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House Financial Services Committee Questions Regulators On Failures of Silicon Valley Bank, Signature Bank

Republicans Fault Lack of Transparency Around Rescue Actions, Seek Confidential Data;
Vargas: 'It Seems Like [SVB] Blew You Off'; Barr Defers Many Answers to Postmortem in May

The House Financial Services Committee Today (Wednesday, March 29) held a hearing on "The Federal Regulators' Response to Recent Bank Failures." The hearing concerned the recent failure and federal rescue of Silicon Valley Bank in California and Signature Bank in New York. The witnesses were Michael Barr, Vice Chair for Supervision, Federal Reserve Board of Governors; FDIC Chairman Martin Gruenberg; and Nellie Liang, Treasury Undersecretary for Domestic Finance. The same group had testified on these matters at the Senate Banking Committee on Tuesday (March 28). Materials from the House hearing are posted [here](#).

Statements

In his [statement](#), Chairman Patrick McHenry (R-NC) said that in the run-up to its failure, "Silicon Valley Bank experienced rapid growth, relying on an undiversified deposit base and investments made risky by a high inflation environment. We know the bank was mismanaged, that much is clear. Now we need insight into the decisions and decision-making process of financial regulators related to the second- and third-largest U.S. banks failures." McHenry said that while Barr had only been on the job at the Fed for less than a year, "you have made time to start a review of climate risks in banking and a review of capital standards for larger banks, with no mention of changes to bank supervision, or liquidity provisions - two matters at issue with this bank failure." McHenry said that neither the Dodd-Frank Act nor the 2018 regulatory relief law widely known as S. 2155 "dealt with the issues presented in March - a digital bank run, the speed and volume of which had never been seen before." He said the committee needed to know if there was planning for a large-scale bank run; if the San Francisco Fed had "followed the playbook to ensure the bank did not fail"; how supervisors missed the "hole in the bank's balance sheet," and what happened during that first week in March, when McHenry said lawmakers had "no insight" into the decisions made by the FDIC chairman. McHenry said there were reports that "multiple banks were interested and ran the traps internally to purchase SVB that weekend... But as we all know, SVB was not purchased until late Sunday, March 26, at an estimated \$20 billion in losses to the Deposit Insurance Fund. Why wasn't a potential buyer accepted sooner?" In a quip that was widely quoted, McHenry said, "We need competent financial supervisors. But Congress can't legislate competence."

In her [statement](#), Ranking Member Maxine Waters (D-CA) said, "Because of the Dodd-Frank reforms Democrats on this Committee passed, as well as the bold and swift response by President Biden, [Treasury] Secretary Yellen and our banking regulators, a crisis was averted, and our banking system remains strong... However, these events are a wake-up call. We must uncover how management, regulatory, and supervisory failures contributed to these events and explore solutions to strengthen the safety and soundness of our banks." Referring to a forthcoming FDIC surcharge necessary to make the Deposit Insurance Fund whole, Waters said, "Community banks and minority depository institutions should not have to pay for the failures of bank mismanagement at SVB or Signature Bank" In a reference to the 2018 "S. 2155" law easing some Dodd-Frank rules, Waters said it was "important to know how we got here: deregulation. Former and disgraced President Trump said he'd do a 'big number on Dodd-Frank,' and his appointed regulators did just that. At that time, I sounded the alarm on the dangers of weakening capital and liquidity rules for

banks like SVB. The light-touch cautions from the Fed to SVB management are clearly not what Congress intended for bank supervision. I hope Republicans will join Democrats in strengthening compliance with bank rules and transparency over this process.” Waters closed by accusing “MAGA Republicans” of starting a “racist” narrative, saying, “Silicon Valley Bank collapsed because of management failures and possible regulatory weaknesses -- not because there was one Black man on the board. We saw this same racist playbook during the 2008 financial crisis when some Republicans blamed the Community Reinvestment Act and loans made to people of color.”

The witnesses reprised their prepared statements from Tuesday’s (March 28) hearing on the Senate side. Summaries of their testimony were included in yesterday’s alert, posted here: <https://taxnews.ey.com/news/2023-0610>

QUESTIONS

Federal Reserve’s Supervision of SVB. As at Tuesday’s Senate hearing, numerous Republicans and some Democrats questioned Barr repeatedly about what they called lapses in supervision by the San Francisco Fed leading up to the collapse of SVB. Chairman McHenry asked all three witnesses exactly when they learned about the imminent collapse of SVB. Barr said he first became aware of stress at SVB the afternoon of March 9, but that the bank reported to supervisors that morning that deposits were stable. The FDIC’s Gruenberg said he also became aware of SVB’s problems that Thursday evening.

McHenry and others also asked why Barr and Gruenberg had not made emergency liquidity funds available faster as SVB verged on collapse. Both McHenry and Ranking Member Waters also pressed Barr on why he and the Fed’s staff had not acted more aggressively as Fed supervisors identified multiple problems at SVB in 2021 and 2022. Barr generally answered that regulators could have done more, and that the Fed is working on an internal report on the situation that will be completed in May. As he did Tuesday, Barr said SVB’s examiners found issues with SVB’s cash management near the end of 2021, hitting the bank with six formal supervisory objections. Then in May 2022, supervisors criticized the SVB board for its oversight and risk management, and by summer, its governance was rated as “deficient.” “These ratings mean that the bank was not ‘well-managed’ and was subject to growth restrictions,” Barr said. In fall 2022, supervisors reprimanded SVB for how it was managing the impact of rising interest rates on its assets.

In a widely quoted remark, Barr said, “Whenever you have a bank failure like this, bank management clearly failed, supervisors failed, and our regulatory system failed,” adding that that the Fed is reviewing what role its regulatory structure may have played in the crisis. Barr also said the Fed is “evaluating whether application of more stringent standards would have prompted [SVB] to better manage the risks that led to its failure.” Also in this vein:

- Pete Sessions (R-TX) asked all three witnesses to acknowledge their own part in SVB’s collapse, saying, “I have heard none of you three accept real responsibility for your role in this endeavor... Accountability is one thing, but admitting you were part of a systemic failure is another thing.” Barr told him, “I agree with you. I think we need to take a good hard look inside at the Federal Reserve and our supervision, at our regulation. I think we need to be humble about that. And I think we’re going to be unflinching in our review,” saying he would “absolutely” include himself in that assessment.
- Ann Wagner (R-MO) told Barr, “Despite U.S. regulators having clear knowledge of insufficient risk management, it seems the examiners and your supervisors were asleep at the wheel – while signs that Silicon Valley Bank was heading towards a collapse were staring them right in the face for many, many months.” Referring to Barr’s remarks on the Senate side Tuesday, criticizing SVB for not modeling interest-rate risk adequately and going for months without a chief risk officer, Wagner said, “Why didn’t the Fed consider escalating any of these issues into a cease-and-desist order, or some other forceful action against the bank to remediate these deficiencies?” Barr called that “a fair point” and said the Fed would look into it.

- French Hill (R-AR) highlighted what seemed like a failure to treat SVB's problems like an emergency and to compel the bank to act on the Fed's warnings, noting that from January 2021 to July 2022, "precisely the time frame... when this bank's business strategy went awry," there was no vice chairman of supervision in office at the Fed until Barr arrived. Hill said there was a 12-month gap between bank exams that identified significant problems at SVB and Signature and when regulators chose to downgrade key ratings for their management. "Twelve months of discussions... that doesn't sound like a very urgent supervisory process," Hill said. Barr was not able to say who had handled his duties at the Fed after the departure of Randal Quarles and before Barr arrived, and said that question would be considered in his office's internal review. Hill asked Barr, "The FDIC, the primary bank regulator, the state can do whatever they want to a bank that's not operating in a safe and sound manner. Isn't that right?" Barr told him the Fed has abundant authority to act when a bank shows trouble signs, saying regulators had given SVB a grade of 3, a poor mark on a scale where 1 is optimal and 5 is worst. "The bank regulators have substantial discretion to use those authorities when banks are operating in an unsafe and unsound manner," Barr agreed.
- Juan Vargas (D-CA) told Barr, "It seems like [SVB] blew you guys off, and you didn't do anything... It didn't seem like there was any enforcement" against the bank for its management failures. "Where was the stick?" Barr told him, "I expect that we're going to find that we need to have more of an emphasis on supervisors using the tools they have more promptly, and putting in mitigations in place more promptly when they see problems at banks that they're supervising."
- Brad Sherman (D-CA) said, "Our entire economy has been hurt. It has been rattled by what happened this month. Our bank regulatory system has some real flaws." Sherman said SVB could have saved itself in 2022 by selling its long-term bonds or hedging its balance sheet risks, but the bank decided that doing so would reduce profits and bonuses. "They decided to take the risk and here we are. It's mis-regulation to let banks ignore advice. You're not running a consulting operation, you're running a regulatory operation that can force banks to take your advice."
- Blaine Luetkemeyer (R-MO) questioned Barr about written warnings the bank's management received and why the institution wasn't forced to respond to the increasing interest rate risk in its balance sheet. Barr repeated that the Fed is reviewing this matter. Like other Republicans, Luetkemeyer was skeptical about imposing new capital and liquidity regulations on regional banks, saying, "How about enforcing the existing ones first?"
- Jim Himes (D-CT) also asked Barr about what he described as a lack of follow-up by the Fed after it had graded SVB's management as "deficient" in July 2022, and suggested that Congress should consider requiring banks to respond to concerns raised by supervisors in a timely way: "We need to tighten up the process. We need to think about automatic mechanisms that when a finding of deficiency is made... kick in."

For his part, the FDIC's Gruenberg said the financial system "remains sound" after interventions by the Fed, but said more information would be available reports the FDIC and Fed will release in May. "My own sense of the supervision of these banks is that both agencies, including the FDIC [and the Fed] were aware there were issues and were trying to address them through the supervisory process," Gruenberg said.

Timeline of the Crisis at SVB. Barr said the Fed was in discussions with SVB the day before its collapse to move pledgeable collateral to the discount window, a facility often used to extend emergency credit to banks. "Staff were working with Silicon Valley Bank basically all afternoon and evening and through the morning the next day to pledge as much collateral as humanly possible to the discount [window] on Friday," Barr said. Describing the outflow of \$42 billion in deposits, Barr said, "That's just an extraordinary scale and speed of a run that I had not ever seen. I think all of us were caught incredibly off-guard by the massive bank run that occurred when it did." Treasury's Liang told McHenry that regulators had concluded risk to the banking system appeared to be "very high" when SVB collapsed, but said, "We think the system has stabilized we have information that deposits have stabilized." McHenry criticized the

regulators for the fact that no notes are publicly available from the emergency meetings they held that weekend, saying, "That lack of transparency has a negative effect on the public view of the safety of the financial arena."

Tougher Capital Rules for Regional Banks. A number of Democrats also said mid-size banks like SVB should be held to some of the same standards applied to the largest financial institutions. "I am frustrated that time and time again, we fail to regulate them like [the largest U.S. banks] and as a result, we find ourselves in situations like the one that we're currently in," said Nydia Velázquez (D-NY). "Without proper regulations that account for the systemic risk profile of a bank, we are incentivizing bankers to search for yield and inviting moral hazard." But Republicans generally said the Fed already has adequate tools to hold banks accountable, and were suspicious of the motives behind calls for more regulation.

Rep. Wagner asked Barr, "Are you just looking for any reason, correlated or not, to justify increasing capital requirements of banks?" Wagner asked Barr. "The capital review that we're doing does not apply to community banks," Barr said. "We're not intending to increase capital requirements on community banks... My understanding from looking at the community banking system is that it is well-capitalized and stable and serving its communities," he said. Barr added that for larger banks, there would be a public comment process followed by a transition period before any banks would be required to hold more capital. The White House is preparing plans for legislation that would reinstate capital and liquidity regulations on midsize banks, the *Washington Post* reported today (March 29).

'Contingent Capital.' Bill Foster (D-IL) was among Democrats arguing that banks need to have higher liquidity requirements and a type of insurance policy in place called "contingent convertible bonds" in order to avoid using money from the Deposit Insurance Fund (DIF). "We have a lot to learn from the two side-by-side failures of Silicon Valley Bank, with total assets of less than 1 percent of GDP, and Credit Suisse, with total assets greater than 100 percent of Swiss GDP, and the difference, I believe, is contingent capital," he said. "Had we followed Congress's direction to include contingent capital into the stacks of U.S. large banks, we would have been able to resolve the SVB without hitting the" DIF.

Assessment to Bolster the DIF. A number of Republicans asked Gruenberg whether small community banks would be asked to pay "special assessments" to make the Deposit Insurance Fund whole after the rescues of depositors from SVB and Signature. Roger Williams (R-TX) asked, "Could you elaborate if smaller community banks in Texas, where I'm from, will be left responsible for bailing out the banks in California and New York?" Gruenberg said the FDIC has "discretion to tailor" that assessment and would offer more information about how the assessment would be distributed in its May report: "We're going to be keenly sensitive to the impact on community banks." Williams told him, "Take a look at it, because we all know that what they'll do is pass the cost on to someone like me." Frank Lucas (R-OK) said regional bank leaders are complaining that they may have to pay "for the mistakes of the most sophisticated institutions, the biggest institutions," urging Gruenberg to ensure smaller banks do not disproportionately shoulder the burden. Andy Barr (R-KY) told Barr the Fed should establish separate risk-based assessments so that community banks don't have to bail out SVB. "Anything we put out will be subject to public comment... we will be keenly sensitive to the impact on community banks," Barr said, while stressing that he couldn't get in front of a decision the Fed has not made yet.

Banks in a Similar Position to SVB. Rep. Sherman asked for a survey of banks that are undercapitalized the same way SVB was. "Are there any banks out there, and roughly how many, that have capital of under 5% -- if you subtract from their stated capital their unhedged, unrealized losses on long-term debt?" Gruenberg said he would have to "get back to you on that... We'll get the numbers and share them with you very quickly."

Deposit Insurance Limits. Treasury's Liang appeared open to the idea of raising the current \$250,000 cap on insuring deposits, but said congressional action would be needed. Liang said she would support proposals for reform, citing a rise in uninsured deposits in recent years.

Confidential Supervisory Information. Bill Huizenga (R-MO) said the committee wanted the raw, confidential supervisory information about SVB and Signature that regulators had in advance of the banks' collapse. Gruenberg suggested the committee would need to issue a subpoena for that, saying, "I think you have the authority to compel that information, and we will be responsive to you." Huizenga asked Barr if the Fed would provide the same information to the Government Accountability Office, which is investigating the bank failures. Barr said, "Yes, consistent with normal practice." Asked if Congress would get the same data, Barr said, "We will make the information that we are using for [the Fed's internal review] report available to you and GAO... The same information we give GAO and in the public report."

Crypto Deposits at Signature. Gruenberg said the FDIC is sending about \$4 billion of Signature Bank deposits held by its former crypto business clients back to its customers. "We sent them a notice that we'll return their deposits to them by early next week," he said. (Signature Bank reportedly had a substantial client base among cryptocurrency traders and operated a real-time payments network, Signet, used by exchanges and trading platforms.) But Treasury's Liang said the shocks that rolled through the crypto markets last year did not play a direct role in the bank's failures.

If you have questions, please contact Will Heyniger or Bob Schellhas at (202) 293-7474 or wcey@ey.com.

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