Congressional Research Service
Informing the legislative debate since 1914

INSIGHT

Silicon Valley Bank, Signature Bank, and P.L. 115-174: Part 2 (Issues Surrounding Their Failures)

March 28, 2023

The recent failure of two large banks, Silicon Valley Bank (SVB) and Signature Bank, has raised questions about changes to large bank regulation made by the Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174). For background on their failures, see CRS Insight IN12125, *Silicon Valley Bank and Signature Bank Failures*.

Part 1 discusses how P.L. 115-174 modified enhanced prudential regulation (EPR) requirements. A description of which EPR requirements apply to each category of large banks can be found in Table 3 of CRS Report R46779, *Over the Line: Asset Thresholds in Bank Regulation*. For background, see CRS Report R45711, *Enhanced Prudential Regulation of Large Banks*. This insight discusses how EPR applied to SVB and Signature.

SVB and Signature Under EPR

Signature Bank was not structured as a bank holding company (BHC), so it was not subject to most EPR requirements, and its primary regulator was the Federal Deposit Insurance Corporation (FDIC). SVB and its holding company, SVB Financial Group, were regulated by the Fed. Due to its rapid growth, SVB Financial Group was first listed as a Category IV BHC by the Fed in November 2021 and had only recently begun to be supervised under the Fed's Large Banking Organizations (LBO) framework. SVB Financial held over $200 billion in assets at the end of 2022.

EPR was intended to address systemic risk. Proponents of P.L. 115-174 argued that banks with under $250 billion in assets were less likely to pose systemic risk or posed less systemic risk than did banks above $250 billion and therefore did not need to be subject to the same level of regulatory stringency. The failures of SVB and Signature triggered fears of a general bank run that led the FDIC, in consultation with the Fed and Treasury Secretary, to invoke the systemic risk exception in order to guarantee uninsured depositors. In this case, the systemic risk arguably stemmed from contagion—the risk that bank runs would spread to other banks—not interconnectedness.

Congressional Research Service
https://crsreports.congress.gov
IN12130

EPR covers a relatively narrow set of issues, and some argue that the problems faced by SVB—interest rate risk, liquidity risk, concentration risk—were more likely to have been caught by general regulatory and supervisory standards applying to all banks rather than EPR. If so, the failures might be attributable to supervisory inadequacies rather than lack of statutory authority. A closer look at the specific EPR requirements provides some insight into this question.

Under EPR, BHCs are subject to **stress tests** to ensure capital adequacy in the event of a severely adverse economic outcome. P.L. 115-174 exempted Category IV BHCs from company-run stress tests. In Fed-run stress tests, the Fed projects what would happen to a number of economic and financial variables under a severely adverse outcome and projects bank losses under that outcome. The Fed's 2019 rule reduced the frequency of Fed-run stress tests from annual to biannual for Category IV BHCs. After P.L. 115-174 the Fed reduced the number of stress test scenarios it used. Under the 2022 severely adverse scenario, interest rates on Treasury securities were assumed to fall and be very low. Part of SVB's losses stemmed from rising Treasury rates (i.e., interest risk). Because SVB Financial only recently became a Category IV BHC and its stress tests were biannual, it had never undergone a stress test.

The proximate cause of SVB's and Signature's failures was the large and sudden withdrawal of deposits (i.e., liquidity risk). EPR requires liquidity standards to help ensure that banks do not fail because of cash flow problems. BHCs are subject to three groups of **liquidity requirements** under EPR: (1) the liquidity coverage ratio (LCR) to ensure sufficient liquid assets that can be sold in a crisis, (2) the net stable funding ratio (NSFR) to ensure that banks have access to sufficient stable funding in a crisis, and (3) internal firm requirements. In the 2019 rule, the Fed no longer required Category IV BHCs to meet (a less stringent version of) the LCR unless they had "$50 billion or more in average weighted short-term wholesale funding" and imposed less stringent internal liquidity requirements on them. The NSFR was not finalized until 2020, and Category IV BHCs were exempted. (Category IV bank subsidiaries are also exempt from the LCR and NSFR.) As defined, neither the LCR nor the NSFR was necessarily geared to catching the sort of problems experienced by SVB. Some of the assets and liabilities that posed problems for SVB Financial would have been treated relatively favorably under the LCR and NSFR. Treasury securities receive the most favorable treatment under the LCR—the LCR is not concerned with whether the market value of a BHC's Treasury securities has fallen. Likewise, most types of deposits receive a 90% or 95% weighting under the NSFR—the NSFR was more concerned with bank overexposure to short-term wholesale funding (debt).

Concentration risk is addressed under EPR by the Single Counterparty Credit Limit (SCCL) requirement. The Fed's SCCL rule, which was finalized after the enactment of P.L. 115-174, exempted Category IV BHCs. This requirement only addresses excessive exposure to a single counterparty, such as a single business, not excessive exposure to a single industry (e.g., the tech industry). It is not known at this time whether concentration to a single counterparty was an issue for SVB Financial.

Risk management is the only Dodd-Frank EPR requirement that applies to banks with $50 billion or more assets under P.L. 115-174. Despite this, SVB reportedly did not have a permanent chief risk officer in place from April 2022 to January 2023.

Interest rate risk could potentially have been captured earlier by a Basel III requirement (as opposed to a Dodd-Frank requirement). Under the bank regulators' implementation of Basel III capital requirements, banks and BHCs that were not Category I or II banks could opt out of Accumulated Other Comprehensive Income (AOCI) requirements since before the enactment of P.L. 115-174. Both banks reported opting out in their call reports. Among other things, AOCI requires covered banks to include unrealized gains and losses on available-for-sale securities in net income, which affects their capital levels. Had the failed banks been subject to AOCI requirements, they might have been required to hold more capital as their securities lost value in the run up to their failure.

The Fed reported in 2022 that current supervisory priorities for LBOs included interest rate risk and changes in deposits. The FDIC also had separate supervisory guidelines for large bank organizations.

Author Information

Marc Labonte
Specialist in Macroeconomic Policy

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.