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GOVERNMENT RELATIONS

**Hearing Summary**

*March 28, 2023*

# Senate Banking Panel Examines Recent Bank Failures

## Executive Summary

Today, the Senate Banking Committee held a hearing to examine the recent failures of Silicon Valley Bank (SVB) and Signature Bank. The discussion featured testimony from several of the nation's top financial regulators — including Federal Reserve **Vice Chair for Supervision Michael Barr,** Federal Deposit Insurance Corporation (FDIC) **Chair Martin Gruenberg,** and Treasury Department **Undersecretary for Domestic Finance Nellie Liang.** Lawmakers probed the witnesses on topics ranging from the root cause of the failure of these banks, the ensuing response from regulators, bank risk management practices, and whether regulators failed in their supervisory roles. Notably, several Committee Democrats sought to target the 2018 banking law (S. 2155) that allowed for regulators to adopt tailoring in their regulatory duties. Conversely, Republicans pushed bank on this assertion. Instead suggesting that the failures can be attributed to regulatory shortcomings and poor risk management practices at SVB.

Additionally, Committee Republicans were joined by several moderate Democrats on the panel in voicing their opposition to increased special assessment fees for regional and community banks to replenish the FDIC's Deposit Insurance Fund (DIF). However, regulators appeared unanimous in their agreement that greater regulatory standards may be needed for banks with consolidated assets exceeding $100 billion. Senators from both sides of the aisle also questioned why regulators had not used their existing authorities more aggressively.

## Opening Statements

**Chair Sherrod Brown (D-OH)** (statement) noted the magnitude and speed at which SVB collapsed, citing the role played by venture capital (VC) firms, banking deregulation, and social media. Further, he highlighted alleged insistences from venture capitalist that the companies they invest in keep their money solely with SVB, suggesting high concentration of SVB's clients. Additionally, Chair Brown stated that the recent bank failures raise serious questions on whether current regulatory standards such as liquidity, stress tests, and deposit insurance should be revisited. Chair Brown expressed his interest in pursuing legislation that would allow regulators to claw back executive compensation of failed banks.

**Ranking Member Tim Scott (R-SC)** (statement) emphasized the importance of hearing from the bank CEOs responsible for the failures and criticized the absence of the Secretary of the Treasury and the Chairman of the Federal Reserve. Ranking Member Scott raised concerns about regulators' "focus" on climate and social policy. Further, he criticized regulators for failing to take corrective action despite being allegedly aware of the issues surrounding SVB for over a year. Additionally, he expressed concern about the FDIC's role in the receivership and sale of both SVB and Signature Bank.

### Witness Testimony

**FDIC Chair Martin Gruenberg** (testimony) discussed the timeline of the recent bank failures and the FDIC's role in the events. Chair Gruenberg noted that, to prevent potential contagion into the broader banking system, the FDIC — in consultation with the Federal Reserve and Treasury Department — utilized its systemic risk exemption authorities (SREA) under the Federal Deposit Insurance Act (FDI) to protect all depositors in winding down SVB and Signature Bank, while shareholders and unsecured creditors suffered losses. Further, he informed the panel that the FDIC will undertake a comprehensive review of the deposit insurance system, release a report by May 1, and issue a proposed rulemaking for a special assessment later that month.

**Fed Vice Chair for Supervision Michael Barr** (testimony) sought to assure lawmakers that the U.S. banking system is "strong and resilient," but recent events have raised questions about what more can be done to prevent isolated banking problems from undermining confidence in the system. Vice Chair Barr discussed his role in overseeing a review of the circumstances leading up to the failure of SVB and found that inadequate risk management and internal controls contributed to the bank's collapse. Further, he asserted that central bank officials had notified SVB on several occasions of risks at the bank. Additionally, he noted that the Fed is also undertaking a review of its actions as well as any potential changes to capital and liquidity requirements, and other supervisory tools.

**Treasury Undersecretary for Domestic Finance Nellie Liang** (testimony) noted the "unique threat" posed by SVB and Signature Bank to the broader banking system and the economy. She sought to justify the action taken by regulators to strengthen public confidence in the U.S. banking system, protect the economy, and prevent uninsured depositor runs. Ms. Liang commended these actions, including the move to ensure FDIC could complete its resolutions of the failed banks in a manner that fully protects depositors, the establishment of the Bank Term Funding Program (BTFP), and coordination with federal and state regulators to monitor developments across the banking and financial system.

### Discussion and Questions

*Nonbanks*

- Sen. Smith wondered how interest rate risk may impact nonbank financial institutions such as mortgage lenders. Vice Chair Barr assured her that the Fed is paying close attention to nonbank institutions but did not provide specifics.

*Regulatory Oversight and Bank Management*

- Chair Brown and **Sen. Mark Warner (D-VA)** pressed Vice Chair Barr on whether regulators failed to see the risk building at SVB due to scaled-back regulatory standards approved by regulators in 2019. Vice Chair Barr attributed SVB's failure to incompetence by management to address interest rate and liquidity risks. Further, he noted that the bank's supervisors highlighted these risks for bank management but that bank management had failed to address the risks, despite the urging of the Fed. In questioning with Sen. Warner, Vice Chair Barr suggested that the situation at SVB appeared "calm" on the morning of March 9, despite SVB's attempts to improve their liquidity position the day prior — which raised significant concerns among investors. He added that over $42 billion was then pulled out of SVB over the course of several hours on March 9. By March 10, Vice Chair Barr said that the capital needed to cover SVB's outflows had reached $100 billion.

- Chair Brown asked how well SVB was managed. Vice Chair Barr noted that the Bank's failure allows him to discuss the confidential information regarding the situation, adding that SVB received a three on the capital adequacy, assets, management capability, earnings, liquidity, and sensitivity (CAMELS) scale. This, he said, indicates that the Bank was poorly managed.
- Chair Brown inquired about what the consequences may have been if regulators had not intervened in the case of SVB and Signature Bank. Chair Gruenberg contended that an absence of action by regulators may have allowed for more widespread contagion to other institutions in the U.S. financial system. Ms. Liang agreed with the characterization.
- **Sen. Mike Crapo (R-ID)** echoed Committee Republicans' insistence that SVB's failure was not a result of the 2018 banking deregulation law. **Sens. Thom Tillis (R-NC)** and Crapo asked Vice Chair Barr if the Fed faced any statutory restrictions in implementing its tailoring rule that would have prevented regulators from implementing more strict prudential standards. Further, Vice Chair Barr reiterated in questioning with **Sen. Katie Britt (R-AL)** that the law provides the Fed with "substantial" discretion and noted that this is something regulators will be revisiting in their review — including if supervisors should have taken more aggressive action.
- **Sen. Catherine Cortez Masto (D-NV)** questioned whether the Federal Reserve is the appropriate body to conduct and after-action review of any supervisory shortcomings, given their prudential oversight role. Vice Chair Barr stated that it is important for the Fed to carry out a "self-assessment," adding that the central bank plans to make its review public on May 1. However, he welcomed independent reviews of the Fed's actions as well. Additionally, Vice Chair Barr indicated that this review will include any findings that may require legislation to address. Chair Gruenberg echoed Vice Chair Barr's remarks.
- Citing the Fed's November supervisory finding on interest rate risk to SVB, **Sen. Mike Rounds (R-SD)** asked whether interest rate risk was listed under the Matters Requiring Immediate Attention (MRIA) section of the supervisory finding. Vice Chair Barr asserted that, to the best of his knowledge, the supervisory finding did include an MRIA highlighting inaccuracies in SVB's interest rate risk management modeling. However, Vice Chair Barr noted that there is no explicit deadline for responding to an MRIA and that the timeframe is circumstantial. Additionally, he pointed to SVB's failure as evidence that executives did not adequately respond to the Fed's supervisory concerns.
- **Sen. Jon Tester (D-MT)** asked at what point enforcement action may be required when banks do not address the risks flagged by regulators. Vice Chair Barr agreed that SVB executives had been aware of the risks highlighted by Fed supervisors but failed to act to

address them. He added that he expects the central bank's report to highlight whether more should have been done at the hands of regulators to coerce the bank to act on their warnings.

- Sen. Rounds expressed concern over reports that SVB did not have a Chief Risk Officer (CRO) for a period of six months last year. Vice Chair Barr shared these concerns.
- **Sen. Tina Smith (D-MN)** voiced concern that other banks and nonbanks may be exposed to the same interest rate and liquidity risks as SVB. Vice Chair Barr assured her that the U.S. banking system is "sound" and "resilient," noting that most banks are "highly effective" in managing interest rate and liquidity risk.
- **Sen. Bill Hagerty (R-TN)** asked if any financial institutions were dissuaded from bidding on SVB by the FDIC or other regulators. Chair Gruenberg asserted that they were not.
- Sen. Britt pressed Chair Gruenberg on what actions the FDIC had taken prior to SVB's failure in its supportive supervisory role. Chair Gruenberg indicated that they were working closely with the Fed in a supportive role.
- Sen. Britt asked if the attempt to place SVB in receivership can be viewed as a "failure" to allow SVB to be purchased. Chair Gruenberg indicated that the bank was placed in receivership but that they were unable to secure a buyer throughout the weekend, leading regulators to open up the bidding process.

*Regional Banks*

- Ranking Member Scott asked Chair Gruenberg to opine on the future of regional banking. Chair Gruenberg stated that regional banks appear to be stable and are a source of strength in the banking system, noting that two of the highest bidders for the failed banks were regional banks.
- Chair Brown asked Chair Gruenberg how regulators will recoup the cost to the DIF from SVB's sale to First Citizen. Chair Gruenberg explained that the cost will be recouped by levying special assessment fees on other institutions, adding that the FDIC plans to issue a notice of proposed rulemaking (NPRM) in May to implement the assessments. Committee Republicans broadly expressed opposition to this, arguing that small community banks should not be made to pay for the mismanagement of larger institutions.
- Multiple Republicans on the panel questioned whether regulators could have acted more swiftly to facilitate a private sector sale of SVB and asked if there were buyers interested on Friday, March 10. Chair Gruenberg told Ranking Member Scott that the FDIC did have several institutions express interest. However, he explained that one offer was invalid while the other would have been more expensive to the DIF than a liquidation of the bank. He added that regulators were successful in facilitating the sale of the failed institutions in the following days and week. Ranking Member Scott and other Senate Republicans expressed that better private sector engagement from regulators may have more quickly resolved the issue.
- **Sen. Bob Menendez (D-NJ)** voiced concern over a perceived "flight" of deposits from regional banks to larger banks, suggesting that increased consolidation may carry its own risks. Vice Chair Barr contended that the goal of the actions taken by regulators is to ensure a diverse and strong banking system, including regional banks.
- Sen. Lummis expressed frustration over the use of special assessment fees to recoup losses to the DIF, asserting that smaller regional and community banks should be subject to higher

assessment fees for the failure of larger banks. Chair Gruenberg explained that the law allows the FDIC the authority to consider the types of entities that may benefit from any actions taken or assistance provided, suggesting that the FDIC has discretion in this regard. However, he declined to indicate whether community banks would be exempt from the fees.

- Sen. Hagerty questioned the assertions made by regulators that actions taken to resolve the recent bank failures will not be borne by taxpayers. In particular, he was worried that community banks may pass on the cost of increased special assessment fees to consumers.
- Senators on both sides of the aisle were frustrated that retail market participants were able to detect "significant" risks at SVB before regulators were. **Sen. Kyrsten Sinema (I-AZ)** asked if Vice Chair Barr was made aware of any "major deficiencies" at SVB prior to its collapse and, if so, when. Vice Chair Barr informed her that the Federal Reserve held a presentation in February on the issue of interest rate risk in the banking system more broadly, but highlighted SVB specifically. However, he added that staff had been aware of the issue since November 2021 and had been in contact with SVB regarding these concerns.

*Stress Testing, Capital Requirements*

- Sen. Crapo asked if SVB was "well capitalized" under current standards. Vice Chair Barr explained that it was well capitalized by statutory standards prior to its failure.
- Citing regulators' use of the Systemic Risk Exemption Authority (SREA), Sen. Menendez pressed regulators on whether the situation at SVB constituted a systemic risk. Vice Chair Barr stated that available data at the time suggested potential contagion and justified the use of SREA. Sen. Menendez argued that this is evidence that, if any of these recent bank failures can result in systemic risk, then they should be identified as systemically important.
- **Sens**. **Elizabeth Warren (D-MA)** and Menendez asked if Vice Chair Barr agreed with President Biden's call for strengthening rules to prevent bank failures in the future. Vice Chair Barr stated that it is important to strengthen capital and liquidity rules, adding that the Fed is currently working on this issue as part of its Basel III reforms and "holistic" review of capital requirements. Additionally, he advocated for a long-term debt requirement that he contended would act as an additional "cushion."
- **Sens. John Kennedy (R-LA)** and **Cynthia Lummis (R-WY)** prompted Vice Chair Barr on whether SVB was subject to Fed stress tests, given that that it had consolidated assets above $100 billion. Vice Chair Barr explained that banks must maintain a four-quarter rolling average of consolidated capital above $100 billion to be subject to stress tests and SVB did not meet that threshold. Further, noted that SVB's first stress test would not have occurred until 2024. Sen. Kennedy questioned whether a stress test on SVB would have "made any difference." However, Vice Chair Barr declined to comment on this. Sen. Kennedy pointed out that the 2022 stress test scenarios did not include factors such as higher interest rates or a decline in the value of U.S. government bonds. Vice Chair Barr agreed and informed him that such scenarios are included for the upcoming stress tests.
- Sen. Warren pressed Vice Chair Barr on whether he would impose more strict prudential standards for institutions with between $100 billion and $150 billion in total consolidated assets. Vice Chair Barr acknowledged that, while any changes to these requirements will need

to go through the rulemaking office, he suspects increasing prudential standards for banks with greater than $100 billion in total assets.

- Sen. Warren asked Chair Gruenberg to commit to reversing the rollback of various regulations undertaken by his predecessor. Chair Gruenberg indicated that he is willing to review these changes in light of recent events.
- **Sen. J.D. Vance (R-OH)** asked at what level do depositors think that uninsured deposits are implicitly insured based on systemic risk. Chair Gruenberg acknowledged the concern and said that such considerations will be considered in the FDIC's May report. Vice Chair Barr explained that regulators were concerned about the broader systemic risk to the financial system. Sen. Vance suggested that, while regulators' actions may have been necessary, they may also impose a "moral hazard" on the banking system.
- Sen. Sinema asked whether the Fed had considered using its Section 401 authority to impose more stringent prudential standards on SVB. Vice Chair Barr noted that under the current framework, the situation was escalated in the form of MRIAs as well as a prohibition on engaging in mergers.

*Other Topics*

- **Sens**. **Chris Van Hollen (D-MD), Raphael Warnock (D-GA)**, and Cortez Masto asked what authority regulators have to claw back executive compensation for failed banks. Chair Gruenberg noted that the FDIC has "substantial" authority to issue monetary penalties, conduct reviews of bank management and affiliated parties, as well as bar individuals from practicing banking. However, he added the Federal Deposit Insurance Act (FDIA) does not grant the FDIC explicit authority to rescind executive compensation, but that there are similar tools under the Dodd-Frank Act. Vice Chair Barr added that the Fed does have this authority, including after a bank has already failed. Sen. Van Hollen pointed out that Dodd-Frank's claw back authority under its Ordinary Liquidation Authority (OLA) provision does not apply to banks of SVB's size. Mr. Gruenberg noted that while the FDIC does not have explicit claw back authority under the provision, they do have the ability to impose civil monetary penalties and restitution, adding that congress could create parity between the Dodd-Frank Act and FDIA to grant explicit claw back authority.
- Citing rulemaking under Vice Chair Randy Quarles clarifying that supervisory guidance does not have the effect of law, Sen. Van Hollen was critical that the rule was undertaken at the insistence of the Bank Policy Institute (BPI) and American Bankers Association (ABA). Sen. Van Hollen wondered whether this rule weakened the authority of supervisory guidance. Vice Chair Barr declined to comment on the matter but noted that it will be considered during the review.
- Sen. Warnock pressed Chair Gruenberg on whether the FDIC plans to revisit its executive compensation rulemaking under Dodd-Frank. Chair Gruenberg suggested that it may be appropriate to do so.
- Sen. Warnock inquired whether the FDIC plans to address instances in which overdraft fees are incurred by consumers due to their payroll providers' inability to access their funds at institutions such as SVB. Chair Gruenberg explained that the FDIC is still in the process of determining if such fees were levied and what actions should be taken in response.

- **Sen. Steve Daines (R-MT)** asked Vice Chair Barr if he would be willing to recommend certain Fed employees be fired if it is found that they were negligent in their duties, to which Vice Chair Barr declined to comment.
- Sen. Daines questioned regulators' focus on issues such as environmental, social, and governance (ESG) issues, suggesting this may have resulted in a misalignment of regulatory priorities — specifically with respect to the San Francisco Fed. Vice Chair Barr argued that he has remains focused on all short and long term risks.
- Sen. Tillis asked whether the Fed's review will include the role of state regulators in California. Vice Chair Barr indicated that the review is focused on its own actions and not that of state regulators.