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17 April 2023

Deputy Pearse Doherty T.D.

Leinster House

Kildare Street

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Re: Recent developments arising out of the collapse of Silicon Valley Bank

Dear Deputy Doherty,

Thank you for your email of 13 March 2023, addressed to Governor Makhlouf. The Governor has asked me to respond on his behalf.

The past month saw increased volatility in global financial markets, triggered by banking developments on both sides of the Atlantic. In the United States, the failures of Silicon Valley Bank (SVB) and Signature Bank led to increased market focus on the financial position of some regional US banks. In Switzerland, eroding market confidence over Credit Suisse led to a takeover of the institution by UBS. The actions taken by authorities in the United States and in Switzerland have led to a stabilisation of market conditions, albeit this remains an evolving situation at a global level.

As you would expect, the Central Bank of Ireland (the "Central Bank") has been evaluating the impact of these developments carefully, including through close engagement with our European counterparts and, domestically, under the auspices of Ireland's Financial Stability Group (FSG). We have also been engaging very closely with regulated institutions from a supervisory perspective, including to ensure these institutions themselves are assessing the impact of global market developments and managing any emerging risks.

Limited direct exposures of the Irish financial system to Silicon Valley Bank

The Irish financial sector, including Irish retail banks, have minimal direct exposure to SVB. The Central Bank has also examined exposures to a number of key regional US banks and, again, the direct exposures of the Irish financial system to these institutions are minimal.

In terms of the impact of SVB's failure on the broader Irish economy, hard data is more limited. SVB (the US parent and its European and UK operations) were not a regulated entity in Ireland and, as such, the Central Bank does not have access to data on its links to Irish non-financial corporate businesses. In light of this, under the auspices of the FSG, we have engaged with IDA Ireland, Enterprise Ireland, the Department of Enterprise, Trade & Employment, and the NTMA to gather more information on the links between SVB and domestic non-financial corporates businesses.

This intelligence suggests that a limited number of Irish Information & Communications Technology (ICT) and Life Science companies had deposits with SVB or relied on credit provision by SVB. In that context, it is important to note that the actions taken by the US authorities to guarantee deposits in SVB, and HSBC's purchase of SVB UK, were important in mitigating the direct risks faced by their customers, including several of the Irish businesses that SVB served.

The Central Bank will continue to engage with the abovementioned agencies to monitor any impact these developments may have on financing conditions for the ICT and Life Sciences sectors over the medium term.

The mix of SVB's underlying vulnerabilities not evident in Irish retail banks or euro area significant banks

The US Federal Reserve Board is currently conducting a review of the regulation and supervision of SVB, in light of its failure.[1] While a full assessment of the factors contributing to SVB's failure needs to await the findings of this review, it seems clear that SVB had a unique mix of acute underlying vulnerabilities. The institution had a very high concentration in terms of its lending and deposit-taking activities to a single sector. In addition, more than 80% of its deposit base consisted of uninsured corporate deposits, which tend to be more volatile than other deposit types. Finally, most of the bank's assets consisted of long-term US fixed income securities, which – when not appropriately hedged – left the institution vulnerable to losses as interest rates rose. Ultimately, as the Vice-Chair of Supervision at the US Federal Reserve Board has indicated, "SVB's failure is a textbook case of mismanagement".[2]

This mix of vulnerabilities is not evident in the Irish retail banking sector or euro area significant banks. The deposit base of Irish retail banks is much more diversified and insured deposits comprise a much higher proportion of their funding. Irish retail banks also have large liquidity buffers, a greater proportion of which is held in central bank reserves, which is the most resiliently liquid asset and does not expose banks to mark-to-market losses if that liquidity needs to be used. Fixed income securities also represent a much smaller proportion of the assets of the retail banking system and interest rate risk

[1] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230313a.htm.
[2] https://www.federalreserve.gov/newsevents/testimony/barr20230328a.htm.

on these exposures is actively hedged. At a euro area level, as noted by Andrea Enria, Chair of the ECB's Supervisory Board, similar factors mean that significant banks supervised by the Single Supervisory Mechanism (SSM) "do not exhibit the outlier features of extreme interest rate risk and predominant reliance on a concentrated, uninsured deposit base – what might be termed the 'SVB business model'".[3]

Beyond the unique balance sheet characteristics and business model of SVB, there are also important differences in terms of the overall regulatory framework between the European Union and the United States. In the European Union, banks – regardless of their nature, size and complexity – are typically subject to the same prudential framework, including the implementation of Basel III standards for bank capital and liquidity. By contrast, in the United States, there is a differential application of the prudential framework depending on banks' size. In practice, this meant that SVB was not subject to the full Basel III standards for bank capital and liquidity.

Finally, from a supervisory perspective, as noted by Andrea Enria, the SSM has been "well aware that the ongoing, fast-paced normalisation of monetary policy conditions is increasing our banks' exposure to interest rate risk"[4]. Indeed, when the first signs of inflationary pressures were emerging in the second half of 2021, the SSM intensified its assessment of interest rate risk and credit spread risk as part of its supervisory priorities at a euro-area wide level (including for the largest Irish banks).

Ensuring resilience in light of broader market and macroeconomic developments

The Central Bank and the broader Eurosystem remain vigilant to the challenges posed by changes in market sentiment as well as broader macroeconomic developments, including the high inflation environment and the associated necessary tightening of monetary policy to bring inflation back to its 2% medium-term target in a timely fashion.

The regulatory architecture built up over the past decade in Europe, including the establishment of banking supervision by the ECB as part of the SSM, the establishment of the Single Resolution Board as well as the broader European System of Financial Supervision, has strengthened the identification and mitigation of risks and vulnerabilities in the financial system.

Most fundamentally, over the past decade, the resilience of the Irish retail banking system has been significantly bolstered, putting it in a better position to absorb potential adverse shocks, rather than amplify them. Substantial buffers of capital and liquidity enable banks to absorb any potential future losses or short-term liquidity shocks. The funding structure of the banking system is more stable, with

[3] https://www.bankingsupervision.europa.eu/press/speeches/date/2023/html/ssm.sp230321_1.en.html.
[4] https://www.bankingsupervision.europa.eu/press/speeches/date/2023/html/ssm.sp230321_1.en.html

much lower reliance on more volatile sources of wholesale funding from abroad than in the past. And the last decade has seen more prudent lending standards by the retail banking system.

In summary, the Irish and euro area banking sectors are less exposed to the risks that SVB was confronted with. But the Central Bank is squarely focused on identifying and evaluating any emerging risks and we will continue to manage any such risks through our own work, including from a supervisory perspective; our engagement with European counterparts as members of the Eurosystem and the European System of Financial Regulators; and through domestic fora, such as the FSG. As the ECB President remarked recently, the Eurosystem stands ready to respond as necessary to preserve price stability and financial stability in the euro area.[5]

I trust that the above is of some assistance and would be very happy to engage further if you have any follow-up questions.

Yours sincerely,

Vasileios Madouros

Deputy Governor – Monetary and Financial Stability

[5] https://www.ecb.europa.eu/press/pressconf/2023/html/ecb.is230316~6c10b087b5.en.html