MPI Collective Goods

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Comments on:
Failure of SVB Oversight: Reacting to Incurred Losses versus Risks Taken

by

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Message of Paper

- SVB Accounts indicated vulnerabilities since at least 2009
- Assets: Lending concentrated on Tech Startups + Securities
- Liabilities: Preponderance of deposits, in particular uninsured deposits from Tech Startups
- Risk profile did not change as the bank grew
- Supervisors were passive
- Supervision pays too little attention to risks taken, as opposed to actual losses.

What was the Problem? Illiquidity vs. Insolvency

- SVB ended up being destroyed by a run.
- But at that time, SVB had already been technically insolvent for several months
- As of September 30, 2022, a fair-value adjustment to HTM securities would have caused equity to become negative.
- The final run was triggered by an announcement showing that AFS securities would shortly be exhausted, implying that HTM securities would be next, at which point the entire HTM portfolio would have to be revalued, causing immediate closure

The role of interest rates

- Money market rates were close to zero from early 2020 to March 2022.
- During this period, deposits grew from \$51 bn. to \$198 bn., loans from \$38 bn. to \$68 bn.
- Securities grew from \$29 bn. to \$127 bn., of which over \$90 bn. was HTM; ca. 1.6% p.a. interest
- March 2022 – March 2023: Interest rates rise to more 4.5 %
- Until December 2022, deposits decline by \$25 bn.
- A run? Or simply a reaction to better alternatives elsewhere?

Interest rates 2

- September 30, 2022 accounts: $ 93 bn. HTM versus $77 bn. after fair-value adjustment
- S&Ls in 1981: Flawed assessment of Illiquidity provided the impetus for deregulation, followed by „come to us at high rates, federally insured!" ...
- Without the run on March 8, 2023, SVB would have been just as insolvent as the S&Ls in the earlier episode.
- We need to think about SVB in terms of insolvency from a bad realization of interest rate risk, rather than illiquidity

Interest Rates 3

- Why no fair-value accounting?
  - Why no consideration of interest rate risk in the bank book?
  - Why no consideration of interest rate risk for HTM securities?

- Relevant questions for both, the assessment of incurred losses and the assessment of risks taken
- Why were the lessons of the S&L crisis forgotten?

Why did the 2023 crisis abate?

- Admati-Hellwig (2023/4): Like the S&L crisis, the 2023 crisis will have an aftermath with gambling for resurrection
- Why did this not happen?
- Central banks pay interest on reserves.
- A key tool for monetary policy?
- Friedman's „Optimum Quantity of Money"?
- Or a means of neutralizing the impact of interest rate risk on the solvency of depository institutions?
- … very expensive! Second-Best???

Passivity of Supervisers

- Silicon Valley Bank: The supervisors preferred not to look closely – Why?
- Credit Suisse: The supervisors had no right to interfere before the declaration of a point of non-viability (Swiss law is incompatible with Pillar 2 of Basel)
- Germany: Supervisors declare they are friends with bankers because otherwise they would not be able to do their job. Before SSM, they would be told from above that they should not interfere.

Why Equity Requirements?

- Buffer for loss absorption
- Incentive device
- Justification for supervisory intervention before the receiver comes in?

- How should this breathing space by used?
- No preparation, no imagination, no resources
- No willingness to take responsibility
- Compare FDICIA with the FDIC's behaviour in 2007-2009.