. I sit here and watch Mr. Barr reluctant to criticize some of the moves of his predecessors at the Federal Reserve. I will leave it at that.

Senator Smith, from Minnesota, is recognized.

Senator SMITH. Thank you, Mr. Chair, and thanks to our folks for being here today. I really very much appreciate it.

So I want to just start by reiterating what I know some of my colleagues have said, which was that as these two banks collapsed I heard you say very clearly, Vice Chair Barr, the Silicon Valley Bank in particular collapsed because of what looks like gross mismanagement, and failure to manage even the most basic of risks, liquidity and interest rate risks.

The Biden administration and regulators took strong and decisive action to protect people and to keep our banking system safe and secure. And the reality is that that action that you took was necessary, but it was also extraordinary. Extraordinary actions were called for in the moment. And you, of course, do not want to have to use extraordinary actions. You want to be able to rely on banks to make good decisions and to protect their shareholders and to protect their depositors.

But let me just clarify one thing before I want to follow up a little bit on Senator Kennedy's questions. The Fed, under the previous Vice Chair of Supervision, put into place rules that I think there is a question about whether those rules—I mean, I think even in the moment you were critical of those rules. Is that right?

Mr. BARR. Yes, that is correct.

Senator SMITH. And so your review will take a look at what would have happened if those rules had not been in place, and then you can make decisions about what new rules need to be in place to protect from this kind of extraordinary situation that we saw with these two banks. Is that correct?

Mr. BARR. Yes, that his correct, Senator.

Senator SMITH. So I think that is just important for us all to understand here, as we think about what has happened.

The Silicon Valley Bank's failure was the result, it appears, of management failures at many levels, all coming together at the worst possible time, and I am particularly struck by the bank's failure to manage interest rate risk—you and I talked about this last week—which is basic bank management. It is not rocket science to manage interest rate risks.

And, you know, interest rates were near zero for more than a decade, and a lot of business models, it appears, including Silicon Valley Bank's business model, was predicated on basically free money. And that obviously presents risk when that changes.

So I am concerned, Vice Chair Barr, about other institutions, banks and nonbanks alike, how they are managing what must be similar interest rate risks. Could you just address that, and talk about how the Fed right now, and others, are monitoring that interest rate risk and what that tells you about what we need to do differently.

Mr. BARR. Thank you, Senator. Let me just start with a basic point which the banking system is sound and resilient. Most banks are highly effective in managing interest rate risk and liquidity risk. It is the bread-and-butter kind of work of bank management.

So we are monitoring the financial system, monitoring the banking system. We are looking at interest rate risk and liquidity risk across the banking system to assess that, where banks need to do better at interest rate risk and liquidity risk management, reporting that out. But I think the fundamental point is the banking system is sound and resilient.

Senator SMITH. I might have mentioned to you when we spoke that I had a chance to meet with a group of Minnesota bankers, including Minnesota has more community bankers, I think, per capita than any State in the country. And they were eager to point out to me that their business models are very different from the business models of highly risky enterprises like Silicon Valley Bank. So I appreciate you raising that. In fact, I have been getting texts from some of my bankers today, watching this hearing, and wanting to point out that difference.

Mr. Barr, can you talk about the risks of interest rates, sort of this interest rate risk as it might affect nonbanking institutions as, for example, mortgage loan companies?

Mr. BARR. Thank you. First let me just say, as you indicated, I hear from community bankers as well, and I know many other Senators have in your home States, the vibrancy and the health of that community banking sector, and we see that too.

We are obviously looking at interest rate risk as it affects not only banks but also the nonbank sector. We look at, of course, nonbank mortgage servicers. We look at hedge funds. We are looking broadly across the financial landscape to see where those risks might arise and how those might propagate in other ways into the bank system. So we are highly attuned to that.

But again, I think the basic point is that the banking system is sound and resilient, depositors are safe, and we have, through our actions, demonstrated that.

Senator SMITH. Thank you very much. Thank you, Mr. Chairman.

Chair BROWN. Thank you, Senator Smith.

Senator Lummis, of Wyoming, is recognized.

Senator LUMMIS. Thank you, Mr. Chairman, and thank you panel. I want to follow up a little bit on Senator Kennedy's line of questioning. As I read Statute 5365, Section C, Risks to Financial Stability, Safety, and Soundness, "The board of Governors may order or rule"—excuse me—"the board of Governors may, by order or rule promulgated pursuant to Section 553, apply any prudential standard established under this section to any bank holding company with consolidated assets equal to or greater than $100 billion." So that was Silicon Valley Bank.

Then you have got Statute 2155, that when it was changed from "may" to "shall" made mandatory a new duty on the Federal Reserve to take into account higher-risk profiles presented by certain banks, and to strengthen supervision of those banks.

So you look at Silicon Valley Bank. They had a number of activities with above average risk profiles—the concentration of deposits, the quantity of uninsured deposits, 94 percent uninsured deposits. Then you look at Federal Reserve authority under Regulation YY, to impose additional risk-based or leverage capital or liquidity requirements or other requirements the board deems necessary to carry out the purposes of Dodd-Frank.

I look at all this and I think that among all these statutes and regulations the Fed had plenty of authority to prevent Silicon Valley Bank and the problems it encountered, and was aware pretty early on that there were unique problems there and that it was a very, very unique financial institution because of its risk profile, but did not do it.

As I look at what authority you have been given, I cannot think of another additional rule or regulation or law that you needed. Tell me whether you agree with that or not.

Mr. BARR. Senator, I agree that the Federal Reserve has substantial discretion to alter, through notice and comment rulemaking, the rules that were put in place in 2019 with respect to firms over $100 billion. There are some areas that the statute would provide some limitation to, but there is substantial discretion for the Federal Reserve to change its rules for firms in the $100 to $250 billion range.

Senator LUMMIS. Change its rules. What would it have to do?

Mr. BARR. We would have to go through a notice and comment rulemaking process.

Senator LUMMIS. Oh, I do not mean the procedure for changing a rule. I mean, what changes would you make to the rule?

Mr. BARR. Senator, we have not made a definitive conclusion on that. We are undertaking this review of SVB's failure in order to better assess whether it would be appropriate to change capital rules and liquidity rules of this size firm, for firms more generally. We are looking at that right now.

Senator LUMMIS. Is fractional reserve banking overly risky in this age of online banking?

Mr. BARR. Senator, let me just repeat what I said before, which is that overall the safety and soundness of the banking system is strong. Banks are safe and sound. Depositors should feel assured that their deposits are safe.

Senator LUMMIS. Well, here is the problem, though. As I see it, the way that these banks have been managed, Wyoming's community banks may end up paying for this through higher assessments from the FDIC. Am I correct, Mr. Gruenberg?

Mr. GRUENBERG. As I indicated, Senator, in regard to these two institutions any cost of the deposit insurance fund from covering uninsured deposits is required by law to be recovered through an assessment on the banking industry.

Senator LUMMIS. Exactly.

Mr. GRUENBERG. If I could make one additional point. The law does give the FDIC authority in implementing that assessment to consider the types of entities that benefit from any action taken or assistance provided.

Senator LUMMIS. So are you saying that you are able to exempt Wyoming's community banks from paying for this?

Mr. GRUENBERG. I am suggesting we have some discretion there and we are going to consider that carefully.

Senator LUMMIS. Will you exempt community banks from having to pay for this?

Mr. GRUENBERG. That is a judgment our board is going to have to make, and as I indicated, we anticipate going out for notice and comment public rulemaking in May to implement the assessment. And as I indicated, we have discretion here——

Senator LUMMIS. Do you have to go through APA rulemaking to assess?

Mr. GRUENBERG. That is the law. That is a legal requirement.

Senator LUMMIS. Thank you, Mr. Chairman.

Chair BROWN. Thank you, Senator Lummis.

Senator Warren, of Massachusetts, is recognized.

Senator WARREN. Thank you, Mr. Chairman.

So we just experienced the second- and third-largest bank failures in American history. Executives at SVB and Signature took wild risks and must be held accountable for exploding their banks. And I will soon introduce a bipartisan bill to do exactly that. But let us be clear. These collapses also represent a massive failure in supervision over our Nation's banks.

So coming out of the 2008 crisis, Congress put tough banking rules in place. Now big banks hated them, and their CEOs lobbied hard to weaken those rules. Ultimately, Congress signed off and then it got bad, really bad. Regulators burned down dozens of safeguards that were meant to stop banks from making risky bets.

The three of you here today represent the U.S. Treasury, and two of our top banking regulators. I would like to know if you believe that we need to strengthen our banking rules going forward to ensure the safety of our financial system.

Vice Chair Barr, let me start with you. Do you believe we should strengthen our financial rules going forward?

Mr. BARR. Yes, I do, Senator.

Senator WARREN. Thank you. President Biden agrees with you as well. Two weeks ago he stated that we must, quote, "strengthen the rules for banks to make it less likely that this kind of bank failure would happen again."

Chairman Gruenberg, what about you? Do you agree with President Biden that we need to strengthen our banking rules?

Mr. GRUENBERG. I do agree, Senator.

Senator WARREN. Good. And now Under Secretary Liang, do you agree with the President on this?

Ms. LIANG. Senator, I agree that we do need to prevent these types of bank failures. And——

Senator WARREN. Well, I am asking you—of course we need to prevent them. But that is not by simply wishing it. It is by stronger regulation. Is that right?

Ms. LIANG. I agree, Senator.

Senator WARREN. OK. Good. Now we need better laws here in Congress but let us also talk about how we can strengthen the rules today even before Congress acts. Under current law, the Federal Reserve has the discretion to apply stronger prudential standards on banks with assets between $100 billion and $250 billion, exactly the size of Silicon Valley Bank. That authority is not being used right now.

Vice Chair Barr, as you use your authority to strengthen rules for the largest banks in this country will you be reaching banks with assets of at least $100 billion?

Mr. BARR. Senator, we, of course, would need to go through a notice and comment rulemaking——

Senator WARREN. I understand.

Mr. BARR. ——in this process. But I anticipate the need to strengthen capital and liquidity standards for firms over $100 billion.

Senator WARREN. OK. So this is the area we are looking at. We are going to push down further in terms of the greater scrutiny.

Chairman Gruenberg, let me turn to you. Once the Fed began torching rule after rule in 2018 for big banks, the FDIC, under your predecessor, joined in on the fun and also started weakening FDIC rules across the board—capital and liquidity requirements, stress tests, you name it. In fact, your predecessor explicitly told these banks that if FDIC bank examiners were asking too many questions that they should, quote, "let us know," end quote. Now there is a banking regulator who makes it clear that she is there to serve the big banks instead of the American public.

Chairman Gruenberg, will you commit to using your authority to undo the rollbacks that your predecessor initiated and to strengthen the rules and supervision for banks with greater than $100 billion in assets?

Mr. GRUENBERG. Senator, as I think you know I was a member of the board at that time——

Senator WARREN. I do.

Mr. GRUENBERG. ——and voted against those measures. And I certainly think it is appropriate for us to go back and review those actions in light of the recent episode and consider what changes should be made.

Senator WARREN. Well, I have to say review sounds a little wishy here. You did not think they were good rules to begin with.

Mr. GRUENBERG. My views have not changed, Senator.

Senator WARREN. All right. So you still think they were a bad idea?

Mr. GRUENBERG. I do.

Senator WARREN. Got it.

You know, each of you at this table has authority that you could exercise right now to strengthen rules for big banks and to ensure that our banking system and our economy are safer. I urge you to use that authority and I urge my colleagues here in Congress to do our part to protect American families and small businesses from yet another banking crisis.

Thank you. Thank you, Mr. Chairman.

Chair BROWN. Thank you, Senator Warren.

Senator Hagerty, from Tennessee, is recognized.

Senator HAGERTY. Thank you, Mr. Chairman. If you would allow me just a moment to speak to the tragedy that occurred at the Covenant School in Nashville, Tennessee, yesterday. A depraved person, a sick person executed a tragic act and it yielded a terrible result. And my entire community is mourning. We are mourning for the families, for the victims, for everybody concerned.

I also want to acknowledge the bravery of the Nashville Police Department. They stepped into harm's way and within 14 minutes brought the situation under control. Tremendous bravery at a time when it is called for, and I want to acknowledge their sacrifices.

Now let us turn to the matter at hand, and I know that politics in Washington always seizes upon any crisis as an opportunity to achieve whatever regulatory or legislative opportunity or goal that may be in front of them. But I would like to talk about managerial execution here. Specifically, I would like to start with you, Chairman Gruenberg. I would like to talk through a series of events that followed SVB's failure 2 weeks ago.

As you know Silicon Valley Bank was taken into receivership on a Friday morning. That gave the FDIC 3 days to find a buyer before markets opened on Sunday night. You had tremendous resources at your disposal, 18 years on the FDIC board yourself, detailed resolution plans, over 5,000 employees, and interest from a number of banks to bid, including at least one formal offer as I understand it.

Instead of successfully executing this process, however, the FDIC used the systemic risk exemption to guarantee all deposits at SVB, creating tremendous uncertainty across our economy. And now, 2 weeks later, the FDIC has announced the sale of less than half the failed bank's assets at a loss of $16.5 billion.

So my first question, in the joint statement released on March 12th you said, quote, "No losses associated with the resolution of Silicon Valley Bank will be borne by the taxpayer." Is that still your position?

Mr. GRUENBERG. Senator, yes. As you know——

Senator HAGERTY. Well, the problem is, with two partial sales completed and over $22 billion in losses already accrued, that position just does not square with reality. These losses are borne by the Deposit Insurance Fund. That fund is going to be replenished by banks across the Nation that had nothing to do with the mismanagement at Silicon Valley Bank or the failure of supervision here. In fact, that is going to be addressed by a special assessment to those banks. And as we all know, these banks will have to pass these costs along. Last time I checked, those costs get passed along to the consumer. Those consumers are American taxpayers.

Chairman Gruenberg, invoking the systemic risk exemption is a last resort emergency option to the typical methods of resolution, and it begs the question of why you had to invoke that extraordinary exception. Just this past Sunday's announcement of a new purchaser of part of SVB, not only were serious losses incurred but the FDIC entered into a loss-sharing agreement with the acquiring bank and a $70 billion line of credit was extended to the purchaser. That is a pretty sweet deal. This makes me wonder what prevented the FDIC from coming to a deal like this 2 weeks prior.

You told Ranking Member Scott that you received bids for SVB over the weekend following its collapse, but that they were insufficient. What was your counteroffer, and did you engage with the board of the bank that did not approve this to get them to step up and approve it?

Mr. GRUENBERG. We received one offer that was, frankly, more expensive than the cost of liquidation. It did not appear to be a viable offer at that moment.

Senator HAGERTY. Was there a counteroffer to that?

Mr. GRUENBERG. I would have to check with our staff in terms of how much of a back-and-forth occurred.

Senator HAGERTY. Let us talk about the bidding process itself. Were certain banks dissuaded by you or anyone else associated with this from bidding on SVB, either before or after the bank was taken into receivership?

Mr. GRUENBERG. No, Senator.

Senator HAGERTY. Throughout the course of that weekend I was inundated with phone calls, telling me that legitimate bidders were being waved off of the process. It is one thing to reject a bid if it is bad, but if ideology had anything to do with this, this entire Committee is going to be deeply concerned about that.

I look forward to the GAO's report on this because the result of this failure places the banking sector in a state of disarray that we have never seen before. In spite of all the preparation and tools at your disposal, the FDIC failed to do its job. There was obviously enough demand to orchestrate a sale. What it looks like to the American people is that you simply did not feel the incentive to execute and leaned on the systemic risk exemption to buy time, and in doing so have placed the entire U.S. banking sector into uncharted waters. I do not see any apparent improvement in outcome, and this is a disgrace. I look forward to the GAO review, and I hope that we get to the bottom of this.

Vice Chair Barr, very quickly I would like to come to you. In response to the 2008 financial crisis, the size and scope of the regulatory regime was dramatically expanded by Congress. Regulators like yourselves were given powers, not to mention hundreds of academics at your disposal, with the sole job of monitoring and addressing risk to the financial system. All of this was in hopes of identifying and preventing bank failures that pose systemic risk.

And in spite of all these tools, we find ourselves in a situation today that is unprecedented. It is pretty clear that Silicon Valley Bank was woefully mismanaged. Their management team, which did not have a Chief Risk Officer for 8 months last year, yet created and maintained a Chief Diversity, Equity, and Inclusion Officer, allowed their bank to accumulate truly shocking levels of risk.

And while this was occurring, the San Francisco Fed was focused on researching left-wing policies that they had absolutely no expertise in, ignoring one of the most basic risks in banking—interest rate risks. Perhaps most damning of all, until the day of their failure SVB's CEO sat on the board of the San Francisco Fed.

So Mr. Barr, in your review of what went wrong in your supervision, will you consider the level of managerial distraction that was evident at the San Francisco Fed?

Mr. BARR. Senator, the staff have free rein to examine any issue that might have addressed supervision. I think the core issues are the ones I suggested at the outset, and they are really basic—interest rate risk mismanagement by the bank, liquidity risk mismanagement by the bank. The examiners at the San Francisco Federal Reserve Bank called those issues out to the board, called them out to the bank, and those actions were not acted upon in a timely way. So, in a way, the issue is pretty straightforward.

Senator HAGERTY. I hope you will dig into the urgency, the sense of urgency that was brought to bear on this, and the sense of pressure, and if every tool at their disposal was used, because they certainly were doing other things well beyond their remit.

Thank you. Thank you, Mr. Chairman.

Senator TESTER [presiding]. Absolutely. Thank you for your questions. I am going to ask the questions now, if I might.

In 2008, I voted against the bailouts of the big banks because I do not support taxpayer bailouts. We do need to protect American consumers and small business folks. We need to hold bank executives accountable when they screw up. And if the regulators were asleep at the wheel we need to hold them accountable.

Look, a correlation I would say is when I run my farm if I look at the price of diesel fuel and seed, and that his all I look at, I do not get the whole picture. And quite frankly, I will not be in business long. If regulators are only looking at capital, that is not everything that is going on.

At Silicon Bank they had a concentration in a highly volatile industry, they had grown rapidly, they had mostly uninsured deposits, their investments were poorly timed with interest rate increases that were clearly forecasted—all setting the conditions for a classic bank run, one that happened quickly due to new technologies that are out there.

So Vice Chair Barr, from 2020 to 2022, the Silicon Valley Bank grew from $71 billion to more than $200 billion. This was a very rapid growth. It was heavily concentrated with techs and startups, industries that have always been volatile. Then the bank took those mostly uninsured deposits and invested them in long-term U.S. Treasuries, when the Fed had been clearly forecasting that rates were going to go up, which the bank executives should have known because their CEO was a director at the San Francisco Fed. And for 2 years it seems that Federal regulators were flagging concerns about this situation.

Is that a fair statement, that for 2 years the Fed was flagging concerns about this bank's financial viability?

Mr. BARR. Senator, the examiners were focused on interest rate risk and liquidity risk at the beginning of November 2021, at least as far as I know from the supervisory record thus far. I have not seen something that said that the supervisors were focused on whether the firm was viable, but our review is underway.

Senator TESTER. But does that not impact the viability?

Mr. BARR. Yes, Senator. A core safety and soundness risk, liquidity risk and interest rate risk are core risks that the bank mismanaged.

Senator TESTER. So were the regulators physically in the bank? I have talked to a lot of intermediate-sized banks. They tell me that the regulators are right there 5 days a week, 7 days a week if they are open 7 days a week. Were the regulators in that bank?

Mr. BARR. Physically speaking——

Senator TESTER. Yes.

Mr. BARR. ——I actually do not know. Part of the supervisory period is during the pandemic when activities were happening——

Senator TESTER. I have got you.

Mr. BARR. ——in part remote.

Senator TESTER. OK.

Mr. BARR. So I do not have yet——

Senator TESTER. But I just want to point out the fact that the pandemic has been over for a bit, for quite a bit, and the opportunity for those regulators to be in there would have been long before a month ago.

Mr. BARR. Yes, Senator. I do not have the full supervisory record. We have just begun our review. And I want to be careful to answer only questions I know.

Senator TESTER. Do you know if the Fed supervisors met with the board of directors of Silicon Valley Bank?

Mr. BARR. I do not know that yet. I know they met with senior management, but I am still reviewing that.

Senator TESTER. So you would not know if Silicon Valley Bank had a risk committee, and if, in fact, the Fed supervisors met with the risk committee?

Mr. BARR. I will know that by the May 1st report.

Senator TESTER. So were they warned about potential finds?

Mr. BARR. I am sorry. Could you say that again?

Senator TESTER. So, I mean, look, they had some problems. Were they warned to either fix them or they were going to get fined?

Mr. BARR. The Matters Requiring Attention and Matters Requiring Immediate Attention, to my understanding, require the fixing of the problem, but I do not know whether they have highlighted any additional steps that might be taken. Certainly the firm was on notice that they needed to fix those problems quite clearly since November of 2021.

Senator TESTER. But yet they did not.

Mr. BARR. They did not.

Senator TESTER. So at what point in time do the Fed regulators drop the hammer on this outfit? I mean, I do not even need to get going on the bank CEO taking a ton of money, right before this thing went belly up, as it was going belly up. At what point in time—we could have all the regulations on the book. I have talked to a lot of bankers who said if this would have happened before Dodd-Frank the regulations would have stopped this from happening.

And we have Dodd-Frank, and we did make 2155 to tailor the regulations to fit the risk—that was a big part of it—on the intermediate banks, and, in fact, on the small banks too. But yet for over a year—and correct me if I am wrong, Mr. Barr—for over a year regulators were saying to this bank, "Straighten up and fly right," and they never did a damn thing about it, and the regulators did not make it so damn miserable—which my understanding is regulators are pretty good at that when they want to be—make it so damn miserable that these folks would adjust their business plan to take care of the risks that were in their bank.

Mr. BARR. Senator, I agree that the risks were there, that the regulators were pointing them out, and the bank did not take action. It is ultimately, in the first instance, the bank management responsibility to fix these problems, and they failed to do it.

Where we did not take enough action, the Federal Reserve supervisors did not take enough action, we are going to be talking about that in our review and we expect to be held accountable for it.

Senator TESTER. So I have got to tell you, Michael Barr, I am not a banker. I ain't even close to being a banker. I am a dirt farmer. And I am going to tell you, when they laid out what had happened at this bank over the last 2 years, you did not have to be an accountant to figure out what the hell was going on here.

Mr. BARR. I agree.

Senator TESTER. And all I have got to say is as you do your look-back into what transpired, it better be fixed. If it is the regulators' fault, it better be fixed. If it is the regulation fault, it better be fixed. If it is something else, I hope there is a report to this Committee saying, "You know what, guys? This can happen again unless this happens." But it looks to me—I will just say this and I am looking from the outside in—it looks to me like the regulators knew the problem but nobody dropped the hammer.

Mr. BARR. Thank you, Senator Tester. As I said, our review is going to be thorough, it is going to be open, and if we find problems like the ones that you just described, we are going to say it clearly and describe what we think should be done.

Senator TESTER. When do you think that report will be done? And I am way over time. Sorry. When do you think that report will be done?

Mr. BARR. May 1st.

Senator TESTER. May 1st. So we have got a month.

Senator SCOTT. We should have them back after the report is done.

Senator TESTER. We look forward to that. Thank you.

Senator SCOTT [presiding]. Senator Vance.

Senator VANCE. Thank you, Mr. Chairman, and thanks to the three of you for being here.

I want to talk just a little bit about the inherent unfairness and what I think transpired with Silicon Valley Bank. I come from the venture capital industry, and this is a statement against interest and certainly a statement against the interest of some of my friends. But the business model of Silicon Valley Bank was to provide banking services to venture capital firms and to venture-backed companies. And if you think about the fundamental trade that was implied—and I would even say explicit in their business model—what they did is they offered highly beneficial financial products to venture-backed companies and venture-capitalists in exchange for having a large number of deposits in your Silicon Valley Bank account, sometimes often exclusively.

So a common practice, for example, was to say that you would provide a line of credit to a venture capital firm but only if that firm put all of its money, 100 percent of its deposits, in Silicon Valley Bank, or they would offer private jet financing and other goodies that are basically beneficial only to the very wealthy, in exchange for having all of your deposits at Silicon Valley Bank.

Now given that that was implied in the business model of the bank, I think it is important that we use the term "bailout"—and I know that some of you do not like that term, but I think it is the only term that applies fairly here, because we, using excess fees on community banks all across the country, effectively chose to bail out the uninsured depositors at Silicon Valley Bank.

Now there are some outrageous examples there. I think one firm had deposits over $3 billion, and another, I think Roku had deposits of $500 million. But there were a lot of people, a lot of firms at Silicon Valley Bank that had deposits well over $1 million, well over $5 million. And what we did, in practice do was bail them out.

I guess my first question, I put this to all three of you, and because time is limited I would like you to answer quickly, is what is the threshold? Whether you guys meant to or not, I think the implication of what happened with Silicon Valley Bank is that there are a lot of people who expect that their uninsured deposits are effectively insured at an unlimited level, or if you are a banker there is an assumption, for a lot of people, that at a certain level if you are systemically important enough you uninsured depositors are going to get bailed out.

Maybe just go from left to right, starting with Mr. Gruenberg. But at what level do you think uninsured deposits, in theory, are effectively unlimited, uninsured in our banking system today?

Mr. GRUENBERG. If I may say, Senator, you are asking important questions. I think we have a lot of lessons to learn from this episode. The decision to cover uninsured depositors at these two institutions was a highly consequential one——

Senator VANCE. Yes.

Mr. GRUENBERG. ——that has implications for the system. I think we need, and I indicated in my statement earlier, we need to do a comprehensive review of our deposit insurance system and consider the questions that you raise. The FDIC is going to undertake that, and by May 1 we will deliver a report, including policy considerations to take into account. So we want to try to be responsive on that.

Senator VANCE. Thank you. Mr. Barr.

Mr. BARR. I also think you raise important questions. When we were looking at the systemic risk determination with respect to these institutions we were thinking about the risk to the broader financial system, not the particular depositors at one or two institutions. We were thinking about and concerned about the extent to which that could impact regional banks across the country, community banks across the country.

We were hearing concerns from bankers and from depositors, from businesses around the country. It is a difficult judgment but one that, at the end of the day, unanimous FDIC board and a unanimous Federal Reserve board and the Treasury Secretary agreed that that risk to the system was not a risk that was worth taking.

And so, you know, today I think we can say that the banking system is sound and resilient, and the steps we took demonstrated that resilience and the safety of deposits around the country.

Senator VANCE. So I am less concerned with the decision itself, though obviously I have a lot of questions there. I think there is an open question about whether we could have provided the confidence to the banking system, the liquidity that was needed in case of a bank run without bailing out the uninsured Silicon Valley

Bank depositors. I think that is maybe a topic for a follow-on hearing.

But what I worry about is the fundamental unfairness here, that we have drawn a line—and I do not know whether the line stops at Silicon Valley Bank. Maybe it goes much further. Maybe it stops there—where if you are systemically important, which is a term that is impossible for anybody here to define with confidence, if you are systemically important, your uninsured deposits are effectively unlimited in their insurance, whereas if you are not systemically important, if you are a regional bank in Ohio, there is a very good chance that your uninsured depositors will not receive that bailout.

And I think that uncertainty is a really, really big problem with what you guys have done. I am not saying that in an accusatory way. I understand that there were reasons to do what you did, even though I do not think it was the right decision. I am just saying I think it has some real moral hazard here.

I know I am over time here, so the one thing I would ask here is just unanimous consent to introduce a letter into the record from American Share Insurance. This is a company that provides private deposit insurance to most State-chartered credit unions, including the 43 in Ohio. And just on this point of moral hazard and on this point of unfairness, what I would you guys to consider doing is extending the same implied offer that you gave to the Silicon Valley Bank uninsured depositors, to do it a little bit further down the banking ladder so that everybody benefits from the rule that you guys have created for Silicon Valley Bank.

Senator SCOTT. Without objection.

Senator Van Hollen.

Senator VAN HOLLEN. Thank you, Mr. Chairman, and thank all of you for your service and testimony today.

Mr. Gruenberg, you are aware, are you not, of the fact that the CEO of SVB sold $3.6 million in company stock just 10 days before the bank collapsed and the FDIC took over its deposits. You are aware of that, right?

Mr. GRUENBERG. I am, Senator.

Senator VAN HOLLEN. And are you aware of the fact that other executives of the bank and employees of the bank received bonuses literally hours before SVB collapsed?

Mr. GRUENBERG. Yes, Senator.

Senator VAN HOLLEN. Now I believe we need to have an independent investigation into any criminal culpability, the possibility of insider trading in this case. But regardless of any criminal culpability that may be there, I think it is simply wrong, and I think almost every American would agree it is simply wrong for the CEO and top executives to profit from their own mismanagement and then leave FDIC to be holding the bag.

Would you agree with that proposition, that that would be wrong?

Mr. GRUENBERG. Yes, Senator.

Senator VAN HOLLEN. Now Dodd-Frank provides clawback authority that applies to the biggest banks under the Orderly Liquidation Authority, under OLA. But as I understand it, that authority does not apply to SVB Bank. Am I right about that?

Mr. GRUENBERG. That is correct, Senator. Could I elaborate on that briefly?

Senator VAN HOLLEN. If you could briefly.

Mr. GRUENBERG. Very briefly. We do not have explicit clawback authority. We do have an obligation to investigate any misconduct by the board and management of the institution, and we do have authorities to impose consequences, including civil money penalties, restitution, and barring individuals from the business of banking.

So we can get at some of the issues raised, but it is true we do not have explicit clawback authority. And I indicated earlier it would be reasonable to create parity between the Dodd-Frank Act and the Federal Deposit Insurance Act in that regard.

Senator VAN HOLLEN. Well, I am glad you raised that. I heard your response earlier, and Senator Kennedy, a Member of this Committee, and I are working right now on bipartisan legislation to accomplish exactly what you said. I hope we can introduce it this week, and I know the Chairman of the Committee is interested as well, in pursuing that. And I asked Secretary Yellen in another hearing last week whether she and the Biden administration fully supported it. The answer was yes.

So I hope we can move forward on that piece as quickly as possible, because there does seem to be a hole in your authority. You have some authorities, you indicated, but there is a hole in that authority that we have to plug, and you agree with that.

Mr. GRUENBERG. I do, Senator.

Senator VAN HOLLEN. So Vice Chair Barr, I wanted to ask you about some guidance, in fact a rule that was issued by your predecessor, former Vice Chair of Supervision Quarles, shortly before his departure in March 2021. And this rule established that supervisory guidance does not have the force of law, and it cannot be used in the event where it would halt banks' abilities to conduct mergers and acquisitions and that sort of thing.

I fully understand the distinction between supervisory guidance and black-letter law, but I think it is important to note that this request for this rule, according to the Fed's staff memo, that this guidance was issued upon industry request, and they specifically note the Bank Policy Institute and the American Bankers Association is submitting a petition asking for this rule to provide guidance to try to weaken the punch of the supervisory rules.

Are you aware of that?

Mr. BARR. Yes, Senator.

Senator VAN HOLLEN. This goes into the frame that the Chairman of the Committee made earlier on, where we have got a lot of folks that had been saying, for months and years, let us rein in the bank supervisors, and now all of a sudden it is like where were the supervisors? Why were they not being more aggressive?

Do you agree that that guidance, putting that into a rule, sent a message that you do not have to listen to supervisors' guidance that much, and would you be willing to take a look at whether or not that should be repealed?

Mr. BARR. Senator, I am not sure of the impact of that guidance. I think it is an appropriate area for us to be looking at. I know that staff are going to be thinking about that with respect to the SVB case, whether it mattered or it did not matter. I do think it is an appropriate area to look at, but I do not have a firm conclusion about it.

Senator VAN HOLLEN. Well, I hope you will take a look at it because it was done at the behest of the industry, and clearly the intent was to undermine the impact of the guidance provided by the regulators. So it seems to be part of a pattern of an effort to push back on regulators' authority and then come back and do the Monday morning quarterbacking and saying where were they.

Thank you, Mr. Chairman.

Chair BROWN [presiding]. Thank you, Senator Van Hollen.

Senator Daines has yielded to Senator Britt, right? Senator Britt is recognized, from Alabama.

Senator BRITT. Thank you, Mr. Chairman. Thank you, Senator Daines. I appreciate the opportunity to be able to ask you all a few questions. I want to start by saying I am proud to be from the great State of Alabama, where our financial institutions are strong, our regional banks, our community banks, our credit unions, and the critical role they play from our Main Streets to our rural roads could not be understated. So I am proud of the work they do and proud of the strength they continue to exhibit.

Mr. Barr, I want to follow up on a question that one of my colleagues brought up. You keep talking about the Fed focusing on the size of SVB and banks. However, 2155 also requires the Fed to take into consideration riskiness, complexity, financial activities, along with other risk-related factors. Tailored supervision ensures that the Fed focuses on the most risky banks. You have said repeatedly that bank mix management led to SVB's failure.

The whole point of 2155 was so that you could tailor your regs and your supervision to risk. So why did you not require definitive corrective action based on the flaws that you saw?

Mr. BARR. Thank you very much, Senator Britt, and I appreciate your comments about the Alabama banking sector, which I think is a thriving sector and is contributing to its communities, and like bankers across the country, is strong and vibrant. You should be very proud.

Senator BRITT. Thank you. We are.

Mr. BARR. We are looking at the range of tailoring approaches the Federal Reserve took. The decision to set those lines by asset size and other risk factors was made back in 2019. I joined the board in July of 2022, and began looking at that approach. I expect to continue to review it as part of the SVB review, and I believe we have substantial discretion to alter that framework.

Senator BRITT. Excellent. You have talked about your review, which is ongoing. In that review will you take a look at if you used all of the tools in your toolbox to prevent this, both before and after? Will that be part of your review?

Mr. BARR. Yes, Senator. The staff are reviewing the steps that supervisors took and whether they should have taken more aggressive action.

Senator BRITT. So at the current rate, though, you cannot speak to whether or not you utilized all of the powers that were given to you.

Mr. BARR. I really would like to wait for the formal review, for the staff to come evaluate the full supervisory record to make an assessment. But we are certainly very focused on that question, and if we did not do the right steps we are going to say that.

Senator BRITT. Yes. Well, I find it concerning, though, when you all were asked, each one of you were asked would you like to see more powers, more strength in this, and every single one of you said yes, when you do not actually know if you utilized the tools in your toolbox correctly or if the people that were under your supervision were supervising appropriately.

I think that is what people hate about Washington. We have a crisis and you come in here without knowing whether or not you did your job. You say you want more. That is not the way this works. You need to be held accountable, each and every one of you. I am a big believer in you have got to own your own space.

And speaking of, Mr. Gruenberg, I want to talk about yours. You were not the primary supervisor here. Obviously that is the Fed. But you are the nonprimary supervisor for SVB, or were. Is that correct?

Mr. GRUENBERG. Yes. We have backup supervision.

Senator BRITT. You have backup supervision. You had that before Dodd-Frank. Correct?

Mr. GRUENBERG. Yes.

Senator BRITT. You had it after Dodd-Frank. Correct?

Mr. GRUENBERG. Yes.

Senator BRITT. And 2155 did not change that responsibility that you had.

Mr. GRUENBERG. That is correct.

Senator BRITT. Right. So in that role what did you do prior to the bank's failure to exercise that power?

Mr. GRUENBERG. In this instance we were working with the Fed as the institution was experiencing difficulties, but I think it is fair to say that it was in a supportive role with the primary regulator.

Senator BRITT. OK. But you did raise this to the primary regulator. You did exercise that.

Mr. GRUENBERG. We were working with the primary regulator in regard to the institution.

Senator BRITT. Excellent. I am so glad to hear that. We have to make sure that we are working together and doing our job in order to prevent these things from happening in the future.

One of the things I also want to talk about is just the different responsibilities that each of you have and whether they were executed, and then additionally we will move into the FDIC's bank auction process for just a minute, although I only have 33 seconds left.

It seems that you failed to put the bank in receivership, and the FDIC passed on allowing the Silicon Valley Bank to be purchased. Is that a correct assessment, or do you feel like that has been incorrectly identified throughout the new cycles?

Mr. GRUENBERG. Yes, Senator. The bank was placed in receivership on Friday morning, and we endeavored to solicit bids over the weekend As I indicated previously it was a rapid failure so there was no opportunity prior to failure to prepare for a resolution. We tried to market it. We had two bids. Neither would have been less costly than liquidation. So we then proceeded to put in place a process where we were able to bid it out.

Senator BRITT. Yes, and I am out of time but I will say, 6 months prior, JPMorgan noticed that there was a problem, their equity research team, and then Moody's obviously met with SVB prior to saying they were going to downgrade. So I have heard you all say this was a rushed process. If the outside sector knew this was happening, you and the Fed and the 4,000 examiners should have known that this was coming as well.

Chair BROWN. Senator Warnock, of Georgia, is recognized.

Senator WARNOCK. Thank you very much, Mr. Chairman.

Many Americans, in fact all of us, would remember the unfairness of 2008 and that crisis, when bankers who made bad decisions, who played games with our economy, not only did they not go to jail, they got to keep their jobs and their multimillion-dollar salaries. I feel that in a particular way as someone who pastors and moves in communities where poor and marginalized people have the weight of the law come down upon them for the smallest of infractions. Not one banker went to jail. They kept their multimillion-dollar salaries. When bankers made risky bets that threatened our entire economy they got to cash in. They should be held accountable.

We discovered shortly after regulators took control of Silicon Valley Bank that top executives at the bank offloaded millions of dollars' worth of stock in the weeks leading up to the collapse—very convenient—including their former CEO, who sold $3.6 million worth of stock 2 weeks before the bank crashed. The Dodd-Frank banking reform law included a compensation clawback provision for executives identified as excessive risk takers, in other words, those who put their banks and the entire economy in jeopardy.

Mr. Gruenberg, the FDIC, in conjunction with the other financial regulators, began working on a rule to implement this provision in Dodd-Frank in 2011, and then again in 2016, but a final rule was never issued. Does the FDIC have plans to revisit this rule?

Mr. GRUENBERG. It has been discussed, Senator, and it seems to me appropriate.

Senator WARNOCK. It is appropriate, and I would say urgent. And I know that the Justice Department and the SEC are looking closely into this matter, and I would encourage them to include any evidence of insider trading. That seems only appropriate given the circumstances. That should be a part of the scope of their probe.

But there is a scenario where these executives not only get away scot-free but also with sizable paydays, and the FDIC should use every tool it has at its disposal to prevent it. We certainly do not want to incentivize this kind of behavior.

So again, Mr. Gruenberg, outside of this rule, tell me where can Congress step in to stop incentivizing this type of high-risk behavior? Does the FDIC need additional legal tools to hold excessive risk takers accountable?

Mr. GRUENBERG. Thank you, Senator. First, as a matter of law, whenever a bank fails the FDIC is required to conduct an investigation of the conduct of the board and the executives of the institution, and we have authorities under the law to impose accountability, including civil money penalties, restitution, and barring individuals from the business of banking. So we have significant civil authorities under the law now.

It was mentioned earlier, and I think it is appropriate, that we do not have explicit clawback authority in regard to compensation. We can get at that issue through our existing authorities, but certainly providing explicit clawback authority under the Federal Deposit Insurance Act, as the FDIC has under the Dodd-Frank Act, would be appropriate, in addition to completing the rulemaking that you raised previously.

Senator WARNOCK. Both of these things are important. We have got to complete the rulemaking and see whatever additional tools may be necessary. Certainly as the ship is sinking we do not want bankers to be able to move all of their products on the lifeboat.

Mr. GRUENBERG. I agree, Senator.

Senator WARNOCK. And so we have got to address this.

I want to switch to a related topic. For several days, payroll providers banking with SVB or Signature Bank had no way to access their deposits—everyday folks—leading to many Americans receiving their paychecks late or having missing paychecks. Too many Americans live paycheck-to-paycheck, and in this case they got it late. And as a result, some of the 64 million Americans living paycheck-to-paycheck were hit with overdraft fees, nonsufficient fund fees due to the disruption, something I have addressed in other settings. And that is why I sent a letter with Senator Booker urging regulators to impose a temporary moratorium on overdraft and nonsufficient fund fees for folks who incurred these fees at no fault of their own.

Mr. Gruenberg, does the FDIC have a plan surrounding overdraft and nonsufficient fund fee protections in the event that we experience broader systemic issues?

Mr. GRUENBERG. Senator, you raise an important question. We received your letter. As a starting point, we know there were delays. We really want to get the facts in terms of if overdraft fees were really imposed as a result of those delays. If we can confirm that information then we can consider what actions to undertake. We are glad to work with you and your staff as we follow up on that.

Senator WARNOCK. I look forward to working with you on this.

Here is the bottom line. Ordinary folks who just showed up, put in their deposits, they should not have to bear the brunt and burden of these bad decisions made by bank executives.

Mr. GRUENBERG. Understood.

Chair BROWN. Thank you, Senator Warnock.

Senator Daines, from Montana, is recognized.

Senator DAINES. Mr. Chairman, thank you.

The failure of Silicon Valley Bank, Signature Bank, and the general turmoil in the banking sector are the direct result of the failures of regulators, including the agencies we have before us today, also the executive teams at these financial institutions, and the inflationary environment sparked, in no small part, by the Biden administration's reckless spending. I remember having debates right here with the Banking Committee about these massive stimulus bills, that $1.9 trillion spending bill, that even Lawrence Summers said was inflationary. On a purely partisan vote it passed, with Democrats supporting and Republicans opposing.

But each of these groups, back to Silicon Valley Bank and Signature Bank, failed to prioritize properly clear and present risks of the inflationary environment, rising interest rates, what it did to bond values, instead opting to focus on climate change, equity, and other factors that did not contribute in any way to the crisis we have before us. I raised these issues of misaligned priorities with Secretary Yellen during a Finance Committee hearing back in June of 2021, when she identified climate change, nonbank financial intermediation, and Treasury market resilience as the key priorities for FSOC.

Now we are facing a situation where responsible banks, in my home State of Montana and elsewhere, will be on the hook for providing tens of billions of dollars, and potentially more, to bail out irresponsible coastal banks for risk-taking that regulators failed to act upon, despite first noticing as far back as 2019.

Turning to my question, Vice Chair Barr, you state in your testimony that your review is, quote, "focusing on whether the Federal Reserve supervision was appropriate for the rapid growth and vulnerabilities of the bank," end quote.

The question is, if you find, as part of your review, that certain individuals were clearly negligent in the performance of their duties, are you willing to recommend they be fired?

Mr. BARR. Senator, I do not want to prejudge in any way the review. I am going to get that evidence back. I am going to understand it fully, and——

Senator DAINES. I said if as part of your review you find them negligent, would you recommend they be fired?

Mr. BARR. It is hard for me to answer in the abstract, sir. I believe we will take appropriate action with respect to the supervisory structure as a whole. With respect to——

Senator DAINES. Are you willing to—is termination one of the options?

Mr. BARR. I do not know——

Senator DAINES. That is an easy question. I just said an option. I am not saying you have to exercise it. Is that an option? Can somebody be fired for this?

Mr. BARR. I would have to understand the basis in our human resources law, and I do not want to——

Senator DAINES. The bank executives lost their jobs, as should some of these regulators. Should that not be the case if they are asleep at the wheel?

Mr. BARR. Senator, I want to be very careful. There are laws and procedure with respect to how you——

Senator DAINES. But you can make a recommendation to HR, and they can tell you whether or not that is allowed or not. I have been in the corporate world for most of my career. I have worked with HR, as is true within the Federal Government. You can make a recommendation if somebody is asleep at the wheel and negligent.

Mr. BARR. I would be happy to follow up with you, Senator. I promise we will take appropriate action based on the review, but I do not have a definitive answer for you at this moment.

Senator DAINES. I do find it ridiculous that you are unwilling to say that if people failed to perform their responsibilities that you might recommend they be fired.

Vice Chair Barr, did you visit the San Francisco Fed in October of last year?

Mr. BARR. October of last year? What year? I mean, in——

Senator DAINES. In 2022.

Mr. BARR. I do not believe so.

Senator DAINES. OK. Well, the San Francisco Fed published a supervision and brief memo, saying the top priorities that you outlined with that visit aligned with their top priorities.

Mr. BARR. It may be that I did a virtual seminar for a range of supervisors, and so the San Francisco Fed folks were in attendance for that, but I do not believe I was in San Francisco.

Senator DAINES. So the regulators' perspective that came out from the 12th District, the San Francisco Fed, said they were aligned with what was top-of-mind for the work being done in the 12th District. The first thing it says is "financial risks from climate change." This is at a time, back in October of 2022, when you saw the discount rate was all the way up to 3 percent. We were seeing those three-quarter-point increases coming out of the Federal Reserve over and over, and they were communicating this was probably going to continue.

And that was about the time that also the Richmond Fed, in the 5th District, they had a little different view in terms of prioritizing risks, and they thought perhaps a rising rate environment might be the highest risk in terms of priority to look at, versus San Francisco Fed says it is about climate change was the number one priority listed, stack-ranked with the three that they placed out.

It is clear, in hindsight, that the Richmond Fed was focused on the clear and present risks of rising interest rates while the San Francisco Fed was not.

My question is, since you were confirmed in July, what percentage of your time have you spent focusing on climate policy and financial inclusion versus how the Federal Reserve's monetary policy might impact banks like Silicon Valley Bank?

Chair BROWN. Be as brief as you can in that answer. Thank you.

Mr. BARR. Senator, I have been focused on risk throughout the system, both short-term and long-term risks, and interest rate risk is a bread-and-butter issue in banking. It is what our supervisors do all the time.

Chair BROWN. Thank you.

Senator DAINES. But the San Francisco Fed said it was climate change. And by the way——

Chair BROWN. Senator Sinema is recognized.

Senator SINEMA. Thank you, Mr. Chairman, and thank you to our witnesses for being here today.

Today's hearing is about trust—whose trust has been broken, who broke that trust, and how all of us work together to reaffirm and rebuild that trust. Trust is a key principle that the modern banking system is built on. Families trust that their hard-earned savings are safe in the U.S. banking system. Congress entrusts are Federal banking regulators with the power to supervise, regulate, and examine banks. We trust you to be the cops on the beat and have given you the tools to do that job.

The failure of Silicon Valley Bank on the Federal Reserve's watch very clearly calls into question whether or not some of trust was misplaced. Make no mistake: the lion's share of the blame is on incompetent bank executives, and it is outrageous that these people took bonuses and sold stock in the days leading up to the bank's failure. We should hold these executives accountable to the fullest extent of the law and claw back those bonuses and stock sales. I am cosponsoring a bill to do just that.

But as I laid out in a letter to you, Vice Chair Barr—that, by the way, was signed by 11 other Senators, spanning the ideological spectrum—it is gravely concerning that retail participants, literally just regular, everyday people, were able to figure out that something was wrong with Silicon Valley Bank before your regulators took appropriate action.

Now these folks do not have access to nonpublic information like the bank examiners do, but when people on Reddit and Twitter can spot bank mismanagement before the regulators, something is terribly wrong.

So my questions today are for you, Vice Chair Barr. I have lots of questions so I would like concise answers, and we will follow up in writing. You were sworn in as Vice Chair for Supervision on July 19, 2022. Your testimony indicates that due to ongoing review you will focus on what you know, so let us start there. The Fed knew of problems at the bank dating back to 2019. Were you personally made aware of major deficiencies at Silicon Valley Bank prior to the collapse, and if so, which ones, and when were you notified?

Mr. BARR. Thank you, Senator. The staff made a presentation to the Board of Governors in the middle of February of this year, that was focused on interest rate risk broadly in the banking system and how banks and managers and supervisors were addressing those risks. And as part of that presentation the staff highlighted the interest rate risk that was present at Silicon Valley Bank, and indicated that they were in the middle of a further review and expected to be basically coming back to the bank shortly with further information about their status. I believe that is the first time that I was told about interest rate risk at Silicon Valley Bank.

Senator SINEMA. So you were first notified shortly after folks on your staff learned about these deficiencies.

Mr. BARR. Senator, the supervisors began highlighting these deficiencies at the firm in interest rate risk management and liquidity risk management in a serious way in November of 2021, as far as I know. So a little bit more than a year prior to that. They intensified that supervisory review as part of its full scope exam in the summer of 2022, when the firm was downgraded for deficiencies in its risk-management practices. And they brought those issues again, according to the record, to the CFO of the firm in October, and issued additional findings in November of 2022.

So that, as far as we know from the current supervisory record, is the picture.

Senator SINEMA. And that is when you—so you were first notified in October and November of 2022?

Mr. BARR. No, Senator. To the best of my knowledge I first learned about the issues at Silicon Valley Bank with respect to interest rate risk in mid-February of 2023, so several weeks before the bank failed staff made a presentation to the board about interest rate risk broadly, and with a highlight, if you will, on Silicon Valley Bank, and indicated that they were following up with the bank with further measures.

Senator SINEMA. So your testimony says that asset size is not necessarily an indicator of complexity, and I agree, which is why Section 401 of S. 2155 gives the Fed explicit authority to impose the regulations and enhance supervision normally reserved for the largest institutions. And you can do that on any bank between $100 and $250 billion in assets, like SVB. The Fed is given this authority to prevent or mitigate risks to the financial stability of the U.S. We both agree that this is existing authority that the Fed has had since the enactment of S. 2155 in 2018. Correct?

Mr. BARR. Yes. The Fed has broad authority to change the rules it uses for different approaches to supervision of firms. Under the rules that were put in place in 2019, the firm was bucketed by a set of categories. I think that it is important to revisit those, as I have been doing since arriving at the Federal Reserve in July.

Senator SINEMA. So given the documented issues that——

Chair BROWN. You are over time, but wrap up if you can. One more question.

Senator SINEMA. This will be my last question. Thank you, Mr. Chairman.

So given the documented issues that your supervisors found with SVB, that we just kind of went over, did the Fed ever consider using its existing Section 401 authority before the failure, to more aggressively regulate the bank?

Mr. BARR. Based on the current supervisory record it looked like the escalations that had occurred were in the format of Matters Requiring Attention and Matters Requiring Immediate Attention. And the supervisors also put in place what is called a 4M agreement, which is a limitation on the firm's ability to engage in merger transactions with financial companies.

Chair BROWN. Thank you, Senator Sinema.

Senator SINEMA. Thank you.

Chair BROWN. Senator Tillis.

Senator TILLIS. Thank you, Mr. Chair. Thank you all for being here.

I want to start maybe with a question that I think, Vice Chair Barr, you answered to Senator Warren, saying you thought banks over $100 billion should have additional prudential requirements. Did I hear that correctly?

Mr. BARR. I think it is important for us to strengthen capital and liquidity requirements for large banks really up the spectrum.

Senator TILLIS. Is there any the tools—you know, just going back—Mr. Chair, I would like, without objection, to submit this to the record. This is the regulatory regimen that applies to banks of certain categories.

Chair BROWN. Without objection.

Senator TILLIS. And so I am curious. I always worry about when we create an arbitrary asset limit for doing something, because it was the activities of Silicon Valley that got them in trouble. And so I just want to ask briefly—I have got a lot of questions, and I will get them done on time—you have mentioned a couple of times, Vice Chair Barr, that the 2019, I guess, implementation of Senate bill 2155—I am inferring that—bucketed Silicon Valley in a certain regulatory regimen. Did that mean that it restricted it from having supervisors make the judgment that the increased prudential regulations or supervisory functions could not occur?

Mr. BARR. Senator, we are bound by the rules we put out. So new framework——

Senator TILLIS. Yeah, OK. So what—in 2019, different administration, predates your tenure, are you saying that the promulgation and the implementation of 2155 took certain supervisory or regulatory regimens off the table for Silicon Valley Bank?

Mr. BARR. The Federal Reserve's implementation in 2019 set basically the standard for how that firm would apply. I think that regulators, supervisors do have judgment——

Senator TILLIS. That is my point.

Mr. BARR. ——and can put in place mitigating matters.

Senator TILLIS. Because when I hear "bucketing" I think about ring-fencing, and I wonder if that meant that a supervisor—in my opinion, if you take a look at the matters requiring attention and then immediate attention, do you know yet—I know we will get the report in May—but do you know yet how many of those MRAs were followed by an MRI? In other words the six that were issued over the course of a year-and-a-half or 2 years, how many of these was an escalation of the Matter Requiring Attention to immediate attention, if any? And if you do not know that you can submit it. Actually, if you will just submit it for the record.

Look, we have got a CEO of Silicon Valley Bank that is a Class A member of the board of the San Francisco Federal Reserve, who got summarily terminated on the day of the bank's collapse. In your review, will we also have insight into California's role in regulating this bank, or will this be purely Federal jurisdiction?

Mr. BARR. We are looking only at the Federal Reserve. The State of California is initiating its own review with respect to this.

Senator TILLIS. I think that is going to be very helpful, because in my opinion I agree with former Fed Tarullo that he sees this as a regulatory lapse. Tarullo was never complimentary of Senate bill 2155. He was implementing Dodd-Frank when we were doing it. He was hammering it. He made the statement, and Mr. Chair, I would also like to submit for the record an article interview with Mr. Tarullo from Marketplace, that he specifically says in here, you know, 2155 is likely or impossible to be a root cause of the problem. I am paraphrasing. He was saying it looks like a regulatory and supervisory lapse. Now I think we are going to find that that lapse is not only with the Fed but more likely even the supervision that the State of California——

Chair BROWN. Without objection, so ordered.

Senator TILLIS. ——was involved in.

So I am also kind of curious in the report, are we going to see any movement? I am not a conspiracy theorist, but there is one question of did we have a level of comfort with this bank, among some of the supervisors? Do we know or have any insight over the past few years if anybody who had worked for the Fed worked for this bank? We know that the CEO was on the Fed board, or on a board at the Fed?

Mr. BARR. Senator, just with respect to the Class A directors that you mentioned, Class A directors are prohibited from participating in any way in supervision.

Senator TILLIS. Yeah, no, I get that. But it is just people in proximity, maybe people calling balls and strikes, the supervisors did not get that quite right.

But, you know, I think that there are some people who—and I want to find the root cause of the problem, and I think that you all will find a lot of information when you issue your report. I do not think that we are doing the banking industry any service going forward if we talk about now we have just got to rein in the small banks, we have got to increase, by default, regardless of the activities of the bank, we have got to increase, by default, their prudential requirements, and with your holistic review, capital requirements, and a number of other things.

When you have a run on a bank like you did with Silicon Valley, could any bank possibly have enough to cover the run? Any bank.

Mr. BARR. You know, Senator, the particular bank in question was quite unique in its structure, in its liability approach, and its interest rate risk management. I can just speak to that particular bank.

Senator TILLIS. If you look at their bank, if you looked at their internal liquidity stress testing, if you took a look at their contracts and interest rate exposure, this does not take a highly sophisticated person to understand the risk, and it damn sure had to be known months before the chickens came home to roost. And I wish that we could just focus on that problem and not use the red herring of some lapse in regulatory oversight that was the root cause of this bank collapse. It simply was not, and I would love to find anybody to prove it wrong.

I do not care how you feel about regulatory tailoring, but use a valid argument to fight against it. Do not use Silicon Valley Bank as an example. I am not suggesting that you have. But there are many people that sit up here who have, at the expense of looking at how we can prevent this in the future.

And I do have questions for the record that I will submit. Thank you all.

Chair BROWN. Thank you, Senator Tillis. Thanks to all three of you for your testimony, your public service, and I look forward to the reviews on these bank failures, and thank you for helping to start that process.

It is interesting, many of my Republican colleagues are now so eager for bank regulators to crack down on banks for taking on too many risks. I hope they remember that when it comes time to empower regulators and strengthen guardrails, including protecting the independent funding financial regulators.

The events of the last month have shown why we need independent regulators funding and stability for all of our financial watchdogs, but now as the Supreme Court considers whether the CFPB's independent funding is constitutional, these independent watchdogs' ability to keep our financial system stable faces an existential threat. U.S. financial regulators, as we know, are independently funded so they can quickly respond when crises happen. On this and every issue I will continue to fight to protect American workers from Wall Street arrogance and greed.

Thank you for joining us. The meeting is adjourned.

[Whereupon, at 12:33 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIR SHERROD BROWN

Thanks to the New Deal and the hard work of our regulators today, most bank failures, while never a good thing, are generally not a big deal.

But the quick collapses of Silicon Valley Bank and Signature Bank were no ordinary failures.

In less than a day, Silicon Valley Bank customers pulled $42 billion out of the bank—fueled by venture capitalists and their social media accounts. They created the largest and fastest bank run in history. In the following days, Signature Bank lost $17.8 billion.

Regulators—both Republicans and Democrats—came together to prevent the panic from spreading.

They increased liquidity, promoted confidence in our banking system, and protected the deposits of customers and small businesses—not the investments of executives and shareholders.

I spent that weekend on the phone with Ohio small businesses and banks and credit unions.

Ohio small business owners simply wanted to make payroll. They didn't want to see years of hard work go down the drain because of venture capitalists panicking on Twitter 2,000 miles away.

One woman told me she was terrified she wouldn't be able to pay her workers the next week.

And Ohio banks and credit unions institutions—institutions that are sound and well-capitalized—didn't want to see deposits flee their institutions for the biggest Wall Street banks.

For anyone who lived through the Global Financial Crisis, it's impossible not to think of 2008.

Once again, small businesses and workers feared they would pay the price for other people's bad decisions. And we're left with many questions—and justified anger—toward bank executives and boards, toward venture capitalists, toward Federal and State bank regulators, and toward policymakers.

The scene of the crime does not start with the regulators before us. Instead, we must look inside the bank, at the bank CEOs, and at the Trump-era banking regulators, who made it their mission to give Wall Street everything it wanted.

Monday morning quarterbacking aimed only at the actions of regulators this month is as convenient as it is misplaced—coming from those who have never met a Wall Street wish list they didn't want to grant.

Many who are the first to scold the regulators for their failures, offer ready ears whenever bank CEOs line up at their offices complaining about "out of control bank examiners."

Remember some of those complaints at our hearing with Fed Chair Powell over the Fed merely reviewing capital? Just three days before Silicon Valley Bank failed?

How soon we choose to forget.

When we ask who should have known how the risks were building in these banks, we should start at the source: with the executives.

Silicon Valley Bank almost quadrupled in size over 3 years, and Signature Bank more than doubled in that time.

The principles here are not complicated—banks should be prudently managed and be mindful of the full scope of risks they face, and should diversify across customers and products.

This Committee must consider how these banks exploded in size, in a way that was clearly unsustainable. Some explanations will focus on complicated-sounding concepts like: balance sheet risk, moral hazard, stress tests, liquidity ratios.

Really though, it comes down to more basic concepts—hubris, entitlement, greed. And always with big paydays for the executives at the top.

The CEOs' own pay was tied directly to the growth at SVB.

At SVB, executive bonuses were pegged to return on equity. So they took more risk by buying assets with higher yields to make higher profits. When those investments started to lose money, they didn't back down.

It won't surprise anyone that Silicon Valley Bank went nearly a year without a Chief Risk Officer.

Venture Capitalists fueled the bank's growth by forcing the companies they invested in and advised to keep their money at Silicon Valley Bank.

And then those same VCs turned around and sparked the bank run by telling the companies to pull their money out, creating more chaos and panic.

Signature Bank found itself in the middle of Sam Bankman-Fried's crime spree at the crypto exchange FTX. The bank let him open multiple accounts and ignored red flag after red flag.

It's all just a variation on the same theme—the same root cause of most of our economic problems:

Wealthy elites do anything to make a quick profit and pocket the rewards. And when their risky behavior leads to catastrophic failures, they turn to the Government asking for help, expecting workers and taxpayers to pay the price.

Even though no taxpayer money is being used to save these depositors, I understand why many Americans are angry—even disgusted—at how quickly the Government mobilized, when a bunch of elites in California were demanding it.

People have a pretty good sense of whose problems get taken more seriously than others in this town.

Of course we have to prevent systemic threats to the economy. But corporate trade deals are a systemic threat to towns in Ohio and across the industrial Midwest. So is a Wall Street business model that rewards short-term profits over investments in innovation and workers.

And those threats are not only tolerated—they've been actively pushed by the same crowd that this month clamored for the Government to save them.

Just as there are no atheists in foxholes, it appears that when there is a bank crash, there are no libertarians in Silicon Valley.

I hope that from now on, those who have no problem with Government intervention to protect their own livelihoods will think a little harder about what their warped version of the free market has done to workers in Ohio.

It may be tempting to look at all this and say, we don't need new rules. The real problem was these arrogant executives.

But there will always be arrogant executives. That's exactly why we need strong rules, and public servants with the courage to stand up to bank lobbyists and enforce them.

The officials sitting before us today know that their predecessors rolled back protections—like capital and liquidity standards, stress tests, brokered deposit limits, and even basic supervision. They greenlighted these banks to grow too big, too fast.

There are important questions about deposit insurance we must examine to consider—whether the current amount works for everyone, including small businesses who need and want to make payroll.

We expect bank executives to understand the basic principles of bank management and to know they can't grow a bank by over-concentrating business in specialized areas and then pay themselves huge bonuses right up until things blow up. That's not being a trusted partner to your customers—it's taking advantage of them.

These executives must answer for their banks' downfalls. I have called on the former CEOs of these failed banks to testify and I thank Ranking Member Scott for joining me in that effort.

But they must also face real consequences for their actions.

Right now, none of the executives who ran these banks into the ground are barred from taking other banking jobs, none have had their compensation clawed back, none have paid any fines.

Some executives have decamped to Hawai'i. Others have already gone on to work for other banks. Some simply wandered off into the sunset.

It will surprise no one in Ohio that these bank executives face less accountability than a cashier who miscounts the cashbox.

That's why I'll be introducing legislation to strengthen regulators' ability to impose fines and penalties, clawback bonuses, and ban executives who caused bank failures from working at another bank ever again.

We also need to look at bank regulators' ability to not only identify risks and problems at banks, but to also be empowered to actually make the banks fix them.

Today, my colleagues and I are asking GAO to follow up on a 2019 report where they highlighted communication failures, and the extent to which senior bank management fully addressed identified deficiencies.

I am looking forward to hearing from our financial watchdogs today. We will be watching them to make sure they assess the damage, hold accountable those responsible, and fix what is broken.

Last, I ask my colleagues to work together to make sure that our financial system is stronger after this crisis.

Americans have watched the same pattern over and over:

A crisis occurs. Some of us push for reforms—and if we're lucky, we're able to seize the moment, and actually pass some.

And then the lobbyists go to work.

Politicians spend the ensuing years rolling back reforms, right up until the next crisis. And that crisis happens because, you guessed it—we rolled back regulations.

And we know who's the first to get help in any crisis.

It's little wonder that workers in Ohio and around the country don't trust banks, and don't trust their own Government. It's time we proved them wrong—ignore corporate lobbyists, and put workers and their families first.

PREPARED STATEMENT OF SENATOR TIM SCOTT

Today, we are here to understand just how we found ourselves in the middle of the second and third-largest bank failures in United States history. Though our questions are nowhere near answered, this is an important first step in providing transparency and accountability necessary to the American taxpayer.

I'd like to thank you, Mr. Chairman, for taking the time and working with me to try to bring the bank CEOs into this hearing. I think it's incredibly important that we hear from the folks specifically and uniquely responsible for the failure of these banks, the folks who managed them.

By all accounts, this is a classic tale of negligence, and it started with the banks themselves. Without any question, that's where the buck stops. So, it is imperative that we hear straight from the horse's mouth, so to speak, to find out why these banks were so poorly managed and so poorly managed their risks.

Unfortunately, the bank executives aren't the only managers we're missing.

The Secretary of the Treasury and the Chairman of the Federal Reserve are also not here to testify. I don't mean to offend the witnesses that are here, but it is hard to believe the Biden administration seriously is concerned about the failure that we're seeing when they themselves are shielding the top official at the Department of Treasury.

The same official who briefed the President and invoked the System Risk Exception.

Nor do we have Chair Powell here, instead, we have the Vice Chair of Supervision here to use our Committee as a platform to talk about the wrongs under his supervision. As the Federal Reserve has already announced, he is conducting a review to assess any supervisory failures, which is an obvious, inherent conflict of interest and a classic case of the fox guarding the hen house.

The Fed should focus on its mission and not the climate arena. This is a waste of time, attention, and manpower. All things that could have gone into bank supervision.

Banks, like any other business, must manage their risk and be good stewards for their customers. But unlike other businesses, banks are highly regulated. Sometimes—banks even have their regulators sitting in their banks and continually monitoring their risks and activities—as is the case with Silicon Valley Bank.

For the last 2½ weeks, the regulators have consistently described Silicon Valley as unique and highly "idiosyncratic"—meaning the warning signs should have been flashing red and SVB should have stood out as what it was—absolutely a problem child. Clear as a bill were the warning signs.

In fact, reports indicate that these warning signs were already flashing, and on March 19, the *New York Times* wrote that "Silicon Valley Bank's risky practices were on the Federal Reserve's radar for more than a year . . . ".

Moreover, Silicon Valley suffered from extreme interest rate risk, due to investments in long-term securities that declined in value because of soaring inflation. Of all our supervisors, the Federal Reserve should have been keenly aware of the impact its interest rate hikes would have on the value of these securities, and it should have been actively working to ensure the banks it supervises were hedging their bets and covering their risk accordingly.

But now we know, based on your testimony Mr. Barr, that the Fed was aware! In fact, in 2021 your supervisors found deficiencies in the bank's liquidity and its management, resulting in six supervisory findings. Later, in 2022, supervisors then issued three findings related to ineffective board oversight, risk-management weaknesses, and the bank's internal audit function. What were the supervisors thinking?

The law and the regulations are crystal clear; the Federal Reserve can take any supervisory or enforcement action it deems necessary to address unsafe and unsound practices.

Recent reports confirm what we already know, your priorities and your work with the San Francisco Federal Reserve Bank President, Mary Daly, centered on climate change—an issue wholly unrelated to the Federal Reserve's dual mandate and role as supervisor. Given SVB's social and climate agenda, one must ask if SVB's investments in climate caused its regulators to be a bit more permissive of its risks.

If you can't stay on mission and enforce the laws as they already are on the books, how can you ask Congress for more authority with a straight face?

To that end, I hope to learn how the Federal Reserve could know about such risky practices for more than a year, and fail to take definitive, corrective action. By all accounts, our regulators appear to have been asleep at the wheel.

In addition, I also hope to learn more from the FDIC about its role in the receivership and sale of both SVB and Signature Bank. Especially on the auction and bid process.

I am very concerned that private sector offers appear to have been submitted, and yet, were denied. If Silicon Valley Bank had been purchased before it failed, the panic and the shock to the market and to market confidence we've seen over the past 2½ weeks may have been avoided.

If Silicon Valley had been purchased over the weekend of March 10, confidence in the marketplace may have sustained Signature Bank and prevented its failure.

The FDIC's bid auction process has been a black hole for Congress and the American people—and we deserve answers.

I know hindsight is 2020—but when you hear rumors that this process was delayed because the White House doesn't like mergers in any shape, form, or fashion, it makes you wonder what actually is going on. Sometimes, when it looks like a duck, quacks like a duck, it's just a duck.

As I close on this opening statement, three things remain clear to me regarding SVB. First, the bank was rife with mismanagement. Second, there was a clear supervisory failure. Our regulators were simply asleep at the wheel. And finally, President Biden's reckless spending caused this 40-year high in inflation, and the country, as well as the bank, experienced tremendous loss.

PREPARED STATEMENT OF MARTIN GRUENBERG

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

MARCH 28, 2023

Chairman Brown, Ranking Member Scott, and Members of the Committee, thank you for the opportunity to appear before the Committee today to address recent bank failures and the Federal regulatory response.

On March 10, 2023, just over 2 weeks ago, Silicon Valley Bank (SVB), Santa Clara, California, with $209 billion in assets at year-end 2022, was closed by the California Department of Financial Protection and Innovation (CADFPI), which appointed the FDIC as receiver. The failure of SVB, following the March 8, 2023, announcement by Silvergate Bank that it would wind down operations and voluntarily liquidate,[1] signaled the possibility of a contagion effect on other banks. On Sunday, March 12, 2023, just 2 days after the failure of SVB, another institution, Signature Bank, New York, NY, with $110 billion in assets at year-end 2022, was closed by the New York State Department of Financial Services (NYSDFS), which also appointed the FDIC as receiver. With other institutions experiencing stress, serious concerns arose about a broader economic spillover from these failures.

After careful analysis and deliberation, the Boards of the FDIC and the Federal Reserve voted unanimously to recommend, and the Treasury Secretary, in consultation with the President, determined that the FDIC could use emergency systemic risk authorities under the Federal Deposit Insurance Act (FDI Act)[2] to fully protect all depositors in winding down SVB and Signature Bank.[3]

It is worth noting that these two institutions were allowed to fail. Shareholders lost their investment. Unsecured creditors took losses. The boards and the most senior executives were removed. The FDIC has authority to investigate and hold accountable the directors, officers, professional service providers and other institution-affiliated parties of the banks for the losses they caused to the banks and for their misconduct in the management of the banks.[4] The FDIC has already commenced these investigations.

Further, any losses to the FDIC's Deposit Insurance Fund (DIF) as a result of uninsured deposit insurance coverage will be repaid by a special assessment on banks

[1] See Silvergate Capital Corporation Press Release, "Silvergate Capital Corporation Announces Intent To Wind Down Operations and Voluntarily Liquidate Silvergate Bank" (March 8, 2023), available at *https://ir.silvergate.com/news/news-details/2023/Silvergate-Capital-Corporation-Announces-Intent-to-Wind-Down-Operations-and-Voluntarily-Liquidate-Silvergate-Bank/default.aspx.*

[2] 12 U.S.C. §1823 (c)(4)(G).

[3] See FDIC Press Release, Joint Statement by the Department of the Treasury, Federal Reserve, and FDIC (March 12, 2023), available at *https://www.fdic.gov/news/press-releases/2023/pr23017.html.*

[4] 12 U.S.C. §1821(d)(13)(E) and (k). See also 12 U.S.C. §1818(e) and (i).

as required by law. The law provides the FDIC authority, in implementing the assessment, to consider "the types of entities that benefit from any action taken or assistance provided."[5]

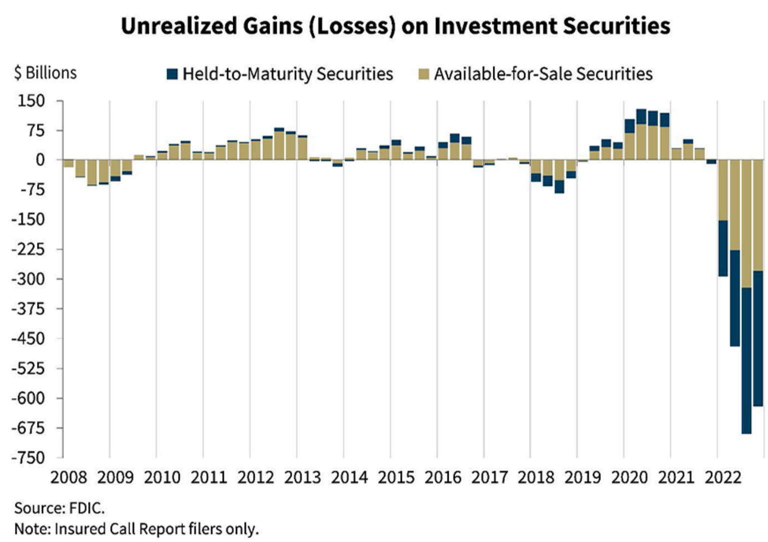
The FDIC has now completed the sale of both bridge banks to acquiring institutions. New York Community Bancorp's Flagstar Bank is the acquiring institution for Signature Bridge Bank, N.A., and First-Citizens Bank & Trust Company is the acquiring institution for Silicon Valley Bridge Bank, N.A.[6]

My testimony today will describe the events leading up to the failure of SVB and Signature Bank and the facts and circumstances that prompted the decision to utilize the authority in the FDI Act to protect all depositors in those banks following these failures. I will also discuss the FDIC's assessment of the current state of the U.S. financial system, which remains sound despite recent events. In addition, I will share some preliminary lessons learned as we look back on the immediate aftermath of this episode.

In that regard, the FDIC will undertake a comprehensive review of the deposit insurance system and will release a report by May 1, 2023, that will include policy options for consideration related to deposit insurance coverage levels, excess deposit insurance, and the implications for risk-based pricing and deposit insurance fund adequacy. In addition, the FDIC's Chief Risk Officer will undertake a review of the FDIC's supervision of Signature Bank and will also release a report by May 1, 2023. Further, the FDIC will issue in May 2023 a proposed rulemaking for the special assessment for public comment.

The two bank failures also demonstrate the implications that banks with assets over $100 billion can have for financial stability. The prudential regulation of these institutions merits serious attention, particularly for capital, liquidity, and interest rate risk. This would include the capital treatment associated with unrealized losses in banks' securities portfolios. Resolution plan requirements for these institutions also merit review, including a long-term debt requirement to facilitate orderly resolution.

Economic Conditions



On February 28, 2023, the FDIC released the results of the Quarterly Banking Profile, which provided a comprehensive summary of financial results for all FDIC-insured institutions for the fourth quarter of last year. Overall, key banking indus-

[5] 12 U.S.C. §1823(c)(4)(G)(ii)(III).
[6] The acquiring institutions entered into purchase and assumption agreements for the bridge banks' deposits and assets, as described in detail later in this statement.

try metrics remained favorable in the quarter.[7] Loan growth continued, net interest income grew, and asset quality measures remained favorable. Further, the industry remained well-capitalized and highly liquid, but the report also highlighted a key weakness in elevated levels of unrealized losses on investment securities due to rapid increases in market interest rates. Unrealized losses on available-for-sale and held-to-maturity securities totaled $620 billion in the fourth quarter, down $69.5 billion from the prior quarter, due in part to lower mortgage rates. The combination of a high level of longer-term asset maturities and a moderate decline in total deposits underscored the risk that these unrealized losses could become actual losses should banks need to sell securities to meet liquidity needs.

This latent vulnerability within the banking system would combine with several other prevailing conditions to form a key catalyst for the subsequent failure of SVB and systemic stress experienced by the broader banking system.

The Wind Down of Silvergate Bank

Silvergate Bank, La Jolla, California, with $11.3 billion in assets as of December 31, 2022, had a business model focused almost exclusively on providing services to digital asset firms. Following the collapse of digital asset exchange FTX in November 2022, Silvergate Bank released a statement indicating that it had $11.9 billion in digital asset-related deposits, and that FTX represented less than 10 percent of total deposits in an effort to explain that its exposure to the digital asset exchange was limited.[8] Nevertheless, in the fourth quarter of 2022, Silvergate Bank experienced an outflow of deposits from digital asset customers that, combined with the FTX deposits, resulted in a 68 percent loss in deposits—from $11.9 billion in deposits to $3.8 billion.[9] That rapid loss of deposits caused Silvergate Bank to sell debt securities to cover deposit withdrawals, resulting in a net earnings loss of $1 billion.[10] On March 1, 2023, Silvergate Bank announced it would be delaying issuance of its 2022 financial statements and indicated that recent events raised concerns about its ability to operate as a going concern, which resulted in a steep drop in Silvergate Bank's stock price.[11] On March 8, 2023, Silvergate Bank announced that it would self-liquidate.[12]

The troubles experienced by Silvergate Bank demonstrated how traditional banking risks, such as a lack of diversification, aggressive growth, maturity mismatches in a rising interest rate environment, and sensitivity to liquidity risk, when not managed adequately, could combine to lead to a bad outcome. Many of these same risks were also present in the failure of SVB.

The Failure of Silicon Valley Bank

SVB was established in San Jose, California, on October 17, 1983. SVB's approximately $191.4 billion in deposit liabilities as of December 31, 2022, were associated with its commercial and private banking clients, mostly linked to businesses financed through venture capital. The bank did not maintain a large retail deposit business. Total assets grew rapidly from under $60 billion at the end of 2019 to $209 billion by the end of 2022,[13] coinciding with rapid growth in the innovation economy and a significant increase in the valuation placed on public and private companies. This influx of deposits was largely invested in medium- and long-term Treasury and Agency securities. SVB also had significant cross-border operations, with a subsidiary in the United Kingdom and branches in Germany, Canada, and the Cayman Islands.

[7] See Remarks by FDIC Chairman Martin Gruenberg on the Fourth Quarter 2022 Quarterly Banking Profile (February 28, 2023) available at *https://www.fdic.gov/news/speeches/2023/spfeb2823.html.*

[8] See "Silvergate Provides Statement on FTX Exposure", *Businesswire* (November 11, 2022), available at *https://www.businesswire.com/news/home/20221111005557/en/Silvergate-Provides-Statement-on-FTX-Exposure.*

[9] See Silvergate Capital Corporation, 4Q22 Earnings Presentation (January 17, 2023), available at *https://s23.q4cdn.com/615058218/files/doc—financials/2022/q4/Ex.-99.2-SI-4Q22-Earnings-Presentation-FINAL.pdf.*

[10] Ibid.

[11] See Silvergate Capital Corporation Form 12b-25, Notification of Late Filing, available at *https://ir.silvergate.com/sec-filings/sec-filings-details/default.aspx?FilingId=100117301783.*

[12] See Silvergate Capital Corporation Press Release, "Silvergate Capital Corporation Announces Intent To Wind Down Operations and Voluntarily Liquidate Silvergate Bank" (March 8, 2023), available at *https://ir.silvergate.com/news/news-details/2023/Silvergate-Capital-Corporation-Announces-Intent-to-Wind-Down-Operations-and-Voluntarily-Liquidate-Silvergate-Bank/default.aspx.*

[13] See Silicon Valley Bank's FFIEC Call Report filings from December 31, 2019, and December 31, 2022.

On the same day that Silvergate Bank announced its self-liquidation, SVB announced that it had sold substantially all of its available-for-sale securities portfolio at a $1.8 billion after tax loss.[14] SVB simultaneously announced an attempt to raise approximately $2.25 billion through the issuance of common equity and mandatory convertible preferred shares via an underwritten public offering and planned private investment.[15] The following day, SVB's share price dropped 60 percent. In an attempt to quell the rising concerns of the bank's depositors and borrowers, the Chief Executive Officer of SVB urged venture capital clients to remain calm and keep their deposits in the institution. The appeal did not have the intended effect.[16] Many of SVB's venture capital customers took to social media to urge companies to move their deposit accounts out of SVB.[17] By the end of the day on Thursday, March 9, 2023, $42 billion in deposits had left the bank.

The evening of March 9, the FDIC was informed by SVB's primary Federal regulator, the Federal Reserve, of the deposit run, subsequent funding shortfalls and that the bank was unlikely to have adequate liquidity to meet the demands of depositors and other creditors. FDIC staff engaged with the chartering authority, the CADFPI, shortly thereafter. FDIC staff worked through the night with SVB's primary regulators in an effort to put a resolution strategy in place. At 11:15 a.m., EST, on March 10, 2023, SVB was closed by the CADFPI, which simultaneously appointed the FDIC as receiver. To protect insured depositors, the FDIC created the Deposit Insurance National Bank (DINB) of Santa Clara, an institution operated by the FDIC on a temporary basis to provide insured depositors with continued access to their funds until they could open accounts at other insured institutions. The FDIC also announced its intent to provide uninsured depositors with an advance dividend against their claims for the uninsured amounts of their deposits as soon as Monday, March 13, when the DINB of Santa Clara was scheduled to reopen.[18]

By using a DINB and announcing an advance dividend, the FDIC hoped to minimize disruption for insured depositors and to provide a measure of immediate relief for the uninsured depositors while the agency worked to resolve the institution. The FDIC did not foreclose the possibility that another institution could purchase the deposits or assets of the failed bank, an unlikely but far preferable outcome to liquidation. Over the weekend, the FDIC actively solicited interest for a purchase and assumption of the failed bank.

Although several institutions expressed an interest in acquiring SVB, given the limited timeframe for bidders to consider making an offer, the FDIC received bids from only two institutions, only one of which provided a valid offer on the insured deposits and some of the assets of SVB.[19] The costs associated with the sole valid offer would have resulted in recoveries significantly below the estimated recoveries in liquidation. Once the systemic risk determination was made, the FDIC was able to move all depositors and assets into a bridge bank and continue the operations of SVB, enabling the FDIC to engage a wider range of potential acquirers. As a result, the decision was made to conduct an expanded marketing effort of the institution on a whole-bank basis, which was anticipated to engender more and better offers.

Signature Bank Closing

Unlike SVB, which catered almost exclusively to venture capital firms, and Silvergate Bank, which was almost exclusively known for providing services to digital asset firms, Signature Bank was a commercial bank with several business lines. For example, of its approximately $74 billion in total loans as of year-end 2022, approximately $33 billion were in its commercial real estate portfolio, approximately $19.5 billion of which consisted of multifamily real estate. Signature Bank also had a $34 billion commercial and industrial loan portfolio; $28 billion of these were loans made through the Fund Banking Division, which provided loans to private equity

[14] See Silicon Valley Bank Strategic Actions/Q1 2023 Mid-Quarter Update (March 8, 2023), available at *https://s201.q4cdn.com/589201576/files/doc—downloads/2023/03/Q1-2023-Mid-Quarter-Update-vFINAL3-030823.pdf.*

[15] See SVB Financial Group Form 8-K (March 8, 2023), available at *https://www.sec.gov/ix?doc=/Archives/edgar/data/719739/000119312523064680/d430920d8k.htm.*

[16] See *New York Times*, "Silicon Valley Bank's Financial Stability Worries Investors" (March 9, 2023), available at *https://www.nytimes.com/2023/03/09/business/silicon-valley-bank-investors-worry.html.*

[17] Ibid.

[18] See FDIC Press Release, "FDIC Creates a Deposit Insurance National Bank of Santa Clara To Protect Insured Depositors of Silicon Valley Bank, Santa Clara, California" (March 10, 2023), available at *https://www.fdic.gov/news/press-releases/2023/pr23016.html.*

[19] The other institution failed to submit a resolution from its board of directors authorizing its offers on SVB; therefore, the offers could not be considered.

firms and their general partners. Unlike SVB, which showed depreciation in its total securities portfolio of 104 percent to total capital, Signature Bank's level of depreciation was approximately 30 percent.

Signature Bank's operating model did share some of the same risk characteristics of both Silvergate Bank and SVB. Like SVB, Signature Bank grew rapidly, from $43 billion in total assets at year-end 2017 to $110 billion at year-end 2022. Growth was particularly significant from 2019 to 2020, when assets grew 64 percent. Also like SVB, Signature Bank was heavily reliant on uninsured deposits for funding. At year-end 2022, SVB reported uninsured deposits at 88 percent of total deposits versus 90 percent for Signature Bank. Signature Bank also operated a business line serving venture capital firms, although it was much smaller than that of SVB, at less than one percent of total loans and only 2 percent of total deposits. Moreover, in 2019, Signature Bank opened an office in San Francisco—the site of SVB's home office—and later opened another in Los Angeles, although West Coast operations were small in relation to the overall bank.

Like Silvergate Bank, Signature Bank had also focused a significant portion of its business model on the digital asset industry. Signature Bank began onboarding digital asset customers in 2018, many of whom used its Signet platform, an internal distributed ledger technology solution that allowed customers of Signature Bank to conduct transactions with each other on a 24 hours a day/7 days a week basis. As of year-end 2022, deposits related to digital asset companies totaled about 20 percent of total deposits, but the bank had no loans to digital asset firms. Silvergate Bank operated a similar platform that was also used by digital asset firms.[20] These were the only two known platforms of this type within U.S. insured institutions.

Signature Bank's balance sheet shrank during 2022, from $118 billion in total assets and $110 billion in total deposits at year-end 2021 to $110 billion in total assets and $89 billion in total deposits at year-end 2022. In the second and third quarters of 2022, Signature Bank, like Silvergate, experienced deposit withdrawals and a drop in its stock price as a consequence of disruptions in the digital asset market due to failures of several high profile digital asset companies.[21] Signature Bank met these deposit withdrawals with cash.

Signature Bank was subject to media scrutiny following the bankruptcy of FTX and Alameda Trading in November 2022, as the bank had deposit relationships with both.[22] Subsequently, in December 2022, Signature Bank announced that it would reduce its exposure to digital asset related deposits.[23] These declines were funded primarily by cash and borrowings collateralized with securities.

In February 2023, Signature Bank was again subject to media attention when a lawsuit was filed alleging it facilitated FTX commingling of accounts.[24] Following the March 1, 2023, announcement by Silvergate Bank regarding the delay in filing its year-end 2022 financial statements and comments about its ability to continue as a going concern, Signature Bank once again experienced negative media attention, which raised questions about its liquidity position.[25] This attention continued as Silvergate Bank later announced its self-liquidation.

Subsequently, as word of SVB's problems began to spread, Signature Bank began to experience contagion effects with deposit outflows that began on March 9 and became acute on Friday, March 10, with the announcement of SVB's failure. On March 10, Signature Bank lost 20 percent of its total deposits in a matter of hours, depleting its cash position and leaving it with a negative balance with the Federal

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[20] See CoinDesk, "Silvergate Closes SEN Platform Institutions Used To Send Money to Crypto Exchanges" (March 3, 2023), available at *https://www.coindesk.com/policy/2023/03/03/silvergate-suspends-sen-exchange-network.*

[21] See Bloomberg, "A $60 Billion Crypto Collapse Leads to a New Type of Bank Run" (May 19, 2022), available at at *https://www.bloomberg.com/news/articles/2022-05-19/luna-terra-collapse-reveal-crypto-price-volatility?leadSource=uverify%20wall.*

[22] See *Businesswire*, "Signature Bank Provides Digital Asset Banking Update" (November 15, 2022), available at *https://www.businesswire.com/news/home/20221115006076/en/*. See also Seeking Alpha, "Silvergate Gives Mid-Quarter Update After FTX Collapse"; stock slips (November 16, 2022), available at *https://seekingalpha.com/news/3908970-silvergate-gives-mid-quarter-update-after-ftx-collapse-stock-slips.*

[23] See PYMNTS, "Signature Bank Tries To Distance Itself From Crypto" (December 6, 2022), available at *https://www.pymnts.com/cryptocurrency/2022/signature-bank-tries-to-distance-itself-from-crypto/*.

[24] See CoinDesk, "Signature Bank Sued for 'Substantially Facilitating' FTX Comingling" (February 7, 2023), available at *https://www.coindesk.com/business/2023/02/07/signature-bank-sued-for-substantially-facilitating-ftx-comingling/*.

[25] See *Crain's New York Business*, "Signature Bank Warns Its Growth Could Be Impacted if the Cryptocurrency World Suffers Another Downdraft" (March 6, 2023), available at *https://www.crainsnewyork.com/finance/signature-bank-warns-its-growth-could-be-impacted-if-cryptocurrency-world-suffers-another.*

Reserve as of close of business. Bank management could not provide accurate data regarding the amount of the deficit, and resolution of the negative balance required a prolonged joint effort among Signature Bank, regulators, and the Federal Home Loan Bank of New York to pledge collateral and obtain the necessary funding from the Federal Reserve's Discount Window to cover the negative outflows. This was accomplished with minutes to spare before the Federal Reserve's wire room closed.

Over the weekend, liquidity risk at the bank rose to a critical level as withdrawal requests mounted, along with uncertainties about meeting those requests, and potentially others in light of the high level of uninsured deposits, raised doubts about the bank's continued viability.

Ultimately, on Sunday, March 12, the NYSDFS closed Signature Bank and appointed the FDIC as receiver within 48 hours of SVB's failure.[26]

Systemic Risk Determination

With the rapid collapse of SVB and Signature Bank in the space of 48 hours, concerns arose that risk could spread to other institutions and that the financial system as a whole could be placed at risk. Shortly after SVB was closed on Friday, March 10, a number of institutions with large amounts of uninsured deposits reported that depositors had begun to withdraw their funds. Some of these banks drew against borrowing lines collateralized by loans and securities to meet demands and bolster liquidity positions. As previously noted, the industry's unrealized losses on securities were $620 billion as of December 31, 2022, and fire sales driven by deposit outflows could have further depressed prices and impaired equity.

With the failure of SVB and the impending failure of Signature Bank, concerns had also begun to emerge that a least-cost resolution of the banks, absent more immediate assistance for uninsured depositors, could have negative knock-on consequences for depositors and the financial system more broadly. With uninsured depositors at the two banks likely to face an undetermined amount of losses, depositors at other banks began to move some or all of their deposits to other banks to diversify their exposures and increase their deposit insurance coverage.[27] There were also concerns that investors could begin to doubt the financial strength of similarly situated institutions making it difficult and more expensive for these banks to obtain needed capital and wholesale funding.

A significant number of the uninsured depositors at SVB and Signature Bank were small and medium-sized businesses. As a result, there were concerns that losses to these depositors would put them at risk of not being able to make payroll and pay suppliers. Moreover, with the liquidity of banking organizations further reduced and their funding costs increased, banking organizations could become even less willing to lend to businesses and households. These effects would contribute to weaker economic performance, further damage financial markets, and have other material negative effects.

Faced with these risks, the FDIC Board voted unanimously on March 12, to recommend that the Secretary of the Treasury, in consultation with the President, make a systemic risk determination under the FDI Act with regard to the resolution of SVB and Signature Bank.[28] That same day, the Federal Reserve Board unanimously made a similar recommendation, and the Secretary of the Treasury determined that complying with the least-cost provisions in Section 13(c)(4) of the FDI Act would have serious adverse effects on economic conditions or financial stability, and any action or assistance taken under the systemic risk exception would avoid or mitigate such adverse effects.

The systemic risk determination enabled the FDIC to extend deposit insurance protection to all of the depositors of SVB and Signature Bank, including uninsured depositors, in winding down the two failed banks. At SVB, the depositors protected by the guarantee of uninsured depositors included not only small and mid-size business customers but also customers with very large account balances. The ten largest deposit accounts at SVB held $ 13.3 billion, in the aggregate.

The systemic risk determination does not protect any shareholders or unsecured debt holders of the two failed banks.[29] The board and the most senior executives of the banks were removed. The FDIC has authority to investigate and hold ac-

[26] See FDIC Press Release, "FDIC Establishes Signature Bridge Bank, N.A., as Successor to Signature Bank, New York, NY" (March 12, 2023), available at *https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/signature-ny.html.*

[27] Depositors also moved funds to Treasury securities and Government money market funds.

[28] 12 U.S.C. §1823(c)(4)(G).

[29] The FDIC as receiver for a failed bank routinely affirms the bank's obligations to providers of services, such as, for example, IT contractors and utility companies, because the payment of these obligations is necessary for the administration of the bank's receivership. 12 U.S.C. §1821(d)(2)(B) & (d)(11).

countable the directors, officers and other professional service providers of the bank for the losses they caused to the bank and for their misconduct in the management of the bank.[30] The FDIC has already commenced these investigations. In accordance with the law, any losses to the DIF as the result of extending coverage to the uninsured depositors are to be recovered by a special assessment on the banking industry.[31]

Establishment of the Bridge Banks

After the systemic risk determination was approved on March 12, the FDIC chartered Silicon Valley Bridge Bank, N.A., (SV Bridge Bank) and transferred all deposits, both insured and uninsured, and substantially all the assets of SVB to SV Bridge Bank.[32] The FDIC also chartered Signature Bridge Bank, N.A., (Signature Bridge Bank) and transferred all deposits and substantially all assets of the failed Signature Bank to Signature Bridge Bank.[33]

A bridge bank is a chartered national bank that operates on a temporary basis under management appointed by the FDIC.[34] It assumes the deposits and certain other liabilities and purchases certain assets of a failed bank. The bridge bank structure is designed to "bridge" the gap between the failure of a bank and the time when the FDIC can stabilize the institution and implement an orderly resolution. It also provides prospective purchasers with the time necessary to assess the bank's condition in order to submit their offers.

Depositors and borrowers of SVB and Signature Bank automatically became customers of the new bridge institutions, which reopened on Monday, March 13, with normal business activities.

Marketing and Sale of the Bridge Banks

The FDIC's ultimate goal in operating a bridge institution is always to return the institution to private control as quickly as possible. In the context of SVB and Signature Bank, this goal was especially important, given the need to provide stability and certainty to affected depositors and customers of the banks, as well as to maintain stability and confidence in the banking system and stem the risk of contagion to other financial institutions. The FDIC opened bidding for the bridge banks on Wednesday, March 15.

Signature Bridge Bank Purchase and Assumption Agreement

Bidding for Signature Bridge Bank closed on Saturday, March 18. The FDIC received five bids from four bidders. The FDIC Board approved Flagstar Bank, N.A., Hicksville, New York, a wholly owned subsidiary of New York Community Bancorp, Inc., Westbury, New York, as the successful bidder.

On March 19, the FDIC entered into a purchase and assumption agreement for the acquisition of substantially all deposits and certain loan portfolios of Signature Bridge Bank by Flagstar Bank, N.A. The 40 former branches of Signature Bank began operating under Flagstar Bank, N.A., on Monday, March 20. Depositors of Signature Bridge Bank, other than depositors related to the digital asset banking business, automatically became depositors of the acquiring institution. The acquiring institution did not bid on the deposits of those digital asset banking customers. The FDIC is providing those deposits, approximating $4 billion, directly to those customers.

As of December 31, 2022, the former Signature Bank had total deposits of $88.6 billion and total assets of $110.4 billion. The transaction with Flagstar Bank, N.A., included the purchase of about $38.4 billion of Signature Bridge Bank's assets, including loans of $12.9 billion purchased at a discount of $2.7 billion. Approximately

[30] The FDIC as receiver for SVB and Signature Bank will pursue all civil actions against directors, officers, and professional service providers of the former banks that are meritorious and cost-effective, as permitted under State and Federal law. Additionally, the FDIC in its supervisory capacity may pursue administrative enforcement actions against SVB's officers and directors and institution-affiliated parties, including the assessment of civil money penalties and prohibitions from the banking industry, where the individual's misconduct evidences personal dishonesty, recklessness, or a willful or continuing disregard for the safety and soundness of the institution. 12 U.S.C. §1818(e) & (i). 12 U.S.C. §1821(d)(13)(E). See also 12 U.S.C. §1821(k) and 12 U.S.C. §1818.

[31] 12 U.S.C. §1823(c)(4)(G)(ii).

[32] See FDIC Press Release, "FDIC Acts To Protect All Depositors of the Former Silicon Valley Bank, Santa Clara, California" (March 13, 2023), available at *https://www.fdic.gov/news/press-releases/2023/pr23019.html.*

[33] See FDIC Press Release, "FDIC Establishes Signature Bridge Bank, N.A., as Successor to Signature Bank, New York, NY" (March 12, 2023), available at *https://www.fdic.gov/news/press-releases/2023/pr23018.html.*

[34] 12 U.S.C. §1821(n).

$60 billion in loans will remain in the receivership for later disposition by the FDIC. In addition, the FDIC received equity appreciation rights in New York Community Bancorp, Inc., common stock with a potential value of up to $300 million.

SV Bridge Bank Purchase and Assumption Agreement

On March 20, the FDIC announced it would extend the bidding process for SV Bridge Bank.[35] While there was substantial interest from multiple parties, the FDIC determined it needed additional time to explore all options in order to maximize value and achieve the optimal outcome. The FDIC also announced it would allow parties to submit separate bids for SV Bridge Bank and its subsidiary Silicon Valley Private Bank. Qualified, insured banks and qualified, insured banks in alliance with nonbank partners would be able to submit whole-bank bids or bids on the deposits or assets of the institutions. Bank and nonbank financial firms were permitted to bid on the asset portfolios.

Bidding for Silicon Valley Private Bank and SV Bridge Bank closed on March 24. The FDIC received 27 bids from 18 bidders, including bids under the whole-bank, private bank, and asset portfolio options. On March 26, the FDIC approved First-Citizens Bank & Trust Company (First-Citizens), Raleigh, North Carolina, as the successful bidder to assume all deposits and loans of SV Bridge Bank. First-Citizens also acquired the bank's private wealth management business. The 17 former branches of SV Bridge Bank in California and Massachusetts reopened as First-Citizens on March 27.

As of March 10, 2023, SV Bridge Bank had approximately $167 billion in total assets and about $119 billion in total deposits. The transaction with First-Citizens included the purchase of about $72 billion of SV Bridge Bank's assets at a discount of $16.5 billion. Approximately $90 billion in securities and other assets remained in the receivership for disposition by the FDIC. In addition, the FDIC received equity appreciation rights in First Citizens BancShares, Inc., Raleigh, North Carolina, common stock with a potential value of up to $500 million.

The FDIC and First-Citizens entered into a loss-share transaction on the commercial loans it purchased of the former SV Bridge Bank.[36] The FDIC as receiver and First-Citizens will share in the losses and potential recoveries on the loans covered by the loss-share agreement. The loss-share transaction is projected to maximize recoveries on the assets by keeping them in the private sector. The transaction is also expected to minimize disruptions for loan customers

Impact on the Deposit Insurance Fund

The FDIC estimates that the cost to the DIF of resolving SVB to be $20 billion. The FDIC estimates the cost of resolving Signature Bank to be $2.5 billion. Of the estimated loss amounts, approximately 88 percent, or $18 billion, is attributable to the cost of covering uninsured deposits at SVB while approximately two-thirds, or $1.6 billion, is attributable to the cost of covering uninsured deposits at Signature Bank. I would emphasize that these estimates are subject to significant uncertainty and are likely to change, depending on the ultimate value realized from each receivership.

Under the FDI Act, the loss to the DIF arising from the use of a systemic risk exception must be recovered from one or more special assessments on insured depository institutions, depository institution holding companies, or both, as the FDIC determines to be appropriate.[37] The FDI Act provides the agency with discretion in the design and timeframe for any special assessment to cover the losses from the systemic risk exception. Specifically, the law requires the FDIC to consider: the types of entities that benefit from the action taken, economic conditions, the effects on the industry, and such other factors as the FDIC deems appropriate and relevant.[38] Finally, the FDI Act requires that a special assessment be prescribed through regulation.[39] The FDIC intends to seek input on any special assessment from all stakeholders through notice-and-comment rulemaking and expects to issue a notice of proposed rulemaking for a special assessment related to the failures of SVB and Signature Bank in May 2023.

Current State of the U.S. Financial System

The state of the U.S. financial system remains sound despite recent events.

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[35] See FDIC Press Release, "FDIC Extends Bid Window for Silicon Valley Bridge Bank, N.A." (March 20, 2023), available at *https://www.fdic.gov/news/press-releases/2023/pr23022.html.*

[36] For more information on FDIC loss share transactions, see *https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/lossshare/index.html.*

[37] 12 U.S.C. §1823(c)(4)(G)(ii)(I).

[38] 12 U.S.C. §1823(c)(4)(G)(ii)(III).

[39] Ibid.

The FDIC has been closely monitoring liquidity, including deposit trends, across the banking industry. Since the action taken by the Government to support the banking system, there has been a moderation of deposit outflows at the banks that were experiencing large outflows the week of March 6. In general, banks have been prudently working preemptively to increase liquidity and build liquidity buffers.

Over the past 2 weeks, banks have relied on new Federal Home Loan Bank (FHLB) advances to strengthen liquidity and have also pre-positioned additional collateral at the FHLB to support future draws, if needed. Banks have also prepared to access the Federal Reserve's Discount Window and new Bank Term Funding Program by ensuring that they have prepositioned collateral. It is important that we, as regulators, message to our supervised institutions that these facilities can and should be used to support liquidity needs. Sales of investment securities have been a less common source of liquidity as the level of unrealized loss across both available-for-sale and held-to-maturity portfolio remains elevated.

With reference to deposits, as expected, banks report that they are closely monitoring deposit trends and researching unexpected account activity. Banks report instances of corporate depositors, in particular, moving some or all of their deposits to diversify their exposures and increase their deposit insurance coverage. Banks have also reported clients moving their deposits out of the banking system and into Government money market funds or U.S. Treasuries. In general, the largest banks appear to be net beneficiaries of deposit flows, increasing the amounts on deposit, or held in custody, at the global systemically important banks and at large regional banks. While some banks are reporting a moderate decline in total deposits over the past 2 weeks, the vast majority are reporting no material outflows.

The FDIC is also following other trends in bank activities, in particular, the steps institutions are taking to support capital and liquidity in times of market instability and uncertain deposit outlook.

More broadly, the financial system continues to face significant downside risks from the effects of inflation, rising market interest rates, and continuing geopolitical uncertainties. Credit quality and profitability may weaken due to these risks, potentially resulting in tighter loan underwriting, slower loan growth, higher provision expenses, and liquidity constraints. Additional short-term interest rate increases, combined with longer asset maturities may continue to increase unrealized losses on securities and affect bank balance sheets in coming quarters.

Preliminary Lessons Learned

In the immediate aftermath of the failure of SVB and Signature Bank, some preliminary lessons can be identified. A common thread between the failure of SVB and the failure of Signature Bank was the banks' heavy reliance on uninsured deposits. As of December 31, 2022, Signature Bank reported that approximately 90 percent of its deposits were uninsured, and SVB reported that 88 percent of its deposits were uninsured. The significant proportion of uninsured deposit balances exacerbated deposit run vulnerabilities and made both banks susceptible to contagion effects from the quickly evolving financial developments. One clear takeaway from recent events is that heavy reliance on uninsured deposits creates liquidity risks that are extremely difficult to manage, particularly in today's environment where money can flow out of institutions with incredible speed in response to news amplified through social media channels.

A common thread between the collapse of Silvergate Bank and the failure of SVB was the accumulation of losses in the banks' securities portfolios. In the wake of the pandemic, as interest rates remained at near-zero, many institutions responded by "reaching for yield" through investments in longer-term assets, while others reduced on-balance sheet liquidity—cash, Federal funds—to increase overall yields on earning assets and maintain net interest margins. These decisions led to a second common theme at these institutions—heightened exposure to interest rate risk, which lay dormant as unrealized losses for many banks as rates quickly rose over the last year. When Silvergate Bank and SVB experienced rapidly accelerating liquidity demands, they sold securities at a loss. The now realized losses created both liquidity and capital risk for those firms, resulting in a self-liquidation and failure.

Finally, the failures of SVB and Signature Bank also demonstrate the implications that banks with assets of $100 billion or more can have for financial stability. The prudential regulation of these institutions merits additional attention, particularly with respect to capital, liquidity, and interest rate risk. This would include the capital treatment associated with unrealized losses in banks' securities portfolios. Given the financial stability risks caused by the two failed banks, the methods for planning and carrying out a resolution of banks with assets of $100 billion or more also merit special attention, including consideration of a long-term debt requirement to facilitate orderly resolutions.

Conclusion

Recent efforts to stabilize the banking system and stem potential contagion from the failures of SVB and Signature Bank have ensured that depositors will continue to have access to their savings, that small businesses and other employers can continue to make payrolls, and that other banks—small, medium, and large—can continue to extend credit to borrowers and serve as a source of support. The FDIC continues to monitor developments and is prepared to use all of its authorities as needed.

The circumstances surrounding the failures of SVB and Signature Bank merit further thorough review by both regulators and policymakers. The FDIC's Chief Risk Officer will undertake a review of the FDIC's supervision of Signature Bank and intends to release a report by May 1, 2023. The FDIC will also undertake a comprehensive review of the deposit insurance system and will release by May 1, 2023, a report that will include policy options for consideration related to deposit insurance coverage levels, excess deposit insurance, and the implications for risk-based pricing and deposit insurance fund adequacy.

The FDIC is committed to working cooperatively with our counterparts at the other Federal regulators as well as with policymakers in the Congress to better understand what brought these institutions to failure and what measures can be taken to prevent similar failures in the future.

PREPARED STATEMENT OF MICHAEL BARR

VICE CHAIRMAN FOR SUPERVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MARCH 28, 2023

Chairman Brown, Ranking Member Scott, and other Members of the Committee, thank you for the opportunity to testify today on the Federal Reserve's supervisory and regulatory oversight of Silicon Valley Bank (SVB). [1]

Our banking system is sound and resilient, with strong capital and liquidity. The Federal Reserve, working with the Treasury Department and the Federal Deposit Insurance Corporation (FDIC), took decisive actions to protect the U.S. economy and to strengthen public confidence in our banking system. These actions demonstrate that we are committed to ensuring that all deposits are safe. We will continue to closely monitor conditions in the banking system and are prepared to use all of our tools for any size institution, as needed, to keep the system safe and sound.

At the same time, the events of the last few weeks raise questions about evolving risks and what more can and should be done so that isolated banking problems do not undermine confidence in healthy banks and threaten the stability of the banking system as a whole. At the forefront of my mind is the importance of maintaining the strength and diversity of banks of all sizes that serve communities across the country.

SVB failed because the bank's management did not effectively manage its interest rate and liquidity risk, and the bank then suffered a devastating and unexpected run by its uninsured depositors in a period of less than 24 hours. SVB's failure demands a thorough review of what happened, including the Federal Reserve's oversight of the bank. I am committed to ensuring that the Federal Reserve fully accounts for any supervisory or regulatory failings, and that we fully address what went wrong.

Our first step is to establish the facts—to take an unflinching look at the supervision and regulation of SVB before its failure. This review will be thorough and transparent, and reported to the public by May 1. The report will include confidential supervisory information, including supervisory assessments and exam material, so that the public can make its own assessment. [2] Of course, we welcome and expect external reviews as well.

Why the Bank Failed

To begin, SVB's failure is a textbook case of mismanagement. The bank had a concentrated business model, serving the technology and venture capital sector. It also grew exceedingly quickly, tripling in asset size between 2019 and 2022. During the early phase of the pandemic, and with the tech sector booming, SVB saw significant

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[1] This testimony uses "Silicon Valley Bank (SVB)" to refer to both the State member bank, Silicon Valley Bank, and its bank holding company, SVB Financial Group.

[2] Typically, the Board does not disclose confidential supervisory information. We are sharing confidential supervisory information in the case of SVB because the bank went into resolution, and its disorderly failure posed systemic risk.

deposit growth. The bank invested the proceeds of these deposits in longer-term securities, to boost yield and increase its profits.[3] However, the bank did not effectively manage the interest rate risk of those securities or develop effective interest rate risk measurement tools, models, and metrics.

At the same time, the bank failed to manage the risks of its liabilities. These liabilities were largely composed of deposits from venture capital firms and the tech sector, which were highly concentrated and could be volatile. Because these companies generally do not have operating revenue, they keep large balances in banks in the form of cash deposits, to make payroll and pay operating expenses. These depositors were connected by a network of venture capital firms and other ties, and when stress began, they essentially acted together to generate a bank run.

The Bank's Failure

The bank waited too long to address its problems, and ironically, the overdue actions it finally took to strengthen its balance sheet sparked the uninsured depositor run that led to the bank's failure. Specifically, on Wednesday, March 8, SVB announced that it realized a $1.8 billion loss in a sale of securities to raise liquidity and planned to raise capital during the following week. Uninsured depositors interpreted these actions as a signal that the bank was in distress. They turned their focus to the bank's balance sheet, and they did not like what they saw.

In response, social media saw a surge in talk about a run, and uninsured depositors acted quickly to flee. Depositors withdrew funds at an extraordinary rate, pulling more than $40 billion in deposits from the bank on Thursday, March 9. On Thursday evening and Friday morning, the bank communicated that they expected even greater outflows that day. The bank did not have enough cash or collateral to meet those extraordinary and rapid outflows, and on Friday, March 10, SVB failed.

Panic prevailed among SVB's remaining depositors, who saw their savings at risk and their businesses in danger of missing payroll because of the bank's failure.

Contagion and the Government's Response

It appeared that contagion from SVB's failure could be far-reaching and cause damage to the broader banking system. The prospect of uninsured depositors not being able to access their funds could prompt depositors to question the overall safety and soundness of U.S. commercial banks. There were signs of distress at other banking organizations, and Signature Bank, an FDIC-supervised institution, experienced a deposit run that resulted in the bank's failure. On Sunday, March 12, the Secretary of the Treasury, upon the unanimous recommendation of the boards of the Federal Reserve and the FDIC, approved systemic risk exceptions for the failures of SVB and Signature. This enabled the FDIC to guarantee all of the deposits of both banks. Equity and other liability holders of the two failed banks were not protected and lost their investments. Senior management was immediately removed.

In addition, the Federal Reserve Board (Board), with the Treasury Department's approval, created a temporary lending facility, the Bank Term Funding Program, to allow banks to receive additional liquidity to meet any unexpected depositor demand. The facility allows banks to borrow against safe Treasury and agency securities at par for up to 1 year. Together with banks' internal liquidity and stable deposits, other external sources, and discount window lending, the new facility provides ample liquidity for the banking system as a whole.

Our Review of the Bank's Failure

Immediately following SVB's failure, Chair Powell and I agreed that I should oversee a review of the circumstances leading up to SVB's failure. SVB was a State member bank with a bank holding company, and so the Federal Reserve was fully responsible for the Federal supervision and regulation of the bank. The California Department of Financial Protection and Innovation—the State supervisor—has announced its own review of its oversight and regulation of SVB.

In the Federal Reserve's review, we are looking at SVB's growth and management, our supervisory engagement with the bank, and the regulatory requirements that applied to the bank. As this process is ongoing, I will be limited in my ability to provide firm conclusions, but I will focus on what we know and where we are focusing the review.

The picture that has emerged thus far shows SVB had inadequate risk management and internal controls that struggled to keep pace with the growth of the bank. In 2021, as the bank grew rapidly in size, the bank moved into the large and foreign banking organization, or LFBO, portfolio to reflect its larger risk profile and was

[3] By year-end 2022, the firm's investment portfolio represented over 55 percent of its total assets.

assigned a new team of supervisors. LFBO firms between $100 billion and $250 billion are subject to some enhanced prudential standards but not at the level of larger banks or global systemically important banks (G–SIBs).

Near the end of 2021, supervisors found deficiencies in the bank's liquidity risk management, resulting in six supervisory findings related to the bank's liquidity stress testing, contingency funding, and liquidity risk management.[4] In May 2022, supervisors issued three findings related to ineffective board oversight, risk-management weaknesses, and the bank's internal audit function. In the summer of 2022, supervisors lowered the bank's management rating to "fair" and rated the bank's enterprisewide governance and controls as "deficient-1." These ratings mean that the bank was not "well-managed" and was subject to growth restrictions under section 4(m) of the Bank Holding Company Act.[5] In October 2022, supervisors met with the bank's senior management to express concern with the bank's interest rate risk profile and in November 2022, supervisors delivered a supervisory finding on interest rate risk management to the bank.

In mid-February 2023, staff presented to the Federal Reserve's Board of Governors on the impact of rising interest rates on some banks' financial condition and staff's approach to address issues at banks. Staff discussed the issues broadly, and highlighted SVB's interest rate and liquidity risk in particular. Staff relayed that they were actively engaged with SVB but, as it turned out, the full extent of the bank's vulnerability was not apparent until the unexpected bank run on March 9.

Review Focus on Supervision

With respect to our review, let me start with the supervision of the bank. For all banks but the G–SIBs, the Federal Reserve organizes its supervisory approach based on asset size. The G–SIBs—our largest, most complex banks—are supervised within the Large Institution Supervision Coordinating Committee, or LISCC, portfolio. Banks with assets of $100 billion or more that are not G–SIBs are supervised within the LFBO portfolio. Banks with assets in the $10 to $100 billion range are supervised within the regional banking organization, or RBO, portfolio. Banks with assets of less than $10 billion are supervised within the community banking organization, or CBO, portfolio.

As I mentioned, SVB grew exceedingly quickly, moving from the RBO portfolio to the LFBO portfolio in 2021. Banks in the RBO portfolio are supervised by smaller teams that engage with the bank on a quarterly basis and conduct a limited number of targeted exams and a full-scope examination each year.[6] Banks in the LFBO portfolio are supervised by larger teams that engage with the bank on an ongoing basis. As compared to RBOs, LFBO banks are subject to a greater number of targeted exams, as well as horizontal (cross-bank) exams that assess risks such as capital, liquidity, and cybersecurity throughout the year.[7] In addition, banks in the LFBO portfolio are subject to a supervision framework with higher supervisory standards, including heightened standards for capital, liquidity, and governance.[8]

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[4] Supervisory findings include Matters Requiring Attention (MRA) and Matters Requiring Immediate Attention (MRIA). An MRA is "a call for action to address weaknesses that could lead to deterioration in a banking organization's soundness." An MRIA is "a call for more immediate action to address acute or protracted weaknesses that could lead to further deterioration in a banking organization's soundness, may result in harm to consumers, or have caused, or could lead to, noncompliance with laws and regulations." MRAs and MRIAs typically are the first step in communicating supervisory findings to a firm. When a bank has a weakness, supervisors decide whether to assign an MRA or MRIA—and the timeline for remediation—depending on the severity of the issue. The number of MRAs and MRIAs per firm is variable and largely reflects the extent of risk-management weaknesses of a firm. While most MRAs and MRIAs are resolved without further escalation, to the extent not resolved, they can serve as the basis for provisions included in a public enforcement action. See Board of Governors of the Federal Reserve System, "Supervision and Regulation Report" (Washington: Board of Governors, November 2019), at 21, *https://www.federalreserve.gov/publications/files/201911-supervision-and-regulation-report.pdf.*

[5] 12 U.S.C. §1843(m), 12 CFR §225.83. The growth restrictions under section 4(m) apply to the expansion of nonbank activities through merger and acquisition.

[6] A full scope examination is an assessment of safety and soundness of a bank and includes an evaluation of financial condition, risk management, and control. A target examination is an assessment of a particular area or risk within a firm.

[7] A horizontal review is an examination in a particular area or risk that is coordinated across several firms. Horizontal reviews also provide a clear picture of the relative risk in an individual firm and allow supervisors to align supervisory expectations with the firm's risk profile. For more information, see Board of Governors of the Federal Reserve System, Supervision and Regulation Report (Washington: Board of Governors, May 2019), at 18, *https://www.federalreserve.gov/publications/files/201905-supervision-and-regulation-report.pdf.*

[8] SR letter 12-17 / CA 12-14, "Consolidated Supervision Framework for Large Financial Institutions," *https://www.federalreserve.gov/supervisionreg/srletters/sr1217.htm.*

In our review, we are focusing on whether the Federal Reserve's supervision was appropriate for the rapid growth and vulnerabilities of the bank. While the Federal Reserve's framework focuses on size thresholds, size is not always a good proxy for risk, particularly when a bank has a nontraditional business model. As I mentioned in a speech this month, the Federal Reserve had recently decided to establish a dedicated novel activity supervisory group, with a team of experts focused on risks of novel activities, which should help improve oversight of banks like SVB in the future.[9]

But the unique nature of this bank and its focus on the technology sector are not the whole story. After all, SVB's failure was brought on by mismanagement of interest rate risk and liquidity risks, which are well-known risks in banking. Our review is considering several questions:

- How effective is the supervisory approach in identifying these risks?
- Once risks are identified, can supervisors distinguish risks that pose a material threat to a bank's safety and soundness?
- Do supervisors have the tools to mitigate threats to safety and soundness?
- Do the culture, policies, and practices of the Board and Reserve Banks support supervisors in effectively using these tools?

Beyond asking these questions, we need to ask why the bank was unable to fix and address the issues we identified in sufficient time. It is not the job of supervisors to fix the issues identified; it is the job of the bank's senior management and board of directors to fix its problems.

Review Focus on Regulation

Let me now turn to regulation. In 2019, following the passage of "The Economic Growth, Regulatory Relief, and Consumer Protection Act", the Federal Reserve revised its framework for regulation, maintaining the enhanced prudential standards applicable to G–SIBs but tailoring requirements for all other large banks. At the time of its failure, SVB was a "Category IV" bank, which meant that it was subject to a less stringent set of enhanced prudential standards than would have applied before 2019; they include less frequent stress testing by the Board, no bank-run capital stress testing requirements, and less rigorous capital planning and liquidity risk-management standards. SVB was not required to submit a resolution plan to the Federal Reserve, although its bank was required to submit a resolution plan to the FDIC.[10] And as a result of transition periods and the timing of biennial stress testing, SVB would not have been subject to stress testing until 2024, a full 3 years after it crossed the $100 billion asset threshold.[11]

Also in 2019, the banking agencies tailored their capital and liquidity rules for large banks, and as a result, SVB was not subject to the liquidity coverage ratio or the net stable funding ratio.[12] In addition, SVB was not subject to the supplementary leverage ratio, and its capital levels did not have to reflect unrealized losses on certain securities.

All of these changes are in the scope of our review. Specifically, we are evaluating whether application of more stringent standards would have prompted the bank to better manage the risks that led to its failure. We are also assessing whether SVB would have had higher levels of capital and liquidity under those standards, and whether such higher levels of capital and liquidity would have forestalled the bank's failure or provided further resilience to the bank.

Ongoing Work To Understand and Address Emerging Risks

As I said a few months ago with regards to capital, we must be humble about our ability—and that of bank managers—to predict how a future financial crisis

[9] Michael S. Barr, "Supporting Innovation With Guardrails: The Federal Reserve's Approach to Supervision and Regulation of Banks' Crypto-related Activities" (speech at the Peterson Institute for International Economics, Washington, DC, March 9, 2023), *https://www.federalreserve.gov/newsevents/speech/barr20230309a.htm.*

[10] Previously, SVB was in the $50 billion to $100 billion category, which under the statutory tailoring framework does not require a resolution plan, stress testing, or liquidity rules.

[11] To be subject to enhanced prudential standards, a bank holding company's assets must exceed $100 billion on a four-quarter rolling average. The phase-in for stress testing is roughly 2 years and was unchanged by the 2019 rule changes. However, moving to an every-other-year stress test for Category IV firms can result in another year lag if the phase-in period concludes in an odd-numbered year.

[12] The banking agencies include the Board, the FDIC, and the Office of the Comptroller of the Currency.

might unfold, how losses might be incurred, and what the effect of a financial crisis might be on the financial system and our broader economy.[13]

The failure of SVB illustrates the need to move forward with our work to improve the resilience of the banking system. For example, it is critical that we propose and implement the Basel III endgame reforms, which will better reflect trading and operational risks in our measure of banks' capital needs. In addition, following on our prior advance notice of proposed rulemaking, we plan to propose a long-term debt requirement for large banks that are not G–SIBs, so that they have a cushion of loss-absorbing resources to support their stabilization and allow for resolution in a manner that does not pose systemic risk. We will need to enhance our stress testing with multiple scenarios so that it captures a wider range of risk and uncovers channels for contagion, like those we saw in the recent series of events. We must also explore changes to our liquidity rules and other reforms to improve the resiliency of the financial system.

In addition, recent events have shown that we must evolve our understanding of banking in light of changing technologies and emerging risks. To that end, we are analyzing what recent events have taught us about banking, customer behavior, social media, concentrated and novel business models, rapid growth, deposit runs, interest rate risk, and other factors, and we are considering the implications for how we should be regulating and supervising our financial institutions. And for how we think about financial stability.

Part of the Federal Reserve's core mission is to promote the safety and soundness of the banks we supervise, as well as the stability of the financial system to help ensure that the system supports a healthy economy for U.S. households, businesses, and communities. Deeply interrogating SVB's failure and probing its broader implications is critical to our responsibility for upholding that mission.

Thank you, and I look forward to your questions.

PREPARED STATEMENT OF NELLIE LIANG

UNDER SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

MARCH 28, 2023

Chairman Brown, Ranking Member Scott, and other Members of the Committee, thank you for inviting me to testify today.

I have had the opportunity to speak with Committee Members several times in recent days to share updates from Treasury regarding current events. In light of that, I will keep my introductory remarks brief.

The American economy relies on a healthy banking system—one that includes large, small, and mid-size banks and provides for the financial needs of families, businesses, and local communities. Households depend on banks to finance their cars and homes and build their savings. Businesses borrow from banks to start and expand their operations, creating jobs for American workers and benefits for their local economies.

Nearly 3 weeks ago, problems emerged at two banks with the potential for immediate and significant impacts on the broader banking system and the economy. The situation demanded a swift response. In the days that followed, the Federal Government took decisive actions to strengthen public confidence in the U.S. banking system and protect the American economy.

On March 9th, depositors of Silicon Valley Bank (SVB), withdrew $42 billion in deposits in a period of just a few hours. After concluding that significant deposit withdrawals would continue the next day, the California State regulator closed SVB and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver on March 10th. Two days later, on Sunday March 12th, the New York regulator closed Signature Bank, which also had experienced a depositor run, and appointed the FDIC as receiver.

Treasury worked to assess the effects of these failures on the broader banking system, consulting regularly with the Federal Reserve and FDIC. On Sunday evening, recognizing the urgency of reducing uncertainty for Monday morning, Treasury, the Federal Reserve, and the FDIC announced a number of actions to stem uninsured depositor runs and to prevent significant disruptions to households and businesses.

First, the boards of the FDIC and the Federal Reserve unanimously recommended, and Secretary Yellen approved after consulting with the President, two

[13] Michael S. Barr, "Why Bank Capital Matters" (speech at the American Enterprise Institute, Washington, DC, December 1, 2022), *https://www.federalreserve.gov/newsevents/speech/barr20221201a.htm.*

actions that would enable the FDIC to complete its resolutions of the two banks in a manner that fully protects all of their depositors. These actions ensured that businesses could continue to make payroll and that families could access their funds. Depositors were protected by the Deposit Insurance Fund. Equity holders and bond holders were not covered.

Second, the Federal Reserve created the Bank Term Lending Program, a new facility to provide term funding to all insured depository institutions eligible for primary credit at the discount window, based on their holdings of Treasury and Government agency securities. This program, along with its preexisting discount window, has helped banks meet depositor demands and bolstered liquidity in the banking system.

This two-pronged, targeted approach was necessary to reassure depositors at all banks, and to protect the U.S. banking system and economy. These actions have helped to stabilize deposits throughout the country and provided depositors with confidence that their funds are safe.

In addition to these actions, on March 16th, 11 banks deposited $30 billion into First Republic Bank. The actions of these large and mid-size banks represent a vote of confidence in the banking system and demonstrate the importance of banks of all sizes working to keep our economy strong. Moreover, on March 20th the deposits and certain assets of Signature Bridge Bank were acquired from the FDIC, and on March 26th the deposits and certain assets of Silicon Valley Bridge Bank were acquired from the FDIC.

We continue to closely monitor developments across the banking and financial system, and coordinate with Federal and State regulators. As Secretary Yellen has said, we have used important tools to act quickly to prevent contagion. And they are tools we would use again if warranted to ensure that Americans' deposits are safe.

Looking forward, while we do not yet have all the details about the failures of the two banks, we do know that the recent developments are very different from those of the Global Financial Crisis. Back then, many financial institutions came under stress because they held low credit-quality assets. This was not at all the catalyst for recent events. Our financial system is significantly stronger than it was 15 years ago. This is in large part due to postcrisis reforms for stronger capital and liquidity requirements.

As you know, the Federal Reserve announced a review of the failure of SVB and the FDIC a review of Signature bank. I fully support these reviews and look forward to learning more in order to inform any regulatory and supervisory responses. We must ensure that our bank regulatory policies and supervision are appropriate for the risks and challenges that banks face today.

The American financial system is strong in part because of our dynamic and diverse banking system. Large, small, and mid-size banks all play an important role in our economy. Small and mid-size banks, including community banks, serve a vital role in providing credit and financial support to families and small businesses. Smaller banks provide 60 percent of loans to U.S. small businesses.[1] Their specialized knowledge, expertise, and relationships in their communities enable them to capably serve customers, and their presence increases competition in the banking sector for the benefit of consumers.

I want to thank the Committee for its leadership on these important issues and for inviting me here to testify today. I look forward to your questions.

[1] *https://cdn.advocacy.sba.gov/wp-content/uploads/2022/07/12095600/2020-Small-Business-Lending-Report-508c.pdf*

RESPONSES TO WRITTEN QUESTIONS OF CHAIR BROWN FROM MARTIN GRUENBERG

Questions for the Record from Chairman Brown for
The Honorable Martin J. Gruenberg
Chair, Federal Deposit Insurance Corporation
March 28, 2023 Hearing entitled "Recent Bank Failures and the Federal Regulatory Response."
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1. **What are the steps in the FDIC bid process for failed banks? How comprehensive is the review of a distressed bank when organizing a sale? What is the criteria for a potential buyer, and what is the process for vetting that buyer? What requirements do a potential buyer need to fulfill?**

RESPONSE: The FDIC follows guidelines outlined in the Bidder Lists Preparation and Clearance Directive (Appendix A) to identify qualified insured depository institutions (IDIs) that meet the bidder list criteria established for a particular failing bank. The criteria include sufficient supervisory assessments, sufficient total assets and capital, and in some cases, geographic considerations. Additional supervisory review may be required under certain economic conditions. The FDIC's Division of Risk Management Supervision approves the bidder qualification criteria, and IDIs meeting the criteria are invited to review the specific acquisition opportunity. The FDIC communicates with the appropriate regulatory agencies of all qualified IDIs interested in potentially submitting a bid. IDIs seek supervisory approval and the appropriate regulatory agencies review the details of a potential bid, including the impact on the bidding IDI's condition. The IDIs must receive supervisory approval to submit a bid, and that approval must be communicated to the FDIC. Once the FDIC identifies a potential winning bidder, the FDIC coordinates with other regulators to obtain approvals for the winning bidder to acquire the failing institution.

In some instances, the FDIC may also consider including non-bank entities (e.g., private equity) to participate in a franchise sale, as an alliance partner with a lead IDI and/or to purchase asset pools. The FDIC evaluates potential non-bank bidders based upon their (i) financial ability, (ii) activeness in the financial services markets, and (iii) breadth of their interest in the subject franchise and the assets. Financial advisors contracted by the FDIC to assist with franchise marketing would also evaluate non-bank bidders based upon their market expertise, as well as institutional knowledge and relationships.

The timeframe for a bank failure due to insufficient capital allows the FDIC approximately 70 days to gather information about the bank operations and allow interested bidders time for due diligence. Standardized reports of assets, deposits, loans and other bank financial and operational documents provide the interested bidders and the FDIC marketing and closing team with the ability to assess the bank's condition.

The timeframe for a bank failure due to a liquidity event is much more rapid, limiting time to gather information from the failing bank and for interested bidder due diligence.

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Bid submission requirements include a completed and signed bid form, a signed Board Resolution indicating authority for a designee to submit a bid, a signed Purchaser Eligibility Certificate, and a signed Confidentiality Agreement Reaffirmation.

2. **Silicon Valley Bank's held to maturity securities lost value as interest rates rose over the past year. Market risk management, including interest rate risk, is a basic concept in prudent banking and many regulators were warning about interest rate risk for months. Please provide a list of materials and public statements warning about interest rate risk that would have been available to all regulated institutions.**

RESPONSE: The FDIC has a number of resources available that address interest rate risk, including rules and guidance, informational resources, and other published reports. In addition, interest rate risk and associated potential liquidity and credit risk implications have been noted in speeches, testimony, and during Quarterly Banking Profile presentations.

The FDIC maintains a web page dedicated to information on interest rate risk in the capital markets section[1] of the Banker Resource Center on www.fdic.gov. This web page includes links to regulations, guidance, an examination manual chapter, instructional technical assistance videos, and Supervisory Insights Journal articles focused on interest rate risk.

The FDIC has published safety and soundness standards, policy statements, and advisories on interest rate risk management and the risks of rising interest rates. The long-held safety and soundness principles conveyed in these documents are consistent with the safety and soundness standards for interest rate exposure contained in Part 364 of the FDIC's Rules and Regulations.

The FDIC has issued four key policy statements and advisories on interest rate risk management:

- The Joint Policy Statement on Interest Rate Risk, issued in 1996, provides guidance on sound practices for managing interest rate sensitivity.[2]

- The Advisory on Interest Rate Risk Management, jointly developed and issued in 2010 by the FDIC and the other members of the Federal Financial Institutions Examination Council, encouraged robust processes for measuring and mitigating exposure to higher interest rates.[3]

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[1] See https://www.fdic.gov/resources/bankers/capital-markets/interest-rate-risk/.
[2] See https://www.fdic.gov/news/financial-institution-letters/1996/fil9652.html.
[3] See https://www.fdic.gov/news/financial-institution-letters/2010/fil10002.html.

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- An Interagency Advisory on Interest Rate Management: Frequently Asked Questions, issued in 2012, clarified and elaborated on the supervisory guidance conveyed in the 2010 Advisory.[4]

- Financial Institution Letter: Managing Sensitivity to Market Risk in a Challenging Interest Rate Environment, issued independently by the FDIC in 2013, re-emphasized the importance of a comprehensive asset-liability and interest rate risk management program, and the implications of unrealized losses on securities for capital and liquidity.[5]

Regarding public statements, on November 16, 2022, then Acting Chairman Martin Gruenberg remarked before the House Financial Services Committee that additional interest rate increases combined with longer asset maturities would present challenges for the banking industry in coming quarters. Chairman Gruenberg further alerted the Committee that increasing market interest rates would not only lead to continued growth in unrealized losses in the banking industry's securities portfolios, but could erode real estate and other asset values as well as hamper borrowers' loan repayment ability.[6] Since fourth quarter 2021, the FDIC Quarterly Banking Profiles have also highlighted the potential adverse financial implications for institutions with elevated interest rate risk exposure as industry balance sheets lengthened in duration and net unrealized losses on securities manifested in early 2022.[7] Additionally, as recently as March 6, 2023, in a speech to the Institute of International Bankers, Chairman Gruenberg highlighted that the current interest rate environment has had dramatic effects on the profitability and risk profile of banks' funding and investment strategies.[8] In his speech, Chairman Gruenberg highlighted that total unrealized losses in investment securities that are available for sale or held to maturity totaled about $620 billion at yearend 2022. He warned that while banks are generally in a strong financial condition, "unrealized losses weaken a bank's future ability to meet unexpected liquidity needs."

Additionally, the 2022 Risk Review (published June 22, 2022) presents key risks to financial institutions, including market risk.[9] The market risk areas discussed include interest rate risk and net interest margin, and liquidity and deposits. Specifically, the report highlights that net interest margins narrowed to a record low in 2021 as low interest rates and excess liquidity continued to weigh on asset yields, particularly in the first half of the year. To capture yield as interest rates began to rise, banks extended their balance sheet maturity by holding more long-term securities. The Risk Review warned that rising interest rates in 2022 could pressure bank funding costs and pose interest rate risk challenges to banks that invested heavily in long-term securities in recent

[4] See https://www.fdic.gov/news/financial-institution-letters/2012/fil12002.html.
[5] See https://www.fdic.gov/news/financial-institution-letters/2013/fil13046.html.
[6] See https://www.fdic.gov/news/speeches/2022/spnov1622.html.
[7] See https://www.fdic.gov/analysis/quarterly-banking-profile/.
[8] See https://www.fdic.gov/news/speeches/2023/spmar0623.html.
[9] See report pages 52-58 at https://www.fdic.gov/analysis/risk-review/2022-risk-review.html.

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years.

3. **Mid-size and large banks can report Treasury holdings and mortgage-backed securities as "held to maturity", which may not reflect current market value. How would requiring Accumulated Other Comprehensive Income (AOCI) reporting for banks with assets between $100B and $250B better reflect a bank's soundness and risk profile?**

RESPONSE: Insured depository institutions categorize their investments in debt securities as trading, available-for-sale, or held-to-maturity consistent with U.S. Generally Accepted Accounting Principles, and more specifically, Financial Accounting Standards Board Accounting Standards Codification Topic 320, Investments—Debt Securities. Held-to-maturity securities are debt securities that an institution has the positive intent and ability to hold to maturity and are measured at amortized costs. Held-to-maturity debt securities are not adjusted for changes in fair value unless there is a confirmed credit loss. Unrealized holding gains and losses arising from changes in fair value of held-to-maturity debt securities are not recognized over the life of the security, so they do not affect current period earnings or AOCI.

Requiring institutions with assets between $100 billion and $250 billion in assets to include AOCI in regulatory capital would require banks to reflect the changes in fair value of their Treasury, mortgage-backed and other investment securities holdings categorized as available-for-sale in regulatory capital. To the extent that the institution is holding securities with unrealized losses, reflecting these losses in regulatory capital aligns with the institution's true economic position. From a liquidity perspective, the market value of a security is a more useful measure of value. The current market value of securities are considered when evaluating an institution's borrowing capacity and balance sheet liquidity position.

The FDIC plans to work with the federal banking agencies to consider various revisions to the regulatory framework. The studies of the recent failures and recommendations that may result will help to inform changes to the current regulatory framework to enhance the risk management for large banking organizations, such as requiring these organizations to include AOCI in regulatory capital.

4. **Stress testing is a useful tool for risk management and bank supervision. Since the Great financial crisis, the words "stress testing" typically refer to supervisory tests of capital adequacy. However, other stress tests are commonly used to manage interest rate risk, liquidity risk, credit risk, and others. Please explain the role of, and note the differences in, stress testing for different risk categories, the bank's management of these risk categories, and capital adequacy. Please also describe the benefits of a qualitative stress test that a quantitative stress test alone cannot capture.**

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RESPONSE: The FDIC agrees that stress testing activities should not be limited to capital adequacy and may be useful in managing other types of risk. All banks should have the capacity to understand their risks and the potential impact of stressful events and circumstances on their financial condition. Stress testing is a mechanism for banks to identify, measure, monitor, and control those risks.

Stress testing efforts may include multiple approaches and applications and are commonly used processes to assess the adequacy of interest rate risk, liquidity risk, credit risk, and other risks through performance of forward-looking assessments of the potential impact of various adverse events and circumstances on a bank. Various approaches may include a mix of scenario analysis, sensitivity analysis, enterprise-wide testing, and reverse stress testing. In some cases, quantitative stress testing efforts may have limitations and qualitative efforts are utilized.

Qualitative assessments and expert judgment-based stress testing sometimes are used when credible data may be lacking, more quantitative tests are operationally challenging or time prohibitive, or subjective overrides are appropriate. One of the benefits of a qualitative approach is that it is not limited to historical data and may assist in highlighting unidentified risks during times of stress. A bank should understand and clearly document all assumptions, uncertainties, and limitations whether quantitative or qualitative efforts are used.

Liquidity Stress Tests
For liquidity stress testing, the scope of the assessment is used to identify and quantify sources of potential liquidity strain and to analyze possible impacts on the institution's cash flows, liquidity position, profitability, and solvency. Stress tests should also be used to ensure that current exposures are consistent with the financial institution's established liquidity risk tolerance. The FDIC published an article describing liquidity stress testing and cash flow analysis, including a stress-testing template that could be used by institutions, in its Summer 2017 issue of Supervisory Insights.[10]

Interest Rate Risk Stress Tests
Interest rate risk stress testing, includes both scenario and sensitivity analysis, and is considered an integral component of Interest Rate Risk (IRR) management. Banks are expected as part of risk management practices to assess a range of alternative future interest rate scenarios in evaluating IRR exposure. This range should be sufficiently meaningful to fully identify basis risk, yield curve risk, and the risks of embedded options. Institutions should ensure their scenarios are severe but plausible in light of the existing level of rates and the interest rate cycle. As noted in the response to Question 2, the FDIC maintains a web page dedicated to information on interest rate risk in the capital markets section of the Banker Resource Center on

[10] https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum17/sisum17.pdf.

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www.fdic.gov. This web page includes links to regulations, guidance, an examination manual chapter, instructional technical assistance videos, and Supervisory Insights Journal articles focused on interest rate risk.

Credit Risk Stress Tests
For credit risk stress testing, banks may evaluate credit risk in the overall loan portfolio, segments of portfolios, or individual loans. For example, institutions with concentrations in credit, such as commercial real estate, may perform portfolio-level stress tests or sensitivity analysis to quantify the impact of changing economic conditions on asset quality, earnings, and capital. Portfolio stress testing and sensitivity analysis may not necessarily require the use of a sophisticated portfolio model. Depending on the risk characteristics of the CRE portfolio, stress testing may be as simple as analyzing the potential effect of stressed loss rates on the CRE portfolio, capital, and earnings.

Stress testing can provide valuable information regarding potential future outcomes; however, like any risk management tool, it has limitations. No single stress test can accurately estimate the impact of all stressful events; therefore, stress tests should be used in combination with other risk management tools, including qualitative assessments to make informed risk management and business decisions. The FDIC has issued articles about commercial real estate risk management practices, including stress testing, in its Summer 2022, Fall 2019, and Summer 2012 issues of Supervisory Insights. In December 2015, the three banking agencies issued a Statement on Prudent Risk Management for Commercial Real Estate Lending[11] that discusses the importance of maintaining underwriting discipline and credit administration practices to identify, measure, monitor, and manage risks. In December 2006, the three banking agencies issued the Interagency Guidance on Concentrations in Commercial Real Estate Lending[12] that promotes sound risk management practices and appropriate capital levels to pursue lending in a safe and sound manner.

5. **Some have argued that SVB and Signature Bank failed because supervisors were asleep at the switch. Yet, following the passage of S. 2155, which weakened capital, liquidity, stress testing, and safety and soundness regulation of large banks, the banking agencies, under Trump-appointed regulators, released a statement explaining that the role of supervisory guidance is essentially a "for your information" communication to the banks.[13] The agencies followed this statement with proposal and comment rulemaking issuing final rules in 2021 which instruct examiners not to criticize institutions if their**

[11] https://www.fdic.gov/news/financial-institution-letters/2015/fil15062.html
[12] https://www.fdic.gov/news/financial-institution-letters/2006/fil06104.html.
[13] https://www.fdic.gov/news/press-releases/2018/pr18059a.pdf

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practices, such as risk management, are not consistent with supervisory guidance.[14] This forces examiners to react once problems arise rather than proactively supervise the institution. Without using supervisory guidance, how do front-line examiners preemptively address unsafe and unsound behavior before problems arise? Do you believe this weakens bank examination as the first line of defense against bank failure and financial stability?

RESPONSE: In July 2016, the FDIC Board issued a statement of policy setting forth its views on the FDIC's development of supervisory guidance, including the role of guidance. That statement makes clear that guidance sets forth "the FDIC's expectations for FDIC-supervised institutions to operate in a safe and sound manner and comply with applicable laws and regulations, including those designed to protect consumers."[15] According to the Board, "[t]he overarching goal of supervisory guidance is to ensure that risk management and consumer protection standards and supervisory expectations are well understood by financial institution management and stakeholders."[16] This view of the role of guidance is upheld in the FDIC's March 2021 rule. Guidance outlines the FDIC's supervisory expectations or priorities and articulates the FDIC's general views regarding appropriate practices for a given subject area, and may provide examples of practices that help institutions manage their risk.

Examiners are instructed by the FDIC's Board of Directors to use supervisory recommendations and matters requiring board attention, a subset of supervisory recommendations, in the Report of Examination or Supervisory Letters to identify emerging risks or problems and to correct deficiencies before the bank's condition deteriorates (or to keep the bank viable if conditions have already deteriorated). A principal purpose of supervisory recommendations is to communicate supervisory concerns to a bank so that it can make appropriate changes in its practices, operations or financial condition and thereby avoid more formal remedies in the future, such as enforcement actions. Examiners "may reference (including in writing) supervisory guidance to provide examples of safe and sound conduct, appropriate consumer protection and risk management practices, and other actions for addressing compliance with laws or regulations."[17]

While "examiners will not criticize through supervisory recommendations (including matters requiring board attention) a supervised financial institution for, and the FDIC will not issue an enforcement action on the basis of, a 'violation' of or 'non-compliance' with supervisory

[14] https://www.govinfo.gov/content/pkg/FR-2021-04-08/pdf/2021-07146.pdf
https://www.govinfo.gov/content/pkg/FR-2021-03-02/pdf/2021-01537.pdf
[15] See "Statement of the FDIC Board of Directors on the Development and Review of Supervisory Guidance," July 2016, available at https://www.fdic.gov/regulations/examinations/supervisory/guidance/guidance.html.
[16] Id.
[17] 12 C.F.R. § 302.

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guidance",[18] as they do not have the force and effect of law, examiner criticisms will address "...practices, operations, financial conditions, or other matters that could have a negative effect on the safety and soundness of the financial institution, could cause consumer harm, or could cause violations of laws, regulations, final agency orders, or other legally enforceable conditions."[19] That is, if there is a practice that could threaten safety and soundness, the institution will be criticized for that practice; it will not be cited or criticized for failing to follow non-binding guidance. For example, if an institution fails to practice sound underwriting practices on its commercial real estate portfolio, the institution may be criticized for that failure. The institution will not, however, be criticized for "violating" the Statement on Prudent Risk Management for CRE Lending.[20]

Guidance continues to provide clarity and is helpful to examiners and supervised institutions. The FDIC will use informal and formal enforcement actions, when necessary, to encourage or require bank management to reduce risks and address deficiencies including unsafe and unsound practices or condition.

6. **Both Silicon Valley Bank and Signature Bank failed to manage the risks corresponding to their rapid growth. First Citizens Bank acquired portions of Silicon Valley Bank, including $56.5B in deposits and $72B in loans. This purchase will double the size of the bank and increase its assets to $219B, compared to $42B three years ago. New York Community Bank's subsidiary Flagstar Bank will also increase in size after the purchase of some of the assets of Signature Bank. How will regulators ensure that the growth of First Citizens and New York Community Bank/Flagstar Bank is monitored and well managed and that the bank is well supervised?**

RESPONSE: First-Citizens Bank & Trust Company (First Citizens) is supervised under a Continuous Examination Program, with a team of experienced FDIC and North Carolina Commissioner of Banks (NCCOB) examiners dedicated to supervising the institution, along with a Federal Reserve Bank of Richmond team providing bank holding company supervision. Examination activities are guided by a comprehensive annual supervisory plan, which incorporates targeted reviews of key risk areas throughout the year, along with ongoing monitoring activities including quarterly analysis of financial statements, key risk and key performance indicators, and meetings with First Citizens senior management and the First Citizens board of directors. In addition to supervision provided by the dedicated examination team, independent and comprehensive second-level review and oversight of First Citizens'

[18] Id.
[19] Id.
[20] See "Statement on Prudent Risk Management for CRE Lending", https://www.fdic.gov/news/financial-institution-letters/2015/fil15062.pdf.

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business activities is provided by dedicated staff from the FDIC's Atlanta Regional Office, Washington Office, NCCOB, and Federal Reserve Bank of Richmond.

As a result of First Citizens' acquisition of Silicon Valley Bank (SVB), the 2023 supervisory plan has been supplemented with enhanced monitoring of management's initial and ongoing integration efforts and efforts to manage the evolving risk profile of the combined institution. In addition, the FDIC's Atlanta Regional Office management team is determining additional staffing needs. The supervisory team is meeting with First Citizens management on a daily basis to discuss current operational activities, and integration plan development and implementation. Ongoing monitoring of existing risk, risk mitigation controls, and integration plan implementation progress will continue. Through frequent meetings with First Citizens management at all levels of the organization, and ongoing review of financial, governance, audit, and operational reporting, examiners will remain attuned to developments and continue to provide observations and supervisory recommendations where needed to facilitate First Citizens management's efforts to preserve and enhance the safety and soundness of First Citizens. These efforts will include a detailed and comprehensive review of the risk management and control gaps within the legacy SVB organization, and holding First Citizens management accountable for remediating issues that remain relevant post-acquisition.

The regulatory team will continue to expand supervisory objectives and expectations in line with the increased size and complexity of First Citizens. Detailed review and analysis of First Citizens, including the impact of the SVB acquisition, will include review of significant components of the loan portfolio and the bank's credit risk management framework; the allowances for credit losses; liquidity and funds management; enterprise risk management program; model risk management program; information technology program; the anti-money laundering/countering the financing of terrorism program; and trust department operations. The regulatory team will continue to draw on specialized resources and expertise to enhance the supervisory program.

The FDIC, along with its regulatory partners, is acutely focused on oversight of First Citizens, its growth, and the capabilities and efforts of bank management to appropriately measure, monitor, and control the risk associated with its operations. Through implementation of a comprehensive supervisory plan, the FDIC will ensure that First Citizens is appropriately supervised, and that bank management is held accountable for preserving the bank's safety and soundness.

Flagstar Bank, National Association, is chartered and supervised by the Office of the Comptroller of the Currency (OCC). The FDIC supervisory activities regarding Flagstar Bank, National Association, are in a backup capacity under Section 10(b)(3) of the FDI Act,[21] and are

[21] See https://www.fdic.gov/regulations/laws/rules/1000-1100.html#fdic1000sec.10b.

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governed by a July 9, 2010, Memorandum of Understanding (MOU) between the FDIC and the other federal regulatory agencies.[22]

The FDIC's backup supervisory activities include the presence of an FDIC onsite dedicated examiner who will work closely with the OCC and FDIC off-site analysts to conduct ongoing monitoring and assessment of the institution's risks, policies, procedures, and financial condition. Backup supervisory activities also include participation on targeted and horizontal examinations led by the OCC; regular meetings with the OCC to discuss the bank's risk profile, current conditions, identified supervisory matters, and material deposit insurance related issues and risk assessments; and participation in meetings between the OCC and the firm's senior management to discuss the bank's risk profile, risk tolerance, and risk management practices. Backup supervisory activities include quarterly internal evaluations of the ratings assigned by the OCC under the Uniform Financial Institutions Ratings System, with subsequent discussions with the OCC on any differing assessments. If the FDIC is unable to reach an agreement with the OCC on any material ratings differences, the FDIC would pursue a formal rating disagreement as outlined in the MOU.

Supervisory concerns are generally communicated to the firm through the OCC's supervisory and examination process and issuance of Matters Requiring Attention, Matters Requiring Immediate Attention, and informal or formal enforcement actions. The FDIC also has authority to conduct independent Special Examinations, in compliance with the MOU, to assess risk to the Deposit Insurance Fund if necessary.

7. **What do SVB's and Signature Bank's failures suggest about the asset threshold established in S. 2155? Was $250B too high of a threshold to set, and do you think it was a mistake for regulators to ease regulatory standards for banks of this size, beyond what Congress had required?**

RESPONSE: Many banking organizations with total assets of $100 billion to $250 billion are not currently subject to the same breadth of liquidity and regulatory capital requirements as banking organizations with assets of $250 billion or greater.[23] The failures of Silicon Valley Bank and Signature Bank demonstrate the implications that banking organizations with total assets of $100 billion or more can have for financial stability. The prudential regulation of these institutions merits additional attention, particularly with respect to capital, liquidity, and interest rate risk. Measures to improve the prudential regulation of banking organizations with total assets of $100 billion or more could be accomplished under existing law. The FDIC is committed to working cooperatively with our counterparts at the other federal regulators as well

[22] See "FDIC Votes to Revise MOU on Backup Supervision Authority," July 12, 2010 at https://archive.fdic.gov/view/fdic/4008.
[23] https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23800.pdf.

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as with policymakers in the Congress to better understand what brought these institutions to failure and what measures can be taken to prevent similar failures in the future.

8. **Silicon Valley Bank and Signature Bank may have offered inducements to their customers unrelated to banking, such as continuing legal education credits to attorneys with IOLTAs, in exchange for keeping all their deposits at the banks. Are you aware of these relationships and to what extent might they violate anti-tying requirements or other restrictions?**

RESPONSE: The FDIC is not aware of these arrangements at Signature Bank or at SVB. Additional information regarding SVB may be available from the Federal Reserve Bank of San Francisco, as the primary federal supervisor.

9. **SVB's collapse demonstrates that tying compensation and bonuses to a bank's growth incentivizes executives to take egregious risks. What steps can regulators take to discourage this kind of behavior from bank executives? What steps should Congress take?**

RESPONSE: The FDIC has authority to investigate and hold accountable the directors, officers, professional service providers and other institution-affiliated parties of the banks for any losses they caused to the banks and for any misconduct in their management of the banks.[24] The FDIC has already commenced these investigations. The FDIC along with the OCC, the Board of Governors of the Federal Reserve System, the Federal Housing Finance Agency, the Securities and Exchange Commission, and the National Credit Union Administration (together, the agencies) proposed rules in 2011[25] and 2016[26] to implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which would address safety and soundness risks related to incentive compensation. The agencies continue to engage in discussions regarding how best to implement the statute.

FDIC-supervised institutions are subject to requirements under Section 39(c) of the FDI Act that prohibit as an unsafe and unsound practice compensation arrangements that provide executive officers, employees, directors, and principal shareholders with excessive compensation fees, or benefits and compensation arrangements that could lead to material financial loss to the institution.[27] In addition, the Interagency Guidance on Sound Incentive Compensation Policies promotes principles to help banking organizations ensure that incentive compensation policies do

[24] 12 U.S.C. § 1821(d)(13)(E) and (k). See also 12 U.S.C. §1818(e) and (i).
[25] 76 Fed. Reg. 21170 (April 14, 2011).
[26] 81 Fed. Reg. 37670 (June 10, 2016).
[27] 12 U.S.C. § 1831p-1; 12 CFR Part 364, Appendix A.

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not encourage imprudent risk-taking and are consistent with the safety and soundness of the organization.[28]

10. Silvergate Bank, a cryptocurrency-centric bank that began to falter after the collapse of cryptocurrency exchange FTX and broader crypto industry turmoil, announced its voluntary liquidation on March 8, 2023, just two days before the failure of SVB. How did the Silvergate Bank liquidation affect the events surrounding the failure of SVB and Signature Bank?

RESPONSE: The run on deposits at Signature Bank was catalyzed by the events first at Silvergate and later at SVB. Silvergate Bank's troubles demonstrated how traditional banking risks, such as a lack of diversification, aggressive growth, maturity mismatches in a rising interest rate environment, and sensitivity to liquidity risk, when not managed adequately, could combine to lead to a bad outcome. Many of these same risks were also present in the failure of SVB. Although there was no direct relationship between Silvergate and Signature, the banks were often referenced in the media and in press articles together for providing banking services to digital assets companies, particularly at a time when digital asset market volatility and digital asset company bankruptcies were exposing both Silvergate and Signature to increasing legal and liquidity risks.

In the fourth quarter of 2022, Silvergate Bank experienced an outflow of deposits from digital asset customers that resulted in a 68 percent loss in deposits – from $11.9 billion in deposits to $3.8 billion.[29] That rapid loss of deposits caused Silvergate Bank to sell debt securities to cover deposit withdrawals, resulting in a net earnings loss of $1 billion. On March 1, 2023, Silvergate Bank announced that it was unable to timely file its 2022 Form 10-K and was reviewing its ability to continue as a going concern. On March 8, 2023, the same day that Silvergate Bank announced its self-liquidation, SVB announced that it had sold substantially all of its available-for-sale securities portfolio at a $1.8 billion after-tax loss. SVB simultaneously announced its plan to raise approximately $2.25 billion through the issuance of common equity and mandatory convertible preferred shares via an underwritten public offering and planned private investment. The following day, SVB's share price dropped 60 percent and $42 billion in deposits left the bank.

Signature Bank's operating model shared some of the same risk characteristics of both Silvergate Bank and SVB. Like Silvergate Bank, Signature Bank focused a portion of its business model on the digital asset industry. Signature Bank began onboarding digital asset deposit customers in

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[28] 75 Fed. Reg. 36395 (June 25, 2010).
[29] See *Silvergate Capital Corporation, 4Q22 Earnings Presentation* (January 17, 2023), available at https://s23.q4cdn.com/615058218/files/doc_financials/2022/q4/Ex.-99.2-SI-4Q22-Earnings-Presentation-FINAL.pdf.

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2018, many of whom used its internal Signet platform. As of year-end 2022, deposits at Signature Bank related to digital asset companies totaled about 20 percent of total deposits, but the bank had no loans to digital asset firms. In the second, third and fourth quarters of 2022, Signature Bank, like Silvergate, experienced deposit withdrawals and a drop in its stock price as a consequence of disruptions in the digital asset market due to failures of several high profile digital asset companies and due to Signature Bank's announced efforts to reduce deposits related to digital asset companies. Following the March 1, 2023 announcement by Silvergate Bank regarding the delay in filing its year-end 2022 financial statements and comments about its ability to continue as a going concern, Signature Bank once again experienced negative media attention, which raised questions about its liquidity position. This attention continued as Silvergate Bank later announced its self-liquidation.

On the day SVB was closed, March 10, Signature Bank lost 20 percent of its total deposits in a matter of hours late in the afternoon, depleting its cash position and leaving it with a negative balance with the Federal Reserve as of close of business; the bank was closed by the New York State Department of Financial Services on March 12, 2023.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM MARTIN GRUENBERG

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1. **It is my understanding from our previous conversations, that there was an effort to sell Silicon Valley Bank before it failed on Friday March 10. You also testified that there were two bids from Friday March 10 to March 12. You stated that "one wasn't valid because it had not been approved by the board of the bank" and that the other "was more expensive than a liquidation of the institution would have been to the FDIC."**

   a. **Can you confirm that there was a potential buyer for Silicon Valley Bank as early as March 9? If so, how many offers were received and why were these "open bank" offers denied?**

RESPONSE: There were no bids solicited or received by the FDIC prior to its failure on March 10. Given the speed of the deposit withdrawals and failure of the institution, there was no opportunity to market Silicon Valley Bank (SVB) prior to its closure. The FDIC began engaging with interested bidders on March 10, immediately after SVB's failure, launched a formal marketing process on March 11, and set an initial bid deadline for March 12, 2023, 3:30pm EDT.

In a typical bank resolution, the FDIC begins evaluating marketing options approximately 90 days before an institution would be closed (i.e., at the time a bank board is given notification under the Prompt Corrective Action framework). This provides time to develop a marketing plan, establish and populate a virtual data room (VDR), contact qualified parties, and approve interested bidders to begin their due diligence. The marketing process usually begins 70 days before closing, and bids are typically accepted approximately 10 days before closing. This allows for appropriate bid analysis, further rounds of bidding (if warranted), the execution of the sale, and the announcement of the transaction at the same time as the institution is closed and the FDIC is appointed as Receiver.

While this timeline can be, and in the past has been, shortened, some advance period of preparation—even a few weeks—is usually necessary to gather and organize the information bidders require to conduct due diligence and make informed bids, generate bidder interest, and evaluate bids. Without an advanced period to initiate the marketing process prior to failure, bidders will significantly discount their offers to account for a lack of information and uncertainty, if they are willing to participate in the bidding process at all.

   b. **What actions did you take to try and secure a buyer for SVB and Signature Bank prior to their failures? Please respond in detail.**

RESPONSE: Please see answer to (a) above.

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c. **Did you consider the "least cost test" to the DIF in evaluating any bids prior to failure? If so, please explain your analysis.**

RESPONSE: There were no bids received prior to failure. (Consequently no least cost tests were performed.)

2. **How many "expressions of interest" did the FDIC receive after Silicon Valley Bank and Signature Bank were placed in receivership? Please provide in detail a fulsome overview of the auction process for each failed institution, including:**

   a. **When was the data room set up?**

RESPONSE: The VDR to market the Deposit Insurance National Bank of Santa Clara (the deposit insurance national bank originally established to resolve the former SVB) was created March 10, 2023 and opened March 11, 2023 to insured depository institutions (IDIs) meeting the bidder list criteria. Up to three contacts from each of these IDIs were granted access to the VDR via emailed invitation from a shared FDIC project mailbox. IDIs expressing interest had the opportunity to request the addition of other bank contacts to assist with due diligence.

The VDR to market Silicon Valley Bridge Bank was opened March 15, 2023 to IDIs meeting the bidder list criteria. The FDIC's financial adviser, Piper Sandler, identified other IDIs and investor groups which included private equity and asset buyer entities that were granted access to the VDR.

The VDR for Signature Bank was created March 11, 2023 and opened March 15, 2023 to IDIs meeting the bidder list criteria. The four days between creating the VDR and opening it was required to gather and upload the bank's data and documents. Up to three contacts of these IDIs were granted access to the VDR. IDIs expressing interest had the opportunity to add other bank contacts to assist with due diligence.

   b. **How is access to the data room granted to potential bidders?**

RESPONSE: Refer to response in part (c) below.

   c. **Who determined and based off what criteria, what entities are considered as potential bidders?**

RESPONSE: The FDIC follows guidelines outlined in the Bidder List Preparation and Clearance Directive (Appendix A) to identify qualified IDIs that meet the bidder list criteria established for a particular failing bank. The criteria include sufficient supervisory assessments, sufficient total assets, and in some cases, geographic considerations. Additional supervisory

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review may be required under certain economic conditions. IDIs meeting the bidder list criteria and receiving clearance from their primary federal regulator are invited to review the specific acquisition opportunity.

FDIC communicates with the appropriate supervisory agencies of all qualified IDIs indicating interest in a specific opportunity and interest in potentially submitting a bid. IDIs seek supervisory approval and the appropriate regulatory agencies review the details of a potential bid, including the impact on the bidding IDI's condition. The IDIs must receive supervisory approval to submit a bid, and that approval must be communicated to the FDIC.

Non-bank entities were assessed and confirmed as potential bidders by the FDIC's financial advisor, Piper Sandler. The non-bank bidders that expressed interest were considered for access to the VDR by the Piper Sandler team following initial dialogue and based on institutional knowledge and relationships, as well as the following criteria, among others: (i) financial ability, (ii) ability to execute in a short timeframe, and (iii) breadth of their interest in the franchise and the assets. We provided 72 non-bank bidders access to the VDR. From the 72 non-bank bidders that were provided data room access, 10 non-bank bidders submitted bids comprising 13 separate bid proposals (bid proposals sometimes including more than 1 bidder; also excluding bid proposals to the extent included in bid proposals from approved bank bidders). Additionally, all non-bank bidders needed to submit a signed Purchaser Eligibility Certificate and a signed Confidentiality Agreement Reaffirmation.

d. What entities were considered potential bidders?

RESPONSE: Potential bidders included approved IDIs, and non-bank entities (e.g. private equity firms). Non-banks were invited to bid on Silicon Valley Private Bank, Loan Pools and alliance with banks to bid on a whole bank transaction.

3. **Please detail the FDIC's resolution processes, including general practices and any internal guidance or "playbooks" that serve leadership in making executive decisions in the event of a bank failure. Additionally, please explain whether there were any deviations from such internal processes and explain why such deviations, if any, were made.**

RESPONSE: The resolution process drew upon existing practices and procedures in terms of execution actions, with the requisite authorities provided by the FDIC Board of Directors for each of these failures.[30] The Board of Directors specifically authorized the actions to accept

[30] The FDIC's *Resolution Handbook* is currently undergoing revisions. See for illustrative purposes only, the FDIC's *Resolution Handbook*, January 15, 2019: https://ypfsresourcelibrary.blob.core.windows.net/fcic/YPFS/resolutions-handbook.pdf.

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appointment as receiver, to take all requisite actions to establish the bridge bank, and to execute on asset sales with respect to each failing bank, and to take all actions to consummate the sale of each bank pursuant to the winning bid. Customary delegations were used for certain resolution actions, at levels approved by the Board of Directors.

a. **Please provide any and all delegations or reservations of authority relating to resolution determinations. Please list any and all resolution and liquidation delegations or reservations of authority, including but not limited to resolution or liquidation determinations, exercised in relation to SVB or Signature.**

RESPONSE: The Board adopted resolutions delegating authority for the resolution of SVB and Signature. Copies of these resolutions, listed below, are attached (Appendix B):

- SVB Failing Bank Board Resolution (088723) – Authorizes staff to accept appointment as receiver and provides general authorities to resolve SVB.
- Systemic Risk Exception Board Resolution (088726) – Authorizes the recommendation of a systemic risk declaration, provides additional authorities with regard to failed bank resolutions conducted in connection with that declaration, and imposes additional approval conditions upon those failed bank resolutions.
- Signature Failing Bank Board Resolution (088728) – Authorizes staff to accept appointment as receiver and provides general authorities to resolve Signature.
- SVB Bridge Bank Authority Board Resolution (088727) – Authorizes actions in connection with the creation of SVB Bridge Bank.
- Signature Bridge Bank Sale Board Resolution (088741) – Authorizes liquidation and sale activities in connection with the winding up of Signature Bridge Bank and the transfer of assets and liabilities to Flagstar Bank, National Association.
- Signature Receivership Funding Board Resolution (088743) – Authorizes the funding of receivership management activities relating to Signature's capital call credit facility portfolio.
- SVB Bridge Bank Sale Board Resolution (088742) – Authorizes liquidation and sale activities in connection with the winding up of SVB Bridge Bank and the transfer of assets and liabilities to First Citizens Bank & Trust Company.
- Robinson Resolution (Third) (062393) – Cross-referenced in several of the resolutions listed above. Authorizes pre-failure preparatory activities and provides a set of bank resolution authorities to be included or referenced in specific failing bank board resolutions.

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- Receivership Management Delegations (composite of existing Board resolutions) (088750) – Cross-referenced in several of the Board resolutions listed above. Authorizes staff to take actions in connection with the operation of failed bank receiverships.

4. **You provided written testimony as follows: "After careful analysis and deliberation, the Boards of the FDIC and the Federal Reserve voted unanimously to recommend, and the Treasury Secretary, in consultation with the President, determined that the FDIC could use emergency systemic risk authorities under the Federal Deposit Insurance Act (FDI Act) to fully protect all depositors in winding down SVB and Signature Bank."**

    a. **Please articulate what criteria the FDIC used and will use in the future to determine whether to invoke the systemic risk authority to fully protect depositors.**

RESPONSE: The criteria to determine whether to invoke systemic risk authority ("systemic risk exception") is contained in section 13(c)(4)(G) of the FDI Act.[31] The systemic risk exception may be invoked if the Board of Directors of the FDIC and the Board of Governors of the Federal Reserve System (Federal Reserve), upon a vote of not less than two-thirds of the members of each respective Board, provide a written recommendation to the Secretary that a systemic risk determination be made. Based upon the joint recommendation, the Secretary may then invoke the exception if the Secretary determines, after consultation with the President, that complying with the least-cost provisions in section 13(c)(4) of the FDI Act would have serious adverse effects on economic conditions or financial stability and any action or assistance taken under the systemic risk exception would avoid or mitigate such adverse effects.

With the rapid collapse of SVB and Signature Bank in the space of 48 hours, concerns arose that risk could spread to other institutions and that the financial system as a whole could be placed at risk. Shortly after SVB was closed on Friday, March 10, a number of institutions with large amounts of uninsured deposits reported that depositors had begun to withdraw their funds.[32] Some of these banks drew against borrowing lines collateralized by loans and securities to meet demands and bolster liquidity positions. The industry's unrealized losses on securities were

[31] 12 U.S.C. § 1823(c)(4)(G).
[32] After the collapse of SVB, the FDIC itself and through other banking regulators actively monitored deposit outflows at certain banks with some characteristics in common with SVB. The information received at the time showed large amounts of uninsured deposits being withdrawn from several banks. Some of these banks recovered deposits by March 31, 2023, the end of the Call Report reporting period. Some did not, and their Call Reports for the period ending March 31, securities filings and public statements reflected deposit losses. See, for example, First Republic's Report on First Quarter 2023 Results; https://ir.firstrepublic.com/static-files/013f57fb-b980-4353-bbb3-0e7a3b27f20a.

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$620 billion as of December 31, 2022, and fire sales driven by deposit outflows could have further depressed prices and impaired equity.

With the failure of SVB and the impending failure of Signature Bank, concerns had also begun to emerge that a least-cost resolution of the banks, absent more immediate assistance for uninsured depositors, could have negative knock-on consequences for depositors and the financial system more broadly. With uninsured depositors at the two banks likely to face an undetermined amount of losses, depositors at other banks began to move some or all of their deposits to other banks to diversify their exposures and increase their deposit insurance coverage. There were also concerns that investors could begin to doubt the financial strength of similarly situated institutions making it difficult and more expensive for these banks to obtain needed capital and wholesale funding.

A significant number of the uninsured depositors at SVB and Signature Bank were small and medium-sized businesses. As a result, there were concerns that losses to these depositors would put them at risk of not being able to make payroll and pay suppliers. Moreover, with the liquidity of banking organizations further reduced and their funding costs increased, banking organizations could become even less willing to lend to businesses and households. These effects would contribute to weaker economic performance, further damage financial markets, and have other material negative effects.

It was for these reasons that the FDIC Board voted unanimously to recommend that the Secretary of the Treasury, in consultation with the President, make a systemic risk determination. The institutional structure of the determination, including supermajority votes of both FDIC and Federal Reserve Boards and determination of the Treasury Secretary in consultation with the President, increases the checks involved in invoking the exception. The criteria required to invoke the exception are highly fact-specific, but would necessarily involve conditions where there was a high probability of financial market stress which would lead to a severe impact to the U.S. economy. Given the stringency of these criteria, this authority has historically been used very sparingly.

5. **Vice Chair for Supervision Barr testified that "the stress test is not the primary way that the Federal Reserve or other regulators test for interest rate risk."**

   a. **What is the primary methodology for FDIC examiners and supervisors to assess interest rate risk?**
   b. **Please provide an outline of the principal components FDIC examiners and supervisors use to assess interest rate risk.**

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RESPONSE: The FDIC and other Federal Financial Institutions Examination Council (FFIEC) members assess interest rate risk exposure using the Uniform Financial Institutions Rating System (UFIRS). Since 1979, the UFIRS has proved to be an effective supervisory tool for evaluating financial institutions on a uniform basis and for identifying institutions requiring special attention. In 1996, revisions to the UFIRS added a sixth component addressing sensitivity to market risk, the explicit reference to the quality of risk management processes in the management component, and the identification of risk elements within the composite and component rating descriptions.

The sensitivity to market risk component reflects the degree to which changes in interest rates, foreign exchange rates, commodity prices, or equity prices can adversely affect a financial institution's earnings or economic capital. When evaluating this component, examiners consider: management's ability to identify, measure, monitor, and control market risk; the institution's size; the nature and complexity of its activities; and the adequacy of its capital and earnings in relation to its level of market risk exposure. For many institutions, the primary source of market risk arises from non-trading positions and their sensitivity to changes in interest rates. In some larger institutions, foreign operations can be a significant source of market risk. For some institutions, trading activities are a major source of market risk. Market risk is rated based upon, but not limited to, an assessment of the following evaluation factors:

- The sensitivity of the financial institution's earnings or the economic value of its capital to adverse changes in interest rates, foreign exchanges rates, commodity prices, or equity prices.

- The ability of management to identify, measure, monitor, and control exposure to market risk given the institution's size, complexity, and risk profile.

- The nature and complexity of interest rate risk exposure arising from non-trading positions.

- Where appropriate, the nature and complexity of market risk exposure arising from trading and foreign operations.

The UFIRS ratings also outline the definitions for each rating category, which examiners use to assign the sensitivity to market risk ("S") component rating and which are a consideration factor in the component rating assigned to the institution.

Additionally, the FDIC has existing policy statements and advisories on interest rate risk management and the risks of changing interest rate environments. The long-held safety and

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soundness principles conveyed in these documents are consistent with the safety and soundness standards for interest rate exposure contained in Part 364 of the FDIC's Rules and Regulations.[33]

The standard for interest rate risk states, "An institution should manage interest rate risk in a manner that is appropriate to the size of the institution and the complexity of its assets and liabilities; and provide for periodic reporting to management and the board of directors regarding interest rate risk with adequate information for management and the board of directors to assess the level of risk."

The FDIC has issued four key policy statements and advisories on interest rate risk management:

- The Joint Policy Statement on Interest Rate Risk,[34] issued in 1996, provides guidance on sound practices for managing interest rate sensitivity.
- The Advisory on Interest Rate Risk Management,[35] jointly developed and issued in 2010 by the FDIC and the other members of the FFIEC agencies, encouraged robust processes for measuring and mitigating exposure to higher interest rates.
- An Interagency Advisory on Interest Rate Management: Frequently Asked Questions,[36] issued in 2012, clarified and elaborated on the supervisory guidance conveyed in the 2010 Advisory.
- Financial Institution Letter: Managing Sensitivity to Market Risk in a Challenging Interest Rate Environment,[37] issued independently by the FDIC in 2013, re-emphasized the importance of a comprehensive asset-liability and interest rate risk management program, and the implications of unrealized losses on securities for capital and liquidity.

Examiners and supervisory staff rely on these policy statements and advisory documents and other resources to assist in their evaluation of the risk management practices and exposure levels at financial institutions and as they assign ratings under the UFIRS. Other resources include the Division of Risk Management Supervision Manual of Examination Policies[38] and comprehensive examination modules, which help examiners carry out forward-looking, risk-focused

[33] 12 C.F.R. § 364.
[34] See https://www.fdic.gov/news/financial-institution-letters/1996/fil9652.html.
[35] See https://www.fdic.gov/news/financial-institution-letters/2010/fil10002.html.
[36] See https://www.fdic.gov/news/financial-institution-letters/2012/fil12002.html.
[37] See https://www.fdic.gov/news/financial-institution-letters/2013/fil13046.html.
[38] See RMS Manual of Examination Policies – Sensitivity to Market Risk Section 7.1 https://www.fdic.gov/regulations/safety/manual/section7-1.pdf.

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examinations of interest rate risk.[39]

6. **Your written testimony states that "one clear takeaway from recent events is that heavy reliance on uninsured deposits creates liquidity risks that are extremely difficult to manage, particularly in today's environment where money can flow out of institutions with incredible speed in response to news amplified through social media channels."**

   a. **Do you agree that the risk of a bank run being provoked by social media is simply a variation of reputation risk that does not change the underlying risk? Please explain.**

RESPONSE: Assessing the stability of funding sources is an essential part of measuring and managing liquidity risk. A wide array of factors may impact the stability of a bank's funding sources that should be considered when a bank assesses the stability of its funding sources as part of the liquidity risk management program. Those factors include, but are not limited to large deposit growth, stability of uninsured deposits, current business cycle, and the history/relationship of large depositors with the institution, among other things. Also essential are realistic contingency funding plans that clearly define strategies for addressing liquidity shortfalls in emergency situations.

As we have seen, as the economy has become more digitized, digital capabilities to initiate and execute payments and withdrawals have become faster, and access to information, through social media and other information channels, is more timely. The combination of increased access to information and greater convenience of moving large amounts of money have changed the dynamic of bank runs, even when triggered by historically similar underlying risks.

7. **What conversations did you or your staff have with the New York state regulators regarding Signature Bank's failure? When did these conversations begin? Please describe in detail.**

RESPONSE: The FDIC and the New York State Department of Financial Services (NYSDFS) were coordinating liquidity monitoring in the days leading up to the failure. The FDIC and NYSDFS were made aware of Signature Bank's significant deposit withdrawals and likely funding shortfall around 5:30 pm on Friday, March 10. The possibility of failure was first discussed that evening, as Signature Bank did not have sufficient cash to fulfill its large volume of deposit withdrawal requests, which equaled 20 percent of total deposits.

[39] See Examination Documentation Module – Rate Sensitivity - Core Analysis at https://www.fdic.gov/regulations/safety/manual/section22-1/pc-rate-sens.pdf and Expanded Analysis at https://www.fdic.gov/regulations/safety/manual/section22-1/px-rate-sens.pdf.

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Due to its weak liquidity risk management practices, Signature Bank management had a difficult time initially ascertaining how much borrowing it needed to fund pending wires, had approached the Federal Home Loan Bank of New York (FHLBNY) too late in the day to draw against its line, and did not have sufficient collateral pledged at the Federal Reserve's Discount Window to cover pending wire requests. Bank officials worked with officials at the FHLBNY and the Federal Reserve Bank of New York (FRB-NY) to resolve the bank's funding shortfall through actions of the FHLB to subordinate its interest in collateral to the FRB-NY in order to gain Discount Window access just before the Federal Reserve's wire room closed.

Signature Bank management intended to pledge capital call loans to the FRB-NY as collateral for additional Discount Window lending. However, FRB-NY would not accept the loans as collateral because they were not eligible as many of them had foreign limited partners. Signature Bank had pursued efforts to pledge these loans for months, hiring two law firms to make the case to FRB-NY to accept the loans. During the weekend that Signature Bank failed, management again tried, unsuccessfully, to pledge this portfolio to FRB-NY. Signature Bank also unsuccessfully tried to identify alternate entities that would accept the portfolio as collateral for a borrowing line. Even though Signature Bank management knew they did not have a formally confirmed avenue to obtain liquidity from this portfolio, they continued to try to include these loans in collateral calculations just hours before the institution failed.

On the afternoon of Saturday, March 11, 2023, the FDIC and NYSDFS met with Signature Bank's Board of Directors to discuss the bank's condition, viability, and potential resolution process. The FDIC and NYSDFS recapped the significant liquidity event that occurred and management's lack of preparedness, as well as the need for updated and accurate financial information to assess the bank's current liquidity position. The FDIC and NYSDFS noted the challenge with receiving accurate information during Friday night's event. Regulators also informed management of forthcoming ratings downgrades.

Throughout the late afternoon and evening of March 11, 2023, the FDIC and NYSDFS staff met several times to discuss the bank's liquidity position, including potential borrowing capacity. The regulators delivered the rating downgrade letter that evening.

The morning of Sunday, March 12, 2023, the FDIC and NSYDFS met to discuss Signature Bank's liquidity position and the resolution process. By that afternoon, outgoing wires for the next day, Monday, March 13, 2023, had climbed steadily throughout the day to $7.9 billion against just $4.27 billion in certain liquidity.[40] Those numbers excluded any additional,

[40] See "New York State Department of Financial Services Internal Review of the Supervision and Closure of Signature Bank," April 28,2023 at https://www.dfs.ny.gov/system/files/documents/2023/04/nydfs_internal_review_rpt_signature_bank_20230428.pdf.

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unknown deposit withdrawal requests that Signature would receive on Monday. On the same evening, the NYSDFS closed Signature Bank and appointed the FDIC as receiver.

8. What conversations did you or your staff have with the California state regulators and the Federal Reserve regarding SVB's failure? When did these conversations begin? Please describe in detail.

RESPONSE: At 5pm EST, March 9, FDIC onsite staff participated in update meetings with CEO Greg Becker, CFO Dan Beck, CRO Kim Olson and staff from the California Department of Financial Protection and Innovation (CADFPI) and the Federal Reserve. Discussions focused on significant deposit withdrawals in the afternoon hours, liquidity shortfalls, and the bank's efforts to pledge additional securities to the Discount Window. Senior Federal Reserve staff thereafter provided senior FDIC staff additional information on the deposit runoffs and funding shortfalls, and shared a view that the bank was unlikely to have adequate liquidity to meet the demands of depositors and other creditors. Conversations with Federal Reserve staff on their ability to lend to SVB continued through the evening. At 11:15pm EST FDIC staff held a call with CADFPI about the potential failure of SVB as it was unclear the bank would have sufficient borrowing capacity to open the next morning.

Federal Reserve staff determined shortly after 7:30am EST, March 10 that SVB would not have sufficient borrowing capacity to open that morning. The FDIC, Federal Reserve and CADFPI convened a call at 8:00am EST to discuss preparations to close the bank and name the FDIC receiver. Communications between the FDIC, Federal Reserve and CADFPI continued that morning. CADFPI closed SVB at 11:15am EST and simultaneously appointed the FDIC as receiver.

9. How many examiners were assigned to supervise Signature? Please provide each of these examiner's work from home schedules.

RESPONSE: FDIC projects its examiner workforce using the combined results of a National Examiner Staffing Model (NESM) and Continuous Examination Process (CEP) Supervisory Plans. The NESM estimates examiner requirements for point-in-time examinations, generally most institutions having assets under $10 billion and some larger, non-complex institutions. CEP Supervisory Plans estimate examiner needs for continuous examinations, generally relating to institutions having assets of $10 billion or greater that possess significant risk characteristics or complexity. CEP Supervisory Plans may also be required for institutions with assets less than $10 billion with significant risk characteristics, complexity, expected growth, or other qualitative or quantitative factors that warrant continuous supervision.

CEP staffing is comprised of regional dedicated and designated staff and Washington Office specialists:

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- Dedicated examiners that are exclusively assigned to a bank;
- Regional examiners that work on different risk areas intermittently over the course of the year (designated examiners); and
- National examiners that specialize in a particular risk area and work on select targets over the course of the year.

Signature Bank was supervised under the FDIC CEP. Below are the number of examiners authorized for Signature Bank and the number of examiners that worked on Signature Bank.

	2022	2021	2020	2019
Authorized Dedicated Examiners	8	5	5	5
Authorized Designated Examiners Full Time Equivalent	3.6	5.1	4.5	5.0

From 2019 to 2023, a total of 120 risk management and 12 compliance examiners worked on Signature Bank. This represents the total number of examiners that worked on the bank at any point during the year. Many of these examiners may have only worked on one particular targeted review. "Authorized" examiners is the number of permanent staff approved as dedicated team members or designated examiner full-time equivalent.

From March 16, 2020 through September 5, 2022, in response to the COVID-19 pandemic, the FDIC generally conducted examination activity remotely. Beginning on September 6, 2022, every examination was required to have an onsite presence by examiners. After September 6th, the Signature Bank dedicated and designated team examiners periodically met in-person with each other and with bank management.

The Signature Bank Examiner-In-Charge implemented a hybrid onsite/offsite model for examination activities:

- The dedicated team typically held internal biweekly meetings to discuss emerging risks and updates from bank management and the regional office. The meeting also included discussions regarding the status of each targeted review, pending deliverables, and observations of deficiencies. Typically, every other team meeting was held in-person.

- Entry meetings to commence a targeted review, close-out meetings to discuss preliminary findings with management, and exit meetings to discuss final conclusions of a targeted

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review with management were held in-person whenever possible. Annual Report of Examination meetings were generally held in-person with bank senior management and with the Board of Directors.

- The team held numerous monthly and quarterly recurring meetings with bank management to stay abreast of emerging issues. These were typically held in-person. Meetings were held virtually for examiners working outside New York or when bank management had a conflict requiring them to attend virtually.

- Between onsite activities, dedicated team members performed reviews of ongoing monitoring reports and the various reports and documents provided in response to targeted review information requests and prepared for upcoming targeted reviews offsite. Preparation included the development of scope memos and information requests. Examiners also finalized targeted reviews offsite. This would include review of examiner conclusion memos, development of summary conclusion memos, drafting and editing of the target conclusion letter and drafting responses to questions from target letter reviewers.

- The dedicated team participated in daily calls via Microsoft Teams to share information and respond to questions from the regional office and Washington office personnel.

10. Were Signature's examiners working from home when SVB failed?

RESPONSE: As described in the response to Question 9 above, examiners followed a hybrid on-site/off-site model for conducting examination activities. The Signature Bank dedicated team of examiners was not on-site at the moment of SVB's failure on Friday, March 10, 2023, but was working from home that day. The dedicated team was scheduled to commence a daily on-site presence at the bank's headquarters beginning Monday, March 13, 2023, in order to monitor the bank's liquidity posture in real-time. See the description of on-site activities conducted at the bank in the response to Question 9 above.

11. If examiners were working in Signature up to the point of failure, please provide each examiner's "return to office" date for their "in bank" or "on site" work?

RESPONSE: On September 6, 2022, the FDIC entered into Phase 3 of its Return to the Office (RTO) Plan. On that same date, examiners were authorized to return to "in bank" or "on-site" examination work and every examination was required to have an on-site presence by examiners. Subsequent to this announcement, examiners within the Signature Bank dedicated team physically returned to the institution on September 21, 2022. Following the date of return to the institution and up to the institution's failure, recurring and periodic on-site activities occurred at Signature Bank. As described in the response to Question 9 above, dedicated team members

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primarily met in-person with bank management for monthly and quarterly ongoing monitoring meetings. Additionally, assigned targeted review participants and dedicated team members periodically worked on site during targeted reviews to hold meetings with bank management in order to ask questions, gather documents, and communicate observations.

12. How have you instructed your examiners to assess and account for social media risk? Please describe in detail including when you first addressed risks stemming from social media with your examiners.

RESPONSE: The size and speed of withdrawals from SVB and Signature Bank, due to digital capabilities, social media, and linkages within connected industries, represent a new dimension to liquidity risk and need to be reviewed carefully and be more fully understood, both in the context of supervision and for resolution planning. It is still early in the process, but the FDIC is conducting a comprehensive assessment of supervisory and regulatory processes.

Since at least September 2011, examination procedures have included consideration of whether management monitors risk arising from sources such as media, internet, and social networks; press releases and annual reports; participation in or sponsorship of community events; and public perception.[41] Examiners are also instructed and trained to assess the adequacy of a bank's liquidity risk management program and contingency funding plans and assign a Liquidity component rating under the Uniform Financial Institutions Rating System (UFIRS) consistent with UFIRS definitions.

This episode demonstrated how quickly trust and liquidity can erode, and the FDIC will review what other measures can be taken to account for and react to rapidly unfolding events. Assessing the stability of funding sources is an essential part of bank management's responsibility to measure and manage liquidity and funding risk. A wide array of factors may impact the stability of a bank's funding sources that management should consider when assessing the liquidity risk management program. Those factors include, but are not limited to large deposit growth, stability of uninsured deposits, current business cycle, and the history/relationship of large depositors with the institution. In general liquidity management practices and contingency funding plans should reflect the ability of the bank to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to quickly liquidate assets with minimal loss. As weve seen, as the economy has become more digitized, digital capabilities to initiate and execute payments have become faster, and the influence of new public communications platforms, such as social media, have had implications for the dynamics of a bank run. The funding structure and liquidity risk of each institution is unique, and the

[41] https://www.fdic.gov/regulations/safety/manual/section22-1/pc-mice.pdf.

liquidity risk management framework should be designed to consider each bank's unique funding and risks.

13. When it comes to supervision and your team, who is in your chain of command? Please list all managers that hold a supervisory role and report to you, including a specific list of the individual supervisory managers for Signature.

RESPONSE: Doreen Eberley, the Director, Division of Risk Management Supervision reports directly to me. The other supervisory managers within her chain of command are listed below.

Doreen Eberley, Director, Division of Risk Management Supervision

Rae-Ann Miller, Senior Deputy Director Supervision & Policy	Frank R. Hughes, Regional Director New York
Pete D. Hirsch, Associate Director Large Bank Supervision Branch	Jessica A. Kaemingk Deputy Regional Director
	Steven P. Slovinski Assistant Regional Director

a. When you found out there was a problem at Signature, who informed you about the issues and when?

RESPONSE: Director Eberley and staff provided notification in the early evening of Friday, March 10.

b. What directives if any, did you give when you were notified of issues at Signature bank?

RESPONSE: I convened the relevant staff to make them aware of the developing situation and establish plans for the weekend.

c. Had Signature Bank received any MRAs, MRBAs, or other supervisory actions, and if so, why and when were these actions taken and how was the bank directed to respond?

RESPONSE: Liquidity and funds management supervisory recommendations date back to at least 2014. Over the next few years, examiners found that Signature Bank management was responsive to and took steps to address recommendations. In 2017, examiners raised concerns

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related to liquidity stress testing assumptions and time horizons, as well as the lack of a board-approved risk tolerance for uninsured deposits.

Following the 2018 liquidity review, the FDIC and NYSDFS issued a Matter Requiring Board Attention (MRBA) regarding the apparent mismatch between the liquidity risk profile and the board-approved liquidity risk appetite. Other concerns included liquidity risk metric breaches, inadequate liquidity stress testing model validation, and liquidity stress testing assumptions and deposit segmentation.

Following the 2019 liquidity review, the FDIC and NYSDFS downgraded the "Liquidity" component rating to '3.' The 2018 MRBA related to liquidity risk appetite had not been addressed, and a new MRBA related to contingency funding plans was issued. Other concerns included ongoing weaknesses in liquidity stress test modeling, assumption support, and documentation, deposit modeling deficiencies, and internal control failures.

In 2020 and 2021, Signature Bank experienced significant deposit growth, with a majority of these funds held in cash and cash equivalents and investments as of year-end 2021. This heightened level of on-balance sheet liquidity mitigated some of the Region's concerns as it related to risks associated with weakness in funds management practices. In addition, at the 2020 and 2021 liquidity reviews, the FDIC and NYSDFS noted some management efforts to address prior weaknesses, including the installation of a new asset/liability management model and the engagement of a third party to perform a deposit study. Nonetheless, concerns about liquidity stress testing, contingency funding plans, and internal controls remained and the 3 rating for liquidity continued.

In 2022, Signature Bank management shifted its strategy and began to deploy liquidity into higher yielding loans and securities as interest rates began to increase. At the same time, deposits began to contract due to volatility in the digital assets market, rising interest rates, declining mortgage financing activity, and a conscious decision on the part of the bank to reduce deposits related to digital asset customers.

The 2022 liquidity review was in process when Signature Bank failed. The preliminary findings from the review included concerns about declining asset liquidity, as well as uncorrected funds management deficiencies related to liquidity stress testing and contingency funding plans. B ased on these findings, the Region was preliminarily in the process of reassessing the ratings for potential downgrades and discussing a related enforcement action.

Given the events of the week of March 6 and management's lack of urgency and reporting weaknesses, the Region began to initiate an interim downgrade to 223242/3 on March 10. Due to the events during the evening of March 10, an interim downgrade to 325252/5 was ultimately finalized and communicated to Signature Bank late in the evening on March 11.

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At failure, Signature Bank had one outstanding MRBA and eleven open Supervisory Recommendations (SRs) related to liquidity risk management. The MRBA directed the Board to establish adequate contingency funding plans, including a well-developed and supported liquidity stress testing framework. Specifically, the Board was instructed to define and model sufficient stress scenarios, develop appropriate stress test metrics and limits, and establish a process for measuring and monitoring the impact of liquidity stress events on capital.

The SRs instructed management to improve documentation of liquidity stress testing assumptions, including deposit run-off rates and the potential changes in customer behavior. The SRs also instructed management to improve documentation and support for the deposit modeling framework, including quantitative support for deposit behavior assumptions and depositor sensitivity to potential changes in the bank's financial condition. Further, the SRs instructed management to improve internal controls for liquidity risk management, particularly internal audit and model validation, and strengthen effective challenge of the liquidity management process.

d. What directives if any, did you give when you were notified of any supervisory actions addressed to Signature?

RESPONSE: In February 2023, I was notified by the Director, Division of Risk Management Supervision that the Region planned to downgrade the bank as part of its issuance of the 2022 roll-up report of examination and pursue enforcement action.

e. What directives if any, did you give when you were notified of Signature's impending failure?

RESPONSE: The evening of March 10, I convened relevant staff to make them aware of the developing situation and to establish plans for the weekend. I met with staff multiple times over the weekend to prepare for that potential event, including in briefings on the receivership and resolution of the bank and the state of the banking system. On March 12, I directed the FDIC's Executive Secretary to convene a meeting of the FDIC Board that same day to act on a failing bank case to authorize the FDIC to be named receiver, should the NYSDFS close the bank, and to recommend to the Secretary of the Treasury that the Secretary invoke, in consultation with the President, the systemic risk exception in connection with the resolution of Signature Bank.

f. When you were notified of the impending failure, did you work to find a buyer for Signature? If so, please detail such actions. If no, please explain why.

RESPONSE: Signature Bank experienced a substantial run on deposits on March 10, 2023. The speed at which the deposit withdrawals and failure over the weekend of March 11 occurred did

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not allow for an opportunity to market the bank before its failure on March 12. However, the FDIC immediately opened a VDR on March 11 to begin to gather information and documents for prospective bidders. The VDR was opened to prospective bidders for due diligence on March 15. The bid deadline was March 18. Flagstar Bank National Association was announced as the winning bidder on March 19, and the former Signature Bridge Bank opened on Monday, March 20 as Flagstar Bank, eight days after it failed.

g. **Please provide any and all delegations or reservations of authority relating to supervisory determinations. Please list any and all supervisory delegations or reservations of authority, including but not limited to supervisory determinations, exercised in relation to Signature.**

RESPONSE: Supervisory determinations during the twelve months prior to failure were limited to determinations regarding filings. Delegations for such determinations have been communicated in the form of matrices that have been posted to the FDIC's public website at: https://www.fdic.gov/regulations/laws/matrix/delegations-filings.pdf. Other actions related to Signature Bank were examination-related, for which delegations have been communicated to staff in the form of internal matrices, which are provided in Appendix C.

These bank failures were unique in many respects, including the size of the banks, the speed of the failures, and the attendant decisions regarding systemic risk and sale of the banks' assets and liabilities. Accordingly, while the resolution process drew upon existing practices and procedures in terms of execution actions, the requisite authorities were provided by the Board of Directors for each of these failures. The Board of Directors specifically authorized the actions to accept appointment as receiver, to take all requisite actions to establish the bridge bank, to undertake contracting and to execute on asset sales with respect to each failing bank, and to take all actions to consummate the sale of each bank pursuant to the winning bid. Customary delegations were used for certain resolution actions, at levels approved by the Board of Directors. (See the response to Question 3a.)

14. Did Signature Bank request, and did the Federal Reserve provide, a letter to the Federal Home Loan Bank of New York or any other Federal Home Loan Bank? Please describe any such request and any such response in detail.

RESPONSE: The FDIC is not aware of such a request.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM MARTIN GRUENBERG

Questions for the Record from Senator Jack Reed for
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1. **Did each of your agencies consider whether to exercise the orderly liquidation authority under Title II of the Dodd-Frank Act to liquidate either Silicon Valley Bank or Signature Bank? Please explain why the agencies declined to use this authority and whether the current use of extraordinary measures to avoid breaching the debt ceiling played a role in that decision?**

RESPONSE: The orderly liquidation authorities under Title II are intended for use where resolution under otherwise applicable law would pose systemic risk, and where the application of Title II authorities would mitigate those risks.

Authorities granted in the Federal Deposit Insurance Act (FDI Act), including the provisions related to the exercise of the systemic risk exception to the least-cost test, provided the FDIC with the authorities it needed to address the risks to the financial industry associated with the failure of Silicon Valley Bank (SVB) and Signature Bank. In the case of Signature Bank, there was no holding company, and the FDI Act is the applicable authority to a bank failure. In the case of SVB, there is a holding company – now in bankruptcy. The holding company controlled very limited assets and activities related to the firm, and the resolution of the holding company and any affiliates outside the bank chain in bankruptcy do not materially change the actions being taken by the FDIC as receiver. The Title II authorities are backup authorities, available only where necessary.

Debt ceiling considerations did not impact the decision, as the debt ceiling impacts would be comparable under either authority.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM MARTIN GRUENBERG

Questions for the Record from Senator Robert Menendez for
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1. **The concentration of uninsured deposits at SVB has brought a new debate over how much deposit insurance should cover, and who should pay for the additional costs.**

   a. **What percent of all account holders have above $250,000 in deposits?**

RESPONSE: According to Call Report data, 0.8 percent of accounts have balances over $250,000, as of fourth quarter 2022. This number has been consistent over the past decade, with deposit accounts in excess of the deposit insurance limit ranging from 0.5 percent to 1.1 percent of total deposit accounts.

   b. **What percent of all account holders have between $250,000 and $500,000 in deposits?**

RESPONSE: The Call Report instructions only require banks to report the number of accounts above $250,000 or below $250,000. Accordingly, the FDIC cannot answer this question.

   c. **What percentage of accounts with more than $250,000 in deposits are business-related and what percentage are personal?**

RESPONSE: Insured depository institutions (IDIs) do not report the number of accounts over $250,000 that are business-related vs. personal, so the FDIC does not have the necessary information to provide an answer to this question.

   d. **How much would premiums to the deposit insurance fund have to increase to cover a rise in the deposit insurance limit to, for example, $500,000?**

RESPONSE: The FDIC does not have the necessary information to provide an answer to this question. As noted above, the FDIC does not have an estimate of the total amount of deposits between $250,000 and $500,000.

2. **In the wake of the financial crisis, Congress included a provision in Dodd Frank requiring financial regulators to issue a rule to rein in the widespread practice of incentive-based compensation packages for bank executives that encouraged excessive risk-taking. However, nearly thirteen years after the passage of Dodd Frank this rule has still not been finalized.**

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a. **What is the timeline for completion of the joint incentive-based compensation rulemaking?**

RESPONSE: The FDIC along with Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Housing Finance Agency, the Securities and Exchange Commission, and the National Credit Union Administration (together, the agencies) proposed rules in 2011[44] and 2016[45] to implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The agencies continue to engage in discussions regarding how best to implement the statute.

FDIC-supervised institutions are subject to requirements under Section 39(c) of the FDI Act that prohibit as an unsafe and unsound practice compensation arrangements that provide executive officers, employees, directors, and principal shareholders with excessive compensation fees, or benefits and compensation arrangements that could lead to material financial loss to the institution.[46] In addition, the Interagency Guidance on Sound Incentive Compensation Policies promotes principles to help banking organizations ensure that incentive compensation policies do not encourage imprudent risk-taking and are consistent with the safety and soundness of the organization.[47]

[44] 76 Fed. Reg. 21170 (April 14, 2011).
[45] 81 Fed. Reg. 37670 (June 10, 2016).
[46] 12 U.S.C. 1831p-1; 12 CFR Part 364, Appendix A.
[47] 75 Fed. Reg. 36395 (June 25, 2010).

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM MARTIN GRUENBERG

Questions for the Record from Senator Catherine Cortez Masto for
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1. **When FDIC closed Signature and Silicon Valley Bank, how much funds did they provide to one or more FHLBanks?**

RESPONSE: At the time the New York State Department of Financial Services closed Signature Bank, the bank's total outstanding Federal Home Loan Bank (FHLBank) advances were $11.2 billion, which were transferred to Signature Bridge Bank (SBB) on March 12, 2023.

At the time the California Department of Financial Protection and Innovation closed Silicon Valley Bank, the bank's total outstanding FHLBank advances were $30 billion, which were transferred into the Silicon Valley Bridge Bank (SVBB) and subsequently fully repaid by March 17, 2023.

2. **Did the FDIC reimburse the FHLBanks for outstanding advances? If so, how much?**

RESPONSE: Between March 12, 2023 and April 30, 2023, SBB repaid $1 billion in advances at their maturity. Approximately $10.2 billion in advances to SBB remain outstanding. SVBB fully repaid the $30 billion outstanding advances and related interest and fees by March 17.

3. **Did the FDIC reimburse one or more FHLBanks for prepayment penalties, interest or other fees? If so, for how much?**

RESPONSE: Between March 12, 2023 and April 30, 2023, SBB repaid $34.7 million in interest. No prepayment fees have been incurred at this time. SVBB paid $162.7 million in prepayment fees, $21.8 million in interest, and $10.6 million in waiver fees.

The Federal Home Loan Banks

4. **How did advances from a Federal Home Loan Bank affect Silicon Valley Bank and Signature Bank? Were advances useful in providing depositors access to their funds?**

RESPONSE: FHLBanks offer a variety of credit products to meet the short and long-term liquidity needs of their members. Each FHLBank makes advances based on the creditworthiness and financial condition of the borrowing institutions and the value of loans and securities pledged (before applying a haircut).

In the fourth quarter of 2022, Signature Bank announced a plan to intentionally decrease deposits in the digital asset banking space by reducing the size of relationships. Signature Bank replaced these deposits primarily with advances from the FHLB of New York (FHLBNY).

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As of year-end 2022, Signature Bank's FHLBNY advances amounted to 10 percent of total assets, a level within its historical range. In January 2023, in response to a Wall Street Journal article, Signature Bank publicly announced it planned to replace its borrowings with other deposits over time. Signature Bank also noted that it heavily invested in government agency securities, the majority of which were pledged with the FHLBNY.

The Federal Reserve addressed Silicon Valley Bank's use of FHLBank advances in its April 28, 2023 Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank.[42]

a. Did FHLB advances allow the banks to function longer than they would have otherwise? Did the advances create an illusion of liquidity?

RESPONSE: As noted above, the advances were used to meet Signature Bank's short-term borrowing needs. The advances were collateralized by government agency securities and loans pledged by the bank to the FHLBNY. The bank had announced a plan to intentionally decrease deposits in the digital asset banking space by reducing the size of relationships. Signature Bank was replacing these deposits primarily with advances from the FHLBNY in the short-term.

The bank's relationship with the FHLBNY spanned more than two decades. The bank also noted that its multifamily lending aligned with the FHLBNY's mission to meet the housing finance and community development needs of its members' communities, as the bank had been a top three multi-family lender in the New York metro area since 2009. Signature Bank was also one of the largest financers of low-to-moderate income multifamily housing in New York. As noted above, the Federal Reserve addressed Silicon Valley Bank's use of FHLBank advances in its April 28, 2023 Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank.

b. Do you have any indication that the availability of FHLB advances led SVB or Signature to take more risk than without access to such funding?

RESPONSE: It is not apparent that the availability of FHLBank advances led Signature Bank or SVB to take more risk than they would have without access to such funding.

5. What types of supervisory information does a Federal Home Loan Bank have access to about its member financial institutions? For example, does an FHLBank have access to supervisory information from the federal and/or state regulator?

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[42] The Federal Reserve's report entitled "Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank" provides details on the Federal Reserve's supervision of SVB leading up its failure on March 10. The report is available at: https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf.

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RESPONSE: Each FHLBank has access to supervisory information about its member financial institutions by requesting such from the applicable federal banking agency. Pursuant to section 719 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989,[43] the banking agencies and the respective FHLBanks entered into a Confidentiality Agreement in 1990, whereby each FHLBank can request confidential supervisory information on its member financial institutions. Such requests must be in writing and specify the purpose for which the information is to be used. Under this arrangement, FHLBanks have requested and received from the FDIC, Reports of Examination and other non-public supervisory information on state-chartered financial institutions that are not members of the Federal Reserve System (state nonmember banks). Such confidential information remains the property of the FDIC and must be properly safeguarded by the receiving FHLBank.

6. **Will you include a discussion in your reviews of SVB and Signature that considers the positive – and possibly – negative role of the Federal Home Loan Banks, including access to supervisory information?**

RESPONSE: A review of the FDIC's supervision of Signature Bank was published on April 28, 2023. The review discusses how Signature Bank management worked with FHLB officials to try to resolve funding shortfalls just prior to the bank's failure. As noted above, the Federal Reserve published a review of the Federal Reserve's supervision and regulation of SVB on April 28, 2023. Questions regarding the content of the review should be directed to the Federal Reserve.

[43] P.L. 101-73 (August 9, 1989), 103 Stat 183, 422; 12 U.S.C. 1442.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HAGERTY FROM MARTIN GRUENBERG

Questions for the Record from Senator Bill Hagerty for
The Honorable Martin J. Gruenberg
Chair, Federal Deposit Insurance Corporation
March 28,2023 Hearing entitled "Recent Bank Failures and the Federal Regulatory Response."
Senate Committee on Banking, Housing, and Urban Affairs

As you know, the FDIC recently coordinated the acquisition of Signature Bridge Bank, N.A., by Flagstar Bank. According to recent coverage of this deal, the FDIC is reported to have taken steps to prevent crypto-related assets and liabilities of Signature from being included in these acquisitions. These reports appear consistent with the FDIC press release announcing the Signature-Flagstar acquisition, which states "Flagstar Bank's bid did not include approximately $4 billion of deposits related to the former Signature Bank's digital-assets banking business."

If these rumors are in fact true, it is highly concerning given that these actions would conflict with a recent joint prudential regulator guidance which states that regulated financial institutions "are neither prohibited nor discouraged from providing banking services to customers of any specific class or type."

1. **Were there any unique terms or conditions placed on Signature's crypto-related assets and liabilities? If so, please provide.**

RESPONSE: There were no terms or conditions placed on the crypto-related assets and liabilities as part of the bidding process for the sale of Signature Bridge Bank, N.A.

2. **Would a reduction in the number of U.S. financial institutions that are willing to bank crypto businesses result in an increase of the amount of concentration risk in the banking system?**

RESPONSE: Each bank is unique, with unique considerations related to asset size, funding sources, and funding mixes. Individual depositors or industry sector depositors that may represent a concentration at one bank may not be a concentration at another bank. Each institution makes its own customer-related business decisions based on internal processes, which may include consideration of funding concentration implications. Each bank needs to implement appropriate liquidity risk management processes commensurate with the risks of the institution, including contingency funding plans establishing strategies for stress events.

RESPONSES TO WRITTEN QUESTIONS OF CHAIR BROWN FROM MICHAEL BARR

Questions for The Honorable Michael Barr, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System, from Chairman Sherrod Brown:

1. **How do different departments within the Federal Reserve (bank supervision staff and monetary policy staff) work together to ensure banks are prepared for shifts in monetary policy, including rising interest rates?**

Supervision is a responsibility and function of the Board, with Reserve Banks conducting supervision under the Board's delegated authority. The Board establishes the regulations to which banks are subject and designs the programs used to supervise firms. At the Board, the Division of Supervision and Regulation (S&R) is primarily responsible for ensuring that Federal Reserve Banks appropriately supervise, monitor, inspect, and examine certain financial institutions to ensure that they comply with rules and regulations, and that they operate in a safe and sound manner. S&R works regularly with other divisions to understand major risks to the U.S. financial system.

Interest rate risk is a foundational risk of banking and is a core area of focus within supervision. As interest rates began to rise beginning in March 2022, Federal Reserve supervision focused increasingly on the impact of increasing rates on the safety and soundness of banks. This included prioritizing examinations of interest rate risk management, engaging proactively with firms with higher interest rate risk exposure, and conducting internal training and external outreach.[2]

There are many ways the different divisions work together to ensure perspectives on monetary policy, financial stability, and supervision and regulation are integrated into analysis and policy proposals provided to policy makers. For example, memos to the FOMC often include authors from a number of different divisions when the memos cover cross-cutting issues. Another example is that officers of the Monetary Affairs serve on different steering committees for different supervisory programs, providing feedback on the development and implementation of supervisory programs incorporating perspectives on monetary policy developments.

2. **Silicon Valley Bank's held to maturity securities lost value as interest rates rose over the past year. Market risk management, including interest rate risk, is a basic concept in prudent banking and many regulators were warning about interest rate risk for months. Please provide a list of materials and public statements warning about interest rate risk that would have been available to all regulated institutions.**

Market risk arising from changes in interest rates is a normal part of banking but can pose a significant threat to an institution's liquidity, earnings and capital base if not managed appropriately. Section 3300 of our Commercial Bank Examination Manual (CBEM) details the importance of effectively managing interest rate risk and sets forth the principles and guidance for measuring and managing the risk that is appropriate for the size and risk profile of the bank.[3]

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[2] *See* https://www.federalreserve.gov/publications/files/202211-supervision-and-regulation-report.pdf and https://www.federalreserve.gov/supervisionreg/files/board-briefing-on-impact-of-rising-interest-rates-and-supervisory-approach-20230214.pdf.

[3] *See* https://www.federalreserve.gov/publications/files/cbem.pdf.

This includes board and senior management oversight, interest rate risk monitoring and reporting, measurement methods, and setting risk limits. The CBEM references the following Supervision and Regulation Letters, which were issued in 2012 and earlier that address interest rate risk:

- SR 12-2: Questions and Answers on Interagency Advisory on Interest Rate Risk Management[4]
- SR 10-1: Interagency Advisory on Interest Rate Risk[5]
- SR 01-14 Joint Agency Advisory on Rate-Sensitive Deposits[6]
- SR 96-13 Joint Policy Statement on Interest Rate Risk[7]

The Federal Reserve's November 2022 Supervision and Regulation Report highlighted the impact of unrealized losses on capital and liquidity positions of firms.[8] In December 2022, the Federal Reserve hosted a webinar with bankers to provide information on our supervisory approach, provide guidance on managing exposures, and answer bankers' questions. In addition, individual Federal Reserve Banks published articles on interest rate risk management.[9]

3. **Mid-size and large banks can report Treasury holdings and mortgage-backed securities as "held to maturity", which may not reflect current market value. How would requiring Accumulated Other Comprehensive Income (AOCI) reporting for banks with assets between $100B and $250B better reflect a bank's soundness and risk profile?**

Mid-size and large banks can classify Treasury holdings and mortgage-backed securities as "available-for-sale" or "held to maturity" but firms are only required for accounting purposes to reflect unrealized gains or losses for available-for-sale securities on their balance sheet through AOCI.

Because of the Federal Reserve's tailoring rules in 2019, SVB was not required to reflect unrealized gains and losses to their regulatory capital. This meant that their capital was about $2 billion lower than it would have been otherwise. That $2 billion cushion may have been helpful when they sold some of their securities at about that amount of loss in early March.

Based on this experience, I believe we should require a broader set of firms to take into account unrealized gains or losses on available-for-sale securities, so that a firm's capital requirements are better aligned with its financial position and risk.

4. **Stress testing is a useful tool for risk management and bank supervision. Since the Great financial crisis, the words "stress testing" typically refer to supervisory tests of**

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[4] *See* https://www.federalreserve.gov/supervisionreg/srletters/sr1202.htm.
[5] *See* https://www.federalreserve.gov/boarddocs/srletters/2010/sr1001.htm.
[6] *See* https://www.federalreserve.gov/boarddocs/srletters/2001/sr0114.htm.
[7] *See* https://www.federalreserve.gov/boarddocs/srletters/1996/sr9613.htm.
[8] *See https://www.federalreserve.gov/publications/2022-november-supervision-and-regulation-report.htm.*
[9] *See* Federal Reserve Bank of Richmond's "Rising Rates and Interest Rate Risk Management", in September 2022; Federal Reserve Bank of St. Louis's "Rising Interest Rates Bring Opportunities and Risks for Banks" on November 07, 2022 "Rising Interest Rates Complicate Bank's Investment Portfolios", on February 9, 2023.

capital adequacy. However, other stress tests are commonly used to manage interest rate risk, liquidity risk, credit risk, and others. Please explain the role of, and note the differences in, stress testing for different risk categories, the bank's management of these risk categories, and capital adequacy.

The capital stress test the Board uses to set capital requirements for the largest firms is based on a macroeconomic scenario, trading book shock, and models developed by the Federal Reserve. These stress tests have placed significant emphasis on ensuring firms can withstand the types of credit-driven downtowns typically seen in severe U.S. recessions. We continuously look for ways to expand the risk capture of that important tool. For example, in 2023, the Board added a second trading book shock for the biggest banks. This exploratory market shock is characterized by a recession with inflationary pressures induced by higher inflation expectations, and thus a rising rate environment.

While stress tests are one of our most visible tools, the Board also relies on a broader set of supervisory and regulatory tools to assess a broad range of risks affecting supervisory institutions. For example, large firms also are required to conduct internal liquidity stress tests based on firm-specific stress scenarios that reflect market stress, an idiosyncratic stress event, and a combined market and idiosyncratic stress event. The Board also imposes liquidity risk management requirements for large firms and, for certain large firms, standardized liquidity requirements, such as the liquidity coverage ratio.

Moreover, supervisory guidance on funding and liquidity risk management notes that firms should, "…conduct stress tests regularly for a variety of institution-specific and market wide events across multiple time horizons." The guidance notes that the tests should be commensurate with the complexity of the firm and the level of its risk exposures. The results of these tests should be used to identify and quantify sources of liquidity strain and to analyze possible impacts on the institution's cash flows, liquidity position, profitability, and solvency.[10] Supervisors examine the results of these tests to help ensure firms have adequate liquidity.

In addition to guidance on liquidity, the Board also has guidance on interest rate risk management. The guidance states that interest rate risk stress testing, including interest rate shock scenarios, should be an integral component of risk management. Supervisors conduct reviews of these firm-run stress tests and conduct their own analysis to ensure firms are appropriately managing interest rate risk.[11]

The Board also has guidance outlining expectations for firms with commercial real estate concentrations to perform portfolio-level stress tests or sensitivity analysis to quantify the impact of changing economic conditions on asset quality, earnings, and capital.[12]

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[10] Supervision and Regulation Letter 10-6, *Interagency Policy Statement on Funding and Liquidity Risk Management*, March 17, 2010.
[11] Supervision and Regulation Letter 10-1, *Interagency Advisory on Interest Rate Risk*, January 11, 2010.
[12] Supervision and Regulation Letter 07-01, *Interagency Guidance on Concentrations in Commercial Real Estate*, January 4, 2007.

5. **In 2019, the Federal Reserve eliminated the requirement for qualitative stress tests for large banks. Please describe the benefits of a qualitative stress test that a quantitative stress test alone cannot capture.**

In 2011, the Board finalized the capital plan rule, which required large firms to develop and maintain capital plans, which the firms use to determine their capital needs and plan for their capital distributions. The firms use internal scenarios designed to stress their unique risk exposures to complement the industry-wide supervisory stress tests completed by the Board. The Board reviews the capital plans on an annual basis, and prior to 2019, made an annual decision whether to object or not to object to them on a quantitative or qualitative basis.

While the Federal Reserve no longer objects to firms' capital plans on a quantitative or qualitative basis, examiners undertake rigorous qualitative assessment of banks' capital plans. Examiners review the capital plans to ensure that firms are meeting expectations with regards to their capital planning processes. These exams focus on firms' governance, risk management, internal controls, capital policy, ability to incorporate stressful events and estimate impact on capital positions. In addition to the assessment carried out subsequent to the submission of the required annual capital plans, supervisory assessments are informed by supervisory activities that are conducted throughout the year to assess a firm's practices and processes used, in part, to support its capital planning. These supervisory activities include reviews that focus on risk management, internal controls, audit, and corporate governance and the monitoring of the firm's progress toward addressing identified weaknesses in capital planning processes and meeting supervisory expectations. The supervisory assessments of firm's capital plans can result in the issuance of supervisory findings and support supervisory ratings and enforcement actions.

6. **Some have argued that SVB and Signature Bank failed because supervisors were asleep at the switch. Yet, following the passage of S. 2155, which weakened capital, liquidity, stress testing, and safety and soundness regulation of large banks, the banking agencies, under Trump-appointed regulators, released a statement explaining that the role of supervisory guidance is essentially a "for your information" communication to the banks.[2] The agencies followed this statement with proposal and comment rulemaking issuing final rules in 2021 which instruct examiners not to criticize institutions if their practices, such as risk management, are not consistent with supervisory guidance.[3] This forces examiners to react once problems arise rather than proactively supervise the institution. Without using supervisory guidance, how do front-line examiners preemptively address unsafe and unsound behavior before problems arise? Do you believe this weakens bank examination as the first line of defense against bank failure and financial stability?**

   [2] https://www.fdic.gov/news/press-releases/2018/pr18059a.pdf.
   [3] https://www.govinfo.gov/content/pkg/FR-2021-04-08/pdf/2021-07146.pdf and https://www.govinfo.gov/content/pkg/FR-2021-03-02/pdf/2021-01537.pdf.

In April 2021, the agencies issued a Final Rule on the Role of Supervisory Guidance (2021 Rule)[13] to codify the long-standing principle of administrative law that supervisory guidance does not have the force and effect of law, but rather "outlines the agencies' supervisory expectations or priorities and articulates the agencies' general views regarding practices for a given subject area."

As described in the preamble to the 2021 rule, examiners are expected to take steps to identify deficient practices before they rise to violations of law or regulation or before they constitute unsafe or unsound banking practices. Early identification of deficient practices serves the interest of the public and of supervised institutions because it protects the safety and soundness of banks, promotes consumer protection, and reduces the costs and risk of deterioration of financial condition from deficient practices resulting in violations of laws or regulations, unsafe or unsound conditions, or unsafe or unsound banking practices.

As described in the recently released report on the supervision and regulation of SVB, the Federal Reserve's tailoring approach in response to the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (EGRRCPA) and a shift in the stance of supervisory policy impeded effective supervision by reducing standards, increasing complexity, and promoting a less assertive supervisory approach. [14] Although the stated intention of policy changes—including the guidance on guidance rule—was to improve the effectiveness of supervision, the changes also led to slower action by supervisory staff and a reluctance to escalate issues. We are how to improve the speed, force, and agility of supervision.

7. **Both Silicon Valley Bank and Signature Bank failed to manage the risks corresponding to their rapid growth. First Citizens Bank acquired portions of Silicon Valley Bank, including $56.5B in deposits and $72B in loans. This purchase will double the size of the bank and increase its assets to $219B, compared to $42B three years ago. New York Community Bank's subsidiary Flagstar Bank will also increase in size after the purchase of some of the assets of Signature Bank. How will regulators ensure that the growth of First Citizens and New York Community Bank/Flagstar Bank is monitored and well managed and that the bank is well supervised?**

As noted in the Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank, the Federal Reserve is evaluating how to ensure that supervision intensifies at the right pace as a firm grows in size or complexity. Rapid growth itself is often a sign of increased risk where additional oversight and mitigants are needed. The supervisory and regulatory program is considering ways to promote resilience of firms with well-identified, material risk-management weaknesses, rapid growth, or substantive business model changes. This could be through, for example, higher capital or liquidity buffers or activity restrictions. By contrast, SVB had a long runway to meet higher standards even as it was growing rapidly.

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[13] *See* Role of Supervisory Guidance, 86 Fed. Reg. 18,173 (April 8, 2021), https://www.federalregister.gov/documents/ 2021/04/08/2021-07146/role-of-supervisory-guidance.

[14] Board of Governors of the Federal Reserve System, Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank (April 28, 2023), https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf.

8. **What do SVB's and Signature Bank's failures suggest about the asset threshold established in S. 2155? Was $250B too high of a threshold to set, and do you think it was a mistake for regulators to ease regulatory standards for banks of this size, beyond what Congress had required? Does the Federal Reserve have the authority to impose enhanced prudential standards on bank holding companies with assets between $100 billion and $250 billion?**

The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 provides the Federal Reserve Board with substantial discretion to apply enhanced prudential standards to bank holding companies with total consolidated assets between $100 billion and $250 billion in a way that is supportive of safety and soundness and financial stability, taking into consideration their capital structure, riskiness, complexity, financial activities, size, and other risk-related factors.

In light of recent events, I plan to revisit the application of enhanced prudential standards for these sized firms generally. Changes to the rules applicable to these firms would be made through notice-and-comment rulemaking and would be accompanied by an appropriate phase-in.

9. **Currently, the Federal Reserve's reserve requirements are at 0%. How does this current percentage impact the safety and soundness of banks during moments of liquidity risk?**

Depository institutions are required to comply with a number of regulations related to the management of liquidity risk, based on the size and complexity of the institution. These include, for example, the regulations implementing the Liquidity Coverage Ratio, the Net Stable Funding Ratio, and the requirement to conduct internal liquidity stress tests. Reserves can be used for liquidity purposes, and banks generally hold ample reserves.

By statute, reserve requirements are used only for monetary policy purposes. Prior to the Global Financial Crisis, reserve requirements were an important determinant of the demand for reserves and a key element of the Federal Reserve's overall approach to monetary policy implementation which relied on reserve scarcity. In more recent years, the level of reserves in the banking system increased substantially and reserve requirements no longer play an important role in the implementation of monetary policy. In 2019, the FOMC announced that it intended to implement monetary policy in an ample reserves framework under which monetary policy is implemented through the use of administered rates. Reserve requirements are not necessary in this framework, and therefore the Board chose to reduce reserve requirements to zero in 2020. Setting reserve requirements to zero provides more flexibility for banks to use their reserve holdings to meet liquidity pressures.

10. **Silicon Valley Bank and Signature Bank may have offered inducements to their customers unrelated to banking, such as continuing legal education credits to attorneys with IOLTAs, in exchange for keeping all their deposits at the banks. Are you aware of these relationships and to what extent might they violate anti-tying requirements or other restrictions?**

We are aware that SVB's loan agreements with certain borrowers required the borrowers to use other services of SVB or an SVB affiliate, including maintaining their primary operating deposit accounts with SVB.[15] The agreements did not, however, prohibit these borrowers from obtaining similar accounts or services from other providers. The types of covenants included in SVB's loan agreements are often seen as prudent credit risk management tools because they provide lenders insight into a borrower's financial condition and ability to repay a loan. As part of its standard supervision, Federal Reserve staff reviewed SVB's loan portfolio. During general discussions with SVB of its loan agreements, staff became aware of the requirement to use other services of SVB or SVB's affiliates. Federal Reserve staff is not aware of any requirements SVB imposed on its borrowers to obtain services other than those identified in this response.

Banking law generally prohibits "tying arrangements," or when a bank extends credit or provides other services on the condition or requirement that the customer obtain some other product or service from the bank or the bank's affiliates.[16] However, the law permits a bank to condition the availability or price of any product on a requirement that the customer obtain a "loan, discount, deposit, or trust service" from the bank or an affiliate of the bank. The covenants known to Federal Reserve staff in SVB's loan agreements qualify for this exception.[17] The law also does not apply when a bank requires a customer to obtain a product or service from the bank or an affiliate in order to obtain a product or service from a nonaffiliated party. Accordingly, the prohibition against tying arrangements would not prohibit a bank from requiring an attorney to maintain its IOLTA accounts with the bank in order to receive free continuing education from a third party.

With respect to Signature Bank, the Board was not the Bank's primary federal supervisor, and the bank did not have a holding company. Thus, the Board does not have insight into the Bank's activities.

11. SVB's collapse demonstrates that tying compensation and bonuses to a bank's growth incentivizes executives to take egregious risks. What steps can regulators take to discourage this kind of behavior from bank executives? What steps should Congress take?

SVB's senior management responded to the incentives approved by the board of directors; they were not compensated to manage the bank's risk, and they did not do so effectively. In May 2022, Federal Reserve examiners issued a Matter Requiring Immediate Attention (MRIA) to the firm related to the effectiveness of SVB's board of directors, citing that "[SVB's] board did not hold senior management accountable through appropriate performance management programs. Senior management performance objectives and incentive compensation practices do not clearly link to risk management objectives." This deficiency contributed to the examiners' decision to rate the firm as "Deficient-1" for its Governance and Controls in August 2022.

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[15] Some borrowers also were required to maintain their operating and securities accounts with SVB and to obtain asset management, letters of credit, and cash management services from SVB or an SVB affiliate.

[16] *See* 12 U.S.C. § 1972(1)(A)–(B).

[17] *See* Federal Reserve Board, Legal Interpretations: Frequently Asked Questions about Regulation Y, 12 CFR 225.7 Q1, https://www.federalreserve.gov/supervisionreg/legalinterpretations/reg-y-frequently-asked-questions.htm (last updated Dec. 30, 2021).

Going forward, the Federal Reserve should consider setting tougher minimum standards for incentive compensation programs and ensure banks comply with the standards already in place. The Federal Reserve continues to evaluate incentive compensation practices as a part of ongoing supervision, consistent with the compensation-related provisions of the Safety & Soundness Guidelines[18] and the Guidance on Incentive Compensation.[19] This includes focusing on monitoring robust risk management and governance around incentive compensation practices rather than prescribing amounts and types of pay and compensation.

The Board is actively working with the federal banking agencies, Federal Housing Finance Agency, Securities and Exchange Commission, and National Credit Union Administration to implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Specifically, we are preparing a proposal that would implement prohibitions against incentive compensation arrangements that could provide excessive compensation or lead to material financial loss and requiring disclosure related to incentive compensation arrangements.

12. Silvergate Bank, a cryptocurrency-centric bank that began to falter after the collapse of cryptocurrency exchange FTX and broader crypto industry turmoil, announced its voluntary liquidation on March 8, 2023, just two days before the failure of SVB. How did the Silvergate Bank liquidation affect the events surrounding the failure of SVB and Signature Bank?

We are not aware of any information that would indicate that Silvergate Bank (Silvergate) had direct linkages with SVB or Signature Bank (Signature); however, while Silvergate's announcement of its intent to voluntarily liquidate indicated that the bank would be wound down in an orderly fashion and would include "full repayment of all deposits,"[20] there may have been confusion about the status of depositor and creditor claims that could contribute to market stress. It is well documented that concerns about the viability of a single financial institution can cause contagion to spread to other financial institutions,[21] and Signature's regulators have indicated that contagion from Silvergate spread to Signature in this instance.[22]

[18] Appendix D-1 to Part 208 - Interagency Guidelines Establishing Standards for Safety and Soundness.

[19] Guidance on Sound Incentive Compensation Policies, 75 *Federal Register* 36395, June 25, 2010.

[20] Silvergate Capital Corporation, Press Release: Silvergate Capital Corporation Announces Intent to Wind Down Operations and Voluntarily Liquidate Silvergate Bank (March 8, 2023).

[21] *See, e.g.*, Charles W. Calomiris et al., Interbank Connections, Contagion, and Bank Distress in the Great Depression 51 Journal of Financial Intermediation 1 (July 2022); Erik Heitfield et al., Contagion During the Initial Banking Panic of the Great Depression NBER Working Paper Series (2017); Daron Acemoglu et al., Systemic Risk and Stability in Financial Networks 105 Am. Econ. Rev. 564 (2015); Hal S. Scott, Connectedness and Contagion 5–12 (2016); Gary Gorton and Andrew Metrick, Getting Up to Speed on the Financial Crisis: A One-Weekend-Reader's Guide, 50 Journal of Economic Literature 128 (2012); Ted Temzelides, Are Bank Runs Contagious? Federal Reserve Bank of Philadelphia Business Review (November/December 1997).

[22] *See* FDIC, FDIC's Supervision of Signature Bank, 2 (April 28, 2023) ("The primary cause of SBNY's failure was illiquidity precipitated by contagion effects in the wake of the announced self-liquidation of Silvergate Bank, La Jolla, California (Silvergate), on March 8, 2023, and the failure of Silicon Valley Bank, Santa Clara, California (SVB), on March 10, 2023, after both experienced deposit runs."). *See also* New York State Department of Financial Services (NYDFS), Internal Review of the Supervision and Closure of Signature Bank, 5 (April 28, 2023) ("The immediate cause of the Bank's failure was a propulsive run on deposits instigated by the consecutive announcements, first on March 8 that Silvergate Bank ("Silvergate") was liquidating itself, and then on March 10

Additionally, it is possible that depositors of SVB or Signature may have had concerns that the headwinds affecting Silvergate would affect their banks given direct and indirect exposures to the crypto-asset industry.[23] It was well-known that Silvergate was significantly exposed to the crypto-asset industry, and that such exposure had led to significant runs and losses since the failure of FTX.[24] Signature Bank was viewed by many as the primary competitor to Silvergate with respect to offering deposit accounts to, and facilitating payments for, the crypto-asset industry; indeed, Silvergate and Signature both operated 24/7 payments networks popular with crypto-firms.[25] While SVB did not have as significant a role with respect to banking and payments activities for crypto-firms, it was heavily involved in banking the venture capital industry that has made significant investments in crypto-firms in recent years. In addition, Circle, issuer of USDC, had previously indicated in its monthly attestations that its reserves were held at Silvergate Bank, Signature Bank, SVB, and four other banks.[26]

that the California Department of Financial Protection and Innovation was taking possession of Silicon Valley Bank ("SVB") following an unprecedented run on its deposits.").

[23] *See* FDIC, FDIC's Supervision of Signature Bank at 14 ("SBNY was also frequently associated with Silvergate in media reports, as these two banks were seen as most closely tied to the crypto industry. Following the March 1, 2023, announcement by Silvergate regarding the delay in filing its year-end 2022 financial statements and comments about its ability to continue as a going concern, SBNY once again experienced negative media attention, which raised questions about its liquidity position. The announcement on March 8, 2023, that Silvergate intended to self-liquidate placed additional pressure on SBNY's liquidity.")

[24] Silvergate Capital Corporation announced that Silvergate Bank had seen an $8.1 billion decline in deposits from crypto-asset customers in the fourth quarter of 2022, leading to a need to increase wholesale funding and a realization of $718 million in losses on sales of debt securities to meet liquidity needs. Silvergate Capital Corporation, Form 8-K, Exhibit 99.1 (January 5, 2023)

[25] NYDFS, Internal Review of the Supervision and Closure of Signature Bank at 31 (remarking that Silvergate, SVB, and Signature were all mentioned as "crypto-friendly" banks).

[26] *See, e.g.,* USDC Reserve Report – October 2022 at n.8 (Nov. 22, 2022), https://www.circle.com/hubfs/USDCAttestationReports/2022/2022 USDC Circle Grant Thornton Report October.pdf.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM MICHAEL BARR

Questions for The Honorable Michael Barr, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System, from Ranking Member Tim Scott:

1. **In your testimony, you acknowledged that the Fed was aware of "deficiencies in the bank's liquidity management," and had even gone so far as to issue supervisory findings. Based on your testimony, the Federal Reserve examiners knew there were issues at Silicon Valley Bank (SVB) for years. Given your role as the Vice Chair for Supervision, you are required to oversee the supervision and regulation of state member banks, including SVB.**

   a. **When it comes to supervision and your team, who is in your chain of command? Please list all managers that hold a supervisory role and report to you, including a specific list of the individual supervisory managers for SVB.**

   b. **When you found out there was a problem at SVB, who informed you about the issues and when?**

   c. **What directives if any, did you give when you were notified of the bank's mismanagement?**

   d. **What directives if any, did you give when you were notified of the supervisory actions addressed to SVB?**

   e. **What directives if any, did you give when you were notified of SVB's impending failure?**

   f. **When you were notified of the impending failure, did you work to find a buyer for SVB? If so, please detail such actions. If no, please explain why.**

   g. **Please provide any and all delegations or reservations of authority relating to supervisory determinations. Please list any and all supervisory delegations or reservations of authority, including but not limited to supervisory determinations, exercised in relation to SVB.**

Supervision is a responsibility and function of the Board, with Reserve Banks conducting supervision under the Board's delegated authority.[1] The Board establishes the regulations to which banks are subject, designs the supervisory programs, provides input and support in supervision, and oversees the Reserve Banks' activities. Board staff provide input and support in supervision, as well as oversight of the Reserve Banks' activities. In the case of SVB, the Federal Reserve Bank of San Francisco (FRBSF) was the responsible Reserve Bank.

For all banks but the G-SIBs, the Federal Reserve organizes its supervisory approach based on asset size. The G-SIBs—our largest, most complex banks—are supervised within the Large Institution Supervision Coordinating Committee, or LISCC, portfolio. Banks with assets of $100

[1] *See, e.g.*, 12 U.S.C. §§ 248(k), 325, 483; 12 CFR §§ 225.3(a), 211.13(d)(1), part 262, 265.20.

billion or more that are not G-SIBs are supervised within the LFBO portfolio. Banks with assets in the $10 to $100 billion range are supervised within the regional banking organization, or RBO, portfolio. Banks with assets of less than $10 billion are supervised within the community banking organization, or CBO, portfolio.

SVB grew exceedingly quickly, moving from the RBO portfolio to the LFBO portfolio in 2021. RBO supervision is delegated to the Reserve Banks, with oversight from the Board. For each supervised firm, Reserve Banks designate a member of supervisory staff as a central point of contact (CPC), who is responsible for supervision of the firm. RBO supervision combines continuous monitoring and firm-specific, point-in-time exams.

LFBO supervision is also delegated to the Reserve Banks but with greater Board staff involvement on substantive topics than in RBO supervision. Reserve Banks select CPCs and assign dedicated supervisory teams (DSTs) who are responsible for supervision of firms in their respective districts. The supervisory plans for LFBO firms are based on portfolio-wide LFBO Management Group (LFBOMG) principles. As compared to RBOs, LFBO banks are subject to a greater number of targeted exams, as well as horizontal (cross-bank) exams that assess risks such as capital, liquidity, and cyber security throughout the year. In addition, banks in the LFBO portfolio are subject to a supervision framework with higher supervisory standards, including heightened standards for capital, liquidity, and governance.

The Board oversees Reserve Bank supervision of banks in the RBO and LFBO portfolio. Both oversight sections have reports and communication protocols that keep staff informed on the status of banks in the portfolio and relevant emerging risks, to include routinely scheduled and ad-hoc meetings.

Under the statute, the Vice Chair for Supervision oversees the supervision and regulation of banks and their holding companies. For the GSIBs, I am in close touch with supervisors about the supervisory issues at these firms. For other firms, staff generally raise issues to me when staff believe that a firm has significant issues or experiences distress. Staff did not raise SVB to my attention as an individual concern, other than as noted below.

The Board received an informational briefing on February 14, 2023, entitled "Impact of Rising Rates on Certain Banks and Supervisory Approach," delivered by S&R and Federal Reserve System risk staff. This presentation highlighted the range of impacts of rising rates on banks, including large unrealized market value losses in investment securities for some banks. The presentation described the increased supervisory activity at banks with significant risk, as well as internal training and outreach to supervised firms on interest rate risk given the current environment.[2] Staff identified Silicon Valley Bank (SVB) as an example of a large bank with substantial exposure to interest rate risk. Staff discussed the actions that the bank was taking to address this risk, including the firm executing its Contingency Funding Plan, as well as the Federal Reserve's response, including the planned downgrade of SVB's CAMELS "S" sensitivity rating to "Less-than-Satisfactory-3," issuance of a supervisory Matters Requiring Attention (MRA) on Interest Rate Risk modeling, and heightened supervisory attention.

[2] *See* https://www.federalreserve.gov/supervisionreg/files/board-briefing-on-impact-of-rising-interest-rates-and-supervisory-approach-20230214.pdf.

On the morning of Thursday, March 9, I received notice from staff indicating that SVB had experienced difficulty in raising capital on the evening of Wednesday, March 8. The bank was reporting to supervisors Thursday morning that deposits were stable. However, later in the day, depositors withdrew funds at an extraordinary rate, pulling more than $40 billion in deposits from the bank on March 9. That evening, the principals of the Treasury, FDIC, and the Federal Reserve began having informal conversations about whether there might be systemic consequences to SVB's failure.

Federal Reserve staff were in discussions with the bank beginning Thursday afternoon to try and move collateral over to the discount window. That work continued Thursday afternoon, Thursday evening, and overnight. Friday morning, the bank indicated that it expected outflows of an additional $100 billion. The bank did not have enough cash or collateral to meet those extraordinary and rapid outflows, and on Friday, March 10, SVB failed.

Following SVB's failure, the FDIC was appointed receiver. The FDIC, in accordance with the least-cost provision of the Federal Deposit Insurance Act, created the Deposit Insurance National Bank of Santa Clara, transferred all insured deposits to it, and developed a list of prospective bidders. FDIC then initiated marketing for the Deposit Insurance National Bank of Santa Clara.

2. **According to a March 19 article in the New York Times, Federal Reserve examiners issued as many as six matters requiring attention (MRA) and/or matters requiring immediate attention (MRIA) and by July 2022 was in a full supervisory review. In reference to the Federal Reserve's knowledge of the duration and interest rate risk of Silicon Valley Bank's securities portfolio, you testified that "the Federal Reserve did cite these problems to the bank and require them to take action. Bank management failed to act on those citations." You further stated that "supervisors began highlighting these deficiencies at the firm and interest rate risk management and liquidity risk management in a serious way in November of 2021" and that "they intensified that supervisory review as part of its full scope exam in the summer of 2022." Please expound upon your testimony:**

    a. **How many MRAs and MRIAs in total were issued to SVB since 2019? What were these MRAs and MRIAs based on?**

    b. **When were the MRAs escalated to MRIAs and what factors were cited for escalation?**

    c. **What actions did each MRA or MRIA require and what was their timeframe for completion?**

    d. **For all MRAs and MRIAs, who were they addressed to? Did any of the MRAs and MRIAs require specific elevation to SVB's board?**

    e. **How many of the MRAs and MRIAs are outstanding?**

f. **Generally, MRAs and MRIAs are issued to remediate unsafe and unsound practices or significant violations of law identified during examination. Please outline what unsafe and unsound practices or violations of law that were determined and resulted in the MRAs and MRIAs.**

g. **Did Silicon Valley Bank have a detailed action plan to resolve the issues identified in the MRAs and MRIAs?**

h. **What other supervisory actions, if any, were taken to address SVB's deficiencies? Please respond in detail, including whether any orders or non-public enforcement actions were issued or initiated.**

Since 2019, Federal Reserve examiners issued 54 Matters Requiring Attention (MRAs) and Matters Requiring Immediate Attention (MRIAs) to the firm (not including consumer compliance issues).[3] These MRAs and MRIAs covered capital planning and positions, liquidity risk management and positions, governance and controls, and the Bank Secrecy Act and anti-money laundering compliance. As of the date of receivership, there were 31 open MRAs and MRIAs. Table 2 on page 28 of the Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank (Report) summarizes the findings.[4]

MRAs and MRIAs generally set forth remediating actions required at the firm and timelines for remediation. The timing to close a supervisory finding varies considerably based on the specific issues being addressed and the necessary time to remediate them. Please refer to page 28 Figure 12 of the Report for the timeline of the firm's MRAs and MRIAs. Escalation of MRAs to MRIAs depends on pace of remediation and other factors. A MRIA can be issued on a stand-alone basis and does not need to occur as part of an escalation of a previously issued MRA.

As a general matter, a MRA or MRIA informs a firm what issues should be remediated and the expected timeframe in which remediation is expected to be completed. In some cases, supervisors may ask for the firm to develop a detailed plan to address the open issue. SVB had provided action plans for some of the findings by the time it failed. For instance, the three MRIAs from the May 2022 Governance exam on Board Effectiveness, Risk-management program and Internal Audit Effectiveness required plans for remediation that were submitted; however, the examination team did not accept the plan as sufficient to remediate the findings and the firm was required to adjust the plan while continuing to remediate portions that were appropriate. It is not unusual for major remediations to take multiple years with periodic plan iterations until they are complete.

After SVB was rated "Deficient-1" for Governance and Controls under the Large Financial Institution (LFI) ratings system on August 17, 2022, there was a rebuttable presumption that an informal enforcement action will be undertaken. The memorandum of understanding (MOU) provisions would have reflected concerns noted in the 2022 Governance and Risk Management

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[3] *See* Figure 11, page 28 of the Board of Governors of the Federal Reserve System, Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank (April 28, 2023), https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf.

[4] Ibid.

and 2021 Liquidity exams. The MOU was still in draft form and was in process of being submitted for another round of review when SVB failed.[5] [6]

3. **In your testimony, you stated that "given that the firm failed and triggered a systemic risk determination, I'm prepared to talk about that confidential information."**

    a. **Do you commit to providing all confidential supervisory information requested by this committee?**

The Federal Reserve has made an unprecedented amount of supervisory information available to the public, including the most critical supervisory documents related to the failure of SVB. The Federal Reserve understands that the Senate Banking Committee (Committee) has its own oversight priorities and may seek to obtain additional information from us. Accordingly, Federal Reserve staff has been working cooperatively with Committee staff to provide information on an ongoing basis.

4. **Throughout your testimony, you emphasized that Silicon Valley Bank failed because its management failed to appropriately address "clear interest rate risk and clear liquidity risk." You stated that in the summer of 2022, Silicon Valley Bank had an overall CAMELS rating of three, meaning that the institution showed a supervisory concern in several dimensions.**

    a. **Please outline why SVB's CAMEL rating was a three.**

    b. **Please describe how long SVB's CAMEL rating had been a three.**

    c. **Please outline why the bank holding company was rated "deficient-1".**

The May 2022 Governance and Risk Management examination highlighted a number of fundamental and critical weaknesses that supported downgrading the firm's LFI Governance and Control rating to "Deficient-1" and the CAMELS Management and Composite ratings to "Less-than-Satisfactory-3." SVB's CAMELS 3 rating reflected broad supervisory concerns.[7] Supervisors downgraded SVB's management and composite ratings to "Less than Satisfactory-3" on August 17, 2022, and it remained rated a Less than Satisfactory-3 until its failure.

When SVB moved into the LFBO portfolio in 2021, staff initially focused on examinations covering key areas affected by the upcoming requirements of enhanced prudential standards, then pivoted to an examination of broader governance and risk management. Initial exams and post-transition meetings indicated to the team that risk management and controls had not kept pace with the growth of SVB. In May 2022, supervisors informed SVB that its "governance and risk-management practices are below supervisory expectations" and that its "risk-management

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[5] Ibid, pages 39-44.

[6] In addition, see https://www.federalreserve.gov/supervisionreg/silicon-valley-bank-review-supervisory-materials.htm for the text of the MRA and MRIAs and the MOU draft.

[7] *See* https://www.federalreserve.gov/supervisionreg/files/SVB-and-svb-2021-supervisory-ratings-letter-20230817.pdf.

program is not effective" through three supervisory findings. SVB was rated "Deficient-1" for Governance and Controls under the LFI ratings system on August 17, 2022, as a result of the May 2022 exam.

5. **Your written testimony states that "social media saw a surge in talk about a run" and that "social media" was one of the factors being analyzed "for how we should be regulating and supervising our financial institutions."**

   a. **How have you instructed your examiners to assess and account for social media risk? Please describe in detail including when you first addressed risks stemming from social media with your examiners.**

To begin, while social media may have contributed to the speed of the firm's downfall, the bank's failure was ultimately caused by concerns by the depositors of its solvency. This is why we must work to strength the capital and liquidity standards applicable to firms like SVB.

The combination of social media, a highly networked and concentrated depositor base, and technology may have fundamentally changed the speed of bank runs. Social media enabled depositors to instantly spread concerns about a bank run, and technology enabled immediate withdrawals of funding. Where these phenomena are combined with a highly networked and concentrated depositor base, the speed of bank runs may have changed fundamentally.

As risks in the financial system continue to evolve, we need to evaluate our supervisory and regulatory framework and be humble about our ability to assess and identify new and emerging risks.

6. **Under the Biden administration, federal financial regulators have spoken frequently about "climate-related risk." Specifically, so-called "transition risk" which amounts to little more than a political prediction about the risk that future efforts by policymakers will lead to drastic steps to significantly curb greenhouse gas emissions.**

   a. **Did Federal Reserve examiners prioritize theoretical "transition risk" over "clear interest rate risk and clear liquidity risk"?**

Through its supervision and regulation of banking organizations, the Federal Reserve promotes a safe, sound, and efficient banking system that supports the growth and stability of the U.S. economy. In this role, the Federal Reserve evaluates the ability of supervised institutions to identify, measure, monitor, and control all material risks—including traditional risks such as interest rate risk and liquidity risk, as well as emerging risks like the financial risks of climate change.

Interest rate risk and liquidity risks are foundational risks of banking and core areas of focus within supervision. As interest rates began to rise beginning in March 2022, Federal Reserve supervision focused increasingly on the impact of increasing rates on the safety and soundness of banks. Specifically, as highlighted in the November 2022 *Supervision and Regulation Report,* supervisors were prioritizing examinations of interest rate risk management.[8] The February 14, 2023, presentation to the Board described the heightened supervisory engagement applicable to banks with higher interest rate risk exposure.[9] It also described the internal training and additional outreach to supervised firms on interest rate risk given the current environment.

The Federal Reserve's responsibilities with respect to climate change are important, but narrow. The Federal Reserve does not have a role in setting climate policy. Our responsibilities are tightly linked to our responsibilities for bank supervision and financial stability.

b. What, if any, supervisory actions have been taken due to climate-related risks?

From a supervisory perspective, our work to understand the financial risks of climate change is in the early stages and is exploratory in nature. It is aimed at understanding how climate-related financial risks may manifest and conducting rigorous analytical work to better assess the materiality of these risks.

In December 2022, the Federal Reserve proposed for public comment Principles for the Climate-Related Financial Risk Management for Large Financial Institutions. These proposed principles would provide a high-level framework for the safe and sound management of exposures to climate-related financial risks for banking organizations with more than $100 billion in total consolidated assets.

In January 2023, the Federal Reserve launched a pilot climate scenario analysis (CSA) exercise involving six of the largest financial institutions in order to better understand how large financial institutions are managing climate-related financial risks and to enhance the ability of both large banking organizations and supervisors to better identify, measure, monitor, and manage these risks. The pilot exercise is exploratory in nature and will have no capital or supervisory implications.

7. According to March 16 reporting in the Financial Times, most of Silicon Valley Bank's 8,500 staff were still working remotely when the bank failed. In SVB's last annual report, the bank acknowledged that it "may experience negative effects of a prolonged work-from-home arrangement." During your testimony, you stated that you were unaware of whether or not examiners were conducting examinations in-person at Silicon Valley Bank.

a. How many examiners were assigned to supervise SVB? Please provide each of these examiner's work from home schedules.

b. Were SVB's examiners working from home when SVB failed?

c. If examiners were working in SVB up to the point of failure, please provide each examiner's "return to office" date for their "in bank" or "on site" work.

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[8] *See* https://www.federalreserve.gov/publications/files/202211-supervision-and-regulation-report.pdf.

[9] https://www.federalreserve.gov/supervisionreg/files/board-briefing-on-impact-of-rising-interest-rates-and-supervisory-approach-20230214.pdf

When SVB transitioned to the LFBO portfolio, FRBSF requested 12 additional staff in March 2021 for a total of 20 full-time employee resources. This request for additional resources reflected the size and complexity of SVB. The request was approved by Board staff in June 2021. As of December 2022, the examination team was staffed with 15 full-time employees. There were an additional five dedicated staff covering financial risks (i.e. market/IRR, liquidity, capital) detailed to the team.

The SVB examination team worked either from the FRBSF office (Los Angeles or San Francisco), or from home. SVB's executive management worked mostly remote and was geographically dispersed, so exams, monitoring meetings, and other engagement were generally conducted remotely. On March 9 as the firm began experiencing distress, an examiner came onsite at the firm, and examiners set up a war room at FRBSF offices so that the firm and the Federal Reserve were in constant contact through the weekend.

8. What is the primary methodology and practice for Federal Reserve examiners and supervisors to assess interest rate risk? Please describe in detail.

Interest rate risk is a fundamental risk in banking. The Federal Reserve and other banking agencies have longstanding policies and supervisory guidelines that establish safety-and-soundness principles for a bank's interest rate risk management (IRR). The Federal Reserve evaluates IRR as part of its assessment of capital adequacy for all supervised firms. Examiners evaluate firms' IRR exposures and management practices as part of regularly scheduled full scope or targeted examinations for CBOs and RBOs. For the larger banks including those supervised by the Large Institution Supervision Coordinating Committee and Large Foreign Banking Organizations program, the Federal Reserve looks at IRR through continuous monitoring activities and targeted exams. For banks, supervisory conclusions on the level and management of interest rate risk are summarized in the Sensitivity to Market Risk component of the interagency CAMELS rating system. These findings also commonly affect assessments of a bank's management, capital adequacy, and liquidity within the rating system. Interest rate risk exposure and management are also included in assessments of capital and risk management within the holding company rating systems.

The Federal Reserve and the other banking agencies set forth their supervisory expectations for a bank's interest rate risk management in a joint Policy Statement Policy Statement in 1996. More recently, the agencies updated this guidance in 2010, as SR 10-1 *Interagency Advisory on Interest Rate Risk Management* and further clarified the guidance with the issuance of FAQs in 2012.

This guidance emphasizes the need for firms to incorporate internal stress-testing to identify and quantify an institution's interest rate risk exposure and potential weaknesses. Internal stress testing, which includes both scenario and sensitivity analysis, should be an integral component of an institution's interest rate risk management. In evaluating interest rate risk, examiners evaluate a bank's ability to fully identify its current IRR exposure and yield curve risks, risks arising from alternative future interest rate scenarios, and whether the bank has effective interest rate risk measurement models, metrics, and limits. This includes evaluating the risks associated with unrealized losses on investment securities that can result from changing interest rates. Banks are also expected to carefully monitor the stability of their deposits and maintain multiple sources of standby funding. This is particularly important during periods of rising interest rates. Simulated parallel shifts in the yield curve of plus and minus 200 basis points may not be sufficient to adequately assess a firm's IRR exposure during periods in which rate changes are more significant. A firm's risk management is expected to consider changes in rates of varying or greater magnitude (e.g., up and down 300 and 400 basis points) across different tenors to reflect potential changing slopes and twists of the yield curve.

Policies should be in place to address interest rate risk and, in particular, establish risk limits. When risk limits are breached, a bank should have procedures for taking corrective actions. Where interest rate risk levels are excessive or risk management practices are insufficient, examiners can cite concerns in a formal written communication requesting the bank to address the deficiencies, take further actions to reduce risk, and improve its IRR risk management.

9. Please provide an outline of the principal components Federal Reserve examiners and supervisors use to assess interest rate risk.

SR 10-1 *Interagency Advisory on Interest Rate Risk Management* outlines the principal components of sound interest rate risk management practices, which include effective corporate governance, policies and procedures, risk measuring and monitoring systems, stress testing, and internal controls related to the IRR exposures of institutions. More detailed guidelines on the basic principles of IRR can be found in the guidance below:

- **Corporate Governance -** Effective board and senior management oversight is the cornerstone of effective IRR management. The board and senior management are responsible for understanding the nature, level, and trend of the bank's IRR and how the risk fits within the bank's overall business strategy and risk appetite. The board and senior management are responsible for taking action when risk exceeds the bank's risk appetite.

- **Policies and Procedures -** Operating with appropriate IRR policies is fundamental to effective risk management. Policies and procedures should be aligned with the board's risk appetite, including establishing expectations for escalation when exposures exceed risk appetite. Policies and procedures should also be designed to ensure that the IRR implications of significant new strategies or new activities are integrated into the bank's risk management system.

- **Risk measuring and monitoring systems -** Accurate and timely IRR measurement is necessary for monitoring IRR effectively and IRR monitoring is the process for management and the board to confirm consistency with the bank's risk appetite. Risk measurement and monitoring systems should be commensurate with the size and complexity of the institution

- **Stress Testing -** Stress testing, which includes both scenario and sensitivity analysis, is an integral component of IRR management. Risk measuring and monitoring systems should be sufficiently robust to capture all material on- and off-balance-sheet positions and incorporate a stress-testing process to identify and quantify the bank's IRR exposure and potential problem areas

10. You provided the following written testimony: "The bank waited too long to address its problems, and ironically, the overdue actions it finally took to strengthen its balance sheet sparked the uninsured depositor run that led to the bank's failure. Specifically, on Wednesday, March 8, SVB announced that it realized a $1.8 billion loss in a sale of securities to raise liquidity and planned to raise capital during the following week."

a. Were Federal Reserve examiners or supervisors aware in advance of Silicon Valley Bank's plan to sell its securities on March 8, 2023?

b. Were Federal Reserve examiners or supervisors involved in SVB's decision to sell its securities on March 8, 2022? If so, please describe in detail.

c. Were Federal Reserve examiners or supervisors aware in advance of SVB's follow-on capital raise efforts?

d. Were Federal Reserve examiners or supervisors involved in SVB's follow-on capital raise efforts? If so, please describe in detail.

To my knowledge, SVB's management first informed supervision staff at the Federal Reserve Bank of San Francisco that the firm was considering a sale of securities and a capital raise during a call on March 1. At the time of this initial call, the capital raise was being discussed among a small group at the firm as part of its plan to restructure its balance sheet by selling a portion of its portfolio of available-for-sale (AFS) securities. SVB's management provided additional detail on March 5 on its intention to move forward with the sale of securities and capital raise during another call with FRBSF supervision staff. FRBSF staff informed FRBSF management and Federal Reserve Board staff of the developments after each call with SVB's management.

The firm's decision to sell its AFS securities and raise capital was based primarily on the warning that Moody's planned to downgrade the firm's credit rating to sub-investment grade, a warning that followed publication of an article in the Financial Times (FT) about the unrealized losses in the firm's securities portfolio.[10] The firm's management was apparently concerned that a credit rating downgrade from Moody's could impact the firm's access to its repo lines. The firm's decision to sell its AFS securities and raise capital was made quickly because the firm expected Moody's to act quickly. However, issues with liquidity risk management and interest rate risk management at the firm were cited by supervisory staff prior to publication of the FT article, and the firm could have acted sooner to address the risks on its balance sheet.

FRBSF supervision staff was not involved in the SVB's decision to sell a portion of its AFS portfolio or in SVB's follow-on capital offering.

[10] Tabby Kinder, Dan McCrum, Antoine Gara, and Joshua Franklin, "Silicon Valley Bank Profit Squeeze in Tech Downturn Attracts Short Sellers," *Financial Times*, February 22, 2023, https://www.ft.com/content/0387e331-61b4-4848-9e50-04775b4c3fa7.

11. You provided the following written testimony: "Depositors withdrew funds at an extraordinary rate, pulling more than $40 billion in deposits from the bank on Thursday, March 9. On Thursday evening and Friday morning, the bank communicated that they expected even greater outflows that day. The bank did not have enough cash or collateral to meet those extraordinary and rapid outflows, and on Friday, March 10, SVB failed."

- **a. What actions, if any, did the Federal Reserve take before Thursday March 9, on Thursday, March 9; and on Friday, March 10, to address this "bank run"?**

- **b. How much did the Federal Reserve lend to SVB in its role as "lender of last resort" to provide liquidity?**

- **c. What conversations did you or your staff have with the California state regulators and the FDIC regarding SVB's failure? When did these conversations begin? Please describe in detail.**

Silicon Valley Bank experienced a run on its deposits on March 9 following its March 8 announcement of a $1.8 billion loss on the sale of a securities portfolio and a plan to raise capital to shore up its balance sheet. On March 9, the bank borrowed as much as it could – approximately $5.3 billion – from the discount window.

Federal Reserve staff worked overnight to assess the amount of Silicon Valley Bank's available collateral and to move collateral into position so that the firm could borrow from the discount window to meet the deposit outflows that were expected on Friday, March 10. However, on Friday morning, before 9:00am EST, Federal Reserve staff were informed by Silicon Valley Bank that the expected outflows for the day, $100 billion, would be significantly larger than previously anticipated. The firm did not have enough collateral to obtain a sufficient volume of discount window credit to meet its expected obligations.

Federal Reserve staff had discussions with staff at the Federal Deposit Insurance Corporation (FDIC) and California Department of Financial Protection and Innovation about the deteriorating condition at the bank and appropriate steps to manage the situation on March 9 and 10.

Beginning on the evening of March 9, the Federal Reserve, FDIC, and Treasury principals discussed whether Silicon Valley Bank's failure may cause contagion to uninsured deposits at other banks.

12. You provided the following written testimony: "The picture that has emerged thus far shows SVB had inadequate risk management and internal controls that struggled to keep pace with the growth of the bank. … Near the end of 2021, supervisors found deficiencies in the bank's liquidity risk management, resulting in six supervisory findings related to the bank's liquidity stress testing, contingency funding, and liquidity risk management. In May 2022, supervisors issued three findings related to ineffective board oversight, risk management weaknesses, and the bank's internal audit function.

In the summer of 2022, supervisors lowered the bank's management rating to "fair" and rated the bank's enterprise-wide governance and controls as 'deficient-1.'"

a. After SVB's Bank Holding Company was rated "deficient-1", what supervisory actions if any were taken with respect to SVB's Bank Holding Company?

After SVB was rated "Deficient-1" for Governance and Controls under the Large Financial Institution (LFI) ratings system on August 17, 2022, there was a rebuttable presumption that an informal enforcement action will be undertaken. The MOU provisions would have reflected concerns noted in the 2022 Governance and Risk Management and 2021 Liquidity exams. The MOU was still in draft form and was in process of being submitted for another round of review when SVB failed.[11] [12]

13. You provided the following written testimony: "In mid-February 2023, staff presented to the Federal Reserve's Board of Governors on the impact of rising interest rates on some banks' financial condition and staff's approach to address issues at banks. Staff discussed the issues broadly, and highlighted SVB's interest rate and liquidity risk in particular."

a. When did the Federal Reserve Bank of San Francisco communicate the known interest rate risks at SVB to the Board of Governors?

As discussed above, interest rate risk is a foundational risk of banking and is a core area of focus within supervision. The Report describes how Federal Reserve supervisors identified some but not all of the interest rate risk-management issues that contributed to the failure of SVBFG. Supervisory responses for IRR were not rapid or severe enough given the fundamental issues in this area that drove poor decisions at SVB.

Staff within the Federal Reserve Board's Supervision and Regulation (S&R) division was alerted to IRR concerns in October 2022, prior to the issuance of the MRA on interest rate risk management.

The Board received an informational briefing on February 14, 2023, entitled "Impact of Rising Rates on Certain Banks and Supervisory Approach," delivered by S&R and Federal Reserve System risk staff. This presentation highlighted the range of impacts of rising rates on banks, including large unrealized market value losses in investment securities for some banks. The presentation described the increased supervisory activity at banks with significant risk, as well as internal training and outreach to supervised firms on interest rate risk given the current environment.[13]

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[11] Ibid, pages 39-44

[12] In addition, see https://www.federalreserve.gov/supervisionreg/silicon-valley-bank-review-supervisory-materials.htm for the text of the MRA and MRIAs and the MOU draft.

[13] *See* https://www.federalreserve.gov/supervisionreg/files/board-briefing-on-impact-of-rising-interest-rates-and-supervisory-approach-20230214.pdf.

Staff identified Silicon Valley Bank (SVB) as an example of a large bank with substantial exposure to interest rate risk. Staff discussed SVB executing its Contingency Funding Plan, a planned downgrade of SVB's CAMELS "S" sensitivity rating to "Less-than-Satisfactory-3," issuance of a supervisory Matters Requiring Attention (MRA) around Interest Rate Risk modeling, and heightened supervisory attention.

b. What actions did the Federal Reserve Bank of San Francisco take against SVB before these issues were raised with the Federal Reserve Board of Governors?

The Report describes how Federal Reserve supervisors identified some but not all of the interest rate risk-management issues that contributed to the failure of SVBFG. Supervisory responses for IRR were not rapid or severe enough given the fundamental issues in this area that drove poor decisions at SVB.

More generally, as noted on pages 28 and 29 of the Report, Federal Reserve Bank of San Francisco took notable actions against SVB before the fall of 2022.[14] The firm had 31 safety-and-soundness MRAs and MRIAs outstanding, and the Federal Reserve Bank of San Francisco had been pursuing an MOU.[15]

14. The Federal Reserve has raised the Federal Funds Rate nine times between March 17, 2022, and March 2, 2023, in response to rapidly rising and persistent inflation.

a. What role did the rapid rise in interest rates in 2022 and into 2023 play in the failure of Silicon Valley Bank?

The rapid rise in interest rates during 2022 led to declines in the value of securities of all financial institutions. Given a large securities portfolio relative to its total assets and relative to most peers, SVB experienced a significant decline in value within the securities portfolio.

SVB's mismanagement of its interest rate risk contributed to the firm's failure. The firm managed interest rate risks with a focus on short-run profits and protection from potential rate decreases, and removed interest rate hedges, rather than managing long-run risks and the risk of rising rates. In addition, the bank changed its own risk-management assumptions to reduce how these risks were measured rather than fully addressing the underlying risks.

These risk-management challenges proved critical when the external environment for the firm changed as interest rates rose sharply and activity in the technology sector slowed in 2022 and 2023.

b. What guidance was provided to Federal Reserve Member Banks regarding interest rate management in relation to interest rate hikes due to inflation?

Market risk arising from changes in interest rates is a normal part of banking but can pose a significant threat to an institution's liquidity, earnings and capital base if not managed

[14] Ibid., pages 28-29.
[15] Ibid., pages 42-43.

appropriately. Section 3300 of our Commercial Bank Examination Manual (CBEM) details the importance of effectively managing interest rate risk and sets forth the principles and guidance for measuring and managing the risk that is appropriate for the size and risk profile of the bank.[16] This includes board and senior management oversight, interest rate risk monitoring and reporting, measurement methods, and 2etting risk limits. The CBEM references the following Supervision and Regulation Letters, which were issued in 2012 and earlier that address interest rate risk:

- SR 12-2: Questions and Answers on Interagency Advisory on Interest Rate Risk Management[17]
- SR 10-1: Interagency Advisory on Interest Rate Risk[18]
- SR 01-14 Joint Agency Advisory on Rate-Sensitive Deposits[19]
- SR 96-13 Joint Policy Statement on Interest Rate Risk[20]

The Federal Reserve's November 2022 Supervision and Regulation Report highlighted the impact of unrealized losses on capital and liquidity positions of firms.[21] In December 2022, the Federal Reserve hosted a webinar with bankers to provide information on our supervisory approach, provide guidance on managing exposures, and answer bankers' questions. In addition, individual Federal Reserve Banks published articles on interest rate risk management.[22]

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[16] *See* https://www.federalreserve.gov/publications/files/cbem.pdf.
[17] *See* https://www.federalreserve.gov/supervisionreg/srletters/sr1202.htm.
[18] *See* https://www.federalreserve.gov/boarddocs/srletters/2010/sr1001.htm.
[19] *See* https://www.federalreserve.gov/boarddocs/srletters/2001/sr0114.htm.
[20] *See* https://www.federalreserve.gov/boarddocs/srletters/1996/sr9613.htm.
[21] *See https://www.federalreserve.gov/publications/2022-november-supervision-and-regulation-report.htm.*
[22] *See* Federal Reserve Bank of Richmond's "Rising Rates and Interest Rate Risk Management", in September 2022; Federal Reserve Bank of St. Louis's "Rising Interest Rates Bring Opportunities and Risks for Banks" on November 07, 2022 "Rising Interest Rates Complicate Bank's Investment Portfolios", on February 9, 2023.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM MICHAEL BARR

Questions for The Honorable Michael Barr, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System, from Senator Jack Reed:

1. **Did each of your agencies consider whether to exercise the orderly liquidation authority under Title II of the Dodd-Frank Act to liquidate either Silicon Valley Bank or Signature Bank? Please explain why the agencies declined to use this authority and whether the current use of extraordinary measures to avoid breaching the debt ceiling played a role in that decision?**

As the financial condition of Silicon Valley Bank (SVB) rapidly deteriorated and Federal Reserve staff began to observe signs of stress at other regional banking organizations, including Signature Bank, a range of options were considered.

SVB was initially taken into receivership by the Federal Deposit Insurance Corporation (FDIC) without the invocation of any additional authorities, such as Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Federal Reserve Board's (Board) subsequent decision, over the weekend of March 11-12, to recommend a systemic risk exception for SVB and Signature Bank, was due to the indications of potential risks that the failures of those two banks could pose to the broader financial system. Based on a wide range of supervisory and financial market contacts and internal analysis, there was growing evidence that failure to protect the uninsured depositors of those two banks would have adverse effects on the banking system and on the broader economy. For example, Board staff believed it was likely that the banking system would have experienced intensified deposit runs and liquidity pressures during the week of March 13 if the uninsured depositors at SVB or Signature Bank had access to their funds interrupted or become subject to losses.

The Board's unanimous decision also was based on an assessment that, subject to the systemic risk exception, the FDIC's resolution of both banks, using its well-established powers under the Federal Deposit Insurance Act, was an appropriate resolution mechanism. The status of the debt ceiling was not a consideration for the Board in assessing an appropriate resolution mechanism.

2. **Can you explain the elements of the Comprehensive Liquidity Analysis and Review (or CLAR) and whether this supervisory tool places limitations on concentrated exposures in a bank's deposit base, evaluates interest rate risk management, and disincentivizes overreliance on uninsured deposits?**

The Large Institution Supervision Coordinating Committee (LISCC) Liquidity Program (which includes the Comprehensive Liquidity Analysis and Review (CLAR)) conducts ongoing assessments of the global systemically important banking organizations' (currently, eight firms) liquidity positions and liquidity risk-management practices through both horizontal and firm-specific examinations. The Horizontal Liquidity Review (HLR) is conducted on an annual basis simultaneously across the portfolio of large domestic and foreign banking organizations not in the LISCC portfolio (LFBOs). The CLAR and HLR reviews are similar in structure and approach and generally assess the same foundational risk management areas, including the effectiveness of firms' internal liquidity stress testing (ILST). Large firms are required to conduct ILSTs based on firm-specific stress scenarios and hold a liquidity buffer comprised of highly liquid assets that are sufficient to meet the firms' projected net stressed outflows.

These supervisory programs evaluate whether banks are appropriately managing the risk of concentrated exposures in a bank's deposit base and holding sufficient liquidity to cover outflows from uninsured deposits. Specifically, examiners evaluate whether firms are appropriately managing their exposure to higher-risk deposits (e.g., retail insured deposits relative to non-retail deposits) by incorporating conservative outflow assumptions in their ILST framework. These more conservative outflow assumptions result in higher projected stressed cash outflows and a larger required liquidity buffer to meet the projected liquidity need.

In addition, examiners assess a firm's reliance on less than fully insured deposits. Firms are expected to assume higher outflow rates for such deposits and therefore hold larger liquidity buffers, and supervisory findings are issued to firms that do not account for this risk.

With respect to interest rate risk, the Federal Reserve evaluates interest rate risk management through examinations and through continuous monitoring. Examinations generally review firms' interest rate risk assessment and management, their management of risk in their securities portfolio, and balance sheet management considerations related to market risk, liquidity risk, and credit risk. In addition to periodic examinations, supervisors regularly meet with firms' corporate treasury and internal controls functions to discuss the firms' management of interest rate risk and review firms' internal reports on strategies and interest rate risk trends.

As discussed in my Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank, there were critical deficiencies in the firm's liquidity and interest rate risk management. With respect to liquidity, supervisors identified serious deficiencies in the firm's liquidity risk management and stress testing and issued six supervisory findings (two Matters Requiring Attention and four Matters Requiring Immediate Attention) to the firm in November 2021. With respect to interest rate risk management, supervisors identified interest rate risk deficiencies in the 2020, 2021, and 2022 Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk (CAMELS) exams but did not issue supervisory findings. The supervisory team issued a Matter Requiring Attention in November 2022 and planned to downgrade the firm's rating related to interest rate risk, but the firm failed before that downgrade was finalized.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM MICHAEL BARR

Questions for The Honorable Michael Barr, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System, from Senator Robert Menendez:

1. **In the wake of the financial crisis, Congress included a provision in Dodd Frank requiring financial regulators to issue a rule to rein in the widespread practice of incentive-based compensation packages for bank executives that encouraged excessive risk-taking. However, nearly thirteen years after the passage of Dodd Frank this rule has still not been finalized.**

    a. **What is the timeline for completion of the joint incentive-based compensation rulemaking?**

The Board is actively working with the federal banking agencies, Federal Housing Finance Agency, Securities and Exchange Commission, and National Credit Union Administration to implement section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Specifically, we are preparing a proposal that would implement prohibitions against incentive compensation arrangements that could provide excessive compensation or lead to material financial loss and requiring disclosure related to incentive compensation arrangements.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM MICHAEL BARR

Questions for The Honorable Michael Barr, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System, from Senator Catherine Cortez Masto:

1. **How did advances from a Federal Home Loan Bank affect Silicon Valley Bank and Signature Bank? Were advances useful in providing depositors access to their funds?**

   a. **Did FHLB advances allow the banks to function longer than they would have otherwise? Did the advances create an illusion of liquidity?**

FHLBs provide advances to member firms that are secured by collateral acceptable to the FHLB. Most banks generally consider these FHLB advances to be a source of funding for managing liquidity, including in response to changes to their deposit base. In fact, many large institutions utilize FHLB advances as a source of liquidity even in normal environments when funding is not constrained. However, a notable increase in utilization of FHLB advances may be considered a concern depending on the specific firm and circumstances. In 2022, SVB management began to take actions to address liquidity pressures by increasing FHLB advances, and so did many peer institutions, offsetting a decrease in deposits. In the absence of FHLB advances, it is likely banks including SVB would utilize other sources of borrowings and repurchase agreements.

   b. **Do you have any indication that the availability of FHLB advances led SVB or Signature to take more risk than without access to such funding?**

In the case of SVB, there is no indication that the availability of FHLB advances led SVB to take on more risk.

2. **What types of supervisory information does a Federal Home Loan Bank have access to about its member financial institutions? For example, does an FHLBank have access to supervisory information from the federal and/or state regulator?**

The Federal Reserve may share supervisory information regarding a specific financial institution's financial condition with the FHLB upon request. This is consistent with a memorandum of understanding we have in place that references Title 12 of the United States Code, section 1442. This law directs the Federal Reserve along with other bank regulators to make available to any FHLB "…such reports, records, or other information as may be available, relating to the condition of any member bank for any FHLB or institution to which such Bank has had or contemplates having transactions." The FHLB may use the information for four permissible activities: decisions with respect to membership applications; FHLB director eligibility; extensions of credit; and collateral valuation.

3. **Will you include a discussion in your reviews of SVB and Signature that considers the positive – and possibly – negative role of the Federal Home Loan Banks, including access to supervisory information?**

FHLB funding can be an important part of a bank's liquidity if used appropriately and in a safe and sound manner. The review which I oversaw focused on the firm and the related supervision activities prior its failure and did not include a broader discussion on the role of the Federal

Home Loan Banks.[1] Historically, FHLB advances have provided needed liquidity to institutions in times of stress.

[1] *See* https://www.federalreserve.gov/publications/review-of-the-federal-reserves-supervision-and-regulation-of-silicon-valley-bank.htm.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARNOCK FROM MICHAEL BARR

Questions for The Honorable Michael Barr, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System, from Senator Raphael Warnock:

1. **Recent reporting by the *Wall Street Journal*, and other publications, indicates that there is a growing concern around the accuracy of some labor market metrics used by the Federal Reserve, with a particular focus on the accuracy of job openings data.[2] With employees increasingly shifting jobs, some firms are listing more job openings online than are actually available, while others may keep postings up simply because they have already paid for spots on job sites.[3] This raises the possibility that there are more job postings than actual jobs, creating data shortfalls that could potentially impact the Federal Reserve's decisions.**

   [2] https://www.wsj.com/articles/that-plum-job-listing-may-just-be-a-ghost-3aafc794.
   [3] *Ibid.*

   a. **What data collection method does the Federal Reserve use when gathering job openings data?**

   b. **Does the Federal Reserve adjust the data to capture a more accurate picture of the job market? If so, please describe that process.**

   c. **The Federal Reserve has cited the high number of job openings as one of the many factors the Federal Open Market Committee raises the target range for the federal funds rate. How does the Federal Reserve account for illegitimates or expired job postings?**

   d. **Given the recent turmoil in the banking sector, which has been partially attributed to the rise in interest rates, are there any data gaps that have the potential to compromise monetary policy decisions? If so, how can Congress provide more resources to capture more accurate data?**

Federal Reserve staff routinely monitor and analyze information on job openings from a number of different sources, including the official job openings statistics from the Bureau of Labor Statistics' Job Openings and Labor Turnover Survey (JOLTS), as well as job postings data produced by firms Indeed and Lightcast. JOLTS measures the number of job openings as of the last business day of each month from a survey of establishments based on a stratified random sample of about 21,000 nonfarm business and government establishments. The employment website Indeed aggregates job listings on a daily basis from thousands of websites, including job boards, staffing firms, associations, and company career pages.[1] The technology company Lightcast (formerly Burning Glass Technologies) pulls data from a large number of online job boards and company websites to develop marketwide statistics about job postings, collecting job postings from more than 51,000 sources daily.[2]

[1] *See* https://www.hiringlab.org/data/ for more information.
[2] *See* https://lightcast.io/about/data for additional information.

While none of these measures is perfect, our assessment is that, taken as a whole, they provide a reasonably accurate picture of the behavior of job openings. JOLTS, in particular, takes important steps to ensure the accuracy of job openings counts. For example, JOLTS counts a job opening as such only if it meets all three of the following criteria: (i) a specific position exists and there is work available for that position; (ii) the job could start within 30 days, whether or not the employer can find a suitable candidate during that time; (iii) the employer is actively recruiting workers from outside the establishment to fill the position.[3] Federal Reserve staff routinely track and analyze data from all three sources, examine disaggregated breakdowns of the data (e.g., by industry or geography) to check for anomalies, and in some instances seasonally adjust the data internally. If the staff notice any anomalies, they reach out to the data providers to discuss potential issues. With regard to data gaps, I would note that survey response rates have declined notably in recent years for many surveys that generate important economic statistics. Declining trends in survey response rates are long-standing and are likely due at least in part to a decline in the number and use of telephone landlines and increases in spam calls.[4] But in many cases the declines have been exacerbated by the COVID-19 pandemic.

More generally, the Federal Reserve is continuously looking for new and timely data to improve our assessment of economic activity, including job openings, and we actively engage with other statistical agencies and the private sector to encourage improvement in their measures. Furthermore, I would stress that we always look at measures of job openings in conjunction with many other labor market indicators to comprehensively assess activity and conditions in the labor market and in the economy more broadly.

2. **On March 23, 2023, the Federal Open Market Committee raised rates another 25 basis points, the ninth consecutive rate hike since March of last year. When Federal Reserve Chairman Powell sat before the Senate Banking, Housing, and Urban Affairs Committee in early March, I cautioned him to be mindful of the potential harm of continuing to raise rates and the threat of applying a cure that's worse than the disease. However, despite what appears to be real conversations about contagion in the banking sector, the Federal Reserve proceeded to raise interest rates.**

    a. **How large a threat is interest rate risk to our broader economy?**

    b. **Have recent events altered the Federal Reserve's views? If so, how?**

The Federal Open Market Committee decided to raise the target range for the federal funds rate to 5 to 5-1/4 percent at its meeting in May. As the Committee noted, inflation remains elevated, and the high level of inflation adversely affects households and businesses across the economy. The Committee continues to emphasize that adjustments to the target range of the federal funds rate will be determined by information on the stance of monetary policy appropriate to ensure that inflation returns to 2 percent over time. In making these determinations, the Committee considers a broad set of information, and the Committee noted following its meetings in March, as well as May, that recent developments in the banking sector are likely to result in tighter credit

[3] *See* https://www.bls.gov/news.release/jolts.tn.htm for more information.
[4] *See*, for example, https://www.wsj.com/articles/falling-survey-response-rates-undermine-economic-data-2137054c.

conditions for households and businesses and to weigh on economic activity, hiring, and inflation, although the extent of these effects is uncertain.

It is important for health of the economy that the stance of monetary policy be guided by the outlook for price stability and maximum employment. At the same time, recent events have demonstrated how failure of financial institutions to properly manage interest rate risk can lead to strains in the financial system that can harm households and businesses and require extraordinary intervention. Our banking system is sound and resilient, and the Federal Reserve and other regulators have the tools to address potential risks and assure depositors of the safety of their deposits.

c. Last month, the Federal Reserve held a closed-door meeting to receive a supervisory update. Were risks related to rising interest rates discussed as a possible threat to our financial system?

Interest rate risk is a foundational risk of banking and is a core area of focus within supervision. As interest rates began to rise beginning in March 2022, Federal Reserve supervision focused increasingly on the impact of increasing rates on the safety and soundness of banks. As highlighted in the November 2022 *Supervision and Regulation Report,* supervisors were prioritizing examinations of interest rate risk management.[5]

On a quarterly basis, the Supervision and Regulation division (S&R) staff hold a briefing for the Board of Governors (Board) to deliver informational presentations on select topics. The Board received an informational briefing on February 14, 2023, entitled "Impact of Rising Rates on Certain Banks and Supervisory Approach," delivered by S&R and Federal Reserve System risk staff. This presentation highlighted the range of impacts of rising rates on banks, including large unrealized market value losses in investment securities for some banks. The presentation described the increased supervisory activity at banks with significant risk, as well as internal training and outreach to supervised firms on interest rate risk given the current environment.[6]

Staff identified Silicon Valley Bank (SVB) as an example of a large bank with substantial exposure to interest rate risk. Staff discussed SVB executing its Contingency Funding Plan, a planned downgrade of SVB's CAMELS "S" sensitivity rating to "Less-than-Satisfactory-3," issuance of a supervisory Matters Requiring Attention (MRA) around Interest Rate Risk modeling, and heightened supervisory attention.

d. Will there be adjustments to how interest rate risks are measured by stress testing scenarios?

While the stress test that the Board uses to set capital requirements for large banks places a significant emphasis on the types of credit-driven downturns that have occurred in severe post-war U.S. recessions, we continuously look for ways to expand the risk capture of the stress test. For example, in 2023 the Board added a second trading book shock for the biggest banks. The

[5] *See* https://www.federalreserve.gov/publications/files/202211-supervision-and-regulation-report.pdf.
[6] *See* https://www.federalreserve.gov/supervisionreg/files/board-briefing-on-impact-of-rising-interest-rates-and-supervisory-approach-20230214.pdf.

exploratory market shock is characterized by a recession with inflationary pressures induced by higher inflation expectations. As I noted in my testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, on March 28, the Board is also investigating the use of multiple scenarios to capture a wider range of risks and uncover channels for contagion.[7]

Capital stress testing is one of the many supervisory tools used to monitor large banks. For example, the Board currently relies on supervisory guidance to ensure firms manage their interest rate risk. The guidance states that interest rate shocks, a form of interest rate stress testing, should be an integral component of risk management.[8]

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[7] *See* https://www.federalreserve.gov/newsevents/testimony/barr20230328a.htm.
[8] Supervision and Regulation Letter 10-1, *Interagency Advisory on Interest Rate Risk*, January 11, 2010.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR FETTERMAN FROM MICHAEL BARR

Questions for The Honorable Michael Barr, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System, from Senator John Fetterman:

1. **The Federal Reserve has spoken extensively about the need to "tailor" regulations and supervision to the unique needs of banks depending on their size and unique characteristics. In particular, the 2018 banking regulation rollback bill discussed during the hearing specifically provided the Federal Reserve to use its own discretion in determining how to supervise and regulate with assets totaling less than $200 billion in place of mandatory oversight. But, as the collapse of Silicon Valley Bank demonstrated, utilizing agency discretion to not conduct more thorough supervision and oversight can have serious consequences. How can leaving oversight and supervisory standards to discretion, rather than maintaining mandatory strict standards, increase the risk for failures such as the one seen at Silicon Valley Bank to occur?**

Mandatory requirements set by regulation are complimented by standards set through supervision. Through the supervisory process, supervisors can evaluate whether a firm is appropriately managing its risks, which may not be captured through standardized measures set forth in regulation. Supervision also allows supervisors to respond to emerging risks quickly, to the extent not contemplated by the regulations.

The Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 provides the Federal Reserve Board with substantial discretion to apply enhanced prudential standards to bank holding companies with total consolidated assets between $100 billion and $250 billion in a way that is supportive of safety and soundness and financial stability, taking into consideration their capital structure, riskiness, complexity, financial activities, size, and other risk-related factors. This discretion allows the Federal Reserve to consider the implications for how it should regulate and supervise financial institutions in light of changing technologies and emerging risks as well as lessons from recent events about banking, customer behavior, social media, concentrated and novel business models, rapid growth, deposit runs, interest rate risk, and other factors.

In my view, Silicon Valley Bank's (SVB) failure demonstrated that it is appropriate to have stronger standards that apply to a broader set of firms. The Federal Reserve plans to revisit the tailoring framework, including to re-evaluate a range of rules for banks with $100 billion or more in assets.[1] Changes to the rules applicable to these firms would be made through notice-and-comment rulemaking and would be accompanied by an appropriate phase-in.

In addition, I plan to make changes to supervision to improve its speed, force, and agility. This includes developing a culture that empowers supervisors to act in the face of uncertainty and encourage supervisors to evaluate risks with rigor, so that they think through the implications of tail events with severe consequences. Once issues are identified, they should be addressed more quickly, both by the bank and by supervisors. Today, for example, the Federal Reserve generally does not require additional capital or liquidity beyond regulatory requirements for a firm with inadequate capital planning, liquidity risk management, or governance and controls. The Federal

[1] Board of Governors of the Federal Reserve System, "Vice Chair for Supervision Cover Note for the Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank," Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank (April 28, 2023).

Reserve should change that in appropriate cases. Higher capital or liquidity requirements can serve as an important safeguard until risk controls improve, and they can focus management's attention on the most critical issues. As a further example, limits on capital distributions or incentive compensation could be appropriate and effective in some cases.

2. In the wake of these bank failures, there was a sizable outflow of deposits from smaller banks to large banks typically called "too big to fail." If this trend continues, the result could be disastrous for small community banks through Pennsylvania and the country. What, if anything, can be further done to reassure depositors that the banking system is stable and to trust in their community financial institutions?

Overall, the U.S. banking system remains strong and resilient, and depositors should be confident that all deposits in our banking system are safe. At the same time, recent stress in the banking system shows the need for us to be vigilant as we assess and respond to risks. We will continue to closely monitor conditions in the banking system. I am committed to maintaining the strength and diversity of the banking system so that it can continue to provide financial services and access to credit for households and businesses.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KENNEDY FROM MICHAEL BARR

Questions for The Honorable Michael Barr, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System, from Senator John Kennedy:

1. **Vice Chair Barr, you mentioned in your prepared testimony that the recent failures highlight the need to move forward to complete the "Basel III endgame" capital actions. But I think you'd agree that, given a $40-billion-plus deposit run over the course of a few business days, a bank couldn't meet customer demands from capital alone.**

   a. **Since more capital alone won't address problems like those of SVB and Signature, shouldn't we pause aggressive actions on the capital front until we can better assess what will address those problems?**

SVB's failure demonstrates that strong bank capital matters. While the proximate cause of SVB's failure was a liquidity run, the underlying issue was concern about its solvency – the bank's ability to absorb the losses on its securities and repay its depositors and other creditors. We should be humble about our ability—and that of bank managers—to predict how losses might be incurred, how a future financial crisis might unfold, and what the effect of a financial crisis might be on the financial system and our broader economy. Stronger capital will guard against the risks that we may not fully appreciate today and protect the public from the extraordinarily high costs of bank failures.

Strong levels of capital also support banks and the U.S. economy, particularly during times of economic stress. Implementing Basel III will help to address outstanding risks and improve safety and soundness in the banking sector.

2. **Vice Chair Barr, banks play an important role in the economy, supporting economic growth by lending to consumers, small businesses, etc., they also safekeep deposits. Risk is inherent to banking, which is why banks are so heavily regulated and supervised. Failure is a normal and necessary part of business– including banking. The regulatory and supervisory frameworks have grown substantially over 100 plus years, whereby economic changes and various stress events led to new regulations on top of the old. Moreover, technology has allowed many bank competitors to flourish without comparable regulation or supervision.**

   a. **Does the current regulatory framework allow banks to operate efficiently? Are the current frameworks calibrated to today's risks across bank and nonbanks that preform comparable activities?**

   b. **What are you doing to ensure that the banking industry remains viable and competitive?**

Our banking system is sound and resilient, with strong capital and liquidity. Recent events have shown that we must evolve our understanding of banking in light of changing technologies and emerging risk.

Part of the Federal Reserve's core mission is to promote the safety and soundness of the banks we supervise, as well as the stability of the financial system to help ensure that the system supports a healthy economy for U.S. households, businesses and communities.

Banks are part of a broader financial system, which includes nonbank financial intermediaries such as money market funds, the insurance sector, government-sponsored enterprises, hedge funds, investment vehicles, and other nonbank lenders. We should monitor the migration of activities from banks to the nonbank sector carefully, but we shouldn't lower bank capital requirements in a race to the bottom.

In times of stress, banks serve as central sources of strength to the economy, and they need capital to do so. Thinly capitalized nonbank intermediaries are often the first to decrease intermediation and forced to shrink during bad times. Better capitalized banks have the capacity to support the economy by continuing to lend to households and businesses through stressful conditions when resilient provision of credit is most important.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR DAINES FROM MICHAEL BARR

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Senator Steve Daines:

1. **You recently mentioned that "events in crypto markets have highlighted the risks associated with new asset classes when not accompanied by strong guardrails"**

   [1] https://www.wsj.com/articles/feds-michael-barr-says-crypto-turmoil-highlights-potential-risks-to-financial-system-11668516393.

   a. **Has the Federal Reserve created any policy recommendations creating these "strong guardrails," and if so, what are they?**

   b. **Where is the line between regulation and stifling innovation and what would a policy guideline following this parameter look like?**

The Federal Reserve has a responsibility to ensure that regulation and supervision foster responsible innovations that improve access to financial services, while at the same time safeguarding consumers, financial institutions, and financial stability. As a general matter, we seek to accomplish that by following the principles of "same risk, same regulation," meaning that novel activities that raise risks that are analogous to those of traditional activities should be regulated in a similar manner.

On August 16, 2022, the Federal Reserve issued Supervision and Regulation (SR) letter SR 22-6, which outlines a process for Federal Reserve-supervised banking organizations engaging or seeking to engage in crypto-related activities to notify their supervisors.[1] Those notifications allow the Federal Reserve to take a coordinated and comprehensive approach to the supervision of banking organizations engaging in these activities.

In addition to the notification requirement, the letter reminds Federal Reserve-supervised banking organizations engaging or seeking to engage in crypto-asset-related activities that, prior to engaging in such activity, they:

- must determine that such activity is legally permissible and determine whether any filings are required under applicable federal or state laws; and
- have in place adequate systems, risk management, and controls to conduct such activities in a safe and sound manner and consistent with all applicable laws, including applicable consumer protection statutes and regulations.

On January 3, 2023, the Federal Reserve Board (Board), the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency issued a joint statement which highlights key risks for banking organizations associated with crypto-assets and the crypto-asset sector, describes the agencies' approaches to supervision in this area, and reminds all supervised institutions to engage in robust supervisory dialog before engaging in crypto-related activities. Specifically, the statement highlights several key risks associated with crypto-assets and the crypto-asset sector that banking organizations should be aware of, as demonstrated by the

[1] *See* https://www.federalreserve.gov/supervisionreg/srletters/SR2206.htm.

significant volatility and vulnerabilities over the past year. These include risk of fraud and scams, legal uncertainties, inaccurate or misleading representations and disclosures, volatility, runs on stablecoins, interconnectedness amongst crypto-asset participants, inadequate governance and risk management practices, and heightened risks associated with open, public, and/or decentralized networks.

The agencies continue to take a careful and cautious approach related to current or proposed crypto-asset-related activities and exposures at each banking organization and continue to assess whether and how those activities can be conducted in a manner that is safe and sound, legally permissible, and in compliance with applicable laws and regulations, including those designed to protect consumers. We are carefully monitoring all supervised institutions engaged in crypto-related activities, including any commitments made with regard to these activities.

2. **Speaking to the Senate Banking Committee earlier this month, you stated that crypto-market meltdowns, "remind us of the potential for systemic risk if interlinkages develop between the crypto system that exists today and the traditional financial system"[2].**

   [2] https://www.wsj.com/articles/feds-michael-barr-says-crypto-turmoil-highlights-potential-risks-to-financial-system-11668516393?mod=livecoverage_web.

   a. **Does the Federal Reserve view any linkage between crypto markets and traditional financial systems to beneficial?**

We aim to be technology neutral, but rather focused on effective risk management. The Federal Reserve's objective is to create a regulatory environment that allows for productive innovation, while at the same time ensuring there are guardrails in place to adequately protect against risks to consumers, financial institutions, and financial stability. So far, we have seen limited spillovers from recent stress in crypto-asset markets to the banking system. Bank engagement with crypto-asset activities is very limited at this time and the primary ties consist of providing core banking services, particularly deposit accounts, to crypto-companies. Banks may engage in permissible activities that are consistent with safety and soundness. However, recent market events have demonstrated that the crypto-asset sector has highlighted several risks, including those related to market volatility, fraud, theft, illicit financing, and market manipulation.

3. **You described scenario analysis in his written testimony as "the resilience of financial institutions assessed under different hypothetical climate scenarios."**

   a. **What are the metrics used for evaluation of these financial institutions, and following evaluations, how will the Federal Reserve encourage institutions to follow guidelines without restricting financial innovation?**

On January 17, 2023, the Board launched a pilot climate scenario analysis (CSA) exercise with six large banks and published participant instructions on its public website.[2] The pilot exercise is expected to conclude around the end of the year.

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[2] *See* https://www.federalreserve.gov/publications/climate-scenario-analysis-exercise-instructions.htm.

Climate scenario analysis—in which the resilience of financial institutions is reviewed under different climate scenarios—is an emerging risk-management and supervisory tool used to evaluate climate-related financial risks. By considering a range of possible future climate pathways and associated economic and financial developments, scenario analysis can help large banking organizations and supervisors understand climate-related financial risks.

This pilot exercise is an exploratory exercise and will not have consequences for bank capital or supervisory implications. The exercise is designed to help us understand how supervised institutions manage climate-related financial risks and to enhance the ability of both banks and supervisors to identify, measure, monitor, and manage these risks.

The pilot CSA exercise comprises two separate and independent modules: a physical risk module and a transition risk module. For both modules, the Board described forward-looking scenarios, and participants will estimate the effect of these scenarios on a relevant subset of their loan portfolios over a future time horizon. For each loan portfolio, participants will calculate and report to the Board credit risk parameters, such as probability of default, internal risk rating grade and loss given default, as appropriate. Participants will respond to qualitative questions describing their governance, risk-management practices, measurement methodologies, results, and lessons learned from this pilot exercises.

The Board anticipates publishing insights gained from the pilot at an aggregate level, reflecting what has been learned about climate risk management practices and how insights from scenario analysis will help identify potential risks and promote effective risk management practices. No firm-specific information will be released.

4. At your confirmation hearing, you stated that the Federal Reserve should not allocate credit, and the only purpose of the Fed's climate scenario analysis should be to understand risks.

a. Given the Federal Reserve already found that the GSIBs would have actually benefitted from extreme weather events, is this pilot scenario really necessary?

As I said at my confirmation hearing, the Federal Reserve should not be in the business of telling financial institutions to lend to a particular sector or not to lend to a particular sector. I stand by that statement.

The Federal Reserve's responsibilities with respect to climate change are important, but narrow. We view climate-related financial risks through the lens of our existing mandates and authorities, particularly those relating to the regulation and supervision of financial institutions and the stability of the broader financial system. From a supervisory perspective, our primary focus is to evaluate whether banks operate in a safe and sound manner and manage all material risks, including those related to climate change. To that end, the purpose of the Federal Reserve's pilot climate scenario analysis exercise is to enhance the ability of supervisors and supervised banking organizations to identify, measure, and manage climate-related financial risks.

Careful and rigorous research also plays an important role in informing the Federal Reserve's work on climate-related financial risks, and the Federal Reserve looks at a wide range of research that explores a variety of approaches and data sources, particularly on complex issues like the financial risks of climate change. The Federal Reserve will continue to approach climate-related financial risks in an analytically rigorous and transparent way.

5. **Will the Federal Reserve's pilot program incorporate the financial risks of an abrupt transition away from fossil fuels without adequate sources of baseload power to meet demand?**

   It seems to me that such a scenario would lead to even more inflation than we are seeing now, and greater financial risks to banks than would be faced under any other scenario.

The Board's pilot climate scenario analysis exercise is designed to enhance the ability of supervisors and supervised banking organizations to identify, measure, and manage climate-related financial risks.

The pilot exercise is exploratory in nature and evaluates the potential impact of climate change on a bank's risk profile across a range of hypothetical scenarios. The pilot exercise considers both physical and transition risk drivers. Physical and transition risk drivers associated with climate change may affect households, communities, businesses, and governments through damages to property, shifts in business activity, or changes in the values of assets and liabilities. These effects could manifest as traditional prudential risks to banking organizations, including credit, market, operational, and liquidity risk. The Board published instructions for the pilot exercise on January 17, 2023.[3]

[3] *See* https://www.federalreserve.gov/publications/climate-scenario-analysis-exercise-instructions.htm.

RESPONSES TO WRITTEN QUESTIONS OF CHAIR BROWN FROM NELLIE LIANG

Committee on Banking, Housing, and Urban Affairs
"Recent Bank Failures and the Federal Regulatory Response."
March 28, 2023

Questions for The Honorable Nellie Liang, Undersecretary for Domestic Finance, U.S. Department of the Treasury, from Chairman Sherrod Brown:

1. Stress testing is a useful tool for risk management and bank supervision. Since the Great financial crisis, the words "stress testing" typically refer to supervisory tests of capital adequacy. However, other stress tests are commonly used to manage interest rate risk, liquidity risk, credit risk, and others. Please explain the role of, and note the differences in, stress testing for different risk categories, the bank's management of these risk categories, and capital adequacy. Please also describe the benefits of a qualitative stress test that a quantitative stress test alone cannot capture. How can stress tests be used to inform decisions about systemic risk?

Stress testing of bank portfolios plays a critical role in the bank supervisory framework, particularly for the largest banks. Banks of all sizes perform internal stress tests on their capital and liquidity positions for various types of risks, such as credit, liquidity, and interest rate, were a set of hypothetical circumstances to occur. For the largest bank holding companies (i.e., those with over $100 billion in assets) the supervisory stress test administered by the Board of Governors of the Federal Reserve System (Federal Reserve Board) is used to set a capital buffer requirement arising generally from credit risks to loans and securities, and liquidity risks to the trading book under hypothetical but plausible scenarios. These stress tests also consider the banks' largest counterparties to assess a potential channel for systemic risk. In addition, the very largest bank holding companies use stress testing to set liquidity buffers for hypothetical funding risks. Qualitative stress testing that assesses a banks' ability to evaluate and quantify its risks can also help supervisors to assess risk at a bank and banks to improve their own risk management.

2. What do SVB's and Signature Bank's failures suggest about the asset threshold established in S. 2155? Was $250B too high of a threshold to set, and do you think it was a mistake for regulators to ease regulatory standards for banks of this size, beyond what Congress had required?

We must ensure that our bank regulatory policies and supervision are appropriate for the risks and challenges that banks face today. As Secretary Yellen has stated, restoring and strengthening the tools to maintain financial stability is a major priority for Treasury. In light of recent events in the banking system, the Federal Reserve Board and Federal Deposit Insurance Corporation (FDIC) have issued reports on the failures of SVB and Signature Bank, respectively. Treasury is reviewing those reports to better understand regulatory and supervisory actions taken regarding those banks, including the threshold for application of enhanced prudential standards.

3. SVB's collapse demonstrates that tying compensation and bonuses to a bank's growth incentivizes executives to take egregious risks. What steps can regulators take to discourage this kind of behavior from bank executives? What steps should Congress take?

Committee on Banking, Housing, and Urban Affairs
"Recent Bank Failures and the Federal Regulatory Response."
March 28, 2023

The federal banking agencies have taken steps to address concerns regarding executive compensation, including final interagency guidance on incentive compensation[1]; and a Federal Reserve Board report on a horizontal review of incentive compensation practices at large banking organizations.[2] Treasury is reviewing the Federal Reserve Board's report on the events that led to the failure of SVB and will continue to stay engaged with the federal banking agencies on potential regulatory responses.

4. Silvergate Bank, a cryptocurrency-centric bank that began to falter after the collapse of cryptocurrency exchange FTX and broader crypto industry turmoil, announced its voluntary liquidation on March 8, 2023, just two days before the failure of SVB. How did the Silvergate Bank liquidation affect the events surrounding the failure of SVB and Signature Bank?

The FDIC has preliminarily noted that SVB's failure and Silvergate Bank's voluntary liquidation both involved the accumulation of losses in the banks' securities portfolios.[3] Managing interest rate risk and funding risk is a core tenet of bank risk management. Bank regulators are in the process of reviewing the events that led to the liquidation of Silvergate Bank and have recently issued reports regarding the failures of SVB and Signature Bank. Treasury is reviewing the recent reports. Treasury officials have been in close touch with the banking regulators and will continue to work together.

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[1] Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395 (June 25, 2010), https://www.federalregister.gov/documents/2010/06/25/2010-15435/guidance-on-sound-incentive-compensation-policies.
[2] Incentive Compensation Practices: A Report on the Horizontal Review of Practices at Large Banking Organizations (October 2011), https://www.federalreserve.gov/publications/other-reports/files/incentive-compensation-practices-report-201110.pdf.
[3] https://www.fdic.gov/news/speeches/2023/spmar2723.html.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM NELLIE LIANG

Committee on Banking, Housing, and Urban Affairs
"Recent Bank Failures and the Federal Regulatory Response."
March 28, 2023

Questions for The Honorable Nellie Liang, Undersecretary for Domestic Finance, U.S. Department of the Treasury, from Ranking Member Tim Scott:

1. How does what happened with Silicon Valley Bank and Signature Bank affect the broader economy, as a whole?

Our banking system is sound and resilient, with strong capital and liquidity. We took decisive actions to protect the U.S. economy and to strengthen public confidence in our banking system. Without swift action, our broader economy would have been at risk, but deposits now have stabilized. We will continue to closely monitor conditions in the banking system and stand ready to take additional action if warranted.

2. Social media was frequently mentioned throughout the hearing as a contributing factor to the deposit flight at Silicon Valley Bank.

   a. Sentiment analysis has long been incorporated into risk analysis, often in reputational risk analysis. Social media is also often considered in a cyber risk context. What guidance if any have you provided regarding social media risk and how has this analysis changed after the market moving events around Gamestop and AMC last year?

Treasury has not issued any specific guidance regarding social media risk; the federal banking agencies issue guidance to their regulated institutions on supervisory issues. The Securities and Exchange Commission (SEC) has been considering this issue as well as many others in the context of ensuring that our capital markets promote competition and continue to operate efficiently.[4]

3. When were you first made aware of the struggles at Silicon Valley Bank?

I became aware of issues at Silicon Valley Bank on Thursday of the week of its failure.

4. Can you confirm that our banking system remains strong and resilient?

Yes, as Secretary Yellen has said repeatedly over the last several weeks, the U.S. banking system is sound.

[4] *See, e.g.,* Securities and Exchange Commission, Staff Report on Equity and Options Market Structure Conditions in Early 2021, https://www.sec.gov/files/staff-report-equity-options-market-struction-conditions-early-2021.pdf.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR REED FROM NELLIE LIANG

Committee on Banking, Housing, and Urban Affairs
"Recent Bank Failures and the Federal Regulatory Response."
March 28, 2023

Questions for The Honorable Nellie Liang, Undersecretary for Domestic Finance, U.S. Department of the Treasury, from Senator Jack Reed:

1. Did each of your agencies consider whether to exercise the orderly liquidation authority under Title II of the Dodd-Frank Act to liquidate either Silicon Valley Bank or Signature Bank? Please explain why the agencies declined to use this authority and whether the current use of extraordinary measures to avoid breaching the debt ceiling played a role in that decision?

The Orderly Liquidation Authority (OLA) under Title II of the Dodd-Frank Act provides the federal government with the necessary authority to liquidate failing financial companies, such as holding companies, that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard.[5] Unlike holding companies, Federally-insured banks, such as Silicon Valley Bank and Signature Bank, are resolved pursuant to the provisions of the Federal Deposit Insurance Act; OLA cannot be used to resolve an insured depository institution.[6]

[5] 12 U.S.C. 5384(a).
[6] 12 U.S.C. 5381(a)(8).

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM NELLIE LIANG

Committee on Banking, Housing, and Urban Affairs
"Recent Bank Failures and the Federal Regulatory Response."
March 28, 2023

Questions for The Honorable Nellie Liang, Undersecretary for Domestic Finance, U.S. Department of the Treasury, from Senator Catherine Cortez Masto:

The Federal Home Loan Banks

1. How did advances from a Federal Home Loan Bank (FHLB) affect Silicon Valley Bank and Signature Bank? Were advances useful in providing depositors access to their funds?

   a. Did FHLB advances allow the banks to function longer than they would have otherwise? Did the advances create an illusion of liquidity?

   b. Do you have any indication that the availability of FHLB advances led SVB or Signature to take more risk than without access to such funding?

2. What types of supervisory information does a FHLB have access to about its member financial institutions? For example, does an FHLB have access to supervisory information from the federal and/or state regulator?

3. Will you include a discussion in your reviews of SVB and Signature that considers the positive – and possibly – negative role of the FHLBs, including access to supervisory information?

Treasury remains closely engaged with the Federal Reserve Board and the FDIC, who were the federal prudential regulators of SVB and Signature Bank, respectively, and with the Federal Housing Finance Agency (FHFA), the regulator of the FLHBs, to proactively monitor and continue to safeguard the U.S. financial system. Treasury recognizes that coordination across the government is critical to the continued strength of the U.S. banking system.

As you are aware, the FDIC and the Federal Reserve Board recently issued reports on the supervision and regulation of SVB and Signature, and the conditions that led to their failure. Treasury is reviewing those reports.

As the FHLBs' regulator, FHFA is best positioned to address questions concerning specific FHLB activities as well as the FHLBs' access to supervisory information. Notably, FHFA launched a public review of the FHLB System in September 2022, which closed for public comment in March 2023. The agency is currently analyzing the results. With respect to the effect of any FHLB advances on the financial condition of SVB or Signature, we would similarly refer you to the Federal Reserve Board and FDIC.

Since the bank failures in March, Treasury has remained in regular contact with FHFA to understand critical trends in FHLB advances and debt issuances. Treasury continues to monitor the financial health of U.S. banks and the broader market trends that impact these institutions.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

LETTER SUBMITTED BY AMERICAN SHARE INSURANCE

AMERICAN SHARE INSURANCE

March 16, 2022

The Honorable Jerome Powell
Chairman
The Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Bank Term Funding Program

Dear Chairman Powell:

As President/CEO of American Share Insurance (ASI), an Ohio domiciled corporation that presently provides primary deposit insurance of $250,000 per account of each member of 103 state-chartered credit unions in 10 states across the nation, I am writing on behalf of the credit unions whose member deposits are insured by ASI.

On March 12, 2023, the Federal Reserve announced the establishment of the Bank Term Funding Program as a means of providing liquidity for depository institutions. The one-page fact sheet released to the public stated that eligible borrowers would be "any U.S. federally insured depository institution (including a bank, savings association, or credit union) or U.S. branch or agency of a foreign bank that is eligible for primary credit."

The new program, under the fact sheet provided, excludes the liquidity needs for all 106 state-chartered credit unions that are privately insured by ASI.

We would ask that the program be modified to include <u>any</u> credit union that is federally or state <u>chartered</u>. While foreign bank agencies are included, we would hope that credit unions like the Fire and Police in Akron or Postal Workers in Cincinnati not remain excluded.

The credit unions ASI insures are state-chartered, state-regulated and subject to the same regulatory requirements as are state-chartered, federally insured credit unions in their respective states. In all aspects, ASI insured credit unions are regulated like all other state-chartered credit union – but, simply not federally insured.

ASI is an approved share guaranty corporation under Ohio law, subject to regulation by the Ohio Department of Commerce as well as regulation and annual licensure by the Ohio Department of Insurance.

In addition, ASI is also subject to regulation by state credit union regulators in its nine other states of operation. ASI has been successfully insuring credit union member deposits since 1974, and has been subject to specific federally-mandated operating and reporting requirements since 1991.

The Federal Deposit Insurance Act, as amended in 1991, recognized state-chartered credit unions insured by a duly approved private deposit insurer (such as ASI), as "depository institutions" [12 U.S.C.1831t], which further subjects these non-federally insured credit unions to federal regulatory oversight by the CFPB.

5656 Frantz Road | Dublin, OH 43017 | 800.521.6342 | AmericanShare.com

The Honorable Jerome Powell
March 16, 2023
Page 2

In 2015, as part of the FAST Act, P.L. 114-94, the U.S. Congress provided non-federally insured credit unions access to the Federal Home Loan Bank System, so it is evident that Congress has acknowledged our unique role in the credit union system as well as state-chartered, privately insured credit unions.

More recently, on April 24, 2020, legislation was signed into law which became Public Law 116-139. This act revised the PPP loan program and set aside $30 billion for credit unions with assets of less than $10 billion - which includes all privately insured credit unions. At the urging of many in Congress, PL 116-139 changed the definition of a credit union in division A, Section 101 (d) (xii), and defined credits unions as including a "state credit union," as defined in Section 101 of the Federal Credit Union Act. This by definition includes all privately insured credit unions.

As additional background, credit unions operated from 1935 to 1971 absent *any* form of deposit (share) insurance.

It is important to note that under Title II of the Federal Credit Union Act, state-chartered credit unions are not required to be federally insured and are permitted to have other forms of state-approved deposit (share) insurance, such as ASI. ASI is currently the only insurer of this type in America.

Additionally, ASI insured credit unions are already eligible to be members of the Federal Reserve Bank.

Our institutions pose no systemic risk. State chartered but ASI insured credit unions range in size from under $1 million to $1.8 billion in total assets, with the average-sized privately insured credit union reporting total assets of approximately $216 million. As of December 31, 2021, 93.5% of our institutions are rated CAMEL 1 or 2.

In closing, we thank you for your consideration of our views and hope that the Board can make this small but important change to the program. We would welcome any additional discussion of this issue. I can be reached at 614-973-7744 or by e-mail at tmason@americanshare.com

Sincerely,

Theresa Mason
CEO
American Share Insurance

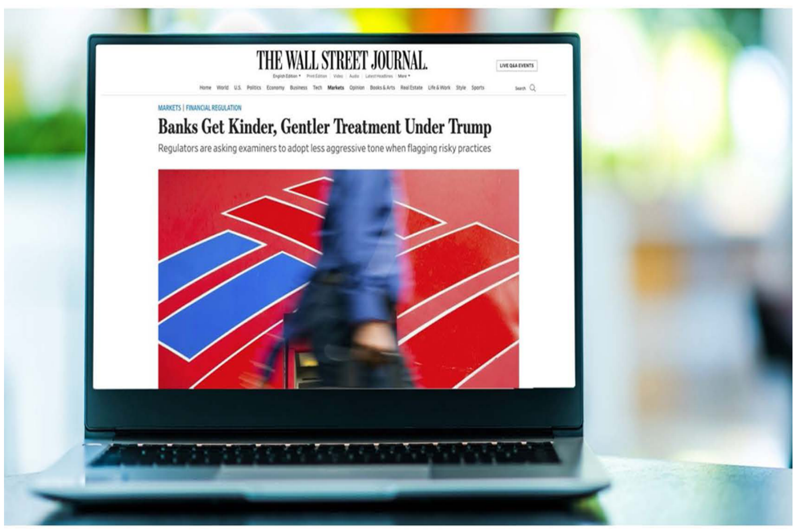
Cc: The Honorable Sherrod Brown

BETTER MARKETS BANKING FACT SHEET

BETTER MARKETS

BANKING FACT SHEET

Powell-Led Federal Reserve Deregulation Caused the Failure of Silicon Valley Bank and the 2023 Banking Crisis



Dennis M. Kelleher | *Cofounder, President, and CEO*

March 27, 2023

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INTRODUCTION

The facts make clear that the failure of Silicon Valley Bank (SVB), Signature Bank, and the ongoing banking crisis was avoidable, and the causes are not a mystery: once Trump took office in 2017, the ***financial industry was significantly unleashed, unsupervised, and unpoliced***. When that happens, the industry is incentivized to take excessive risks and engage in reckless if not illegal behavior because they get to enrich themselves by gambling with other people's money. The result is that bankers and financers have unimaginable upside and little if any downside, which taxpayers and Main Street families end up paying for. ***The evidence for this is objective, overwhelming, indisputable, and publicly available***, including as specifically applied to SVB and others impacted by the current banking crisis.

This should surprise no one. Eliminating financial protection rules and weakening supervision are like getting rid of the security guards, taking the locks off the doors, and removing the alarm systems at banks in a high crime area while simultaneously reducing the cops patrolling the streets and taking away the ammo of the few cops who are left. There is only going to be one result: high risk, reckless, and illegal behavior. That is what happened in banking and finance during the Trump administration.

While the results of this irresponsible deregulation are only becoming visible now, they were ***inevitable, predictable and, indeed, predicted in detail in real time*** starting early in the Trump administration. As described below, the very risks now materializing were identified in the dissents of then-Federal Reserve Governor Lael Brainard, then-FDIC Director Marty Gruenberg, as well as by Better Markets in more than 50 deregulatory rulemakings across the financial regulatory agencies and in many reports, fact sheets, and articles throughout the Trump administration (as detailed in Appendixes 1 and 2 attached below).

Yet in the face of this public, high-profile, substantive, and repeated opposition that detailed the very risks that have now materialized, Federal Reserve (Fed) Chair Jay Powell, former Vice Chair for Supervision (VCS) Randy Quarles, and others nonetheless massively deregulated and delivered the very banking crisis now happening in the country. That's why if local Fed supervisors failed at SVB or elsewhere, it's because they were set up to fail by Powell and Quarles who undermined them and tied their hands, as detailed below. Blaming others would be nothing more than scapegoating much less culpable people for the knowing failures of the Fed's leadership.[1]

Given the Fed's lead role in deregulating the banks and causing the current crisis, the focus of this Fact Sheet is on banking deregulation at the Fed. It comprehensively reviews the Fed's deregulation that was enacted during the Trump Administration, including the significant and direct role of Chair Powell as aided and abetted by Quarles once he got to the Fed. Tellingly, Powell began deregulating even before Quarles arrived at the Fed when, in August of 2017, he pushed a proposal that weakened the use of Matters Requiring Attention ("MRA"s) and even Matters Requiring Immediate Attention ("MRIA"s), now at the center of the SVB collapse. Then, in September 2018, they undermined supervision at SVB and elsewhere by de facto eliminating the use of guidance, tying the hands of supervisors. Deregulating and undermining supervision from Washington DC, however, was not enough for the Fed. Quarles (along with FDIC Chair McWilliams) traveled the country determined to ensure that the Fed's on-the-ground line-supervisors got the message to go easy on the banks and bankers, ushering in "kinder, gentler treatment" that empowered bankers at the expense of supervisors, safety and soundness, and even financial

[1] Of course, none of the actions or conduct of the Fed, Powell, Quarles or other personnel from the Fed or any other regulatory agency in any way absolves the members of the Board of Directors or the executives and officers of SVB for their deficient conduct, gross mismanagement, irresponsible if not reckless or illegal conduct in connection with the collapse of the bank. They, first and foremost, are responsible for what happened, and they should be held fully accountable by the Department of Justice, the SEC, shareholders, and regulators as warranted by the facts and circumstances.

stability. Regulators, with the Fed in the lead, also gutted the Volcker Rule which enabled SVB to, among other things, increase investments in venture capital firms and sell its hedges in 2022 on $15.26 billion of its available for sale (AFS) securities for short term gains. That opened the gaping hole of unrealized and unhedged losses at SVB in March 2023, causing the collapsed and contagion that has required bailouts and inflicted widespread pain across the US (as detailed below and in Appendix 3 attached below).

Unfortunately, those deregulation facts are getting lost in a tidal wave of misinformation. With so many involved in causing or contributing to the failure of SVB, Signature Bank, and the ongoing banking crisis, many are now engaged in coordinated disinformation campaigns to distract from their roles or looking for scapegoats to avoid responsibility and accountability. Unsurprisingly, the banking industry and their allies are foremost among them, seeking to blame anyone but themselves, releasing incomplete and misleading information masquerading as "analysis," and doing whatever it takes to prevent additional financial safety rules, no matter how necessary. Sadly, the Fed isn't far behind, apparently selectively disclosing highly confidential supervisory information to the media in an attempt to distract from involvement and the failures of Chair Powell, shape a more friendly narrative, and preempt VCS Michael Barr's investigation.

In focusing on the actual facts, it is important to remember that while the Trump administration was in the lead and deserves the largest share of blame, it did not do this alone. It was aided and enabled by bank directors and executives supported by their trade groups, lobbyists, lawyers and their many political, academic, media and other allies, as well as by financial regulators, elected officials, prosecutors, and the broader financial industry, including the titans of Wall Street, who all irresponsibly pushed a deregulation agenda when most knew better. After all, the catastrophic crash in 2008 was caused by many if not most of the same drivers of this banking crisis, including in particular widespread deregulation in the years preceding that crash and regulators catering to the industry rather than protecting the public.

As important, the debate over the significance of the law passed on a bipartisan basis in 2018 (with the Orwellian title of "Economic Growth, Regulatory Relief, and Consumer Protection Act," EGRRCPA) is a misleading distraction. Yes, it deregulated large banks like SVB and Signature, and, yes, it sent a loud and clear message that deregulation was coming, that systemic risk concerns were limited mostly to the largest Wall Street megabanks, and greenlighted the Fed to deregulate further than the letter and spirit of the law. However, that law was just one piece of a much larger, broad-based, sweeping deregulation juggernaut during the Trump administration. That included more than 50 deregulation rules and actions across all the financial regulatory agencies (see Better Markets' Road to Recovery Report), as directed and supported by the Trump White House. While the media and others focus on the easy-to-cover, easy-to-understand Congressional actions like EGRRCPA, the real action deregulating finance happens in the dark and almost entirely uncovered corners of multiple regulatory agencies—where Better Markets has participated in more than 400 rulemakings since being founded in 2010. Focusing on EGRRCPA is literally missing the forest of deregulation for a tree, albeit a sizeable one.[2]

[2] EGRRCPA deregulation predictably contributed to the current crisis because large U.S. banks were known to be domestic systemically important banks—DSIBs—even if not GSIBs. Nevertheless, EGRRCPA eliminated the legislative requirement that enhanced standards be applied to bank holding companies with between $50 billion and $100 billion in assets and raised the asset size-based threshold for the required application of those stronger rules and standards for bank holding companies from $50 billion to $250 billion. It also gave the Fed broad discretion to determine whether it should continue to apply the stronger, enhanced prudential standards to bank holding companies like SVB with assets of between $100 billion and $250 billion. The Fed, under the leadership of Chair Powell and VCS Quarles, exercised that discretion to significantly deregulate banks like SVB far beyond what the law required. Like the rest of the deregulation during the Trump administration, facts didn't matter much when EGRRCPA was passed. For example, supporters of EGRRCPA claimed it was necessary because the Fed was mindlessly imposing a one-size-fits-all regulatory regime on all banks, but that was inaccurate. The Fed actually had a range of prudential standards that it applied depending on a bank's risk profile and tailored to the risks of its activities, as detailed here. This Fact

None of this is to suggest that the Dodd-Frank Financial Reform and Consumer Protection Act (Dodd-Frank) was eviscerated. Thankfully, that didn't happen. While the pillars of financial reform were significantly weakened during the Trump administration, there is no question that the banks and the financial system are much stronger now than they were in 2008, with more capital, liquidity, and resilience. However, that is the wrong benchmark. After all, in 2008 the financial system was in the worst shape since the Great Crash of 1929, so it had better be in better shape now than then. The key question is whether the financial system in 2023 is as strong as it needs to be to protect the economy and the American people. The answer to that question is clearly no and it was made much weaker, fragile, and vulnerable by the deregulation during the Trump administration, led by Chair Powell at the Fed.

Trump's Massive, Widespread Deregulation

From the start of the Trump administration, deregulating finance was on the top of the agenda, and he appointed deregulators at the White House, the Fed, the FDIC, the OCC, the SEC, the CFTC, and the CFPB. Tellingly, this deregulation agenda was not enacted based on evidence or data (as made clear by the absence of such in the rulemakings), but on vacuous words and phrases, like "tailoring," "efficiency," "right-sizing," "streamlining," "fairness," and "fine-tuning." This was fueled by a mindless ideology and zeal that found every self-interested industry argument for deregulation compelling and persuasive, no matter how unsupported.

But the rhetoric used to disguise their deregulation cannot hide the reality of their primary objectives: (1) to dramatically reduce the rules that protect Main Street families from the high risk, dangerous activities of finance, and (2) to interfere with supervisors' ability to ensure that banks operated in a safe and sound manner and were not a threat to financial stability. The Trump administration and its many enablers accomplished their objectives and the failures of SVB, Signature and the ongoing financial crisis are a direct result.

At the Fed, the deregulation work was led by Chair Powell and Vice Chair for Supervision Quarles; at the FDIC, by Chair McWilliams; at the OCC, by Acting Comptroller Noreika followed by Comptroller Otting; at the CFPB, by Directors Mulvaney and Kraninger; at the CFTC, by Chairs Giancarlo and Tarbert; and, at the SEC, by Chair Clayton. These deregulators were abetted by others in the Trump administration, including at the Treasury Department by Sect. Mnuchin, who was also Chair of the Financial Stability Oversight Council (FSOC), which he neutered; at the White House by the Chair of the National Economic Council (NEC) Gary Cohn, the former Goldman Sachs' President, and his deputy Andrew Olmem; at the Office of Financial Research (OFR) by Dino Falaschetti; and at the PCAOB by Bill Duhnke. These deregulators were supported by Republicans in the House, especially those on the House Financial Services Committee (HFSC), and in the Senate, especially the members of the Senate Banking Committee (SBC).

Reviewing all their deregulatory actions would probably take a book or two and the Fed's actions were most consequential for banks, SVB, and the ongoing banking crisis. That is the focus of this Fact Sheet.

Sheet is not going to further discuss the law and the role it played in the collapse of SVB because it has already been widely reviewed elsewhere, whereas the Fed's dramatic deregulation and Powell's role have not been. *See, e.g.*, Caitlin Reilly, *Post-mortems begin on Silicon Valley Bank failure*, ROLL CALL (March 13, 2023), *available at* https://rollcall.com/2023/03/13/biden-raps-2018-bank-law-as-post-mortems-begin-on-svb-failure/.

Fed Deregulation of SVB Was Led by Chair Powell

While the deregulation was widespread, there is no question that Chair Powell and VCS Quarles at the Fed were in the lead pushing further and faster than others, including the legislators who passed EGRRCPA. In enacting the rules required by EGRRCPA, the Fed deregulated the large banks like SVB, Signature and others far beyond what the law required and beyond even what some supporters of the law believed appropriate. But that was just the tip of the deregulation iceberg.

Powell Leads the Charge on Deregulation and Weakening Supervision

Some want to pin all the blame for the Fed's deregulation on former VCS Quarles, who does in fact deserve a great deal of blame. However, that would overlook and understate the critical role of Chair Powell, who favored deregulation long before he got to the Fed. At the Fed, Chair Powell not only voted for every single deregulation rule Quarles proposed, but he also enthusiastically supported that deregulation in speeches, Q&As, and in Congressional testimony (including in decidedly misleading testimony when he misrepresented the Fed's deregulation and tried to minimize his role). Tellingly, Chair Powell also lead the deregulatory charge **before** VCS Quarles was even sworn in on November 6, 2017.

It's important to understand that this was a strategic, targeted two-prong attack on the Fed's regulation **and** supervision of banks. While regulation gets most of the attention, supervision is as important, which is why the industry attacked both and why Powell and Quarles materially weakened both.

There are a couple of hundred people working on regulation at the banking regulators, but there are more than 5,000 working in supervision. Many of those working in supervision do not go to work at the offices of the banking regulators; they work on-site at the banks, especially at the biggest banks, working full time examining all the operations and activities of the bank. Regulations are detailed rules that result from a time-consuming, lengthy process (often taking years) governed by the Administrative Procedure Act, which includes significant if not overwhelmingly industry input and influence. However, those rules do not and cannot capture all the many aspects of banking and bankers' conduct. If they did, the rules would be forever long, detailed and, nevertheless, quickly outdated as the world of banking and finance rapidly changes. That's why guidance is so critically important to the proper regulation and supervision of banks: it flexibly fills in the many interstices of the rules in a dynamic and flexible way as the world and banking evolves, enabling supervisors to require bankers to prioritize safety, soundness, and financial stability at all times even as conditions change.

Powell, Quarles, and others weakened regulation **and** supervision, enabling excessive risk taking that resulted in banks being fragile and prone to failure like SVB, Signature and others. Much of that is captured and detailed in the documents in Appendix 1 (including as summarized in a Sept. 15, 2020 Special Report by Better Markets: "The Road to Recovery: Protecting Main Street from President Trump's Dangerous Deregulation of Wall Street") and in the rule proposals in Appendix 2 (including Better Markets comments letters addressing those rules), so only a few key actions will be highlighted here.

For example, Chair Powell was the driving force behind two proposals the Fed made on August 3, 2017. One proposed changes to the rating systems for large financial institutions and was finalized on Nov. 11, 2018 and impacted the entire range of supervision at banks, including SVB and Signature. The other was innocuously and misleadingly entitled "supervisory expectations for Boards of Directors," which seriously changed how supervisors reviewed the conduct of banks and, importantly, how they communicated deficiencies with management and the Board—key issues at SVB.

Better Markets strenuously objected to this proposal in a detailed comment letter. It pointed out that the proposal failed to disclose material information about or the basis for these significant changes, set supervisory expectations too low, and enabled management to keep boards in the dark about key supervisory issues which would prevent boards from discharging their management oversight duties. Weak boards and dominating management restricting information to boards were key problems in the 2008 crash and often enabled a culture and practice of excessive risk taking if not illegal conduct. Yet Powell's proposed rule did not consider any of that but would significantly limit supervisors' ability to hold management to account for such actions and limited their ability to ensure that the Board was informed and could exercise their oversight of management.

For example, Powell's proposal would fundamentally change the Fed's then existing practice regarding the communication of critical supervisory findings to boards. It provided that most informal enforcement actions, known as Matters Requiring Attention ("MRA"s) and even more urgent Matters Requiring Immediate Attention ("MRIA"s), would only be directed to senior management for corrective action, not to boards, who would be left in the dark. Removing supervisory direct access to boards would dramatically reduce the authority of supervisors and the power MRAs and even MRIAs. It would also deprive boards of information they needed to discharge their oversight duties and would make boards even more dependence on senior management for the availability and quality of key information.

This was a radical proposal given that the information contained in MRIAs and MRAs is on its face highly material to a board's oversight function. The proposal described MRIAs as "matters of significant importance and urgency that the Federal Reserve requires a supervised institution to address immediately." It explained that such matters include those—

(1) that "have the potential to pose significant risk to the safety and soundness of the institution;"

(2) that "represent significant noncompliance with applicable laws or regulations;"

(3) that constitute "repeat criticisms that have escalated in importance due to insufficient attention or inaction by the institution;" and

(4) that "have the potential to cause significant consumer harm."

MRAs rise to nearly the same level of importance. They are matters concerning the same basic array of threats to an institution as MRIAs, including dangerous, destabilizing and even lawless conduct, but that pose less urgency because the harm is less imminent. The proposal explained that issues giving rise to MRAs are "important" and "must be addressed to ensure the institution operates in a safe-and-sound and compliant manner," although the threats to safety and soundness and to consumer protection are considered "less immediate."

The proposal was dangerous in other ways also pointed out in the comment letter. While this wasn't finalized as a rule until February 26, 2021, it nonetheless immediately sent an unmistakable message to supervisors to back off both management and board members, including related to the identification of some of the most important matters like MRIAs and MRA.

This proposal is directly related to seriously weakening and undermining the supervision of banks like SVB and undoubtedly enabled the mismanagement and risk taking at SVB and elsewhere, as increasingly specific leaks to the media of highly confidential supervisory information have revealed.[3]

[3] Confidential supervisory information (CSI) cannot be publicly disclosed even by the bank that the CSI relates to. Indeed, it is a violation for the bank or anyone to even publicly acknowledge the existence of MRAs, MRIAs, or a 4(m) restriction. Because there are civil and criminal penalties if CSI is improperly disclosed, such information is often a closely held secret even within the bank itself. It cannot be overstated what a serious and very rare breach it is for anyone to be disclosing or discussing such CSI publicly as has recently frequently been the case regarding SVB.

First, *Bloomberg News* reported on March 17, 2023, that starting in 2022 Fed

> "examiners began sending [SVB] two types of warnings: [MRAs and MRIAs]. [They] are supposed to seize executives' attention, requiring they fix problems to avoid more severe sanctions, known as consent orders."

Second, *The New York Times* reported on March 19, 2023 even more detailed highly confidential supervisory information about SVB, including that

> "In 2021, a Fed review of the growing bank found serious weaknesses in how it was handling key risks. Supervisors ... issued six ... warnings known as [MRAs and MRIAs], flagged that [SVB] was doing a bad job of ensuring that it would have enough easy-to-tap cash on hand in the event of trouble. But the bank did not fix its vulnerabilities. By July 2022...[it was] rated deficient for governance and controls...."

Also on March 19th, the *Wall Street Journal* reported on an apparently internal SVB presentation that disclosed that the Fed

> "raised concerns about risk management at SVB ***starting at least four years before***.... In January 2019, the Fed issued a [MRA] to SVB over its risk management systems.... Regulators are supposed to make sure the problem is addressed, but it couldn't be learned if the Fed held SVB to that standard in 2019. Over time, the [Fed] issued numerous warnings to SVB."

Third, the *Wall Street Journal* reported on March 24, 2023 that "SVB was placed in a '4M' restriction" after getting the MRAs and MRIAs, and that

> "Last fall, the San Francisco Fed met with senior management of the bank and highlighted problems with the bank's handle on interest-rate risk in a rising rate environment...."

It also reported that Powell said at a press conference on Wednesday, March 22, 2023, that "The supervisory team was apparently very much engaged with the bank [and] repeatedly was escalating." But he failed to mention that these supervisory actions did not include the transmission of the MRAs or MRIAs being sent by supervisors to SVB's board because of the deregulatory actions he had previously pushed.

Apparently, this "volley of warnings about the company's poor risk management" and the "stack of MRAs and MRIAs" at SVB had little if any impact. Or, as *The American Prospect* noted, "[i]n reality, [the matters requiring attention/MRAs and matters requiring immediate attention/MRIAs] obviously *didn't* require any attention" and "the only takeaway from the SVB situation is that this troubled bank with poor risk management did not fear its regulator." That would seem to be the foreseeable result of Powell's push to downgrade MRAs and MRIAs and supervision generally.[4]

As *The American Prospect* also noted, the entire SVB debacle is "an effective admission that banks don't really listen to them [the Fed's supervisors], confident in the knowledge they won't suffer any penalties for such imprudence and will in fact be rescued if anything goes really wrong."

As starkly illustrated in the attached Appendix 2, these rule proposals, however dangerous, were just the beginning of the Fed's deregulatory juggernaut, which increased in frequency and impact once Quarles arrived in November 2017.

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[4] Of course, SVB's CEO being on the board of the Federal Reserve Bank of San Francisco, SVB's regional regulator and supervisor, undoubtedly played a role as well. *See* Gretchen Morgenson, *The Federal Reserve is supposed to monitor the nation's banks for risk. Is it up to the job?*, NBC News (March 22, 2023), available at https://www.nbcnews.com/business/business-news/federal-reserve-san-francisco-silvergate-silicon-valley-bank-failure-rcna75908.

Fed Undermines Supervision Further by Tying Supervisors' Hands

Another example of the Fed making supervision even more difficult—and, again, directly related to the collapse of SVB, Signature and the problems at other banks—was when the Fed, the FDIC, the OCC, the CFPB and the National Credit Union Administration issued a joint statement on September 11, 2018, that greatly limited the power and authority of supervisors. Again, it was innocuously if not misleadingly entitled "Agencies Issue Statement Reaffirming the Role of Supervisory Guidance."

Rather than "reaffirming the role of supervisory guidance," they were in fact announcing its demise. The regulators stated, in substance, that supervisors could not use guidance to rein in a bank's risky conduct even if it threatened safety and soundness or financial stability unless it also broke a specific law or rule. For many years, banking regulators and supervisors had issued guidance covering a wide range of issues and conduct, often at the request of the industry for clarity and, well, guidance. Supervisors used that guidance to force banks to focus on safety, soundness, and financial stability by limiting banks' riskiest conduct. That, however, limited the banks' highest risk activities which were also the most profitable activities. Restricting and defanging the use of guidance by supervisors was at the top of the industry's wish list. This reportedly included lobbying of the Fed and OCC by the CEOs of the Bank of America and JPMorgan Chase, among others. As they did for more than four years (because Quarles did not resign as VCS until the end of December 2021, almost a full year into President Biden's first term), Trump's deregulators delivered, meaningfully limiting one of the supervisors' most important tools in reining in risk at the banks like SVB, Signature and others.

As former Fed Governor Dan Tarullo said,

> "I believe that part of it [the problems at SVB] is just the 'Don't be too tight on your supervision, you need to find legal problems before you tell the banks to change what they were doing."

That shifts the balance of power from the supervisors to the bankers who can press them to identify specific rules or laws that relate to supervisors' identification of threats to safety and soundness. Moreover, the supervisors know that the most senior leadership of the Fed will not back them up. Indeed, they are the ones insisting that supervisors go easy on the banks. To do otherwise would not just be unwise or unfruitful, but a career limiting decision for supervisors.

As a banking expert recently put it in a *New York Times* article,

> "[W]hen it came to 'bringing in the big guns' – backing up the stern warnings with legal enforcement – supervisors must, in many ways, rely on the Fed Board in Washington. If bank leadership thought the Board was unlikely to react to their deficiencies, it might have made them less keen to fix the problems."

As one FDIC official recently said to the *Wall Street Journal*,

> "Absent some emergency...it can be challenging for supervision to push back against management if the bank is in compliance with all of its capital and liquidity requirements, as SVB was."

Moreover, as reported by the *Wall Street Journal*, once the Fed issued its "guidance on guidance" expressly stating it didn't have the force of law,

> "After that, it became more of a battle to get a bank to agree to changes, according to a former big-bank examiner for the San Francisco Fed, who said the move 'created 10,000 more steps.'"

The article detailed the problems supervisors faced once the Fed Board deprived them of the ability to rely on guidance and forced them to focus narrowly on specific rules and laws to get banks to comply:

"Ideally, when bank examiners pointed out problems, the bank's management would agree and voluntarily comply. But former examiners for the San Francisco Fed said that a bank might involve its lawyers if it didn't agree with the examiners' findings, treating the process as a court case rather than a routine oversight matter.

"If examiners thought the bank should prepare for a scenario such as rapid growth, soaring interest rates and abrupt loss of deposits, as later happened to SVB, examiners would be hobbled by the absence of explicit regulatory guidance calling for such preparations, another examiner said. The bank could point out such a combination of events had never happened before and preparing for it would hurt shareholder returns, this former examiner said."

Of course, equipping the banks with arguments to fight supervisors seeking safety and soundness changes was what the industry wanted and that's what the Fed's actions were inevitably going to deliver. **If the supervisors could not point to a specific rule or law relating to the conduct, bankers and their lawyers fought them every step of the way. And the supervisors, bankers and lawyers knew that Chair Powell, VCS Quarles, and the leadership in Washington would not support them in disagreements with the bankers.**

Remarkably, even the Fed issuing such guidance expressly stating that the banks didn't have to pay attention to guidance wasn't enough for the financial industry. It wanted even greater leverage to fight supervisors fulfilling their duty to ensure banks were operating in a safe and sound manner. They lobbied the five agencies that issued the joint statement in 2018 to codify it as a rule and, on October 29, 2020, just days before the Presidential election in 2020, they proposed just that and the Fed and the other agencies adopted the final rule on March 31, 2021.

Fed Directly Beats on the Bank Supervisors to Go Easy on the Banks

While those proposals indirectly undermined the proper supervision of banks, Quarles wasn't about to do indirectly what he had the power to do directly: use his full weight and authority as the Fed's Vice Chair for Supervision to personally and directly beat up on the supervisors to go easy on the banks, albeit using euphemisms to try to hide his intent and objective. Coming on top of the actions reviewed above, this *Wall Street Journal* headline on December 12, 2018 says it all:

Banks Get Kinder, Gentler Treatment Under Trump

Regulators are asking examiners to accept less aggressive tone when flagging risky practices

The story reported that,

> "[t]wo Trump-appointed officials [Fed VCS Quarles and FDIC Chair McWilliams] have spent several months touring the country, visiting bank examiners in regional offices and asking them to adopt a less-aggressive tone when flagging risky practices and pressing firms to change their behavior."

The article noted that "[t]he internal effort to change the culture among examiners has included specific directives from Trump-appointed officials. Mr. Quarles told Fed examiners to include positive feedback in their reports instead of focusing only on deficiencies."

Quarles was quoted basically bragging about how extensive he intended to gut the supervision of banks:

> "Changing the supervision culture 'will be the least visible thing I do and it will be the most consequential thing that I do."

As if foreseeing the collapse of SVB, Signature and problems at other banks, the story then reports that "[c]ritics say friendlier examiners could blunt the effect of postcrisis rules, giving banks more freedom to engage in riskier practices." The prescient article explicitly detailed the risks of Quarles' actions as well as their similarities to what regulators had done wrong in the years before the 2008 crash. History was repeating itself, although it didn't materialize until 2023.

The Fed-Led Gutting of the Volcker Rule Enabled SVB to Increase Risk-Taking and Sell Its AFS Hedges for Short Term Gains, Directly Resulting in Its Collapse

A key driver of the 2008 crash was banks engaging in very high risk and dangerous proprietary trading, which used and endangered depositors' money to subsidize banks' socially useless but incredibly lucrative gambling. This was little more than reckless, leveraged, swing-for-the-fences, risk-taking to maximize short term returns and bankers' annual bonuses, routinely reaching $10 million and some reaching as much as $100 million – for one year.

These activities were dramatically curtailed in the Dodd-Frank Act in provisions referred to as the "Volcker Rule," which had two parts: one limited banks' direct prop trading and one limited banks' indirect prop trading by investments in outside funds like venture capital (called "covered funds"). Both parts of the rule were gutted by Fed-led changes under the leadership of Powell and Quarles. SVB used this deregulation to take excessive risks and amplify (short term) returns, contributing to its failure. These Fed-driven changes were accurately reported as a "victory for the financial services industry."

The first weakening of the rule was proposed on July 17, 2018 (finalized on July 22, 2019). As pointed out in our 57-page comment letter, the new rule very broadly gutted the Volcker Rule in many material ways and, again, lacked a valid basis, mostly just repeating conclusory industry claims without any data or supporting information that Powell, Quarles and others nonetheless found persuasive. Among other things, this rule eliminated a presumption that was a bright line and replace it with a complicated if not impossible series of tests to determine compliance with what was left of the rule. The new rule eliminated the original presumption that positions held for less than 60 days were prohibited short term prop trading. Because the rule also expanded information asymmetries between supervisors and banks, the result of eliminating the presumption was to put supervisors in the impossible position of policing the rule in the dark, which de facto meant that positions held for less than 60 days were excluded from the enforcement of the rule.

Another key change was to the applicability of the Volcker Rule to banks' trading books and liquidity management like the US Treasury and agency securities SVB had in its available for sale (AFS) portfolio. The original rule would have prohibited SVB from realizing short term profits from sales in its AFS portfolio. Once the Volcker Rule was no longer applicable due to this change, SVB could realize those short-term profits from such sales, and it did in very significant amounts with consequences that directly relate to its failure.

Specifically, at the end of 2021, SVB had more than $15 billion of its AFS portfolio hedged as it prepared for the Fed to raise rates. However, as its short-term profitability dropped in 2022, SVB unwound $11 billion of those hedges to book short term gains of $517 million in the first six months of 2022. As reported by the *Financial Times* in "How crazy was Silicon Valley Bank's zero-hedge strategy?,"

> "And at the end of 2021, SVB's financial accounts indicate that on the AfS side it held $15.26bn of interest rate swaps to hedge against the impact of rising rates on its big bond portfolio. So, what happened? Well, it looks that weakening profitability in 2022 as the tech world made SVB do something really dumb. In the first quarter, it unwound $5bn of AFS hedges to book a $204mn gain, and in the second quarter it dumped another $6bn of hedges to lock in a $313mn gain."

By the end of 2022, SVB "only had $563 million worth of hedges left on its books."

SVB clearly sold the swaps hedging its AFS position to realize short-term gains. This would have been prohibited by Volcker Rule before it was weakened. The original Volcker Rule required that the

> "sale of securities contemplated and authorized by the plan must be principally for the purpose of managing the liquidity of the banking entity, and **not** for the purpose of short-term resale, benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits, or hedging a position taken for such short-term purposes."

Thus, the Fed-led changes to the Volcker Rule allowed SVB to reduce $15.26 billion in hedges on its AFS portfolio to almost nothing. (This is spelled out in more detail in Appendix 3 attached below.) Put differently, **imagine what would have happened if the Fed didn't weaken the Volcker Rule and, in March of 2023, SVB had $15.26 billion less in unrealized losses.**

The second very significant weakening of the Volcker Rule was proposed on Feb. 28, 2020 and finalized on July 31, 2020. As pointed out in our comment letter, the new rule targeted a key part of the Dodd-Frank Volcker Rule restrictions that limited banks' investments in hedge funds, private equity, and, notably, venture capital funds, which would expose the banks to the high-risk investments and volatility of those funds. These so-called "covered funds" were largely off limits to banks like SVB, until the Fed and others weakened and removed several key limitations.

These changes were consequential for SVB, which took full advantage of them to dramatically increase its risk in a way that was directly tied to its fragility and failure. While five regulators had to agree to change the rule, the Fed was in the lead and they changed the definition of "Covered Funds" to exclude credit funds, certain venture capital funds, customer accommodation funds, and family wealth management vehicles. The exclusion of venture capital funds was due to the direct lobbying of Silicon Valley Bank, so much so that regulatory agency staff often referred to it as the "Silicon Valley Exemption."

In addition to increasing SVB's geographic and industry concentration in venture capital, these changes to the Volcker Rule contributed in the year following to SVB nearly doubling in size, driven in part from returns from investments:

> "SVB also has an incredibly powerful stream of fee income that has generated more revenue than the bank's lending business in the last four quarters. The bank has solid core fee income that encompasses most typical banking fees and then other fee income lines such as foreign exchange and credit card fees. Silicon Valley Bank also has developed a strong investment bank that specializes in the healthcare and life sciences sector

> and continues to perform well. The bank also makes a ton of money from warrants and equity investments it earns when it banks early-stage companies that most banks will not service. When some of these start-ups go public or get acquired later on, the bank cashes in on those warrants and investments. For instance, the bank sold shares that it obtained from a warrant in the crypto exchange Coinbase Global for $166 million."

There's no denying that the weakening of the Volcker Rule by the regulators—with the Fed in the lead—enabled SVB and other banks to increase their risk-taking, undermining their resilience, creating fragility, and contributing to collapse.

Fed's Deregulatory Agenda Included Many Other Rules

The Fed's deregulation rulemakings included more than a dozen rules in addition to those discussed above. They included rules weaking and lower capital for many banks, weakening stress tests, decreasing liquidity requirements, exempting large banks from crucial supervisory requirements, and weakening the substance and reducing the frequency of stress tests. The rules the Fed proposed and finalized during the Trump administration are listed in Appendix 2 with links to Better Markets' comment letters, which identify the risks and dangers of the many deregulations and weakening of supervision.

In addition to comment letters and participating in the rulemaking process, Better Markets also repeatedly detailed the risks and dangers of the deregulation being implemented at the Fed and at the other agencies. For example, these risks were spelled out as early April 10, 2018, in a law review article entitled "Financial Reform Is Working, But Deregulation That Incentivizes One-Way Bets Is Sowing the Seeds of Another Catastrophic Crash," in a presentation on "Stress Testing as a Policy Tool" at a Federal Reserve Conference in Boston, Massachusetts on July 9, 2019, in a Fact Sheet on Aug. 28, 2019 that highlighted "The Key Changes That Seriously Weaken The Volcker Rule," in a presentation on Sept. 16, 2019 to the Financial Stability Board at the Federal Reserve Bank of New York entitled "The Too Big To Fail Problem Is Alive, Well and Getting Worse," and in a White Paper issued in December of 2020, entitled "Federal Reserve Actions Under the Trump Administration Have Significantly Weakened Post-Crisis Banking Protection Rules." A selected list of these materials and more produced by Better Markets related to Powell and the Fed's deregulation actions are in Appendix 1 attached below.

Another way to understand the extent and gravity of the Powell's and Quarles' deregulation is to read the dissents of then-Fed Governor Lael Brainard. Her votes and dissents, along with her speeches and other public statements, were only the visible part of her fight against the Fed's deregulation juggernaut, as detailed in this June 2019 article: "How an Obama Fed appointee is scuttling Wall Street's bid to ease rules." Notably, because of the Fed's culture of unanimous decision making and collegiality, votes against rules—much less actual dissents—have been rare. In fact, Brainard's vote against a deregulatory rule in April 2018 was the first time a Fed governor voted against a rule in more than seven years at the time. (To a lesser extent, a similar deregulation dynamic was playing out at the FDIC where then-FDIC Director Marty Gruenberg repeatedly dissented from Chair McWilliams deregulation agenda.)

Additional Fed Supervision Failures

Having dangerously weakened the stress tests and reduced their frequency, it is still inexplicable that the Fed didn't at least include material interest rate risk in what was left of the stress tests, given it is such a longstanding, well-known and obvious risks for banks. Those failures were compounded by the Fed when it radically and rapidly changed interest rates from zero to 5% (compounding years of policies that decoupled asset pricing from underlying risks, giving rise to widespread systemic instability as detailed here and discussed here and here).

The Fed should have required supervision to send swat teams into almost every bank as soon as it was determined to implement such a major if not historic policy pivot. Remember, Powell in a very short period of time went from "we're not even thinking about thinking about raising rates" and stridently and unequivocally insisting that inflation was "transitory" to "we're going to raise rates a lot and really fast to stop skyrocketing inflation." The risks embedded in banks' balance sheets were clear and those swat teams should have been sent in the early fall of 2021 as it became clear inflation was not transitory and been completed by the end of 2021 in preparation for the move to QT and rate increases in early 2022. This isn't unfair hindsight. It should have been a no brainer at the time. Every bank has an abundance and variety of interest rate sensitive assets, and it was clear that the Fed's interest rate policy changes were going to drive the value of those assets down. Interest rate risk is ***the*** known, obvious risk.

Yes, the Fed warned the banks like they warned everyone else with their public statements, moving in effect from "transitory" to "not transitory" to "inflation is such a serious problem that the Fed is going to change policy 180 degrees." But banks have portfolios of various sizes and compositions that cannot be repositioned as quickly as the Fed can change interest rate policy. The Fed knows that which is why it's inexcusable for the Fed not to have required supervisors to review and size the scope of the ticking time bombs embedded in banks' balance sheets that they were creating before they exploded. Of course, that would not excuse the inexplicable failure to include material interest rate increases in stress tests scenarios over the years. Regrettably, this is all too consistent with the overall thrust of deregulation generally and weakening stress tests and making them less reliable in particular.

CONCLUSION

While the blame game and search for scapegoats have begun, the facts make clear that the Fed, with Chair Powell in the lead, are responsible in large part for the failure of SVB and the ongoing banking crisis. Both were avoidable, and the causes are not a mystery: once Trump took office in 2017, the financial industry was significantly unleashed, unsupervised, and unpoliced. When that happens, the industry is incentivized to take excessive risks and engage in reckless if not illegal behavior because they get to enrich themselves by gambling with other people's money. The evidence for this is objective, overwhelming, indisputable, and publicly available, including as specifically applied to SVB and the current banking crisis.

While the results of this irresponsible deregulation are only becoming visible now, they were inevitable, predictable and, indeed, predicted in detail in real time starting early in the Trump administration. Nevertheless, Powell, Quarles, and others massively deregulated the banks and gutted supervision, delivering the very banking crisis now happening in the country. Powell began this in August of 2017 even before Quarles arrived at the Fed when he pushed a proposal that weakened the use of Matters Requiring Attention ("MRA"s) and even Matters Requiring Immediate Attention ("MRIA"s), now at the center of the SVB collapse. In September 2018, they also undermined supervision at SVB and elsewhere by de facto eliminating the use of guidance, tying the hands of supervisors. Deregulating and undermining supervision from Washington DC, however, was not enough for Quarles. He traveled the country determined to ensure that the Fed's on-the-ground line-supervisors got the message to go easy on the banks and bankers, ushering in "kinder, gentler treatment" that empowered bankers at the expense of supervisors, safety and soundness, and even financial stability. Powell, Quarles, and others also gutted the Volcker Rule which enabled SVB to, among other things, increase investments in venture capital firms and sell its hedges in 2022 on $15.26 billion of its available for sale (AFS) securities for short term gains. That opened the gaping hole of unrealized and unhedged losses at SVB in March 2023, causing the collapsed and contagion that has required bailouts and inflicted widespread pain across the US.

Those are just the tip of the Powell-led Fed's deregulation juggernaut that caused this crisis. That's why if on-the-ground Fed supervisors failed at SVB or elsewhere, it's because they were set up to fail by Powell, Quarles and others who undermined them and tied their hands. Blaming others for the intended and foreseeable results of their actions would be nothing more than scapegoating much less culpable junior people for the knowing failures of the Fed's leadership. These facts also make clear why the Fed cannot investigate itself: no one working at the Fed, no matter how diligent and credible, is going to identify the current Chair as a leading cause of the collapse of SVB and the ongoing crisis no matter how overwhelming the evidence.

Of course, none of the actions or conduct of the Fed, Powell, Quarles or other personnel from the Fed or any other regulatory agency in any way absolves the members of the Board of Directors or the executives and officers of SVB for their deficient conduct, gross mismanagement, irresponsible if not reckless or illegal conduct in connection with the collapse of the bank. They, first and foremost, are responsible for what happened, and they should be held fully accountable by the Department of Justice, the SEC, shareholders, and regulators as warranted by the facts and circumstances.

APPENDIX 1

Selected Reports, Fact Sheets, and Articles Detailing the Dangers of Deregulation Throughout the Trump Administration

April 10, 2018 Law Review: "Financial Reform Is Working, But Deregulation That Incentivizes One-Way Bets Is Sowing the Seeds of Another Catastrophic Crash."

July 9, 2019 Federal Reserve Conference Presentation: "Stress Testing as a Policy Tool."

Aug. 28, 2019 Fact Sheet: "The Key Changes That Seriously Weaken The Volcker Rule."

Sept. 16, 2019 Presentation to the Financial Stability Board: "The Too Big To Fail Problem Is Alive, Well and Getting Worse."

June 24, 2020 White Paper: "No Financial Crash Yet Thanks to Dodd-Frank and Banking Reforms."

July 21, 2020 Special Report: "Then Years of Dodd-Frank and Financial Reform: Obama's Successes, Trump's Rollbacks and Future Challenges."

Sept. 15, 2020 Special Report: "The Road to Recovery: Protecting Main Street from President Trump's Dangerous Deregulation of Wall Street."

Dec. 3, 2020 White Paper: "Federal Reserve Actions Under the Trump Administration Have Significantly Weakened Post-Crisis Banking Protection Rules."

June 28, 2021 Fact Sheet: The Fed's "2021 Stress Test Results: All Bank and No Bite."

Aug. 23, 2021 Special Report: "Should Federal Reserve Chairman Jay Powell Be Reappointed?"

Oct. 26, 2021 Op Ed: "Why Jay Powell has been a 'dangerous man' at the Fed."

March 24, 2022 Report: "The Increasing Dangers of the Unregulated 'Shadow Banking' Financial Sector."

July 13, 2022: An Agenda for the Incoming Federal Reserve Vice Chair for Supervision Michael S. Barr.

Aug. 11, 2022: "The Increasing Dangers of the Unregulated 'Shadow Banking' Financial Sector: Money Market Funds."

Dec. 22, 2022 Report: "Protecting our Economy by Strengthening the US Banking System Through Higher Capital Requirements."

January 17, 2023 Report: "Federal Reserve Policies and Systemic Instability: Decoupling Asset Pricing from Underlying Risks."

March 23, 2023 Report: "The Ongoing Use and Abuse of Cost-Benefit Analysis in Financial Regulation."

APPENDIX 2

The Federal Reserve Board Rulemaking During the Trump Administration

August 9, 2017: Proposed to amend the supervisory expectations for boards of directors at financial institutions. Better Markets' comment letter. Finalized on February 26, 2021.

December 7, 2017: Proposed a trio of changes to stress testing model disclosures. Better Markets' comment letter. Finalized separately on February 28, 2019 (here and here).

April 19, 2018: Proposed rule weakening capital requirements for large banks. Better Markets' comment letter.

April 25, 2018: Proposed rule undermining stress testing requirements. Better Markets' comment letter. Finalized on March 13, 2019.

July 17, 2018: Proposed rule weakening the "Volcker Rule" ban on proprietary trading. Better Markets' comment letter. Finalized on July 22, 2019.

November 21, 2018: Proposed rule exempting many large banks from crucial supervision requirements. Better Markets' comment letter. Finalized on November 1, 2019.

December 21, 2018: Proposed rule lowering capital requirements for many banks. Better Markets comment letter. Finalized on November 1, 2019.

January 8, 2019: Proposed rule unnecessarily reducing the frequency of stress tests. Better Markets' comment letter. Finalized here and here.

April 4, 2019: Proposed rule relating to total loss absorbing capacity of large banks. Better Markets' comment letter. Finalized on January 6, 2021.

March 15, 2019: Proposed rule lowering supervision requirements for foreign banks. Better Markets' comment letter. Finalized on November 1, 2019.

March 24, 2019: Proposed rule weakening capital requirements for large banks. Better Markets' comment letter. Finalized on November 1, 2019.

November 7, 2019: Proposed rule eliminating important margin requirements on inter-affiliate swaps. Better Markets comment letter. Finalized on July 1, 2020.

February 28, 2020: Proposed rule further weakening the "Volcker rule" ban on proprietary trading. Better Markets' comment letter. Finalized on July 31, 2020.

March 20, 2020: Interim final rule making it easier for banks to continue to pay dividends during the height of the Covid-19 pandemic. Better Markets' comment letter. Finalized on October 8, 2020.

March 23, 2020: Interim final rule once again bailing out money market funds. Better Markets' comment letter. Finalized on October 28, 2020.

May 11, 2020: Rule finalizing the decision to enable bank dividends during the Covid-19 pandemic. Better Markets' comment letter. Finalized on October 8, 2020.

July 16, 2020: Rule on "Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks." Interim final rule.

October 7, 2020: Proposed rule on "Amendments to Capital Planning and Stress Testing Requirements for Large Bank Holding Companies, Intermediate Holding Companies and Savings and Loan Holding Companies." Better Markets' comment letter. Finalized on February 3, 2021.

October 15, 2020: Proposed rule on "Rules Regarding Availability of Information." Better Markets' comment letter. Finalized on April 9, 2021.

November 5, 2020: Proposed rule on "Role of Supervisory Guidance." Better Markets' comment letter. Finalized on April 8, 2021.

January 12, 2021: Proposed rule on "Computer-Security Incident Notification Requirements for Banking Organizations and Their Bank Service Providers." Finalized on November 23, 2021.

APPENDIX 3

Silicon Valley Bank's Use of the Fed-Weakened Volcker Rule to Eliminate AFS Hedges for Short Term Gains

The activities engaged in by Silicon Valley Bank (SVB) with respect to their management of US Treasury and agency securities would need to comply with liquidity management requirements of the Volcker Rule. As originally written in 2013, the Volcker Rule had specific requirements that must be followed for liquidity management activities to be excluded from the prohibition on proprietary trading. The following is an excerpt from the preamble of the original Volcker Rule that explains these requirements (italics and bold highlights are added for emphasis and were not in the original text):

> After carefully reviewing the comments received, the Agencies have adopted the proposed exclusion for liquidity management with several important modifications. As limited below, liquidity management activity serves the important prudential purpose, recognized in other provisions of the Dodd-Frank Act and in rules and guidance of the Agencies, of *ensuring banking entities have sufficient liquidity to manage their short-term liquidity needs*.
>
> To ensure that this exclusion is not misused for the purpose of proprietary trading, the final rule imposes a number of requirements. First, the liquidity management plan of the banking entity must be limited to securities (in keeping with the liquidity management requirements proposed by the Federal banking agencies) and specifically contemplate and authorize the particular securities to be used for liquidity management purposes; describe the amount, types, and risks of securities that are consistent with the entity's liquidity management; and the liquidity circumstances in which the particular securities may or must be used. **Second, any purchase or sale of securities contemplated and authorized by the plan must be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, *benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits*, or hedging a position taken for such short-term purposes.** Third, the plan must require that any securities purchased or sold for liquidity management purposes be highly liquid and limited to instruments the market, credit and other risks of which the banking entity **does not reasonably expect to give rise to appreciable profits or losses as a result of short-term price movements. Fourth, the plan must limit any securities purchased or sold for liquidity management purposes to an amount that is *consistent with the banking entity's near-term funding needs***, including deviations from normal operations of the banking entity or any affiliate thereof, as estimated and documented pursuant to methods specified in the plan. Fifth, the banking entity must incorporate into its compliance program internal controls, analysis and independent testing designed to ensure that activities undertaken for liquidity management purposes are conducted in accordance with the requirements of the final rule and the entity's liquidity management plan. Finally, the plan must be consistent with the supervisory requirements, guidance and expectations regarding liquidity management of the Agency responsible for regulating the banking entity.
>
> The final rule retains the provision that the financial instruments purchased and sold as part of a liquidity management plan be highly liquid and ***not reasonably expected to give rise to***

appreciable profits or losses as a result of short-term price movements. This requirement is consistent with the Agencies' expectation for liquidity management plans in the supervisory context. It is not intended to prevent firms from recognizing profits (or losses) on instruments purchased and sold for liquidity management purposes. Instead, ***this requirement is intended to underscore that the purpose of these transactions must be liquidity management.*** Thus, the timing of purchases and sales, the types and duration of positions taken and the incentives provided to managers of these ***purchases and sales must all indicate that managing liquidity, and not taking short-term profits (or limiting short-term losses)***, is the purpose of these activities.

The exclusion as adopted does not apply to activities undertaken with the stated purpose or effect of hedging aggregate risks incurred by the banking entity or its affiliates related to asset liability mismatches or other general market risks to which the entity or affiliates may be exposed. **Further, the exclusion does not apply to any trading activities that expose banking entities to substantial risk from fluctuations in market values, unrelated to the management of near-term funding needs, regardless of the stated purpose of the activities.**

Robin Wigglesworth in a Financial Times's FT Alphaville article titled "How crazy was Silicon Valley Bank's zero-hedge strategy?" outlined the activities that SVB undertook with respect to the assets it held for liquidity management purposes:

The first thing to remember is that SVB's bond portfolio was basically in two different accounting buckets. At the end of 2022 it held $91.3bn in a "held-to-maturity" portfolio — bonds you plan to hold on to until they are repaid — and $26.1bn in an "available-for-sale" portfolio, which is marked to market.

***

Because of rising rates the *actual* market value of the HTM portfolio was about $76bn at the end of 2022, according to someone who has seen the details of the portfolio and shared them with FTAV — an unrealised loss of $15.1bn.

Yes, SVB didn't have any hedges on this bit. But doing so would arguably be nonsensical. Remember, the entire HTM portfolio is held at par, but the value of the hedge would obviously fluctuate with the market.

So if rates rise then a bank makes money on the hedge, but the bonds stay at par. If rates fall then they lose money on the hedge, but they can shift bonds from HTM to AfS and sell them at the higher price. That means it basically becomes a directional bet on interest rates that flows straight into the income statement, something that most banks abhor.

***

The AfS bucket is definitely where most self-respecting banks lugging around a big portfolio of bonds will hedge their interest rate risk. Otherwise, the income statement would bounce around according to whatever the market does from one quarter to the next. SVB seems to have been aware of danger. Here's what CFO Daniel Beck told analysts in early 2021:

"We're certainly positioning at this point for the potential for higher rates. So in the quarter, we put on close to $10 billion worth of swaps on that available-for-sale portfolio. And we're going to continue to do more to protect against that, to mitigate the impact of potential further rate movement."

And at the end of 2021, SVB's financial accounts indicate that on the AfS side it held $15.26bn of interest rate swaps to hedge against the impact of rising rates on its big bond portfolio. So, what happened?

Well, it looks that weakening profitability in 2022 as the tech world made SVB do something really dumb. **In the first quarter, it unwound $5bn of AFS hedges to book a $204mn gain, and in the second quarter it dumped another $6bn of hedges to lock in a $313mn gain.**

Or as the bank put it in a July 2022 presentation to investors, it was "shifting focus to managing downrate sensitivity". (H/T the FT's Antoine Gara for the below slide):

You can see the shift here in SVB's 2022 annual report. **By the end of last year it only had $563mn worth of hedges left on its books....**

As the FT Alphaville article shows, SVB clearly sold the swaps hedging its AFS position to lock in short-term gains that arose from the Fed's increase in interest rates. ***<u>This action appears contrary to the original Volcker Rule</u>*** which required (as quoted at length above) that the

"sale of securities contemplated and authorized by the plan must be principally for the purpose of managing the liquidity of the banking entity, and not for the purpose of short-term resale, *benefitting from actual or expected short-term price movements, realizing short-term arbitrage profits*, or hedging a position taken for such short-term purposes."

Importantly, the original Volcker Rule would not likely have precluded SVB from selling its swap positions held for hedging their AFS portfolio. However, SVB would have had significant hurdles to show that selling only the hedge was necessary for prudent liquidity management. In most likelihood, SVB would have had to have taken one of these possible actions:

(a) Sell the AFS portfolio along with the AFS hedge positions, or
(b) Sell a portion of both the AFS portfolio along with a portion of the AFS hedge positions in a proportionate manner that kept the remaining AFS portfolio hedged while generating necessary *liquidity for SVB.*

But, neither of these actions would likely have generated significant net gains to increase SVB's earnings, which appears to have been the motive for selling the hedges.

That was only allowed because of the 2020 weakening of the Volcker Rule, which significantly modified the definition of the trading account. That radically narrowed the scope of the Volcker Rule. Under the Dodd-Frank law, ***proprietary trading*** is defined as engaging as principal for the trading account of the banking entity in any purchase or sale of one or more financial instruments.

In the original Volcker Rule, the "trading account" was defined broadly to cover as much of a bank's securities activities as possible. For example, when a bank may have an account defined as "trading" under GAAP, GAAP does not preclude a bank from buying and selling securities through other accounts. Indeed, banks often buy and sell securities through their AFS account or the account for equity securities with readily determinable fair value.

However, in 2020, the scope of the Volcker Rule proprietary trading ban was effectively narrowed to just a portion of the trading book to which the market risk capital rule applies. Section 351.3 (when read its entirety) allows a bank to limit application of the proprietary trading ban to the operative portion of Section 351.3(b)(ii):

> "Any account that is used by a banking entity to purchase or sell one or more financial instruments that are **both** market risk capital rule covered positions **and** trading positions (or hedges of other market risk capital rule covered positions)...."

As such, SVB's AFS positions, including the swaps hedging the AFS position, were excluded from the definition of proprietary trading once the Fed-led regulators weakened the Volcker Rule in 2020.

BETTER MARKETS

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Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

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For press inquiries, please contact us at press@bettermarkets.com or (202) 618-6430.

1825 K Street, NW | Suite 1080 | Washington, DC 20006 | 202-618-6464 | www.bettermarkets.org

LETTER SUBMITTED BY CUNA

Credit Union National Association
CUNA

Jim Nussle
President & CEO

Phone: 202-508-6745
jnussle@cuna.coop

99 M Street SE
Suite 300
Washington, DC 20003-3799

March 28, 2023

The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20515

The Honorable Tim Scott
Ranking Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, DC 20515

Dear Chairman Brown and Ranking Member Scott,

On behalf of America's credit unions, I am writing regarding your committee's hearing on the failure of Silicon Valley Bank (SVB) and Signature Bank. The Credit Union National Association (CUNA) represents America's credit unions and their more than 130 million members.

While much remains to be discovered regarding the causes of the collapse of SVB—and we hope this hearing today uncovers more information—we can be clear on this: our community-focused credit unions did not cause the collapse of one of the largest regional banks in the country, and should not face more federal regulation or increased fees due to these banks' actions. Risks borne by the banks should not be paid for by credit unions that serve communities across our country.

With more than 91% of credit union deposits insured,[1] credit unions remain stable, safe and secure during this time of uncertainty in the banking sector. The credit union difference makes us stronger by helping improve the financial well-being of Americans nationwide. Credit unions are member-owned, not-for-profit financial cooperatives that put our members ahead of the bottom line. Credit union members have equal ownership and voting rights, so we focus on what helps our members most versus the demands of outside stockholders. Finally, the majority of credit union deposits are insured by the National Credit Union Administration (NCUA) up to $250,000 per individual depositor—the same level as any federally insured financial institution.[2]

Central Liquidity Facility Enhancements

With uncertain times ahead, we remain alert to potential reverberations caused by SVB's collapse to our smallest credit unions. CUNA strongly encourages the committee to examine the lapsed enhancements to the Central Liquidity Facility, which expired at the end of 2022 as part of the CARES Act. One such enhancement allowed the over 3,600 credit unions across the country with assets under $250 million to use their corporate credit union to access liquidity on their behalf. For the thousands of small credit unions with limited resources, this agent enhancement would streamline and expedite the process considerably if unexpected liquidity needs arise.

Bipartisan legislation to extend this enhancement for three years has already been introduced in the Senate by Senators Padilla (D-CA) and Cramer (R-ND). We strongly encourage the committee to quickly hold a mark-up on this legislation to help small credit unions under $250 million in assets access liquidity more easily. This would provide much-needed confidence for our small financial institutions—at no cost to taxpayers.

[1] National Credit Union Administration.
[2] With the exception of a relatively small number of credit unions that opt for private deposit insurance, regulated by state financial regulators and disclosed to their members.

Exclusion of Privately Insured Credit Unions

While most credit unions are federally insured by the NCUA, over 100 state-chartered credit unions in 10 states around the country are privately insured. Unfortunately, privately insured credit unions have been unable to access the Federal Reserve's Bank Term Funding Program (BTFP) because the Federal Reserve has decided to limit it to federally insured credit unions. Privately insured credit unions range in size from under $1 million to over $1.5 billion in total assets and are well-governed financial institutions with over 93.5% of privately insured credit unions having a CAMELS score of 1 or 2.

Privately insured credit unions are state-chartered, state-regulated and subject to the same regulatory requirements as are state-chartered, federally insured credit unions in their respective states. In all aspects, privately insured credit unions are regulated like all other state-chartered credit unions, except they are not federally insured.

CUNA strongly encourages the Federal Reserve to allow all credit unions, regardless of the source of their deposit insurance, to access the BTFP and asks that the committee bring up this important issue with Vice Chair Barr in the hearing today. Privately insured credit unions have historically been included in government liquidity programs and their exclusion in this instance is a significant shift in government policy regarding access to liquidity.

On behalf of America's credit unions and their more than 130 million members, thank you for considering our views.

Sincerely,

Jim Nussle
President & CEO

LETTER SUBMITTED BY NAFCU

NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

March 27, 2023

The Honorable Sherrod Brown
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Tim Scott
Ranking Member
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

Re: Tomorrow's Hearing: "Recent Bank Failures and the Federal Regulatory Response"

Dear Chairman Brown and Ranking Member Scott:

I write today on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) in conjunction with tomorrow's hearing, "Recent Bank Failures and the Federal Regulatory Response." NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 135 million consumers with personal and small business financial service products. NAFCU appreciates the Committee's ongoing oversight of this matter.

The credit union industry remains a strong, well capitalized, and safe place for consumers. As not-for-profit, member-owned cooperatives, credit unions' focus is on service to their members, not chasing profits. Unlike the banking system where roughly 50 percent of deposits were uninsured by the Federal Deposit Insurance Corporation (FDIC) before the recent failures, nearly 90 percent of credit union deposits are insured by the National Credit Union Administration (NCUA) and its National Credit Union Share Insurance Fund (NCUSIF). Even though the insurer is different, the coverage levels from the NCUSIF are the same as for the banks and the FDIC – an important element to ensure consumer confidence in the system.

In addition, credit unions have access to the full array of liquidity options, including Federal Home Loan Banks, the Federal Reserve discount window, the new temporary Bank Term Funding Program, and the NCUA's Central Liquidity Facility.

Credit unions have not seen runs on their deposits like some banks because of the relationship they have with their members – who know their money is safe at their credit union. That is the credit union difference. Our industry prioritizes members' financial well-being over profits. Credit unions do not make risky investments that could undermine their institution or harm their members; they invest in the programs and products that strengthen them.

While we are not advocating for changes for coverage limits for the NCUSIF at this time, any changes to FDIC coverage levels must include parity in coverage levels for the NCUSIF while not changing the tried and tested structure, funding, and operations of the NCUSIF. We urge you to ensure that problems from a few banks do not create new burdens for well-run credit unions in an effort to respond to this recent situation.

Credit unions are proud that no one has ever lost a penny due to a failure of an insured credit union. The credit union system remains safe and strong and ready to serve the American consumer. We appreciate your leadership and focus on this important topic and look forward to working with you on it. Should you have any questions or require any additional information, please do not hesitate to contact me or Lewis Plush, NAFCU's Senior Associate Director of Legislative Affairs, at 703-842-2261.

Sincerely,

Brad Thaler

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the Senate Committee on Banking, Housing, and Urban Affairs