American Bankruptcy Institute

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Banking in 2023 | Today's Panel

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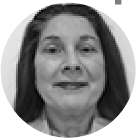

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Agenda

I. Overview of Banking Issues & FDIC
II. Overview of Receivership Powers
III. Market Conditions
IV. Regulatory Environment
V. Q&A

I. Overview of Banking Issues & FDIC

Timeline of Bank Failures

Key drivers of the **GFC:**
- Rising interest rates
- Subprime mortgage crisis
- Excessive risk taking among banks

Key drivers of the **2023 Banking Crisis**:
- Rising interest rates
- Held-To-Maturity losses
- Yield curve inversion

Jul'08 — **Aug '09**

Jul '08: IndyMac collapses. The bank underwrote Alt-A mortgages using bank deposits as funding. IndyMac experienced a **bank run** and was seized by regulators shortly after

Sep '08: Regulators seize **WaMu** and arrange a sale of assets to JP Morgan Chase. The largest bank failure in US history at the time. Failed due to collapse of MBS market and overexpansion

Aug '09: Colonial Bank was seized by regulators due to mortgage fraud and major exposure to real estate lending. This was the largest bank failure of 2009

Source: FDIC

Timeline of Bank Failures (cont.)

Feb '23 — Mar '23

Feb 24: KPMG signs audit report giving SVB a **clean bill of health** for 2022

Mar 8-9: SVB books a **$1.8 billion loss** after selling investments to cover increasing withdrawals. **SVB stock crashes** when markets open on Mar 9. **Silvergate Bank** announces voluntary winddown

Mar 10: SVB shares **halted premarket**. Fed regulators take control of SVB before open

Mar 11-12: Tech startups scramble over the weekend to line up funding for payroll and operations as deposits are locked up

Mar 12: Fed regulators take control of a second bank, **Signature Bank**

Mar 13: President Biden speaks publicly to restore confidence

Mar 14: Justice Department and SEC investigate SVB's collapse, separately

Mar 15: Credit Suisse shares decline on contagion spreading across the Atlantic. US Regional banks slide as First Republic Bank (FRC) is downgraded to junk

Mar 16: Credit Suisse shares jump after borrowing 50B Swiss Franc to shore up finances. FRC shares jump after news of the large bank's rescue plan

Mar 17: FRC shares plunge again. **SVB's parent company files for Chapter 11**

Source: WSJ

Timeline of Bank Failures (cont.)

Mar 18-19: UBS takes over Credit Suisse for over $3B

Mar 20: Jamie Dimon leads discussions with other bank CEOs to stabilize FRC

Mar 21: Treasury Secretary Janet Yellen says the fed could step in to protect depositors at additional banks

Mar 27: FDIC announces **First Citizens will acquire SVB's assets**

Apr 7: FRC suspends quarterly cash dividend

Apr 24: FRC discloses that **customers pulled ~$100B in deposits** in March and it is "pursuing strategic options"

Apr 28: Fed releases postmortem on SVB, saying **regulators failed to take action** to address problems at the bank

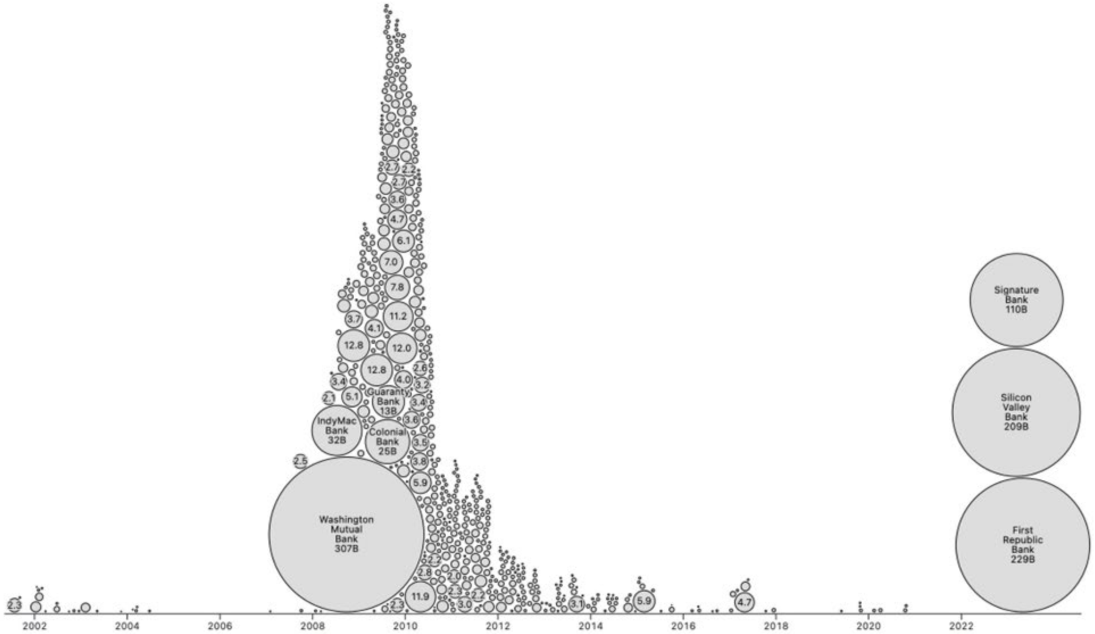
May 1: Fed regulators **seized FRC and sold bulk of assets to JPMorgan Chase**

May 4: PacWest shares plunge off report that it will sell itself. Other regional bank stocks fall, despite the Fed reassuring that the banking system is sound

Mar '23 — May '23

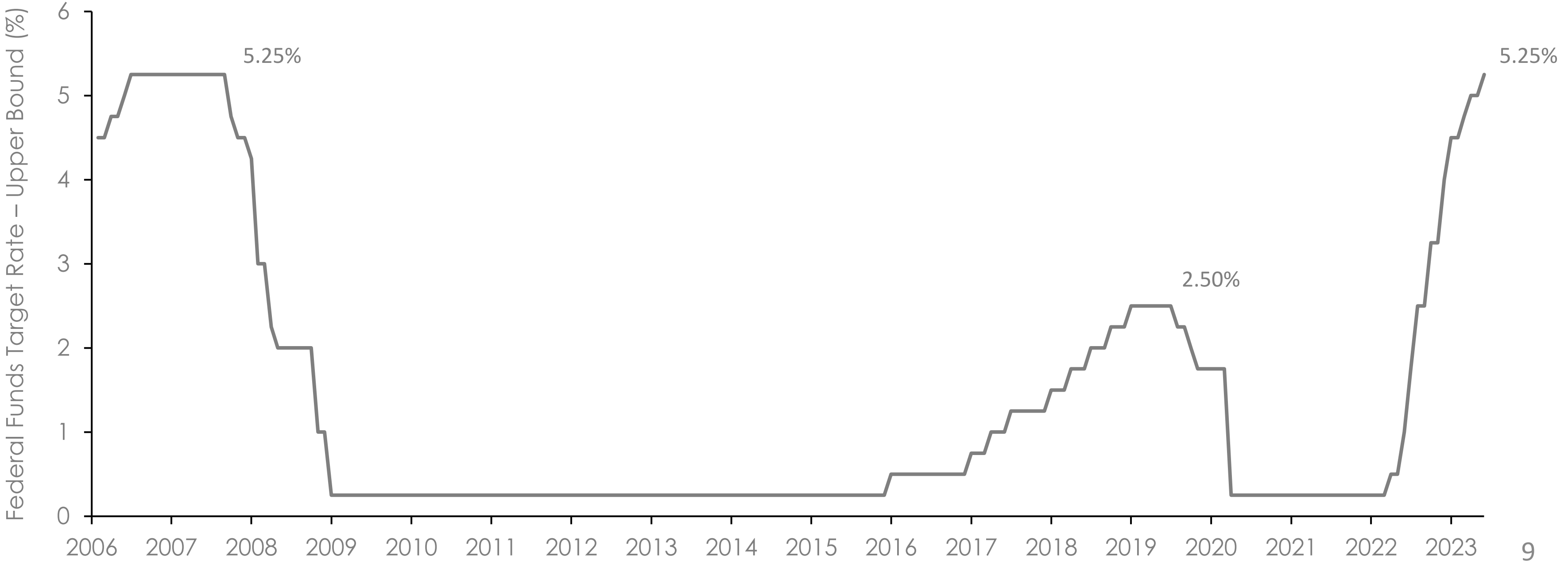
Source: WSJ

Bank Failures Since 2000



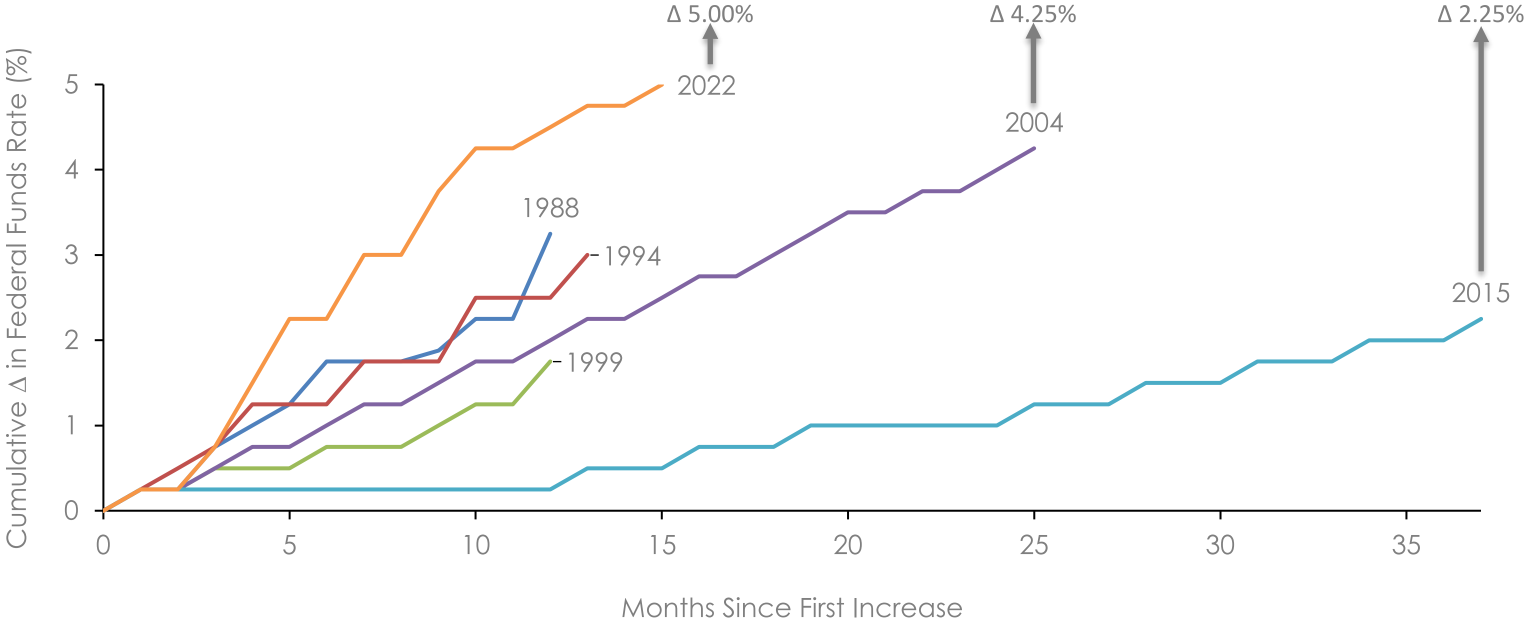
Source: FDIC.gov

Interest Rate Hikes Since 2006



Source: Bloomberg

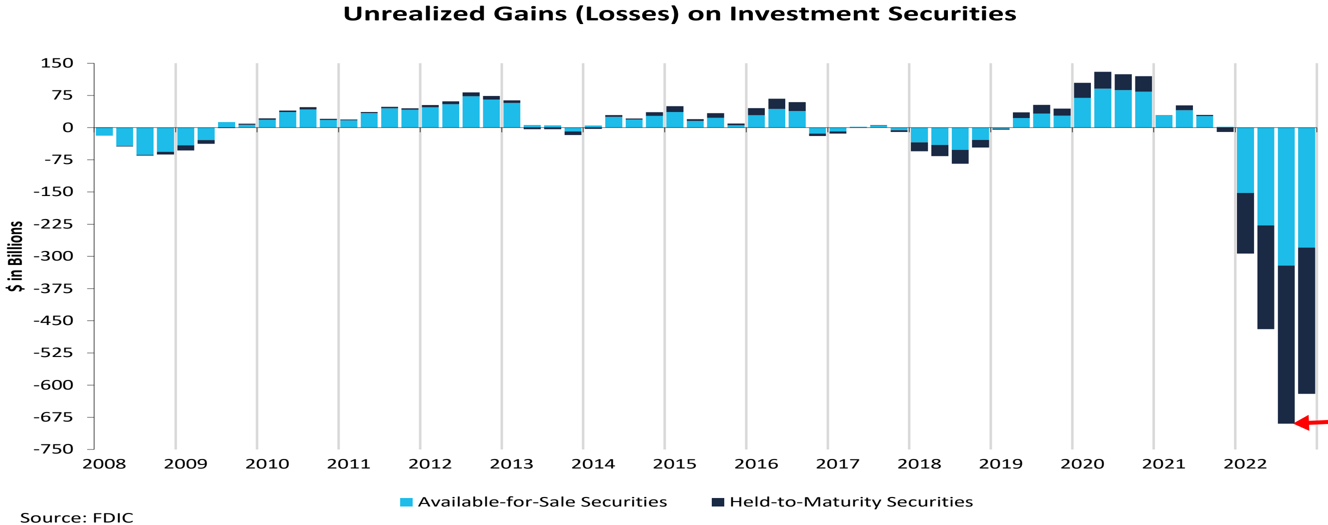
Historical Federal Fund Rate Increases



Source: Bloomberg

Unrealized Losses for Banks?

- Held to Maturity Securities ("HTM") recorded at cost – unrealized losses do not impact the income statement
- Available for Sale Securities ("AFS") recorded at fair value but not via the income statement



Source: FDIC
Note: Insured Call Report filers only

SVB had $15B in HTM losses on $16B of equity

Massive system wide losses on HTM and AFS

Unrealized losses on HTM and AFS securities are approaching $700B across the banking system

FDIC – Program To Insure Depositors

Maintains stability and public confidence in the US financial system through the Deposit Insurance Fund (DIF)

- Primary objectives
  - Insure deposits and protect the depositors of insured banking institutions
  - Resolve and assist failed banks
- Two sources of funding
  - **Assessments**, or insurance premiums, on FDIC-insured institutions
  - **Interest earned** on funds invested in U.S. government obligations
- Fund management
  - Maintain a level to uphold public confidence
  - Dodd-Frank Act (2010) – set requirements for the Designed Reserve Ratio (DRR) and redefined the assessment base
    - **DRR** = DIF / Total Estimated Insured Deposits. DRR is set to **2.0%**
    - **Assessment Base** = (Average consolidated total assets – Average tangible equity)
      - Bank's pay assessments on **<u>total liabilities</u>**, not on only insured deposits
      - Average tangible equity = (Average common stockholders' equity – Annual average goodwill – Average identifiable intangible assets)

Source: FDIC.gov

FDIC – Insurance Premium For Banks

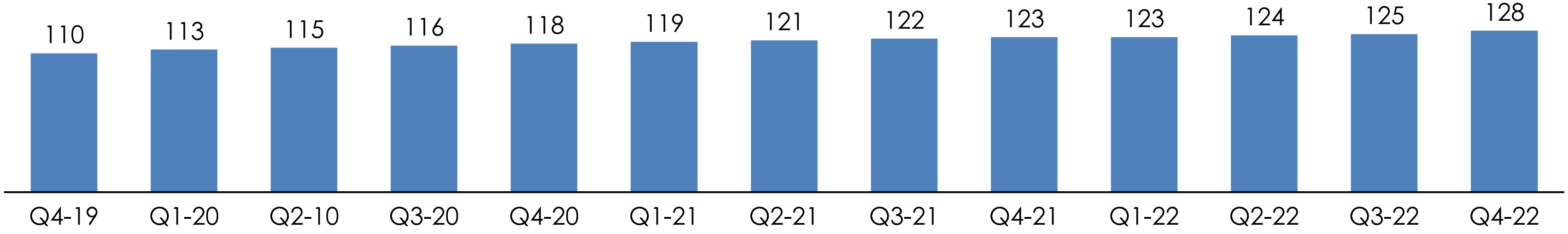
DIF is maintained through **quarterly assessments** on insured banks: Assessment rate * Assessment base

- Small banks (Less than $10 billion in assets)
  - Assigned an individual rate based on a formula using financial data and CAMELS component ratings:
    - Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity
- Large banks ($10 billion or more in assets)
  - Assigned an individual rate based on a scorecard
  - There are two versions of the scorecard: one for most large institutions and a second for highly complex institutions
  - Combine the following measures:
    - CAMELS component ratings, financial measures used to measure bank's ability to withstand asset and funding related stress, and a measure of loss severity that measures potential losses to FDIC in the event of a failure
- Subject to adjustments
  - Decrease for issuance of long-term unsecured debt
  - Increase for holdings of long-term unsecured/subordinated debt issued by other insured banks
  - For banks that are not well-capitalized or well-rated, increase for significant holdings of brokered deposits

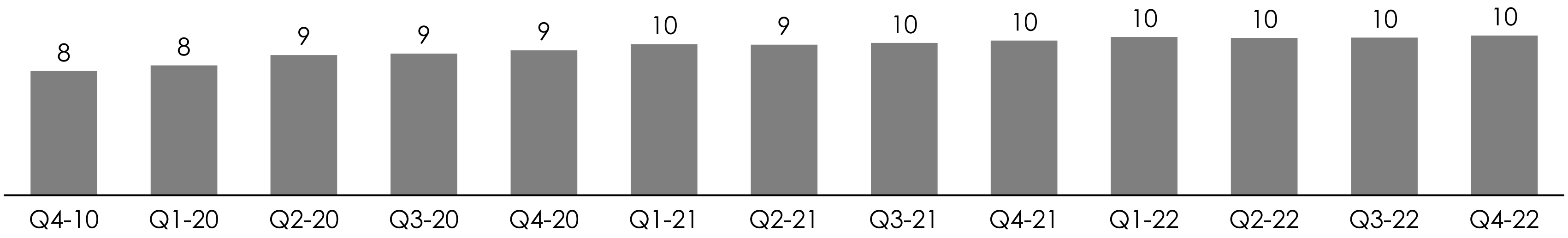
Source: FDIC.gov

FDIC – Program To Insure Depositors

DIF Balance ($, Billions)



DIF – Insured Deposits ($, Trillions)



Source: FDIC.gov

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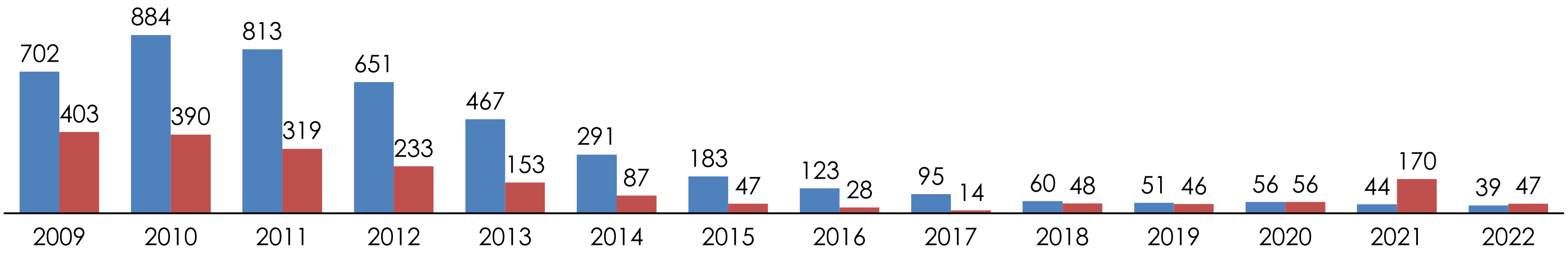
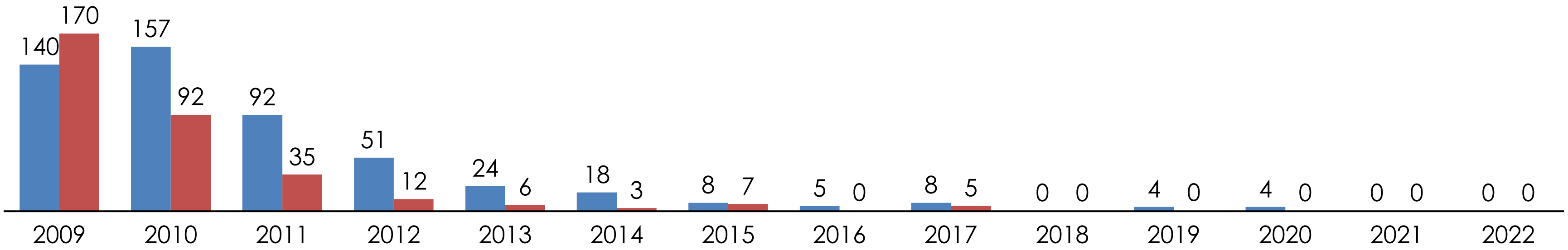
FDIC – Program To Insure Depositors

Problem Institutions



Number of Institutions
Total Assets ($, M)

Failed Institutions



Source: FDIC.gov

II. Receivership Powers & Flexibility

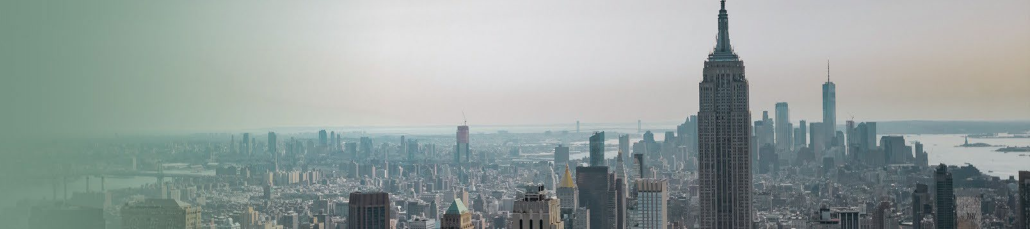
Overview of Receivership Powers/Flexibility

- How does FDIC make decisions to put into receivership
- How do claims work: priority and claims process
- Single point of entry
- Operational issues from Holdco/bank being in separate processes

FDIC Powers as a Receiver

FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

- Access institution's books and records
- Operate institution, including collecting on obligations and preserving assets
- Take any action authorized by statute that FDIC determines to be in the best interests of the depository institution, its depositors, or the FDIC
- Transfer institution's assets/liabilities to a new depository institution (bridge bank)
- Transfer any asset or liability of the bank without any need for approval, assignment, or consent for the transfer
- Merge with another insured institution



Claims Process

- FDIC has broad powers to establish claim filing and review procedures
- Courts lack subject matter jurisdiction to intervene in the process or hear claims before the claimholder goes through the claims process
- Mandatory timeframes / deadlines:
  - Deadline to submit proofs of claim (not less than 90 days after notice)
  - FDIC has 180 days to decide whether to allow or disallow
- Failure to file a claim results in mandatory disallowance

Claims Priority

1. Secured claims / Claims for funds held in trust
2. Administrative costs
3. Deposit liabilities
4. Other general or senior liabilities of the bank
5. Subordinated obligations
6. Equity holder claims

Single Point of Entry Overview

- Under the Dodd-Frank Act, FDIC can place a financial institution into an FDIC receivership process
  - Fall back to bankruptcy if determined that a bankruptcy would have serious adverse effects on U.S. financial stability
- FDIC developed SPOE strategy as potential tool in such situations
  - Would place bank holding company into receivership
  - Would hold shareholders, debt holder, management of holding company accountable for failure
  - Operating subsidiaries would remain open to avoid systemic contagion

III. Market Conditions

Bank Term Loan Program – Mar 2023

- To provide liquidity to U.S. depository institutions, each Federal Reserve Bank would make advances to eligible borrowers, taking as collateral certain types of securities
  - Many of the securities that would be collateral (e.g., long term treasuries) could not be sold for par today given current rate environment
    - Rate is one-year overnight index swap rate plus 10 basis points
    - Eligible collateral is any collateral eligible for purchase by the Federal Reserve banks in open market operations (so long as owned by borrower on 3/12/2023)
    - Collateral valued at par, with margin = 100% of par value
- Department of the Treasury will make available up to $25 billion from the Exchange Stabilization Fund as a backstop for the BTFP
- Depository institutions may obtain liquidity against a wide range of collateral through the discount window
- Program Duration: Advances can be requested under the Program until March 11th, 2024

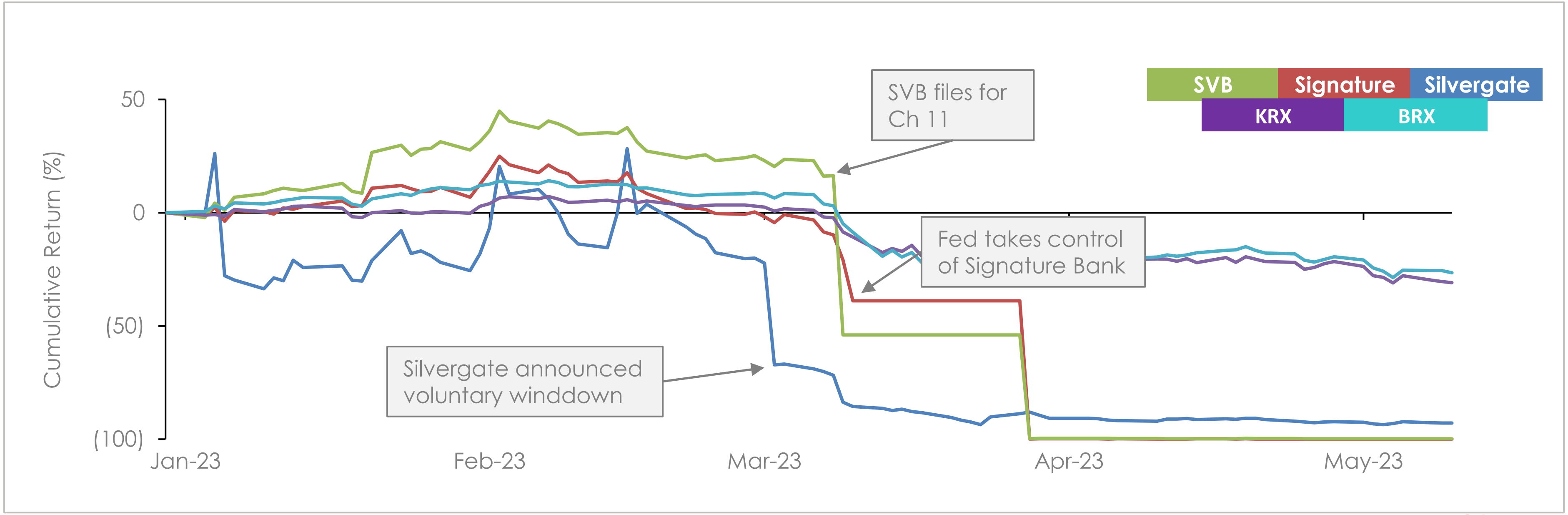
Source: federalreserve.gov

Federal Home Loan Banking

- The FHLB is defined as a funding source for a variety of mortgage products, including those focused on very low- and low- and moderate- income households
  - Advances help members originate mortgages that they want to hold in portfolio or sell later
- Silicon Valley Bank, Signature Bank and Silvergate Bank were among the largest borrowers last year of the FHLB
  - The three failed banks received a combined $30.6B from the FHLB last year
- Other banks with interest rate-related strains were among the largest borrowers of the FHLB System last year, including First Republic Bank and Charles Schwab
- The $1.2T FHLB System has pumped nearly $500B into the banking industry so far this year

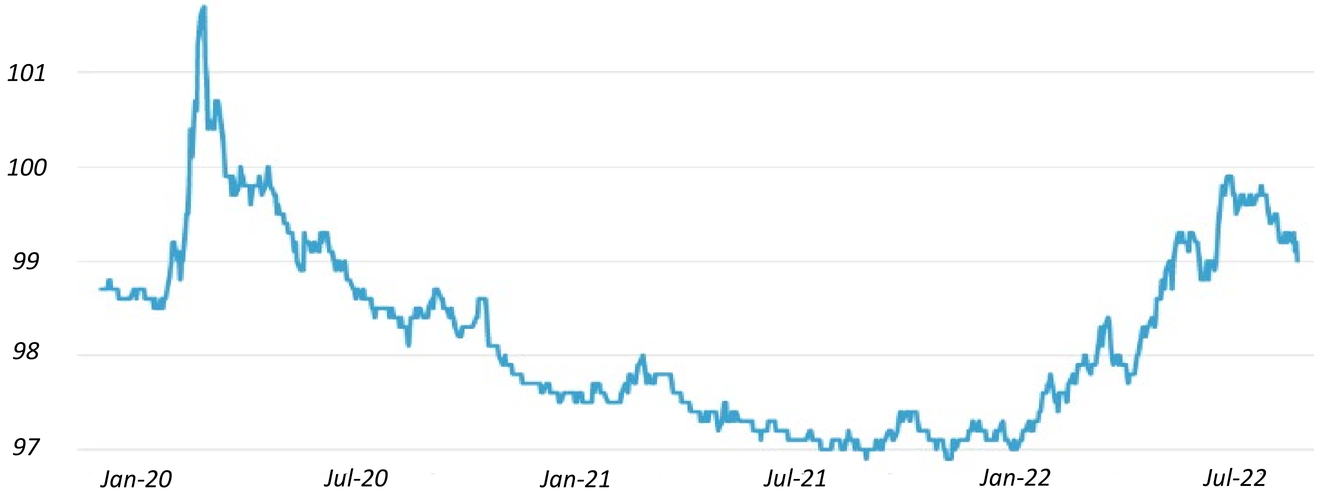
Source: Bloomberg

Regional Bank Stock Performance



Source: Yahoo Finance

Goldman Sachs US Financial Conditions Index



Falling value indicates loosening, and rising value indicates tightening. The historical index average is 100 points

Source: reuters.com

IV. Current Regulatory Environment

Deposit Insurance

FDIC's report on deposit insurance system and call for "targeted" coverage reform. Trends in uninsured deposits have increased the exposure of the banking system to bank runs. Technological changes may increase the risk of bank runs

A primary objective of deposit insurance is to promote financial stability

- **Limited Coverage:** maintains the current structure
- **Unlimited Coverage:** provides unlimited deposit insurance
- **Targeted Coverage:** allows for different levels of deposit insurance coverage across different types of accounts; higher coverage for business payment accounts; possibility that some account types receive unlimited coverage, while others do not

Recently, congress has discussed the possibility of private insurance of deposits

Source: fdic.gov

Dimon 9 Point Plan

1. We want to strengthen regional, midsized & community banks, which are essential to American economic system
2. We need large, complex banks to continue to play a critical role in the U.S. and global financial system
3. We should want a system in which a bank failure does not cause undue panic and financial harm
4. We want proper transparency and strong regulations
5. We should want market makers to have the ability to effectively intermediate
6. We need banks to be there for their clients in tough times
7. Regulation, particularly stress testing, should be more thoughtful and forward looking
8. We should decide *a priori* what should stay in the regulatory system and what shouldn't
9. We need banks to be attractive investments

Recent Government Intervention

Days before Government intervention

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Silicon Valley Bank

- In late 2022, SVB held $209B in assets and $191B in deposits, primarily from private banking and VC Funds
- On Mar 9th, 2023, SVB notes on an investor call that it is raising capital to satisfy liquidity
- On Mar 10th, 2023, SVB's stock dropped 70%. Over the weekend, the FDIC stepped in and took control

Signature Bank

- In late 2022, Signature held $110B in assets and $89B in deposits, primarily in the digital banking industry
- Without warning to the market, regulators seized Signature Bank on the same weekend as SVB
- Prior to the bank's closure, there had been rumor that Signature might fail (including as a result of its exposure to cryptocurrency clients and potential related regulatory risks)

Washington Mutual Bank

- On Sep 15th, 2008, WaMu's holding company received a credit rating agency downgrade, triggering a nine-day bank run where customers withdrew $16.7B in deposits
- From Jul 2008 through Sep 24th, 2008, customers withdrew a total of $22B in cash deposits
- On Sep 24th, 2008, Office of Thrift Supervision closed the bank and FDIC sells its assets to JPM for $1.9B

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Regulatory Response

Key Bank Issues:

- **Rate increases**: The Fed has engaged in an aggressive tightening campaign, raising rates from near 0% to 5%+ in 16 months (the quickest pace since the 1980s)

- **Duration mismatch**: Banks invested in longer term treasuries at ultra-low interest rates. Once rates increased, those securities portfolios declined in value (the now-well known "HTM losses")

- **Management missteps**: Large banks ($50B+ in assets) are required to have a risk committee that reports to the Board. In several instances, these committees appear to have lacked proper experience and have not provided appropriate oversight. In particular–and despite obvious risks–several banks engaged in the unhedged "invest long", "borrow short" strategy that took down SVB. HTM losses as well as other issues (often related, including in bank's commercial real estate lending portfolios), will likely continue to impact the market in the months and quarters to come

Leads to:

- **Management claw backs**: The Senate Banking Committee is exploring how it can strengthen its claw back powers. The committee is focusing on bank executives' compensation, specifically during the five years leading up to the failure

V. Q&A