



Learning from the Silicon Valley Bank failure

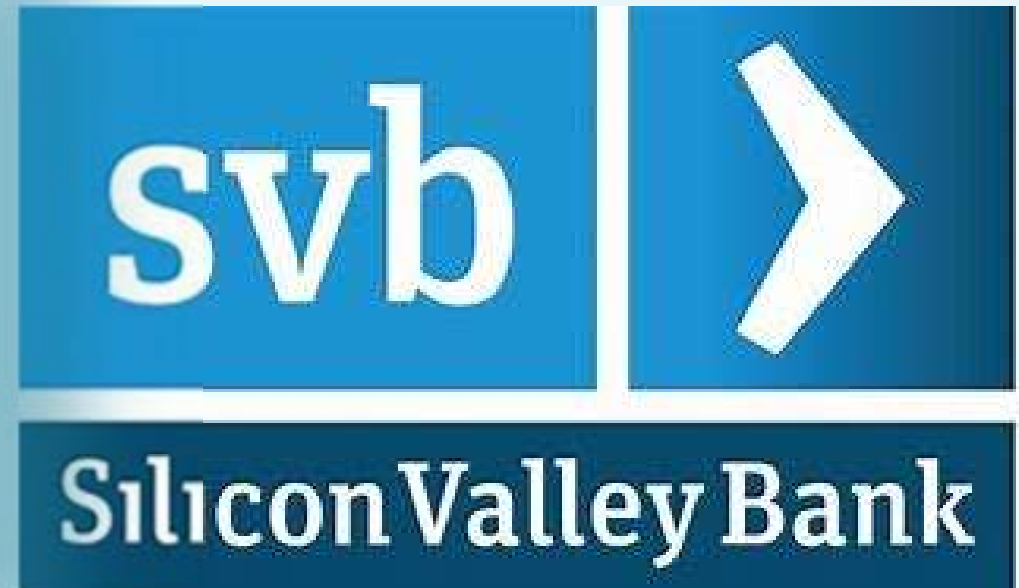
**“Social Media Risk” and a short-term “Liquid
Cash Ratio”**

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Agenda

- **Silicon Valley Bank: recap**
- **Social media and PR mismanagement**
- **A new liquidity approach**
- **Other potential responses**
- **Questions**



Ask a question



To ask a question

Click on the **Q&A** button in the bottom toolbar to open the submit question prompt.

Type your question and click send

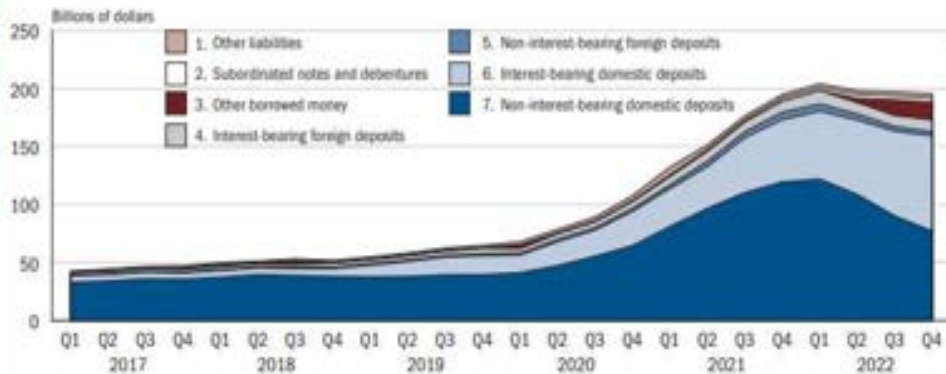
NOTE: If you wish to ask your question anonymously check the **send anonymously** box shown on the illustration.



Silicon Valley Bank: recap

Silicon Valley Bank: the rise

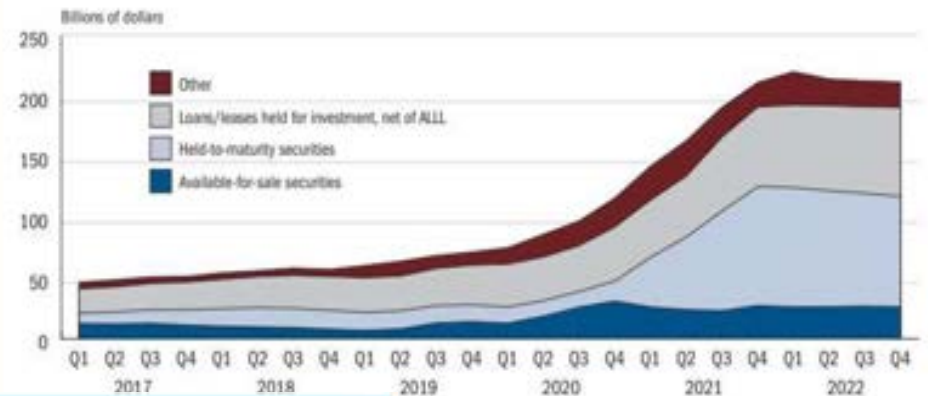
Figure 6. Composition of SVBFG liabilities



Note: The key identifies areas in order from top to bottom. SVBFG's c
tions with a maturity of one year or less.

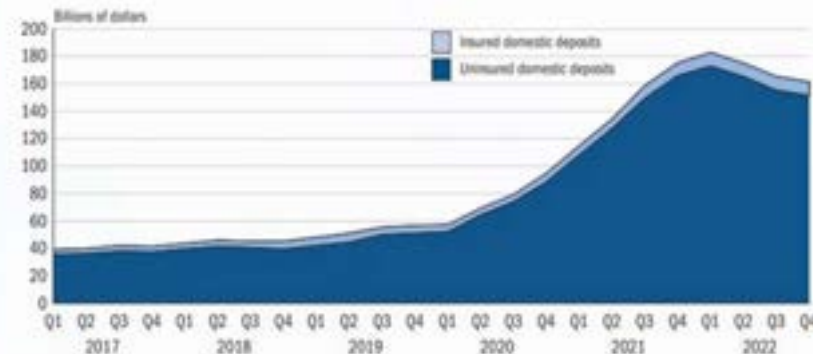
Source: FR Y-9C.

Figure 8. Composition of SVBFG assets



bottom. ALLL is allowance for loan and lease losses.

Figure 7. SVB deposit insurance coverage



Note: The key identifies areas in order from top to bottom.

Source: Call Report.

Silicon Valley Bank: the fall

24 February:
Annual results

1 Mar

Moodys likely downgrade

8 Mar

\$1.8bn securities loss & capital raising
Moodys downgrade senior unsecured

9 Mar

\$42bn deposit outflow
60% stock price falls

10 Mar

Projected \$100bn deposit outflow

Avalanche readiness check

Corporate governance	Poor
Corporate Culture	Poor
Risk management	Poor
Regulatory supervision	Lax



Silicon Valley Bank: Social media, new risks, and PR mismanagement

SVB: social media reveals new risks

Frequency of social media activity was heightened dramatically over the critical days of the 8th and 9th of March, amplifying negative sentiment, as online banking allowed a deposit run to manifest from a trickle into a flood.



More tweets, bigger stock declines

Shares in banks that were the subject of a larger number of tweets fell further than shares of banks with fewer tweets in early March 2023. This volatility coincided with the demise of Silicon Valley Bank on March 10.

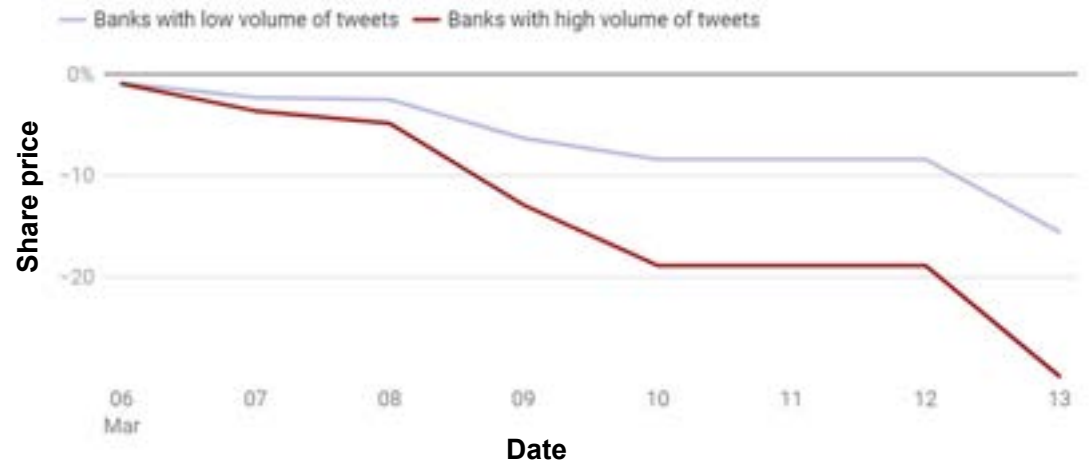


Chart: The Conversation, CC-BY-ND • Source: [Social media as a bank run catalyst](#) • [Get the data](#) • [Download image](#) • Created with [Datawrapper](#)

SVB: PR mismanagement?

Breakdown in communications

- 1) **WHAT** was said;
- 2) **WHO** the audience was;
- 3) **WHEN** it was communicated;
and,
- 4) **HOW** it was framed



Press release:

SVB Financial Group Announces Proposed Offerings of Common Stock and Mandatory Convertible Preferred Stock

March 08, 2023

SANTA CLARA, Calif., March 8, 2023 /PRNewswire/ -- SVB Financial Group ("SVB") (NASDAQ: [SVB](#)) announced today that it intends to offer \$125 billion of its common stock and \$500 million of depository shares, consisting of 10 million depository shares each representing a 1/20th interest in a share of its Series F Mandatory Convertible Preferred Stock ("Preferred Stock"), liquidation preference \$1,000 per share (equivalent to a liquidation preference of \$50 per depository share), in separate underwritten registered public offerings. In addition, prior to commencing the offerings, SVB entered into a subscription agreement with General Atlantic, a leading global growth equity investor, to purchase \$500 million of common stock at the public offering price in the offering of common stock in a separate private transaction. The subscription agreement with General Atlantic is contingent on the closing of the offering of common stock and is expected to close shortly thereafter. SVB also intends to grant (i) the underwriters in the common stock offering an option to purchase up to an additional \$187.5 million of common stock and (ii) the underwriters in the Preferred Stock offering an over-allotment option to purchase up to an additional \$75 million, or 15 million depository shares in the Preferred Stock offering. SVB intends to use the net proceeds from the offerings for general corporate purposes. The consummation of each offering is not contingent upon the consummation of the other offering.



Additionally, earlier today, SVB completed the sale of substantially all of its available for sale securities portfolio. SVB sold approximately \$21 billion of securities, which will result in an after-tax loss of approximately \$1.8 billion in the first quarter of 2023.

A Division of First Citizens Bank. Goldman Sachs & Co. LLC and SVB Securities will act as book-running managers for each offering.

Non-existent messaging – adding fuel to the fire





A new “LCR”

Was this a new kind of bank collapse....?



....or did their failure all have something in common?

....Are there any genuinely new risks / lessons we can learn from them?

- /// *"Do you remember the case, Gregson?"*
- /// *"No, sir."*
- /// *"Read it up - you really should. There is nothing new under the sun. It has all been done before."*

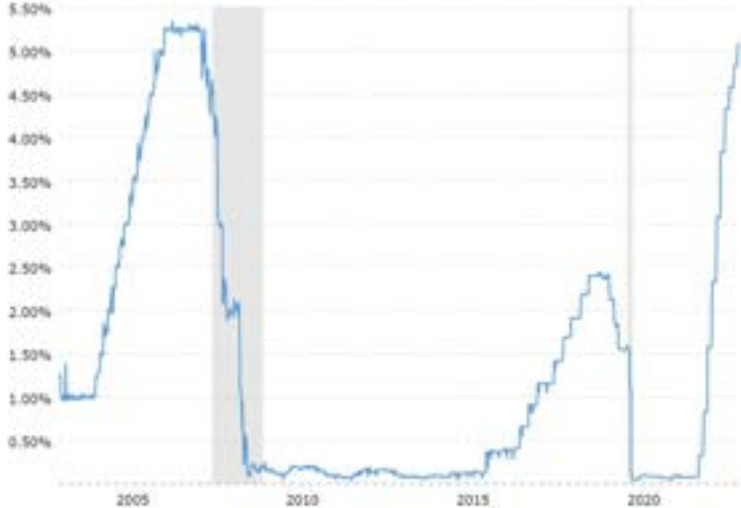
--- Sherlock Holmes, *A Study in Scarlet*, 1887 (Sir Arthur Conan Doyle)





These banks' failure is being blamed by some on the rise in interest rates...

- /// This chart seems to be implying something scary and “unprecedented”....
- /// Fed Funds Rate: 20-year view:



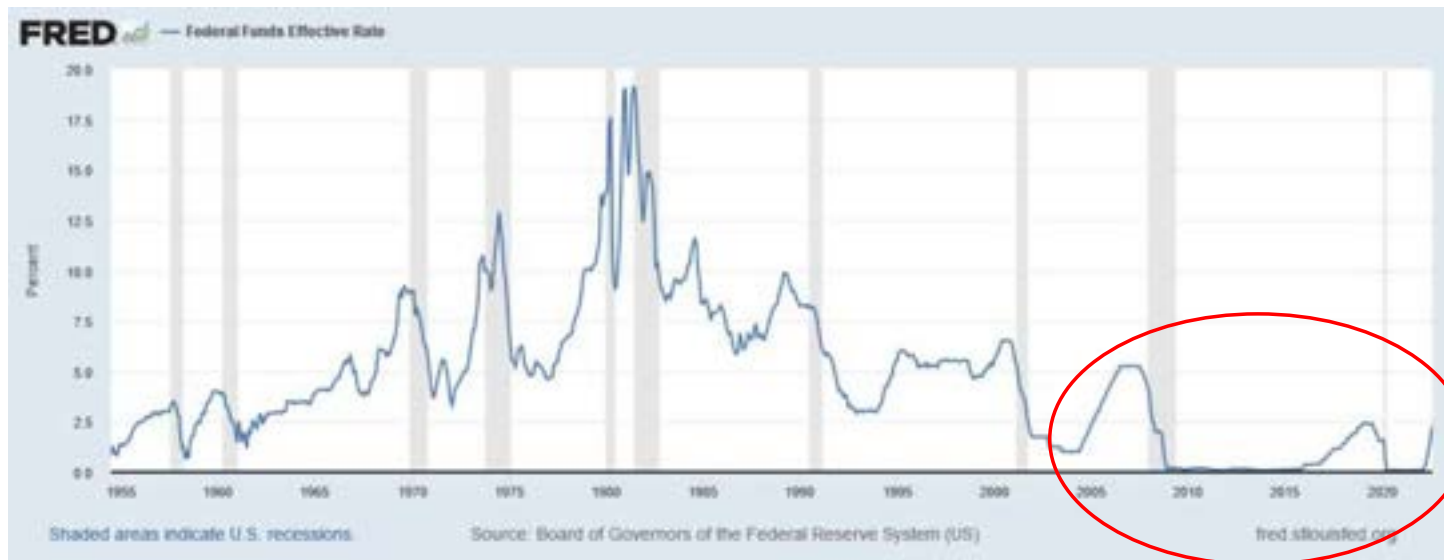
Source: ICAEW 2023





But it isn't “unprecedented”...!

/// Fed Funds rate: 40-, 50- and 60-year history



Source: Wikipedia.





The original sin

- /// Every bank in the USA (not to mention in UK and EU) had to deal with and manage the rise in interest rates during 2022 and 2023
- /// The large majority of them didn't go bust!
- /// The impact of rising rates exposed a flawed funding model at Silicon Valley Bank (as it did at Signature Bank and was shortly to at First Republic Bank)...

Concentrated funding structure

- /// SVB deposit customers were concentrated excessively in what the UK FSA used to call “Type A” deposits and depositors
 - /// Large corporates, often non-bank FI entities
 - /// High proportion of “uninsured” deposits
- /// These are not to be considered as “stable” funding
- /// But let’s take a step back...

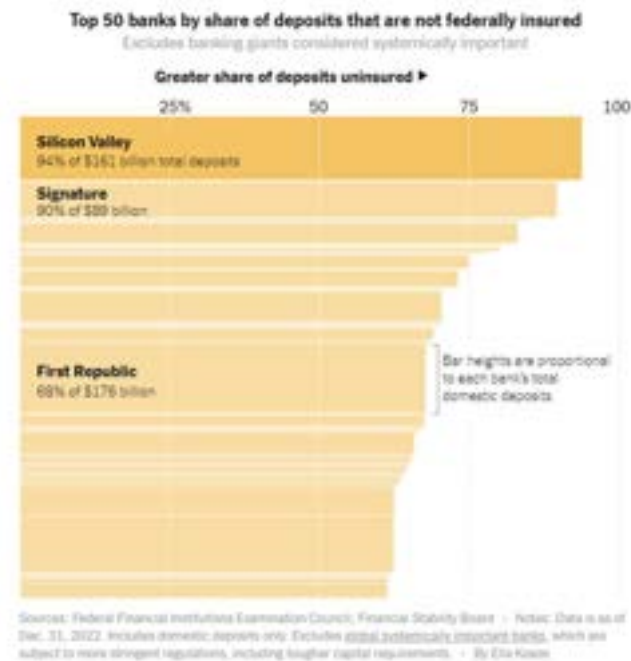


Image source: ICAEW 2023



Liquidity risk management

- /// In the UK we have the concept of “Pillar 2 liquidity” guidance from the PRA (in 2016)
- /// Amongst other things, it addresses:
 - /// Those risk types addressed by the FSA ILAA regime not covered by Liquidity Coverage Ratio (LCR)
 - /// Those risk types not covered by LCR and not previously covered by ILAA
- /// These include:
 - /// Funding maturity mismatch beyond a 30-day tenor (up to 90 days minimum)
 - /// Concentration of funding
- /// There is no “Pillar 2” or equivalence for non-systemic banks in the USA
- /// SVB had a high concentration of funding:
 - /// Concentration by depositor type (one commentator described them as “Crypto and VC @-----”)
 - /// Concentration by contractual maturity
 - /// Concentration by product type
- /// SVB was not obliged to report NSFR and LCR
- /// In any case, we note that SVB’s LCR at the time it attempted a Rights Issue was ~71%...below the 100% Basel III minimum
- /// Once the bank run started, the bank was doomed
- /// ***But the funding structure itself was always more vulnerable to a bank run following loss of confidence than a bank that followed “Pillar 2” discipline***
- /// ***This caused failure...the loss of confidence that leads to a bank run was not mitigated in any way***



SVB Governance structure

- /// SVB's asset-liability committee (ALCO) reported into the "Finance Committee"
- /// The Finance Committee reported into the Board, or, depending on your media source, the Board Risk Sub-Committee
- /// As we have observed with bank failures in 2007-09, this (orthodox and very common) operating model **places genuine understanding of the balance sheet – and its risk sensitivity to changes in market factors – too far away from the Board**
- /// Every failed bank in 2007-08 and 2023 exhibited this similar balance sheet management governance framework (which is one that most regulatory authorities expect to see)...
- /// ...the orthodox governance framework for managing the balance sheet **doesn't really have a very good track record!**
- /// See a reference from 2017 that highlights this (in the Appendix)





Recap: The Liquidity Coverage Ratio (LCR)

The Basel III LCR metric is a universal international liquidity risk standard and is calculated as follows:

$$\frac{\text{Stock of high quality liquid assets}}{\text{Total net cash outflows over the next 30 calendar days}} \geq 100\%$$

It is designed to ensure that a financial institution has sufficient unencumbered, high quality liquid resources to survive a severe liquidity stress scenario lasting for one month.

The UK PRA refers to LCR as “Pillar 1 liquidity”.

So what about “Pillar 2 liquidity” risk?



Simplified Overview of LCR (per BCBS 2013)

LCR – maintain enough liquid assets for 30 days under stress scenario specified by supervisor





But today, an LCR for 2023...

- /// SVB case study has highlighted the existence of “social media risk” when it comes to Liquidity Risk Management
 - /// **Silicon Valley Bank suffered a \$35bln outflow in under 48 hours!**
 - /// Negative social media commentary “spread like wildfire” and hastened the elimination of confidence in the bank
- /// LCR (“Pillar 1 liquidity”) does not capture this risk speedily enough
- /// Author’s solution (there is no regulation on this – this is a personal opinion!):
 - /// **A 3- or 7-day LCR metric** alongside the regulator 30-day one where the numerator is composed of cash only
 - /// Set your assumed % outflow in first 72 hours
 - /// Set your assumed outflow for days 3-7 (higher outflow earlier)
 - /// The first 48 hours is crucial (especially if it’s over a weekend)
 - /// The ratio keeps the >100% standard LCR requirement but with the HQLA cover being held entirely in cash instant access (essentially cash at central bank but also nostro at SIFI banks)
 - /// Hence, “Liquid Cash Ratio”....a minimum liquidity standard
 - /// Any resemblance to the Basel LCR acronym is purely coincidental ☺



An example stress scenario

/// Customers withdraw 36% in 7 days..

/// Day 1: 18%

/// Day 2: 9%

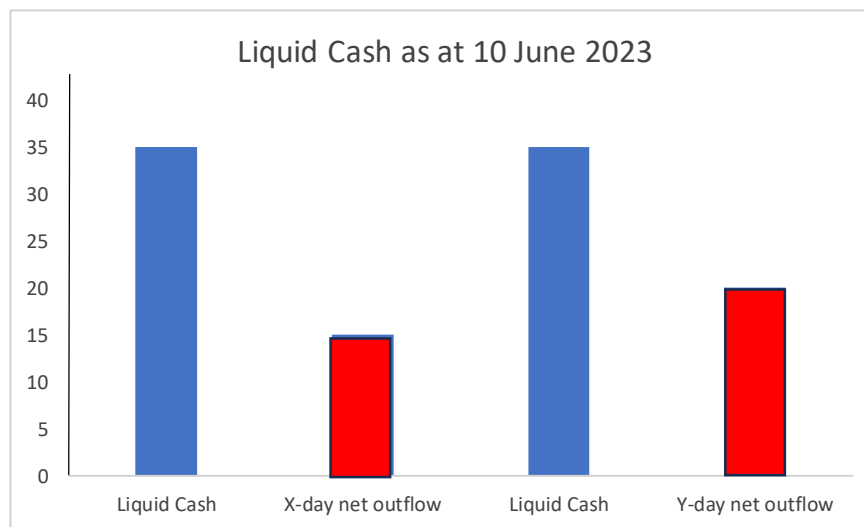
/// Days 3-7: 1.8%

/// 2-day LCR:

/// 27% outflow assumption



A picture is worth a “thousand” metrics...



The assumptions behind this outflow number are key...



Pillar 2 liquidity risk: concentration risk... ...and “social media risk” impacting reputation

- /// Concentration in funding is perhaps the most significant “Pillar 2” liquidity risk
 - /// Concentration by product type (EG., instant access deposits)
 - /// Concentration by customer type (EG., large corporates or non-bank financial institutions)
 - /// Concentration across tenor points (EG., overnight contractual tenor)
- /// Banks that exhibit funding concentration – not uncommon when they are “challenger banks”, “neo-banks” or banks with a narrow customer franchise – would benefit more from the “3-day or 7-day Liquid Cash Ratio” (LCR) measure
- /// The 3-day or 7-day LCR is a response to “social media risk”
- /// It isn’t a panacea, and it isn’t an alternative to sound overall asset-liability management discipline
- /// It isn’t a metric that is meant to address all ALM risks!
- /// At the same time, this risk must be addressed by rapid and open language responses to negative social media comment....
- /// ...see next slide



Social media and reputational risk

/// Good-practice illustration from a digital challenger bank:

- /// *Social media has amplified the speed with which news spreads, including “fake news”. Our bank is a brand that attracts much online attention, and has been consistently targeted by journalists and influencers in an attempt to increase their engagement. Several events in markets recently have triggered fake narratives about their impact on our bank. EG., the weekend after SVB's failure triggered the only two days of net same-day outflows we have ever seen.*
- /// *Reputational Risk is one of the main concerns for our liquidity today, as it is one of the most plausible triggers for a stressed event liquidity run. Observation since SVB shows that the overall sentiment of online comments is volatile, with peaks of negative comments occurring from time to time.*
- /// *Also, comments from influential persons with extensive social media reach can drive swift changes in customer behaviour, especially if it's a source with credibility in the financial sector.*



Managing Social Media Risk

Source: Risk.net May 2023





Conclusions

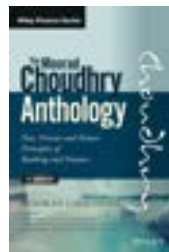
- /// Liquidity risk is a “risk register” item that is as old as banking itself
- /// In fact it’s a very definition of banking
- /// The discipline required to manage it remains unchanged
- /// The “new” factor impacting liquidity risk today is the much increased speed of transmission, in an age of
 - /// Instant access to customer deposits (in some countries 24/7) via mobile digital devices
 - /// Speed of transmission of “bad news” or “fake news” via social media
- /// The current suite of liquidity risk metrics (and there are a large number of them) does not really address this issue for certain types of banks
- /// The author suggests a short-term Liquid Cash Ratio in response



Further reading on liquidity risk and reputational risk



The Principles of Banking, 2nd Edition, Singapore:
John Wiley & Sons Ltd 2022, chapters 11-15



Moorad Choudhry Anthology: Past, Present and Future Principles of Banking and Finance, Singapore: John Wiley & Sons Ltd 2018, chapters 8, 10-14

Email: mooradchoudhry@gmail.com





Other potential responses

Responses to SVB

Now

Reassess risks - eg

- social media
- uninsured deposits
- rapid growth outstrips controls
- concentrations (both sides of the balance sheet)
- Interest rate exposures

Additional work to assess and mitigate risks

- monitor more media channels
- enhanced stress tests

Considering

Operation of regulatory (prudential and resolution) regime:

- what is systemic
- simpler regimes for smaller banks
- liquidity & funding
- interest rate risk
- supervisor behaviour

Approach to UK branches

Changes to the UK deposit protection scheme

Other

Going concern

Enhanced disclosures of risks

Silicon Valley Bank



Questions

Next up...

Date	Topic and Title	Registration
19 October 2023	Demystifying the digital pound and CBDCs - an introduction	Book now
04 October 2023	CASS 5 audits - insights and hot topics	Book Now

Link: [Financial Services Faculty 2023 events | ICAEW](#)

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Appendix

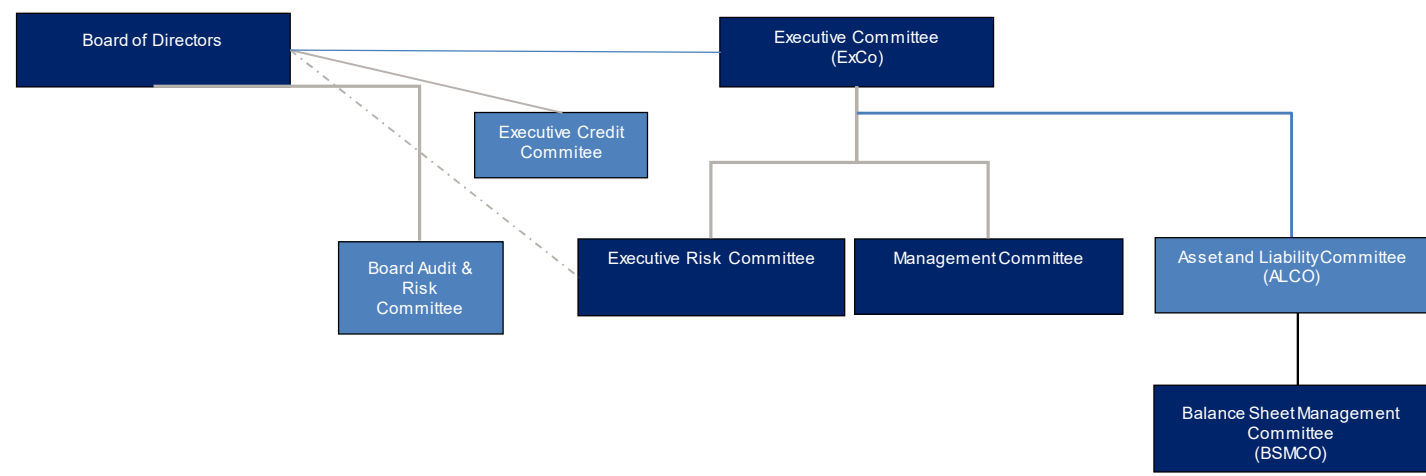
ALCO governance framework



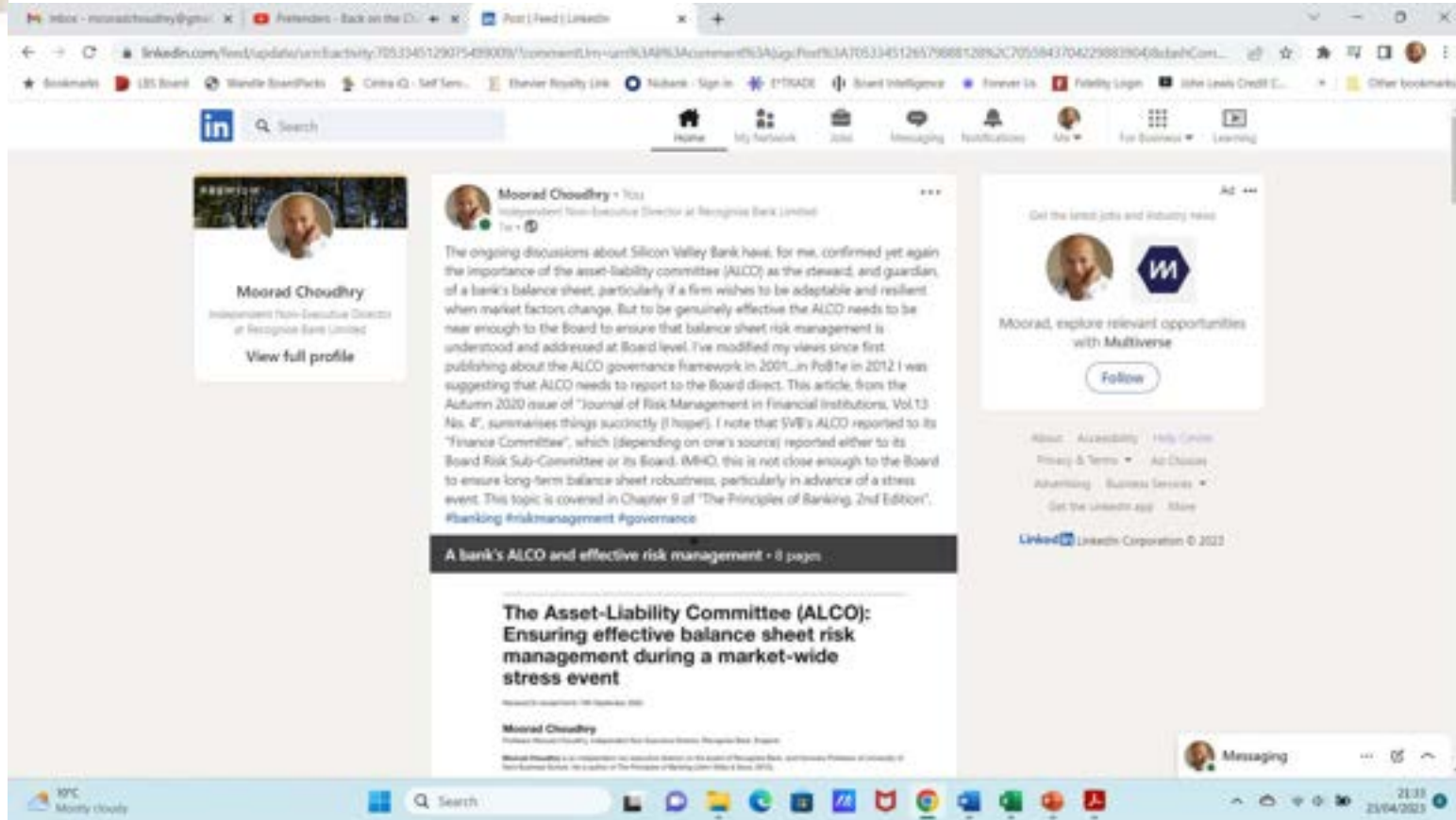
ALCO reporting to a committee that is one or two further steps to the Board was the operating model exhibited by every failed bank in 2007, 2008, 2009 and 2023....

ALCO governance framework - traditional

/// The traditional Board ALCO governance framework operating model has been shown to be ineffective when considering failed banks!



ALCO and distance from the Board



The screenshot shows a LinkedIn post by Moorad Choudhry, an Independent Non-Executive Director at Recognise Bank Limited. The post discusses the importance of the Asset-Liability Committee (ALCO) as a steward and guardian of a bank's balance sheet, particularly in times of market stress. It mentions that the ALCO should report directly to the Board, rather than being a sub-committee. The post is titled "The Asset-Liability Committee (ALCO): Ensuring effective balance sheet risk management during a market-wide stress event" and is part of a document titled "A bank's ALCO and effective risk management".

Moorad Choudhry • You
Independent Non-Executive Director at Recognise Bank Limited

The ongoing discussions about Silicon Valley Bank have, for me, confirmed yet again the importance of the asset-liability committee (ALCO) as the steward and guardian of a bank's balance sheet, particularly if a firm wishes to be adaptable and resilient when market factors change. But to be genuinely effective the ALCO needs to be near enough to the Board to ensure that balance sheet risk management is understood and addressed at Board level. I've modified my views since first publishing about the ALCO governance framework in 2001...in PoBte in 2012 I was suggesting that ALCO needs to report to the Board direct. This article, from the Autumn 2020 issue of "Journal of Risk Management in Financial Institutions, Vol.13 No. 4", summarises things succinctly (I hope). I note that SVB's ALCO reported to its "Finance Committee", which (depending on one's source) reported either to its Board Risk Sub-Committee or its Board. IMHO, this is not close enough to the Board to ensure long-term balance sheet robustness, particularly in advance of a stress event. This topic is covered in Chapter 9 of "The Principles of Banking, 2nd Edition". #banking #riskmanagement #governance

The Asset-Liability Committee (ALCO): Ensuring effective balance sheet risk management during a market-wide stress event

A bank's ALCO and effective risk management • 8 pages

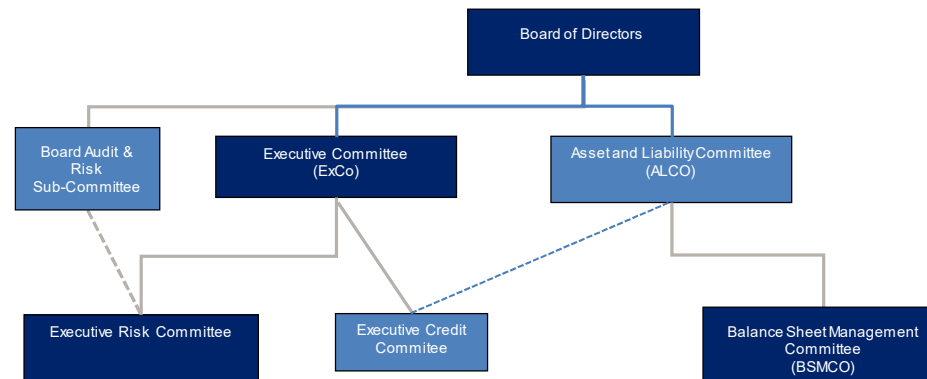
Article from European Financial Review (2017): <http://www.europeanfinancialreview.com/?p=17469>





So we need this one:

- /// The recommended Board, BRC, Exco and ALCO operating model: reflects paramount importance of the ALCO in the overall ERM and prudential regulation compliance process



“The Principles of Banking, 2nd edition (2022) Figure 9.7





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