Ms. Liang:

... That banks face today. Thank you to the committee for its leadership on these important issues and for inviting me here to testify. I look forward to your questions.

Chairman Brown:

Thank you, Ms. Liang, and almost every member of this committee will be here today on both sides of the aisle. Make your answers as brief and as quick as you possibly can, so thank you for that. In 2019, by votes of four to one and five to one, now chair of the NEC, Lael Brainard, the only dissenter in every one of those votes, the Fed ruled back stronger rules and was responsible for supervising Silicon Bank. Mr. Vice Chair Barr, did the Fed drop the ball because it didn't see the risk that was building?

Michael Barr:

Thank you, Chairman Brown for that question. Fundamentally, the bank failed because its management failed to appropriately address clear interest rate risk and clear liquidity risk. That interest rate risk and liquidity risk was cited, was highlighted by the supervisors of the firm. Beginning in November of 2021, the board... Sorry, the Federal Reserve Bank brought forward these problems to the bank and they failed to address them in a timely way. That exposure led the firm to be highly vulnerable to a shock, and that shock came on the evening of Wednesday, March 8th, when it very belatedly attempted to adjust its liquidity position and reported losses on its available for sales securities. The market reaction to that was quite negative, and that eventually on Thursday sparked a depositor run.

Chairman Brown:

So, some of their practices appeared to have violated the basic principles of banking 101, concentration risk, over-reliance on uninsured deposits, inadequate liquidity, poor risk management, the list goes on. How poorly managed was this bank?

Michael Barr:

Supervisors had rated the bank at a very low rating, normally we would not be describing these matters, confidential matters, but given that the firm failed and triggered a systemic risk determination, I'm prepared to talk about that confidential information, that the firm was rated a three in the CAMELS scale, which is not well managed, and at the holding company level, it was rated deficient, which is also clearly not well managed.

Chairman Brown:

Thank you. Chair Gruenberg, I heard from many small businesses over that weekend who had money in SVB and were worried about making payroll in Ohio, making payroll as a result of the failure, I heard from Ohio small banks and credit unions worried about deposits leaving their institutions. I know that I'm not unique, many of my colleagues from both sides of the aisle heard those same concerns in their state. Given the unprecedented scale of the bank run, what would've been the impact when small banks and small businesses across the nation if you and other regulators had not taken action to protect depositors at SVB and Signature Bank?

Chairman Gruenberg:

Senator, that was our central concern. I think the evidence suggested from the sequential failures of first, Silicon Valley and then Signature, that there was a significant risk of contagion to other institutions.

And in fact, over that weekend, we were seeing serious stress at other institutions, and the potential knock on effects of that contagion is really what led the Federal Reserve Board and the FDIC board unanimously to recommend to the Treasury Secretary-

Chairman Brown:

So, you're saying the actions taken were the least bad option for small businesses and banks across the nation. If you hadn't acted that way, do you think there would've been a contagion?

Chairman Gruenberg:

I think there would've been a contagion and I think we'd be in a worse situation today with consequences for the actors in our economic system that you [inaudible 00:04:12]-

Chairman Brown:

Regulators, Republicans, Democrats, all across the board there was agreement on those actions.

Chairman Gruenberg:

Yes.

Chairman Brown:

Undersecretary Liang, do you agree with that?

Ms. Liang:

Senator Brown, I do agree with that. I think the actions that were taken have been working to stabilize deposits. Had they not been taken, the runs by uninsured depositors from many small and regional sized banks and mid-sized banks would have intensified and caused serious problems for small banks' liquidity and their ability to support small businesses.

Chairman Brown:

Thank you, and if you could answer this really briefly, because I don't want to go over my five minutes. Chair Gruenberg, the FDIC announced the sale of SVB into First Citizens Bank and Trust from Senator Tillis' North Carolina, estimated would cost the deposit insurance fund approximately $20 billion. How's that cost covered?

Chairman Gruenberg:

Oh, that is required by law, and I indicated in my opening statement the FDIC has to impose an assessment on the banking industry to cover the cost of a coverage for any uninsured deposits. And, I would note that the law provides the FDIC authority in implementing that assessment to consider the types of entities that benefit from any action or assistance provided, and as I also indicated in my statement, we expect to issue a notice of proposed rulemaking for public comment in May to implement the assessment.

Chairman Brown:

Thank you, and I would point out in your testimony in your answer there, there are no tax dollars, nothing funded through the Congressional appropriations process. Senator Scott.

Senator Scott:

Thank you, Mr. Chairman. What is the future of regional banking? Sure.

Chairman Gruenberg:

Oh, I think we have a strong set of regional banks in the United States. And as a general matter, their liquidity has remained stable through this episode, and I think it was a good indication, frankly, that in the two failed institutions, in both of those cases, the strongest bids we received to acquire those failed institutions were from two other regional banks that had the capability and strategic business interest to acquire them. So, there are a lot of cautionary lessons to be learned from this, senator. I completely agree with that and we're going to need to carefully review this episode, but as a general proposition, I think the regional banks in the United States remain a source of strength for the system.

Senator Scott:

I walked in on the chairman's comments about the actions that were taken the weekend of the March 9th and how important it was and the importance of making sure we get credit for doing something that actually I thought could have been avoided frankly. I thought it could have been avoided if we had someone in the private sector make the decision to buy the bank, buy the assets. Had that been done on Friday, March the 10th, I think we could have literally eliminated the fiasco that we saw over the weekend. Were there folks interested in buying Silicon Valley Bank on Friday?

Chairman Gruenberg:

Senator, just to be clear, before the bank failed on an open institution basis?

Senator Scott:

After.

Chairman Gruenberg:

Oh, after the failure on a closed basis?

Senator Scott:

Yes.

Chairman Gruenberg:

Oh, we had expressions of interest. Remember, this was a very rushed process, if I may say. The bank failed on Friday morning. The other institution failed over the weekend. We had to set up two bridge institutions to manage those failed banks. To your point though, we had expressions of interest. We quickly set up a bidding process that we ran on Sunday. We received two bids. One wasn't valid because it had not been approved by the board of the bank and the other, after we evaluated it, indicated that it was more expensive than a liquidation of the institution would've been to the FDIC. So in effect, we did not have an acceptable bid, and it was really a determination that we made to try to set up two bridge institutions to manage for a short period of time these two failed banks, and then to organize an open bidding process for both institutions, which we ultimately were able to implement successfully and sell Signature Bank previous weekend, two weekends ago, and then to sell SVB this past weekend.

Senator Scott:

Are you suggesting that the fact that the board had not approved the offer that was on the table was the primary reason why you turned down that offer?

Chairman Gruenberg:

It was one of the bids. As a matter... We were required for a bank to make a valid offer for the board of the bank-

Senator Scott:

To approve the offer. That was the primary reason why you did not got for [inaudible 00:09:29]-

Chairman Gruenberg:

For that bid. The other bid did not have that issue, but the other bid was more costly than liquidation would've been.

Senator Scott:

So, you're suggesting that a private sector engagement would've increased the cost, not decreased the cost?

Chairman Gruenberg:

At that point. I think in part because it takes a bit of time for... This is a substantial institution, it takes some time for a bank to do appropriate due diligence to evaluate the assets and liabilities and to make an informed bid for the institution. And I think as a practical matter, that was difficult to do given the compressed timeframe over that initial weekend. I think that's why we set up the bridge institutions to try to put in place quickly an orderly bidding process where any interested party could submit a bid, have an opportunity to do due diligence in order to evaluate the institution and to make an informed bid. I think we were ultimately able to do that for both of these failed institutions.

Senator Scott:

I'll just say with my remaining time that I look forward to the second round of questions, but I will say without question that if we would have had a better private sector engagement with quicker action from the Feds, I think we could have avoided the concept that rushed us to a decision which was a concern of contagion. In part, that could have been avoided if we had had a decision made on Friday if there were a private sector folks willing to make a decision, but we'll have an opportunity hopefully on the second round.

Chairman Brown:

Thank you. Senator Warner from Virginia, welcome.

Senator Warren:

Thank you, Mr. Chairman, and thank you for having this hearing. It's good to see all of you. A couple weeks ago when we were in a finance committee hearing, I asked Secretary Yellen that I thought it was very important that we try to get all the facts out about what happened here. I very much appreciate Vice Chairman Barr, you taking on this unenviable task of sorting this out because I've got real questions.

Was this a regulatory and bank management failure or was it, as some on my side of the aisle have indicated, was it a statutory failure? If it was a statutory failure and an additional test or activity was needed, I'm all for putting it in place, but my operating premise at this point is if this had been not a $200 billion bank but a $5 billion bank that management's mistakes, not having a risk offers or other items and failure of basic prudential regulation should have caught this.

We had two chief regulators, a state regulator that at some point, Mr. Chairman, I hope we would get in front to where were they and obviously the San Francisco Fed. So, I'm going to be very interested in making sure we get to the bottom of this. I think some of the things you've already pointed out, Vice Chair Barr, is the bank's business concentrating in one industry, an industry that I used to be part of, but the fact that there was such high concentration of counterparty risk, my understanding 10 depositors alone had about $13 billion of deposits. Again, it seems to me interest rate mismanagement is banking 101 and again, even at a $5 billion bank that should have been called out. I also think the speed, I've often cited the fact that the largest bank failure we've seen was WaMu back in the crisis, $16 billion left that bank over a 10-day period.

In this case, $42 billion, the equivalent of 25 cents on every deposit went out in six hours. I'm not sure at that point what regulatory structure could have prevented that. And at least from reports, it seems to me that, and I say this As somebody that used to be in the VC industry, some of the very VCs who banked for a long time at SVB may have started this run and demanded all of their ancillary companies all go out at once. So Vice Chair Barr, can you take us through with a little more detail, starting Wednesday night through Friday afternoon, how this happened, how we got here and what you've seen so far?

Michael Barr:

Thank you very much, senator. I'll, I'll start where you did, which this is a textbook case of bank mismanagement. The risk the bank faced, interest rate risk and liquidity risk, those are bread and butter banking issues. The firm was quite aware of those issues. They had been told by regulators, investors were talking about problems with interest rate and liquidity risk publicly, and they didn't take the action necessary. They were quite vulnerable to risk, to shocks, and they didn't take the actions necessary to meet that. What happened on Wednesday night is they belatedly attempted to improve their liquidity position and they did it in a way that spooked investors, that spooked depositors, that spooked the market. Nonetheless, on Thursday morning, things appeared calm according to the bank's report to supervisors, but later Thursday afternoon, deposit outflows started and by Thursday evening we learned that more than $42 billion, as you had indicated, had rushed out of the bank.

That's an extraordinary pace in scale. Federal Reserve Bank staff worked with the bank through the afternoon, evening and overnight to try and find enough collateral that the Federal Reserve could continue discount window lending against. On Friday morning, it appeared that it might be possible to meet the outflow that was expected the day before, but that morning the bank let us know that they expected the outflow to be vastly larger based on client requests and what was in the queue. A total of $100 billion was scheduled to go out the door that day. The bank did not have enough collateral to meet that, and therefore they were not able to actually meet their obligations to pay their depositors over the course of that day and they were shut down.

Chairman Brown:

Senator Crapo is recognized from Idaho.

Senator Crapo:

Thank you very much, Mr. Chairman. In your testimony, Mr. Barr, you indicated that you were going to be in one of the aspects of what you're working on, you're going to be looking at whether more stringent standards are needed, and I want to follow up on Senator Warner's questions relating to this argument that has been put out there, I think, as a part of the blame shifting game, and there's a lot of that going on right now, that it was a statutory failure. That brings us to the 2018 reforms, Senate Bill 2155, and I just want to read to you a couple of sentences out of Senate Bill 2155 with regard to the question of whether that legislation prohibited our Federal regulators, and particularly the Fed, from doing anything they needed to do with regard to applying the appropriate strict standards. And to start out with, I will read what Senate Bill 2155 did was to stop a one size fits all system and mandate by changing the word may to shall, mandate that the Federal Reserve tailor its regulations to the risk and so forth.

I want to read the language. It mandates that the Federal Reserve differentiate, as it tailors, differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities, including financial activities of their subsidiaries, size and any other risk related factors that the Board of Governors deems appropriate. And then at the conclusion of that section of the statute, it makes it crystal clear, and this is the statutory language, nothing in subsection A shall be construed to limit the authority of the Board of Governors of the Federal Reserve System in prescribing prudential standards under this section or any other law to tailor or differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities, including financial activities of their subsidiaries, size and any other risk related factors that the Board of Governors deems appropriate.

And, I could go on with multiple times that language was repeated. My question to you is, was there any statutory restriction faced by the Federal Board of Reserves as it issued its regulations on tailoring that would've prohibited them from applying the strictest standards they could to address the prudential needs of our banking system?

Michael Barr:

Thank you, Senator Crapo. I agree with you, there was a substantial discretion under that act for the Federal Reserve to put in place tailoring rules that were different from the tailoring rules that had put in place in 2019. I think there is still to this day a substantial discretion in changing those by notice-and-comment rulemaking. That's one of the areas that we'll be looking at in our review, whether there should be appropriate changes. There are some areas, particularly for smaller firms, firms between 50 and 100 billion where the act is more prescriptive, but for the firms of the category that we're addressing today, there's substantial discretion for the Federal Reserve to change those rules in a way that is supportive of safety and soundness and financial stability.

Senator Crapo:

Thank you, and I appreciate your answer. You said recently that the bank failed, referring to SVB, as the public began to focus on changes in values of securities in the bank's held to maturity account. That's correct, right? My question to you there is, did the standards on that risk that are used for supervision, were those changed at all in Senate Bill 2155 in 2018?

Michael Barr:

The standards for capital rules are determined by the bank agencies. The bank agencies made a decision for smaller categories of these large banks to not require the pass through of AOCI into the capital structure, but that was a decision that is a available to be altered by the discretion of the bank agencies.

Senator Crapo:

That was not mandated by 2155?

Michael Barr:

No, it was not mandated by 2155.

Senator Crapo:

Last question is, under the current standards that are applied with regard to capital, was SVB adequately capitalized?

Michael Barr:

Yes, prior to its failure, it was categorized under current capital rules, as well capitalized.

Senator Crapo:

All right, thank you very much.

Chairman Brown:

Thanks, Senator Crapo. Senator Cortez Masto from Nevada is recognized.

Senator Cortez Masto:

Thank you, Mr. Chair. Thank you all three of you for being here. Vice Chairman Barr, let me start with you. You've talked about how the Federal Reserve is undergoing an investigation to determine whether the Federal Reserve actually failed in this instance. Is the Federal Reserve the appropriate body to conduct this investigation or should we have an independent investigation?

Michael Barr:

Thank you, senator. It's a terrific question. We described what we're doing as a review. We're reviewing our own practices. I think it's an important part of risk management to do self-assessment. I think it would be irresponsible and imprudent of us not to do self-assessment. We're going to take that very seriously, we're going to be thorough, we're going to be transparent, and we're going to be far-reaching in that. I also think it's appropriate for outsiders to have independent reviews and we expect and welcome independent reviews of our actions.

Senator Cortez Masto:

And, if you uncover in your investigation that the Federal Reserve failed here in some of its supervisory roles, will you make that public?

Michael Barr:

Yes, we intend to make our report fully public on May 1st, and that report will include... Normally, it's not our practice to include, but that report will include confidential supervisory information, such as the exam reports.

Senator Cortez Masto:

And in the scope of your review, you identify the scope of that review in your written testimony. Is there anything in addition that's not in your written testimony that you'll be reviewing here in that scope?

Michael Barr:

Thank you, senator. I've asked the staff to be far-reaching. So, if they determine that an issue should be in scope, they have full discretion to put that issue in scope and to address it in the review. So, there are no limitations on their ability to review how the Federal Reserve conducted its supervision and the regulatory oversight of the firm.

Senator Cortez Masto:

Thank you, and then one final thing, because there's been a lot of discussion about the previous rollback of some of the regulation in votes in this body just recently, if you find that change in the law impacted the Federal Reserve's ability to conduct the appropriate tests based on the tiering of the bank's assets, would you be forthcoming with that and say so?

Michael Barr:

Yes, we intend to describe where we think supervisory and regulatory failings occurred. If changing those to make them what we think is the right standard would require an act of Congress, we will say so in that review.

Senator Cortez Masto:

And then, Chairman Gruenberg, same to you, you're conducting a scope of the FDIC. Are you comfortable that you can conduct that and be transparent and accountable, or should there be an independent body looking at this?

Chairman Gruenberg:

I think there's room for both. As Michael indicated, I think it's important for each of our agencies to look internally at our supervision of these institutions and draw lessons from it. In our case, we've asked our chief risk officer who's not directly involved in the supervision process and whose role is to evaluate risk at the FDIC, to undertake this internal review of our supervision of Signature Bank.

Senator Cortez Masto:

Thank you, and then there's been a lot of talk in the media about the executive salaries, about the executive bonuses, about the sale of stock. Let me ask the three of you, my first question is, what authority do you have to claw back any of those bonuses or the executive pay or even deal with the sale of the stock? And maybe, Mr. Gruenberg, let's start with you and then go down.

Chairman Gruenberg:

Thank you, senator. As I indicated in my opening statement, the FDIC for every failed institution is required to undertake an investigation of the conduct of the members of the board, the management of the institution, as well as professional service providers and other institution affiliated parties. We've already begun that investigation and we have significant authority under the law, depending on the findings of the investigation, to impose civil money penalties, restitution, and as well bar individuals from the business of banking. So, the authorities are substantial and we're going to pursue this as expeditiously as we can. I know there's interest... We do not have under the Federal Deposit Insurance Act, explicit authority for claw back of compensation. We can get to some of that with our other authorities. We have that specific authority under Title II of the Dodd-Frank Act, if you are looking for an additional authority, specific authority under the FDI Act for claw back probably would have some value here.

Senator Cortez Masto:

Thank you. Mr. Barr?

Michael Barr:

Thank you. The board does have authority to pursue actions against individuals who engage in violations of the law, who engage in unsafe or unsound practices, who have engaged in breaches of fiduciary duty. We retain this authority even after a bank fails and we stand ready to use this authority to the fullest extent based on the facts and circumstances, and as with Chair Gruenberg, potential consequences include a prohibition from banking, civil money penalties, or the payment of restitution. We intend to use these authorities to the fullest extent we are able.

Senator Cortez Masto:

Thank you, Ms. Liang, and I know-

Chairman Brown:

Briefly.

Senator Cortez Masto:

The chairman's indulgence-

Chairman Brown:

Briefly, Ms. Liang.

Ms. Liang:

Yes, I defer to the FDIC and Federal Reserve on this.

Senator Cortez Masto:

Thank you. Thank you, Mr. Chairman.

Chairman Brown:

That was brief. Thank you, undersecretary. Senator Rounds of South Dakota is recognized.

Senator Rounds:

Thank you, Mr. Chairman. First of all, thank you to all of you for appearing before our committed today. Vice Chair Barr, in your testimony, you said that in November the Fed supervisors delivered a supervisory finding on interest rate risk management to Silicon Valley Bank. As you know, the communication of supervisory findings must be focused on significant matters that require attention, matters requiring immediate attention or MRIAs are matters of significant importance that the Fed believes need to be resolved right away, including matters that have the potential to pose significant risk to the safety and soundness of the banking organization. My question, Vice Chair Barr, was managing interest rate risk listed in the MRIA section of the supervisory finding issued to SVB, and if it was not, why not?

Michael Barr:

Senator, we're still reconstructing the supervisory record. We've just started the review, but my understanding is that they were issued a matter requiring immediate attention based on the inaccuracy of their interest rate risk modeling. Essentially, the risk model was not at all aligned with reality.

Senator Rounds:

A pretty interesting statement if it was not aligned with reality. I recognize that you're going to have a complete report, and I'm not going to try to push you too far into this, but I'm really curious, what's the timeframe that's expected for a response for an MRIA, one that requires immediate attention?

Michael Barr:

Senator, there's not a fixed amount of time. It depends on the issue, the scope of the issue, the complexity of resolving the issue. So, I don't have a way of giving you a firm baseline on the action, but they're expected to be a top priority for management to address, and particularly in the interest rate environment that we're in, and knowing that the firm had been cited previously for other problems with liquidity risk management and interest rate risk management, supervisors would expect that that would take a high priority attention by top management. The supervisors met with the CFO of the firm in the fall, in October of 2021, to convey the seriousness of the findings directly.

Senator Rounds:

During this time period, perhaps for as much as six months during that previous year, the bank was without a risk management officer, is that correct?

Michael Barr:

That's my understanding. I think it's terrible risk management, obviously, not to have a CRO at the firm. You need an effective CRO as part of risk management at the firm, and as I indicated previously, the supervisors had told the firm in the summer that they had deficiencies in governance and controls at the management level and the board level, and that was related to their failure to-

Michael Barr:

At the management level and the board level, and that was related to their failure to appropriately manage risk.

Senator Rounds:

My understanding is that there was a period of time there in which they were without a CFO as well. Is that correct?

Michael Barr:

I don't have the details of that, but I'm happy to get back to you.

Senator Rounds:

Okay. And I recognize that there is a difference between a matter requiring immediate attention and a matter requiring attention. Can you share with us the difference? There clearly is a defined difference between a matter of such importance that it requires immediate attention versus one where it requires attention. Can you talk a little bit about what the expectations are between the two?

Michael Barr:

They both really signal that bank management should pay attention to what's in front of them. They're not issued lightly. A matter requiring immediate attention is, as its name suggested, telling managers that they should place a priority on fixing this issue over other issues, but the exercise of the line between the two is a matter of supervisory judgment.

Senator Rounds:

Just to follow up a little bit, recognizing once again that we'll get a full report in the next couple of weeks, but it seems to me that when it turns into an MRIA, there is an expectation that the board or the executive officers would respond fairly quickly. To your knowledge at this point, was that expectation met?

Michael Barr:

Well, I think the fundamental fact is the firm failed because of its interest rate risk and its liquidity risk, and that is, I think, evidence of the fact that they didn't respond strongly enough and promptly enough.

Senator Rounds:

In other words, with the information that you had and that the regulators had, they were able to determine that there was a problem at the bank and they directed that there be a response immediately, an immediate response based upon the data that they were able to gather at that time. That's a reasonable assumption, is it not?

Michael Barr:

I don't know what the timeframe set out in each of the individual orders were, so I'm not able to answer your question with precision and I want to be very careful to be able to do that.

Senator Rounds:

That's fair.

Michael Barr:

And not go beyond the record.

Senator Rounds:

Let me just finish this though. But we will receive that information when the full report comes out?

Michael Barr:

Yes. On May 1st, we'll release the full report and it will include the reports of examination, and so people will be able to see what's in the record.

Senator Rounds:

Very good. Thank you. Thanks Chairman.

Speaker 3:

Senator Menendez of New Jersey is recognized.

Speaker 1:

Thank you Mr. Chairman. In 2018, Congress passed a bill which was signed to law by President Trump that relaxed regulation for institutions like Silicone Valley Bank. That law, which I opposed, exempted those banks from enhanced prudential standards, stress tests, raised the threshold at which a bank would be considered systemically important. But even as that law kept Silicone Valley Bank off the list of systemically important institutions, the Fed and the FDIC rightly cited systemic risk to justify their actions to prevent runs on other banks. So Mr. Barr, Mr. Gruenberg, each of you voted to invoke what is known as the, quote, systemic risk exception. So with a simple yes or no, can you tell me that the situation at Silicon Valley Bank posed systemic risk?

Michael Barr:

Thank you, Senator. I think it's an absolutely crucial question. The invocation, the systemic risk exception required judgment as well as incoming data, and our best assessment, the assessment of a unanimous Federal Reserve Board and unanimous board of the FDIC and the treasury secretary was that we were seeing signs of contagion in the banking system that threatened to put at risk depositors and banks across the country, and to make sure that banks could continue to lend in their communities, to make sure that depositors were safe, to make sure that businesses could pay payroll. Well, we thought it was important to invoke that systemic risk determination and prevent that.

Speaker 1:

Because you felt that Silicone Valley Bank was a systemic risk at that point in time?

Michael Barr:

The judgment was really broadly about the risk that the failures of these institutions and other stresses in the system we're posing as a whole as opposed to a particular decision-

Speaker 1:

It seems to me that that sounds like a distinction without a difference. If any single bank's failure can cause contagion that threatens the system, then it seems that the bank should be considered systemically important. And so you all need to have an obligation to be clear with us and with the American people when you took extraordinary steps to protect uninsured depositors that could very well lead to increased fees charged to banks and ultimately to consumers. So I think we need to be clear about what is a systemic risk, and so I'm looking forward a more crystallized version of that. I was here in 2008, I don't want to live through it again. Do you agree with President Biden's statement two weeks ago that Congress should strengthen rules for banks to make it less likely that we will see another failure similar to that of Silicon Valley Bank?

Michael Barr:

Thank you, Senator. I think it's important for us to strengthen capital and liquidity rules. We're working on strengthening them as part of our Basel III reforms and our holistic review of capital, and I think we need to move forward with that. And as both Chair Gruenberg and I suggested, with a long-term debt requirement that would provide an additional cushion in addition to capital for large institutions. That work will need to go through notice and common rulemaking. There will be transition periods for it, but I think that is really important work for us to do and I'm committed to doing it.

Speaker 1:

Well, let me ask you, Mr. Barr. This morning, I, along was Senator Rounds and other members of this committee sent a letter to Chairman Powell asking him to explain whether the Fed's applied enhanced supervision or prudential standards to Silicone Valley Bank or any similar size bank using the Fed's existing authority. We've also learned from public reporting that Fed supervisors began flagging problems as a SVB as far back as 2021. Now, I understand we have a lot more to learn about the facts of what transpired, both at the bank with any management failures, but I expect that we are going to see that all factored in as part of a review. So as you begin that review, let me ask you, do you agree with Chairman Powell's statement last week that from what we know, it is, "clear that we do need to strengthen supervision and regulation?"

Michael Barr:

Yes, I absolutely agree with that statement.

Speaker 1:

Thank you for that. Now, lastly, what I would love to know, Mr. Gruenberg, as we think about should we raise the federal deposit insurance, what percentage of account holders does that account for? How much is private versus business, and what are the costs that are associated with it? So I'll just put that out there for you to submit an answer to the record because it will take more time than what I have. But the last point I want to make is we have seen a flight from regional and community banks to, quote unquote, too big to fail banks, and a concentration of deposits at a select few institutions also brings about its own risks to the financial system. At the end of the day, it seems that we are incentivizing entities to go to too big to fail banks. It only makes it even more consequential in terms of too big to fail. Is that what we want to ultimately achieve in this process?

Michael Barr:

Senator, I think that the goal of the actions that we took are to make sure that we have a thriving and diverse system of banking in the United States, including community banks and regional banks that are the lifeblood of many communities all across the country.

Speaker 1:

Thank you.

Speaker 3:

Senator Kennedy of Louisiana's recognized.

Speaker 2:

Thank you, Mr. Chairman. Thank you all for being here today. Chairman Barr, the Federal Reserve stress tested 34 banks in 2022. Is that correct?

Michael Barr:

Senator, I don't have the exact number in front of me, but that sounds correct.

Speaker 2:

Well, I have your report. It says 34. And the cutoff was a $100 billion, is that right?

Michael Barr:

Yes.

Speaker 2:

Okay. You didn't stress test Silicon Valley Bank, did you?

Michael Barr:

No. Under the Federal Reserve Board's rules that were put in place for transition into the stress testing, it takes a while for a firm to be considered above the threshold. They need to have a rolling four quarter average.

Speaker 2:

Did you stress test Silicon Valley Bank in 2022?

Michael Barr:

No.

Speaker 2:

Okay. Silicon Valley Bank had more than a $100 billion in assets at the end of 2021, did it not?

Michael Barr:

Senator, as I was explaining, that the transition rules in place at the time require a rolling four quarter average to be above that amount.

Speaker 2:

Okay.

Michael Barr:

And then if the firm happens to be in a year that isn't the year, since it's an every other year test, that a test is running, then it waits till the next year. So for Silicon Valley Bank, that would've meant 2024 would be its first stress test.

Speaker 2:

But the point is you didn't test Silicon Valley Bank.

Michael Barr:

We did not apply a stress test to Silicon Valley Bank. It was of course using its own stress test.

Speaker 2:

Did you have the authority to do it?

Michael Barr:

Under our existing regulations, no. We would have to change our regulations to have that authority.

Speaker 2:

Under the Congress' amendment to Dodd-Frank, Senator Crapo talked about at 2155, section 252.3. Isn't it a fact that we gave the Federal Reserve the authority to stress test Silicon Valley Bank?

Michael Barr:

Under that legislation, the Federal Reserve could have put in place a rule defining the word periodic-

Speaker 2:

But you didn't.

Michael Barr:

In a different way than was done.

Speaker 2:

Right, but you didn't, did you?

Michael Barr:

The Federal Reserve did not do that.

Speaker 2:

Okay. If you had a stress test... well, let me put it this way. If you had stress tested Silicon Valley Bank in 2022, it wouldn't have made any difference, would it?

Michael Barr:

I don't know the answer to that question.

Speaker 2:

Well, you didn't test for Silicon Valley Bank's problem. I've read your report. Your stress test, you stress tested these 34 banks for falling GDP, spiking unemployment and defaults in commercial real estate. Isn't that correct?

Michael Barr:

Yes. In a typical adverse scenario for banks, we're testing falling interest rate environments-

Speaker 2:

But that wasn't our problem in 2022.

Michael Barr:

I completely agree with you.

Speaker 2:

It's not our problem today. The problem is inflation, high interest rate and loss of value in government bonds, isn't it?

Michael Barr:

I completely agree with you.

Speaker 2:

So you stress tested in 2022 for the wrong thing.

Michael Barr:

The stress test is not the primary way that the Federal Reserve or other regulators test for interest rate risk.

Speaker 2:

But you stress tested for the wrong thing.

Michael Barr:

As I said, Senator, I agree with you that it would be useful to test for higher rising interest rates. That's why in our alternative scenario, multiple scenario that we put in place for this year's stress test, we do that. These decisions were made before I arrived, but I agree with you-

Speaker 2:

But it's like somebody going in for a test for COVID and getting a test for cholera, isn't it?

Michael Barr:

I don't know enough about either of those tests to know.

Speaker 2:

Yeah. Well, they're different. So all this business about, well, the amendment to Dodd-Frank kept him from stress testing. The way I see it, you chose not to stress test and if you had stress tested Silicon Valley Bank, you wouldn't have caught the problem.

Michael Barr:

Yeah, as I said, Senator, I agree with you that the statute requires periodic stress testing. The Federal Reserve made a decision about how to implement that in 2019. That resulted in SVB not being planned to be tested until 2024. But as I said, the stress test requirements-

Speaker 2:

I'm sorry to cut you off but the chairman's going to cut me off in a second. The Federal Reserve knew well in advance the Silicon Valley Bank had a problem withholding too much of its money in interest rate sensitive long government bonds, didn't you?

Michael Barr:

I think the investing public and the Federal Reserve, which cited it for interest rate risk problems, knew that it had interest rate risk. I think the nobody anticipated the bank-

Speaker 2:

The Federal Reserve didn't do anything about it, did it?

Michael Barr:

I'm sorry, I couldn't hear you.

Speaker 2:

The Federal Reserve didn't do anything about it, did it?

Michael Barr:

I disagree with that, Senator, respectfully. The Federal Reserve did cite these problems to the bank and require them to take action. Bank management failed to act on those.

Speaker 2:

You didn't follow up, did you?

Speaker 3:

The senator's time has expired. I think that I sit here and watch Mr. Barr reluctant to criticize some of the moves of his predecessors at the Federal Reserve. I'll leave it at that. Senator Smith from Minnesota's recognized.

Speaker 4:

Thank you, Mr. Chair, and thanks to our folks for being here today. I really very much appreciate it. So I want to just start by reiterating what I know some of my colleagues have said, which was that as these two banks collapsed, I heard you say very clearly, Vice Chair Barr, the Silicon Valley Bank in particular collapsed because of what looks like gross mismanagement and failure to manage even the most basic of risks and liquidity and interest rate risks. The Biden administration and regulators took strong and decisive action to protect people and to keep our banking system safe and secure, and the reality is that that action that you took was necessary, but it was also extraordinary. Extraordinary actions we're called for in the moment, and you of course don't want to have to use extraordinary actions. You want to be able to rely on banks to make good decisions and to protect their shareholders and to protect their depositors.

But let me just clarify one thing before I want to follow up a little bit on Senator Kennedy's questions. The Fed under the previous vice chair of supervision put into place rules, that I think there's a question about whether those rules... I mean, I think even in the moment, you were critical of those rules. Is that right?

Michael Barr:

Yes, that's correct.

Speaker 4:

And so your review will take a look at what would've happened if those rules hadn't been in place and then you can make decisions about what new rules need to be in place to protect from this kind of extraordinary situation that we saw with these two banks. Is that correct?

Michael Barr:

Yes, that's correct, Senator.

Speaker 4:

So I think that's just important for us all to understand here as we think about what has happened. The Silicon Valley Bank's failure was the result, it appears, of management failures at many levels all coming together at the worst possible time, and I'm particularly struck by the bank's failure to manage interest rate risk. You and I talked about this last week, which is basic bank management. It's not rocket science to manage interest rate risks, and interest rate were near zero for more than a decade and a lot of business models it appears, including Silicon Valley Bank's business model, was predicated on basically free money and that obviously presents risks when that changes. So I'm concerned, Vice Chair Barr, about other institutions, banks and non-banks alike, how they are managing what must be similar interest rate risks. Could you just address that and talk about how the Fed right now and others are monitoring that interest rate risk and what that tells you about what we need to do differently?

Michael Barr:

Thank you, Senator. Let me just start with the basic point, which is the banking system is sound and resilient. Most banks are highly effective in managing interest rate risk and liquidity risk. It is the bread and butter kind of work of bank management. So we are monitoring the financial system, monitoring the banking system. We're looking at interest rate risk and liquidity risk across the banking system to assess that. Where banks need to do better at interest rate risk and liquidity risk management, we're pointing that out, but I think the fundamental point is the banking system is sound and resilient.

Speaker 4:

I might have mentioned to you when we spoke that I had a chance to meet with a group of Minnesota bankers, including Minnesota has more community bankers I think per capita than any state in the country, and they were eager to point out to me that their business models are very different from the business models of highly risky enterprises like Silicon Valley Bank, and so I appreciate you raising that. In fact, I've been getting texts from some of my bankers today watching this hearing and wanting to point out that difference. Mr. Barr, can you talk about the risks of interest rate, this interest rate risk as it might affect non-banking institutions, as for example, mortgage loan companies?

Michael Barr:

Thank you. First, let me just say, as you indicated, I hear from community bankers as well and I know many other senators have in your home states the vibrancy and the health of that community banking sector, and we see that too. We are obviously looking at interest rate risk as it affects not only banks but also the non-bank sector. We look of course at non-bank mortgage servicers, we are looking at at hedge funds. We're looking broadly across the financial landscape to see where those risks might arise and how those might propagate in other ways into the banking system, so we're highly attuned to that. But again, I think the basic point is that the banking system is sound and resilient, depositors are safe, and we've through our actions demonstrated that.

Speaker 4:

Thank you very much. Thank you, Mr. Chair.

Speaker 3:

Senator Smith. Senator Lummis of Wyoming is recognized.

Speaker 5:

Thank you, Mr. Chairman, and thank you panel. I want to follow up a little bit on Senator Kennedy's line of questioning. As I read, Statute 5365, section C, risks to financial stability, safety and soundness. The board of Governors may, by order or rule promulgated pursuant to Section 553, apply any Prudential standard established under this section to any bank holding company with consolidated assets equal to or greater than $100 billion, so that was Silicon Valley Bank. Then you've got Statute 2155, that when it was changed from May to Shell, made mandatory a new duty on the Federal Reserve to take into account higher risk profiles presented by certain banks and to strengthen supervision of those banks. So you look at Silicon Valley Bank. They had a number of activities with above average risk profiles. Their concentration of deposits, the quantity of uninsured deposits, 94% uninsured deposits.

Then you look at Federal Reserve authority under Regulation YY to impose additional risk base or leverage capital or liquidity requirements or other requirements the board deems necessary to carry out the purposes of Dodd-Frank. I look at all this and I think that among all these statutes and regulations, the Fed had plenty of authority to prevent Silicon Valley Bank and the problems it encountered, and was aware pretty early on that there were unique problems there and that it was a very, very unique financial institution because of its risk profile, but didn't do it. As I look at what authority you've been given, I can't think of another additional rule or regulation or law that you needed. Tell me whether you agree with that or not.

Michael Barr:

Senator, I agree that the Federal Reserve has substantial discretion to alter through notice and comment rulemaking the rules that were put in place in 2019 with respect to firms over a hundred billion. There are some areas that the statute would provide some limitation to, but there is substantial discretion for the Federal Reserve to change its rules for firms in the 100 to $250 billion range.

Speaker 5:

Change its rules. What would it have to do?

Michael Barr:

We would have to go through a notice and comment rulemaking process.

Speaker 5:

Oh, I don't mean the procedure for changing a rule. I mean what changes would you make to the rule?

Michael Barr:

Senator, we haven't made a definitive conclusion on that. We're undertaking this review of SBV's failure in order to better assess whether it would be appropriate to change capital rules and liquidity rules for this size firm, for firms more generally. We're looking at that right now.

Speaker 5:

Is fractional reserve banking overly risky in this age of online banking?

Michael Barr:

Senator, let me just repeat what I said before, which is that overall, the safety and soundness of the banking system is strong. Banks are safe and sound. Depositors should feel assured that their deposits are safe.

Speaker 5:

Well, here's the problem though. As I see it, the way that these banks have been managed, Wyoming's community banks may end up paying for this through higher assessments from the FDIC. Am I correct, Mr. Gruenberg?

Chairman Gruenberg:

Well, as I indicated, Senator, in regard to these two institutions, any cost to the deposit insurance fund from covering uninsured deposits is required by law to be recovered through an assessment on the banking industry.

Speaker 5:

Exactly.

Chairman Gruenberg:

If I may, just one additional point, the law does give the FDIC authority in implementing that assessment to consider the types of entities that benefit from any action taken or assistance provided.

Speaker 5:

So are you saying that you're able to exempt Wyoming's community banks from paying for this?

Chairman Gruenberg:

I'm suggesting we have some discretion there and we're going to consider that issue carefully.

Speaker 5:

Will you exempt community banks from having to pay for this?

Chairman Gruenberg:

That's a judgment our board is going to have to make, and as I indicated, we anticipate going out for notice and comment, public rulemaking in May to implement the assessment. And as I indicated, we have discretion to-

Speaker 5:

Do you have to go through APA rulemaking to assess?

Chairman Gruenberg:

That's the law. That's the legal requirement.

Speaker 5:

Thank you, Mr. Chairman.

Speaker 3:

Thank you Senator Lummis. Senator Warren of Massachusetts is recognized.

Elizabeth Warren :

Thank you, Mr. Chairman. So we just experienced the second and third largest bank failures in American history. Executives at SVB and Signature took wild risks and must be held accountable for exploding their banks, and I'll soon introduce a bipartisan bill to do exactly that. But let's be clear, these collapses also represent a massive failure in supervision over our nation's banks. So coming out of the 2008 crisis, Congress put tough banking rules in place. Now, big banks hated them and their CEOs lobbied hard to weaken those rules. Ultimately, Congress signed off and then it got bad, really bad. Regulators burned down dozens of safeguards that were meant to stop banks from making risky bets.

Now, the three of you here today represent the US Treasury and two of our top banking regulators. I'd like to know if you believe that we need to strengthen our banking rules going forward to ensure the safety of our financial system? Vice Chair Barr, let me start with you. Do you believe we should strengthen our financial rules going forward?

Michael Barr:

Yes, I do,

Elizabeth Warren :

Senator. Thank you. President Biden agrees with you as well. Two weeks ago, he stated that we must, quote, strengthen the rules for banks to make it less likely that this kind of bank failure would happen again. Chairman Gruenberg, what about you? Do you agree with President Biden that we need to strengthen our banking rules?

Chairman Gruenberg:

I do agree, Senator.

Elizabeth Warren :

Good. And now, Under Secretary Liang, do you agree with the president on this?

Speaker 6:

Senator, I agree that we do need to prevent these types of bank failures.

Elizabeth Warren :

Well, I'm asking you, of course we need to prevent them but that's not by simply wishing it. It's by stronger regulation, is that right?

Speaker 6:

I agree, Senator.

Elizabeth Warren :

Okay, good. Now, we need better laws here in Congress, but let's also talk about how we can strengthen the rules today, even before Congress acts. Under current law, the Federal Reserve has the discretion to apply stronger prudential standards on banks with assets between a hundred billion and 250 billion - exactly the size of Silicon Valley Bank. That authority is not being used right now. Vice Chair Barr, will you use your authority to strengthen rules for the largest banks in this country? As you use your authority to strengthen the rules for the largest banks in this country, will you be reaching banks with assets of at least a hundred billion dollars?

Michael Barr:

Senator, we of course would need to go through a notice and comment rulemaking.

Elizabeth Warren :

I understand.

Michael Barr:

In this process, but I anticipate the need to strengthen capital and liquidity standards for firms over a hundred billion dollars.

Elizabeth Warren :

Okay. So this is the area we're looking at. We're going to push down further in terms of the greater scrutiny. Chairman Gruenberg, let me turn to you. Once the Fed began torching rule after rule in 2018 for big banks, the FDIC under your predecessor joined in on the fund and also started weakening FDIC rules across the board - capital in liquidity requirements, stress tests, you name it. In fact, your predecessor explicitly told these banks that if FDIC bank examiners were asking too many questions, that they should, quote, let us know, end quote. Now, there's a banking regulator who makes it clear that she is there to serve the big banks instead of the American Public. Chairman Gruenberg, will you commit to using your authority to undo the rollbacks that your predecessor initiated and to strengthen the rules and supervision for banks with greater than a hundred billion dollars in assets?

Chairman Gruenberg:

Senators, I think you know I was a member of the board at that time.

Elizabeth Warren :

I do.

Chairman Gruenberg:

And voted against those measures, and I certainly think it's appropriate for us to go back and review those actions in light of the recent episode and consider what changes should be-

Elizabeth Warren :

Well, I have to say, review sounds a little wishy here. You didn't think they were good rules to begin with.

Chairman Gruenberg:

My views haven't changed, Senator.

Elizabeth Warren :

All right. So you still think they were a bad idea?

Chairman Gruenberg:

I do.

Elizabeth Warren :

Got it. Each of you at this table has authority that you could exercise right now to strengthen rules for big banks and to ensure that our banking system and our economy are safer. I urge you to use that authority and I urge my colleagues here in Congress to do our part to protect American families and small businesses from yet another banking crisis. Thank you. Thank Mr. Chairman.

Elizabeth Warren :

... from yet another banking crisis. Thank you.

Sherrod Brown:

Thank you, Senator Warren.

Elizabeth Warren :

Thank you, Mr. Chairman.

Sherrod Brown:

Thank you, Senator. Senator Hagerty from Tennessee is recognized.

Bill Hagerty :

Thank you, Mr. Chairman. If you'd allow me just a moment to speak to the tragedy that occurred at the Covenant School of Nashville, Tennessee yesterday. A depraved person, a sick person, executed a tragic act and yielded terrible result. And my entire community is mourning. We're mourning for the families, for the victims, for everybody concerned. I also want to acknowledge the bravery of the National Police Department. They stepped into harm's way and within 14 minutes, brought the situation under control. Tremendous bravery at a time when it's called for, and I would acknowledge their sacrifices.

Now, let's turn to the matter at hand. And I know that politics in Washington always seizes upon any crisis as an opportunity to achieve whatever regulatory or legislative opportunity or goal that may be in front of them. But I'd like to talk about managerial execution here. Specifically, I'd like to start with you, Chairman Gruenberg. I'd like to talk through a series of events that followed SVB's failure two weeks ago. As you know, Silicon Valley Bank was taken into receivership on a Friday morning. That gave the FDIC three days to find a buyer before markets opened on Sunday night.

You had tremendous resources at your disposal. 18 years of experience on the FDIC board yourself. Detailed resolution plans, over 5,000 employees and interest from a number of banks to bid, including at least one formal offer as I understand it. Instead of successfully executing this process however, the FDIC used the systemic risk exemption to guarantee all deposits at SVB, creating tremendous uncertainty across our economy. And now two weeks later, the FDIC has announced the sale of less than half the failed bank's assets at a loss of 16 and a half billion dollars. So my first question, in the joint statement released on March 12th, you said quote, "No loss is associated with the resolution of Silicon Valley Bank will be borne by the taxpayer." Is that still your position?

Chairman Gruenberg:

Senator, yes. As you know-

Bill Hagerty :

Well, the problem is with two partial sales completed and over 22 billion in losses already accrued, that position just doesn't square with reality. These losses are borne by the Deposit Insurance Fund. That fund's going to be replenished by banks across the nation that had nothing to do with the mismanagement of Silicon Valley Bank or the failure of supervision here. In fact, that's going to be addressed by a special assessment to those banks. And as we all know, these banks will have to pass these costs along. Last time I checked, those costs to get passed along to the consumer. Those consumers are American taxpayers.

Chairman Gruenberg, invoking the systemic risk exemption is a last resort emergency option to the typical methods of resolution. And it begs the question of why you had to invoke that extraordinary exception. Just this past Sunday's announcement of a new purchaser of part of SVB, not only were serious losses incurred, but the FDIC entered into a loss sharing agreement with the acquiring bank and a $70 billion line of credit was extended to the purchaser. That's a pretty sweet deal. And this makes me wonder what prevented the FDIC from coming to a deal like this two weeks prior. You told ranking member Scott that you received bids for SVB over the weekend following its collapse, but that they were insufficient. What was your counter offer? And did you engage with the board of the bank that didn't approve this to get them to step up and approve it?

Chairman Gruenberg:

We received one offer that was frankly more expensive than the cost of liquidation. It didn't appear to be a viable offer at that moment.

Bill Hagerty :

Was there a counter offer to that?

Chairman Gruenberg:

I would have to check with our staff in terms of how much of a back and forth occurred.

Bill Hagerty :

Let's talk about the bidding process itself. Were certain banks dissuaded by you or anyone else associated with this from bidding on SVB either before or after the bank was taken into receivership?

Chairman Gruenberg:

No, Senator.

Bill Hagerty :

Throughout the course of that weekend, I was inundated with phone calls telling me that legitimate bidders were being waved off of the process. It's one thing to reject a bid if it's bad, but if ideology had anything to do with this, this entire committee's going to be deeply concerned about that. I look forward to the GAO's report on this because the result of this failure places the banking sector in a state of disarray that we've never seen before.

In spite of all the preparation and tools at your disposal, the FDIC failed to do its job. There was obviously enough demand to orchestrate a sale. What it looks like to the American people is that you simply didn't feel the incentive to execute and leaned on the systemic risk exemption to buy time. And in doing so, have placed the entire U.S. banking sector into uncharted waters. I don't see any apparent improvement in outcome, and this is a disgrace. I look forward to the GAO review and I hope that we get to the bottom of this.

Vice Chair Barr, very quickly, I'd like to come to you. In response to the 2008 financial crisis, the size and scope of the regulatory regime was dramatically expanded by Congress. Regulators like yourselves are given powers, not to mention hundreds of academics at your disposal with the sole job of monitoring and addressing risk to the financial system. All of this was in hopes of identifying and preventing bank failures that pose systemic risk. And in spite of all these tools, we find ourselves in a situation today that is unprecedented.

It's pretty clear that Silicon Valley Bank was woefully mismanaged. Their management team, which didn't have a chief risk officer for eight months last year, yet created and maintained a chief diversity equity inclusion officer, allowed their bank to accumulate truly shocking levels of risk. And while this was occurring, the San Francisco Fed was focused on researching left wing policies that they had absolutely no expertise in, ignoring one of the most basic risks in banking, interest rate risks. Perhaps most damning of all, until the day of their failure, SVB CEO sat on the board of the San Francisco Fed. So Mr. Barr, in your review of what went wrong in your supervision, will you consider the level of managerial distraction that was evident at the San Francisco Fed?

Michael Barr:

Senator, the staff have free rein to examine any issue that that might have addressed supervision. I think the core issues are the ones I'd suggested at the outside, and they're really basic. Interest rate risk mismanagement by the bank, liquidity risk mismanagement by the bank. The San Francisco examiners, the examiners at the San Francisco Federal Reserve Bank called those issues out to the board, called them out to the bank, and those actions were not acted upon in a timely way. And so I hope you'll in a way the issue is pretty straightforward.

Bill Hagerty :

I hope you'll dig into the urgency, the sense of urgency that was brought to bear on this and the sense of pressure and if every tool at their disposal was used because they certainly were doing other things well beyond their remit. Thank you. Thank you, Mr. Chairman.

Jon Tester:

Absolutely. Thank you for your questions. I'm going to ask the questions now if I might. In 2008, I voted against the bailouts of the big banks because they don't support taxpayer bailouts. We do need to protect American consumers and small business folks. We need to hold bank executives accountable when they screw up. And if the regulators were asleep at the wheel, we need to hold them accountable. Look, a correlation I would say is when I run my farm, if I look at the price of diesel fuel and seed and that's all I look at, I don't get the whole picture. And quite frankly, I won't be in business long.

If regulators are only looking at capital, that isn't everything that's going on. At Silicone Bank, they had a concentration in a highly volatile industry. They had grown rapidly, had mostly uninsured deposits. Their investments were poorly timed with interest rate increases that were clearly forecasted, all setting the conditions for a classic bank run. One that happened quickly due to new technologies that are out there. So Vice Chair Barr, from 2020 to 2022, the Silicon Valley Bank grew from 20, grew from 71 billion to more than 200 billion. This was a very rapid growth. It was heavily concentrated with techs and startups, industries that have always been volatile.

Then the bank took those mostly uninsured deposits and invest them in long-term U.S. treasuries. When the Fed had been clearly forecasting that rates were going to go up, which the bank executives should have known because their CEO is a director at the San Francisco Fed. And for two years, it seems that federal regulators were flagging concerns about this situation. Is that a fair statement, that for two years that the Fed was flagging concerns about this bank's financial viability?

Michael Barr:

Senator, the examiners were focused on interest rate risk and liquidity risk at the beginning in November 2021. There at least as far as I know from the supervisory record thus far, I have not seen something that said that the supervisors were focused on whether the firm was viable, but our review is underway.

Jon Tester:

But doesn't that impact the viability?

Michael Barr:

Yes, Senator. It's a core safety and soundness risk. A liquidity risk and interest rate risk are core risks that the bank mismanaged.

Jon Tester:

So were the regulators physically in the bank? So I've talked to a lot of intermediate sized banks. They tell me that the regulators are right there five days a week, seven days a week if they're open seven days a week. Were the regulators in that bank?

Michael Barr:

Physically speaking?

Jon Tester:

Yes.

Michael Barr:

I actually don't know. Part of the supervisory period is during the pandemic when activities were happening-

Jon Tester:

I've got you.

Michael Barr:

... in part remote, so I don't have yet, but we will have-

Jon Tester:

I just want to point out the fact that pandemic's been over for a bit, for quite a bit, and the opportunity for those regulators to be in there would've been long before a month ago.

Michael Barr:

Yes, Senator. I don't have the full supervisory record. We've just begun our review and I want to be very careful to answer only questions I know.

Jon Tester:

Do you know if the Fed supervisors met with the Board of Directors of Silicon Valley Bank?

Michael Barr:

I don't know that yet. I know they met with senior management, but I'm still reviewing the record.

Jon Tester:

So you wouldn't know if the Silicon Valley Bank had a risk committee and if in fact the Fed supervisors met with the risk committee?

Michael Barr:

I will know that by the May 1st report.

Jon Tester:

So were they warned about potential fines?

Michael Barr:

I'm sorry. Could you say that again?

Jon Tester:

So I mean look, they had some problems. Were they warned to either fix them or they were going to get fined?

Michael Barr:

The matters requiring attention and matters requiring immediate attention to my understanding require the fixing of the problem. But I don't know whether they've highlighted any additional steps that might be taken. Certainly the firm was on notice that they needed to fix those problems quite clearly since November of 2021.

Jon Tester:

But yet, they didn't.

Michael Barr:

They did not.

Jon Tester:

So what point in time does the Fed regulators drop the hammer on this outfit? I mean, I don't even need to get going on the bank CEO taking a ton of money right before this thing went belly-up, as it was going belly-up. At what point in time ... We could have all the regulations on the book. I've talked to a lot of bankers who said if this had happened before Dodd-Frank, the regulations were there to stop this to happen. And we have Dodd-Frank, and we did make 2155 to tailor the regulations to fit the risk. That was a big part of it on the intermediate banks and in fact on the small banks too.

But yet for over a year, correct me if I'm wrong, Mr. Barr, for over a year, regulators were saying to this bank, "Straighten up and fly right," and they never did a damn thing about it, and the regulators didn't make it so damn miserable which my understanding is regulators are pretty good at that when they want to be. Make it so miserable that these folks would a adjust their business plan to take care of the risks that was in their bank.

Michael Barr:

Senator, I agree that the risks were there, that the regulators were pointing them out and the bank didn't take action. It's ultimately in a first instance, the bank management responsibility to fix these problems, and they failed to do it. We didn't take enough action if the Federal Reserve supervisors didn't take enough action. We're going to be talking about that in our review, and we expect to be held accountable for it.

Jon Tester:

So I got to tell you, Michael Barr, I am not a banker. I ain't even close to being a banker. I'm a dirt farmer. And I'm going to tell you, when they laid out what at this bank had happened over the last two years, you did not have to be an accountant to figure out what the hell was going on here.

Michael Barr:

I agree.

Jon Tester:

And all I've got to say is as you do your look-back into what transpired, it better be fixed. If it's the regulator's fault, it better be fixed. If it's the regulation fault, it better be fixed. If it's something else, I hope there's a report to this committee saying, "You know what guys? This can happen again unless this happens." But it looks to me like I'll just tell you this and I'm looking out from the outside in, it looks to me like the regulators knew the problem but nobody dropped the hammer.

Michael Barr:

Thank you, Senator Tester. As I said, our review is going to be thorough. It's going to be open. And if we find problems like the ones that you just described, we're going to say it clearly and describe what we think should be done.

Jon Tester:

When do you think that report will be done? And I'm way over time. Sorry. When do you think that report will be done?

Michael Barr:

May 1st.

Jon Tester:

May 1st. So we got a month.

Tim Scott:

We should have them back after the report is done.

Jon Tester:

We look forward to that. Thank you.

Tim Scott:

Senator Vance.

J. D. Vance:

Thank you, Mr. Chair, and thanks to the three of you for being here. I want to talk just a little bit about the inherent unfairness and what I think transpired with Silicon Valley Bank. And I come from the venture capital industry, and this is a statement against interests and certainly a statement against the interests of some of my friends. But the business model of Silicon Valley Bank was to provide banking services to venture capital firms and to venture backed companies. And if you think about the fundamental trade that was implied, and I would even say explicit in their business model, what they did is they offered highly beneficial financial products to venture backed companies and venture capitalists in exchange for having a large number of deposits in your Silicon Valley bank account. Sometimes, often exclusively.

So a common practice, for example, was to say that you would provide a line of credit to a venture capital firm, but only if that firm put all of its money, 100% of its deposits in Silicon Valley Bank, or they would offer private jet financing and other goodies that are basically beneficial only to the very wealthy in exchange for having all of your deposits at Silicon Valley Bank. Now, given that that was implied in the business model of the bank, I think it's important that we use the term bailout. And I know that some of you don't like that term, but I think it's the only term that applies fairly here, because we using excess fees on community banks all across the country effectively chose to bail out the uninsured depositors of Silicon Valley Bank.

Now, there are some outrageous examples there. I think one firm had deposits over $3 billion, another, I think Roku had deposits of 500 million, but there were a lot of people, a lot of firms at Silicon Valley Bank that had deposits well over a million, well over $5 million. And what we did in practice do was bail them out. I guess my first question, I put this to all three of you, and because time is limited like to you to answer quickly is, what is the threshold? Whether you guys meant to or not, I think the implication of what happened with Silicon Valley Bank is that there are a lot of people who expect that their uninsured deposits are effectively insured at an unlimited level or if you're a banker, there's an assumption from a lot of people that at a certain level if you're systemically important enough, your uninsured depositors are going to get bailed out. Maybe just go from left to starting with Mr. Gruenberg, but at what level do you think uninsured deposits in theory are effectively unlimited uninsured in our banking system today?

Chairman Gruenberg:

Well, if I may say, Senator, you're asking important questions. I think we have a lot of lessons to learn from this episode. The decision to cover uninsured depositors at these two institutions was a highly consequential one that has implications for the system. I think we need, and I indicated in my statement earlier, we need to do a comprehensive review of our deposit insurance system and consider the questions that you raised. The FDIC is going to undertake that and by May 1, we'll deliver a report including policy considerations to take into account. So we want to try to be responsive on that.

J. D. Vance:

Thank you. Mr. Barr.

Michael Barr:

I also think you raised important questions. When we were looking at the systemic risk determination with respect to these institutions, we were thinking about the risk to the broader financial system, not the particular depositors at one or two institutions. We're thinking about and concerned about the extent to which that could impact regional banks across the country, community banks across the country. We were hearing concerns from bankers and from depositors, from businesses around the country. It's a difficult judgment, but one that at the end of the day, a unanimous FDIC board and a unanimous Federal Reserve Board of the Treasure Secretary agreed that risk to the system was not a risk that was worth taking. And so today, I think we can say that the banking system is sound and resilient, and the steps we took demonstrated that resilience and the safety of deposits around the country.

J. D. Vance:

I'm less concerned with the decision itself, though obviously I have a lot of questions there. I think there's an open question about whether we could have provided the confidence to the banking system and the liquidity that was needed in case of a bank run without bailing out the uninsured Silicon Valley Bank depositors. I think that's maybe a topic for a follow-on hearing. But what I worry about is the fundamental unfairness here that we've drawn a line, and I don't know whether the line stops at Silicon Valley Bank. Maybe it goes much further. Maybe it stops there, where if you're systemically important, which is a term that's impossible for anybody here to define with confidence. If you're systemically important, your uninsured deposits are effectively unlimited in their insurance. Whereas if you're not systemically important, if you're a regional bank in Ohio, there's a very good chance that your uninsured depositors will not receive that bailout.

And I think that uncertainty is a really, really big problem with what you guys have done. I'm not saying that in an accusatory way. I understand that there were reasons to do what you did, even though I don't think it was the right decision. I'm just saying I think it has some real moral hazard here. I know I'm over time here. So the one thing I'd ask here is just unanimous consented to introduce a letter to the record from American Share Insurance. This company provides private deposit insurance to most state chartered credit unions, including the 43 in Ohio. And just on this point of moral hazard and on this point of unfairness, what I'd like you guys to consider doing is extending the same implied offer that you gave to the Silicon Valley Bank uninsured depositors, to do it a little bit further down the banking ladder so that everybody benefits from the rule that you guys have created for Silicon Valley Bank.

Sherrod Brown:

Without objection. Senator.

Chris Van Hollen:

Thank you. Thank you, Mr. Chairman. Thank all of you for your service and testimony today. Mr. Gruenberg, you're aware, are you not of the fact that the CEO of SVB sold $3.6 million in company stock just 10 days before the bank collapsed and the FDIC took over its deposit? So you're aware of that, right?

Chairman Gruenberg:

I am, Senator.

Chris Van Hollen:

And are you aware of the fact that other executives of the bank and employees of the bank received bonuses literally hours before SVB collapsed?

Chairman Gruenberg:

Yes, Senator.

Chris Van Hollen:

Now, I believe we need to have an independent investigation into any criminal culpability, possibility of insider trading in this case, but regardless of any criminal culpability that may be there, I think it's simply wrong. And I think almost every American would agree it's simply wrong for the CEO and top executives to profit from their own mismanagement and then leave FDIC to be holding the bag. Would you agree with that proposition that that would be wrong?

Chairman Gruenberg:

Yes, Senator.

Chris Van Hollen:

Now, Dodd-Frank provides clawback authority that applies to the biggest banks under the orderly liquidation authority under OLA, but as I understand it, that authority does not apply to SVB Bank. Am I right about that?

Chairman Gruenberg:

That is correct, Senator. Could I elaborate on that for briefly?

Chris Van Hollen:

If you could briefly.

Chairman Gruenberg:

Very briefly. We do not have explicit clawback authority. We do have an obligation to investigate any misconduct by the board and management of the institution, and we do have authorities to impose consequences including civil money penalties, restitution, and barring individuals from the business of banking. So we can get at some of the issues raised, but it's true, we do not have explicit clawback authority. I indicated earlier there would be reasonable to create parody between the Dodd-Frank Act and the Federal Deposit Insurance Act in that regard.

Chris Van Hollen:

Well, I'm glad you raised that. I heard your response earlier. And Senator Kennedy, a member of this committee and I are working right now on bipartisan legislation to accomplish exactly what you said. I hope we can introduce it this week. And I know the chairman of the committee's interested as well in pursuing that. And I asked Secretary Yellen in another hearing last week, whether she and the Biden administration fully supported it. The answer was yes. So I hope we can move forward on that piece as quickly as possible, because there does seem to be a hole in your authority. You have some authorities as you indicated, but there is a hole in that authority that we have to plug. And you agree with that?

Chairman Gruenberg:

I do, Senator.

Chris Van Hollen:

So Vice Chair Barr, I wanted to ask you about some guidance, in fact, a rule that was issued by your predecessor, former Vice Chair of Supervision Quarles shortly before his departure in March 2021. And this rule established that supervisory guidance does not have the force of law, and it cannot be used in the event where it would halt bank's abilities to conduct mergers and acquisitions and that sort of thing. I fully understand the distinction between supervisory guidance and black letter law, but I think it's important to note that this request for this rule, according to the Fed's staff memo, that this guidance was issued upon industry request, and they specifically note the Bank Policy Institute and the American Banker's Association is submitting a petition asking for this rule to provide guidance to try to weaken the punch of the supervisory rules. Are you aware of that?

Michael Barr:

Yes, Senator.

Chris Van Hollen:

This goes into the frame that the chairman of the committee made earlier on where we've got a lot of folks that had been saying for months and years let's reign in the bank supervisors. And now all of a sudden it's like, where were the supervisors? Why weren't they being more aggressive? Do you agree that that guidance, putting that into rule, sent a message that you don't have to listen to supervisors guidance that much? And would you be willing to take a look at whether or not that should be repealed?

Michael Barr:

Senator, I'm not sure of the impact of that guidance. I think it's an appropriate area for us to be looking at. I know that staff are going to be thinking about that with respect to the SVB case, whether it mattered or it didn't matter. I do think it's an appropriate area to look at, but I do not have a firm conclusion about it.

Chris Van Hollen:

Well, I hope you'll take a look at it because it was done at the behest of the industry, and clearly the intent was to undermine the impact or of the guidance provided by the regulators. So it seems to be part of a pattern of an effort to push back on regulators authority and then come back and do the Monday morning quarterbacking and saying, "Where were they?" Thank you, Mr. Chairman.

Sherrod Brown:

Thank you, Senator Van Hollen. Senator Daines has yield to Senator Britt, right? Senator Britt's recognized from Alabama.

Katie Britt:

Thank you, Mr. Chairman. Thank you, Senator Daines. I appreciate the opportunity to be able to ask you all a few questions. I want to start by saying I am proud to be from the great state of Alabama where our financial institutions are strong. Our regional banks, our community banks, our credit unions, and the critical role they play from our main streets to our rural roads could not be understated. So I am proud of the work they do and proud of the strength they continue to exhibit.

Mr. Barr, I want to follow up on a question that one of my colleagues brought up. You keep talking about the Fed focusing on the size of SVB and banks. However, 2155 also requires the Fed to take into consideration riskiness, complexity, financial activities, along with other risk related factors. Tailored supervision ensures that the Fed focuses on the most risky banks. You've said repeatedly that bank mismanagement led to SVB's failure. The whole point of 2155 was so that you could tailor your regs and your supervision to risk. So why did you not require definitive corrective action based on the flaws that you saw?

Michael Barr:

Thank you very much, Senator Britt, and I appreciate your comments about the Alabama banking sector, which I think is a thriving sector and is contributing to its communities and like bankers across the country, is strong and vibrant. You should be very proud.

Katie Britt:

Thank you. We are.

Michael Barr:

We are looking at the range of tailoring approaches the Federal Reserve took. The decision to set those lines by asset size and other risk factors was made back in 2019. I joined the board in July of 2022 and began looking at that approach. I expect to continue to review it as part of the-

Katie Britt:

Review process.

Michael Barr:

... SVB review, and I believe we have substantial discretion to alter that framework.

Katie Britt:

Excellent. So you've talked about your review, which is ongoing. In that review, will you take a look at if you used all of the tools in your toolbox to prevent this both before and after? Will that be part of your review?

Michael Barr:

Yes, Senator. The staff are reviewing the steps that supervisors took and whether they should have taken more aggressive action.

Katie Britt:

So at current rate though, you can't speak to whether or not you utilized all of the powers that were given to you?

Michael Barr:

I really would like to wait for the formal review, for the staff to come evaluate the full supervisory record to make an assessment. But we're certainly very focused on that question. And if we didn't do the right steps, we're going to say that.

Katie Britt:

Yes. Well, I find it concerning though, when you all were asked, each one of you were asked, would you like to see more powers, more strength in this? Every single one of you said yes, when you don't actually know if you utilize the tools in your toolbox correctly or if the people that were under your supervision were supervising appropriately. I think that's what people hate about Washington. We have a crisis, and you come in here without knowing whether or not you did your job. You say you want more. That's not the way this works. You need to be held accountable, each and every one of you. I'm a big believer you got to own your own space. And speaking of, Mr. Gruenberg, I want to talk about yours. So you were not the primary supervisor here, obviously that's the Fed, but you are the non-primary supervisor for SVB or were. Is that correct?

Chairman Gruenberg:

Yes. We have backup supervision.

Katie Britt:

You have backup supervision. You had that before Dodd-Frank, correct?

Chairman Gruenberg:

Yes.

Katie Britt:

You had it after Dodd-Frank, correct?

Chairman Gruenberg:

Yes.

Katie Britt:

And 2155 did not change that responsibility that you had?

Chairman Gruenberg:

That's correct.

Katie Britt:

Right. So in that role, what did you do prior to the bank's failure to exercise that power?

Chairman Gruenberg:

Yeah, in this instance we were working with the Fed as the institution was experiencing difficulties, but I think it's fair to say-

Chairman Gruenberg:

... Experiencing difficulties, but I think it's fair to say that it was in a supportive role with the primary regulator.

Katie Britt:

Okay, but you did raise this to the primary regulator. You did exercise that authority.

Chairman Gruenberg:

We were working with the primary regulator in regard to the institution.

Katie Britt:

Excellent. I am so glad to hear that. We have to make sure that we are working together and doing our job in order to prevent these things from happening happening in the future. One of the things I also want to talk about is just the different responsibilities that each of you have, and whether they were executed. And then additionally, we'll move into the FDIC's bank auction process for just a minute, although I only have 33 seconds left. It seems that you failed to put the bank in receivership, and the FDIC passed on allowing the Silicon Valley Bank to be purchased. Is that a correct assessment? Or do you feel like that's been incorrectly identified throughout the news cycles?

Chairman Gruenberg:

Yes, Senator. The bank was placed in receivership on Friday morning, and we endeavored to solicit bids over the weekend. As I indicated previously, it was a rapid failure, so there was no opportunity prior to failure to prepare for a resolution. We tried to market it, we... Two bids, neither would've been less costly than liquidation. So we then proceeded to put in place a process where we were able to bid out [inaudible 01:31:32].

Katie Britt:

Yes, and I am out of time, but I will say, and six months prior, JP Morgan noticed that there was a problem, their equity research team and then Moody's obviously met with SVB prior to saying they were going to downgrade, so I've heard y'all say this was a rushed process. If the outside sector knew this was happening, you and the Fed and the 4,000 examinators should have known that this was coming as well.

Chairman Brown:

Senator Warnock of Georgia is recognized.

Raphael Warnock:

Thank you very much, Mr. Chairman. Many Americans, in fact all of us, would remember the unfairness of 2008 and that crisis, when bankers who made bad decisions, who played games with our economy, not only did they not go to jail, they got to keep their jobs and their multimillion dollar salaries. I feel that in a particular way, as someone who pastors and moves in communities where poor and marginalized people have the weight of the law come down upon them for the smallest of infractions. Not one banker went to jail. They kept their multimillion dollar salaries. When bankers made risky bets that threaten our entire economy, they got the cash in, they should be held accountable.

We discovered shortly after regulators took control of Silicon Valley Bank, that top executives at the bank offloaded millions of dollars worth of stock in the weeks leading up to the collapse. Very convenient, including their former CEO who sold $3.6 million worth of stock two weeks before the bank crashed. The Dodd-Frank banking reform law included a compensation clawback provision for executives identified as excessive risk-takers, or in other words, those who put their banks and the entire economy in jeopardy. Mr. Gruenberg, FDIC, in conjunction with the other financial regulators, began working on a rule to implement this provision in Dodd-Frank in 2011, and then again in 2016, but a final rule was never issued. Does the FDIC have plans to revisit this rule?

Chairman Gruenberg:

It has been discussed, Senator, and it seems to me appropriate.

Raphael Warnock:

It's appropriate, and I would say urgent. And I know that the Justice Department and the SEC are looking closely into this matter, and I would encourage them to include any evidence of insider trading. That seems only appropriate. Given the circumstances, that should be a part of the scope of their probe. But there is a scenario where these executives not only get away scot-free, but also with sizable paydays. And the FDIC should use every tool it has at its disposal to prevent it. We certainly don't want to incentivize this kind of behavior. So again, Mr. Gruenberg, outside of this rule, tell me, where can Congress step in to stop incentivizing this type of high risk behavior? Does the FDIC need additional legal tools to hold excessive risk-takers accountable?

Chairman Gruenberg:

Thank you, Senator. First is a matter of law. Whenever a bank fails, the FDIC is required to conduct an investigation of the conduct of the board and the executives of the institution, and we have authorities under the law to impose accountability including civil money penalties, restitution, and barring individuals from the business of banking. So we have significant civil authorities under the law now. It was mentioned earlier, and I think it's appropriate that we do not have explicit clawback authority in regard to compensation. We can get at that issue through our existing authorities, but certainly providing explicit clawback authority under the Federal Deposit Insurance Act as the FDIC has under the Dodd-Frank Act would be appropriate, in addition to completing the rulemaking that you raised previously.

Raphael Warnock:

Now, both of these things are important. We've got to complete the rulemaking and see whatever additional tools may be necessary. Certainly as the ship is sinking, we don't want bankers to be able to move all of their products on the lifeboat.

Chairman Gruenberg:

I agree, Senator.

Raphael Warnock:

And so we've got to address this. I want to switch to a related topic. For several days, payroll providers banking with SVB or Signature Bank had no way to access their deposits, everyday folks, leading to many Americans receiving their paychecks late, or having missing paychecks. Too many Americans live paycheck to paycheck, and in this case, they got it late. And as a result, some of the 64 million Americans living paycheck to paycheck were hit with overdraft fees, non-sufficient fund fees, due to the disruption, something I've addressed in other settings. And that's why I sent the letter with Senator Booker, urging regulators to impose a temporary moratorium on overdraft and non-sufficient fund fees for folks who incurred these fees at no fault of their own. Mr. Gruenberg, does the FDIC have a plan surrounding overdraft and non-sufficient fund fee protections in the event that we experience broader systemic issues?

Chairman Gruenberg:

Senator, you raised an important question. We received your letter. As a starting point, we know there were delays. We really want to get the facts in terms of if overdraft fees were really imposed as a result of those delays. If we can confirm that information, then we can consider what actions to undertake, and we're glad to work with you and your staff as we follow up on that.

Raphael Warnock:

I look forward to working with you on this here. Here's the bottom line, ordinary folks who just showed up, put their deposits, they shouldn't have to bear the brunt and burden of these bad decisions made by bank executives.

Chairman Gruenberg:

Understood.

Chairman Brown:

Thanks, Senator Warnock. Senator Daines from Montana is recognized.

Steve Daines:

Chairman, thank you. The failure of Silicone Valley Bank, Signature Bank and the general turmoil in the banking sector, are the direct result of the failures of regulators, including the agencies we have before us today. Also, the executive teams, these financial institutions and the inflationary environment, sparked in no small part by the Biden administration's reckless spending. I remember having debates right here with the banking committee about these massive stimulus bills, that $1.9 trillion spending bill that even Lawrence Summers said was inflationary. On a purely partisan vote, it passed with Democrat supporting and Republicans opposing. But each of these groups, back to Silicon Valley Bank and Signature Bank, failed to prioritize properly clear and present risks of the inflationary environment, rising interest rates, what it did to bond values, instead opting to focus on climate change, equity and other factors that did not contribute in any way the crisis we had before us.

I raised these issues of misaligned priorities with Secretary Yellen during a finance committee hearing back in June of '21, when she identified climate change, non-bank financial intermediation and treasury market resilience as the key priorities for FSOC. Now, we're facing a situation where responsible banks in my home state of Montana and elsewhere will be on the hook for providing tens of billions of dollars and potentially more, to bail out irresponsible coastal banks for risk taking that regulators failed to act upon, despite first noticing as far back as 2019. Turning to my question, Vice Chair Barr, you state in your testimony that your review is, "Focusing on whether the Federal Reserve's supervision was appropriate for the rapid growth and vulnerabilities of the bank." Question is, if you find as part of your review that certain individuals were clearly negligent in the performance of their duties, are you willing to recommend they be fired?

Michael Barr:

Senator, I don't want to prejudge in any way the review. I'm going to get that evidence back, I'm going to understand it fully and-

Steve Daines:

I said, but if part of your review you find they're negligent, would you recommend they be fired?

Michael Barr:

It's hard for me to answer in the abstract, sir. I believe we'll take appropriate action with respect to the supervisory structure as a whole, whether with respect to [inaudible 01:40:18]-

Steve Daines:

Are you willing to... Is termination one of the options?

Michael Barr:

I don't know-

Steve Daines:

That's an easy question. I just said an option, I'm not saying you have to exercise it. Is that an option? Could somebody be fired for this?

Michael Barr:

I would have to understand the basis in our human resources laws, and I don't want to pre-judge-

Steve Daines:

The bank executives lost their jobs, as should some of these regulators. Shouldn't that be the case if they're asleep at the wheel?

Michael Barr:

Senator, I want to be very careful. There are laws and procedures with respect to how you treat employees.

Steve Daines:

But you can make a recommendation to HR, and they can tell you whether or not that's allowed or not. I've been in the corporate world for most of my career. I've worked in HR. As is truth within the federal government. You can make a recommendation if somebody's asleep at the wheel and negligent.

Michael Barr:

I would be happy to follow up with you, Senator. I promise we'll take appropriate action based on the review, but I don't have a definitive answer for you at this moment.

Steve Daines:

I do find it ridiculous that you're unwilling to say that if people fail to perform the responsibilities, that you might recommend may be fired. Vice Chair Barr, did you visit the San Francisco Fed in October of last year?

Michael Barr:

October last year? What year?

Steve Daines:

Of '22.

Michael Barr:

I don't believe so.

Steve Daines:

Okay. Well, the San Francisco Fed published a supervision and brief memo saying the top priorities that you outlined with that visit aligned with their top priorities.

Michael Barr:

It may be that I did a virtual seminar for a range of supervisors, and so the San Francisco Fed folks were in attendance for that, but I don't believe I was in San Francisco.

Steve Daines:

So the regulator's perspective that came out from the 12th district, the San Francisco Fed, said they were aligned with what was top of mind for the work being done in the 12th district, the first thing it says is financial risks from climate change. This is at a time back in October '22 when you saw the discount rate was always up to 3%, we were seeing those three-quarter point increases coming out of the Federal Reserve over and over, and they were communicating that it was going to probably continue, and that was about the time that also the Richmond Fed in the fifth district, they had a little different view in terms of prioritizing risks, and they thought perhaps a rising rate environment might be the highest risk in terms of priority to look at, versus San Francisco Fed says it's about climate change was their number one priority listed, stacked ranked the three that they placed out.

It's clear in hindsight that the Richmond Fed was focused on the clear and present risks of rising interest rates, while the San Francisco Fed was not. My question is, since you were confirmed in July, what percentage of your time have you spent focusing on climate policy and financial inclusion, versus how the Federal Reserve's monetary policy might impact banks like Silicone Valley?

Chairman Brown:

Be as brief as you can in that answer. Thank you, Mr. Barr.

Michael Barr:

Senator. I've been focused on risk throughout the system, both short term and long-term risks, and interest rate risk is a bread and butter issue in banking. It's what our supervisors do all the time.

Chairman Brown:

Thank you [inaudible 01:43:35].

Steve Daines:

But the San Francisco Fed said it was climate change risk, and by the way-

Chairman Brown:

Senator Sinema is recognized.

Kyrsten Sinema:

Thank you, Mr. Chairman, and thank you to our witnesses for being here today. Today's hearing is about trust. Whose trust has been broken, who broke that trust, and how all of us work together to reaffirm and rebuild that trust. Trust is a key principle that the modern banking system is built on. Families trust that their hard-earned savings are safe in the US banking system, Congress entrusts our federal banking regulators with the power to supervise, regulate and examine banks. We trust you to be the cops on the beat, and have given you the tools to do that job. The failure of Silicon Valley Bank on the Federal Reserve's watch very clearly calls into question whether or not some of that trust was misplaced. Make no mistake, the lion share of the blame is on incompetent bank executives. And it's outrageous that these people took bonuses and sold stock in the days leading up to the bank's failure. We should hold these executives accountable for the fullest extent of the law, and clawback those bonuses and stock sales. I'm co-sponsoring a bill to do just that.

But as I laid out in a letter to you, Vice Chair Barr, that by the way was signed by 11 other senators spanning the ideological spectrum, it's gravely concerning that retail participants, literally just regular everyday people, were able to figure out that something was wrong with Silicon Valley Bank before your regulators took appropriate action. Now, these folks don't have access to non-public information like the bank examiners do, but when people on Reddit and Twitter can spot bank mismanagement before the regulators, something is terribly wrong. So my questions today are for you, Vice Chair Barr. I have lots of questions, so I'd like concise answers, and we'll follow up in writing. You were sworn in as Vice Chair for Supervision on July 19th, 2022. Your testimony indicates that due to ongoing review, you'll focus on what you know, so let's start there. The Fed knew of problems at the bank dating back to 2019. Were you personally made aware of major deficiencies at Silicon Valley Bank prior to the collapse? And if so, which ones, and when were you notified?

Michael Barr:

Thank you, Senator. The staff made a presentation to the board of governors in the middle of February of this year that was focused on interest rate risk broadly in the banking system, and how banks and managers and supervisors were addressing those risks. And as part of that presentation, the staff highlighted the interest rate risk that was present at Silicon Valley Bank and indicated that they were in the middle of a further review and expected to be basically coming back to the bank shortly with further information about their status. I believe that is the first time that I was told about interest rate risk at Silicon Valley Bank.

Kyrsten Sinema:

So you were first notified shortly after folks on your staff learned about these deficiencies?

Michael Barr:

Senator, the supervisors began highlighting these deficiencies at the firm in interest rate risk management and liquidity risk management in a serious way in November of 2021, as far as I know. So about a little bit more than a year prior to that. They intensified that supervisory review as part of its full scope exam in the summer of 2022, when the firm was downgraded for deficiencies in its risk management practices. And they brought those issues again according to the record, to the CFO of the firm in October, and issued additional findings in November of 2022. So that, as far as we know from the current supervisory record, is the picture.

Kyrsten Sinema:

And that's when you... So you were first notified in October and November of 2022?

Michael Barr:

No, senator, to the best of my knowledge, I first learned about the issues at Silicon Valley Bank with respect to interest rate risk in mid-February of 2023. So several weeks before the bank failed, staff made a presentation to the board about interest rate risk broadly, and with a particular [inaudible 01:48:12] on Silicon Valley Bank, and indicated that they were following up with the bank with further measures.

Kyrsten Sinema:

So your testimony says that asset size is not necessarily an indicator of complexity, and I agree, which is why section 401 of S2155 gives the Fed explicit authority to impose the regulations and enhanced supervision normally reserved for the largest institutions. And you can do that on any bank, between 100 and 250 billion in assets, like SVB. The Fed is given this authority to prevent or mitigate risks to the financial stability of the US. We both agree that this is existing authority that the Fed has had since the enactment of S2155 in 2018, correct?

Michael Barr:

Yes. The Fed has brought authority to change the rules it uses for different approaches to supervision of firms. Under the rules that were put in place in 2019, the firm was bucketed by a set of categories. I think that is important to revisit those, as I have been doing since arriving at the Federal Reserve in July.

Kyrsten Sinema:

So given the documented issues that-

Chairman Brown:

Your over time. Wrap up if you can. One more question.

Kyrsten Sinema:

This will be my last question. Thank you, Mr. Chairman. So given the documented issues that your supervisors found with the SVB that we just kind of went over, did the Fed ever consider using its existing section 401 authority before the failure to more aggressively regulate the bank?

Michael Barr:

Based on the current supervisory record, it looked like the escalations that had occurred were in the format of MRIs, and... Sorry, matters requiring attention and matters of requiring immediate attention, and the supervisors also put in place what's called a 4M agreement, which is a limitation on the firm's ability to engage in merger transactions with financial companies.

Chairman Brown:

Thank you, Senator Sinema. Senator Tillis.

Thom Tillis:

Thank you, Mr. Chair. Thank you all for being here. I want to start maybe with a question that I think, Vice Chair Barr, you answered Senator Warren saying that you thought banks over $100 billion should have additional prudential requirements. Did I hear that correctly?

Michael Barr:

I think it's important for us to strengthen capital and liquidity requirements for large banks really up the spectrum.

Thom Tillis:

Is there any of the tools, just going back at... Mr. Chair, I'd like without objection to submit this to the record. This is the regulatory regimen that applies to banks of certain categories. And so I'm curious, I always worry about when we create an arbitrary asset limit for doing something, because it was the activities of Silicon Valley that got them in trouble. So I just want to ask briefly, I got a lot of questions, and I will get them done on time, you've mentioned a couple of times, Vice Chair Barr, that the 2019 implementation of Senate bill 2155, I'm inferring that, bucket at Silicon Valley and in a certain regulatory regimen. Did that mean that it restricted it from having supervisors make the judgment that the increased prudential regulations or supervisory functions could not occur?

Michael Barr:

Senator, we're bound by the rules we put out. So if we want a new framework, we need to change-

Thom Tillis:

In 2019, different administration, predates your tenure, are you saying that the promulgation and the implementation of 2155 took certain supervisory or regulatory regiments off the table for Silicon Valley Bank?

Michael Barr:

The Federal Reserve's implementation in 2019 set basically the standard for how that firm would apply. I think that regulators, supervisors do have judgment.

Thom Tillis:

That's my point.

Michael Barr:

And then can put in place mitigated matters.

Thom Tillis:

That's my point, because when I hear bucketing, I think about ring-fencing, and I wonder if that meant that a supervisor, that in my opinion, if you take a look at the matters requiring attention and immediate attention, do you know yet, I know we'll get the report in May, but do you know yet how many of those MRAs were followed by an MRI? In other words, the six that were issued over the course of a year and a half or two years, how many of them was an escalation of the matter requiring attention to immediate attention, if any? And if you don't know that, you can submit it... Actually, if you will just submit it for the record. Look, we've got a CEO of Silicon Valley Bank that is a class A member of the Board of the San Francisco Federal Reserve who got summarily terminated on the day of the bank's collapse. In your review, will we also have insight into California's role in regulating this bank? Or will this be purely federal jurisdiction?

Michael Barr:

We're looking only at the Federal Reserve. The State of California is initiating its own review with respect to its-

Thom Tillis:

Well, I think that's going to be very helpful. Because in my opinion, I agree with former Fed Tarullo that he sees this as a regulatory lapse. Tarullo was never complimentary of Senate Bill 2155. He was implementing Dodd-Frank when we were doing it, he was hammering it, he's made the statement, and Mr. Chair, I'd also like to submit for the record an article interview with Mr. Tarullo from Marketplace that he specifically says in here, 2155 is likely or impossible to be a root cause of the problem. I'm paraphrasing. He was saying it looks like a regulatory and supervisory lapse. Now to think we're going to find that lapse is not only with the Fed, but more likely even the supervision that the State of California...

Chairman Brown:

Without objection [inaudible 01:54:08].

Thom Tillis:

... Was involved in. So I'm also kind of curious in the report, are we going to see any movement... And I'm not a conspiracy theorist, but there is one question of did we have a level of comfort with this bank among some of the supervisors? Do we know or have any insight over the past few years if anybody who had worked for the Fed works for this bank? We know that the CEO was on the Fed board, or on a board at the Fed.

Michael Barr:

Senator, just with respect to the class A directors that you mentioned, class A directors are prohibited from participating in any way in supervision.

Thom Tillis:

Oh no, I get that. But it's just people in proximity, maybe people call them balls and strikes, the supervisors didn't get that quite right. But I think that there are some people who... And I want to find the root cause of the problem. And I think that you all will find a lot of information when you issue your report. I don't think that we're doing the banking industry any service going forward if we talk about, now we just got to reign in the small banks, we've got to increase by default, regardless of the activities of the bank, we've got increase by default their prudential requirements and with your holistic, review capital requirements, a number of other things, when you have a run on a bank like you did with Silicon Valley, could any bank possibly have enough to cover the run? Any bank.

Michael Barr:

Senator, the particular bank in question is quite unique in its structure, its liability approach and its interest rate risk management. I can just speak to that particular bank, that particular bank had-

Thom Tillis:

If you look at their bank, if you looked at their internal liquidity stress testing, if you took a look at their contracts on an interest rate exposure, this does not take a highly sophisticated person to understand the risk. And it damn sure had to be known months before the chickens came home to roost. And I wish that we could just focus on that problem, and not use the red herring of some lapse in regulatory oversight that was the root cause of this bank collapse. It simply was not, and I'd love to find anybody to prove it wrong. I don't care how you feel about regulatory tailoring, but use a valid argument to fight against it. Do not use Silicon Valley Bank as an example. Not suggesting that you have, but there are many people that sit up here who have, at the expense of looking at how we can prevent this in the future. And I do have questions for the record that I'll submit. Thank you all.

Chairman Brown:

Thank you, Senator Tillis. Thanks all of the three of you for your testimony, your public service. I look forward to the reviews on these bank failures and thank you for helping start that process. It's interesting, many of my Republican colleagues are now so eager for bank regulators to crack down on banks for taking on too many risks. I hope they remember that when it comes time to empower regulators and strengthen guardrails, including protecting the independent funding of financial regulators. The events of the last month have shown why we need independent regulators, funding and stability for all of our financial watchdogs. But now as the Supreme Court considers whether the CFPB's independent funding is constitutional, these independent watchdogs' ability to keep our financial system stable faces an existential threat. US financial regulators, as we know, are independently funded so they can quickly respond when crises happen. On this and every issue, I'll continue to fight to protect American workers from Wall Street arrogance and greed. Thank you for joining us, meeting is adjourned.