Monetary Tightening and U.S. Bank Fragility in 2023: Mark-to-Market Losses and Uninsured Depositor Runs?

Discussion

03/11/2023

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Overview

- The paper in a nutshell

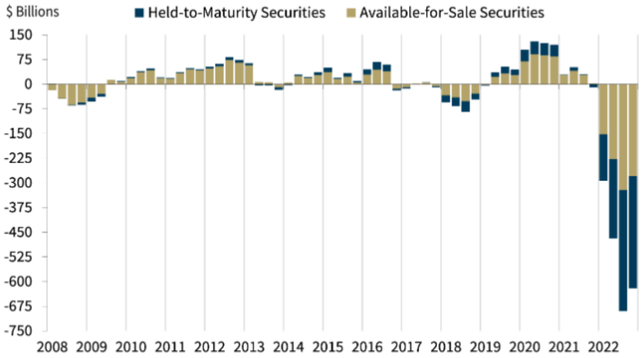
- Three (main) comments
  - Liquidity requirements as a backstop for insolvency
  - The U.S. banking system as a (almost) closed system
  - Dissecting further deposits at risk

The paper in a nutshell

- Topical paper!
- Important contribution: dissecting case of SVB + policy-relevant conclusions on bank resilience
- This paper: Simple and very intuitive, given the sequence of events

Last Updated: February 28, 2023

Unrealized Gains (Losses) on Investment Securities



Source: FDIC.
Note: Insured Call Report filers only.

California Financial Regulator Takes Possession of Silicon Valley Bank

Mar 10, 2023

Download this press release (PDF)

SAN FRANCISCO – The California Department of Financial Protection and Innovation (DFPI) announced today that, pursuant to California Financial Code section 592, it has taken possession of Silicon Valley Bank, citing inadequate liquidity and insolvency. The DFPI appointed the Federal Deposit Insurance Corporation (FDIC) as receiver of Silicon Valley Bank.

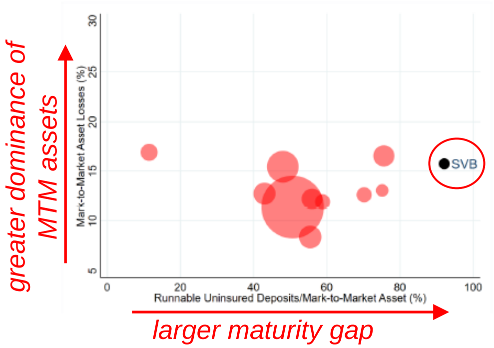
Silicon Valley Bank is a state-chartered commercial bank based in Santa Clara and is a member of the Federal Reserve System, with total assets of approximately $209 billion and total deposits of approximately $175.4 billion as of Dec. 31, 2022. Its deposits are federally insured by the FDIC subject to applicable limits.

Liquidity crises do not need to lead to insolvency

- In the paper, solvency seems to be the only thing that matters
  - But in reality, also liquidity matters!

- This can affect the policy implications of the paper
  - For instance, stricter liquidity (and capital) requirements for medium-sized banks → shorter asset duration to hedge against liquidity risk

- SVB was exempt from liquidity requirements and was subject to more lenient capital requirements under the FED’s tailoring rule



The U.S. banking system as a (almost) closed system

Where does the money go?

- If in banknotes, it would be good to spell out what the adjustments are in the central bank balance sheet that underpin these scenarios
- If it is partly re-distribution across financial institutions (banks + non-banks) would be good to factor that in

Recourse to central bank funding facilities → more excess liquidity in the system → generalised runs do not happen, as the central bank always intervenes

In general, size of scenarios seems quite big (50% of uninsured deposits = $4.5trn, compared to total assets of the FED of around $8.5 trn currently)

Dissecting further deposits at risk

Paper finds that counties with more disadvantaged background on average tend to exhibit higher shares of deposits at risk

→ Would be interesting to exploit the underlying mechanism!

1. Deposit-at-risk based on MTM assets and size of (regional) deposit base
   – So banks in disadvantaged regions engage in more maturity transformation?
2. But this is a bank run story, so actual risk depends on a run occurring
   – In regions with more disadvantaged backgrounds deposits are presumably smaller, therefore less flighty?
   – What about financial literacy?
   – And social media/network effects? e.g. Koont et al (2023), Cookson et al (2023)

Both facts can interact:

Do less flighty deposits tilt banks' optimization towards assuming more risk?

Summary and some open questions

- Very interesting and intuitive paper!
- Leaves lots of food for thought, in particular on:
  - Action/inaction by regulators and supervisors
  - Reaction/role of Lender of Last Resort (LoLR)
  - Determinants of deposit base fragility