OVERSIGHT OF SILICON VALLEY BANK AND SIGNATURE BANK: GAO'S PRELIMINARY REVIEW

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTEENTH CONGRESS

FIRST SESSION

MAY 11, 2023

Printed for the use of the Committee on Financial Services

Serial No. 118–21

U.S. GOVERNMENT PUBLISHING OFFICE
52–933 PDF WASHINGTON : 2023

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CONTENTS

OVERSIGHT OF SILICON VALLEY BANK AND SIGNATURE BANK: GAO'S PRELIMINARY REVIEW

Thursday, May 11, 2023

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2220, Rayburn House Office Building, Hon. Bill Huizenga [chairman of the subcommittee] presiding.

Members present: Representatives Huizenga, Sessions, Wagner, Rose, Meuser, Ogles; Green, Horsford, Tlaib, Garcia, and Williams of Georgia.

Ex officio present: Representative Waters.

Also present: Representative Barr.

Chairman HUIZENGA. Good morning. The Subcommittee on Oversight and Investigations will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Oversight of Silicon Valley Bank and Signature Bank: GAO's Preliminary Review."

I now recognize myself for 5 minutes for an opening statement.

Congressional oversight is a Constitutional authority used to maintain the well-being of our system of government. This lesson of oversight was something that I learned from someone who is considered the, "lion of the House," John Dingell. He was still in Congress when I first came here, and he taught me a couple of things. The first, he called, "the tyranny of the vote." It did not matter whom you were with, what you were doing, what was happening, or where you were, when they rang the bells, we had to go to the House Floor to vote.

The second was our Constitutional standing, our obligation, frankly, of oversight of the Administration, and he was an expert at that. It did not matter what the party label was, he always fought for the standing of Congress. The Government Accountability Office (GAO), is an investigative arm of Congress. They provide fact-based, non-partisan information that can be used to improve government and save taxpayers billions of dollars. Committee Republicans and Democrats should support robust oversight of our financial regulators, aiming to seek transparency and demanding that accountability.

Unfortunately, as you will hear in today's testimony, regulators in Washington are attempting to paint a bit of a different picture. But the facts are clear: The collapses of SVB and Signature Bank were the result of risky business strategies, no doubt, and years of failed supervisory action. In fact, some of the concerns identified in GAO's April report are not new. In 2013, in a report entitled, "Financial Institutions: Causes and Consequences of Recent Bank Failures," the GAO highlighted that aggressive growth strategies, using non-traditional, riskier funding, similar to those of SVB and Signature, were key factors in bank failures. These uninsured, unstable deposits accounted for much of SVB's and Signature Bank's total assets, which the FDIC noted in 2019, "could pose risks to regional banks." SVB was also affected by rising interest rates, which was fueled by reckless spending in the Federal Reserve, that was too late to react.

In 2015, a GAO report on bank failures concluded that the regulatory process was not always effective or timely in correcting the underlying problems before these banks failed. In the years prior to their collapse, the Federal Reserve and the FDIC identified management risks at both banks, yet allowed those risks to go unfixed. The failure of Federal regulators to mitigate or escalate management concerns proved costly.

The GAO's report examines Treasury's use of the Systemic Risk Exception (SRE), and the establishment of the Bank Term Funding Program (BTFP). Particularly, the use of the SRE is a powerful emergency tool, and that has not been without criticism. As part of our investigation into the government's response to these bank failures, the subcommittee hopes to better understand how the Federal Reserve and the FDIC concluded that recommending use of the SRE was a last resort.

Again, the GAO reported that the use of the Systemic Risk Exception, "may weaken market participants' incentives to properly manage risk."

While the Treasury Secretary has warned the public not to assume these actions create a guarantee of deposits, it is hard, frankly, to think otherwise. Ultimately, losses to the Deposit Insurance Fund (DIF) will be passed down to hardworking Americans.

Frankly, any loss of confidence in our banking system is a loss of confidence in our regulators. Regulators had the tools at their disposal to prevent these bank failures from happening, and they missed it, period. And instead of concentrating on the basics, the things that they did not get right, some of my friends on the other side of the aisle want to give our regulators even more complicated rules. As the Biden Administration and the Federal Reserve attempt to shift the narrative, the GAO's report provides no evidence that the failure of either SVB or Signature Bank was the result of relaxed regulations.

I believe it is necessary to reiterate how important it is that this committee receives the information that has been requested, and the information we will be requesting, moving forward. The American people deserve answers. We should not allow history to be rewritten. And I welcome the FDIC and the Federal Reserve to appear at future subcommittee hearings to further answer our questions.

I am committed to making sure this subcommittee does not just draw conclusions but bases its findings on evidence. That is what oversight is, and as the chairman, that is my commitment to our members.

So, I look forward to hearing from Director Clements, and I yield back the balance of my time.

And with that, the Chair now recognizes the ranking member of the subcommittee, the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. Mr. Chairman, I commend the prompt response of President Biden, Full Committee Ranking Member Waters, and Federal regulators to the failures of Silicon Valley Bank and Signature Bank. This collective judicious response, led by President Biden, prevented extensive contagion, protected depositors, and preserved the integrity of our banking system, among many other things. The rapid collapse of these banks revealed how quickly bank runs can occur in our increasingly-connected world.

Although fingers will be pointed at technology, President Biden, and regulators as factors in the failure of Silicon Valley Bank and Signature Bank, they were not—N–O–T—the root cause of the banks' failures.

The focus of today's hearing should be the mismanagement of these banks by their executives in the years leading up to the collapse, in tandem with the Trump-era deregulation that enabled this mismanagement to fester.

Both Silicon Valley Bank and Signature Bank experienced outsized growth between 2018 and 2022. Signature Bank grew from approximately $47 billion in total assets in 2018, to $110 billion in 2022. Silicon Valley Bank increased from $56 billion to $209 billion over that same period of time. Mr. Chairman, some things bear repeating: Silicon Valley Bank increased from $56 billion to $209 billion over that same period of time.

This outsized growth in assets was fueled by more than 70-percent uninsured deposits at both banks, far higher than the median of 32 percent for comparable banks. The executives at both banks knew, or should have known, that their risk management practices had to be strengthened appropriately as they grew exponentially.

Adding insult to injury, Mr. Chairman, Silicon Valley Bank irresponsibly operated without a chief risk officer from April until December of 2022.

Is it a coincidence, I ask, that these banks grew rapidly beginning in 2018, and failed to adequately manage their risk around the same time that former President Trump signed S. 2155, his Bank Deregulation Bill, into law? S. 2155 diminished regulatory standards on these mid-sized banks, resulting in much less enforcement security.

Friends, blaming President Biden and regulators will not reinstate stronger regulations on mid-sized banks or promulgate needed legislation to enable lawful clawback of ill-gotten mismanagement executive compensation. Only legislation can do that.

I want to thank you for the time, and I would like to ask Full Committee Ranking Member Waters if she desires any time?

Ms. WATERS. Thank you very much, Mr. Green.

Mr. GREEN. I yield to the ranking member.

Chairman HUIZENGA. The gentleman yields to Ranking Member Waters.

Ms. WATERS. I thank the GAO for the preliminary review it issued at my and Chairman McHenry's request on the failure of Silicon Valley and Signature Banks. The GAO has clearly described how the FDIC and the Fed repeatedly informed these banks, as early as 2018, about deficiencies in their liquidity and risk management. But instead of taking action, these banks ignored the warnings. Let me be clear: Regulators need to be more aggressive, something I have long been demanding with regard to repeated abuses at Wells Fargo. However, it was the responsibility of the banks, first and foremost, to swiftly and thoroughly correct the deficiencies that were flagged by regulators.

We now need to hold banks and their executives accountable, reverse Trump-era deregulation, enhance supervision of banks, and reform deposit insurance.

Thank you, and I yield back.

Chairman HUIZENGA. Thank you.

Today, we welcome the testimony of Mr. Michael Clements. Mr. Clements is the Director of GAO's Financial Markets and Community Investment Team. He leads GAO's work in overseeing the financial markets and the regulators. Mr. Clements led the team responsible for preparing the interim report issued by the GAO 2 weeks ago, on the March 2023 bank failures.

Since 1999, Mr. Clements has contributed to GAO's mission of supporting Congressional oversight efforts over the regulation of the financial banking regulators, and previously, the broadband communications and telecommunications industries as well.

We thank you for taking the time to be here today, sir. You will be recognized for 5 minutes to give an oral presentation of your testimony, and without objection, your written statement will be made a part of our permanent record.

And you are now recognized for 5 minutes.

STATEMENT OF MICHAEL E. CLEMENTS, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, GOVERNMENT ACCOUNTABILITY OFFICE (GAO)

Mr. CLEMENTS. Good morning, Chairman Huizenga, Ranking Member Green, Full Committee Ranking Member Waters, and members of the subcommittee. I am pleased to be here today to discuss GAO's preliminary work on the March 2023 bank failures, as reflected in our April 28th report to the committee.

As you know, at the time of their failure, Silicon Valley Bank, or SVB, and Signature Bank were the 16th- and 29th-largest banks, respectively, in the country. Their failures could impose a $22-billion cost on the Deposit Insurance Fund. And while not part of our work, First Republic's recent failure could impose another $13-billion cost on the Deposit Insurance Fund.

For today's hearing, I will focus on: one, bank-specific factors that contributed to the failures; and two, supervisory actions that regulators took leading up to the failures.

First, the bank failures. We found that risky business strategies and weak liquidity and risk management contributed to the fail-

ures at SVB and Signature Bank. SVB and Signature both experienced rapid growth, far exceeding a group of 19 peer banks. For example, SVB's assets more than tripled in the 3 years prior to its failure.

SVB and Signature also relied heavily on uninsured deposits, which are prone to run risks. For example, Signature funded 82 percent of assets with uninsured deposits.

SVB and Signature also exhibited weak liquidity and risk management controls. When confronted with external pressures, rising interest rates for SVB, and weakening digital asset markets for Signature, the risky business strategies and weak management contributed to the banks' failures.

Second, the regulators' supervisory actions. We found that the regulators identified problems at SVB and Signature Bank, but the regulators did not escalate supervisory actions in time to mitigate the risks. Federal Reserve staff who examined SVB, and FDIC staff who examined Signature, identified problems at the banks. For example, between 2018 and 2022, the Federal Reserve issued 10 Matters Requiring Attention (MRAs) to SVB for liquidity and risk management problems. Likewise, the FDIC issued Matters Requiring Board Attention (MRBAs) and other supervisory recommendations to Signature for similar problems. However, we found that the Federal Reserve and the FDIC did not adequately escalate their supervisory actions.

The Federal Reserve was generally positive in ratings of SVB from 2018 through June of 2022, rating SVB's overall condition as, "satisfactory." When SVB moved from the Federal Reserve's Regional Banking Organization, examiners began downgrades. Yet, despite the consistent liquidity and serious management problems, the Federal Reserve did not issue an enforcement action before the banks failed.

Likewise, FDIC's ratings of Signature Bank found its overall condition was, "satisfactory," from 2018 through 2021. FDIC staff told us they were considering escalating supervisory actions in 2022, including taking enforcement actions. However, despite Signature's repeated failures to remediate the liquidity and management problems, the FDIC only issued enforcement action the day before the bank failed.

GAO has reported similar findings in the past. In 2015, we reported that although regulators often identified risky practices, the regulators' process was not always effective or timely in correcting the underlying problems at banks.

Chairman HUIZENGA. Mr. Clements, I am so sorry. We have just gotten notice that they are having a difficult time hearing you through the audio, and this is being televised, so if you could just pull the microphone a little closer. We can hear you fine in the hearing room, but apparently not through the television. So, just pick up where you are at; that is helpful. Thank you. Sorry about that.

Mr. CLEMENTS. In 2011, following the financial crisis, we recommended that regulators consider adding non-capital triggers to the prompt corrective action framework to help give more advance notice of deteriorating conditions. And in 1991, following the savings and loan crisis, we found that regulators did not always use

the most-forceful actions available to them to correct unsafe and unsound practices. We continue to believe taking early action would give regulators and banks more time to address deteriorating conditions.

Chairman Huizenga, Ranking Member Green, and members of the subcommittee, this completes my prepared statement. I would be happy to respond to any questions you may have.

[The prepared statement of Director Clements can be found on page 30 of the appendix.]

Chairman HUIZENGA. Thank you, Mr. Clements. We appreciate that. We will now turn to Member questions, and the Chair recognizes himself for 5 minutes for questioning.

Again, Mr. Clements, thank you for testifying before our subcommittee today. The work you and your team have done to complete the preliminary report so quickly is much appreciated. Your report is the only impartial review, frankly, conducted on these bank failures, in my estimation, and I would like to start by setting the stage a little bit, starting with how the preliminary review was conducted. I understand that you conducted interviews with staff from the Federal Reserve, the FDIC, and Treasury.

Can you talk to us about how those witnesses were identified for you to interview? Did you do that on your own or how did that work?

Mr. CLEMENTS. We had one meeting with each of those entities. Our standard practice is to send our list of questions over to the agencies and then the agencies will identify staff who are best-positioned to answer those questions. In follow-up work, which we do tend to complete with this, we will be more specific in asking for particular individuals with whom to speak.

In the case of the Federal Reserve, we met with Board staff in the Supervision and Regulation Division and also with staff from the Federal Reserve Bank of San Francisco.

Chairman HUIZENGA. Did you feel like you had full access to Agency staff? Were you able to do follow-up with those folks as they were getting back with some of these answers? You said you had passed those questions along, and they self-identified who would be best to answer them. Were you able to interview those folks and do some follow-up?

Mr. CLEMENTS. At this point, we just had the one meeting with the three agencies. Again, moving forward, we will have further meetings with them.

Chairman HUIZENGA. Okay. So, were those meetings in person?

Mr. CLEMENTS. They were not. They were virtual.

Chairman HUIZENGA. They were virtual, okay. And then, do you know if, in the interviews that you conducted, there were multiple people on at the same time, or was it with one individual at a time?

Mr. CLEMENTS. These were hour-long meetings with the entire staff that the agencies had identified for us.

Chairman HUIZENGA. Okay. So it was kind of a whirlwind, you had everybody on the screen doing this Zoom?

Mr. CLEMENTS. It is what we refer to as an, "entrance conference."

Chairman HUIZENGA. I'm sorry—a what conference?

Mr. CLEMENTS. An entrance conference. It is our preliminary, initial meeting with the agencies to go over what our work is going to be and some preliminary questions that we have for them.

Chairman HUIZENGA. So in other words, you were planning on doing follow-up?

Mr. CLEMENTS. We do plan additional work once we move beyond getting the April 28th report out.

Chairman HUIZENGA. This preliminary report, okay. And did you feel like the regulators provided you with access to all of the documents and the material facts that you had requested in a timely manner? What was the turnaround time from when these requests were sent in, to when you were actually doing these Zoom interviews?

Mr. CLEMENTS. The Agencies were responsive in getting us the desired information. We had requested a variety of supervisory information—scoping memos, schedules, records of exams, supervisory letters. We received all of those, I would say, within probably 3 or 4 days. I know the Fed staff was working over the weekend to get us that information. So, we actually did appreciate the timeliness for this engagement. I think they recognized the importance of this work.

Chairman HUIZENGA. I am glad to hear they were responsive to somebody in this, because we have a number of letters that have been out that are lacking that response, frankly.

Now, I would like to pivot and ask about something specific in your report, or rather something that was maybe not in your report. GAO is in a position to provide sort of an unique historical perspective on bank failures with other economic events from the past, because you have done some of these reports in the past, correct, on previous challenges?

Mr. CLEMENTS. That is correct. We go back to 1991, or I think 1989 might have been our first work, looking at the savings and loan community.

Chairman HUIZENGA. Savings and loan failures, then. In contrast to the GAO report, the report issued by the Federal Reserve partially blames the failure of Fed examiners to escalate SVB's liquidity and interest rate risk concerns quickly on, "a shift in culture and expectations that changed how supervision was executed."

From what you saw, was a culture shift referenced in any discussions that you had with the Fed staff, or in any of the documents that you reviewed over the course of compiling your initial report?

Mr. CLEMENTS. I have no basis to say whether there was a culture shift one way or the other. Again, we had the single meeting with the Fed. The issue of culture was not brought up. In fairness, we did not ask it, but they did not bring it up either.

Chairman HUIZENGA. Okay. But it features prominently in their report that there was this culture shift. It seems a little odd to me that they would not have brought that up in your investigation.

To your knowledge, was a culture shift mentioned in any past GAO work on similar bank supervision issues in 1991 or 2011 or 2015 or 2019, when you have done some of these other reports?

Mr. CLEMENTS. I am not aware of there being a culture change. We have previously reported that, in general, examiners in the

past have taken a cooperative and formal approach with agencies, and that has been as early as 1991.

Chairman HUIZENGA. Okay. My time has expired. We are going to be sending you some additional written questions from me as well, regarding the FDIC and trying to make sure that we understand the process for both SVB and Signature Bank.

I now recognize the ranking member of the full Financial Services Committee, Ms. Waters, for 5 minutes.

Ms. WATERS. Thank you very much. Mr. Clements, when I served as Chair of the Financial Services Committee, I investigated the egregious pattern of consumer abuse at Wells Fargo and found that regulators failed to use escalating enforcement actions to correct the bank's bad behavior, even as new and similar abuses emerged. I have legislation that would require the bank regulators to impose limits on bank growth, divestment, and other penalties for noncompliance. That is why I am pleased to hear that regulators like the Consumer Financial Protection Bureau (CFPB) and the Office of the Comptroller of the Currency (OCC) are beginning to focus on ways to ensure that repeat offenders correct their bad behavior.

According to the GAO report, the Federal Reserve and the FDIC had been advising Silicon Valley Bank and Signature Bank about the weaknesses in their risk management and liquidity programs in multiple examinations since 2018.

Mr. Clements, from your review, did the banks receive adequate explanation and information from the regulators to know that they had problems, what those problems were, and what was needed to fix them?

Mr. CLEMENTS. We certainly saw numerous instances of Matters Requiring Attention (MRAs), Matters Requiring Board Attention (MRBAs), and Matters Requiring Immediate Attention (MRIAs), that laid out issues, and we focused on the liquidity and risk management because that was sort of the approximate causes of the failures. We did not go on the various other consumer angles as well.

But we have, in the past, reported that the communication, the clarity of some of the supervisory letters could be clearer. We issued a report in 2019 on those issues. The agencies have taken steps to address the lack of clarity that they do provide to these banks, and their supervisory letters are records of this examination.

Ms. WATERS. So Mr. Clements, if the banks had adequate information on what the problems were and how to fix them for 5 years, what were the reasons they offered for not being able to correct problems in that time period?

Mr. CLEMENTS. We, in our past work, have seen a couple of issues. In some instances, the bank would disagree with the finding, and in fact, in the case of Signature Bank, I think there were a few instances where it did not agree with the supervisors' thoughts on where there were problems.

In other instances, the bank simply is unable to fix the problems, and we certainly saw, in the case of SVB, it agreed with the findings, but it was simply taking them a longer time than needed to

get the problems fixed, and obviously, in the interim, the bank failed.

Ms. WATERS. Could you explain a little bit further the excuse that the banks were unable to fix the problem, for example?

Mr. CLEMENTS. In a number of instances, the bank would agree with the problem being cited, but it would simply say it was going to take a while to fix the underlying problem. And, in fact, in the case of SVB and the San Francisco Fed, they agreed that it was going to take a while to fix the problem. Unfortunately, the problem got large enough where the bank failed before the problem could get resolved.

Ms. WATERS. Let me just raise a question with you that I really need to understand further, on the balance sheet. Did the balance sheet reflect liquidity, and do they have the responsibility to report the securities that they have and the value and whether the value has changed? Someone told me that for the regionals, it is just a footnote. Can you explain that?

Mr. CLEMENTS. A bank of the size of both SVB and Signature is required to mark securities that are considered available for sale, mark those to the market value. Any changes in that value is an account called, "other comprehensive income," where it would be recorded. So, it is being recorded. If the securities are held not for sale, then those securities are not marked for the market.

Ms. WATERS. Have there been recommendations about how the balance sheet should reflect the value of those securities?

Mr. CLEMENTS. I am not aware of any. In our past work, we have recommended or reported that it is important to have an accurate accounting of the firms, that the bank's financial condition be able to have a good sense of its vulnerabilities.

Ms. WATERS. Thank you very much. I yield back.

Chairman HUIZENGA. The gentlelady's time has expired.

The gentleman from Texas, Mr. Sessions, is recognized for 5 minutes.

Mr. SESSIONS. Mr. Chairman, thank you very much. Mr. Clements, I would like to continue down the line that the ranking member was coming down, and I have the report in front of me here and it provides me—and I am sure, other people here—a lot of intrinsic information. But it talks about how the amount of outstanding shares of advances under the program on April 19, 2023, was approximately $74 billion in outstanding advances.

Does that mean that they put all this excessive money that they had into a longer-term something that would generate money to them, perhaps interest? Is that what you are referring to, outstanding advances under the program? It is at the bottom of page, I think the first page that I have here says, "As of April 19, 2023, outstanding advances under the program were approximately $74 billion." Can you describe that to me?

Mr. CLEMENTS. Sure. That is the Federal Reserve's Bank Term Funding Program. At the point when SVB and Signature were failing, the Treasury made the systemic risk determination, which essentially allowed the coverage of uninsured and insured deposits at the two banks. The Federal Reserve also set up this Term Funding Program. The purpose of the program is to allow banks that perhaps would be experiencing liquidity problems to borrow money

from the Fed, the collateral being the securities that they are holding, which would be Treasuries and mortgage-backed agency securities.

Mr. SESSIONS. I am going to keep going here. Maybe, I will catch up with myself at some point. But they took an excessive amount of money. What did they do with those uninsured risks that are being discussed here? Where were they holding that money? Were they loaning it back out? Was it unavailable at the time that someone would need the money to be available when they wrote checks? What did they do with all of this money that came in?

Mr. CLEMENTS. I think there are two separate issues. There is this issue of the Federal program and the $79 billion, which it s lending to existing non-failed banks just to help them cover their liquidity.

Mr. SESSIONS. Whose money was that?

Mr. CLEMENTS. This is the Fed's money.

Mr. SESSIONS. The Fed's money. But what about all of this money that SVB brought in? What did they do with that large amount of money that was called an, "uninsured risk?"

Mr. CLEMENTS. Correct. In the period of 2018 through mid-2020, SVB grew rapidly, and it grew rapidly through uninsured deposits, principally from venture capital-backed firms.

Mr. SESSIONS. Right.

Mr. CLEMENTS. It used those funds to purchase what, in theory, would be safe securities—

Mr. SESSIONS. Long-term Treasuries?

Mr. CLEMENTS. —Treasuries, mortgage-backed securities, agency securities.

Mr. SESSIONS. And then, they marked those that they were going to, over the long run, be getting back money. And they got pulled out early to where there was an unrealized—

Mr. CLEMENTS. Correct. So, they held those securities. Unfortunately, they had invested in longer-term securities, had not hedged the securities, and when the interest rates started going up, the value of those securities dropped. About the same time, the venture capital tech industry started pulling their deposits because they were no longer getting a bunch of funding.

Mr. SESSIONS. They maybe pulled them out—

Mr. CLEMENTS. The deposit base started falling. The bank eventually needed to start selling those securities, and it was selling them at a loss. At some point, depositors and other investors got spooked.

Mr. SESSIONS. But what it would have expected to have received.

Mr. CLEMENTS. Correct.

Mr. SESSIONS. Are you saying they lost money, or did not realize what they thought they were going to get and so they booked it as a loss?

Mr. CLEMENTS. They lost money, because the value of the securities had dropped as the interest rates—

Mr. SESSIONS. They lost money.

Mr. CLEMENTS. Yes.

Mr. SESSIONS. Okay. I am clear. This is what I thought coming into this, but I did not understand that most of this—am I at my time, Mr. Chairman?

Chairman HUIZENGA. Yes. You can complete your thought.

Mr. SESSIONS. My point is—

Chairman HUIZENGA. We will have a light gavel today.

Mr. SESSIONS. Thank you, because I think the ranking member will want to get to this. Who was that held by? Treasury? Most of these assets?

Mr. CLEMENTS. The securities were held by the bank, by SVB.

Mr. SESSIONS. Right.

Mr. CLEMENTS. So again, it took in money in deposits and invested that money in long-dated Treasuries and other securities. When the deposits started falling because the tech firms needed the money for payroll and whatever, the bank needed to sell the securities, and sold them at a loss.

Mr. SESSIONS. I got it. That is what I thought happened too, but you connected it for me. Mr. Chairman, thank you very much.

Chairman HUIZENGA. Thank you, and we will be mindful of the time on both sides.

Mr. Horsford, you are recognized for 5 minutes.

Mr. HORSFORD. Thank you, Mr. Chairman, and thank you to the ranking member of the Subcommittee and the ranking member of the Full Committee. And thank you to Director Clements for taking the time to discuss this important report, and for the GAO's nonpartisan work, which is crucial to our ability to know what occurred during the rapid collapse of Silicon Valley and Signature Banks, and now others that have followed.

And while this may be only a preliminary report, the insights provided point to serious deficiencies with both supervisory practices as well as management's reaction to glaring issues. Actually, it would be more fitting to describe it as management's inaction to the warning signs that were flashing when it came to even the most rudimentary risk management.

And I really want to point out that reality right now, in this moment, dealing with the default on America, that my colleagues on the other side are failing to acknowledge, and their role in basic rudimentary risk management against an economic collapse that none of us can even imagine.

According to the White House, in the event of a default because of our colleagues on the other side's unwillingness to raise the debt limit, "a crisis characterized by spiking interest rates and plunging equity prices, including home equity, would be ignited. Short-term funding markets, which are vital for the liquidity backing long-term mortgages would likely shut down completely. There would be a rapid and complete tightening of credit at regional and community banks, which would no longer be able to accurately price their Treasury bills or use them as high-quality collateral. Since these banks do the bulk of mortgage lending, the mortgage rates would go through the roof."

That is the management decision of the House of Representatives in this moment. We are standing here as the board of directors for the people of America, whose mortgages, whose car loans, and whose financing ability is being jeopardized because of Kevin McCarthy and the default on America proposal that is holding America ransom in paying its bills.

Mrs. WAGNER. —to the Chair.

Mr. HORSFORD. Excuse me. I have the floor.

Mrs. WAGNER. I have a parliamentary inquiry.

Chairman HUIZENGA. There is a parliamentary inquiry, which is appropriate.

Mrs. WAGNER. The gentleman needs to make his remarks to the Chair, not to individuals.

Mr. HORSFORD. That has nothing to do with this—

Chairman HUIZENGA. Just a moment. The Chair did not hear a reference to another Member.

Mr. HORSFORD. I reclaim my time.

Chairman HUIZENGA. Just a moment.

Mr. HORSFORD. I reclaim my time.

Chairman HUIZENGA. Just a moment. There was not a reference to another Member. It was not that. He was talking about the Speaker, so the Chair does not see the problem.

Mrs. WAGNER. By name.

Chairman HUIZENGA. By name. Correct. So it is noted, and the gentleman may continue.

Mr. HORSFORD. Clearly, I have hit a nerve, because this is about the American people and their finances, which are being held hostage because of a ransom note that is being offered by Kevin McCarthy and the default on America proposal that they have made, rather than our obligation to raise the debt limit and to pay the bills that have already been incurred by the prior Administration and prior Congresses.

So, I think that while we do our job in examining Silicon Valley Bank and Signature Bank and First Republic Bank, we should actually do our job as Congress and avoid this major catastrophe that is weeks away, and we know it. We have a responsibility as Congress to manage risk, and we are failing to do our job.

Now, let me make it clear: Republicans are failing to do their job. So, I am asking that we use the time of our committees to focus on the crisis that is right in front of us. And if my constituents—small businesses, people who have mortgages, families who are worried about meeting their obligations—are going to be impacted by higher interest rates because of Congress' inability to do its job, then we should be discussing that at this time.

Mr. Clements, you primarily focus on the failure of regulators to adequately escalate their supervisory concerns, and we certainly have some work to do bolstering supervisory escalation. However, I found the sections in the report focused on management's unwillingness to address repeated shortcomings just as alarming. For example, if Silicon Valley Bank's board, which I would say is the Congress right now, is unwilling or unable to, as you say, "provide effective oversight of implementation of the risk management framework," then what is the use of the framework in the first place?

You go on to say that the behavior of these executives and board members was irresponsible at best, as they let multiple supervisory letters fall on deaf ears, as we are hearing economists tell us today. Specifically for Silicon Valley, I am particularly—the other side went for more than a minute the last time. I am just using—

Chairman HUIZENGA. The Chair is very aware of the timing. I am giving you a tap of wrapping it up.

Mr. HORSFORD. If the Federal Reserve is correct in their report statement that Silicon Valley Bank's management was focused on the short-run impact of profits, in this report it is mentioned that Silicon Valley Bank did take steps to revise its incentive compensation programs, but evidently—

Chairman HUIZENGA. The gentleman will suspend.

Mr. HORSFORD. —they failed to do so.

Chairman HUIZENGA. The gentleman will suspend. If we are going to play that game, we will play that game.

The gentlelady from—

Mr. HORSFORD. The only game being played is by the other side failing to do its job.

Chairman HUIZENGA. The gentleman is not—

Mrs. WAGNER. Order—

Mr. HORSFORD. I do not mind being out of order.

Chairman HUIZENGA. The gentleman will suspend. The Chair will not accept this behavior. I let a line of questioning go for an answer that was along the lines of the ranking member's. I then allowed you to have a full minute, which was not what my colleague from Texas got. So, I expect that we are going to behave like adults at this table—just a moment—as you are demanding that Congress act. So, lead by example, everybody.

Ms. WATERS. Parliamentary inquiry.

Chairman HUIZENGA. Yes, ma'am.

Ms. WATERS. Parliamentary inquiry. Are you going to afford to every member of the committee an additional minute?

Chairman HUIZENGA. No, I will not. We will be adhering to the exact 5 minutes from now on. It has been even on both sides.

Ms. WATERS. Chair—

Chairman HUIZENGA. Everyone is—

Ms. WATERS. I would caution you not to imply that—

Chairman HUIZENGA. The ranking member is—

Ms. WATERS. —Members are not acting like adults. I do not think that is a credible statement.

Chairman HUIZENGA. The ranking member will suspend. That comment was to all sides, and everybody watching, as we are on television. Let us present to the American people that we can actually act like adults at this table, everyone.

Ms. WATERS. I think we are, and we do not need you to admonish us.

Chairman HUIZENGA. Thank you for your commentary.

Ms. WATERS. And thank you.

Chairman HUIZENGA. And with that, the gentlelady from Missouri, Mrs. Wagner, is recognized for 5 minutes.

Mrs. WAGNER. Thank you. Thank you, Mr. Chairman. And I would remind my good friend from Nevada, Mr. Horsford, that the only body in Congress or the Administration that has passed a debt ceiling are the Republicans in the United States House of Representatives weeks ago. We have waited over 100 days to hear from the White House regarding the very important issue of the debt limit, and reining in out-of-control spending, which, frankly, has driven inflation, which drove interest rates, that drove us to some of the banking volatility that we are currently seeing right now.

So, I would remind us all once again that it is the Republican House that passed a debt ceiling. Thank you very much.

Mr. Clements, I want to thank you for appearing before us today, and certainly for GAO's very quick work in preparing this thorough and independent report on the March 2023 bank failures.

Over the past 2 months, this committee has gathered more information about the management failures within these banks and the blatant lack of urgency for many years by Federal regulators to act more forcefully in preventing these failures. I am committed to investigating and holding accountable those who were asleep at the wheel, once again, and allowed these preventable failures to occur.

Mr. Clements, on page 23 of your report you note that the Federal Reserve Bank of San Francisco did not recommend the issuance of a single enforcement action against SVB, despite the bank's serious liquidity and management issues. On March 29th, Vice Chair Barr stated that there were seven supervisory determinations raised, but we have now come to learn that since 2018, there were actually 15 related liquidity and risk management issues.

After 15 MRAs and MRIAs had been issued, did you agree that escalating supervisory actions should have happened sooner, sir?

Mr. CLEMENTS. Yes.

Mrs. WAGNER. Thank you. What is the GAO's perspective when it comes to this slow-to-act pattern we are seeing from Federal regulators?

Mr. CLEMENTS. Again, this has been a pattern going back to 1991. Following the financial crisis in 2011 we had similar findings. We have, in the past, recommended trigger mechanisms. For example, if a particular measure is hit or if there are multiple instances of not resolving a problem, that would force an escalation.

Mrs. WAGNER. And enforcement must happen, after so many citations having been given out year after year after year after year. Mr. Clements, in your work, did the GAO see a notable shift in how SVB was supervised, particularly as it rapidly grew in size from a bank of approximately $71 billion in assets in 2019, to over $200 billion in 2022? What were those differences?

Mr. CLEMENTS. There was a shift. Under $100 billion, SVB was overseen by the Regional Banking Organization at the Fed. Once it passed over that threshold, it moved to the Large and Foreign Banking Organization. At that point, the number of examiners expanded rapidly; I think it got up to around 20 examiners looking at the bank, doing very targeted samples—

Mrs. WAGNER. But these liquidity and risk management citations that were issued went all the way back to 2018, sir.

Mr. CLEMENTS. That is correct.

Mrs. WAGNER. Okay. In the report, the Fed cited the pandemic as one of the factors explaining why the agency failed to properly supervise SVB. Yet, according to the Fed's November 2020 Supervision and Regulation Report, "Reduced examination activity only lasted for 3 months, from late March to mid-June, with the greatest reduction occurring at the smallest banks." Do you think the 3-month pause was a significant contributor to the Fed's challenges in escalating SVB's known supervisory issues?

Mr. CLEMENTS. I think the pause is separable from the decision to escalate. There were a number of warning signs along the way. Clearly there was the combination of the pandemic and their switch between regulatory divisions causing that.

Mrs. WAGNER. Three months only, and mainly the smallest banks.

I have a couple more questions, Mr. Clements, but I am going to adhere to the clock and decorum, and I will yield back the rest of my time, Mr. Chairman, and I thank you.

Chairman HUIZENGA. The gentlelady yields back. The gentlewoman from Georgia, Ms. Williams, is recognized for 5 minutes.

Ms. WILLIAMS OF GEORGIA. Thank you, Mr. Chairman.

In our Full Committee hearing on the failures of Silicon Valley Bank and Signature Bank on March 29th, I reminded everyone listening of the regular, hard-working people who are impacted by these failures. I want to continue to center on these same people that these failures of SVB, Signature Bank, and now First Republic bank have affected.

As the Congresswoman for Atlanta, the City with the largest racial wealth gap in the country, I am focused on how we can prevent future bank failures that disproportionately impact marginalized communities. We have regulators—the OCC, the Fed, and the FDIC—to monitor banks' behavior and practices and ensure repeat offenders correct their bad behavior. Regulators repeatedly warned SVB and Signature Bank about their weak risk management and liquidity issues.

In fact, regulators identified numerous Matters Requiring Attention and Matters Requiring Immediate Attention regarding the liquidity and risk management of SVB and Signature Bank. These warnings were not sufficiently acted upon, and as a result, many small business owners, including Black entrepreneurs from Atlanta, were faced with the possibility of not being able to make payroll. If entrepreneurs of color cannot trust that the bank regulators are taking serious action to ensure that their banks are safe, then how are they supposed to build their businesses and create wealth in communities like Atlanta?

Mr. Clements, how can regulators ensure that Matters Requiring Attention and Matters Requiring Immediate Attention are appropriately addressed by banks?

Mr. CLEMENTS. Yes, I think that goes back to our prior recommendations to have some type of trigger mechanism. The regulators currently operate on a more-informal basis, trying to get a collaborative solution. It was our recommendation in 1991, and then again in 2011, to have some type of trigger mechanism so that if the problem is serious enough or if there are multiple instances where the problem is not getting resolved, it would automatically require enforcement action.

Ms. WILLIAMS OF GEORGIA. How does that impact the escalation framework? How can regulators improve their escalation framework for regional banks?

Mr. CLEMENTS. Again, I think it takes some of the discretion away from the regulator by requiring particular enforcement action if a particular trigger has been met.

Ms. WILLIAMS OF GEORGIA. And how could those improvements be applied or adapted and then applied to larger banks, especially the banks considered too-big-to-fail?

Mr. CLEMENTS. In our work, I think we would apply those standards throughout, having a trigger, again, if particular conditions are met that would require either an informal or a formal enforcement action, or other escalations of supervisory actions.

Ms. WILLIAMS OF GEORGIA. GAO's preliminary review states that in the years prior to 2023, the Federal Reserve and the FDIC identified what turned out to be key drivers of bank failures—liquidity and management risk. However, according to GAO, neither regulators' actions resulted in the banks' management sufficiently mitigating the risks that contributed to the banks' failures.

Mr. Clements, based on the GAO's review, can we determine whom is at fault here? I see three potential options, and I would like your thoughts on which is the most accurate portrayal of fault. Was it the inability of the banks to mitigate risk due to the failure of regulatory agency officials to adopt examiner recommendations for corrective actions? Was it the banks' failure to effectively institute the corrective actions directed by the agencies? Or was it the banks' failure to effectively institute the corrective actions directed by the agencies, combined with the agencies' failure to take strong action the when banks' responses were insufficient?

Mr. CLEMENTS. At the end of the day, it is the bank's responsibility to manage the organization in a safe and sound manner. At the same time, we would expect that if a supervisor is seeing problems, and they are repetitive, that more forceful action would be taken.

Ms. WILLIAMS OF GEORGIA. As we sit here less than 2 weeks after the failure of the First Republic Bank, and 2 months after the failures of SVB and Signature Bank, the second-, third-, and fourth-largest bank failures in the country's history, I am concerned about the possibility of yet another bank failure that would impact my constituents, one that could have even more disastrous effects.

I would like you to speak to what Congress should take away from the GAO preliminary report.

Mr. CLEMENTS. Again, at the end of the day, it is a bank's responsibility to manage the organization. However, we think that if there are repeated problems or serious problems, the regulators need to take more forceful and early action before the problems become too large to get resolved. In fact, when we were talking with the San Francisco Fed officials and they described illiquidity at SVB, and they said it was going to take a while for SVB to fix the problem because it was so big, the natural question you ask yourself is, why did it become so big?

Ms. WILLIAMS OF GEORGIA. Mr. Clements, my time has expired, but I have many more questions that I would like to submit to you in writing for the hearing record.

Chairman HUIZENGA. The gentlelady is allowed to do so.

With that, the gentleman from Tennessee, the Vice Chair of this subcommittee, Mr. Rose, is recognized for 5 minutes.

Mr. ROSE. Thank you, Chairman Huizenga, and Ranking Member Green, for holding this hearing on what is obviously an important topic. I want to dive right in.

Director Clements, in response to a question from Chairman Huizenga earlier, you mentioned that there were multiple people in the interviews between the GAO, the FDIC, and Fed staff. Director Clements, were staff conferring with counsel during these interviews?

Mr. CLEMENTS. Traditionally, the agencies would have their General Counsel's office there.

Mr. ROSE. So, they were conferring during these particular interviews?

Mr. CLEMENTS. The staff spoke freely to us, but it is fairly common for somebody from the legal division to be present at these meetings.

Mr. ROSE. Okay. Thank you.

Mr. CLEMENTS. Not simply these meetings, but in general.

Mr. ROSE. First Citizens Bank's stock has nearly doubled since acquiring Silicon Valley Bank, but the FDIC capped its potential gain on First Citizens stock at $500 million, which to me seems like the FDIC got a raw deal for us. My concern is that sweetheart deals like this actually encourage acquiring banks to wait until the FDIC takes over a bank before making a bid, because they can get a better deal once they are in conservatorship. Why buy the cow when the milk is free, so to speak.

So Director Clements, did GAO review the terms of the offers that were submitted to the FDIC?

Mr. CLEMENTS. We did not have time to get to that level of detail. I do know that in the request from the committee, there is interest in those topics.

Mr. ROSE. Going forward, would you commit to reviewing that issue, these issues of offers that are considered but not accepted?

Mr. CLEMENTS. I think, and again, we are working with the staff, to sequence with the committee staff, to sequence our range of work, so that is certainly something we can consider.

Mr. ROSE. Okay. The FDIC and the Federal Reserve staff told the GAO that as SVB and Signature Bank failed, they conducted analyses and worked closely together, including exchanging drafts of the recommendations to invoke the Systemic Risk Exception (SRE) for the two banks. Do you have any insight into how many drafts of the recommendations there were to invoke the Systemic Risk Exception?

Mr. CLEMENTS. I do not. We saw the final letters that were sent, along with some preliminary analysis that the agencies had conducted.

Mr. ROSE. The GAO report notes that Treasury staff consulted regularly with the FDIC and the Federal Reserve and concurred with the basis of their recommendations to invoke the Systemic Risk Exception. Could you please provide some specifics on what this consultation actually looked like?

Mr. CLEMENTS. I do not have the specific details on that. They certainly told us that there were conversations between the three agencies over that weekend, as each were doing their own analyses.

Mr. ROSE. Thank you. The GAO report notes that you will be moving forward with more work on this issue as we move throughout the year. As I am sure you are aware, in the United States we have a Financial Stability Oversight Council (FSOC), which is charged, by statute, with identifying risks to the financial stability of the United States, promoting market discipline, and responding to emerging threats to the stability of the U.S. financial system. It seems to me the FSOC was asleep at the switch here and was instead busy studying the weather when they should have been concerned with interest rate risks.

So Director Clements, would the GAO commit to conducting a review of FSOC's actions during these bank failures?

Mr. CLEMENTS. We actually currently have ongoing work looking at FSOC. I am aware that in its most recent annual report, it did have a recommendation pertaining to interest rate risk, but you may know that the recommendations that FSOC makes are nonbinding.

Mr. ROSE. I hope you do continue to look at that. Some have argued that Signature Bank's involvement with digital assets customers somehow contributed to its subsequent failure. There also appear to be competing views from the FDIC and the New York State Department of Financial Services in their recent reports about the role digital assets played in Signature's failure.

Did GAO review whether Signature Bank's customer base contributed to its failure?

Mr. CLEMENTS. We looked at the supervisory letters and records of examinations. We certainly saw instances where there were large deposits from the digital assets space. But again, it was simply holding the deposits in operating accounts for those entities. Following some of the turmoil in 2022, in particular FTX, some of those deposits did start falling off.

Chairman HUIZENGA. The gentleman's time has expired.

Mr. ROSE. I hope you will dig into that issue. Thank you, and I yield back.

Chairman HUIZENGA. The gentleman's time has expired. The gentlewoman from Michigan, Ms. Tlaib, is recognized for 5 minutes.

Ms. TLAIB. Thank you so much, Mr. Chairman. And thank you, Director Clements, for this report to kind of really dig deeper into this. I get a lot of questions regarding the lack of transparency of fully understanding this.

Did you look at the timeline of some of the compensation and payouts and things like that, which led up to the failure?

Mr. CLEMENTS. We have not gotten to that. We do know that, again—

Ms. TLAIB. Is that something you would look into?

Mr. CLEMENTS. It is one of the requests that is in the letter that we received from Chairman McHenry and Ranking Member Waters.

Ms. TLAIB. That would be wonderful. One of the things that my good colleague was talking about is regarding regulators, and you said it is not binding. When was the first time the regulators said, "Something is going on, could you call us back?" What year was that?

Mr. CLEMENTS. The first instance that FSOC brought up the interest rate risk was its most-recent annual report, which would have come out early this year.

Ms. TLAIB. So, they sent a letter, they tell them whatever. Can they go arrest them? Can they fine then? What can they do to make them respond?

Mr. CLEMENTS. The recommendations in the annual report are nonbinding. They can also do what are called Section 120 recommendations, but again, those are also nonbinding.

Ms. TLAIB. So when you do look at the timeline, because I do not know if you can answer this question, why did the banks take on the risks and ignore repeated warnings? Why? Why ignore the Federal Government and their warnings?

Mr. CLEMENTS. I do not have a good answer to that.

Ms. TLAIB. I think bankers know how to manage risks. They are not stupid. I just think they are greedy, and senior employees promoted unsound practices and ignored risks because they stood to benefit from it. Look at the timeline, Director, when you do this next follow-up report. SVB offered some of the most-generous compensation packages around. Look at it. Compare it to other banks.

In 2022, CEO Greg Becker's salary was roughly $1 million, but he enjoyed over $5 million in stock awards last year and $2 million in stock options. Becker also earned over $6 million since 2020, from an incentive compensation plan on SVB's net income, even when the warnings were coming in.

This helps explain to me why, during 2022, SVB terminated close to $15 million in interest rate swaps that hedge against the impact of rising rates. The same bank started in 2023 almost completely unhedged because, for senior employees, higher net income meant higher compensation. Correct?

Mr. CLEMENTS. I am not familiar with their arrangements. Again, that would be something we could look at.

Ms. TLAIB. The timeline is critically important, because you can see how it led up, but they still got benefits. They still won, even though, again, this is impacting now other banks, and really people, the payroll, small businesses, and so forth.

Last year, Signature Bank CEO Joe DePaolo received over $8 million in total compensation. Mr. Clements, do you think that compensation incentives contributed to the poor risk management by the banks?

Mr. CLEMENTS. I do not have a basis to answer that at this point.

Ms. TLAIB. I know you can't. I just really love to ask that question.

I think in the report, one of the things in the Dodd-Frank Act, and it is something that our committee has been wonderfully educating me on, but Section 956—it has been, what, 12 years, and they have not implemented it. Can you, in your role, Director, look at the impact of not implementing Section 956 of the Dodd-Frank Act?

Mr. CLEMENTS. We can certainly take a look at that.

Ms. TLAIB. Yes, this is really important, because we need teeth. We need enforcement. We need to be able to claw back. We need to be able to, again, hold them accountable, because they are just not going to respond. There is nothing we can do. They are just

going to ignore us so they can set it up so they can benefit from it over and over again.

One of the things that I think the American people do fully understand is, we, as a role of oversight, is that we can call it out and basically expose the greed. But unless we give the authority and kind of the force and the binding force for our regulators to do something about it when folks do not respond, other banks are going to do the same; they are just not going to respond to us. They are just going to continue doing this kind of really crooked, very criminal-like, actually, set up so they can benefit and get more compensation. They sold the stock when they knew it was—they knew and they never informed us. To pick up the phone, and tell us, "Hey, sorry. Tomorrow, we are closing shop." Why isn't anybody more mad at the banks? They have literally just ignored the American people when they ignored the regulators.

Thank you. I yield back.

Chairman HUIZENGA. The gentlelady's time has expired. The gentleman from Pennsylvania, Mr. Meuser, is recognized for 5 minutes.

Mr. MEUSER. Thank you, Mr. Chairman. Mr. Clements, you are the Director of GAO's Financial Markets and Community Investment team. I want to just ask you first a couple of quick questions. In 2021 and 2022, this Congress overspent by over $5 trillion, with policies that caused huge spikes in energy, causing high levels of inflation, and in turn, we got much higher interest rate escalation, rattling the economy, and crushing pension funds and disposable income.

Do you think the American people trust Congress with a blank check, moving forward, particularly when it is the American people who have to pay the bills?

Mr. CLEMENTS. I do not think I am qualified, honestly, to answer and to direct that question.

Mr. MEUSER. Okay. Thank you. According to a report, the SVB was downgraded on June 30, 2022, by the Federal Reserve Bank of San Francisco, due to concerns about its liquidity risk management, from a May 22nd review. Your report states that the Federal Reserve Board's team was still working on how to address this issue when SVB failed in March of 2023.

Is it not true that the regulators have discretion for oversight on such banks, regardless of the S. 2155-set thresholds, if there are red flags—they have all kinds of discretion?

Mr. CLEMENTS. The regulators have options to do supervisory letters, recommendations, information, and formal enforcement actions, including civil monetary penalties.

Mr. MEUSER. Okay. So, blaming it on S. 2155 would head us down the wrong direction and we would never actually solve the problem or uncover where the problems occurred?

Mr. CLEMENTS. The agencies have plenty of authorities now. We do know that the committee has asked us to look at the enhanced prudential standards, so I do not want to prejudge where we might come in on that.

Mr. MEUSER. Thank you. GAO also points out in its report that the San Francisco Fed gave SVB a 7-month extension to address a November 2021 deficiency. A key finding from the report was

that the regulators did not escalate supervisory actions to mitigate key risks associated with the bank failure. Specifically, you state that the San Francisco Fed lacked urgency, the San Francisco Fed did not recommend the issuance of a single enforcement action despite the bank's serious liquidity and management issues before the bank's failure. Why do you think that is?

Mr. CLEMENTS. Again, this has been a repetitive problem going back to the 1990s and the early 2000s, and now the regulators, in general, favor an informal, cooperative process. It also is a little challenging if a bank is profitable, has adequate capital, to then suggest to the bank that it needs to stop behaviors that the regulator thinks are potentially risky. So, there are a variety of issues that could affect it. Again, I think we looked at this environment and saw numerous instances where escalation probably was warranted.

Mr. MEUSER. But your report does say the supervisory teams blamed tailoring reform under S. 2155 for these failures. We know that the Fed and the FDIC have discretion regardless of those thresholds, as mentioned earlier, to address, investigate, and perceive potential or discovered problems. Why didn't they, and why would they blame it on something that really did not stand in the way in the first place?

Mr. CLEMENTS. Again, I think it is the standard, what we have seen in the past, which is a hesitancy to take more-aggressive actions.

Mr. MEUSER. Okay. Let me ask you this: In general, do you think community banks are much better managed than these outliers that have failed?

Mr. CLEMENTS. I do not think I have any basis to talk about the distinction between the banks. We can go back to the 1990s, and a number of the smaller banks failed.

Mr. MEUSER. No, I am talking about now, and I believe they are, based upon my research and knowledge and discussions and financial discussions with community banks. You do not feel that the community banks would be better managed than these banks that have failed, SVB, First Republic, and Signature?

Mr. CLEMENTS. In the case of these two banks, they are obviously better managed than the two that failed.

Mr. MEUSER. Okay. What about regional banks? Do you think they are managed better?

Mr. CLEMENTS. We have not done any work for me to be able to opine on their management.

Mr. MEUSER. Okay. Well, state of affairs then. These banks have been rattled by all of this, this bailout that occurred with SVB, and now community banks are concerned that they may bear the brunt in higher FDIC fees, and that is unnerving some of their depositors. Do you think that is undue, unnecessary? What are your thoughts?

Chairman HUIZENGA. The gentleman's time has expired.

Mr. MEUSER. I yield back, Mr. Chairman. Thank you.

Chairman HUIZENGA. And Mr. Clements, you will be able to answer that question in writing.

With that, the gentlewoman from Texas, Ms. Garcia, is recognized for 5 minutes.

Ms. GARCIA. Thank you, Mr. Chairman, and thank you, Mr. Clements, for being here with us today. I wanted to also lay out a few facts before I begin, and the first one is that the President has lowered the deficit by $1.7 trillion—$1.7 trillion—in his first 2 years in office. So, when we talk about the debt ceiling and we look at everything, we really need to get some facts out. This President has made it clear that defaulting on the debt is not an option. The statement made earlier that Republicans were the only ones who have passed anything is probably true, but what is not said is that it is not a clean debt ceiling raising. It comes with cuts, cuts that are so deep that they would impact Social Security, they would impact Medicaid, they would impact our veterans, our teachers, and it would create more job losses. That is the reason many of us cannot support that.

There has always been a raise of the debt ceiling, hundreds of times. In fact, every year since World War II, it has been raised. Only because it is this President and this year do we see so many concerns about making cuts before or doing it together.

We do not have any problem with making some cuts. They just should not be tied to the raising of the debt ceiling. It should be a debt ceiling that is clean, one that has been done so many times before, including for former, twice-impeached President Trump. Many of the people talking about this issue now did that last time, so where were they then, making some of these comments?

Second, I am glad that we are having this hearing, but I wonder, Mr. Chairman, when we are going to really focus on the root causes of what caused some of these failures, and when we are going to look at comprehensive legislation and responsible governance? Because as I review some of these items, it appears to me that I agree with others who have already said it here at the table, that this was about governance, it was about management, it was about failing to minimize risks.

And I was particularly drawn to the response that you gave the ranking member when she asked you about some of the reviews that are done by the examiners, and you said that you were told that, "it would take a while to fix the problem."

Since when has taking a while to fix a problem been acceptable when someone does an audit? I was the City Controller of Houston, and I oversaw a $2.3-billion budget. We did audits. If somebody told us, "Oh well, it is going to take us a while to fix the problem," the first thing we would say is, "What is your timeline for getting it fixed?" Did we see any of that, or did the examiners just kind of say, "Oh, okay, fine. You all fix it?"

Mr. CLEMENTS. That occurred in the 2022 timeframe. As I think we mentioned in the report, starting in August, the San Francisco Fed and the Federal Reserve itself—

Ms. GARCIA. But let's get to my question, sir. Were they given a timeline, something that told management to respond, to take corrective action, that we are going to be back? Were examiners back to make sure that they did what they promised to do, or was it just let go?

Mr. CLEMENTS. In many instances, the supervisory letters did detail what needed to be done and the timeframes. But again, for

some of these larger issues, it appeared that the dates were allowed to slip.

Ms. GARCIA. Things were allowed to slip. That is part of the root of the problem, is it not, if things were allowed to slip? Can you give us an example of what was so major that they could not do it immediately and take corrective action that would, "take time to fix a problem?"

Mr. CLEMENTS. A concern was principally about the liquidity and the governance of the liquidity and the liquidity controls at SVB.

Ms. GARCIA. So, they did not have investment review committees or an investment team that really looked at that?

Mr. CLEMENTS. There were numerous failures in its internal liquidity stress testing, and the Fed was looking for solutions to those problems.

Ms. GARCIA. Right. And let me ask you, because there has been a lot of focus on the Federal examiners, what about the State examiners? What responsibility do they have in this whole scheme?

Mr. CLEMENTS. There is a mix depending upon, that Signature and SVB are a little bit different because they are dealing with different States and how they managed those relationships. For the most part, the Federal regulators were the ones in charge.

Chairman HUIZENGA. The gentlelady's time has expired.

Ms. GARCIA. Thank you. I yield back.

Chairman HUIZENGA. The gentleman from Tennessee, Mr. Ogles, is recognized for 5 minutes.

Mr. OGLES. Thank you, Mr. Chairman, and if I may, I would like to correct the record. I think my colleague had inadvertently mischaracterized some things that were taking place. As far as the debt ceiling goes, there is no intent to impact Social Security or Medicare, nor are we going to impact our veterans. In fact, if you go back to 2011, our current President, in his own words, stated that compromise was part of the process. In fact, he said it was the normal political order of things to do so. So Mr. Chairman, I did want to just set the record straight.

I know we have talked a lot about this, and I do not want to beat a dead horse, and we do have the benefit of kind of after-action or the rear-view-mirror approach. But as you look at some of the high marks, the satisfactory marks that were given to SVB, you mentioned the hesitancy and the difficulty it is for the regulator to step in, if you will. But, in part, isn't that their job?

Mr. CLEMENTS. It is the purpose of supervisory regulation to ensure that banks operate in a safe and sound manner.

Mr. OGLES. As we look forward, and keep in mind that the small and mid-sized banks—there are roughly 4,700 doing it right, so we do not want to target an industry because of a few bad actors. But how do we fix the process and the culture that seems to have crept into the regulatory structures that is, quite frankly, preventing them from doing their job in a timely fashion?

Mr. CLEMENTS. I think that is where we think triggers come into play, that if a particular measure exceeds a threshold or, in these cases, where there have been MRAs, MRIAs, MRBAs, multiple times, that triggers an action. The regulator would then be required to take action, rather than continuing to wait and trying to work through a problem.

Mr. OGLES. And again, I am not going to ask you to second-guess the regulators in these specific instances, but when you look back, all the way going back to, for SVB, 2018, there were clear signals and signs that there was a problem. But yet, fast-forward 4 years later, and nothing was happening in a timely fashion.

Again, if you were to lay out a roadmap of, how do we improve the process, what timelines might you map out for the regulators to say, here is a problem, yes, they are profitable, however, you have increased liquidity risk. Yes, you are profitable. However, you have this flight risk as you move forward. What would you see those triggers looking like?

Mr. CLEMENTS. In the past, we have recommended that the regulators and industry work together to find out what would be the best practices to ensure that there is adequate action, but you do not want action for a bank that is healthy, and that the regulator thinks, well, perhaps the problem will occur, because then you end up imposing unnecessary costs and burdens on that institution. So, the regulators and industry working together to come up with adequate measures and benchmarks.

Mr. OGLES. I have said it once, and I will say it again: Ronald Reagan said that the scariest phrase in the American language, and I will paraphrase it, is, "I am from the government, and I am here to help." And I think as we move forward, we have to be cautious about reaching too far in this process. But I do look at the regulatory regimes in both California and New York and see a systemic failure on their part to take action. When you look at, again, the timeline of when the draft is taking place in the previous year, and 6 months later, the draft is still being drafted, and meanwhile, SVB collapses, is that acceptable on the part of the regulators to take 6 months to draft a letter? I am no Shakespeare, but I can write a letter in a more-timely fashion than 6 months, even if I am having to research data points.

Mr. CLEMENTS. I think we had the concern, and again, that is why we talked about a lack of urgency and timely action. In that case, obviously, going from August 2022, I guess the argument was they needed to collect additional information, but it did seem to us that there were enough instances of these MRIAs and MRAs finding those problems that they could have moved forward with more urgency.

Mr. OGLES. In my last 30 seconds, is there anything in the regulatory regime that would have prevented the regulators from doing their job?

Mr. CLEMENTS. The regulators have authority to make recommendations, and formal and informal enforcement actions, again, up to and including civil monetary penalties.

Mr. OGLES. Yes, sir. Mr. Chairman, I yield back.

Chairman HUIZENGA. The gentleman yields back. With that, the ranking member of the subcommittee, the gentleman from Texas, Mr. Green, is recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman. Mr. Director, you are not here to tell us that the banks are not responsible, are you?

Mr. CLEMENTS. The bank management is responsible for operating the—

Mr. GREEN. The bank management.

Mr. CLEMENTS. —bank in a safe and sound manner.

Mr. GREEN. Yes. And you are here to tell us that these bank managers mismanaged the banks' business. Is that a fair statement?

Mr. CLEMENTS. The records we saw were numerous instances of at least liquidity and risk management problems that had been identified going back to 2018.

Mr. GREEN. You have said that the regulators were calling things to their attention that you thought should have been dealt with, and you have indicated as much. Do you now say that the banks did not have the responsibility to make these changes themselves?

Mr. CLEMENTS. The banks are responsible for resolving the problems that the supervisors identify, and that is the bank side. The supervisory concern is when nothing happens—

Mr. GREEN. Excuse me. Let's talk about the bank side for just a moment, if you would please. You also have indicated that the agency has plenty of authority, and then you went on to say but you did not want to prejudge. You would like to have an opportunity to review. Is that a fair statement?

Mr. CLEMENTS. Correct.

Mr. GREEN. Excuse me, if I may, I just needed to know if that was a fair statement. Now knowing this, that it has plenty of authority, you are not saying that they have enough authority, are you? Because enough would mean that you would not have the time to review.

Mr. CLEMENTS. The committee's request is for us to look at enhanced prudential standards and we can do that.

Mr. GREEN. Are you saying that the regulators have enough authority and that nothing more should be done?

Mr. CLEMENTS. I am not in the position right now to judge whether—I am saying they have authority.

Mr. GREEN. They have authority. But you are not saying they have enough authority, are you?

Mr. CLEMENTS. I think we would need to do additional work in that space.

Mr. GREEN. To determine?

Mr. CLEMENTS. Correct.

Mr. GREEN. So today, you are not saying they have enough authority?

Mr. CLEMENTS. We are saying they have authorities. We need—

Mr. GREEN. But they do not have enough.

Mr. CLEMENTS. —to conduct additional work.

Mr. GREEN. You don't know that they have enough.

Mr. CLEMENTS. I cannot, at this point, say that they have enough.

Mr. GREEN. Okay, that is fair enough. You cannot, at this point, say that they have enough. And it is important for you to say this, Mr. Director, because the other side is making the case for enough authority. They are making the case for the status quo. They are making the case for banks to be able to do what Silicon Valley did. We are making the case for doing something that can have an impact on the people who have the responsibility to manage the depositors' money. They are not.

Now, Mr. Director, is it true that the stress test can have an impact on the decisions that regulators make, once they review it? If it is an adverse conclusion, can it have an impact on their decisions?

Mr. CLEMENTS. It is a factor in the supervision of organizations.

Mr. GREEN. So it can have an impact on what they think, can it not? Are you shy about saying that an adverse stress test will have an impact on the decisions of regulators, Mr. Director?

Mr. CLEMENTS. Supervisory tests are an important element.

Mr. GREEN. I understand, but let's talk about the stress test.

Mr. CLEMENTS. Yes.

Mr. GREEN. Okay. Thank you.

Mr. CLEMENTS. It is—

Mr. GREEN. And because of changes, the stress test was scheduled for 2024 for Silicon Valley Bank.

Let me use my last 48 seconds to say this. I want to commend all of the Members for their questions, but I want to commend especially the Members on this side, and those who decided to talk about the preeminent issue facing this Congress, which is, are we going to allow a default? I commend them for bringing it up. It is not unusual for us to bring up issues that relate to the business of the Congress but do not necessarily relate to the business of a given hearing. And I thank Mr. Horsford for what he did. He is upset because we may be facing a default, that may cause a collapse of our economy.

I yield back.

Chairman HUIZENGA. The gentleman's time has expired. In accordance with committee rules, we do allow non-subcommittee members to waive on for questioning, and we will be doing so with the gentleman from Kentucky, Mr. Barr, who is also the Chair of our Subcommittee on Financial Institutions and Monetary Policy. So with that, the gentleman from Kentucky has 5 minutes.

Mr. BARR. Mr. Chairman, thank you. Thanks for allowing me to waive on. I want to start off by thanking the GAO, Mr. Clements, and your team for putting out a timely, nonpartisan, apolitical report that is external to the self-assessments we have seen from the Fed and the FDIC, that do not give a complete narrative. I think it is vital that we have an unbiased, external report that helps inform the American public and the Congress. I also want to thank my good friends, Mr. Green and Mr. Horsford, for raising the important, preeminent issue facing the Congress, and that is raising the debt limit, and avoiding default. And I would just remind my colleagues that the only institution in government that has actually done that work of raising the debt limit is the Republican Majority in the Congress, and every single Democrat Member of the House of Representatives voted against raising the debt limit.

To get to my questions, in your work in looking at the bank supervisors here, especially the San Francisco Fed, do you see any evidence of concern leading up to Silicon Valley Bank's failure, about the large concentration of uninsured deposits in a single sector?

Mr. CLEMENTS. There was concern. We certainly saw concerns raised.

Mr. BARR. So, there was evidence that they raised that concern?

Mr. CLEMENTS. Correct.

Mr. BARR. Okay. I believe the Fed report that I have reviewed, their self-assessment, they say in here that Silicon Valley Bank crossed the Regional Bank Organization portfolio to the Large Bank Organization portfolio within the Federal Reserve structure in February of 2021. Is that correct? That is what the Fed says.

Mr. CLEMENTS. I do not have the specific dates.

Mr. BARR. Well, that is what the Fed says. The Fed says that they crossed that supervisory threshold almost 2 years before the bank's failure.

Mr. CLEMENTS. I think it was certainly the case in our report. I think we might say June, but it is somewhere in the 2021 timeframe.

Mr. BARR. The Fed says they crossed that threshold in February 2021. So, in other words, enhanced prudential standards applied to this institution, as a large institution, according to the Fed's own determination, 2 years before the bank failed. Is that correct?

Mr. CLEMENTS. It would have been a Category 4 firm at that time.

Mr. BARR. Right. And that is enhanced prudential standards, under Dodd-Frank, as amended by the bipartisan Regulatory Relief Law of 2018.

Mr. CLEMENTS. Correct, at that point it is subject—

Mr. BARR. As implemented by the Fed, that $100-billion threshold.

Mr. CLEMENTS. Correct, and then there is tailoring above that level.

Mr. BARR. Sure. But in this case, this bank, under Fed regulations implementing Dodd-Frank, as amended by the Regulatory Relief Law of 2018, enhanced prudential standards applied to this bank, categorized as a large financial institution, as of February 2021, 2 years before the bank failed.

Mr. CLEMENTS. That is correct. In 2021, it got into that group and was subject to large foreign institutions.

Mr. BARR. The Fed report also says that Board staff, meaning Federal Reserve Board staff, provided the San Francisco Fed team a waiver to delay the initial set of ratings under the Large Financial Institution (LFI) rating system by 6 months, until August 2022. In your investigation, do you have any insight or visibility as to why the board waived that requirement?

Mr. CLEMENTS. That is additional work we will need to do.

Mr. BARR. Yes, please look into that, because the regulators at the Fed are delaying implementation. The law does not say that they have to, but they, the supervisors, the bank examiners, are delaying implementation of the law that we passed, and that we amended in 2018, and that the Fed implemented. So look, it is on the supervisors.

Let me just say this also. According to your report, in 2020 the examiners at the Federal Reserve Bank of San Francisco found that SVB was not doing all required liquidity stress testing. Specifically, SVB did not provide liquidity risks for a period of 30 days or less, as they were required. But examiners continued to give SVB a satisfactory mark for liquidity and the highest CAMELS rating for liquidity from 2018 to 2022.

In your experience, would it be unusual for an examiner to give a bank a high liquidity rating despite some of the required testing not being done?

Mr. CLEMENTS. I think that is the concern we had, the high ratings, especially for liquidity, and also for management.

Mr. BARR. Yes. Also, your report describes informal non-public enforcement action that was taken by the Federal Reserve Board staff to address ineffective governance. However, as of March 2023, the memorandum of understanding (MOU) was still in the drafting process.

Chairman HUIZENGA. The gentleman's time has expired.

Mr. BARR. For the gentleman, for the record maybe, is it typical for an—

Chairman HUIZENGA. The gentleman's time has expired.

Mr. BARR. —informal enforcement action like this to take more than 6 months?

Chairman HUIZENGA. The gentleman's time has expired.

Mr. BARR. It has expired. I appreciate—

Chairman HUIZENGA. And we will allow you to—

Mr. BARR. —you—

Chairman HUIZENGA. Excuse me, ranking member, I have it handled. The gentleman will suspend.

The gentleman from Kentucky can submit his final thoughts and final question to the witness for a written response.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And with that, this hearing is adjourned.

[Whereupon, at 11:34 a.m., the hearing was adjourned.]

A P P E N D I X

May 11, 2023

United States Government Accountability Office

Testimony

Before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives

For Release on Delivery
Expected at 10:00 a.m. ET
Thursday, May 11, 2023

BANK REGULATION

Preliminary Review of Agency Actions Related to March 2023 Bank Failures

Statement of Michael E. Clements, Director,
Financial Markets and Community Investment

Chairman Huizenga, Ranking Member Green, and Members of the Subcommittee

I am pleased to be here today to discuss preliminary findings from our April 2023 report on the failures of Silicon Valley Bank (SVB) and Signature Bank in March 2023.[1] More specifically, my statement provides observations on factors that may have caused the banks to fail and supervisory actions regulators took leading up to the failures.

At the time of closure, SVB was the 16th largest U.S. bank and Signature Bank the 29th largest. As of March 28, 2023, the Federal Deposit Insurance Corporation (FDIC) estimated the cost to the Deposit Insurance Fund of resolving SVB to be $20 billion and Signature Bank, $2.5 billion.[2] Subsequent to our April 2023 report, on May 1, 2023 First Republic Bank, the 14th largest U.S. bank, failed with an estimated cost of $13 billion to the Deposit Insurance Fund.

This statement is based on our April 2023 report. For the topics discussed today, we analyzed regulatory financial data from 2018–2022 on the two banks and assessed their condition relative to a peer group of banks. We also reviewed Federal Reserve Bank of San Francisco (FRBSF) and FDIC examination records (including schedules, memorandums, and reports) and bank management responses to supervisory concerns for the banks (including supervisory letters and documentation of informal enforcement actions) from January 2018 through March 2023. We focused our review on supervisory activities related to the banks' liquidity and risk management. We also interviewed staff from FDIC, the Board of Governors of the Federal Reserve System (Federal Reserve), and FRBSF. More detailed information on our scope and methodology can be found in our April 2023 report. Our work was performed in accordance with generally accepted government auditing standards.

[1]GAO, *Bank Regulation: Preliminary Review of Agency Actions Related to March 2023 Bank Failures*, GAO-23-106736 (Washington, D.C.: Apr. 28, 2023). The federal regulators for the two banks also published reports on the failures on April 28, 2023. See Board of Governors of the Federal Reserve System, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* (Washington D.C.: Apr. 28, 2023); and Federal Deposit Insurance Corporation, *FDIC's Supervision of Signature Bank* (Washington, D.C; Apr. 28, 2023).

[2]The Deposit Insurance Fund is funded by assessments levied on insured banks and savings associations and is used to cover all deposit accounts (such as checking and savings) at insured institutions, up to the insurance limit.

Risky Business Strategies along with Weak Liquidity and Risk Management Contributed to the Recent Bank Failures

SVB and Signature Bank experienced rapid growth and relied on less stable funding—indicators of risky business strategies.

- From December 2018 to December 2022, SVB's total assets more than tripled from $56 billion to $209 billion, and Signature Bank's more than doubled from $47 billion to $110 billion. From 2019 through 2021, the total assets of SVB and Signature Bank grew by 198 percent and 134 percent, respectively—far exceeding growth for a group of 19 peer banks (33 percent growth in median total assets).
- To support their rapid growth, the two banks relied on uninsured deposits, which can be an unstable source of funding because customers with uninsured deposits may be more likely to withdraw their funds during times of stress. At the end of 2021, SVB's share of uninsured deposits to total assets was 80 percent and Signature's was 82 percent—approximately two times higher than for a group of peer banks.[3] The two banks' reliance on uninsured deposits may indicate a long-standing concentration of risk.

Additionally, SVB and Signature Bank exhibited weak liquidity and risk management.

- SVB had exposure to interest rate risk through its investment in longer-term securities to generate yield against its deposits. According to FRBSF staff and examination documents, the bank did not effectively manage the interest rate risk of the securities or develop appropriate risk-management tools for this risk. Federal Reserve and FRBSF staff noted that SVB failed due to ineffective management of its deposits and assets.
- Signature Bank had exposure to deposits from the digital assets industry. According to FDIC officials and examination documents, poor governance and risk-management practices prevented the bank from adequately managing its liquidity risk. FDIC officials noted that poor governance and unsatisfactory risk-management practices were the root cause of Signature Bank's failure.

[3]We compared SVB and Signature Bank to a group of 19 banking institutions with reported deposit balances and which each had total assets of $100–$250 billion at year-end 2022. In 2018–2022, the median share of uninsured deposits to total assets for the group of peer banks ranged from 31 to 41 percent.

Regulators Did Not Escalate Supervisory Actions in Time to Mitigate Key Risks Associated with the Bank Failures

In the years prior to 2023, FRBSF and FDIC identified liquidity and management risks at SVB and Signature Bank—key drivers of the banks' failures. However, neither regulator's actions resulted in management sufficiently mitigating those risks. GAO's prior work identified the importance of regulators taking timely and effective actions to address underlying problems.

Federal Reserve Identified Risks and Took Supervisory Actions, but Did Not Adequately Escalate Actions Prior to SVB's Failure

FRBSF was generally positive in its ratings of SVB from December 2018 to June 2022, rating SVB's overall condition as "satisfactory." During that same period, FRBSF assigned SVB the highest available CAMELS rating for liquidity-management practices and the second-highest available rating for management practices.[4] As noted earlier, deficient liquidity and management practices were factors contributing to the bank's failure.

Despite the overall satisfactory ratings, FRBSF noted several concerns, which were relevant to the bank's March 2023 failure. For example, in 2018 FRBSF found that despite liquidity levels appearing strong, funding sources were concentrated and might become volatile with little notice. In 2020, examiners found that stress test modeling showed the bank had ample liquidity over stressed periods but the stress tests did not provide insight into liquidity risks for stressed periods of 30 days or less. In 2018, 2019, and 2020, FRBSF also issued (or had outstanding) matters requiring attention related to risk management and liquidity.

FRBSF staff generally accepted SVB's planned actions to correct deficiencies. Our review of examination staff's acknowledgement of SVB management responses found the staff generally agreed that SVB's planned actions were reasonably designed to remediate the underlying supervisory issues.

[4]Bank examiners review and evaluate an institution's condition using the Uniform Financial Institutions Rating System, also known as CAMELS (capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk). An institution is rated on each CAMELS component and then given a composite rating, which relates to (but is not an average of) the component ratings. Both types of ratings are scored on a scale of 1 (best) to 5 (worst). Regulatory actions typically correspond to the composite rating and generally increase in severity as ratings worsen.

Subsequent to SVB's shift into a different examination category, examiners identified additional liquidity and management deficiencies. Increases in asset levels at SVB Financial Group, the holding company for SVB, moved the entity from the Federal Reserve's Regional Banking Organization category into the Large and Foreign Banking Organization category in June 2021.[5] SVB Financial Group became subject to examination under the Large Financial Institution rating system. According to Federal Reserve staff, SVB then had a larger dedicated examination team (with a specific team member covering liquidity) and was subject to more rigorous supervisory requirements.

More specifically, in an August 2021 review, FRBSF raised serious concerns around how the institution was managing liquidity risk. It found that liquidity risk-management practices were below supervisory expectations. It issued two matters requiring immediate attention (which reflect serious supervisory concerns) and four matters requiring attention on these issues. FRBSF described the review in its scoping memorandum as a baseline and further noted that it conducted limited supervisory work on liquidity and stress testing over the past two supervisory cycles.[6]

A May 2022 target review of SVB Financial Group and SVB—conducted under the Large Financial Institution rating system—found that the bank's governance and risk-management practices also were below supervisory expectations. In response to these issues, FRBSF issued three matters requiring immediate attention related to risk management.

On June 30, 2022, FRBSF downgraded SVB's ratings. Specifically, FRBSF downgraded the bank's CAMELS composite rating from a 2 to a 3, its management component rating from a 2 to a 3, and its liquidity

[5]Before 2018, all bank holding companies with more than $50 billion in assets were subject to enhanced prudential regulation to address too-big-to-fail concerns. In 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No.115-174, raised this asset threshold to $250 billion and provided the Federal Reserve with discretion to apply tailored regulation to banks with $100 billion–$250 billion in assets. In its implementing regulation, the Federal Reserve created four categories of tiered regulation for banks with more than $100 billion in assets. Silicon Valley Bank was considered a Category IV bank under the Federal Reserve's regulations, subject to the least-stringent enhanced prudential regulation requirements (that is, relative to banks considered Category I–III).

[6]As reasons for the limited supervisory work, FRBSF cited an examination pause for regional banking organizations during the pandemic and the tailoring of enhanced prudential standards that resulted in less stringent regulation for the organizations.

component rating from a 1 to a 2. Examiners found that the bank's management and board performance needed improvement and were less than satisfactory. For example, the board did not provide effective oversight of implementation of the risk-management framework and did not hold management accountable for the root causes contributing to weaknesses in liquidity risk management and other risks.

On August 17, 2022, FRBSF issued a supervisory letter to SVB Financial Group and SVB on its first Large Financial Institution rating. FRBSF rated SVB Financial Group "Deficient-1" for governance and controls, stating its risk-management program was not effective, did not incorporate coverage for all risk categories, and did not address foundational, enterprise-level risk-management matters. FRBSF rated SVB Financial Group's liquidity as "Conditionally Meets Expectations." It stated that while actual and post-stress liquidity positions reflected a sufficient buffer, the firm lacked several foundational elements for liquidity risk management.

In the same supervisory letter, FRBSF stated its intent to initiate an informal, nonpublic enforcement action, in the form of a memorandum of understanding, with SVB Financial Group and SVB. The memorandum's provisions were focused on correcting the management and liquidity risk issues mentioned above and on holding the bank's board and executive management accountable for addressing the root causes of the deficiencies.

FRBSF staff told us that staff started working on the memorandum of understanding after communicating the July 2022 downgrade. In addition, Federal Reserve Bank staff started working with the Federal Reserve Board's Supervision and Regulation and Legal divisions in late August 2022 to develop the memorandum. According to Federal Reserve staff, Federal Reserve Board and FRBSF staff collaborated on provisions of the memorandum, including those related to liquidity and risk management, which required senior-level review. They kept the memorandum open to allow for the completion of additional examination work by FRBSF. However, the Federal Reserve did not finalize the memorandum before SVB failed in March 2023.

Although Federal Reserve staff stated that the Federal Reserve's supervisory actions compelled SVB to take steps including replacing the Board Chair, Chief Risk Officer, and Treasurer and revising its incentive compensation program to incorporate risk management as a formal assessment criteria, its supervisory actions were inadequate given the bank's known liquidity and management deficiencies. Furthermore,

FRBSF's actions lacked urgency. For example, FRBSF did not recommend the issuance of a single enforcement action despite the bank's serious liquidity and management issues before the bank's failure.

FDIC Identified Risks and Took Supervisory Actions, but Did Not Adequately Escalate Actions Prior to Signature Bank's Failure

FDIC's ratings of Signature Bank found that the bank's overall condition was "satisfactory" from December 2018 to December 2021. In addition, FDIC assigned the second-highest available CAMELS rating for the bank's management practices. As noted earlier, weak management practices contributed to the bank's failure.

Despite FDIC's overall "satisfactory" assessment during 2018–2021, FDIC took numerous supervisory actions to mitigate liquidity and management deficiencies at the bank, including downgrading Signature Bank's liquidity component from 2 to 3 during the 2019 examination cycle, meaning the bank's liquidity management practices needed improvement.

In its examination documents, FDIC explained that Signature Bank's practices did not correspond with the bank's complexity, risk profile, and scope of operations due to weaknesses in areas including liquidity contingency planning and internal controls. These weaknesses prevented the bank from appropriately understanding the potential effects of adverse liquidity events and emergency cash flow needs.

FDIC also issued matters requiring board attention and supervisory recommendations related to management, liquidity, and corporate governance risks in each year before the bank's failure. For example, FDIC issued two matters requiring board attention in 2018 and one matter requiring board attention in 2019 related to bank management's handling of increasing liquidity and management risks. The matters focused on issues including the bank's adherence to its risk appetite statement and liquidity contingency planning. Many matters and recommendations carried over to later years because they were unresolved. For instance, a 2019 matter on liquidity contingency planning remained outstanding through March 2023.

FDIC had not completed 2022 examination documents for Signature Bank at the time of its failure. FDIC staff told us they were considering escalating supervisory actions in 2022—including taking enforcement actions and downgrading CAMELS composite or component ratings—based on the findings of the completed 2022 corporate governance target review and the in-process target reviews for liquidity and other topics.

These escalatory actions would have taken place in the second quarter of 2023, after FDIC staff finalized documentation such as the 2022 report of examination and supervisory letters. According to preliminary findings we reviewed from FDIC's 2022 liquidity target examination, FDIC planned to reiterate its 2019 matter requiring board attention on liquidity contingency planning. It also had drafted a new matter requiring board attention on the bank's audit program for liquidity and funds management, as well as several supervisory recommendations.

FDIC stated that because Signature Bank did not mitigate its liquidity and management-related issues in a timely manner, it issued an interim CAMELS rating downgrade on March 11, 2023, the day before Signature Bank was closed. In the downgrade letter, FDIC stated that management failed to demonstrate the capability to properly identify, measure, monitor, and control the bank's liquidity position. Furthermore, funds management practices were critically deficient for the complexity of the bank's liquidity risk profile, and the continued viability of the institution was threatened. The lack of urgency, formality, and preparedness around liquidity contingency funding plans reflected poorly on management and was another factor for these downgrades. In the letter, FDIC also notified Signature Bank of its intent to pursue a formal enforcement action against the bank for failure to mitigate concerns outlined in the downgrade letter, but the bank failed the next day.

Signature Bank's management failed to take adequate steps to mitigate the bank's long-standing liquidity and management issues before the bank's failure. For example, FDIC staff told us that Signature Bank management could sometimes be unresponsive and difficult to work with. They added that Signature Bank management would report to FDIC that it mitigated an issue, only for FDIC staff to find the issue unresolved during transaction testing. This behavior caused FDIC to issue repeat supervisory recommendations to Signature Bank.

Although FDIC took some actions to escalate its supervisory actions in 2019 and 2020, its actions were inadequate given the bank's longstanding liquidity and management deficiencies. Furthermore, FDIC lacked urgency despite Signature Bank's repeated failures to remediate liquidity and management issues. FDIC did not pursue more forceful supervisory actions in a timely manner that might have helped the bank correct its liquidity and management issues before its failure in March 2023. For example, FDIC only issued an enforcement action and further downgraded the bank's composite or component CAMELS ratings the day before Signature Bank's failure in 2023. Taking more decisive actions

in the years prior to Signature Bank's failure could have helped compel bank management to mitigate the liquidity and management weaknesses that contributed to the bank's failure.

GAO's Past Work Warned about the Risks of Untimely Escalation by Regulators and the Need for Early Triggers

We previously noted in a 2015 report that although regulators often identified risky practices well before failures, the regulatory process was not always effective or timely in correcting underlying problems before banks failed.[7] Furthermore, GAO has longstanding concerns about escalation of supervisory concerns. In 1991, we found that bank regulators did not always use the most forceful actions available to correct unsafe and unsound banking practices.[8] In 2011, we recommended that regulators consider adding noncapital triggers to their framework for prompt corrective action (to help give more advanced warning of deteriorating conditions).[9] The regulators considered noncapital triggers, but have not added them to the framework—thus missing a potential opportunity to take early action to address deteriorating conditions at banks.

Chairman Huizenga, Ranking Member Green, and Members of the Subcommittee, this completes my prepared statement. I would be pleased to respond to any questions that you may have at this time.

GAO Contact and Staff Acknowledgments

If you or your staff have any questions about this testimony, please contact Michael Clements, Director, Financial Markets and Community Investment at (202) 512-8678 or clementsm@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. In addition to the contact named above, GAO staff who made key contributions to this testimony are Karen Tremba (Assistant Director), Aaron Colsher (Analyst in Charge), Lisa Reynolds, and Barbara Roesmann.

[7]GAO, *Bank Regulation: Lessons Learned and a Framework for Monitoring Emerging Risks and Regulatory Response*, GAO-15-365 (Washington, D.C.: June 25, 2015).

[8]GAO, *Bank Supervision: Prompt and Forceful Regulatory Actions Needed*, GAO/GGD-91-69 (Washington, D.C.: Apr. 15, 1991).

[9]GAO, *Bank Regulation: Modified Prompt Corrective Action Framework Would Improve Effectiveness*, GAO-11-612 (Washington, D.C.: June 23, 2011). We found that the prompt corrective action framework—designed in 1991 to improve regulators' ability to identify and promptly address deficiencies at depository institutions and minimize losses to the Deposit Insurance Fund—did not result in consistent actions to elevate concerns. We noted that because the framework's triggers for action rely on capital—a lagging indicator of bank health—problems might be discovered too late for banks to recover.

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Hearing Entitled:
Oversight of Silicon Valley Bank and Signature Bank: GAO's Preliminary Review
May 11, 2023

Representative Andy Barr (KY-06) Questions for the Record

The GAO's report describes the informal, nonpublic enforcement action that was being taken by the Federal Reserve Board staff to address ineffective governance and risk management issues, identified as a memorandum of understanding (MOU). The report found that the first draft of the MOU started in August of 2022. However, as of the March 2023 failure of SVB, the MOU was still in the drafting process.

- **In your experience, is it typical for an informal enforcement action like this to take more than 6 months to draft?**

  We have not conducted the work necessary to answer this question. However, relatedly, in 2019 we reported that the Federal Reserve collected data in a manner that made it difficult to reliably determine the extent of escalation from supervisory concerns to enforcement actions. We also reported that the Federal Reserve lacked detailed policies and procedures for escalation. We recently began a new study where we plan to analyze the timeliness of the escalation of supervisory actions, including informal enforcement actions. This work is in response to a request made by the Chairman of the Senate Committee on Banking, Housing, and Urban Affairs.

- **Do you have any insight into what may have caused the process to be so drawn out?**

  In our interview with Federal Reserve officials, they said the MOU drafting process is not completed by the reserve bank alone. The Federal Reserve Board's review of the supervision and regulation of Silicon Valley Bank (SVB) also stated that "Enforcement actions for banks with assets greater than $100 billion are not delegated to Reserve Banks but require approval from Board staff". In addition to the Reserve Bank, the MOU drafting process involves the Federal Reserve Board Division of Supervision and Regulation, Federal Reserve Board Legal Division, and the state regulator if applicable. As such, MOU drafting can be a time consuming process. With respect to the SVBFG MOU, FRBSF staff said they were working with Board Legal staff to "get the wording right" when SVB failed. They were also waiting for information from several target examinations (IT, internal audit, and third-party risk management) to add to the content of the draft MOU.

Oversight of Silicon Valley Bank and Signature Bank: GAO's Preliminary Review 5/11/23

Questions for the Record (Rep. Alex X. Mooney)

Director Michael Clements:

The collapses of Silicon Valley Bank (SVB), Signature Bank, and now First Republican Bank, have caused many of my constituents to have concerns about the stability of the U.S. financial system. Unfortunately, these bank failures likely never would have happened without the inflation crisis of this administration's own making and poor supervision by the regulators.

Please provide answers to the following questions:

1. **The Government Accountability Office (GAO) plans to further study whether the federal government's use of the "systemic risk exception" to resolve SVB and Signature Bank further incentivizes poor risk management. Can you elaborate on what specifically you will be looking at?**

   Under the systemic risk exception, the Federal Deposit Insurance Corporation (FDIC) can provide certain emergency assistance if the Secretary of the Department of the Treasury (Treasury), in consultation with the President and upon written recommendation of FDIC and the Board of Governors of the Federal Reserve System (Federal Reserve), determines that compliance with certain cost limitations would result in serious adverse effects on economic conditions or financial stability and that such assistance could mitigate these systemic effects. Such a determination exempts FDIC from the Federal Deposit Insurance Act's (FDI Act) least-cost rule, which requires FDIC to use the least costly method when assisting an insured institution and prohibits FDIC from increasing losses to the Deposit Insurance Fund by protecting creditors and uninsured depositors of an insured institution.

   The FDI Act requires GAO to review and report to Congress on each systemic risk determination made by the Secretary of the Treasury.[1] GAO will examine (1) the steps taken by Treasury, the Federal Reserve, and FDIC to invoke the systemic risk exception; (2) the basis for each determination and the purpose of actions taken pursuant to each determination; and (3) the likely effects of each determination on the incentives and conduct of insured depository institutions and uninsured depositors.

2. **Will the GAO be doing any investigation on how the recent use of the "systemic risk exception" impacts customer confidence in smaller, community banks that are not guaranteed resolution in the event of a failure?**

   GAO's prior work that assessed systemic risk determinations made during the 2008 financial crisis found that systemic risk determinations raised moral hazard concerns and

[1] 312 U.S.C. § 1823(c)(4)(G)(iv).

may have exacerbated the perception that some firms are big to fail. As noted in our response to question 1, our upcoming mandated study will also include a review of the effects that the use of systemic risk exception may have on the incentives and conduct of insured deposit institutions and uninsured depositors.

With respect to the resolution of failed banks, our prior work on bank failures found that FDIC's preferred resolution method for failed banks is purchase and assumption transactions (the direct sale of a failed bank to another, healthier bank). FDIC strives to effect a whole bank purchase and assumption agreement, in which essentially all of the failed bank's deposits, assets, and certain liabilities are sold and transferred to the acquiring institution. We reported that from January 2008 through December 31, 2011, FDIC was appointed as receiver for the 414 failed banks, with $662 billion in book value of failed bank assets. FDIC used purchase and assumption agreements to resolve 394 failed institutions amounting to approximately $652 billion in failed institution assets, which represents 98 percent of the total assets of failed banks and thrifts since 2008.

3. **Has the GAO ever reviewed how bank failures impact regional and small community banks? If so, what was found?**

   We have not conducted the work necessary to answer how bank failures impact regional and small community banks. However, we have analyzed the effect of bank failures on local communities. We found that the acquisitions of failed banks by healthy banks appears to have mitigated the potentially negative effects of bank failures on communities, although the focus of local lending and philanthropy may have shifted.

West Virginians are predominantly served by smaller banks. The last thing we need to tell Americans is that their money is only safe at big banks.

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