

Perspectives on recent banking crises

On March 16th, 2023, Bank Governance Leadership Network (BGLN) participants met in London. Given the recent failure of Silicon Valley Bank (SVB), the second largest bank failure in US history, Credit Suisse's distress, and broader volatility in bank shares, participants spent the first part of the meeting discussing these events and their implications.

SVB's failure offers some familiar lessons and new insights

- **SVB played a unique role in the start-up community, creating concentration risk.** SVB's failure would have represented *"an extinction-level event for many tech companies,"* according to one participant who said, *"SVB was a very important part of the venture ecosystem. There was a lot of hysteria."* Even those venture investors who took a measured approach to these events ultimately told portfolio companies, *"if there is any risk of losing capital, pull out."* While acknowledging that some of this was driven by *"irrationality and panic,"* participants noted that it has forced venture investors and early-stage companies to think differently about capital management and concentration risk. An executive observed, *"SVB was the only option for many of these companies. Since start-ups often have no profit, this is an industry that needs to be powered by risk takers. We should have been more conscious of the concentration risk, but SVB was the only option."* SVB was uniquely focused on the start-up community and developed products and services to meet those companies' needs. Start-ups and their founders would often consolidate their banking relationships with SVB; some of SVB's loan covenants required that customers keep their cash deposits with the bank,¹ adding to the concentration risk. The question now, according to one participant, is *"How do you spread that risk and have a more federated approach to banking the start-up world?"*
- **SVB represents the first bank run in the social media era.** One of the striking things about the SVB failure was *"The speed with which news can travel,"* and the influence that *"a few very loud voices"* can have. A participant observed, *"We have witnessed a generational bank run, done on apps. It was so quick. I don't think the people who worked on the post-crisis regulatory reform package envisioned this."* Some pointed to the *"echo chamber"* of a relatively small venture community as a major contributor to the speed with which the bank run spread, but participants fear the possibility of a similar result elsewhere. One even warned, *"There is a risk here that this gets weaponized. It is pretty cheap and it is pretty effective to spread fear on social media."*

- **SVB failed to manage risk for their customers.** Participants noted that many of the companies who banked with SVB lacked the people and expertise to effectively understand and manage the risk they were taking by concentrating their business with SVB – *“most do not have a treasurer,”* one participant pointed out. A participant said, *“These companies don’t have the discipline to manage liquidity. That’s the job of SVB, and it doesn’t explain why they had the liquidity mismatch.”* SVB’s failure highlights the need to marry innovative ways of serving customers with the core banking responsibility of prudent risk management. *“The customers of SVB had modern banking needs that weren’t satisfied by the current incumbent banks and yet there was a failure because of the way that SVB managed its business. The core of what a bank is, and what customers should expect, is trust that a bank will look after their money and be there when they need them,”* one participant said.
- **This experience offers some other lessons for risk management.** A director said they had revisited their Internal Liquidity Adequacy Assessment Process (ILAAP), based on their realization that *“cash is king. Cash is what you need in these situations. We are delving deeper into stress tests and what could go bad.”* Others suggested that stress tests might need to be revisited to ensure they include a broader set of scenarios.

Credit Suisse also raised questions about tipping points

Few participants expected Credit Suisse to require an intervention like that which ultimately led to its proposed acquisition by UBS. A director noted, *“The trigger wasn’t financial information, it was the word ‘controls.’ A bank out of control—wow. And the cash flow statement is really scary. The combined effect of questions about your controls and getting your cash flow statement wrong is really tough.”* Several participants admitted that banks *“misjudged the risk from Credit Suisse,”* because they looked at scenarios that didn’t reflect the events as they ultimately played out. A participant said, *“The board asked, What have we got for the Credit Suisse scenario? and the response was, ‘We’ll be fine.’”* In response to this understatement of the potential risks, another participant said, *“We’ve had to sharpen a bit our scenarios and potential views on what will happen. We do need to understand where the systemic risks lie.”* Several raised questions about where systemic risks might be building up and what could trigger additional problems elsewhere in the system.

A new round of regulatory reforms could be coming

Participants expect added scrutiny of banks and their regulators as policymakers look to ensure a broader scope of potentially systemic risks is properly managed.

- **The post-crisis recovery and resolution playbook following 2008 was thrown out.** A participant observed, *“The last financial crisis was worse because it became very local very quickly. It is all being done very locally again. Solutions are all local again.”* Despite the work of the Basel Committee and the Financial Stability Board to come up with internationally agreed standards and approaches, including to recovery and resolution planning, when large

banks ran into trouble, the local regulators and governments ignored those plans and acted locally. Another participant said, *“Fragmentation is a reality. The world feels like a less global place; the power still sits with the national banks.”* And because national authorities stepped in, another participant said, *“We have the return of moral hazard.”*

- **Regulators and banks face a period of reflection and review.** Participants predicted that regulators will be pressured to identify additional sources of potentially systemic risk. One said, *“Regulators will be having conversations about VC firms and other unregulated players who can move markets.”* While some questioned whether SVB’s failure would have triggered systemic problems, a director asked, *“When we do have systemic risks, do we put the right guiderails around it? The analysis has yet to come. I don’t think you need to re-regulate all the smaller banks in the US, but there will be a review.”*

Others predicted that the usual quest for accountability will also lead to investigations into what went wrong: *“Where is the puck going to go? Inevitably, people will ask questions about the San Francisco Fed’s supervision of SVB. Did they get comfortable with it in some way? There’s the question on Trump softening regulations, questions about the different classes of capital that you’ve got to hold. Then you’ve got the concentration risk piece.”*

- **Events are renewing questions about too-big-to-fail banks.** A participant noted that market jitters were prompting a flight to quality, such that many of the largest banks were inundated with deposits, stretching their onboarding capacity. At the same time, efforts to avoid direct government bailouts meant that the resolution of SVB’s situation in the UK was an acquisition by Europe’s largest bank, and the answer for Credit Suisse was a government facilitated takeover by its largest rival. A participant observed, *“There is still this view that we are not going to let the big banks get any bigger, and we can see why in terms of systemic risk. On the other hand, if diversification is suddenly king, where do you get that? The big banks.”*

¹ <https://www.bloomberg.com/news/articles/2023-03-15/svb-clients-at-risk-of-default-may-have-no-choice-but-to-return?leadSource=verify%20wall>