



## Testimony

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# BANK REGULATION

## Preliminary Review of Agency Actions Related to March 2023 Bank Failures

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

Accessible Version

Chairwoman McClain, Ranking Member Porter, 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.<sup>1</sup> 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.<sup>2</sup> 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.

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<sup>1</sup>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).

<sup>2</sup>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.

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## 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.<sup>3</sup> 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

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<sup>3</sup>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.

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poor governance and unsatisfactory risk-management practices were the root cause of Signature Bank's failure.

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## 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.

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### 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.<sup>4</sup> 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,

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<sup>4</sup>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.

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.

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.<sup>5</sup> 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.<sup>6</sup>

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<sup>5</sup>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).

<sup>6</sup>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.

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 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.

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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.

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### 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



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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.

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## 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.<sup>7</sup> 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.<sup>8</sup> 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).<sup>9</sup> The regulators considered noncapital triggers, but have not added them to the framework—thus

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

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

<sup>9</sup>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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missing a potential opportunity to take early action to address deteriorating conditions at banks.

Chairwoman McClain, Ranking Member Porter, 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.

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## 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](mailto: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.

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