Oversight of Financial Regulators:
Financial Stability, Supervision, & Consumer Protection in the Wake of Recent Bank Failures
Senate Committee on Banking, Housing, and Urban Affairs
May 18, 2023

Opening Statements

Chairman Brown (D-OH) opened the hearing by saying the executives from SVB and Signature chased profits off the cliff and ignored risks to their banks. Brown said they failed banking 101 and only cared about their profits. He pointed to how they lobbied against the "unfair regulatory burden" years prior. Brown also noted how there was a lot of blame placed on regulators, adding that Sen. Tester said days prior that they should have dropped the hammer. Brown noted S. 2155 and the weaker rules imposed by the Trump administration and indicated this is to blame for the actions of the executives and their banks. Brown said bank regulators serve the public and are not banks' friends, adding that they are charged with keeping Americans' money safe. Brown said we need to ensure regulators have the resources necessary and said we need to consider options for deposit insurance reforms and look at merger and acquisition policies. Brown said banks must be well managed and pointed to the executives' high compensation all while they pursued further risky actions. Brown said he expects punishments and holding executives accountable in the aftermath of these bank failures.

Ranking Member Scott (R-SC) disagreed with the idea that this is a legislative failure and pushed back on S. 2155 being the reason regulators could not do their job. He said regulators had the tools necessary but did not use them. Scott said many Americans are now looking at banks with skepticism and that they should not be the ones dealing with the repercussions of the bank failures. Scott continued that he wanted to know why regulators did not act and said the bank failures were caused by bank mismanagement, supervisory failure, and soaring inflation. Scott pushed back on the notion that the bank failures happened quickly, noting that SVB had the same business model for 20 years and that warning lights have been going off since early 2022. He said the regulators failed the American people in keeping their confidence high in the US financial system. He added that the regulators will not hold themselves or anyone at the agency accountable. Scott said Barr's review found that the Federal Reserve did not do its job and again pushed back on his claim, and the claim of many Democrats, that S. 2155 is to blame for the bank failures. Scott went on to say that the more capital they push to the sideline, the smaller business owners are being robbed of capital to create more stable and resilient communities. Scott said that Americans should not suffer because regulators did not do their job.

Witness Testimony

The Honorable Michael Barr, ***Vice Chairman for Supervision, Board of Governors of the Federal Reserve System,*** said that the banking system remains strong and resilient. He said that his review of SVB failure shows that there are weaknesses in regulation and supervision that must be addressed. On current banking conditions, Barr said banks have strong capital and liquidity, adding that the recent bank failures have shown the risks of concentrated funding sources and poor management of interest rate risk. Barr then turned to his review of SVB, highlighting key takeaways from the report. He specifically noted how the Fed's approach in response to S. 2155 and a shift in the stance of supervisory policy impeded effective supervision. Barr added that were these changes not made, SVB would have been subject to supervision within the large and foreign banking organization (LFBO) portfolio and subject to heightened standards beginning in 2019. Additionally, Barr discussed lessons that were learned from the bank failure, including the importance of strong levels of bank capital, as well as the broader consequences that SVB's distress had on the banking system. Barr said we need to evaluate whether our capital requirements appropriately measure the ability of banks to absorb losses, evaluate how we supervise and regulate a bank's management of interest-rate risk, and evaluate how we supervise and regulate liquidity risk. Lastly, Barr said he plans to diligently improve the speed and agility of supervision.

The Honorable Martin Gruenberg, *Chairman, Federal Deposit Insurance Corporation,* said that the banking industry remains resilient despite the recent crisis. He said that the system remains well capitalized, but institutions still face risks. Gruenberg then pointed to the NPRM that the FDIC released last week on special assessments to replenish the Deposit Insurance Fund (DIF). He also discussed the sale of First Republic to JP Morgan and how this sale will cost the DIF $13 billion. Gruenberg then turned to the FDIC's reports on Signature Bank and Deposit Insurance Reform. He said that they found poor management at Signature Bank and that FDIC supervision could have been more forceful. On deposit insurance, Gruenberg noted how the report recommended a targeted approach with coverage for business accounts. He pointed to how the failures of SVB and Signature demonstrate the implications that banks with over $100 billion in assets can have on financial stability. He closed by saying that his prepared testimony goes into further detail and the FDIC looked forward to engaging with policymakers on these issues.

The Honorable Todd Harper, *Chairman, National Credit Union Administration,* discussed the state of the credit union industry, some of the NCUA's recent efforts to strengthen the system, and a few critical legislative requests. He said that the overall performance of federally insured credit unions and the Share Insurance Fund (SIF) are stable despite inflation and higher interest rates. Harper noted that the increase in interest rate risk and liquidity risk in the current economic environment underscores the value of the NCUA's Central Liquidity Facility (CLF). He said the CLF acts as a shock absorber and how many credit unions lost access to the CLF, which contracted the CLF's capacity by almost $10 billion. He said at a time when rates are increasing, a liquidity lifeline should be protected. Harper then discussed the NCUA's efforts to enhance cybersecurity, protect consumers, preserve Minority Depository Institutions (MDIs), and advance diversity, equity, and inclusion (DEI). He then outlined a legislative request from the NCUA on permanently adjusting the CLF agent-member requirements. Harper also addressed potential deposit insurance reform and how any changes should be reflected in the SIF as well.

The Honorable Michael Hsu, *Acting Comptroller, Office of the Comptroller of the Currency,* said that he has always emphasized the importance of avoiding complacency at banks and he believed that OCC regulated banks have heeded this call. He then offered some preliminary observations on steps that can be taken to restore full confidence in the banking system. First, he thought that supervisors need support to act in a timely and effective manner. Hsu added that the regulations regarding the resilience and resolvability of large banks need to be strengthened. Regarding deposit insurance coverage, he believed that it needed to be updated and thought the FDIC's analysis on this was worth careful consideration. Hsu also emphasized that the diversity of the banking system must be preserved as the industry evolves, noting that community and regional banks play an invaluable role in our economy.

The Honorable Adrienne Harris, ***Superintendent, New York Department of Financial Services,*** opened her testimony by saying that the run that caused First Republic to fail was instigated by the self-liquidation of Silvergate Bank and the failure of SVB. After narrowly surviving through the night on March 10, Harris said Signature was then unable to present a credible liquidity plan to meet its known outstanding deposit withdrawals. Harris continued that to prevent a mid-day shutdown and further contagion in the banking industry, DFS took possession of Signature and appointed the FDIC as receiver. She went on to say that in 2020 and 2021, regulators required bank management and the Board to implement corrective actions to remediate the identified liquidity-related weaknesses that had been unresolved since 2019. Harris continued that the management acknowledged regulatory findings but did not heed the regulators' orders. She added that the bank was slow to remediate supervisory recommendations and that many issues remained unresolved when the bank failed. She said Signature's failure to remediate outstanding liquidity management issues undoubtedly contributed to its collapse, adding that the immediate cause was the run-on deposits, instigated by the self-liquidation of Silvergate Bank and the failure of SVB. Harris said that DFS had one objective: to preserve the safety and soundness of the financial system.

The Honorable Clothilde "Cloey" Hewlett, ***Commissioner, California Department of Financial Protection, and Innovation,*** explained how SVB was regulated by both state and federal regulators and noted that the bank was an important service provider for California's tech economy, the life sciences and healthcare sector, nonprofits, and small businesses. Hewlett described the chain of events that led to the closure of SVB and said that DFPI examined SVB in coordination with the San Francisco Federal Reserve Bank (SFFRB) and they flagged concerns with SVB's liquidity management and interest rate risk going back to 2021. She noted the DFPI's internal review and how it highlights the need to make changes to promote safety and soundness. Hewlett said that the DFPI will increase its focus on a bank's level of uninsured deposits and require banks to evaluate and account for emerging risks posed by technology-enabled activities such as social media and real-time withdrawals. She looked forward to working with Congress and regulators on these issues.

Member Questions

Chairman Brown (D-OH) started by saying that regulators identified interest rate risk and corporate governance issues and asked the regulators if it is true that executives fixed the problems they identified. Barr said they fixed some but not all. The rest replied no. Brown asked them to commit to examinations and enforcement to hold bank executives accountable. They all answered yes. Brown turned to Gruenberg and asked if it is hard to hold bank executives accountable. Gruenberg said they have the authority to do this and have done so in the past. Brown pointed to rapid growth of the banks and asked how long transition periods for SVB and Signature contributed to its standards. Barr said that under the previous approach, they would have had heightened prudential standards applying to them as they grew. Brown asked Hewlett the same question. Hewlett said SVB, because of their rapid growth, was the first bank to go through this transition and that it did contribute to its eventual failure. Brown asked Gruenberg and Harper to explain what tools the regulators must address the bank mismanagement that we have seen with SVB and Signature. Gruenberg said we need to look at concentrations of uninsured deposits and that it poses a liquidity risk. Harper noted the importance of working on CLF reforms so they can ensure they have access to liquidity.

Ranking Member Scott (R-SC) opened his questioning by saying that this hearing is a great example of scapegoating and that the regulators are blaming their predecessors. Scott said we are dancing around the problems and the regulators are not taking accountability for not doing their job. He said he was struck by the fact that the Fed was able to issue 31 supervisory findings with the roles they had, but they are asking for more supervision. Scott said the result of them not doing their job and asking for more control over the economy, further restricts access to credit. Scott asked about concern for the ripple effect of increased regulation, given the tightening we are seeing in the marketplace. Barr said he accepts responsibility for failure of supervision at the Federal Reserve and is committed to solving these problems. Scott asked who they fired, and Barr said nobody.

Sen. Reed (D-RI) started by talking about section 10 of the SAFE Banking Act and asked if it will get in the way of regulation. Barr said he did not think it is the regulator's job to tell banks who and who not to lend to, but that he would also be concerned about any language that would limit the ability of a supervisor to take prompt action. Hsu agreed and said it is important regulators have the ability to enforce compliance. Reed asked Barr if liquidity stress testing is made public. Barr said it is an internal process. Reed asked if SVB failed any liquidity tests and if any action was taken. Barr said they did but that it was not always successful. Reed said he hopes they adopt stronger liquidity rules. Reed turned to former SVB CEO Becker being on the Board of the San Francisco Fed and asked if it influenced the treatment of this bank. Barr said the report did not find evidence of this but that the structural issues are there. Reed said that in the human dimension, if someone is sitting on a Board, then there is likely a certain sensitivity by the inspectors. Barr again said the report does not show this. Reed said this is another area they should look at.

Sen. Rounds (R-SD) asked when the Fed gave initial feedback to SVB on their interest rate risk. Barr said the MRA was given very close to when the issues were found. Barr added that the review found the Federal Reserve staff could have pushed harder on remediation. Rounds pointed to how Becker said all supervisory notices were remediated. Barr said this is not true and that at the time they were shut down, they had 31 open supervisory findings open and that interest rate risk was included in these. Rounds turned to claw back authority and asked if Gruenberg is recouping bonuses. Gruenberg said they have authority to investigate the executives and can order restitution if it is necessary. Rounds asked if they invoked this. Gruenberg said they are pursuing investigations. Rounds said you have executives who received bonuses, eliminated hedging that was protecting deposits, and who were chasing profits and asked if Gruenberg will pursue this. Gruenberg answered yes.

Sen. Menendez (D-NJ) started by asking if they agree with Barr's analysis of SVB's financial compensation practices. He asked if they agreed. Gruenberg, Harper, and Hsu said yes. Menendez said the incentive at SVB rewarded breakneck growth and asked if the 2016 proposed rule on Dodd Frank section 956 had been implemented, would this have mitigated SVB's incentive compensation. Barr said yes. Menendez asked if they would commit to acting on this rule. They all said yes. Menendez then discussed how the banks received satisfactory ratings, despite not resolving their problems and asked Barr why supervisors are so reluctant to downgrade banks ratings. Barr said the report identified that the supervisors were slow to change ratings and that this can be partially attributed to the standards that were in place. He said supervisors need the tools to act quickly. Menendez said Barr's job is to identify risk proactively and asked him to commit to sharpening the focus of his supervisory effort. Barr said he commits to this, and that the supervisory system needs to be more agile.

Sen. Vance (R-OH) said the San Francisco Fed focused on climate risk and other issues, instead of prioritizing interest rate risks. Vance asked Barr how these activities help the Fed's monetary dual mandate. Barr said supervisors were focused on the right set of risks regarding SVB, adding that they did not act quickly enough. Vance asked if it is his view that the Fed is doing studies on climate risk and other things does not have an impact on them doing their basic job. Barr said the review shows that they were focused on the right set of risks. Vance questioned the Fed's priorities and worried that focusing on non-financial issues would make our financial system less safe. Vance asked if Barr worried that building politics into our risk assessment will harm our financial system and ability to assess if future banks are a problem. Barr said politics should never be a part of risk assessment and that there is no evidence of that here.

Sen. Tester (D-MT) said the stress from the failures we have had are adversely affecting Americans. Tester asked if they would support an independent review. They all agreed. Tester pointed to Barr's testimony on prudential standards and asked if it is fair to say that every bank would have been subject to the same standards. Barr said he was referring to the approach based on the asset-class of the institution. Tester asked if regulation should fit the risk. Barr said yes. Tester asked if tailoring is allowed, even to the smallest community bank. Barr said they have ample discretion under S. 2155 to take a risk-based approach to supervision. Tester asked if he will propose new regulations in response to the failures. Barr said he wants to look at changes to supervision and regulation going forward. Tester questioned if his report concluded that it is not a regulatory failure. Barr said the report found that supervision and regulation played a role in reduced resiliency at the bank. Tester said regulation needs to meet the risk and that when S. 2155 was put up, it was done with the idea that if you have a risky portfolio, regardless of size, the Fed had the ability to tailor those to whatever threat that those risks posed. Barr said they are not seeking a change in law and that they have ample authority. Tester said he fears community and regional banks will pay the price for mistakes of banks like SVB and asked Barr how he will protect those entities. Barr said it is vital that they have a strong community banking sector and that they are attentive to that. Barr said the rules he is talking about are regarding big banks. Tester said he hopes Gruenberg holds the executives accountable.

Sen. Cramer (R-ND) said more rules and regulations without more appropriate regulating will get them nowhere. Cramer asked if there was not a social media-fueled bank run, would they even be having the hearing. Barr said it is difficult to know what shock will come to the financial system. Cramer said he worries that in today's social media world, fear and panic is exacerbated. Cramer turned to the sale of the assets and the lack of transparency here and asked if we should have considered other options. Gruenberg said they were considering the least cost under the law. Cramer asked if OCC has more leeway regarding the soundness of the system. Hsu said they must consider financial stability and that their actions result in coordinated government action and that they support minimal cost to the DIF and prevent contagion. Cramer said that the Fed prioritizing climate and other issues did take away from their focus.

Sen. Warner (D-VA) said the bank run was unprecedented and that no supervisory structure would have stopped it. He said short selling has not received a lot of attention and that a wholesome look at this would be something on which they can collaborate. Warner asked Gruenberg about tools we have to prevent bank runs like this. Barr said the speed of the run was unprecedented and that it is worth looking at that in relation to our banking tools. Gruenberg said we learned some hard lessons about liquidity risk, noting that deposits were uninsured and focused on a small number of depositors, which contributed to the way in which the bank run happened. Hsu said this is something we need to be responsive to. Warner said he appreciates these comments but has not heard any policy recommendations. Warner noted how addressing inappropriate short selling might introduce some hesitancy, but that they need to look at the way this bank run happened. Warner said we need to act quickly.

Sen. Britt (R-AL) said she was sad to hear the lack of responsibility exhibited by the bank executives for their failures. Britt said that after reading Barr's report, she felt he did not take adequate responsibility but that she appreciated him doing that during the hearing. Britt noted how much of the time Barr was in his position prior to the bank failures, he was doing speeches on climate issues and other things and said the focus on the safety and soundness of the banking system is not there. She said the focus needs to be on the 31 supervisory findings on SVB and asked if there were 31 findings. Barr said yes. She asked why they did not do more here to enforce remediation. Barr said the report found the supervisors were not moving fast enough. Britt said the tools were there and they did not use them efficiently, so we do not need more rules. She asked Gruenberg if it would have been better for the economy if SVB was sold while it was still an open bank. Gruenberg said yes. Britt asked if there were any interested parties to purchase SVB. Gruenberg said he was not aware of any and that he was not the primary regulator on this.

Sen. Warren (D-MA) started by talking about big banks getting bigger. She asked Hsu if he knows the first item on the OCC's list of factors when evaluating risk to the stability of the banking system. Hsu said it relates to whether the merger will have financial stability impact. Warren said it is whether the transaction will increase in risk to financial stability due to the increasing size of the financial institution. She rhetorically asked how we know if a purchasing bank poses risk to the banking system, noting that regulators use the GSIB score. She said they approved of JP Morgan over PNC and asked Hsu how much bigger JP Morgan's GSIB score is than PNC. Hsu said he was not sure, and Warren said it was eight times bigger. She asked the same for Citizens Bank and said it was 14 times bigger. She said Hsu's job is to determine the risk to the system from making big banks bigger and asked how he can explain approving a sale to a bank that increases risk to the banking system. Hsu said for every merger they follow the law and guidelines. He said there are several factors, other than the GSIB at play here. He said if they strictly used the GSIB, there would have been financial instability. Warren asked if there are other factors that weighed against the other bidders. Hsu said a GSIB score approach to the handling of this situation would not have been a wise one and that the GSIB score is not part of the framework. Warren said the single biggest threat to the banking system is concentration and that she was concerned with how this was handled.

Sen. Tillis (R-NC) referenced a letter he sent with Sen. Tester about an external review and was happy to hear they agreed that it would be helpful. He also referenced Sen. Warner's comments that no bank - even a well-capitalized one - could withstand the deposit flight that occurred so quickly. Tillis said he thought it was a mixture of bad management, supervision, and external factors, but it is not as simple as some have tried to make it. He asked Barr about the 31 open MRAs and how Congress is supposed to view the effectiveness of the supervisors when they allow a bank to rack up that many MRAs. Barr said the MRAs are assigned to hold the bank accountable, but in this case the bank failed before supervisors finished the MRA process. He agreed that it showed the bank had significant problems and supervisors had downgraded the bank and, in the process, to start an enforcement action. Barr said that SVB was slower at addressing MRAs than their peer banks. Tillis said it seems like post-SVB failure, there has been a dramatic increase across the industry of MRAs. Barr said he has not looked at that but will examine it. Tillis said 20 out of 20 bankers he asked in North Carolina said they had an increase in MRAs in the last couple of months. Tillis said he would submit additional QFRs on this.

Sen. Cortez Masto (D-NM) noted how executives of the banks did not take accountability. She said the former SVB CEO, Greg Becker, said that no Federal Reserve supervisor raised interest rate risk with him prior to the failure of SVB. Cortez Masto said Barr is saying that is not correct and asked him to expand on this. Barr said Becker's words are not true and that they did alert the bank of its interest rate risk. Cortez Masto asked Barr that based on his analysis, was this a cause for some individuals to conduct a run on the bank. Barr said the primary cause for the run seems to be related to the bank's insolvency and that the insolvency was largely because of interest rate risk. Cortez Masto turned to moral hazard and asked at what point do we stop bailing out individuals who should know better and investors who invest without insuring their money. She asked Gruenberg what we should be doing here. Gruenberg said SVB and Signature posed a tough judgment for the agency to make and that for SVB, they did not necessarily believe the SRE was warranted. He added that when Signature failed shortly after and others saw serious liquidity stress at other financial institutions, it was apparent that contagion was occurring. Cortez Masto asked if we should be looking at deposit insurance coverage and what we should be considering here. Gruenberg said the option with the most promise would be increasing coverage for business payment accounts. Cortez Masto said the thing that is missing in all of this is that this is impacting small businesses, community banks, and families and that they must address this.

Sen. Hagerty (R-TN) opened with Barr, highlighting the Fed's competing priorities and tension between the Fed's mandate and supervisory role. Hagerty asked how someone in Barr's role could objectively vote to raise interest rates while also overseeing bank supervision, which will be impacted by interest rate decisions. Barr said he did not think there was a conflict between the two. He said in his role at FOMC, he is solely focused on the FOMC mandate. Hagerty said this tension deserves additional dialogue over the coming months. Hagerty brought up former SVB CEO's testimony that he tried to assist the FDIC in selling the bank, but the FDIC rebuffed the offer. Gruenberg said his understanding is that FDIC staff did meet with Becker on that Saturday and get input from him on the institution as well as input on potential inquirers. Hagerty noted that Becker and Gruenberg were telling two different stories, and we need to get to the bottom of this conflict. Hagerty brought up last year's FDIC RFI on bank mergers and said that he is troubled by the agency's opposition to bank mergers. He asked Gruenberg if he agreed that a bank merger before a bank fail is better than tapping into FDIC insurance, and Gruenberg agreed. Hagerty asked for an update on the FDIC's merger guidance, and Gruenberg said this is the first review in 25 years and is doing this in conjunction with other regulators and the DOJ.

Sen. Van Hollen (D-MD) started by putting into the record a Financial Times article about how executive pay at SVB soared after a big bet on risky assets. Van Hollen pointed to Barr's report and how it includes a section on incentive compensation and that it concluded that the incentive compensation decisions of these banks were focused on profits and ignored risk management. He asked if they profited by taking on more risk. Barr agreed and said the supervisors found that risk management was ignored within their compensation scheme. He added that they chose to take actions to expose themselves to more risk to juice profits. Van Hollen said this is problematic because this impacts depositors and public money that came in to address the situation. Van Hollen asked if we need to better align executive compensation rules for banks that are FDIC insured with the risks that are being taken. Barr agreed and said the agencies are working on rulemaking with respect to this. Van Hollen assumed he was talking about section 956 of Dodd Frank and urged him to get this done by the end of the year. Van Hollen said he hoped that we would find ways to claw back compensation in situations like this and ways to prevent this from happening again.

Sen. Kennedy (R-LA) said it should not go unnoticed that when someone in the federal government gets it wrong, no one is ever fired. He asked if Barr's previous comments indicate that his agency has not done a good job, but that Congress should give them more power. Barr said he does not want more power from the committee. Kennedy asked if they are going to promulgate new rules to give them more power. Barr said they are going to use their authority to strengthen supervision and regulation. Kennedy said he heard Barr saying his people screwed up, but it was not their fault because Trump and Randy Quarles ate their homework. He said he finds Barr's acceptance of responsibility hollow and asked if he was right. Barr said he disagrees with the characterization. Kennedy asked if Quarles was at fault. Barr said he was at fault. Kennedy said the report does not indicate that.

Sen. Smith (D-MN) noted that Barr's report indicates that decisions made, and actions taken prior to his time as VC had an impact on the ways regulations were enforced and if she has that right. Barr said yes, that the 2019 tailoring rules led to lower supervisory standards. Smith said this is the reality. She turned to the bank executives and said she was struck by the lack of urgency to fix these problems and asked why they did not address the deficiency ratings they received. Barr said banks in most places behave accordingly and if they do have deficiencies, they address them. He added that SVB did not address their deficiencies and often went the opposite way. Smith said she appreciates that Barr wants to bring swiftness and agility to the process, adding that there must be more accountability. Barr said there were plenty of yellow cards issued but not enough red cards. Smith said she would submit a QFR about replenishing the Deposit Insurance Fund.

Sen. Sinema (I-AZ) said she was concerned about the number of examiners at the FDIC and noted the shortage in the region where Signature is based. She asked Gruenberg if he is confident that other banks in the region are being adequately supervised. Gruenberg said they are. Sinema said since they set their own budget, she wanted to know what the FDIC is doing to address staffing shortages. Sinema turned to Barr and asked how he is defining success regarding cultural and operational changes at the Federal Reserve. Barr said we need to have an agile workforce that acts quickly and forcefully to prevent similar problems in the future. Sinema asked if he had a timeline. Barr said he did not. Sinema noted how turnaround time at the Federal Reserve is a problem and asked what the median turnaround time is for a Fed regulatory response. Barr said the bank was late in responding to the supervisors' concerns and when they were late, the supervisors did not escalate fast enough. Sinema said she would like to know a more specific answer in the future. Sinema asked if they have identified new metrics to measure success regarding operational and cultural changes and if so, what are those metrics. Barr said they are working on detailed work plans but did not have those today. Sinema asked if they have staff at the Fed delegated to this issue or contractors. Barr said they will have both. Sinema asked how much money they are allocating for this. Barr said they are still working this out.

Chairman Brown (D-OH) said they all seem to agree that supervisors need to hold banks accountable to the rules that are needed to keep banks safe. He said that as banks started to rapidly grow in 2019, Congress, former President Trump, and former regulators gave them the green light. Brown said the basic rules of the game at that time made it so that banks like SVB had weaker capital and liquidity standards and that we now need to strengthen those guardrails. Brown said they need to make sure that banks like SVB and Signature are held to higher standards so they can protect the financial stability of the entire banking system.