14 MAR 2024

SVB's collapse revisited: The cost of time pressure

Florian Heider, Jonas Schlegel, and Tobias Tröger: A reassessment of the 2023 banking turmoil from today's perspective shows that there is still a need to protect uninsured depositors and to reduce the substantial profits of acquirers during resolution process

When supervisors closed the Silicon Valley Bank (SVB) on 10 March 2023 and named the US Federal Deposit Insurance Corporation (FDIC) receiver, the situation at that time was far from an idiosyncratic bank run on SVB's deposits. Signature Bank and First Republic, the14th largest U.S. bank at the time, followed in the US and Credit Suisse in Europe.

Furthermore, the US Congress invoked the "systemic risk exception", allowing the FDIC to ensure the safety of uninsured deposits at the failed banks. As a proactive measure against contagion effects, the Federal Reserve initiated the establishment of a Bank Term Funding Program (BTFP) to provide liquidity at face value to U.S. depository institutions for a duration of up to one year. Accepting collateral at face value rather than at fair market value was a novelty for the Federal Reserve. In addition, to reassure international markets, several major central banks announced US dollar swap arrangements to respond to US dollar liquidity shortages.

Protection of uninsured bank deposits helps prevent bank runs

The withdrawal of bank deposits creates liquidity problems that force an institution into fire sales and, if distrust persists, lead to liquidation or bankruptcy. Bank runs are panic-driven outflows of bank deposits and are typically self-reinforcing, which explains the prompt and forceful reaction in the US.

At the heart of every bank run, and the reason why bank runs are rarely confined to a single bank, is the risk that depositors lose their money. This is particularly acute when depositors are uninsured. By protecting all deposits, including so far uninsured ones, the risk of bank runs can be prevented effectively. Recall that although three large U.S. banks had to be stabilized during the turmoil of March 2023, no depositor was harmed because the FDIC was enabled to put a burden on the insured deposit system. Deposit insurance thus can establish clear ex ante guidelines, eliminating the need to rely on unpredictable ad hoc ex post reactions such as the "systemic risk exception" or even government support putting taxpayer money at risk.

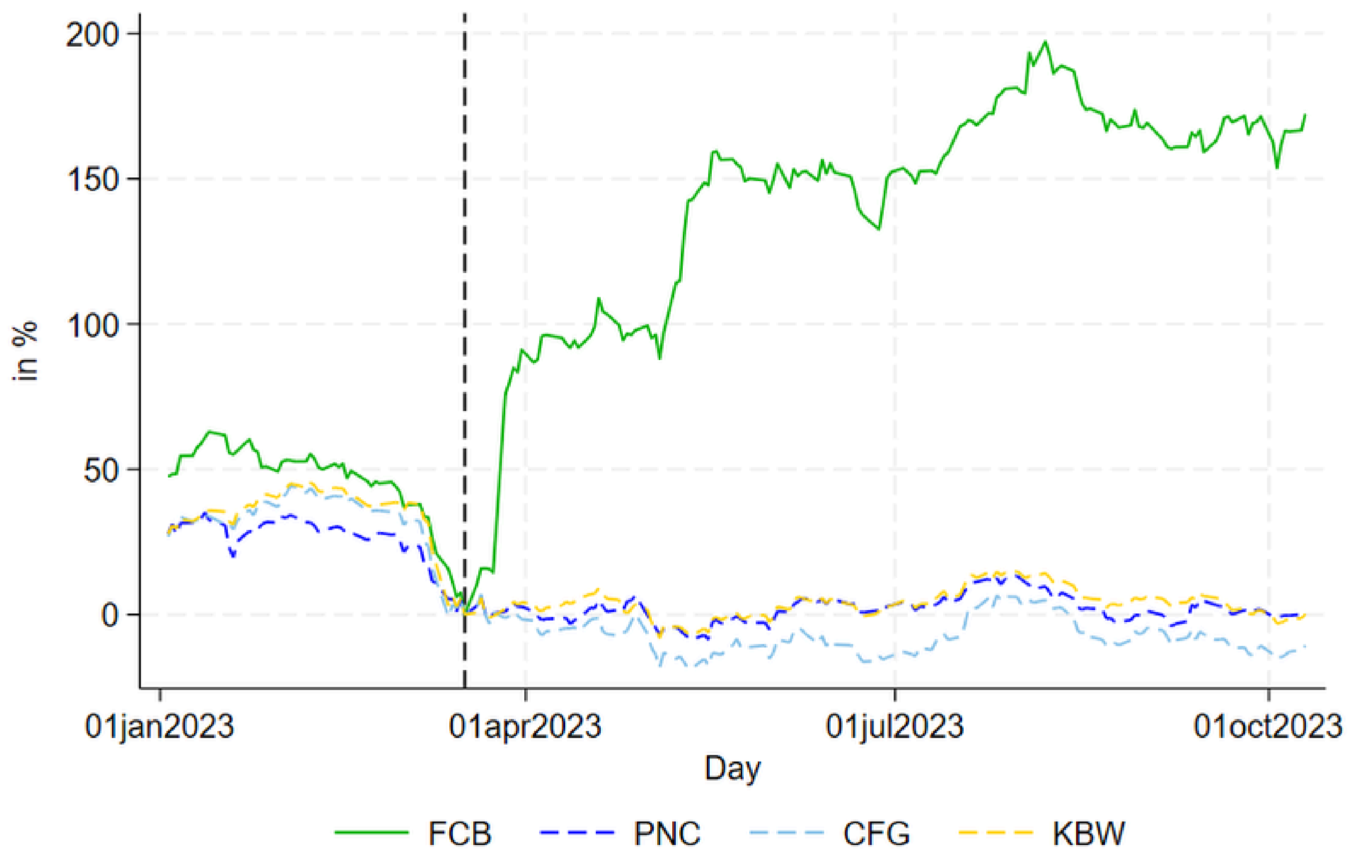
In the EU, regulation requires banks to issue a separate asset class, known as the Minimum Requirements for Own Funds and Eligible Liabilities (MRELs). These liabilities serve as a loss absorbing buffer and recapitalization facility in the event of a resolution, mitigating the impact of a bank's failure on deposits. Setting this buffer at an appropriate level alongside existing equity and securing its availability for early loss absorption helps reduce the likelihood of bank deposits bearing losses. Issuing and trading this asset class in the market also instills market discipline, putting constraints on the bank's risk taking and investment decisions. MREL bonds can therefore take over the disciplinary role of uninsured deposits. Our SAFE Policy Letter No. 98 (English) and our follow-up contribution in Vierteljahreshefte der Wirtschaftsforschung (German) provide more in-depth analysis to this topic and counteract common points of criticisms.

Excessive profits by acquirers of banks in resolution

The purchase and assumption transactions that ultimately resolved the failing banks in spring 2023, teaches another often-overlooked lesson for bank crisis management. All four banks were eventually acquired by competitors, and none of them was liquidated. The three US institutions were sold in auctions, while Credit Suisse was sold in a government-brokered national deal.

At the request of the European Parliament's Committee on Economic and Monetary Affairs (ECON), SAFE White Paper No. 98 provides an in-depth analysis of the pricing of these transactions and concludes that the acquirers have made substantial marked-based profits, both in percentage and dollar terms.

Figure: Abnormal returns for First Citizen Bank, the acquirer of SVB



Source: Yahoo, authors' calculations.

The figure shows the stock price performance of First Citizen Bank (FCB), the acquirer of SVB, two selected competing, but unsuccessful bidders (PNC Bank (PNC), Citizens Financial Group (CFG)) and the U.S. bank benchmark index KBW Nasdaq Bank Index (KBW). We see that FCB's share price nearly tripled, while its peers and the banking benchmark remained flat. This indicates that market participants considered the acquisition highly profitable for FCB with the seller leaving money on the table and stakeholders (FDIC, taxpayers) ultimately picking up the tab. Similar patterns can be observed for all the other US cases and for the Credit Suisse deal.

From protected demand deposits to more time for a more efficient resolution process and to less excessive profits for the acquirer

The aftermath of the 2008 financial crisis and the banking turmoil of spring 2023 were very different, but one similarity stands out: Chaotic, over the weekend negotiations between resolution authorities, governments, and central banks. Fears of further market turmoil and contagion rose to such a level that authorities felt forced to conclude negations and auctions before the market opened on Monday morning. This is remarkable after more than a decade of improvements in banking regulation, introducing comprehensive resolution planning and detailed living wills.

Time pressure has its price. Negotiated deals or auctions forced by authorities are fraught with information asymmetries for potential acquirers. This reduces the number of bidders and increases the risk premiums they ask for. Both outcomes reduce the price for the bank in resolution and make the necessary takeover less efficient.

By protecting demand deposits, bank runs can be prevented. If authorities do not have to fear further liquidity outflows in demand deposit runs, chaotic weekend negations will no longer be necessary. Would-be acquirers of banks in resolution will have the time they need to access relevant information about the bank in resolution, which should ultimately increase the price paid and reduce the costs for stakeholders such as resolution authorities and taxpayers.

Florian Heider is Scientific Director at SAFE and Professor of Finance at Goethe University Frankfurt.

Jonas Schlegel is Co-Head of SAFE's Policy Center.

Tobias Tröger is Director of the SAFE Research Cluster Law & Finance and Professor of Private Law, Commercial and Business Law, Jurisprudence at Goethe University Frankfurt.

Blog entries represent the authors' personal opinion and do not necessarily reflect the views of the Leibniz Institute for Financial Research SAFE or its staff.

NEWS & LATEST

- All News
- SAFE Finance Blog
- Events
- Videos
- SAFE in the media
- Newsletter
- Research Magazine Points
- Distribution List

In this Section:

CONTACT

Leibniz Institute for Financial Research SAFE

Theodor-W.-Adorno-Platz 3
60323 Frankfurt am Main

Phone: +49 69 798 30080
Fax: +49 69 798 30077
Email: info@safe-frankfurt.de

Funded by:

© 2023 SAFE