EBERHARD KARLS UNIVERSITÄT TÜBINGEN

The Recent Failure of US Banks: Background, Solutions, Lessons to be learned

11th EBI Academic Debate
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I. Background

- **The changing interest rate environment: cause or trigger?**
  - Silicon Valley Bank, Santa Clara (CA):
    - rapid growth btw 2019 and 2022
    - highest depository base among US depository institutions
    - frequently employed by tech sector: high levels of deposits, largely unprotected by DGS (FDIC)
    - generally 'satisfactory' supervisory ratings of governance and liquidity position
    - exempted from restrictive, Basel-based regulatory standards from 2018 (including liquidity requirements and annual stress-testing)
    - large long-term, unhedged portfolio of Govt bonds, need for mark-to-market re-valuation of Govt bond holdings following change in monetary policy; fire-sale of assets at substantial discount
    - followed by massive outflow of deposits
    - cf. Federal Reserve: Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank (April 2023)
  - further cases: Signature Bank, First Republic

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II. Solutions

- **Friday 10 March:** Silicon Valley Bank (SVB), Santa Clara (CA) closed by California Dept of Financial Protection and Innovation, FDIC appointed as receiver (cf. U.S.C. § 1821(d))
- **Sunday 12 March:** Signature Bank (SB), New York, closed by NY authorities
- **Sunday 12 March:** 'Systemic risk exception' declared by FDIC and backed by US Treasury – 'no losses will be borne by the taxpayer'. Cf. U.S.C. § 1823(c)(4)(G):
  - exemption from general principle of 'least cost resolution', *i.e.*, permission to guarantee also uninsured deposits (above USD 250,000)
  - all costs to be covered through levies from regulated institutions
- by **Monday 13 March**
  - FDIC transferred <u>all</u> deposits (insured AND uninsured) of SVB to a newly created Bridge Bank: Silicon Valley Bridge Bank
  - FDIC transferred <u>all</u> deposits of SB to newly created Signature Bridge Bank

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II. Solutions

- **Friday 10 March:** Bank of England declares intent to apply for initiation of Bank Insolvency Procedure in relation to Silicon Valley Bank UK Ltd. (SVB UK)
  - insolvency procedure modelled after general insolvency law (court-administered procedure), but with exclusive application rights for BoE, FSA (with BoE's consent), and Secretary of State (cf. sections 90 et seq Banking Act 2009)
  - triggering mandatory payout of insured deposits (GBP 85,000 per individual, GBP 170,000 for joint accounts)
- **Monday 13 March:** BoE, in consultation with Prudential Regulation Authority, HM Treasury and Financial Conduct Authority, reports successful sale to sell SVB UK to HSBC UK Bank Plc
  - no Bank Insolvency liquidation!
  - application of resolution powers (section 11 Banking Act 2009: Private Sector Purchaser power)

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II. Solutions

- **Sunday 26 March:** FDIC announces purchase and assumption transaction with regard to Silicon Valley Bridge Bank: all deposits and loans taken over by First Citizens Bank & Trust Co., Raleigh (NC)
- **Monday 1 May:** FDIC announces purchase and assumption transaction in relation to First Republic Bank, San Francisco (CA):
  - all deposits (totalling 103.9 USD) and all assets (totalling 229.1 USD) to be taken over by JP Morgen Chase Bank
  - JP Morgan to engage in a loss-share transaction with FDIC
  - total costs to FDIC around 13 bn USD

III. Lessons to be learned

- **The regulatory perspective**
  - The common denominator: substantial deficiencies in (liquidity and solvency-related) risk management
  - Revisiting the wide exemptions for small and medium-sized banks: Key driver of the crisis?
  - Wither Deposit Insurance: Is there a case for comprehensive coverage?
    - cf. FDIC: Options for Deposit Insurance Reform (May 1, 2023)
    - Florian Heider et al.: European Lessons from Silicon Valley Bank Resolution: A plea for a comprehensive demand deposit protection scheme (March 2023)
- **The resolution perspective**
  - Was it a Bail-out? The systemic risk exception and the costs to other intermediaries (and their customers)
  - Predictable standard practice: P & A transactions and Bridge Banks
  - The other creditors: no Bail-in, no extension to AT 1 (unlike CH!)
  - what follows for the EU: resolution or liquidation?