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Executives of Failed Banks SVB and Signature Testify At Senate Banking Committee

Becker, Shay, Howell Blame Historic Bank Runs, Not Mismanagement, for Collapses; Brown Says 'It Sounds a Lot Like the Dog Ate My Homework'

The Senate Banking Committee today (Tuesday, May 16) held a hearing on "Examining the Failures of Silicon Valley Bank and Signature Bank." The witnesses were Gregory W. Becker, former CEO, Silicon Valley Bank; Scott A. Shay, former chairman and co-founder of Signature Bank; and Eric R. Howell, former president of Signature Bank. Materials from the hearing are posted here.

Statements

In his opening statement, Chairman Sherrod Brown (D-OH) said that while many policy-makers in Washington are asking if Silicon Valley Bank failed "so spectacularly" because regulators didn't do their jobs, or new technology such as social media caused a brutal run, "the simplest explanation is best. It is first and foremost the bankers' fault that the banks crashed. We know that federal and state banking officials repeatedly told managers and directors of your banks where there were problems… the kind of problems you can't ignore. The kind you have to start fixing right away. Bank executives didn't listen." Brown said SVB grew too fast, more than tripling in size from 2019 to 202, without doing "basic bank management." He said the dangers the banks faced "were not hard to spot: the liquidity risk; the unstable nature of uninsured deposits; the concentration of customer deposits all were giant risks sitting there in broad daylight on your bank's balance sheets." Brown said uninsured deposits at both banks reached over 90 percent of their overall deposits." He said Federal Reserve supervisors had cited uninsured deposits as a risk at SVB as far back as 2018, but the bank never fixed it. "In 2021 and 2022, the Fed identified weaknesses in SVB's Contingency Funding Plan, defects in its interest rate models, weak risk management, inadequate Board oversight and management. This is Banking 101." Meanwhile, the FDIC detected similar problems at Signature Bank dating back to 2018 and 1019, such as "poor governance and unsatisfactory risk management practices." Signature's managers "would tell the FDIC they fixed some of the problems, but in reality you never did," and in the end that bank failed because it was not able to accurately track its own liquidity while it faced a devastating run.

Brown also pointed to compensation practices, saying that at SVB, "executive bonuses were tied to the bank's return on equity, so they bought securities with higher yields to chase higher and higher and higher profits. When the warning lights started to flash and those investments started to lose money, your bank didn't change course. Instead you doubled down." At Signature, he said "bank executives had incentive compensation plans that were tied to return on assets to 'reflect additional focus on profitability.' " Brown added that Becker "dumped millions of dollars in company stock in the days leading up to the crash… You were paying out bonuses until literally hours before regulators seized your assets."

In his statement, Ranking Member Tim Scott (R-SC) listed three major issues with the bank failures: 1) bank mismanagement, 2) supervisory failure and 3) "rocketing inflation." He faulted congressional Democrats for inflation, saying "when you spend and print trillions of dollars, leading to the highest inflation we've seen in my lifetime… 10 interest rate hikes in about a year sends a signal of what is actually happening in the marketplace that seems to have been completely ignored by the bank execs." Turning to Becker, Scott said that SVB under his leadership "made

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significant bets on interest rates falling when everything indicated exactly the opposite… anyone that paid close attention to the economy over the past two years could plainly see that the Federal Reserve was going to continue to increase interest rates… So I hope to hear your analysis on why you did not act on the ballooning risk and how you failed to adapt to the increasingly vulnerable inflationary environment." Scott noted that "not only did you fail to hire a chief risk officer in a timely manner… [for] several months… Even more concerning, the Federal Reserve's report stated that with respect to both liquidity and interest rate risk your management team was more focused on chasing profitability than stability. Sounds like greed. Perhaps this is why your institution had 31 open supervisory findings when it failed, which is about three times the average number." He said Becker's " lack of judgment… shows that you should not have been running the bank."

Turning to Signature Bank, Scott said that bank's board and management "also pursued rapid unrestrained growth without developing and maintaining adequate risk management practices and control appropriate for the size, complexity and risk profile of the institution. Nor did the management prioritize good corporate governance practices." He said an FDIC report had found that Signature's executives were "not always responsive or timely in addressing FDIC supervisory comments and recommendations. The laws are not above you."

Witnesses

All three executives contended that the runs that runs that devastated their banks were caused by unprecedented events, not mismanagement. In his prepared statement and during questions, former Silicon Valley Bank CEO Greg Becker said his bank was "adequately capitalized" before it sold of a portfolio that had diminished in value due to the Fed's interest rate increases. Becker said the flight of deposits started when Silvergate Bank, which catered to cryptocurrency users, decided to "voluntarily wind down and liquidate," causing panic among Silicon Valley investors. Becker said "rumors and misconceptions" led to the unprecedented bank run, which became overwhelming. He called the situation an "anomaly" and that the bank's board and executives believed it had adequate liquidity. According to regulators, customers pulled $42 billion of deposits from SVB on March 9, one day after the bank announced it needed to raise capital. The previous largest bank run in U.S. history, he said, was $19 billion in deposits over the course of 16 days. "I do not believe that any bank could survive a bank run of that velocity and magnitude," Becker said, adding that the bank's failure was "personally and professionally devastating, and I am truly sorry for how this has impacted SVB's employees, clients, and shareholders."

Becker said he believed SVB "had a positive impact on the roughly 100,000 companies we supported over multiple decades." He defended SVB's decision to invest heavily in Treasury bonds, noting that lenders of all sizes made the same decision, arguing the Fed misled bankers about the course of rate hikes: "Importantly, throughout 2020 until late 2021, the messaging from the Federal Reserve was that interest rates would remain low and that the inflation that was starting to bubble up would only be 'transitory.' " Instead, he said, the Fed imposed "the steepest rate increase over a 12-month period in almost 40 years." Becker said SVB's substantial proportion of large, uninsured accounts took place because the bank focused on companies and individuals whose own wealth was growing. He blamed the media for raising questions about the firm's financial disclosures and said it was SVB's board that chose not to offset the bank's bond holdings with hedges, which would have reduced its risks. Becker said his sale of SVB stock in February was a planned transaction unrelated to the events that rapidly afflicted the bank.

When Katie Britt (R-AL) noted that Becker had traveled to Hawaii shortly after SVB failed. When she asked Becker what he could have done differently to prevent SVB's failure, he said, "Senator, I've thought about your question, especially, over the last eight weeks, pretty much every day… when we were making the decisions… I truly do believe that we made the best decisions we could… I was the CEO of Silicon Valley Bank. I take responsibility for what ultimately happened."

Former Signature Bank chairman and co-founder Scott Shay said volatility in the cryptocurrency sector translated to panic among the company's depositors and prompted a flight of withdrawals, despite a "solid plan to continue in operation." Shay said Signature had heard regulators' concerns about volatility in the crypto sector and that the bank

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then took steps to "significantly reduce its digital asset deposits…. Unfortunately, a series of truly extraordinary and unprecedented events unfolded quickly. On March 7, a bank with strong ties to the digital asset sector announced it was going out of business, and three days later, on March 10, a second bank was seized by regulators. And then, within just a few hours our depositors withdrew $16 billion from the bank." Shay told the committee he didn't believe the FDIC needed to shutter his bank. "Although I believed that the bank was in a strong position to weather the storm, regulators evidently saw things differently." Former Signature president Eric Howell insisted that his bank was "well-capitalized, solvent, and had sufficient borrowing capacity" before the FDIC seized control of it, and that mismanagement did not play a role in the bank's failure.

QUESTIONS

Risk Management & Uninsured Deposits. Chairman Brown told Becker, "Your version of events blames SVB's failure on too many interest rate hikes, a social media-driven bank run, the closure of the much smaller Silvergate Bank, and the regulators for being slow to highlight its long standing problems. It sounds a lot like 'the dog ate my homework.' Your explanations ignore that your bank was without a chief compliance officer for the better part of a year… while you watched deposits leave and losses on long-term investment securities began to pile up. Your version leaves out that you only tried to fix things when you were told that SVB was going to be downgraded." Becker told him that he and the SVB board "decided, along with feedback from the regulators, that we were going to look for even more experienced [chief risk officer]. And in my experience it takes six to nine months to find the best person for a role."

Ranking Member Scott said it was hard to believe Becker's assertion that he had taken risk management seriously. "Your bank had about 90 percent of its deposits uninsured. If you're taking risk management seriously as you grow from $50 billion to over $200 billion in a very short period of time, [as a business owner], the one thing I had to do is figure out how to get out of my business so I could work on my business. When you're the CEO, you're working in the business. It's very challenging to see your own blind spots…. When your bank is such an anomaly in an industry where 90-plus percent of your deposits were uninsured, how did you see that risk and then not respond to it? Becker told him, "on the level of uninsured deposits, I was at the bank for 30 years… our clients have always had substantial amounts of cash. That's just the profile. So that's not something that happened in the last three years, four years, or five years, it's always been that way…. and I think the ratings that were given to us by the regulators would show that we had substantial amounts of liquidity."

Effect of Rising Rates. Several senators faulted the executives for not preparing for the impact of rising interest rates. John Kennedy (R-LA) noted that SVB had sold off hedging contracts that could have mitigated some of the effect of rising rates. That was "bone deep, to the marrow, stupid… Mr. Becker, you made a really stupid bet that went bad. You had all of your eggs in one basket." When Becker told him the bank run that wracked SVB was "unprecedented," Kennedy said, "This wasn't unprecedented. Unless you were living on the International Space Station, you could see interest rates were rising and you weren't hedged." He said SVB had not hedged because that would have cost the bank money, cutting into its executives' compensation. "If you'd made less money, that would've affected your bonus, wouldn't it?" Becker said, "Our compensation was predominantly long-term in nature." Other senators criticized Becker for delegating the bank's interest rate risk issues to a committee instead of being more directly involved, and cited the large number of other "deficiencies" supervisors had found in several parts of its business.

Executive Compensation. A number of questions focused on the executives' pay and stock options. Becker said he had earned nearly $10 million in 2022 and sold $3.6 million in SVB stock on February 27, shortly before the bank's collapse, testifying that those sales were planned. Becker and other SVB executives reportedly sold $84 million in company stock over the past two years. "From the standpoint of compensation, that is determined by the board of directors," Becker told Chairman Brown. "I know they believed it was fair, and I believe they were accurate."

When senators asked if Becker, Shay or Howell planned to return any of their bonus compensation, the answer was generally no, with Shay calling Signature a "responsibly managed bank." "Your opinion on what is a responsibly

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managed bank is now laughable," Elizabeth Warren (D-MA), told him. Warren asked Becker, "How much of the $40 million that you earned from loading up SVB with risk are you planning to return to the FDIC? Are you planning to return a single nickel to what you cost the fund?" Becker answered that he would wait to see if regulators would compel him to return his bonuses as part of their ongoing review. "I'll take that as a no," Warren said. "If we don't fix it, every CEO for these multibillion-dollar banks will keep right on loading up on risks and blowing up banks, and everybody else is going to have to pay for it." Warren and four other senators have introduced legislation that would give the FDIC authority to claw back any pay made to executives in the five years leading up to a bank's failure.

J.D. Vance (R-OH) said, "So in 2022, in particular, you paid yourself a $1.5 million cash bonus even as the value of the company that you were managing declined by two-thirds. That's not bad work, if you can get it… Let's say it was [found to be] legal. Was it ethical?" Becker declined to answer. Becker said his stock sales were approved by the bank's legal team, adding that there was "nothing irregular or accelerated" about bonuses some employees received for 2022 performance before the bank was seized. In questions with Sen. Britt about returning some of his compensation, Becker said he is "committed to cooperate with the process with the regulators and other agencies that I know are going to be looking into that specific question." Britt told him, "Well, I hope even if, for whatever reason, they say you don't have to, I hope that you dig deep and you decide that that needs to be somewhere besides in your pocket."

Insider Trading. Robert Menendez (D-NJ) questioned whether Becker and other executives had possibly traded on material non-public information when they sold a total of about $84 million in company stock over the past two years, mentioning dozens of non-public findings from regulators that pointed out risks and issues at the bank. "I didn't believe it was" material information, Becker said. "Thirty different supervisory findings, all of which are elements of the collapse of the bank, and you didn't believe those were material findings? Maybe you can understand why our shareholders observing from the outside might feel differently," Menendez told him. Becker said he regularly sold the underlying shares of his stock options before they expired through 10b5-1 plans.

Blaming Crypto Assets. In questions with Shay and Howell, Cynthia Lummis (R-WY), a booster of the crypto industry, said she was disappointed that previously crypto-friendly bank executives would not accept responsibility for Signature's failure, while partly blaming volatility in the crypto sector. "It looks like there has been a lot of deflection of blame onto those particular depositors that deal in digital assets and onto regulators, but you haven't accepted any blame yourself," Lummis said. She said that according to the New York state financial regulator, "deposits from digital asset businesses in cash, not crypto, made up about 18 percent of total deposits prior to your bank's collapse," and that "outflows on March 10th were relatively proportional, meaning depositors who had nothing to do with digital assets were responsible for the significant majority of withdrawals during the run." Shay told her that "I did not point earlier…. to digital assets being a particular cause or not" of Signature's failure. But Lummis said, "You mentioned in your testimony digital assets 10 times, implying that digital assets were a driver" of the bank's collapse.

Ignoring Fed's Supervision. Jon Tester (D-MT) told Becker it was "hard for me to understand how somebody who… is in tune with what's going on in the economy, somebody that had regulators tell them you've got stuff that has to be dealt with here, didn't take the kind of response that should have been taken. Whether it's you as president of the bank, or whether it's people on your board of directors… But the fallout of this isn't just Silicon Valley Bank going down. It's the fact that we're going to have a lot of banks out there that are yet to get the screws put to them, because you guys didn't react to the recommendations that were made by the Fed, and hopefully other regulators, but absolutely, by the Fed. And I just don't understand how, for three years this went on, and nothing was done. And it ends up where that bank no longer exists."

'Work Requirements.' John Fetterman (D-PA) noted that Republicans increased work requirements for the Supplemental Nutrition Assistance Program (SNAP), a food program for low-income families, in the debt ceiling bill the House GOP passed last month. He asked the executives if the same type of work requirements should be in place for executives of banks that are given federal assistance when they collapse. "A hungry family has to have these kinds of working requirements," Fetterman said. "Shouldn't you have a working requirement, after we bail out your bank?" The

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executives did not answer his question, and Chairman Brown told Fetterman he "didn't see an eagerness on the panel to answer your questions."

Effect of 2018 Regulatory Relief Law. Sen. Warren said that "the last time this committee received testimony from Mr. Becker… he was lobbying Congress, us, to do away with the Dodd-Frank rules designed to protect our nation's banking system. Now, unfortunately, too many people in Congress listened. And now here we are three bank collapses later, picking up the pieces of Mr. Becker's successful efforts at deregulation. In recent reviews of the failures of SVB and Signature Bank, regulators found that weakened bank rules helped cause this crisis." In his opening statement, Chairman Brown said the banks' risk-taking was "aided by former Federal Reserve Vice Chair for Supervision Randal Quarles, who led the regulatory rollbacks in 2018, 2019, 2020. It's clear those rollbacks emboldened bank executives to take on more risk… This all comes back to the power of your industry from the rules that big banks, including yours, lobbied to weaken, to the impunity with which executives have been allowed to operate the largest banks."

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