

Banking, Liquidity, and the New Financial Ecosystem

Private Roundtable at the Wharton Future of Finance Forum

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Moderator:

- [Itay Goldstein](#), Joel S. Ehrenkranz Family Professor, Professor of Finance, Professor of Economics (Secondary), Chair, Finance Department at the Wharton School of the University of Pennsylvania

Speakers:

- [Arthur J. Murton](#), Deputy to the Chairman for Financial Stability at Federal Deposit Insurance Corporation
- [Sharon Yang](#), Managing Director and Head of Regulatory Affairs at JP Morgan Chase & Co., Former Deputy Assistant Secretary for International Affairs at US Treasury
- [Amias Gerety](#), Partner at QED Investors, Former Assistant Secretary for Financial Institutions at US Treasury
- [Eric Boughner](#), Chairman, BNY Mellon Pennsylvania and Senior Client Executive Global Client Management at BNY Mellon
- [Richard Vague](#), Managing Partner of Gabriel Investments, Former Secretary of Banking and Securities for Pennsylvania
- [Richard Green](#), Executive Chairman of the Board of Firsttrust Bank
- [Jelena McWilliams](#), Partner, Corporate at Cravath, Swaine & Moore LLP, and Former Chair of the Federal Deposit Insurance Corporation

Silicon Valley Bank (SVB) and Banking Crisis:

- The crisis that unfolded at Silicon Valley Bank (SVB) and eventually led to its mid-morning closure serves as a prime example of the challenges faced by financial institutions. A bank run precipitated this crisis, creating significant disruptions in the financial sector.
- To address the crisis, a mechanism was implemented to provide depositors with access to their funds. Notably, this mechanism drew a distinction between insured and uninsured depositors. Insured depositors received their deposits in full, while uninsured depositors were granted a "dividend."
- The contagion effect of the SVB crisis extended its reach to other financial institutions, with Signature Bank being a notable casualty. Signature Bank's subsequent failure added to the overall turmoil.
- A pivotal moment in this crisis was the invocation of the systemic risk exception by the Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Board. This decision effectively insured all depositors, emphasizing the systemic significance of the crisis.
- The discussion also highlighted the case of First Republic, a bank that initially received a capital infusion but ultimately failed. The resolution of this case involved purchase and assumption transactions via a least cost test.
- The issue of the "too big to fail" framework, as raised by Credit Suisse, added an additional layer of complexity to the conversation, underscoring broader concerns about the financial system's robustness.

Deposit Insurance and Regulatory Framework:

- The discussion delved deep into the intricacies of the deposit insurance regime, with a specific focus on the \$250,000 deposit limit. This limit has been a longstanding feature of the system and prompted various viewpoints regarding its purpose and efficacy.
- For instance, some maintain that deposit insurance still serves a valuable role, particularly for depositors who possess the sophistication to utilize it properly. In contrast, others contended that modern commerce often

involves positions that far exceed the \$250,000 limit, making the constraint less effective in protecting larger depositors.

- It was pointed out that the primary intent of deposit insurance was to safeguard smaller depositors, not corporations or larger entities. The discussion urged an honest understanding of the deposit insurance system's true purpose.

Banking Business Models and Risk Profiles:

- The importance of comprehending the risk profiles, business models, asset concentration, and growth profiles of banks emerged as a central theme. These factors were deemed essential in assessing the stability and viability of financial institutions.
- Banks' risk profiles and business models can significantly impact their susceptibility to crises, highlighting the need for robust risk management practices and regulatory oversight.

Challenges for Small Banks:

- The future of community banking emerged as a critical point of discussion. There were concerns regarding whether smaller banks, often labeled as "too small to succeed," can effectively compete in the evolving financial landscape.
- Smaller banks face distinct challenges in technology adoption and compliance with an increasingly complex regulatory environment. Maintaining a level playing field for smaller banks to compete fairly was highlighted as a key concern.

Regulation and Politics:

- The discussion shed light on the reactive nature of financial regulation and legislative action. Despite efforts to be proactive, the complexity and timing of financial crises often hinder regulatory responses.
- The role of politics in banking resolution processes was evident, particularly in the case of SVB, where political considerations seemingly

delayed a timely resolution of the crisis. The impact of political interference on financial stability remains a significant concern.

Value of Community Banks:

- The intrinsic value of local and community banks in the financial ecosystem was highlighted. These banks often play a crucial role in supporting local communities and businesses, emphasizing their role in promoting economic stability.

Competition and Technology:

- Smaller banks face substantial challenges in competing with larger financial institutions, particularly in technology adoption and compliance. The discussion underscored the need for a level playing field, ensuring that smaller banks have an equitable opportunity to succeed.
- Fintech partnerships were suggested as a potential means for smaller banks to remain competitive in an evolving financial landscape.

Conclusion:

- The SVB banking crisis and subsequent failures were attributed to a combination of factors, including deficiencies in risk management skills and regulatory responses that were insufficient in addressing the crisis effectively.
- The deposit insurance regime, particularly the \$250,000 limit, prompted diverse opinions regarding its purpose and efficacy. It also raised questions about whether the limit remains aligned with modern financial practices.
- The future of community banking and the challenges faced by smaller banks in an evolving financial landscape were significant concerns, with a call to create conditions that allow these banks to compete on a level playing field.

- Recognizing the unique value of local and community banks in the financial ecosystem was a recurring theme, emphasizing their role in supporting local communities and businesses.
- The evolving nature of the financial sector and the challenges it presents to smaller banks, particularly in technology adoption and compliance, underscored the importance of equitable competition and opportunities for partnerships with fintech companies.