Monday, May 1, 2023

FedFin Analysis: GAO Slams FRB, FDIC Supervision

Client Report: REFORM223

Executive Summary

Following our analyses of the Fed's report on SVB (see *Client Report* **REFORM221**) and the FDIC's on SBNY (see Client Report **REFORM222**), we turn now to one from the General Accountability Office sure to have at least as much impact on bipartisan consideration of what needs next to be done to govern regional banks. HFSC Chairman McHenry (R-NC) has already cited the GAO report in his rebuttal to those from the banking agencies, and it may well have tempered Senate Banking Chairman Brown's (D-OH) support of a focus solely on new law and rule. As detailed in this FedFin report, the GAO appears frustrated that all of its work following previous failures did not avert these, noting for example its 2011 recommendation that the agencies add non-capital triggers to their prompt corrective action framework. GAO also notes a 2015 report urging the banking agencies to ensure faster remediation following supervisory concerns. GAO also reviews the inter-agency systemic-risk determination and the Fed's decision to open the Bank Term Funding window, largely confining itself in this report to a description of facts and the rationale presented to it by the Treasury, Fed, and FDIC. However, this is the first of several reports the GAO has promised Congress, suggesting these backstops will get additional GAO attention in concert with an assessment of FRC's failure in the context of those analyzed here.

Analysis

GAO characterizes this report as preliminary, noting for example that it is required under law to report to Congress following each Treasury systemic-risk designation. It may also study FRB decisions to extend emergency-liquidity support as was done in the wake of the SVB and SBNY failures, with GAO also planning to review how the FDIC resolved both banks. Based on the report's content, it seems likely that GAO also plans to assess the extent to which Fed and FDIC supervisory protocols were followed. The report finds that:

- As with the banking agencies, both SVB and SBNY were at grave risk due to poor management and risky business strategies, weak liquidity-risk management, and fast growth;

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- Again like the agencies, there were significant supervisory failures to escalate concerns. Supervisory downgrades did not occur until the day before each bank failed;
- The San Francisco Federal Reserve Bank gave SVB remarkably high ratings for liquidity-risk management until June of 2022 and maintained its overall satisfactory status until immediately before failure even though serious concerns were noted as early as 2018. The FRB generally discontinued regional-bank examinations during periods in the pandemic, leading GAO in 2022 to recommend to the Fed that it improve its overall ability to assess bank enterprise risk management and remote work.

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