Financial Regulation: SVB and Beyond

Hoover Monetary Policy Conference: How to Get Back on Track?
May 12, 2023
SVB: An Outlier?
Monetary Tightening and U.S. Bank Fragility in 2023: Mark-to-Market Losses and Uninsured Depositor Runs?
Unrealized Losses

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>RMBS</th>
<th>Non-RMBS</th>
<th>Residential Mortgage</th>
<th>Other Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>MTM Loss</td>
<td>2.2</td>
<td>1.0</td>
<td>0.3</td>
<td>0.6</td>
<td>0.3</td>
</tr>
</tbody>
</table>
Hedging?
Uninsured Leverage
Uninsured Leverage & Unrealized Losses

Flight risk v turbulence
Equity/Assets
A Solvency Run…

- When interest rate increases sufficiently, a “solvency run” is possible.

- Banks at a higher risk of solvency run:
  - Lower initial capitalization (Equity)
  - Higher uninsured leverage
  - More awake uninsured depositors
Where are self-fulfilling solvency runs possible?

Number of Insolvent Banks

Aggregate Assets of Insolvent Banks (in Trillions)
What about Regulators?

- **Liquidity**: Fed report on SVB “liquidity” appears 320 times, “solvency” once!

- **But liquidity issues addressed, and yet banks keep failing!** LOTS of liquid assets, Other liquidity interventions

- **Bad management!** Board of directors and management failed to manage their risks
What about Regulators?
Beyond SVB?

U.S. bank failures in each year, adjusted for inflation

- $432 billion, Washington Mutual Bank
- $209 billion, Silicon Valley Bank
- $213 billion, First Republic Bank
- $94 billion, 24 other banks
- $110 billion, Signature Bank
Beyond SVB?
Now What?

Extended coverage to uninsured depositors

Bank Term Funding Program

Mitigates short term risk...

...but losses remain.

S&L Crisis (1980s)
“Gambling for Resurrection”
What next in the short run?

Resolving the Banking Crisis

This Version: April 12, 2023 (with FAQs)
First Version: March 28, 2023
Link to Current Draft

Peter DeMarzo (Stanford), Erica Jiang (USC), Arvind Krishnamurthy (Stanford), Gregor Matvos (Northwestern), Tomasz Piskorski (Columbia), Amit Seru (Stanford and Hoover)

Summary

1. New economic conditions have led to insolvency concerns across the banking system.
2. There are too many banks in this situation to resolve with one-off solutions.
4. Requiring banks to promptly raise equity capital will both reduce fragility and provide a needed market test to identify truly insolvent banks.
5. The amount of private capital needed is in the range of $190 to $400 billion.
What about the long run?

“Careful Regulations to address unprecedented and unanticipated risks?”

Interest Rate Risk