March 12, 2023

MEMORANDUM: The Board of Directors

THROUGH: John Conneely, Director JOHN CONNEELY Digitally signed by JOHN CONNEELY Date: 2023.03.12 16:54:14 -04'00'
Division of Complex Institution Supervision and Resolution

Doreen R. Eberley, Director DOREEN EBERLEY Digitally signed by DOREEN EBERLEY Date: 2023.03.12 16:52:36 -04'00'
Division of Risk Management Supervision

FROM: Ryan Tetrick, Deputy Director Resolution Readiness
Division of Complex Institution Supervision and Resolution

SUBJECT: Systemic Risk Exception Recommendation

Recommendation

Staff recommends that the Board of Directors adopt a systemic risk recommendation under section 13(c)(4)(G) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1823(c)(4)(G), and authorize the FDIC, subject to a systemic risk finding by the Secretary of the Treasury ("Secretary"), to take certain actions to avoid or mitigate serious adverse effects on economic conditions or financial stability from widespread and sizeable withdrawals of deposits driven by concern over sudden financial losses stemming from the failures of Silicon Valley Bank, First Republic Bank, and Signature Bank (the "Banks"). We understand that the Board of Governors of the Federal Reserve System expects to make a comparable systemic risk recommendation and that the Secretary, after consultation with the President, expects to make the recommended systemic risk determination.

Background

Sections 11(a)(4) and 13(c)(4) of the FDI Act (12 U.S.C. §§ 1821(a)(4) & 1823(c)(4)) place restrictions on the FDIC's use of the Deposit Insurance Fund ("DIF") that do not apply if a systemic risk determination is made under section 13(c)(4)(G) (the "systemic risk exception"). The systemic risk exception may be invoked if the Board of Directors of the FDIC and the Board of Governors of the Federal Reserve System, upon a vote of not less than two-thirds of the members of each respective Board, provide a written recommendation to the Secretary that a systemic risk determination be made. Based upon the joint recommendation, the Secretary may then invoke the exception if the Secretary determines, after consultation with the President, that complying with the least-cost provisions in section 13(c)(4) of the FDI Act would have serious adverse effects on economic conditions or financial stability and any action or assistance taken under the systemic risk exception would avoid or mitigate such adverse effects.

Silicon Valley Bank was established and insured in San Jose, California, on October 17, 1983, as a state member bank. The bank's main strategy was collecting deposits from businesses financed through venture capital. The bank expanded into banking and financing for venture capital, and added products and services to maintain clients as they matured from their startup phase. It had total assets of $209 billion at December 31, 2022, and about $175.4 billion in total deposits.

Signature Bank is a state nonmember commercial bank headquartered in New York, New York. The bank offers commercial deposit and loan products, and until 2018, focused primarily on multi-family and other commercial real estate banking products and services. In 2018 and 2019, the bank expanded its business model into new areas, including launching services to the private equity industry, such as lending to venture capital companies. At the end of the fourth quarter 2022, Signature Bank had total assets of $110 billion and about $88.6 billion in total deposits.

First Republic Bank is a state nonmember bank headquartered in San Francisco, California. It provides commercial and retail banking services and other financial services in the United States, and its core business involves collecting retail deposits and utilizing them to support a mortgage banking business. At the end of the fourth quarter 2022, First Republic Bank had total assets of $213 billion and total deposits of $177 billion.

Systemic Risk Exception

Staff believe that without FDIC action to avoid or mitigate serious adverse financial effects of the Banks' failures, businesses and consumers are likely to withdraw uninsured deposits rapidly and in large volumes, likely resulting in a wave of bank failures. As staff observes with respect to Silicon Valley Bank, concerns over losses on uninsured deposits or lack of immediate customer access to that funding can have a ripple effect across other sectors of the U.S. economy.

The banking industry has experienced a sharp outflow of uninsured deposits after peaking in the second quarter of 2022. Industry deposits fell 2.6 percent in the year ending March 1, 2023, according to Federal Reserve data. This is the sharpest decline since at least 1974. The industry-level trends were driven by tightening monetary policy, but the effects were not felt on all banks equally. Many of the banks that had seen the largest inflows, and had invested those deposits into the securities portfolio, later saw the largest outflows. On Friday, March 10, a number of banks with large amounts of uninsured deposits reported that depositors were initiating large withdrawals. These banks had difficulty in meeting these demands either because the demands were so high that they could not borrow a sufficient amount against available collateral to meet demands or because their impaired securities portfolio and its impact on their tangible equity ratios barred them from accessing funding or. Industry unrealized losses on securities were $620 billion as of December 31, 2022, and fire sales driven by deposit outflows could further depress prices and impair equity. Staff expects the outflows to spread more widely among uninsured depositors, driven by concerns based on depositor haircuts at failing banks, which could result in a wave of bank failures and a large adverse effect on the United States economy.

The high-profile runs on the Banks have led to a range of adverse effects for FDIC-insured depository institutions, the broader financial markets, and the United States economy. The uncertainty surrounding recent rapid losses has shaken the confidence of investors and other counterparties in the banking industry, and it has prevented the inflow of private capital necessary to restore the industry's financial health and facilitate new lending activity. Staff believes that the proposed resolutions will alleviate such adverse effects and will mitigate losses to the uninsured depositors, the DIF, and the nation's financial system.

In the fourth quarter of 2022, Silvergate Bank of San Diego, California, experienced a run on deposits held by a concentrated market segment that resulted in a 68-percent loss in deposits – from $11.9 billion in deposits to $3.8 billion. That rapid loss of deposits caused Silvergate Bank to sell debt securities intended to be held to maturity earlier than planned to cover deposit withdrawals, resulting in a further loss of $1 billion in the fourth quarter. On Wednesday, March 8, 2023, Silvergate Bank announced that it would self-liquidate rather than face being placed in receivership.

Also on Wednesday, March 8, Silicon Valley Bank of Santa Clara, California, announced that it had sold securities from its portfolio at a $1.8 billion loss in order to cover a decline in deposits. The CEO of Silicon Valley Bank urged clients to "stay calm," which had the reverse effect of accelerating deposit withdrawals from the bank. On Friday, March 10, 2023, the California Department of Financial Protection and Innovation closed Silicon Valley Bank and appointed the FDIC as receiver. As of December 31, 2022, Silicon Valley Bank had approximately $209 billion in total assets, making it the eighteenth largest bank in the United States. On March 10, it became the second largest bank failure in United States history.

Following news of Silicon Valley Bank, on Friday, March 10, 2023, shares of the holding company for Signature Bank of New York, New York, fell by 23 percent as that bank experienced a significant flight of deposits. Signature Bank is the twenty-ninth largest bank in the United States by total assets.

Similarly, in the wake of Silicon Valley Bank's receivership, First Republic Bank of San Francisco, California, experienced a significant decline in deposits and a 15 percent decline in its holding company's stock value on March 10, 2023. First Republic Bank is the fourteenth largest bank in the United States by total assets.

The financial markets recognize the systemic risk caused by the rapid deterioration in the deposits. The losses at Silicon Valley Bank were so significant and sudden that the New York Stock Exchange halted trading on its holding company's shares on March 10, 2023. Following that, trading in the shares of both Signature Bank and First Republic Bank, among others, was temporarily halted due to the extreme price movements. In the wake of Silicon Valley Bank's failure and Silvergate Bank's self-liquidation, the S&P regional banks index had its worst week since 2009, and United States banks lost more than $100 billion in stock value in two days.

All of these institutions relied heavily on uninsured deposits. As of December 31, 2022, Signature Bank reported that approximately 90 percent of its deposits were uninsured; Silicon Valley Bank reported that 88 percent of its deposits were uninsured; and First Republic Bank reported that approximately 68 percent of its deposits were uninsured. The significant proportion of uninsured deposit balances exacerbates deposit run vulnerabilities and makes both the Banks and other FDIC-insured institutions susceptible to contagion effects from the quick moving financial news. Other failures of institutions with a similar business model, reliance on uninsured deposits, or both would have serious adverse effects on economic conditions or financial stability. Financial institutions have already experienced net outflows as customers utilize existing lines of credit and depositors and investors withdraw funds.

The FDIC is already aware of several reports of businesses, including large corporate borrowers, withdrawing large amounts of uninsured deposits. These uninsured depositors carry a risk of loss in the event that the depository institution fails and, thus, are more likely to exit the institution during a period of stress. As uncertainty over potential spillover effects of the Banks' failures continues, staff are concerned that significant withdrawals by uninsured depositors could result in a run on other similarly situated banks. Consumers, nonprofit corporations, and businesses large and small will experience significant losses if they are unable to recover their uninsured deposits, which may have broader, significant, detrimental effects beyond the nation's financial system.

In this environment, a least-cost resolution of the Banks with no assistance to uninsured depositors would be expected to have significant systemic consequences. The failure of the Banks would lead investors to doubt the financial strength of other institutions that might be seen as similarly situated. The flight of deposits from the Banks, and the risk of that flight spreading to other banks, would intensify liquidity pressures on United States banks, which are vulnerable to a loss of confidence by uninsured deposits and wholesale suppliers of funds. The Banks' sudden failure could also lead investors to reassess the risk in United States commercial banks more broadly, particularly given the current fragility of financial markets generally and the term funding markets for financial institutions.

Staff believes that any resolution transaction effected by the FDIC under a least-cost framework would result in significant losses to uninsured depositors of the Banks. Without invoking the systemic risk exception, the FDIC would be prohibited from taking action to protect the Banks' uninsured depositors if such action would cause losses to the DIF.

Staff also believes the consequences of a least-cost resolution could extend to the broader economy. The financial turmoil that could result from a least-cost resolution of the Banks and the potential for the rapid flight of deposits from other FDIC-insured institutions would further undermine consumer and corporate confidence. With the liquidity of banking organizations further reduced and their funding costs increased, banking organizations would become even less willing to lend to businesses and households. These effects would contribute to weaker economic performance, further damage financial markets, and have other material negative effects.

Conclusion

Staff believes that the threat to the market posed by the rapid flight of deposits is a systemic problem that threatens the stability of a significant number of insured depository institutions, thereby increasing the potential for losses to a significant number of uninsured depositors and the DIF in the resolutions of such insured depository institutions. Large losses by uninsured depositors could also threaten public confidence in the nation's banking system.

Staff believes that the imposition of a least-cost resolution on the Banks would almost surely have major systemic effects. Both financial stability and overall economic conditions would likely be adversely affected for the reasons discussed herein. In view of the current intense financial strains, as well as the likely consequences to the general economy and financial system of a least-cost resolution of three large commercial Banks, staff believes that circumstances such as Congress envisioned are clearly present and that invocation of the systemic risk exception is justified. The resolutions presented separately to the Board would best mitigate the adverse effects of the failure on the financial markets and the broader economy.

Staff recommends that the Board take this action in order to lessen the risk to the Corporation, uninsured depositors, and systemic risks posed by the instability in the bank debt market. Staff further recommends that the Board authorize the Chairman, or his designee, to provide the written recommendation to the Secretary of the Treasury specified under Section 13(c)(4)(G)(i) of the FDI Act, 12 U.S.C. § 1823(c)(4)(G)(i).

Finally, staff recommends that, following invocation of the systemic risk exception for each of the Banks, each member of the Board will receive regular updates regarding potential transactions for each Bank, including a list of all bids received. Furthermore, any transaction involving any of the Banks would require approval of the Board by a two-thirds vote. This does not in any way impede the ability of the Corporation to commit to protecting uninsured depositors, but ensures that the Board is able to make the final decision on how the systemic risk exception is executed, consistent with the two-thirds vote threshold Congress included in the FDI Act.

Concur:

HARREL PETTWAY
Digitally signed by HARREL PETTWAY
Date: 2023.03.12 16:51:07 -04'00'

Harrel M. Pettway
General Counsel, FDIC

This recommendation was prepared by:

SCOTT CHRISTENSEN
Digitally signed by SCOTT CHRISTENSEN
Date: 2023.03.12 16:49:06 -04'00'

Scott H. Christensen
Deputy General Counsel, FDIC

RESOLUTION

WHEREAS, on March 10, 2023, the California Department of Financial Protection & Innovation closed Silicon Valley Bank, Santa Clara, California, and appointed the FDIC as its receiver;

WHEREAS, as soon as March 12, 2023, the New York Department of Financial Services may close Signature Bank, New York, New York, and appoint the FDIC as its receiver;

WHEREAS, as soon as March 12, 2023, the California Department of Financial Protection & Innovation may close First Republic Bank, San Francisco, California, and appoint the FDIC as its receiver (Silicon Valley Bank, Signature Bank, and First Republic Bank are referred to collectively as "Banks");

WHEREAS, staff presented information to the FDIC Board of Directors ("Board") indicating that liquidation of the Banks under Sections 11(a)(4) and 13(c)(4) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. §§ 1821(a)(4) and 1823(c)(4), including subparagraphs (A) and (E) of section 13(c)(4), would have serious adverse effects on economic conditions or financial stability.

NOW, THEREFORE, BE IT RESOLVED, that the Board finds that severe financial conditions exist that threaten the stability of a significant number of insured depository institutions.

BE IT FURTHER RESOLVED, that by the vote of at least two-thirds of the members of the Board, the Board finds that Corporation's compliance with Section 13(c)(4)(A) and 13(c)(4)(E) of the FDI Act, 12 U.S.C. §§ 1823(c)(4)(A) and (c)(4)(E), in connection with the liquidation of the Banks under Sections 11(a)(4) and 13(c)(4) of the FDI Act, 12 U.S.C. §§ 1821(a)(4) and 1823(c)(4), would have serious adverse effects on economic conditions or financial stability.

BE IT FURTHER RESOLVED, that the Board determines that the FDIC's compliance with subparagraphs (A) and (E) of section 13(c)(4) of the FDI Act, 12 U.S.C. § 1823(c)(4), with respect to any of the Banks for which the FDIC has been or will be appointed receiver would have serious adverse effects on economic conditions or financial stability.

BE IT FURTHER RESOLVED, that the Board determines that action or assistance with respect to the Banks under Section 13(c)(4)(G)(i) of the FDI Act, 12 U.S.C. § 1823(c)(4)(G)(i) for the purpose of resolving the Banks, would avoid or mitigate such adverse effects.

BE IT FURTHER RESOLVED, that, only with respect to the Banks being placed into receiverships, the Board hereby authorizes the Chairman, or his designee, to provide the written recommendation to the Secretary of the Treasury specified under Section 13(c)(4)(G)(i) of the FDI Act, 12 U.S.C. § 1823(c)(4)(G)(i).

BE IT FURTHER RESOLVED, that the Corporation may take other action under section 13 of the FDI Act, 12 U.S.C. § 1823, notwithstanding subparagraphs (A) and (E) of section 13(c)(4) of the FDI Act, 12 U.S.C. § 1823(c)(4), for the purpose of winding up of any of the Banks for which the Corporation has been [or will be] appointed receiver as necessary to avoid or mitigate the serious adverse effects on economic conditions or financial stability that the Corporation's compliance with subparagraphs (A) and (E) of section 13(c)(4) of the FDI Act, 12 U.S.C. § 1823(c)(4), with respect to any of the Banks for which the FDIC has been or will be appointed receiver would have.

BE IT FURTHER RESOLVED, that the Board hereby authorizes the Director, Division of Complex Institutions and Resolutions, or designee, and the Director, Divisions and Resolutions and Receiverships, or designee, and all other FDIC staff to take all appropriate action to implement the provision of the actions or assistance authorized hereunder or under any existing or subsequent resolutions regarding the winding up of any of the Banks.

BE IT FURTHER RESOLVED, that the Board hereby requires staff to consult with, and provide regular updates to, each member of the Board regarding potential resolution options, including informing each Board member of all bids for each of the Banks. Furthermore, no transaction involving any of the Banks may be executed without a further vote by the Board with two thirds of the members of the Board voting in favor.