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Statement by

Michael S. Barr

Vice Chair for Supervision

Board of Governors of the Federal Reserve System

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Chairman Brown, Ranking Member Scott, and other members of the Committee, thank you for the opportunity to testify today. Overall, the U.S. banking system remains strong and resilient, and depositors should be confident that all deposits in our banking system are safe. At the same time, recent stress in the banking system shows the need for us to be vigilant as we assess and respond to risks.

My review of Silicon Valley Bank's (SVB) failure demonstrates that there are weaknesses in regulation and supervision that must be addressed, and I am committed to doing so.[1] I am also committed to maintaining the strength and diversity of the banking system so that it can continue to provide financial services and access to credit for households and businesses. As we consider adjustments to our rules and supervisory practices, I am sensitive to how changes may affect banks in the current economic environment.

Accompanying my testimony today is the Federal Reserve's *Supervision and Regulation Report*. I am also submitting my report that examines the factors that led to the failure of SVB, including the role of the Federal Reserve. My testimony will offer an overview of banking conditions, the findings of the review, and opportunities for strengthening the Federal Reserve's regulatory and supervisory framework.

Banking Conditions

Let me begin with conditions in the banking system. Overall, banks have strong capital and liquidity, enabling them to lend and provide financial services to households and businesses.

At the same time, recent stress in the banking system shows the need for us to be vigilant as we assess and respond to risks. The recent failures of three large U.S. banks have also

[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.

demonstrated the risks of concentrated funding sources and poor management of interest rate risks. As interest rates have risen, fair values of investment securities have declined significantly. Deposit costs have also increased from low levels, and firms are turning to wholesale borrowings to address emerging funding needs. Delinquency rates for some loan segments have started to increase from the low levels seen over the past several years. Banks have increased provisions for credit losses in anticipation of asset quality deterioration. Accordingly, supervisors are redoubling their efforts to assess banks' preparedness for emerging credit, liquidity, and interest rate risks.

SVB Review

Let me turn to the SVB review. Immediately following SVB's failure, I led a review of the Federal Reserve's supervision and regulation of the bank. Staff who were not involved in the supervision of SVB conducted the review. The resulting report takes an unflinching look at the conditions that led to the bank's failure, including the role of Federal Reserve supervision and regulation. There are four key takeaways from the report.

First, SVB's board of directors and management failed to manage the bank's risks. The bank tripled in size between 2019 and 2021—expanding from $71 billion to $211 billion—as the rise in tech and venture capital activity led to growth in uninsured deposits, which the bank then invested largely in held-to-maturity securities. As the bank grew, its board and management failed to effectively oversee the risks inherent in the bank's concentrated business model and high level of reliance on uninsured deposits. The bank repeatedly failed its own liquidity tests, and SVB responded, in part, by changing the assumptions that determined its liquidity needs. The bank also mismanaged its interest-rate risk. Its senior leadership focused on short-term profits, removed interest-rate hedges that would have helped to protect the bank in a rising rate environment, and ignored multiple breaches of long-term interest-rate-risk limits.

The second key takeaway is that Federal Reserve supervisors did not fully appreciate the extent of the vulnerabilities as SVB grew in size and complexity. This meant that SVB remained well-rated through the summer of 2022, even as significant risk to the bank's safety and soundness were growing.

The third key takeaway is that when supervisors did identify vulnerabilities, they did not take sufficient steps to ensure that the bank fixed those problems quickly enough. When SVB became subject to heightened supervision in the large and foreign banking organization, or LFBO, portfolio in 2021, it was clear to supervisors that there were serious problems at the bank. However, Federal Reserve regulations provided SVB with a long runway to meet higher standards, and the bank entered the LFBO portfolio with a default view as satisfactory, which led examiners to wait to accumulate evidence to impose a lower rating. Yet supervisors found many serious problems: when the bank failed, it had 31 unaddressed safety and soundness supervisory findings—triple the number of peer banks. Overall, the supervisory approach at SVB was too focused on the continued accumulation of supporting evidence in an environment for supervision that emphasized consensus.

Finally, the fourth key takeaway is that the Federal Reserve Board's tailoring approach in response to the Economic Growth, Regulatory Relief, and Consumer Protection Act and a shift in the stance of supervisory policy impeded effective supervision by reducing standards, increasing complexity, and promoting a less assertive supervisory approach. Absent these changes, SVB would have been subject to supervision within the LFBO portfolio and subject to heightened standards beginning in 2019—throughout the bank's period of rapid growth. While higher supervisory and regulatory requirements may not have prevented SVB's failure, they would have meant that the bank had stronger risk management and more financial resources to weather the stress.

The four key takeaways show failures by SVB's board and senior management and failures by the Federal Reserve. It is crucial that we address those failures. Next, I will outline how we can strengthen both our supervision and regulation based on what we have learned and based on the Federal Reserve's existing authorities. I highlight a few examples below.

Lessons Learned from SVB's Failure

To start, SVB's failure confirms the importance of strong levels of bank capital. While the proximate cause of SVB's failure was a liquidity run, the underlying issue was concern about its solvency—the bank's ability to absorb the losses on its securities and repay its depositors and other creditors. We should be humble about our ability—and that of bank managers—to predict how losses might be incurred, how future financial stress might unfold, and what the effect of financial stress might be on the financial system and our broader economy. Stronger capital will guard against the risks that we may not fully appreciate today and reduce the costs of bank failures.

A second key lesson is that SVB's distress proved to have broader consequences for the banking system, even though SVB was not extremely large, highly connected to other financial counterparties, or involved in critical financial services. We need to reconsider the requirements that apply to banks based on size and risk.

With respect to capital, we need to evaluate whether our capital requirements appropriately measure the ability of banks to absorb losses. Had SVB been required to reflect declines in the face value of available-for-sale securities in its capital, it may have held more capital to cover these losses. Any rule changes such as these that we might propose would not be effective for several years because of the standard notice and comment rulemaking process and would be accompanied by an appropriate phase-in.

We also should evaluate how we supervise and regulate a bank's management of interest-rate risk. While interest-rate risk is a core risk of banking that is not new to banks or supervisors, SVB did not appropriately manage its interest-rate risk, and supervisors did not force the bank to fix these issues quickly enough.

In addition, we should evaluate how we supervise and regulate liquidity risk, starting with the risks of uninsured deposits. For instance, liquidity requirements and models used by both banks and supervisors should better capture the liquidity risk of a firm's uninsured deposit base. We should also consider applying standardized liquidity requirements to a broader set of banks. Any adjustments to our rules would, of course, go through normal notice and comment rulemaking and have appropriate transition periods.

In addition, our oversight of incentive compensation for bank managers should also be improved. SVB's senior management responded to the poor incentives approved by its board of directors; they were not compensated to manage the bank's risk, and they did not do so effectively.

Speed, Force, and Agility of Supervision

I also plan to improve the speed, force, and agility of supervision. Supervisors did not fully appreciate the extent of the vulnerabilities as SVB grew in size and complexity, and when supervisors did identify vulnerabilities, they did not take sufficient steps to ensure that SVB fixed those problems quickly enough.

Supervision should intensify at the right pace as a bank grows in size or complexity. Within our supervisory structure, there should be more continuity between the portfolios for banks of different sizes and risk so that a bank is ready to comply with heightened regulatory and supervisory standards more quickly. We also need to be especially attentive to the particular risks that banks with rapid growth, concentrated business models, or other special factors might pose regardless of asset size.

Once identified, issues should be addressed more quickly, both by the bank and by supervisors. Today, for example, the Federal Reserve generally does not require additional capital or liquidity beyond regulatory requirements for a bank with inadequate capital planning, liquidity risk management, or governance and controls. I believe that needs to change in appropriate cases. Higher capital or liquidity requirements can serve as an important safeguard until risk controls improve, and they can focus management's attention on the most critical issues.

Moreover, we need to ensure we have a culture that empowers supervisors to act in the face of uncertainty. Supervisors should be encouraged to evaluate risks with rigor and consider a range of potential shocks and vulnerabilities so that they think through the implications of tail events with severe consequences.

Conclusion

I want to reiterate that the banking system remains strong and resilient. Recent events demonstrate that we—as regulators—must do better. We need to ensure that we have strong supervision and regulation to make the financial system safer and fairer, in support of an economy that serves the needs of households and businesses.

Thank you, and I look forward to your questions.