

10:00 a.m. EDT
March 29, 2023

Statement by

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Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

March 29, 2023

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

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

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

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

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

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

Why the Bank Failed

To begin, SVB’s failure is a textbook case of mismanagement. The bank had a concentrated business model, serving the technology and venture capital sector. It also grew exceedingly quickly, tripling in asset size between 2019 and 2022. During the early phase of the pandemic, and with the tech sector booming, SVB saw significant deposit growth. The bank invested the proceeds of these deposits in longer-term securities, to boost yield and increase its profits.³ However, the bank did not effectively manage the interest rate risk of those securities or develop effective interest rate risk measurement tools, models, and metrics.

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

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

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

The Bank's Failure

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

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

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

Contagion and the Government's Response

It appeared that contagion from SVB's failure could be far-reaching and cause damage to the broader banking system. The prospect of uninsured depositors not being able to access their funds could prompt depositors to question the overall safety and soundness of U.S. commercial banks. There were signs of distress at other banking organizations, and Signature Bank, an FDIC-supervised institution, experienced a deposit run that resulted in the bank's failure. On Sunday, March 12, the Secretary of the Treasury, upon the unanimous recommendation of the

boards of the Federal Reserve and the FDIC, approved systemic risk exceptions for the failures of SVB and Signature. This enabled the FDIC to guarantee all of the deposits of both banks. Equity and other liability holders of the two failed banks were not protected and lost their investments. Senior management was immediately removed.

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

Our Review of the Bank's Failure

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

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

The picture that has emerged thus far shows SVB had inadequate risk management and internal controls that struggled to keep pace with the growth of the bank. In 2021, as the bank

grew rapidly in size, the bank moved into the large and foreign banking organization, or LFBO, portfolio to reflect its larger risk profile and was assigned a new team of supervisors. LFBO firms between \$100 billion and \$250 billion are subject to some enhanced prudential standards but not at the level of larger banks or global systemically important banks (G-SIBs).

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

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

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

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

Review Focus on Supervision

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

As I mentioned, SVB grew exceedingly quickly, moving from the RBO portfolio to the LFBO portfolio in 2021. Banks in the RBO portfolio are supervised by smaller teams that engage with the bank on a quarterly basis and conduct a limited number of targeted exams and a full-scope examination each year.⁶ Banks in the LFBO portfolio are supervised by larger teams that engage with the bank on an ongoing basis. As compared to RBOs, LFBO banks are subject to a greater number of targeted exams, as well as horizontal (cross-bank) exams that assess risks

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

such as capital, liquidity, and cyber security throughout the year.⁷ In addition, banks in the LFBO portfolio are subject to a supervision framework with higher supervisory standards, including heightened standards for capital, liquidity, and governance.⁸

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

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

- How effective is the supervisory approach in identifying these risks?
- Once risks are identified, can supervisors distinguish risks that pose a material threat to a bank’s safety and soundness?
- Do supervisors have the tools to mitigate threats to safety and soundness?

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

⁸ SR letter 12-17 / CA 12-14, “Consolidated Supervision Framework for Large Financial Institutions,” <https://www.federalreserve.gov/supervisionreg/srletters/sr1217.htm>.

⁹ Michael S. Barr, “Supporting Innovation with Guardrails: The Federal Reserve’s Approach to Supervision and Regulation of Banks’ Crypto-related Activities” (speech at the Peterson Institute for International Economics, Washington, D.C., March 9, 2023), <https://www.federalreserve.gov/newsevents/speech/barr20230309a.htm>.

- Do the culture, policies, and practices of the Board and Reserve Banks support supervisors in effectively using these tools?

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

Review Focus on Regulation

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

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

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

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

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

Ongoing Work to Understand and Address Emerging Risks

As I said a few months ago with regards to capital, we must be humble about our ability—and that of bank managers—to predict how a future financial crisis might unfold, how losses might be incurred, and what the effect of a financial crisis might be on the financial system and our broader economy.¹³

The failure of SVB illustrates the need to move forward with our work to improve the resilience of the banking system. For example, it is critical that we propose and implement the Basel III endgame reforms, which will better reflect trading and operational risks in our measure of banks' capital needs. In addition, following on our prior advance notice of proposed rulemaking, we plan to propose a long-term debt requirement for large banks that are not G-SIBs, so that they have a cushion of loss-absorbing resources to support their stabilization and allow for resolution in a manner that does not pose systemic risk. We will need to enhance our

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

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

stress testing with multiple scenarios so that it captures a wider range of risk and uncovers channels for contagion, like those we saw in the recent series of events. We must also explore changes to our liquidity rules and other reforms to improve the resiliency of the financial system.

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

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

Thank you, and I look forward to your questions.