Recent Bank Failure & FDIC Call for Review of the Deposit Insurance System

As we shared with you immediately following the failures of the Silicon Valley Bank, Signature Bank, and Silvergate Banks several weeks ago, GoWest is actively engaging with elected officials and regulators, and collaborating with CUNA and the league system, to proactively prepare and drive strategy for policy discussions around deposit insurance reform and potential shifts in financial services regulation.

Extensive dialogue with you, our member credit unions, is helping to inform our positions for policy discussions taking place on the Hill and with regulatory bodies, as we continue our proactive advocacy on your behalf. We greatly appreciate the candid feedback and guidance. It clarified what was important to you and your members as we again defend credit unions against legislative and regulatory overreach in reaction to failures in the for-profit banking model.

This advocacy update is intended to provide GoWest member credit unions an analysis on the latest developments related to deposit insurance reform, as well as other potential policy discussions that will be taking place following the conservatorship of First Republic Bank coupled with three separate government reports released in recent days that could result in both Congressional and regulatory action.

GoWest Analysis of Deposit Insurance Reform

On Monday, May 1, the Federal Deposit Insurance Corporation (FDIC) issued a report on Options for Deposit Insurance Reform where the FDIC outlines three primary options for deposit insurance reform with particular attention paid to targeted coverage specifically for large commercial depositors.

- Limited Coverage: Maintaining the current deposit insurance framework, which provides insurance to depositors up to a specified limit (possibly higher than the current $250,000 limit) by ownership rights and capacities.

- Unlimited Coverage: Extending unlimited deposit insurance coverage to all depositors.

- Targeted Coverage: Offering different deposit insurance limits across account types, where business payment accounts receive significantly higher coverage than other accounts.

The Association has worked quickly and diligently alongside our partners at CUNA and in conjunction with other leagues to assess and model the impacts of each of these policy scenarios. We view the impact of raising the deposit insurance limit and offering unlimited coverage as options that would require little to no regulatory changes and would only have a modest impact on the National Credit Union Share Insurance Fund (NCUSIF) equity ratio. The NCUSIF is fully funded by credit unions at no cost to the taxpayer.

The FDIC suggests that the targeted coverage option would provide substantial additional coverage to business payment system accounts without extending similar insurance to all deposits and would provide the most effective financial stability relative to its costs. GoWest credit unions, in several discussions over the last month, have shared interest in looking at possible solutions to provide additional deposit insurance to commercial members. We are still evaluating how targeted coverage could be structured and applied should policymakers decide to create a Federal Commercial Deposit Insurance construct or something similar. Based on the member credit union input we've heard, we are focused on maintaining targeted coverage that is unique to credit unions and structured similarly to the existing SIF model construct.

Review of Additional Policy Discussions

On Friday, April 28 three separate government reports were released detailing recent bank failures.

The Federal Reserve released a review of the supervision and regulation of Silicon Valley Bank. Separately the Government Accountability Office issued a report to the House Committee on Financial Services titled Preliminary Review of Agency Actions Related to March 2023 Bank Failures. The FDIC also released a report titled Supervision of Signature Bank. All three provide internal and external insight into the missteps and breakdowns that resulted in the failure, receivership, and sell-off of three regional banking institutions in early March.

The initial three reports focus primarily on the condition and health of the failed institutions that led to the deposit runs and subsequent bank failures.

While there were some differences in each report, there were a number of themes that were consistent and will inform policymakers and regulators moving forward:

- **Executive Compensation** – There have been several regulatory proposals that have been shelved that we might see resurface likely as a multi-agency rule that could impact incentive compensation related to risk-taking.

- **Tying** – Banking law generally prohibits "tying arrangements" under which a bank extends credit or provides other services on the condition or requirement that the customer obtains some other product or service from the bank or an affiliate.

  There are some exceptions that allowed SVB to require customers to maintain their primary operating account with SVB. The Association anticipates that policymakers will consider strengthening anti-tying laws and regulations; however, we are unaware of credit unions utilizing this practice. In this circumstance, there may also be an opportunity to educate policymakers on certain archaic Field of Membership requirements that result in members having to open share/savings accounts to obtain other financial services from credit unions.

- **Bank Holding Company Act and Investments in Foreign Subsidiaries** – The Federal Reserve report assesses whether various approvals and merger and acquisition (M&A) actions should have been more closely scrutinized, specifically focusing on three investments in SVB UK, two investments in SVB Shanghai, and an M&A agreement with Boston Private Financial Holdings that also resulted in SVB acquiring Boston Private Bank and Trust Company. The Association does not anticipate additional scrutiny of purchase and assumption (P&A) agreements or of credit union mergers. We will be monitoring the situation and continuing our ongoing dialogue with regulators to ensure that agreements are reviewed and approved in a timely manner.

- **S. 2155** – In the supervisory reports, the passage of S. 2155 is outlined regarding previous regulatory scrutiny that SVB would have been subject to prior tailoring powers given to the regulators. These included enhanced liquidity risk management requirements, full standardized liquidity requirements (i.e., LCR and NSFR), enhanced capital requirements, company-run stress testing, supervisory stress testing at an earlier date, and tailored resolution planning requirements that may have bolstered resilience and resulted in closer scrutiny of the firm's financial position. The provisions in S. 2155 that may have been a factor in the lack of regulatory oversight for banks do not apply to credit unions. The relatively few provisions in S. 2155 that apply to credit unions did not result in less regulatory oversight and provided broader opportunities for credit unions to serve their members.

- **Capital & Economic Value of Equity (EVE) Modeling** – In response to EVE breaches, SVBFG made model changes that internally reduced the level of risk depicted by the model, which failed to capture the actual cost and ability to raise capital for SVB. As not-for-profit cooperatives, credit unions rely primarily on retained earnings to build capital and we do not raise capital through equity offerings. Therefore, potential modeling changes that result in the standardization of EVE modeling will not impact credit unions.

- **Dual Chartering and Appropriate Oversight** – There was general discussion included in the reports that outlined the lack of experience or staff for the regulatory oversight that generally came from the community/regional pool of bank examiners. In those departments, there may have been a lack of experienced examiners with governance and risk-management practices of more sizable and complex institutions like SVBFG. Credit Unions with over $15 Billion in assets are overseen by NCUA ONES examiners that have the appropriate experience with complex governance and risk-management practices.

- **Liquidity, Stress Testing, and Capital Planning** – The Fed report noted that SVB only used the most basic Internal Rate of Return modeling. In response to liquidity shortfalls, SVB management changed assumptions rather than the balance sheet to alter reported risks. In April 2022, SVB made a poorly supported change in assumption to increase the duration of its deposits based on a deposit study conducted by a consultant and in-house analysis, even as deposits were beginning to flow off the balance sheet. The Association believes that policymakers and financial regulators may put additional scrutiny and emphasis on these areas.

Political Landscape on Capitol Hill

GoWest and CUNA will leverage the opportunity to promote federal policies and legislation to help credit unions to better serve their members' needs. As your liaison to federal advocacy, Ryan Fitzgerald spent extensive time on Capitol Hill last week. He held several productive conversations in Congressional offices discussing potential actions focused on deposit insurance reform, and flexibility for credit unions to serve a broader group of individuals within each of our communities. With a politically divided Congress, there will be challenges moving legislation in the areas mentioned above, but there is a growing need to provide a secure location for deposits and broader financial services to the underserved.

With the recent bank failures, we have heard a great deal about concentration risk, diversity of investment portfolios, and the need to have a broader group of depositors and lenders, beyond that of the regional institutions currently under scrutiny, and the "too big to fail" mega banks. As these discussions take place, credit unions have a unique opportunity to promote policies we have outlined in the past, but with a new vision and vigor for a broader and more balanced financial system. The GoWest team is working with key league stakeholders and CUNA to identify policy areas that can be further developed into legislation to bolster credit union member services. These include:

Diversification of Concentration

- MBL cap expansion and elimination of disparities between banks and credit unions, currently allowing banks to generally charge less for business loans.
    - *S. 539 – Veteran Member Business Loan Act* - Introduced in Congress.
    - *Pending Introduction* – Tribal Member Business Lending Act.

Diversification of Portfolios

- Expansion and diversification of investment authority for credit unions.
- Increase in overall interest rate cap to allow federal credit unions to serve higher risk borrowers.
- Increase in maturity limits on secondary mortgages.

Diversifying Membership

- Field of Membership (FOM) expansion – credit unions have cumbersome FOM statutes and regulations that prohibit them from serving a broader group of individuals. FOM restrictions are an outdated vestige that remains from the original 1934 Credit Union Act, which only hurts consumers and weakens the U.S. financial system.

Liquidity Option Expansion

Unlike banks, credit unions have not had historic levels of significant liquidity events and therefore the NCUA's Central Liquidity Facility (CLF) has not been modernized like the Federal Reserve system in order to meet a variety of liquidity needs. The CLF should be overhauled to provide liquidity beyond being a lender of last resort. In addition, the Community Development Revolving Loan Fund (CDFIRLF) could also be expanded to provide long-term capital for more credit unions.

- Permanent extension of the CLF and allowance of agency relationships for smaller credit unions to access liquidity – *S. 544 - Introduced in Congress*.
- Modernization of the CLF to act as an active liquidity source to better serve credit union stability needs.
- Expand access to the newly appointed Fed liquidity program beyond one year and make it available for privately insured credit unions.

Next Steps

As policy engagement and legislative development opportunities become more pronounced, we will keep in close communication with you to share talking points and calls to action as well as Congressional and regulatory connection points where we can advocate for legislation and regulatory policies that provide flexibility for credit unions, while further stabilizing the financial services in the U.S.

GoWest credit unions are well-prepared to highlight the credit union difference and the strength of the not-for-profit model. Your insights have prepared GoWest to be a leader in the advocacy of deposit insurance solutions that are in the best interests of the credit union system. We will continue to have dialogue with policymakers and regulators to ensure that regulatory modernization is timely and appropriate --not only in response to bank failures -- but for comprehensive access for credit unions to further serve their members and communities.

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