

Fate of First Republic Bank hangs in the balance as report on SVB collapse exposes “regulatory” framework

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Officials from the US Treasury, the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC) are working with major banks to organise some kind of takeover of the effectively bankrupt First Republic Bank, as a report into the collapse of the Silicon Valley Bank (SVB) in March makes clear that so-called regulations and supervision of the banking system, supposedly to prevent “systemic crises,” are virtually non-existent.

SVB collapsed on March 10 after \$42 billion had been withdrawn in a single day and another \$100 billion was lined up to be pulled out in what was a bank run, forcing the FDIC to intervene and take it over.

But that did not bring the latest phase of the financial crisis to a close, as the First Republic Bank went into free fall with the revelation that it had lost \$100 billion in the first three months of this year.

Since the beginning of March its shares have fallen by 97 percent from \$115 to around \$3.50.

The efforts to somehow prevent a complete collapse of the bank, carrying with it the risk of “contagion” to other banks, centre on the organisation of a takeover.

Three major banks, including JPMorgan Chase, are reported to have submitted bids to buy all or parts of its operations, with one of the main issues being whether the FDIC will invoke “systemic risk” exemption to allow the bailout of uninsured depositors holding more than \$250,000.

In the report, Vice Chair for Supervision Michael S. Barr advanced what has become the mantra of financial officials that the failure of SVB was a “textbook case” of mismanagement, that it was something of an “outlier” in terms of its operations and that overall, the banking system is “sound and resilient.”

But his report was shot through with contradictions which expose these assertions.

“Regulatory standards for SVB were too low, the supervision of SVB did not work with sufficient force and urgency, and contagion from the firm’s failure posed systemic consequences not contemplated by the Federal Reserve’s tailoring framework,” he wrote.

The obvious point is that if SVB was an “outlier” then why did its collapse pose risks for the entire system if it is “sound and resilient.”

The reference to the Fed’s tailoring framework goes some way to providing the answer. It was introduced in 2019 under bipartisan legislation passed in 2018 that allowed the Fed to “tailor” rules in risk assessment for smaller banks, lifting some of the regulations imposed on them after the 2008 crisis and making them subject to less supervision.

According to Barr, the Fed policy shift “impeded effective supervision by reducing standards, increasing complexity, and promoting a less assertive supervisory approach.”

But even if regulations had been maintained, it is doubtful whether the crisis would have been prevented because the “stress” tests conducted on banks did not include their response to rapid interest rate rises, which was the main cause of the SVB collapse when the market value of its Treasury bonds fell as the Fed started lifting interest rates last year.

Apart from the specifics of the SVB case, Barr’s report contained admissions that made clear those supposedly in charge of the financial system have little idea of its operations, much less how to control and regulate it.

He noted that a “firm’s distress may have significant

consequences through contagion – where concerns about one firm spread to other firms – even if the firm is not extremely large, highly connected to other financial counterparties, or involved in critical financial services.”

In effect, this means that any firm is “too big to fail” because its collapse can have far-reaching consequences of which the regulators are unaware.

Of course, Barr did not explicitly state that would-be regulators are very much operating in the dark, but this is the meaning of the following passage in his report:

“As risks in the financial system continue to evolve, we need to continuously evaluate our supervisory and regulatory framework and be humble about our ability to assess and identify new and emerging risks,” he wrote.

There was a need to bolster resiliency broadly in the financial system and “not focus solely on specific drivers.”

The latter comment is significant because the latest two financial storms in the financial system – the British pension crisis of September last year and the SVB collapse in March – have come from an unexpected source.

However, in both cases the fundamental cause was the same – the sharp rise in interest rates which has meant that all business models throughout the system are now called into question because they were based on a decade and a half of ultra-easy money policy, meaning that a crisis could potentially erupt from anywhere.

In his policy prescriptions Barr noted that, while interest rate risk was a “core risk” of banking that was not new, it was not appropriately managed by SVB and “supervisors did not force the bank to fix these issues quickly enough.”

Authorities would also need to supervise and regulate liquidity risk, starting with the risks of uninsured deposits he said, and added:

“Any adjustments to our liquidity rule would, of course, go through normal notice and comment rulemaking and have appropriate transitions rules, and thus not be effective for several years.”

There was also a need to improve capital requirements considering the SVB experience to take account of unrealised losses on securities.

“Again, these changes could not be effective for

several years because of the standard notice and comment rulemaking process and would be accompanied by an appropriate phase-in.”

One may well ask why the delay of “several years” in introducing rule changes when the financial system has come to the brink of a meltdown?

This is because the “standard notice and comment rulemaking process” refers to the practice where the banks and their representatives in Congress work over legislation to have removed, as far as possible, any restrictions on their profit-making and speculative activities.

But apart from these issues, concerning the lack of regulation, there is a deeper and more fundamental reason. It is rooted in the anarchy of the private ownership of the financial system which makes inherently impossible any conscious control of its operations.

After insisting weaknesses and supervision and regulation “must be fixed,” Barr concluded:

“In doing so, we should be humble about our ability ... to predict how losses might be incurred, how future financial crisis might unfold, and what the effect of a financial crisis might be on the financial system and our broader economy.”

In other words, billions of workers all over the world are going about their daily lives trying to make ends meet with a sword of Damocles hanging over their heads, that could fall at any time. This situation cannot and will not be ended unless and until the entire financial system is taken out of private hands and placed in public ownership under democratic control.



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