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To:	Global Counsel Network
Date:	03/13/2023
Subject:	Implications of USG actions to guarantee uninsured deposits at SVB, seize Signature Bank: Regional banks at risk; “too big to fail” debate reignited; moral hazard returns

In an extraordinary series of developments on March 12th, US policymakers – the Federal Reserve, the Treasury Department and the Federal Deposit Insurance Corporation (FDIC) – jointly announced that the federal government would protect all depositors of SVB Financial (ticker: SIVB). The parent company of Silicon Valley Bank, a major financier to the US venture-backed economy, SVB had been taken into receivership by the FDIC the previous Friday after reports of large securities losses sparked a run on the bank that led to a liquidity crisis. **US policymakers moved to backstop *un*insured as well as insured deposits of SVB** (the FDIC guarantees deposit accounts up to $250,000, but many businesses maintain balances well in excess of that level); insured balances comprised 88% of SVB’s deposits (as of year-end 2022). The policymakers announced all SVB depositors would gain access to their funds as of Monday, March 13th, responding to concerns from thousands of venture-backed companies and their owners who held uninsured deposits at SVB they were unable to withdraw after the FDIC’s seizure last week.

Separately but in clearly coordinated fashion, the FDIC announced it had seized Signature Bank (ticker: SBNY), like SVB a mid-tier, business-focused bank, which had started to experience outsized deposit outflows in the wake of SVB’s troubles last week. Some 90% of Signature $89bn in deposits as of year-end 2022 were uninsured, according to its most recent 10-k. The FDIC said Signature’s deposits – again, both insured and uninsured – would be made whole under the same “systemic risk exemption” applied to SVB, with any losses recouped through a special assessment on US banks that contribute to the FDIC’s deposit insurance fund (as opposed to being borne by taxpayers). Finally, the Fed in the same release announced a new program for eligible institutions to meet the needs of “all their depositors”, presumably including insured as well as insured (see further detail below).

Though the situation is evolving rapidly, we make the following brief observations about the policy and political implications of these events:

1. **The regional, commercially focused US banking model is suddenly at risk...** US policymakers at many levels have long lauded regional, more specialized banks that have retained their focus on a certain geographic area, a narrow set of products, or both, standing in contrast to the mega-banks that have come to dominate the US banking landscape over the past 30 years. Indeed, in 2018, Congress voted with wide, bipartisan margins (and then-President Trump signed into law) in support of a bill to relax supervisory standards on banks with between $50bn and $250bn of total assets. “The Main Street banks and credit unions that people depend on, they've been suffering," Rep. Jeb Hensarling (R-TX), who chaired the House Financial Services Committee in 2018, said upon the bill’s passage. "They've been suffering for years under the weight, the load, the volume, the complexity, the cost of heavy Washington bureaucratic red tape.” This bill captured both

SVB and Signature, and is now drawing a second look given the events of the past week. But it is not an exaggeration to say that nearly every Member of Congress knows the CEOs of banks headquartered in his or her district or state, and these institutions represent not just engines of local economic growth but well-paying jobs and civic pride. The rapid collapse of both SVB and Signature could play a role in the Federal Reserve's "holistic" review of bank capital requirements currently being undertaken with regional banks potentially being more closely examined under this review process.

SVB's rapid collapse, and now the seizure of Signature over a single weekend, strikes a sharp blow to the commercially focused US bank business model. Bank executives and regulators must now adapt to a world in which social media, near-instantaneous dissemination of news and rumor alike, and ubiquitous online access to bank accounts make banks with high levels of uninsured deposits (and non-banks, for that matter) highly vulnerable to runs, which can cripple even banks that appear healthy by any reasonable metric. California's banking regulator, in announcing the closing of SVB on March 10th, noted that the bank had lost $42bn, or 24% of its total deposits, in a single day on March 9th, as tech executives and venture capitalists scrambled to withdraw funds.

The sudden seizure of Signature, in particular, will surely reverberate for some time to come in the banking industry, and may well be challenged by its shareholders and/or bondholders. Signature reported in its annual 10-k filing on March 1st that it was categorized as "well-capitalized" by the FDIC, with capital ratios exceeding that standard across all four measured categories. As of the close of trading on March 10, SBNY maintained an equity market cap of $4.4bn and reported $572m of subordinated debt. Most or all of this $5bn in enterprise value will presumably be wiped out due to the FDIC's receivership, as the agency noted in its announcement that Signature's "shareholders and certain unsecured debt holders will not be protected," adding that Signature's management had also been removed. Supporters of the FDIC's move might argue that Signature had made an outsized bet on serving cryptocurrency and other digital assets customers in recent years, leaving it more vulnerable to systemic concerns as values of such assets declined substantially last year. But Signature had taken meaningful actions to reduce its exposure to digital assets, cutting $8bn-$10bn in deposits in the fourth quarter of 2022, versus total deposits of $89bn at year-end 2022, and had made the digital assets push in the first place under the regulators' watch.

One can debate Signature management's actions. But preventing the bank from attempting a capital raise over even a single trading day may well have a chilling effect on debt and equity investors contemplating investments in similar firms, as well as managements of mid-sized banks considering taking a risk in a new asset class. As one sign of this new concern, as of this writing on the morning of March 13th, shares of First Republic (ticker: FRC), another San Francisco-based commercial bank, were down 65% pre-market in the wake of this weekend's events, while Phoenix-based Western Alliance (WAL) was down 52% and PacWest Bancorp (ticker: PACW) was down 33%. Whether intended or

Global Counsel

not, the agencies' weekend action could necessitate capital raises or mergers of equals by these and other regional banks at distressed prices, as the banks attempt to demonstrate to their customers that they have ample capital to withstand an SVB-like liquidity event.

2. **… But are regulators ready for the big banks to get bigger as a result?** The largest US banks, widely cited as weak links in the chain leading up to the Global Financial Crisis (GFC) of 2007-08 given their low capital levels and risky behavior in the housing bubble that preceded it, can rightly take credit for building substantial capital and lowering their risk profiles in the years since, in part due to the multi-faceted regulatory regime over the largest US banks installed by regulators in the crisis' wake. The eight US banks designated as Globally Systemically Important Financial Institutions (G-SIBs) by the Financial Stability Board – Bank of America, Bank of New York Mellon, Citigroup, Goldman Sachs, JPMorgan Chase, Morgan Stanley and Wells Fargo – have all passed the annual Fed-administered stress tests for each of the past six years (in 2015 the Fed cited "deficiencies" in granting BofA only a conditional pass and requiring resubmission to the test). Indeed, **BofA, Citi, JPM and Wells are arguably the most logical acquirers for SVB,** given their size, their more retail-balanced deposit bases, and their expertise in commercial banking as well as evaluating SVB's substantial on-balance-sheet portfolio invested in the venture-backed companies it banked (BofA and Wells have the added benefit of large retail banking footprints in the San Francisco and Los Angeles areas where SVB's branches are located). Indeed, well-known commentator and financial services executive Mohamed El-Arian on March 13th called in an op-ed for US regulators to relax size restrictions on US banks so that the US financial system could digest SVB's collapse (Wells Fargo, for instance, has operated under a Fed-imposed cap on its total assets since 2018 following a series of scandals involving the fabrication of fake customer accounts, which an acquisition of all of SVB would cause it to break).

   But should the crisis at SVB, SBNY and who knows which commercially focused lender is next result in banks already deemed as "too big to fail" getting even larger? **Clearly any close observer of the leadup to and fallout from the GFC would question such a result. But the alternative may well require more creative approaches by the FDIC and other regulators than the typical approach of finding a single larger acquirer of banks that fail.** Another mid-sized bank may be interested in buying some or all of SVB or Signature, for instance, but may seek the same "systemic risk exemption" just offered to those two, and for enough time to get through the contagion sweeping through the US banking system at the moment. Would regulators, and ultimately the public, go along with such an arrangement?

3. **Moral hazard returns without warning - what will be the political fallout?** The scope and speed of the joint agency action on March 12th will surely revive criticism of US bank regulators picking winners and losers in response to a financial crisis, and in this case one that, unlike the GFC, has not (yet?) touched most US businesses or consumers. Republicans in Congress and elsewhere will likely argue that the Fed, Treasury and FDIC have potentially opened a massive new liquidity program (the agencies' joint release was distinctly devoid of any numbers) in response to problems with two banks focused on serving moneyed, liberal

Global Counsel

elites (with SVB based and focused on the Bay Area, and Signature in New York City and the New York metro region). And critics of the Fed will question what the central bank meant by a comment hastily released on a Sunday afternoon before the opening of Asian financial markets of a new liquidity facility “to help assure banks have the ability to meet the needs of all their depositors.” Did the Fed just guarantee the some $9tr in uninsured deposits ($1.5tr of which is held by depositors of non-US banks, who do not qualify for US deposit insurance), in addition to the $10tr in insured deposits the FDIC estimated were held in US banks at year-end 2022? If not, which banks will qualify for such relief, and which will not?

Outside of the liquidity program itself, Sunday’s actions will surely lead to more macro-level questions of the Fed, FDIC and the Biden Administration. Will the Fed slow its recently-reiterated plans to continue to increase interest rates to reduce inflation to provide relief to banks’ bond portfolios, losses on which as rates have risen were the catalyst for last week’s run on Silicon Valley Bank? Were there bids for some or all of SVB on the table when the “systemic risk exemptions” were announced, and if so why were they not accepted? Were Congressional leaders notified?

We will start to get answers as soon as March 13th, when media reports suggest President Biden is scheduled to address the actions. While less dramatic and complex than the months-long battle to contain the GFC, US policymakers’ actions of March 12th set meaningful precedents for future industry and regulatory action and reflect the difficult policy choices regulators face in this new crisis.