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Supervision and Regulation after Silicon Valley Bank

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Last spring, we witnessed the failures of three mid-sized banks: Silicon Valley (SVB), Signature (SBNY), and First Republic (FRBC). Though representing a fairly small part of the banking system, two of these three failures were deemed "systemic" by federal regulators, and all have engendered considerable public debate and concern about the safety of bank deposits and overall stability of the banking system. A group of senior advisors to the Center for Financial Stability undertook an assessment of the root causes of these failures, with a particular focus on SVB. We also assessed the pros and cons of various proposals for reform. We evaluated the role of monetary and fiscal policies, management failures, supervisory and regulatory lapses, as well as the banks' high reliance on "runnable" liabilities in the form of uninsured deposits. This effort culminated in the preparation of two papers: one dealing with fiscal and monetary policies, and this one focusing on bank management, supervision and regulation. **We are encouraged that both Vice-Chair for Supervision Michael Barr[1] and Governor Michelle Bowman[2] have suggested that third party reviews would be welcome.**

The group represents a wide array of backgrounds in government, academia, and industry and a full range of policy views. While there were differences of opinions on some specific proposals, there was also strong consensus on the main drivers of the failures and key issues related to proffered reforms.

General Observations

Monetary and fiscal policies have combined to create significant challenges for banks and their supervisors to ensure that risks associated with rapidly rising interest rates are properly managed – as discussed in our complementary paper.[3]

Since the completion of our work, various reviews of supervisory weaknesses associated with these failures have been generally consistent with the conclusions of our group.[4,5]

[1] Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank, Board of Governors of the Federal Reserve System, April 28, 2023.

[2] Michelle W. Bowman, Responsive and Responsible Bank Regulation and Supervision, Board of Governors of the Federal Reserve System, The Salzburg Global Seminar, June 25, 2023.

[3] Sheila Bair et al., The Role of Monetary and Fiscal Policies in Recent Bank Failures, Center for Financial Stability, October 16, 2023.

[4] Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank, Board of Governors of the Federal Reserve System, April 28, 2023.

[5] Material Loss Review of Silicon Valley Bank: Evaluation Report, Office of Inspector General, Board of Governors of the Federal Reserve System, September 25, 2023.

Regrettably, little has been done to meaningfully address those weaknesses. Capital and liquidity stress tests continue to treat government securities as risk-free and highly liquid. Uninsured deposits remain vulnerable to runs. As it becomes apparent that the Federal Reserve will need to maintain a "higher for longer" interest rate stance, pressure on banks' funding costs and net interest margins will intensify, increasing the risk of more bank failures. Regulators have proposed massive changes to capital requirements, known as the "Basel III End Game," but these primarily address issues stemming from the Great Financial Crisis (GFC), not current bank turmoil. **Whatever the merit of these proposals, the more urgent need is to address the very real risk of future bank failures and their impact on system stability.** Surprisingly, **none of the Federal Reserve's own assessments of SVB's failure even mention the role of monetary policy. Until regulators fully acknowledge the impact tightening monetary conditions are having on banking stress, they will be ill-equipped to navigate the rocky road ahead.**

Clearly, the managements of these three recently failed institutions were not up to the challenge, and regrettably, the supervisory process did not require prompt remediation of their failures in basic risk management in time to avert the banks' collapse. Much of the ensuing debate has focused on whether the failures could have been prevented if more stringent, "enhanced" prudential standards (EPS) had applied to them, similar to those applied to the largest institutions. While people of good can and will differ on the extent to which supervisory approaches should be adjusted based on the size and complexity of an institution, enhanced standards should not have been needed for supervisors to catch and remediate the fundamental mismanagement of these banks which violated basic "Banking 101" principles of asset and liquidity management. This is particularly true given the classic red flags presented by all of them: rapid growth fueled by a highly unstable deposit base. **As discussed below, while targeted reforms may be worth considering, wholesale changes to the prudential framework applicable to regional banks do not appear to be warranted and would only distract policy makers from the more urgent need to determine why the rules and processes that we already in have place — which should have been sufficient— weren't.**

Before layering on a host of new rules, bank regulators should fix problems imbedded in the current system. These include a lack of sufficient attention by supervisors and monetary policy makers to the interplay of bank stability with monetary tightening; a lack of sufficient agility and empowerment among bank examiners; capital and liquidity regulations which treat government backed securities as essentially risk free, regardless of duration; and lack of sufficient disincentives for banks to rely excessively on uninsured depositors with correlated behaviors. Steps to improve banks' access to stable liquidity should also be considered. This could be done, for instance, by expanding deposit insurance for business transaction accounts and giving banks the ability to pre-position collateral with the Federal Reserve for immediate access to central bank loans if and when needed.

The Role of Bank Management

The management of these three banks has been broadly criticized, with particular focus on Silicon Valley Bank (see Figure 1). All three relied heavily on uninsured depositors with correlated behaviors, and made little apparent effort to diversify their deposit base or attract more stable insured deposits. **All three grew rapidly, without basic risk controls, and all three failed to adequately hedge their interest rate risk, even as they increased their exposure to long-dated, low yielding assets (see Figure 2).** Such fundamental errors and missteps inevitably raise the question of whether bank executives are adequately incentivized to manage and contain risks, and whether there is more policy makers can and should do.

Figure 1. No Chief Risk Officer (CRO) for Eight Months

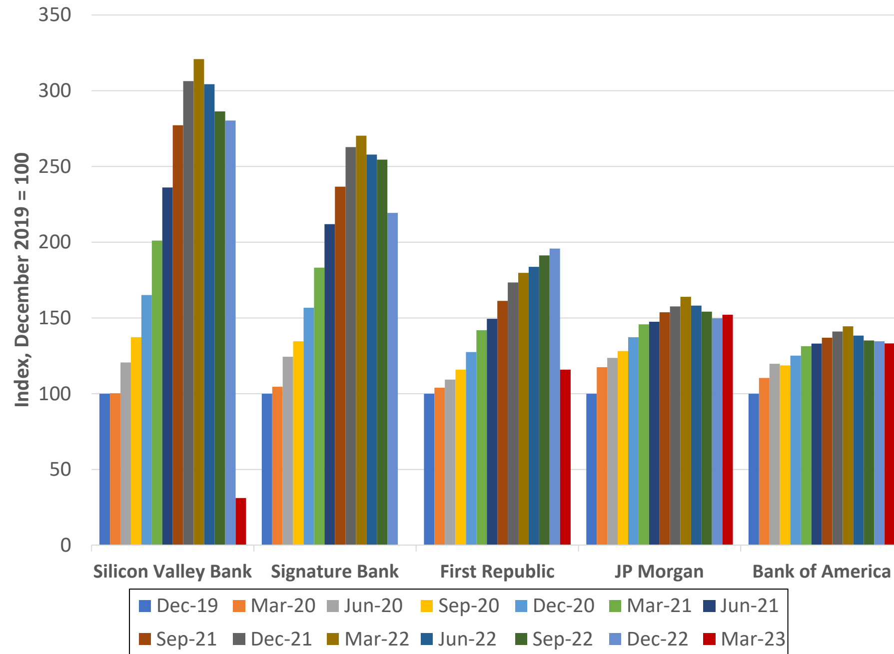
- Former CRO Laura Izurieta was employed by SVB from 2017 to April 2022 (stepped down), and departed on 10/1/22.
- Feb 2022, SVB notified its intention to terminate Izurieta's employment in April 2022 to the California Dept of Financial Protection and Innovation, but did not inform DFPI that Izurieta remained at SVB in a transition role until October.
- In the interim, SVB established an office of the CRO to perform the CRO function by committee.
- The Risk Committee on the SVB Board of Directors met 18 times in 2022, compared to 7 meetings in 2021. The Board of Directors assigned 7 directors, including CEO & President Becker, to its Risk Committee. The other 5 committees of the Board have 5 directors each.
- Kim Olson was hired in December 2022, publicly appointed as the new CRO on 1/4/23, and remained in that position until SVB's failure.

Source: Center for Financial Stability.

The group was highly supportive of bipartisan efforts to strengthen executive compensation clawbacks when a bank fails. (The Dodd-Frank Act already gives the FDIC authority to claw back up to two years of past compensation when a large, systemic institution fails.) Greater financial liability for bank executives should improve incentives for them to make prudent decisions. If a bank fails, clawbacks also shift some of the costs back to the responsible parties. Bank failures can impose significant losses on shareholders, unsecured debt holders, uninsured depositors, with the greatest losses typically falling upon the Federal Deposit Insurance Corporation. Fairness demands that responsible executive insiders share in the financial pain. Such an approach is rooted in history. Indeed, unlimited liability was the norm for bank executives during much of the 19th century and did not seem to deter individuals from entering the banking profession.[6]

[6] CAE Goodhart and RM Lastra, "Equity Finance: Matching Liability to Power," Journal of Financial Regulation, Volume 6, Issue 1, 20 March 2020, Pages 1–40.

Figure 2. Bank Deposits at Three Regionals and Two Money Center Banks



Source: Bloomberg and Center for Financial Stability.

While the group strongly supported increased management accountability, it also recognized that banks can fail for reasons other than mismanagement. In addition, those in charge when a bank fails may not be culpable- they may have been hired to correct the mistakes of their predecessors. As a consequence, we also agreed that some due process should be available to protect executives who were not responsible for the bank's failure.

The Role of Bank Supervision

The primary federal regulator for Silicon Valley Bank was the Federal Reserve. The FDIC was the primary federal regulator of Signature Bank and First Republic. Both agencies are to be commended for quickly undertaking self-assessments of supervisory gaps and missteps which contributed to these failures.

The group felt sympathy for supervisors, who are given no public credit when they do catch and remediate problems at banks given the confidential nature of the supervisory process, but are widely criticized when banks fail. However, we also felt supervisors should have placed greater focus on the financial instability implications of monetary and fiscal policy. The supervisory process, in general, does not seem sufficiently attuned to risks associated with rising interest rates. It is particularly troubling that the Federal Reserves' most recent supervision and regulation reports say virtually nothing about interest rate risk. It is also troubling that in the Fed's annual Comprehensive Capital Analysis and Review (CCAR), high stress, high interest rate scenarios are not included. While the Fed has argued that it conducts nonpublic interest rate risk stress tests, the public CCAR is the primary tool for determining large banks' resilience in severely adverse economic conditions. Moreover, interest rate and

liquidity risk need to be integrated into any assessment of a bank's capital adequacy. As we saw with these recent failures, if an illiquid bank is forced to sell underwater securities to meet deposit withdrawals, the attendant losses will quickly deplete capital. Regulators need to take a holistic approach when it comes to capital and liquidity oversight. Clearly the public needs to know whether the largest banks can remain stable and resilient if we enter a recession but inflation and interest rates remain high.

Examiners did not place sufficient urgency on remediating weaknesses in interest rate and liquidity even after they were identified at both institutions. This reflects a larger cultural issue around the need for greater agility in the supervisory process. Instead of being encouraged to adapt to current conditions and emerging risks, bank examiners are too often laden with backward looking check lists, bureaucracy, and cumbersome layers of review. They should be encouraged to focus on major problems that heighten the risk of bank failures, but instead frequently feel obliged to identify scores of "matters requiring attention" (MRAs) and "matters requiring immediate attention (MRIAs) which can number into the hundreds at the largest institutions. At Silicon Valley Bank, on the date of its failure, it had 32 MRAs and MRIAs, few of which dealt with real financial risks, even as those matters relating to interest rate risk languished, unaddressed (see Appendix 1).

The process of remediation also needs to be faster and less cumbersome. When problems are not timely remediated, examiners should have the ability to quickly escalate approval of enforcement actions with their higher-ups. Where bank management resists remediation, the use of daily fines or other mitigants such as restrictions on bonus pay and shareholder distributions, should be swiftly imposed. Just as bank executives need to be held accountable, the heads of supervision also need to be accountable for bank failures that could have been prevented with more effective oversight. It is their job to ensure examiners are adequately trained, staffed, and empowered to take timely, decisive action.

As discussed in more detail below, the failure of SVB has revived debate over whether the Federal Reserve should be a bank supervisor. But no organizational structure will be effective without well-trained examiners who are encouraged to be agile, adaptive, and focused on the big issues, as well as empowered to take swift action to secure remediation. We do not support removal of supervision from the Fed. The UK took that approach with the creation of the Financial Services Authority and concluded it was a mistake. It led to weaker bank oversight, while denying the Bank of England important information about emerging issues and problems in the financial sector. We do believe consideration should be given to creating a separate financial policy committee at the Fed with responsibility for regulation and supervision. This committee should have interlocking memberships and equal stature with a newly constituted monetary policy committee which would be responsible for the conduct of monetary policy. . This would elevate supervisory issues at the Fed, while ensuring improved coordination and awareness of the connections between monetary policy and financial stability, and decision-making that reflects those connections.

The Role of Capital and Liquidity Regulation

Current regulations treat government issued securities as zero risk and highly liquid. Securities implicitly backed by the government, such as debt and mortgage-backed securities issued by Government Sponsored Entities (GSEs) also receive highly favorable treatment under the capital and liquidity rules. This favorable treatment extends regardless of maturity, even though those instruments can be highly risky when interest rates rise.

Unrealized market losses on securities do not need to be deducted from banks' regulatory capital if a bank places them in its "hold to maturity" or HTM portfolio. For securities held as available for sale (AFS), banks over $700 billion must reflect unrealized losses or gains in their regulatory capital. Banks less than $700 billion have the option of not marking gains or losses against their capital. This treatment differs from Europe, where authorities follow the Basel international capital framework and require banks to mark unrealized gains or losses in AFS portfolios against regulatory capital.

Much of the regulatory debate surrounding these three failed banks relates to whether they should have been required to deduct unrealized losses on their AFS investments. Michael Barr, Vice-Chair of Supervision at the Federal Reserve, has suggested that banks above $100 billion should be required to do so. Studies suggest that this would not have prevented the failures, as most of the failed banks' market losses were concentrated in their HTM portfolios. However, they also show that SVB would have been required to maintain higher levels of capital which, while not preventing SVB's failure, could have reduced the FDIC's losses when it failed.

It is important to note that the treatment of unrealized losses on AFS investments is a longstanding issue, dating back to 2012, when US regulators first proposed that banking organizations recognize unrealized gains and losses on AFS securities in their regulatory capital. This was pursuant to a larger set of banking reforms agreed to by the Basel Committee, in response to the 2008/2009 financial crisis. In the US, the proposal was met with a firestorm of controversy with opponents arguing such a change would introduce considerable volatility into bank capital levels, and result in reduced liquidity as banks would shift much of their AFS portfolios into HTM. This would make banks less liquid as they could not sell them to raise cash without severe accounting consequences. Because of these concerns, the final rules only applied to banks with assets greater than $250 billion or internationally active banks with more than $10 billion in foreign exposures. As predicted, these larger banks responded by shifting much of their AFS holdings to HTM.[7] In 2019, the threshold was raised to banks with $700 billion in assets or $75 billion in foreign exposures (see Figure 3).

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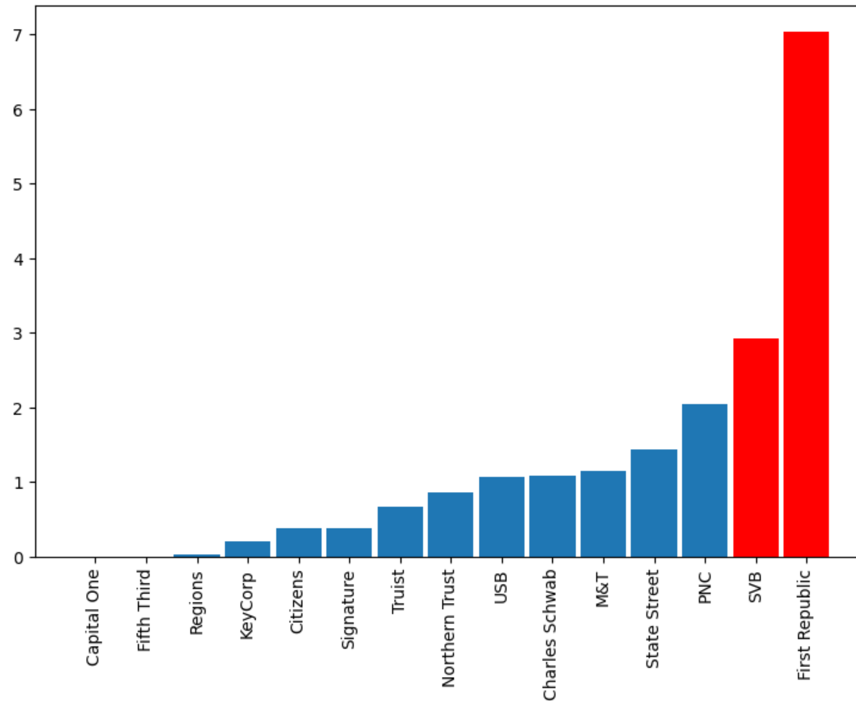
[7] Andreas Fuster and James Vickery, What Happens When Regulatory Capital Is Marked to Market?, Liberty Street Economics, Federal Reserve Bank of New York, October 11, 2018.

Figure 3. Bank Investment and Accounting Election:
Ratio of HTM to AFS Securities (12/31/22, Fair Value Basis)



Source: Financial Statements of Companies and Center for Financial Stability.

Proponents of now lowering the threshold to $100 billion in assets argue that it would increase transparency and better reflect a banks' true capital strength. They also point out that such a change would bring the US into greater alignment with international agreements to which it was a part. **Our group had differing views on this issue, but there was general consensus that bank auditors and supervisors need to limit HTM treatment where a bank relies on unstable funding. The test for HTM treatment is that the bank must have both the intent and ability to hold those securities to maturity. A bank such as SVB that was heavily reliant on uninsured depositors with highly correlated behaviors should not have passed the "ability" test.**

The group also differed on whether the liquidity coverage ratio (LCR) should apply to a broader range of banks. The LCR requires that banks hold a sufficient amount of "high quality liquid assets" or "HQLA" to manage net cash outflows over a 30 day stress scenario. Currently, it does not apply to banks with less than $250 billion in assets. Research is conflicting as to whether SVB would have passed the LCR test if it had applied to the bank.[8,9] Application of the LCR would likely have improved SVB's liquidity position, but it would not have prevented SVB's failure. This is because the LCR does not distinguish between short-and long-dated securities or between securities with unrealized market losses and those trading at par. Expanding

[8] Greg Feldberg, Lessons from Applying the Liquidity Coverage Ratio to Silicon Valley Bank, Yale Program on Financial Stability, March 27, 2023.
[9] Bill Nelson, Silicon Valley Bank Would Have Passed The Liquidity Coverage Ratio Requirement, Bank Policy Institute, March 14, 2023.

application of the LCR, or simply requiring that banks hold more HQLA against uninsured deposits will not address this fundamental flaw. Instead of focusing on the amount of HQLA, it would be better for regulators to focus on what counts as HQLA. For instance, there could be a penalty for any under-water assets that cannot be sold without a loss, duration caps on what counts as HQLA, or permitting only short-duration assets to count as HQLA against unstable uninsured deposits.

The Role of Uninsured Deposits

All of the banks that failed were exceptionally reliant on uninsured deposits and all were subject to substantial "uninsured" runs which contributed to their failures. As noted above, the growth of uninsured deposits has been fueled by monetary and fiscal policies that have pumped trillions into the economy – much of which inevitably flowed into bank deposits.

Though the problem of excess deposits is symptomatic of massive government stimulus in response to the Covid 19 pandemic, there is nothing new or idiosyncratic about uninsured deposit runs. While FDIC-insured deposits have proven highly stable over time, in periods of financial turmoil, uninsured deposits tend to migrate to larger, "too big to fail" TBTF institutions or other venues viewed as safer by depositors such as government money market funds. Uninsured deposit migration from smaller banks to TBTF banks was a significant problem during the Great Financial Crisis and the reason why the FDIC, working with the Fed and Treasury Department, invoked special emergency authorities to provide a temporary unlimited guarantee on transaction accounts used by small businesses, nonprofits and other organizations to receive and make payments, including employee payroll. By their very nature, these accounts almost always exceed deposit insurance caps. Yet, these transaction accounts are the lifeblood of regional and community banks whose core business is to serve the banking and credit needs of small and medium sized organizations.

Much has been written about the role of social media in spurring uninsured deposit runs. But the internet has been with us for a long time, as has the opportunity to quickly spread misinformation about a bank. Though social media posts by SVB depositors announcing their deposit withdrawals contributed to the bank run, it seems the bigger problem was the close knit nature of the VC community. At SVB, 94% of deposits were uninsured at the end of 2022, with the vast majority held by a core group of venture capitalists and their portfolio companies. With or without Twitter, word was going to spread quickly. This suggests that supervisors need to put greater emphasis on depositor diversification, just as they now focus on asset diversification as a risk management tool. Heavy reliance on uninsured depositors who are concentrated in particular industry sectors increase run risk. At a minimum, the FDIC should treat this kind of deposit base as higher risk and charge significantly higher deposit premiums. In addition, the FDIC should reassess its assumptions around the stability of uninsured deposits given the speed with which negative information can travel through social media and consider increasing deposit insurance premiums for banks excessively reliant on them, even if the depositor base is diversified.

Much has also been written about technological advances making it easier to withdraw money quickly. But here again, electronic deposit withdrawals have been available for decades. Indeed, they were a big factor in the near collapse and bailout of Continental Illinois in 1984. In any event, there is no turning back the clock. The ability of depositors to more quickly and easily withdraw their funds only underscores the need for banks to maintain strong balance sheets and be transparent about their capital strength.

The resurgence of uninsured deposit runs has led to calls for universal deposit insurance. The group was skeptical of the need and wisdom for unlimited coverage for bank depositors. This would certainly solve the problem of runs, but would also completely eliminate any incentive for large, sophisticated depositors to monitor bank health. Weak banks could game such an unlimited guarantee by offering high rates to induce large depositors to place their money with them. An unlimited guarantee would primarily benefit the wealthy as the current limit of $250,000 is more than ample for the average American household. Finally, an unlimited guarantee could distort capital flows, likely drawing funds away from short-term Treasuries and money market funds.

A more limited approach- and one discussed favorably in a recent FDIC report[10] would significantly increase deposit caps for business transaction accounts. This would help ensure that when a bank fails, business depositors would continue to have access to the money they need to make payroll and meet other operational expenses, limiting disruptions to the real economy. Such an approach would also strengthen the community and regional bank sectors, which the group agrees is essential to the credit needs of small and medium sized organizations. It would help prevent migration of this business to the so-called TBTF banks, thus mitigating increased concentrations in the largest banks which have already seen substantial deposit inflows in the wake of recent failures.

In addition to more generous deposit insurance coverage, **there are other ways to improve banks liquidity position and ease concerns of uninsured depositors which should be considered:**

Rethinking Central Bank Liquidity: The Federal Reserve currently discourages banks from relying on Fed lending facilities to manage liquidity. Banks get no credit for their borrowing capacity in evaluating the resilience of their liquidity position. The Fed understandably wants banks to maintain liquidity independent of its "last resort" backstop. However, in reality, in times of stress, the Fed may be one of the few, reliable liquidity providers. Yet, if banks have pledged their collateral elsewhere, they will be unable to borrow from the Fed if they suffer a deposit run. As a practical matter, many banks have turned to the Federal Home Loan Bank system to access liquidity, displacing the Fed in its core function as lender of last resort. This is an inappropriate use of the FHLB system which is less disciplined than the Fed and less inclined to coordinate with the FDIC when a bank is on the brink. Instead, the Fed should allow, if not require banks with large uninsured deposits, to preposition collateral with it which they could

[10] Options for Deposit Insurance Reform, Federal Deposit Insurance Corporation, May 1, 2023.

use to tap Fed liquidity immediately in the event of an uninsured deposit run. Knowing that this liquidity backstop is in place could re-assure uninsured depositors that they are protected and reduce the risk of runs in the first place.[11]

Minimum Levels of Long-Term Debt Issuance: Another way to re-assure uninsured depositors while promoting market discipline would be to require banks above $100 billion to issue a certain minimum amount of unsecured, long-term debt. Long-term debt is a highly stable source of bank funding. If readily convertible to equity, it can help prevent bank failures. In addition, since bondholder claims are subordinate to those of uninsured depositors, it provides an added level of loss absorption for depositors if a bank does fail. The largest banks are already subject to minimum long-term debt requirements, as part of their "total loss absorbing capital" requirements, or TLAC. Regulators have already suggested they will be proposing similar requirements for regional banks later in the year.

Regional banks have argued that they will be at a competitive disadvantage to the largest banks as the latter are viewed as "too-big-to-fail". Thus, their debt is viewed as lower risk than that of regional banks, which will have to pay a higher rate on their TLAC. This concern could be addressed by requiring lower amounts of TLAC for regional banks or offsetting additional costs by reducing their deposit insurance premiums. The FDIC already provides a modest reduction in deposit insurance premiums for long-term unsecured debt issuance.

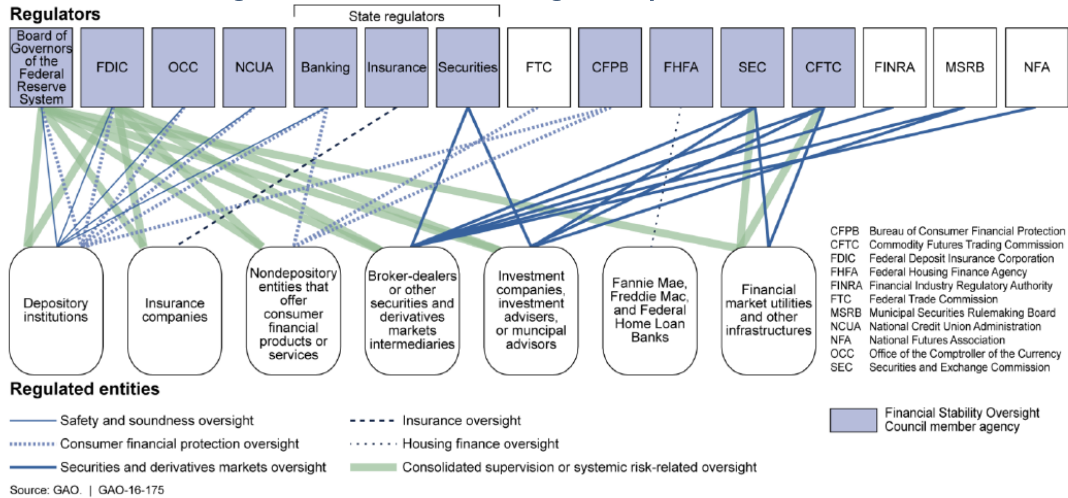
Regulatory Model and Structure

The group's review of regulatory and supervisory weaknesses led to a broader discussion of bank regulatory structure and specifically whether regulation and supervision should be removed from the Fed, as some have advocated.

Banking regulation in the US is incredibly complex (see Figure 4).[12] The current system includes the Federal Reserve Board, the Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency at the federal level, as well as state oversight for state-chartered banks.

[11] Mervyn King, "We need a new approach to bank regulation," Financial Times, May 12, 2023.
[12] United States Government Accountability Office (GAO), Financial Regulation: Complex and Fragmented Structure Could Be Streamlined to Improve Effectiveness, Report to Congressional Requesters, February 2016.

Figure 4. U.S. Financial Regulatory Structure, 2016



Note: This figure depicts the primary regulators in the U.S. financial regulatory structure, as well as their primary oversight responsibilities. "Regulators" generally refers to entities that have rulemaking, supervisory, and enforcement authorities over financial institutions or entities. There are additional agencies involved in regulating the financial markets and there may be other possible regulatory connections than those depicted in this figure.

Source: United States Government Accountability Office.

However, the group did not endorse a single regulator model. Many members felt this was putting too many eggs in one basket and increased the risk of regulatory capture. For instance, the FDIC plays an essential supervisory role given its historic insistence on strong capital, including its crucial role in stopping the implementation of the Basel II advanced approaches. The Fed benefits from having access to supervisory information which it needs to understand trends and emerging risks. Even those sympathetic to the single regulator model acknowledged it would be politically difficult given past opposition by the Fed, FDIC, and state regulators.

However, the group felt that a separate regulatory and supervisory board at the Fed had merit and could be less controversial. This could be accomplished by placing the Fed's monetary policy responsibilities under a newly constituted, seven-member Monetary Policy Committee (MPC) and placing regulation and supervision under a separate, seven-member Financial Policy Committee (FPC). This would leave regulation and supervision with the Fed, but strengthen and elevate its importance in decision-making. Recent bank failures were the regrettable, yet predictable, manifestation of a rapid inflationary surge on financial institutions with interest-rate-sensitive assets and runnable liabilities. **A closer connection between the Fed's monetary policy and bank regulatory/supervisory responsibilities might have done a better job of focusing supervision on those risks. Completely separating the two might have made it worse. To maximize this potential benefit of a new FPC, the group felt there should be overlapping membership with it and the Monetary Policy Committee. One way to accomplish this would be to have the Chairs of the MPC and FPC sit on both committees and perhaps one additional member.**

The creation of an FPC could also address concerns – which the group shares- about bank executives serving on the boards of the Federal Reserve's regional banks. The board of the

Fed's 12 reserve banks each have nine-person boards, three of whom come from the banking industry. There has been considerable public criticism of the fact that SVB's CEO, Greg Becker, served on the San Francisco regional bank's board. While regional bank boards have no role in setting regulatory or supervisory policy, the optics of bank executives serving on them undermine public confidence and inevitably lead to speculation that their presence compromises bank oversight. We note that the San Francisco Regional Bank has suffered significant reputational damage from SVB's failure, even though SVB's supervision was functionally overseen by the Federal Reserve Board in Washington. The best solution is to prohibit banks executives from serving on the Fed's regional bank boards. **However, if they continue to do so, we would recommend that all regulation and supervision, functional as well as administrative, be completely removed from the regional banks and placed under the FPC.**

Placing regulation and supervision under an FPC could help ensure that bank examiners are overseen in Washington by a committee comprised of experts in the fields of regulation and financial stability. This would also help guard against local political influence over the supervisory process. At the same time, as previously discussed, examiners need to be supported and respected in their supervisory roles. They will have the best "on-the-ground" understanding of a bank's weaknesses and gaps in risk management. They must be empowered to act swiftly to remediate major problems that could threaten a bank's viability. A key responsibility of the FPC should be to ensure that examiners are well-trained, well-resourced, and have the ability to act quickly, unencumbered by layers of Washington bureaucracy.

The creation of an FPC would also help address Fed groupthink. The resistance to thinking in monetary quantity terms is deep seated at the Fed, even though this metric can be an important predictor of financial instability. Similarly, there is seldom meaningful dissent on monetary or regulatory matters. Ideally, the FPC would include un-conflicted individuals with practical financial markets knowledge and experience. A new FPC should actively work to strengthen stress testing capabilities by a focused number of meaningful and realistic scenarios. A less academic, more realistic reflection of real-world risks that a bank faces would better inform institutions and their regulators about the full landscape of potential risks.

Conclusion

In this report, we have tried to undertake an objective assessment of the facts and issues associated with recent bank failures, finding agreement on a number of points, and amicable disagreement on others. As the public policy debate continues to unfold over banking reform, we hope government policy makers will similarly undertake an assessment that is nonpartisan, collegial, and driven by the facts. Our findings are summarized below:

- **We agreed that monetary and fiscal policies were significant factors in these failures while also agreeing that they could have been prevented with better risk management and supervisory vigor.**

- **There was strong agreement that monetary policy setters do not adequately take into account the impact of their decisions on financial stability, and that greater attention to money supply measures, in conjunction with more traditional variables, would better alert the Fed to emerging financial stability risks.**

- **Though the group did not feel financial regulation and supervision should be removed from the Fed, it did feel structural changes should be considered, including a separate Financial Policy Committee which would oversee those functions and have inter-locking members with a newly constituted Monetary Policy Committee where the Fed's monetary policy functions would reside. .**

- **There was strong agreement for greater financial liability for bank failures by responsible bank executives to better incentivize prudent decision-making.**

- **There was concern that bank supervision generally has become a bureaucratic, "check the box" exercise. Examiners should be empowered and encouraged to focus on material financial risks and secure swift remediation.**

- **There was a diversity of views as to whether the liquidity coverage ratio should be expanded to more banks, but strong agreement that liquidity testing should take duration into account in determining whether securities are "highly liquid".**

- **There was a diversity of views as to whether AFS gains and losses should be marked against bank regulatory capital, but consensus that auditors and supervisors need to deny HTM treatment where banks are heavily reliant on volatile liabilities.**

- **While the group did not support universal deposit insurance coverage, it did support expanded coverage of business transaction accounts, as suggested in the FDIC's recent report on deposit insurance. It also felt that given the speed with which negative information about banks can travel through social media, the stability of uninsured deposits should be reconsidered. At a minimum, the FDIC should impose much stiffer insurance premiums on banks excessively reliant on uninsured deposits, particularly where deposits are concentrated in close-knit industry sectors.**

- **The group also felt the Fed should consider a facility which would allow banks to preposition collateral to facilitate immediate access to liquidity in the event of a deposit run.**

- **Finally, the group felt there was merit in requiring regional banks to issue minimum levels of unsecured, long-term debt to provided extra protection to uninsured deposits in the event of a bank failure.**

Appendix 1. Regulator Communication with Silicon Valley Bank, June 2019 to March 2023

6/15/19	One MRA related to Governance and controls, concerning systems/technology second line of defense
11/19/19	Target Corporate Governance/Global Risk Management Supervisory letter
6/30/20	One MRA related to Governance and controls, concerning identity access management. One MRIA relating to Governance and controls, concerning vulnerability remediation.
2/11/21	Joint IT Part 2 Target Review Supervisory letter. Two MRIA and two MRA. IT components Management, Support & Delivery, and the Composite rating downgraded to less than satisfactory (3). SVB responded on 3/12/21
8/6/21	Joint IT Part 1 Target Review Supervisory letter. No new MRIA or MRA.
8/17/21	Joint Asset Quality Target Review Supervisory letter. Two MRA. SVB responded on 9/16/21.
2/18/22	Joint IT Part 2 Target Review Supervisory letter IT components Management, Support & Delivery, and the Composite rating downgraded to less than satisfactory (3). SVB responded on 3/18/22
5/31/22	Governance and Risk Management Target Supervisory letter 3 MIRA
6/4/22	Two MRAs related to Bank Secrecy Act/Anti-Money Laundering concerning oversight of compliance, monitoring and testing, and sanctions country of interest risk management
8/17/22	2021 Supervisory Ratings letter Supervisory letter notes that MRIAs and MRAs from the November 2021 letter remain open and SVB is notified that an MOU is being initiated.
8/19/22	2022 LFBO Horizontal Capital Review Supervisory letter One MRA related to allowance for credit loss stress methodology.
10/7/22	Two MRIA and Two MRA related to Governance and controls
11/15/22	2022 CAMELS Examination Supervisory letter 1 MRA related to interest rate risk. SVB's Interest Rate Risk assumptions for its forecast model was unreliable. SVB responded on 12/22/22.
11/21/22	One MRA related to Governance and controls concerning trust and fiduciary services oversight and risk management

12/21/22	One MRIA and Two MRA related to Governance and controls
12/27/22	Internal Audit Target Supervisory letter
1/31/23	One MRIA related to Governance and controls concerning third-party risk management governance and risk identification.
2/28/23	SVB was informed that credit rating agency Moody's was considering a double downgrade
3/8/23	SVB announces a $2.25 billion share sale plan to shore up its balance sheet.
3/10/23	SVB collapses and U.S. government takes control.

In addition:

Nov 2021	The FRBSF informally raised concerns with SVB that it was not ready to operate under the LFBO program and asked what SVB was doing to slow its growth.
Aug 2022	Total DFPI exam hours on SVB increased from 3,000 to 6,000 for 2023.
Oct 2022	DFPI and FRBSF examiners noted concerns regarding the amount of unrealized losses for SVB's available for sale securities. As of September 30, 2022, the unrealized loss in AFS was $2.8 billion.

Source: Axios and Center for Financial Stability.

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