FedFin Client Report

Monday, May 1, 2023

FedFin Assessment: FDIC Blames Signature Governance, Clarifies Failure Scenario

Client Report: REFORM222

Executive Summary

In this report, we build on our assessment earlier today of the Fed's SVB autopsy (see *Client Report* **REFORM221**) with an assessment of the FDIC's self-review of Signature's failure. As noted on Friday, the FDIC confines this report to Signature's supervision; a separate report will address policy recommendations. Although the analysis has some findings in common with the Fed's SVB assessment with regard to matters such as supervisors' failure to keep up with a fast-growing bank, the FDIC principally focuses on key risk indicators at the bank rather than supervisory shortcomings. Where these are addressed, it is principally with regard to shortfalls in supervisory resources at the FDIC's New York office along with workplace issues the FDIC was already attempting to address. As with the Fed, the FDIC gave Signature a satisfactory rating despite these weaknesses until just the day before closing the bank.

Although HFSC Republican leadership accused the FDIC of shuttering Signature because of its crypto activities (see *Client Report* **REFORM219**), the FDIC's report attributes Signature's vulnerability to "poor management" unable to withstand the contagion risk caused by Silvergate's and SVB's failures.

This FedFin report also details some policy-significant findings from the FDIC's timeline, noting for example that the problems with getting discount-window assistance before the Fed's wire-room closure related to SBNY's effort to get the Fed to accept high-risk loans as collateral and/or persuade the FHLB to subordinate its collateral claims to the Fed's. We expect aspects of these findings to apply to FRC, but the rushed resolution as evidenced by these collateral challenges seems unlikely given all the warning the FDIC has had of FRC's weakness since mid-March. However, FRC was also a large FHLB borrower, likely complicating the FDIC's ability to execute a least-cost resolution outside a purchase-and-assumption transaction.

Analysis

The FDIC report also details how Signature Bank failed to implement even basic liquidity or other essential risk controls, ignored FDIC supervisory edicts, and allowed risks in areas

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such as AML to proliferate. Still, Signature received an overall CAMELS rating of 2 until just the day before it failed. Key risks of note highlighted by the FDIC with implications for near-term policy action include:

- High growth,
- A fast-changing, high-risk business model;
- Management and board failure to remediate weaknesses identified by the FDIC;
- Undue reliance on uninsured deposits from a concentrated depositor base holding very large positions;
- Plans to post subscription loans to foreign borrowers as discount-window collateral even though the Federal Reserve Bank of New York informed the bank that these loans are ineligible collateral, with the bank still including these loans in collateral calculations just hours before failure. Interestingly, the bank also sought to get the Federal Home Loan Bank of New York to subordinate its collateral interests to those of the Fed in hopes of getting a discount-window advance before the Fed's wire room closed. It does not appear that this occurred;
- A faulty year-end 2022 call report, with an accurate report of pledged securities provided only on the day the bank failed; and
- Reputation and contagion risk due to extensive crypto activities, with SBNY efforts to reduce risk in this area during the fourth quarter of 2022 due to market forces, not FDIC intervention.

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