What went wrong at Silicon Valley Bank? (SVB)

An unusual combination of red flags – very rapid growth, extreme concentration risks, unmitigated interest rate risk, and a general lack of an internal risk management framework – drove SVB's underlying weakness and a social-media induced run led to its precipitous failure. Typically, these risks are managed internally by banks, which also must comply with a strong supervisory and regulatory framework; outliers such as SVB typically trigger enhanced supervisory attention.

- SVB tripled in size in two years. Very few other banks of their size experienced similar levels of growth.
- SVB focused on the technology sector, so its core constituency was highly interconnected, under pressure, and demanding cash to meet its own obligations as the Fed began raising rates.
- SVB did not appropriately manage its risk as all banks are expected to do, nor did it diversify its deposit concentration or take steps to limit its exposure to the rapidly-rising rate environment.
- The steep rise in interest rates depressed the value of SVB's treasuries and other safe assets, in turn preventing the bank from raising enough cash to meet deposit outflows. Moreover, unrealized losses reflected on its balance sheet undermined confidence in the bank's solvency.
- When those weaknesses became clearer, the banks' highly concentrated and connected customer base began withdrawing their funds, leading to a social-media-fueled bank run.

Did S. 2155 roll back requirements that could have prevented this failure?

- No. The law and the implementing rules did not address interest rate risk, rapid growth, or idiosyncratic concentration – the factors that caused SVB's failure.
- Banks of all sizes are expected to engage in robust interest rate and liquidity risk management – and asset liability management is a core tenant of safety and soundness.
- With or without S. 2155, SVB would still have needed to perform the risk management functions necessary for all banks. Further, S. 2155 maintained the requirement that banks of SVB's size have a risk committee dedicated to the establishment of a risk management framework, oversight of risk management practices and a Chief Risk Officer (CRO). SVB did not have a CRO for almost a year prior to its failure.
- While S. 2155 removed the annual stress testing requirement for banks SVB's size, it is not clear that it would have caught SVB's unique risks, given the test's focus on broad macroeconomic scenarios rather than the concentration and interest rate issues that ultimately brought down SVB. Moreover, the rulemakings related to S. 2155 focused on tailoring complex international capital standards for smaller, less complex banks. SVB was well capitalized, even at the end.
- Even after S. 2155, the Federal Reserve, through safety and soundness authority, has had the capability to apply supervisory scrutiny to banks of SVB's size.

What comes next?

- The Federal Reserve, SVB's primary federal regulator, announced that it will conduct its own review by May 1. It is important to allow time to assess the supervisory lapses and idiosyncratic circumstances.
- An independent review of the bank's supervision is also likely necessary to ensure a comprehensive assessment.