

# Bank Supervision: More Timely Escalation of Supervisory Action Needed

GAO-24-106974

Report to Congressional Requesters

March 6, 2024

## Why This Matters

The recent failure of two large U.S. banks may cost the Deposit Insurance Fund about \$22.5 billion. State banking supervisors closed Silicon Valley Bank (SVB) and Signature Bank in March 2023 and named the Federal Deposit Insurance Corporation (FDIC) as receiver. As of March 28, 2023, FDIC estimated the cost to the Deposit Insurance Fund of resolving losses at SVB and Signature Bank to be \$20 billion and \$2.5 billion, respectively. The Deposit Insurance Fund is funded primarily by assessments levied on insured banks and savings associations. It is used to cover all deposit accounts (such as checking and savings) at insured institutions, up to the insurance limit of \$250,000 for each account category per depositor at each insured entity.

The failures have raised questions from members of Congress and the public about bank supervision. The Board of Governors of the Federal Reserve System (Federal Reserve) and FDIC served as the primary federal regulators for SVB and Signature Bank, respectively. We were asked to examine these regulators' communication and escalation of supervisory concerns in the years before the failures.

This report assesses the Federal Reserve's and FDIC's communication of supervisory concerns to SVB and Signature Bank and the sufficiency of the agencies' procedures for escalating such concerns.<sup>1</sup> This report also examines adopting noncapital triggers that require early and forceful regulatory actions tied to unsafe banking practices.

## Key Takeaways

- Federal Reserve and FDIC examination staff generally adhered to their requirements for communicating concerns to SVB and Signature Bank.
- The Federal Reserve's procedures on when to escalate supervisory concerns often were not clear or specific. The procedures often did not include measurable criteria for examiners to use when recommending informal or formal enforcement actions. This lack of specificity could have contributed to delays in taking more forceful action against SVB. Better procedures could promote more timely enforcement action to address deteriorating conditions at banks in the future.
- We recommend that the Federal Reserve revise its escalation procedures to be clearer and more specific and to include measurable criteria.
- In August 2023, FDIC updated its procedures for escalating supervisory concerns. The new procedures require FDIC examiners to consider escalating supervisory concerns that are repeated or uncorrected at the end of an examination cycle. FDIC intends to further update its procedures to expect examiners to require, instead of consider, escalation in these situations.

- We also recommend that Congress consider requiring the adoption of noncapital triggers that require early and forceful regulatory actions tied to unsafe banking practices before they impair capital—such as by amending the Federal Deposit Insurance Act to require corrective actions based on indicators other than capital adequacy (such as interest rate risk, asset concentration, and poor management).

## How do regulators supervise banks?

Regulators supervise banks through on-site examinations and off-site monitoring. To oversee large, complex banks and bank holding companies, bank examiners conduct ongoing examination activities that target specific functional areas or business lines. Regulators discuss such activities with bank management throughout the year and incorporate findings into examination reports issued at the end of each supervisory cycle. Between on-site examinations, regulators also use off-site systems to monitor the financial condition of individual banks and the banking system as a whole.<sup>2</sup> These actions are designed to help ensure that banks operate in a safe and sound manner and comply with federal laws and regulations for the provision of banking services.

Regulators assess the strength of banks using the Uniform Financial Institutions Rating System, also known as CAMELS. Bank examiners rate an institution on each CAMELS component (capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk). They then give a composite rating (which closely relates to the component ratings but is not an average of them). Both types of ratings are scored from 1 (best) to 5 (worst) and can be downgraded. As ratings worsen, corresponding supervisory actions generally increase in severity.

Regulators use progressive enforcement regimes to address supervisory concerns (see table 1 for FDIC and Federal Reserve examples). Regulators issue supervisory recommendations and matters requiring attention for concerns that can be resolved in the normal course of business. If the bank does not respond in a timely manner or if the concern is serious and requires an immediate response, regulators may take informal or formal enforcement action, depending on the severity of the circumstances. Informal enforcement actions include obtaining a bank’s commitment to implement corrective measures under a memorandum of understanding. Formal enforcement actions include written agreements and issuance of a cease-and-desist order or assessment of a monetary penalty.

**Table 1: Types of Supervisory Concerns Issued by FDIC and the Federal Reserve**

Supervisory concern level	Federal Deposit Insurance Corporation (FDIC)	Board of Governors of the Federal Reserve System
Concern resolved in normal course of business	Supervisory recommendation	Matter requiring attention
Serious concern that demands immediate board attention	Supervisory recommendation, listed as matter requiring board attention	Matter requiring immediate attention
Lack of adequate institution response to serious concern that demands immediate response or certain legal standard(s) triggered	Informal or formal enforcement action	Informal or formal enforcement action

Source: GAO. | GAO-24-106974

In addition, section 38 of the Federal Deposit Insurance Act, also known as the prompt corrective action framework, requires regulators to take increasingly severe actions as a bank's capital deteriorates. It is meant to enhance regulators' ability to identify and promptly address deficiencies at depository institutions and minimize losses to the Deposit Insurance Fund. Specifically, prompt corrective action restricts or prohibits certain activities for insured depository institutions. It also establishes a framework of supervisory actions for undercapitalized depository institutions.<sup>3</sup>

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## What were the characteristics of SVB and Signature Bank?

### Characteristics of Silicon Valley Bank

SVB (headquartered in Santa Clara, California) was a state-chartered bank and a member of the Federal Reserve System. It was the main bank subsidiary of SVB Financial Group (a holding company). The California Department of Financial Protection and Innovation served as SVB's state regulator. The Federal Reserve was the primary federal regulator for the bank and SVB Financial Group.

SVB primarily served entrepreneur clients in technology, health care, and private equity. The bank's deposits were mostly linked to businesses financed through venture capital. As the bank grew, it added products and services to maintain clients as they matured from their start-up phase. SVB reported assets of about \$209 billion and total deposits of about \$175 billion at year-end 2022.<sup>4</sup>

On March 10, 2023, the California regulator closed SVB (citing inadequate liquidity and insolvency) and appointed FDIC as receiver.

### Characteristics of Signature Bank

Signature Bank was a state-chartered commercial bank headquartered in New York City. The New York State Department of Financial Services was its state regulator and FDIC was its primary federal regulator.

The bank offered commercial deposit and loan products. Until 2018, it focused primarily on multifamily and other commercial real estate banking products and services. In 2018 and 2019, the bank launched services to the private equity industry, such as lending to venture capital companies. Signature Bank also conducted significant business with the digital assets industry. The bank reported total assets of about \$110 billion and total deposits of about \$89 billion at year-end 2022.

On March 12, 2023, the New York State regulator closed Signature Bank and appointed FDIC as receiver.

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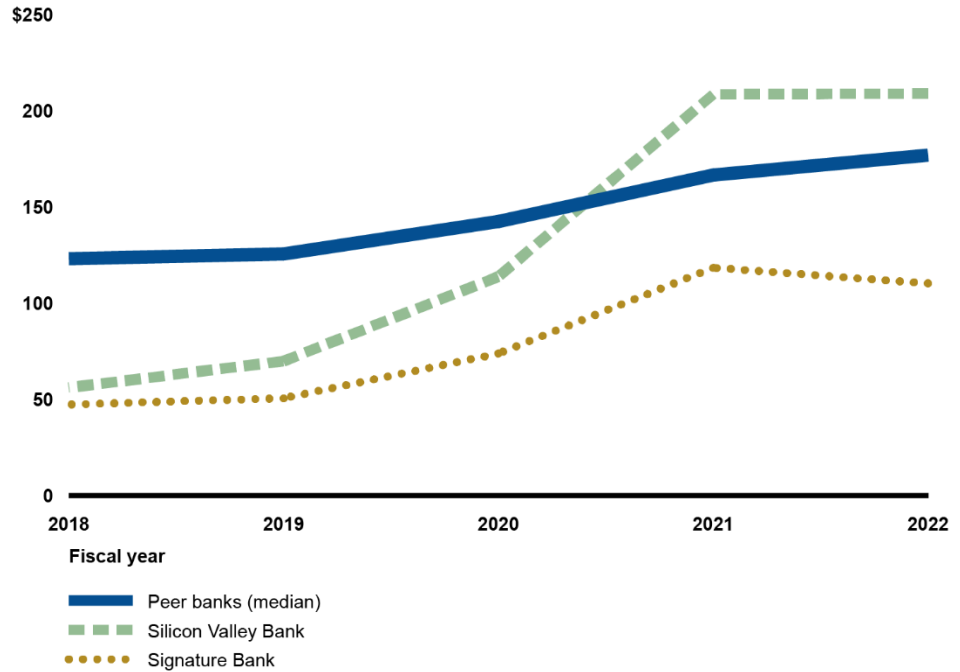
## What were the key contributors to the failures of SVB and Signature Bank?

SVB and Signature Bank used risky business strategies, which included rapid growth and less stable funding, and had outstanding liquidity and risk-management deficiencies that contributed to their failures.<sup>5</sup>

In 2019–2021, the total assets of SVB and Signature Bank grew by 198 percent and 134 percent, respectively (see fig. 1). This far exceeded the growth for a group of 19 peer banks (33 percent growth in median total assets). Rapid growth increases the risk that a bank's risk-management practices will not maintain pace with its growth.

**Figure 1: Total Assets of Silicon Valley Bank and Signature Bank and Median Total Assets for Peers, 2018–2022**

Dollars in billions



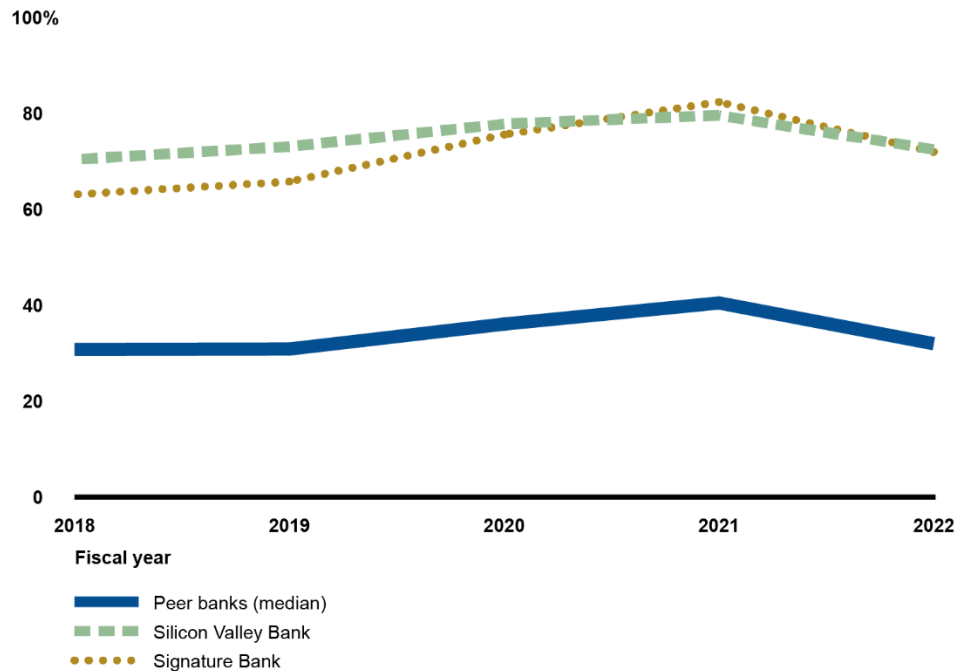
Source: GAO analysis of S&P Capital IQ Pro data. | GAO-24-106974

Note: Our analysis compared Silicon Valley Bank and Signature Bank to a group of 19 banking institutions with reported deposit balances that each had total assets of \$100 billion–\$250 billion at year-end 2022.

Both banks had high percentages of uninsured deposits, which can be an unstable source of funding (see fig. 2). Customers with uninsured deposits may be more likely to withdraw their funds during times of stress. Both banks failed to adequately manage their balance sheet risks, including from uninsured deposits.

**Figure 2: Ratio of Uninsured Deposits to Total Assets for Silicon Valley Bank, Signature Bank, and Peer Banks, 2018–2022**

Percentage



Source: GAO analysis of S&P Capital IQ Pro data. | GAO-24-106974

Note: Our analysis compared Silicon Valley Bank and Signature Bank to a group of 19 banking institutions with reported deposit balances that each had total assets of \$100 billion–\$250 billion at year-end 2022.

SVB also was affected by rising interest rates. SVB had invested in longer-term securities to generate yield against its deposits. As interest rates rose, SVB's interest rate risk increased, and the bank accumulated unrealized losses on its lower-yielding securities.

According to FDIC, Signature Bank had exposure to the digital assets industry, which contributed to its failure. For example, an FDIC report stated that as interest rates rose and volatility increased in the digital assets market in 2022, the bank experienced significant outflows of digital asset-related deposits.<sup>6</sup>

In the 5 years before 2023, regulators identified liquidity and risk-management deficiencies at SVB and Signature Bank. However, both banks were slow to mitigate problems regulators identified and regulators did not escalate supervisory actions in a timely fashion, which could have helped to prevent the failures.

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### **What are Federal Reserve and FDIC policies for communicating concerns to banks?**

Federal Reserve and FDIC policies require examination staff to communicate supervisory concerns to institutions in writing. These written communications are to include the significance and purpose of a concern, cause of and potential effect of the concern, and required corrective actions.

Other required elements of the communications vary by type of supervisory recommendation. For example, the Federal Reserve's Commercial Bank Examination Manual states that for all concerns, staff must communicate information in clear writing using standardized language. For matters requiring attention, staff also must include time frames for resolving the concern. For matters requiring immediate attention, examination staff must signal that the expected time frame for addressing a deficiency is short or immediate.

For FDIC, the Report of Examination Instructions states that staff must describe the concern and required action for all supervisory recommendations. Also, examiners must explain the basis for any supervisory concerns and document management's commitment to correcting the concern.

For matters requiring board attention, staff must describe what changes are needed to a bank's practices, operations, or financial condition (to help directors prioritize actions to correct deficiencies or keep the bank viable). Staff also must include a reminder that follow-up will occur before the next examination.

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### **To what extent did examiners follow agency communication policies for SVB and Signature Bank?**

Federal Reserve and FDIC examination staff generally adhered to their respective requirements for communicating supervisory concerns to SVB and Signature Bank.

#### **Communication to Silicon Valley Bank**

The Federal Reserve consistently adhered to its communication policies, based on our review of 16 supervisory concerns to SVB from January 2018 through March 2023. Federal Reserve examiners clearly communicated the corrective actions needed to address deficiencies in the 16 concerns. They communicated the cause of deficient practices in all 16 concerns and the potential effect of the identified deficiencies in 14. The two concerns that did not communicate a potential effect were issued before the Federal Reserve's April 2020 update to its supervisory communication policies to include potential effect.

#### **Communication to Signature Bank**

FDIC generally adhered to its communication policies, based on our review of 69 supervisory concerns to Signature Bank from January 2018 through March 2023.

Examiners clearly communicated deficient practices, operations, or financial conditions observed at Signature Bank in all 69 supervisory concerns. They communicated the cause of deficient practices in 59 of 69 concerns and the potential effect in 68.

On August 29, 2023, FDIC issued a memorandum to its regional directors that included a reminder to staff to always include a description of the root cause when communicating concerns to regulated institutions. The memorandum emphasized the importance of addressing root cause so that corrective actions would mitigate the underlying cause(s) of an issue effectively.

We plan to further assess the federal banking regulators' communication of supervisory concerns in a forthcoming review.

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## **What procedures and statutory authority do the Federal Reserve and FDIC have for escalating supervisory concerns?**

Both agencies established internal procedures for when to escalate concerns to enforcement actions. Provisions in the Federal Deposit Insurance Act also help regulators determine when to escalate supervisory concerns. In addition, the Dodd Frank Act directed the Federal Reserve to establish early remediation standards for large bank holding companies, but these standards have not been finalized.

### **Federal Reserve Escalation Procedures**

According to the Federal Reserve's Commercial Bank Examination Manual, formal or informal enforcement actions typically are taken against a bank with a composite CAMELS rating of 3 or worse. Informal enforcement actions generally are used for a bank with a composite CAMELS rating of 3. Formal enforcement actions generally are used for a bank with a composite rating of 4 or 5.

Federal Reserve guidance also includes 10 factors that examiners are to consider in determining whether to escalate a concern. These include the bank's supervisory rating and financial condition, number of open supervisory concerns, the materiality of the open concerns to the bank's safety and soundness, and the bank's history of instituting timely corrective actions. See appendix I for a list of all 10 factors. Federal Reserve officials stated that they use similar criteria to determine whether enforcement actions should be informal or formal.

### **FDIC Escalation Procedures**

FDIC also uses composite CAMELS ratings to decide whether to escalate a supervisory concern to an enforcement action. FDIC's Formal and Informal Enforcement Actions Manual states that formal or informal enforcement actions are taken against a bank with a composite CAMELS rating of 3 or worse.

The enforcement action manual further states that FDIC may pursue enforcement actions regardless of the composite CAMELS rating if the "specific facts and circumstances make such an action appropriate," and lists 11 factors that "are designed to assist examination staff in determining whether to seek informal or formal action." These factors include whether the bank's violations or unsafe or unsound practices were willful or intentional, reckless, repetitive, substantive, or numerous; and the bank's commitment to complying with laws or regulations and correcting unsafe or unsound practices. See appendix I for a list of all 11 factors. However, FDIC officials told us that these factors are only used to determine whether an enforcement action should be formal or informal, and not whether a concern should be escalated.

In addition to using composite CAMELS ratings to decide whether to escalate a supervisory concern, on August 29, 2023, FDIC issued a memorandum that advised examiners to consider elevating a matter requiring board attention to an enforcement action if the matter was repeated or uncorrected at the end of an

examination cycle. If an examiner identified such a case and believed it did not warrant escalation, the examiner would have to provide written justification to their regional office management. The guidance does not specify how long examiners have to submit their written justification. Management would then determine whether to agree or disagree with the examiner's recommendation to not escalate the repeated or uncorrected concern.<sup>7</sup>

### Prompt Corrective Action and Noncapital Supervisory Actions

Regulators also may escalate supervisory concerns based on two provisions of the Federal Deposit Insurance Act, particularly if a bank's financial condition poses a significant risk to the Deposit Insurance Fund.

- **Prompt corrective action.** Section 38 of the act requires regulators to classify banks into one of five capital categories and take increasingly severe actions, known as prompt corrective action, as a bank's capital deteriorates. The appropriate regulators can direct a bank to take corrective action when they are undercapitalized, significantly undercapitalized, or critically undercapitalized.

Section 38 primarily focuses on capital as an indicator of bank health; therefore, supervisory actions under it are designed to address a bank's deteriorating capital level. Regulators typically issue a prompt corrective action letter advising a bank on specific actions to take to restore its financial health. For example, they can require a bank to improve management by dismissing directors. When a bank becomes critically undercapitalized as defined by prompt corrective action regulations, its chartering agency can close the bank.<sup>8</sup> By law, FDIC can be appointed receiver.

- **Noncapital actions.** Section 39 of the act directs regulatory attention to a bank's operations and activities in multiple areas aside from capital that also can affect safety and soundness. These areas include operations and management; compensation; and asset quality, earnings, and stock valuation.

If a regulator determines a bank failed to meet certain standards described in section 39, the regulator may require the institution to file a safety and soundness plan specifying how it will correct the deficiency. If the institution fails to submit an acceptable plan or fails to materially implement or adhere to an approved plan, the regulator must order the institution to correct identified deficiencies. It also may take other enforcement actions pending correction of the deficiency.

### Dodd Frank Act and Early Remediation Standards

The Dodd Frank Act directs the Federal Reserve to establish early remediation standards that would require authorities to intervene quickly, rather than waiting until a bank was about to fail.<sup>9</sup> Specifically, Section 166 requires the Federal Reserve to establish an early intervention framework based on a broad range of forward-looking financial metrics in addition to a bank's capital levels. Examples of such metrics could include noncapital triggers based on liquidity metrics, risk-management weaknesses, and other market indicators. Although the Federal Reserve proposed a rule to implement early remediation standards for large bank holding companies in 2012, it never finalized the rule.

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**To what extent would the Federal Reserve’s escalation procedures trigger prompt action for addressing deficiencies, such as those at SVB?**

The Federal Reserve’s escalation procedures often are not clear and specific, and often do not include measurable criteria that act as a trigger to prompt action for addressing deficiencies. This could have contributed to delays in taking more forceful action against SVB.

For example, Federal Reserve procedures state the agency is to consider the volume of open matters requiring attention and matters requiring immediate attention and the materiality of the issues to the safety and soundness of the bank. But the procedures do not specify how many supervisory concerns would warrant escalation or what issues are to be considered material.

Although Federal Reserve officials told us that SVB had three times more supervisory concerns than an average bank in the Large and Foreign Bank Organizations program and that they initiated an informal enforcement action in July 2022, Federal Reserve examiners did not finalize the enforcement action before SVB failed in March 2023.<sup>10</sup>

Of the 17 open concerns as of year-end 2019, three related to liquidity and risk-management issues—factors that ultimately contributed to the bank’s failure, which indicate they were material to the bank’s safety and soundness.<sup>11</sup>

Federal Reserve officials stated that their escalation procedures were designed to allow for supervisory discretion. Specifically, they stated that the current principles-based approach enables examiners to tailor their activities to the specific circumstances of each bank. They said that establishing more specific criteria could limit examiners’ discretion and leave little room for interpretation when facing emerging risks.

However, a report by the Bank for International Settlements stated that a rules-based approach is important for setting minimum standards. It said that, although rules-based supervision can overlook unique risks associated with novel or outlier business models and technological developments, such an approach would help ensure a core level of compliance and predictability in terms of supervisory actions and consequences. The report also noted that supervisory discretion can complement a rules-based approach to address issues even when specific rules have not been breached. This allows for supervision to adapt to changes in a bank’s business model and risks.<sup>12</sup>

Although SVB examiners we interviewed generally said that their agency’s escalation procedures were clear and easy to apply, they did not escalate concerns in a timely manner. A few examiners told us that additional detail in the procedures would be helpful. For example, one examiner said it would be useful for the procedures to specify when to consider escalation if the bank only addressed part of a concern.

Federal standards for internal control maintain that management should implement control activities through policies that are designed to achieve objectives and address related risks. Furthermore, policies are to have the appropriate level of detail to allow management to effectively monitor the control activity. Controls are not properly designed when the objective would not be achieved even when they operated as intended.<sup>13</sup> Without clear and specific procedures that include measurable criteria on when to escalate deficiencies to informal or formal enforcement actions, the Federal Reserve may delay taking stronger actions to compel a bank to correct deficiencies before they materially affect its financial condition.



**To what extent would FDIC’s escalation procedures trigger prompt action for addressing deficiencies, such as those at Signature Bank?**

FDIC’s updated escalation procedures provide a trigger for when examiners should consider escalating concerns to enforcement actions. Such a trigger could have resulted in earlier consideration of escalation in the case of Signature Bank, but it is unclear whether the concerns would have been escalated.

As previously noted, FDIC examiners base escalation decisions on composite CAMELS ratings and, beginning in August 2023, on the amount of time a concern has been open. Specifically, FDIC examiners must consider escalation if a concern has been open for more than one examination cycle.

In the case of Signature Bank, FDIC first made several liquidity supervisory recommendations (related to liquidity stress tests and a contingency funding plan) to Signature Bank in 2018 that remained open until the bank failed in 2023. If the new guidance had been in place, it would have required examiners to consider escalation as early as 2019. FDIC only issued an enforcement action the day before Signature Bank’s failure in 2023.

However, the new guidance does not require escalation. As a result, the guidance does not ensure that examiners will escalate supervisory concerns to senior management on a timely basis. FDIC officials told us that they will be updating their process so that examiners will be expected to require escalation (not just consider escalation) when a concern has been open for more than one examination cycle. We plan to further examine agency escalation practices and other related topics in an upcoming GAO review.

**What noncapital concerns did regulators communicate to SVB and Signature Bank before the March 2023 failures?**

In the years before 2023, the Federal Reserve and FDIC identified numerous liquidity and risk-management concerns that could have triggered more urgent action if noncapital triggers had been included in the prompt corrective action framework. These noncapital issues were key contributors to the failures.

**Silicon Valley Bank.** Examiners issued supervisory findings on SVB as early as 2018 that indicated concerns with liquidity and risk-management practices, according to our review of supervisory documents (see table 2).

**Table 2: Federal Reserve Supervisory Findings Issued to Silicon Valley Bank, 2018–2023**

Supervisory action	2018	2019	2020	2021	2022	2023
Matters requiring immediate attention (MRIA)	0	0	2	5	6	1
MRIsAs related to liquidity or risk management	0	0	0	2	3	0
Matters requiring attention (MRA)	10	14	7	14	9	0
MRAs related to liquidity or risk management	2	3	0	4	1	0

Source: GAO presentation of Federal Reserve Bank of San Francisco information. | GAO-24-106736

In 2020, examiners found that the stress test modeling reviewed during the examination cycle showed the bank had ample liquidity over stressed periods. But the tests did not provide insight into liquidity risks for stressed periods of 30 days or less.

In 2021, examiners found that SVB’s liquidity risk-management practices were “below supervisory expectations” and that it had “foundational shortcomings” in its internal liquidity stress testing, liquidity limits framework, and contingency funding planning. For example, SVB’s internal liquidity stress test did not reflect forward-looking assessments of the bank’s risks and relied on key assumptions based on incomparable peer benchmarks. And according to the Federal Reserve’s *Review of the Federal Reserve’s Supervision and Regulation of*

*Silicon Valley Bank*, SVB failed its own internal liquidity stress tests and did not have workable plans to access liquidity in times of stress.<sup>14</sup>

**Signature Bank.** FDIC took numerous supervisory actions intended to mitigate liquidity and management deficiencies. For example, FDIC downgraded the bank’s liquidity component rating from 2 to 3 during the 2019 examination cycle. In its examination documents, FDIC explained that the bank’s practices did not correspond with its complexity, risk profile, and scope of operations due to weaknesses in areas including liquidity contingency planning and internal controls. These weaknesses prevented the bank from appropriately understanding the potential effects of adverse liquidity events and emergency cash flow needs.

FDIC also issued a number of matters requiring board attention and supervisory recommendations related to management, liquidity, and corporate governance risks in the years before the bank’s failure (see table 3). For example, FDIC issued three matters requiring board attention related to noncapital concerns beginning in 2018. In 2019, it issued 18 supervisory recommendations on liquidity and 12 on sensitivity to market risks. These actions often carried over to later years because they remained unresolved.

**Table 3: FDIC Supervisory Actions Related to Liquidity and Risk Management Issued to Signature Bank, 2018–2022**

Supervisory action	2018	2019	2020	2021	2022
Matters requiring board attention related to liquidity or risk management	2	1	0	0	N/A
Liquidity supervisory recommendations	4	18	0	0	N/A
Model risk management supervisory recommendations	3	0	0	12	N/A
Sensitivity to market risks supervisory recommendations	2	12	0	0	N/A
Corporate governance or enterprise risk management supervisory recommendations	5	0	0	0	4

N/A = not available

Source: GAO analysis of information from the Federal Deposit Insurance Corporation (FDIC). | GAO-24-106736

Note: The last year in which FDIC conducted examinations before the bank’s failure (in March 2023) was 2022. FDIC did not finalize some of its 2022 examinations before the bank failed, so some concerns were not available for our review.

**Would adopting noncapital triggers help regulators take more timely supervisory actions?**

Yes. Adopting noncapital triggers would help regulators take more timely and forceful supervisory actions to address unsafe banking practices before they impaired capital and would limit losses to the Deposit Insurance Fund. The liquidity and risk-management issues that were key contributors to SVB’s and Signature Bank’s failures are examples of noncapital issues.

**Prompt Corrective Action Framework**

Since the 1990s, we and others have reported that the effectiveness of the prompt corrective action framework is limited because it relies on capital measures, which can lag other indicators of bank health.<sup>15</sup> The framework repeatedly has demonstrated weaknesses for addressing deteriorating financial conditions in banks and has not achieved a principal goal of preventing widespread losses to the Deposit Insurance Fund.

For example, although SVB and Signature Bank had strong capital measures in 2022, they failed in 2023. SVB’s financial holding company (SVB Financial Group) had a common equity tier 1 capital ratio of 12 percent as of year-end 2022.<sup>16</sup> This was higher than the average for similarly sized banks. Similarly,

Signature Bank's ratio was 10 percent as of year-end 2022, which exceeded regulatory requirements. The FDIC Office of Inspector General's Material Loss Review of Signature Bank also found the bank was well capitalized before its failure (based on defined capital measures in the prompt corrective action framework). Despite having strong capital positions, the estimated costs to the Deposit Insurance Fund for resolving the two banks was \$22.5 billion.

### **Section 39 Noncapital Standards**

Section 39 contains noncapital standards that may be useful to consider when developing noncapital triggers, but it also has weaknesses as an escalation tool. The standards focus on certain noncapital elements of bank operations and activities, including management of interest rate risk and asset growth, that may affect safety and soundness when deficient. But changes to the Federal Deposit Insurance Act in 1994 gave regulators considerable flexibility over how and when to use their authority under the section to address safety and soundness deficiencies at banks.<sup>17</sup>

Federal Reserve officials told us they had not used section 39 as an escalation tool. They said it was less effective to pursue enforcement under this section because it excludes depository institution holding companies due to 1994 legislative changes. FDIC officials told us they used section 39 as an escalation tool only three times since January 2018.

We recommended in 2011 that the federal banking regulators (1) consider additional triggers that would require early and forceful regulatory actions tied to specific unsafe banking practices, and (2) make recommendations to Congress on how prompt corrective action should be modified.<sup>18</sup>

In response, the regulators established a working group to review enforcement practices and tools. However, they decided not to recommend that Congress amend the Federal Deposit Insurance Act to include noncapital triggers in the prompt corrective action framework. Although the Federal Reserve participated in the working group, officials told us they had not carefully considered the advantages and disadvantages of adding noncapital triggers to the framework. FDIC officials noted that adding noncapital triggers would help banks avoid the mistakes that contributed to recent bank failures, and implementation costs would be low. But they also noted that the noncapital factors relevant for past banking crises might not be relevant for future crises. In addition, they said that explicit triggers for certain noncapital factors could be publicly perceived as supervisory restrictions on lending, among other concerns.

Congress created the prompt corrective action framework to address deteriorating conditions at banks and limit losses to the Deposit Insurance Fund. However, the effectiveness of the framework is limited because it relies on capital measures, which can lag other indicators of bank health. Adopting noncapital triggers that require early and forceful regulatory actions tied to unsafe banking practices before they impaired capital—such as by amending the Federal Deposit Insurance Act to incorporate noncapital triggers—would encourage earlier and more consistent action that could give banks more time to address deteriorating conditions before capital was depleted.

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## **Conclusions**

Federal Reserve officials did not finalize enforcement actions prior to SVB's failure and FDIC officials only issued an enforcement action the day before Signature Bank's failure, despite observing repeated and longstanding management and liquidity concerns at the banks. Tying corrective actions to noncapital triggers could establish a minimum standard for compliance and help

ensure timely supervisory action. In turn, this could allow banks more time to address deteriorating conditions and ultimately minimize losses to the Deposit Insurance Fund.

Moreover, the Federal Reserve's procedures for its examiners do not include specific criteria or expressly call for earlier escalation. Establishing clear, specific procedures with measurable criteria could help clarify when escalation to informal or formal enforcement action would be required and help ensure that regulators take earlier and more forceful actions to compel bank management to correct deficiencies. FDIC updated its procedures and now requires examiners to consider escalating supervisory concerns under certain conditions, which we will review in future work.

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### **Matter for Congressional Consideration**

Congress should consider requiring the adoption of noncapital triggers that require early and forceful regulatory actions tied to unsafe banking practices before they impair capital, such as by amending the Federal Deposit Insurance Act to incorporate noncapital triggers into the prompt corrective action framework. (Matter for Consideration 1)

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### **Recommendation for Executive Action**

The Chair of the Federal Reserve Board of Governors should ensure that the Director of the Division of Supervision and Regulation revise its procedures on when to escalate supervisory concerns to informal or formal enforcement actions to be clearer and more specific and to include measurable criteria. (Recommendation 1)

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### **Agency Comments**

In its comments, reproduced in appendix II, the Federal Reserve agreed with recommendation 1, stating that it recognizes that clarifying its examination procedures may promote addressing supervisory concerns in a timely manner. The Federal Reserve and FDIC also provided technical comments, which we incorporated as appropriate.

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### **How GAO Did This Study**

We reviewed Federal Reserve and FDIC internal policies and procedures related to supervisory communication and escalation, including the Federal Reserve's Commercial Bank Examination Manual and FDIC's Formal and Informal Enforcement Actions Manual. We also requested and received Federal Reserve and FDIC supervisory documentation for SVB and Signature Bank from January 2018 through March 2023. This documentation included examination schedules, scope memorandums, supervisory letters, reports of examination, and management responses. We assessed these examination records to determine the extent to which supervisory documentation adhered to supervisory communication policies. We also reviewed how the regulators implemented procedures for escalating supervisory concerns at the two banks prior to failure.

We compared Federal Reserve and FDIC escalation procedures against federal standards for internal control. We determined that the control activities component was significant for this review. We assessed the escalation procedures to see if the design allowed the regulators to achieve objectives. We also used prior GAO reports that included information on factors that contributed to the March 2023 bank failures and the prompt corrective action framework.<sup>19</sup> We determined that the financial information used in our report on the March 2023 failures of Silicon Valley Bank and Signature Bank was sufficiently reliable for assessing these banks' financial condition.

We also reviewed reports issued by the regulators describing the bank failures, and publications by other groups, such as the Bank for International Settlements.

We reviewed relevant legislation, such as the Riegle Community Development and Regulatory Improvement Act of 1994, to understand regulators' requirements. In addition, we interviewed staff from the Federal Reserve, Federal Reserve Bank of San Francisco, and FDIC. This included staff responsible for conducting examinations of SVB and Signature Bank.

We conducted this performance audit from July 2023 to March 2024 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## List of Addressees

The Honorable Sherrod Brown  
Chairman  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Catherine Cortez Masto  
United States Senate

The Honorable John Fetterman  
United States Senate

The Honorable Robert Menendez  
United States Senate

The Honorable Jack Reed  
United States Senate

The Honorable Kyrsten Sinema  
United States Senate

The Honorable Tina Smith  
United States Senate

The Honorable Jon Tester  
United States Senate

The Honorable Chris Van Hollen  
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The Honorable Mark R. Warner  
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The Honorable Raphael Warnock  
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## Appendix I: Federal Reserve and FDIC Escalation Factors

**Table 4: Factors the Federal Reserve Considers for Escalating Enforcement Actions**

**Examiners should consider the following key factors in determining whether to recommend additional formal or informal investigation or enforcement action:**

1. Volume of open matters requiring immediate attention and matters requiring attention and the materiality of the issues therein to the safety and soundness of the banking organization
2. Organization's supervisory ratings and financial condition
3. Whether the issues involve unsafe or unsound practices, violations of laws, noncompliance with regulations, insider abuse, fraud, or other material deficiencies
4. Severity or repetitive or intentional nature of the issues
5. Management's willingness and ability to correct the issues
6. Management's history of instituting timely remedial or corrective actions
7. Whether management already initiated corrective action or established procedures to prevent future deficiencies
8. Whether criminal or other regulatory authorities are taking a formal enforcement or prosecutorial action against the same institution
9. Organization's history of violations of laws; noncompliance with regulations; and unsafe and unsound, or unsatisfactory practices
10. Any other circumstances that warrant use of an enforcement action

Source: GAO analysis of documentation from the Board of Governors of the Federal Reserve System (Federal Reserve). | GAO-24-106974

**Table 5: Factors FDIC Considers for Determining Whether to Seek Formal Versus Informal Enforcement Actions**

**The following criteria are designed to assist examination staff in determining whether to seek informal or formal action. This list is not all-inclusive.**

1. The bank's condition as reflected by its supervisory composite and component ratings
2. Bank management's commitment toward complying with laws and regulations or correcting unsafe or unsound practices
3. The degree of concern regarding the institution's financial condition and the amount of time it may take to restore areas of concern to a satisfactory condition or level
4. The ability of management and the board of directors to address the underlying causes for the institution's weakened financial condition
5. Whether violations or unsafe or unsound practices were willful or intentional, reckless, repetitive, substantive, or numerous
6. The institution's history of violations or unsatisfactory practices, as well as its history of instituting remedial or corrective action in a timely manner once violations or undesirable practices have been identified
7. Whether deficiencies resulted from changes in management or key personnel

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8. Whether the institution has already initiated corrective action and established procedures to prevent future deficiencies or violations

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9. The extent of financial or other harm caused, or was likely to be caused, by the violations or unsafe or unsound practices

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10. Whether deficiencies in the anti-money laundering/countering the financing of terrorism program are serious or systemic in nature, or apparent violations result from management's failure to develop and administer an effective program

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11. Any other circumstances that, in staff's judgment, may weigh in favor of a formal or informal action

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Source: GAO analysis of documentation from the Federal Deposit Insurance Corporation (FDIC). | GAO-24-106974

## Appendix II: Comments from the Federal Reserve



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20551

DIVISION OF  
SUPERVISION AND REGULATION

February 14, 2024

Michael E. Clements  
Director  
Financial Markets and Community Investment Team  
United States Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Clements:

Thank you for providing the Board of Governors of the Federal Reserve System ("Federal Reserve" or "Board") with an opportunity to review the final draft of the Government Accountability Office ("GAO") report *Bank Supervision: More Timely Escalation of Supervisory Action Needed* (GAO-24-106974). Among other things, the report discusses the GAO's review of the Federal Reserve's communication of supervisory concerns to Silicon Valley Bank ("SVB") and the sufficiency of the Board's guidance to examiners for escalating such concerns. We appreciate the GAO's recognition that the Federal Reserve consistently met its established policies for communicating supervisory concerns to SVB in the years leading up to the bank's failure and clearly communicated to SVB the corrective actions needed to address the identified deficiencies.

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[www.federalreserve.gov](http://www.federalreserve.gov)

The GAO's report makes one recommendation to the Board:

The Chair of the Federal Reserve Board of Governors should ensure that the Director of the Division of Supervision and Regulation revise its procedures on when to escalate supervisory concerns to informal or formal enforcement actions to be clearer and more specific and to include measurable criteria.

The Board recognizes that clarifying its examination procedures may promote addressing supervisory concerns in a timely manner. The Board is presently evaluating its procedures for escalating supervisory concerns and issuing enforcement actions to help ensure that supervisory concerns requiring a more detailed resolution are promptly communicated to bank management. Based on that evaluation, we will revise our guidance, as necessary, to ensure it outlines the Federal Reserve's expectations for use and escalation of enforcement actions and incorporates measurable criteria where appropriate.

We appreciate the GAO's review of the Federal Reserve's communication and escalation of supervisory concerns with respect to SVB and for the opportunity to comment on this report.

Sincerely,



Michael S. Gibson

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## Endnotes

<sup>1</sup>This report is the first of two reports examining the communication and escalation of supervisory concerns. It also follows an April 2023 report on the March 2023 bank failures: GAO, *Bank Regulation: Preliminary Review of Agency Actions Related to March 2023 Bank Failures*, [GAO-23-106736](#) (Washington, D.C.: Apr. 28, 2023).

<sup>2</sup>Regulators generally must conduct a full-scope, on-site safety and soundness examination of each bank they supervise at least once during each 12-month period (or an 18-month period for certain smaller, well-managed banks under certain conditions).

<sup>3</sup>Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (codified, as amended, in scattered sections of 12 and 15 U.S.C.).



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<sup>4</sup>Throughout this report, we rounded dollars to the nearest billion and percentages to the nearest percentage point.

<sup>5</sup>[GAO-23-106736](#).

<sup>6</sup>Federal Deposit Insurance Corporation, *FDIC's Supervision of Signature Bank* (Washington, D.C.: Apr. 28, 2023).

<sup>7</sup>Federal Deposit Insurance Corporation, *Supervisory Recommendations (Including Matters Requiring Board Attention) and Progressive Supervisory Response*, 2023-015-RMS (Washington, D.C.: Aug. 29, 2023). The memorandum also advises examiners to elevate concerns to at least a matter requiring board attention if supervisory recommendations are repeated or remain uncorrected at the next examination cycle.

<sup>8</sup>Bank closure is not the only option available for critically undercapitalized institutions. Upon obtaining concurrence from FDIC and creating supporting documentation, the appropriate federal banking agency could determine that another action would better achieve the purpose of the prompt corrective action statutory requirements. Such a determination needs regular renewals, or the institution will go into receivership. 12 U.S.C. § 1831o(h)(3).

<sup>9</sup>Dodd-Frank Wall Street Reform and Consumer Protection Act, § 166, 124 Stat. 1376, 1432 (2010) (codified at 12 U.S.C. § 5366).

<sup>10</sup>Federal Reserve officials told us that although they downgraded the bank's ratings in August 2022, the downgrades did not precipitate further supervisory action before SVB's failure.

<sup>11</sup>Six of 20 active supervisory concerns in 2021 (four matters requiring attention and two matters requiring immediate attention) and five of 30 active supervisory concerns in 2022 (one matter requiring attention and four matters requiring immediate attention) also related to risks that ultimately contributed to the bank's failure.

<sup>12</sup>Bank for International Settlements, Basel Committee on Banking Supervision, *Report on the 2023 Banking Turmoil* (Basel, Switzerland: October 2023).

<sup>13</sup>GAO, *Standards for Internal Control in the Federal Government*, [GAO-14-704G](#) (Washington, D.C.: Sept. 10, 2014).

<sup>14</sup>Board of Governors of the Federal Reserve System, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* (Washington, D.C.: Apr. 28, 2023).

<sup>15</sup>GAO, *Bank Regulation: Lessons Learned and a Framework for Monitoring Emerging Risks and Regulatory Response*, [GAO-15-365](#) (Washington, D.C.: June 25, 2015); and *Bank Supervision: Prompt and Forceful Regulatory Actions Needed*, GAO/GGD-91-69 (Washington, D.C.: Apr. 15, 1991).

<sup>16</sup>Common equity tier 1 capital is the most loss-absorbing form of capital. It includes qualifying common stock and retained earnings.

<sup>17</sup>Pub. L. No. 103-325, § 318, 108 Stat. 2160, 2223-2224 (1994) (providing for the standards to be issued either by regulation [as originally specified in Federal Deposit Insurance Corporation Improvement Act] or by guideline and eliminating the requirement to establish quantitative standards for asset quality and earnings).

<sup>18</sup>GAO, *Bank Regulation: Modified Prompt Corrective Action Framework Would Improve Effectiveness*, [GAO-11-612](#) (Washington, D.C.: June 23, 2011). We directed our 2011 recommendations to FDIC, the Federal Reserve, and the Office of the Comptroller of the Currency.

<sup>19</sup>[GAO-23-106736](#), [GAO-11-612](#).