Banking and Finance Law Daily Wrap Up, OVERSIGHT AND INVESTIGATION—OIG: Fed bank supervisors 'missed opportunities' to stop SVB's failure, (Sept. 29, 2023)

Banking and Finance Law Daily Wrap Up

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By Tom Leithauser

Fed supervisors failed to notice dangers associated with SVB's fast growth and risky asset mix before the dominos began falling, according to the OIG's review.

By year-end, the Federal Reserve Board will change how it supervises rapidly growing banks and assesses forward-looking financial risks to address deficiencies identified in a "Material Loss Review" conducted by the Federal Reserve Board's Office of Inspector General that examined the failure of Silicon Valley Bank (SVB), according to the OIG's report.

The OIG conducted the review pursuant to a Federal Deposit Insurance Act provision that requires reviews when the Deposit Insurance Fund suffers a material loss. In SVB's case, those losses could have been avoided if Fed supervisors had paid closer attention to factors that led to the bank's collapse in March, the OIG found.

The OIG attributed the bank's crash, in part, to Fed supervisors' failures to do the following:

- Promptly transition the classification of SVB from a Regional Banking Organization (RBO) to a Large and Foreign Banking Organization (LFBO) subject to greater scrutiny as it grew;
- Recognize the risks inherent in SVB's asset portfolio, including investments in Treasury bonds and mortgage-backed securities that became problematic as interest rates rose; and
- Tailor supervisory activities to reflect SVB's "unique characteristics, growth rate, concentrated business model, liquidity risk management issues," and other evident corporate management gaps.

Contributing factors included, among other things, the Fed's focus on institutions with exposure to the restaurant and hospitality sectors during the COVID-19 pandemic—which did not include SVB—and the lack of expertise in large bank supervision by the team assigned to SVB, according to the OIG. In addition, the enactment of the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act gave the Fed more flexibility in its supervisory activities, the OIG stated.

The OIG made seven recommendations for the Fed's Division of Supervision and Regulation that would improve the Fed's supervisory activities, including by reassessing the existing RBO supervisory framework to "determine whether adjustments should be made based on a supervised institution's size and complexity;" developing an "approach for transitioning institutions from the RBO portfolio to the LFBO portfolio and determine how best to involve LFBO Supervision earlier;" and tailoring supervisory plans to address forward-looking risks, such as bond investments sensitive to interest rate hikes.

The OIG's findings largely reflect the conclusions of an earlier Fed review of SVB's collapse conducted by Vice Chair for Supervision Michael S. Barr (see *Banking and Finance Law Daily*, April 28, 2023). As such, the Fed concurred with the OIG's recommendations and stated it had begun to implement reforms that it expected to complete by year-end, according to the review.

Companies: Silicon Valley Bank

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