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From FDICIA to Silicon Valley Bank: The Evolution of the Systemic Risk Exception

By Andrew Olmem*

In this article, the author recounts the legislative history of the systemic risk exception from its creation in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). The author also explains how the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 amendments to the systemic risk exception shaped the recent resolutions of Silicon Valley Bank and Signature Bank. The author concludes by noting that the use of the systemic risk exception to protect the uninsured depositors of those banks was not an exceptional action, but instead was consistent with the treatment of uninsured depositors in all but a few bank resolutions since 2008.

On March 12, 2023, Treasury Secretary Janet Yellen twice invoked the systemic risk exception under Section 13 of the Federal Deposit Insurance Act (FDIA)[1] to authorize the Federal Deposit Insurance Corporation (FDIC) to provide financial support to protect the uninsured depositors of Silicon Valley Bank (SVB) and Signature Bank (Signature).[2] The Secretary's actions came after both institutions experienced rapid and substantial depositor withdrawals the prior week, which prompted state regulators to close SVB on March 10 and Signature on March 12.[3] The FDIC had tried but was unable to promptly sell SVB. This raised the prospect that as part of each bank's resolution their uninsured depositors, who accounted for approximately 80 percent of each institution's deposits, could incur losses on the amount of their deposits that exceeded the $250,000 federal deposit insurance cap.[4] Such an outcome alarmed federal financial regulators, who thought it could trigger uninsured depositor runs at other banks.[5] To forestall a broader run on the banking

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[1] 12 U.S.C. §1823(c)(4)(G)(i).

[2] Joint Statement by the Department of the Treasury, Federal Reserve, and FDIC (March 12, 2023). https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312b.htm.

[3] See Government Accountability Office (GAO), Preliminary Review of Agency Actions Related to March 2023 Bank Failures (April 2023) (GAO Report 2023). https://www.gao.gov/assets/gao-23-106834.pdf; The Federal Deposit Insurance Corporation, The FDIC's Supervision of Signature Bank (April 28, 2023). https://www.fdic.gov/news/press-releases/2023/pr23033a.pdf.

[4] GAO Report (2023) at 13.

[5] See Testimony of Martin Gruenberg, Chair of the Federal Deposit Insurance Corporation,

system, the board of directors of the FDIC and the members of the Board of Governors of the Federal Reserve System (Federal Reserve Board) provided the statutorily-required recommendation to allow Secretary Yellen to invoke the systemic risk exception.

This was the first time that a Secretary of the Treasury has invoked the systemic risk exception since Congress amended its statutory language in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank). The resolutions of SVB and Signature therefore provide useful case studies on how the systemic risk exception functions following Dodd-Frank and how it could, and could not, potentially be used to respond to future bank failures or financial crises.

To explicate the legal authority conferred by the systemic risk exception, this article first recounts how Congress created the systemic risk exception in the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) in an attempt to simultaneously advance two competing public policy goals: combating too-big-to-fail and ensuring that financial regulators can respond to bank runs and financial crises. This article then discusses how Dodd-Frank's amendments to FDICIA clarified the scope of the authority granted by the systemic risk exception. It also explains why these amendments need to be viewed within the context of several other provisions of Dodd-Frank that counteract the effect of those amendments, particularly the increase in the deposit insurance cap. This article concludes with an analysis of how the use of the systemic risk exception to resolve SVB and Signature was shaped by the Dodd-Frank amendments. Ultimately, the resolutions of SVB and Signature resulted in an outcome for uninsured depositors that was anything but exceptional. Although Congress had sought in FDICIA to have uninsured depositors bear losses in bank failures, since 2008 uninsured depositors have been nearly always protected from bearing losses. Therefore, by protecting the uninsured depositors of SVB and Signature, the FDIC merely treated them in the same manner it has treated uninsured depositors in all but a small minority of bank failures.

THE ORIGINS OF THE SYSTEMIC RISK EXCEPTION

The systemic risk exception's origins lie in the aftermath of the savings and loans crisis. After the failure of more than 2,000 banks and thrifts in the 1980s,

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before the Senate Committee on Banking, Housing, and Urban Affairs (March 29, 2023). "Recent Bank Failures and the Federal Regulatory Response," https://www.fdic.gov/news/speeches/2023/spmar2723.pdf.

Congress passed FDICIA to reform how the FDIC resolves failed insured depository institutions.[6] A primary goal of those reforms was to combat the FDIC's too-big-to-fail policy.

At the time of FDICIA's passage, Congress viewed too-big-to-fail as including two distinct policies.[7] The first too-big-to-fail policy was the FDIC's determination that certain large banks should not be allowed to fail if their failure could pose systemic risks to the entire financial system. Congress cited to the FDIC's protection of all of the depositors of Continental Illinois in 1984, which cost the FDIC $1 billion, as a prime example of this policy.[8] The second too-big-to-fail policy was the FDIC's customary practice of protecting uninsured depositors of even small or medium-sized banks whose failures did not present systemic risks. In Congress' view, the FDIC had too frequently protected uninsured depositors in both situations and, in doing so, had created significant moral hazard. These actions reduced incentives for uninsured depositors to monitor their depository institutions, which increased risk taking by depository institutions and created greater losses for the deposit insurance fund.[9] With FDICIA, Congress sought to reform the bank resolution process to limit the ability of the FDIC to protect uninsured depositors and, thereby, enhance market discipline for insured depository institutions.

At the center of FDICIA's reforms is the least-cost resolution requirement. The least-cost resolution requirement prohibits the FDIC from using its authorities to provide assistance (including asset purchases, loans, and the assumption of liabilities) to an insured depository institution under 12 U.S.C. § 1823(c)(1) and (8), or to facilitate a merger of an insured depository institution under 12 U.S.C. § 1823(c)(2) and (3), (f), and (k) unless:

(a) such assistance is "necessary to meet the obligation of the [FDIC] to provide insurance coverage for the insured deposits in such institution;" and

(b) the cost of such assistance "is the least costly to the Deposit Insurance Fund of all possible methods for meeting the [FDIC's] obligations

[6] GAO, Federal Deposit Insurance Act: Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify Provision (April 2010) (GAO Report 2010) at 10.

[7] Report of the Committee on Banking, Housing, and Urban Affairs to accompany S. 543 together with Additional Views (1991) (Senate Report) at 44.

[8] Id.

[9] Id.

[namely deposit insurance coverage]."[10]

Further, the least-cost resolution requirement explicitly prohibits the FDIC from taking "any action, directly or indirectly, with respect to any insured depository institution that would have the effect of increasing losses to the Deposit Insurance Fund by protecting (I) depositors for more than the insured portion of deposits" and "(II) creditors other than depositors."[11]

Besides the least-cost resolution requirement, FDICIA also prohibits the FDIC from providing open bank assistance to non-troubled banks. Under 12 U.S.C. § 1823(c)(8), the FDIC may only provide "direct financial assistance to a depository institution prior to the appointment of a conservator or receiver for the institution" if (1) "grounds for the appointment of a conservator or receiver exist or likely will exist in the future unless the depository institution's capital levels are increased," and (2) "it is unlikely that the institution can meet all currently applicable capital standards without assistance."[12] Congress also subjected the FDIC's provision of any such open bank assistance to the least-cost resolution requirement, so open bank assistance could only be provided where the cost would be less than paying out deposit insurance claims.

Despite its determination to address too-big-to-fail, Congress also recognized in FDICIA that an exception to the least-cost resolution requirement was needed where "the failure of an insured depository institution poses a genuine risk to the financial system."[13] As enacted in Section 13(c)(4)(G)(i) of the FDIA,[14] the systemic risk exception permits the Secretary of the Treasury to authorize the FDIC to take actions without regard to the least-cost resolution requirement. However, this authority as initially enacted could be exercised only (a) upon the written recommendation by not less than a two-thirds vote of each of the board of directors of the FDIC and the members of the Federal Reserve Board, and (b) if the Treasury Secretary then determines (in consultation with the President) that:

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[10] 12 U.S.C. § 1823(c)(4)(A)(i) & (ii). The least-cost resolution requirement also applies to the FDIC's authorities under 12 U.S.C. §1823(d) (sales of assets to the FDIC by conservators/ receivers), (h) (reopening branches of certain foreign banks), and (i) (a repealed section).

[11] Id.

[12] 12 U.S.C. § 1823(c)(8). The FDIC also may not provide such assistance if the institution's management violated applicable laws, rules, or supervisory directives or orders, or "engaged in any insider dealings, speculative practices, or other abusive activity." 12 U.S. § 1823(c)(8)(A)(ii).

[13] Senate Report at 45-46 (attributing the inclusion of the systemic risk exception to the recommendation of several witnesses, including former Federal Reserve Chairman Alan Greenspan).

[14] 12 U.S.C. § 1823(c)(4)(G)(i).

> "(I) [the FDIC's compliance with the least-cost resolution requirement] with respect to an insured depository institution would have serious adverse effects on economic conditions or financial stability;" and
>
> "(II) [the FDIC could take other actions or provide assistance that] would avoid or mitigate such adverse effects."[15]

Upon the invocation of the systemic risk exception, the FDIC "may take other action or provide assistance under [Section 13 of the FDIA] as necessary to avoid or mitigate such effects."[16]

In the event any assistance the FDIC provides through the systemic risk exception results in losses to the Federal Deposit Insurance Fund, the FDIC was authorized to levy assessments on insured depository institutions.[17] Subsequently, Congress also authorized the FDIC to levy such assessments on depository institution holding companies, subject to the concurrence of the Secretary of the Treasury.[18]

Congress' inclusion of the systemic risk exception in FDICIA highlights Congress' struggle to combat too-big-to-fail without impeding financial regulators' ability to respond to a financial crisis. The systemic risk exception was the compromise to resolve these competing goals. By allowing the FDIC to provide assistance to address a systemic risk, the systemic risk exception preserved important emergency authority. By requiring multiple regulators to sign off on the use of the systemic risk exception, though, Congress intentionally sought to ensure that the system risk exception would not be routinely utilized. Congress expected that in most cases uninsured depositors and non-depositor creditors would not be protected from market discipline.

THE 2008 FINANCIAL CRISIS AND THE GAO REVIEW

The systemic risk exception went unused until the 2008 financial crisis, when the Treasury Secretary invoked it three separate times.[19] One invocation was to facilitate the acquisition of a troubled depository institution, and another was to provide open bank assistance. The third invocation was to establish the

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[15] 12 U.S.C. § 1823(c)(4)(G)(i)(I) & (II).

[16] Id.

[17] 12 U.S.C. § 1823(c)(4)(G)(ii).

[18] Helping Families Save Their Homes Act of 2009, Section 204(d) (2009).

[19] GAO Report (2010) at 2. The FDIC and the Federal Reserve Board also made two other recommendations for the use of the systemic risk exception, but the Treasury Secretary ultimately did not make the requisite determinations to invoke the authority.

Temporary Liquidity Guarantee Program (TLGP), which provided guarantees for (a) newly issued uninsured debts of all insured depository institutions, their holding companies, and eligible affiliates, and (b) uninsured non-interest-bearing transaction accounts.[20] By having the FDIC guarantee uninsured deposits and unsecured debts with TLGP, financial regulators sought to pre-emptively prevent bank runs and an escalation of the financial crisis.

To invoke the systemic risk exception to create the TLGP, however, financial regulators had to employ a broad reading of the statute because the TLGP provided assistance not only to non-troubled insured depositories, contrary to 12 U.S.C. § 1823(c)(8), but also to their holding companies and affiliates. The FDIC's express authorities are limited to providing assistance to insured depository institutions. To address these statutory limitations, financial regulators first contended that the systemic risk exception could be invoked based on a determination under subclause (I) of the systemic risk exception (12 U.S.C. § 1823(c)(4)(G)(I)) that compliance with the least-cost resolution requirement for "the banking industry as a whole," rather than for a specific institution, would have a "serious adverse effects on economic conditions or financial stability."[21] Financial regulators argued that having to wait for bank failures and make "institution-by-institution determination[s]" before they could act would be more costly than pre-emptively providing assistance through the TLGP.[22]

Financial regulators also contended that the FDIC could provide assistance under the systemic risk exception "beyond that otherwise authorized by the [FDIA]," because the "systemic risk exception waives all of the normal statutory restrictions on FDIC assistance, as well as creates new authority to provide assistance."[23] Based on this reasoning, financial regulators argued that the systemic risk exception authorized the FDIC to provide assistance to non-troubled insured depository institutions, and their holding companies and affiliates.[24]

In its statutorily-required review of the basis for invoking the systemic risk exception, the Government Accountability Office (GAO) concluded that there was support for the financial regulators' interpretation that the systemic risk

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[20] https://www.fdic.gov/regulations/resources/TLGP/index.html.

[21] GAO Report (2010) at 43, 47; Krimminger, Michael H., The Temporary Liquidity Guarantee Program, in First Responders: Inside the U.S. Strategy for Fighting the 2007 – 2009 Global Financial Crisis, Yale University Press (2020) at 235-36.

[22] Id.

[23] GAO Report (2010) at 18, 43, 50. Krimminger at 237-38.

[24] Id.

exception could be invoked based on problems with the banking system as a whole, rather than on an institution-by-institution basis.[25] However, the GAO questioned the financial regulators' arguments that the systemic risk exception grants new authority to provide assistance. The GAO concluded that "the overall legislative history of FDICIA also suggests Congress did not intend the exception to provide the breadth of new authority claimed by the agencies."[26] The GAO noted that the systemic risk exception only specifically waives the requirements of the least-cost resolution requirement but does not reference other statutory requirements with respect to the FDIC's authority to provide assistance. Further, the GAO questioned whether Congress would have granted the FDIC new and broader authority in an exception to the least-cost resolution requirement, given that FDICIA was designed to limit the authority of the FDIC to provide assistance.[27] The GAO maintained that the better reading of the statute is that the systemic risk exception does not confer new authority on the FDIC (other than not having to comply with the least-cost resolution requirement), leaving it without authority to assist non-depository institutions, such as holding companies and affiliates.[28] In addition, the GAO indicated that the statute preserved the other restrictions on the FDIC's provision of assistance, including the restriction on providing assistance to non-troubled insured depository institutions under 12 U.S.C. §1823(c)(8).

Due to the importance of the legal and policy issues raised by the systemic risk exception and need for financial regulators to have clear authority during a financial crisis, the GAO recommended that Congress pass legislation to clarify the "requirements and assistance authorized under the exception."[29]

THE DODD-FRANK ACT AMENDMENTS

Shortly after GAO issued its report, Congress followed the GAO's recommendations and included in Dodd-Frank two amendments to clarify the requirements and scope of the systemic risk exception. The first Dodd-Frank amendment specified that the Secretary of the Treasury's determination under subclause (I) of the systemic risk exception must be made with respect to compliance with the least-cost resolution requirement for "an insured deposi-

[25] GAO Report (2010) at 49.

[26] Id. at 53.

[27] Id. at 54.

[28] The Supreme Court's recent decision in West Virginia v. EPA, 597 U.S. __ (2022), which announced the major questions doctrine, may also support this conclusion.

[29] Id. at 57.

tory institution for which the [FDIC] has been appointed receiver."[30] This amendment rejected the financial regulators' contention that the systemic risk exception could be invoked based on general problems with the banking system. Instead, the determination must be made with respect to compliance with the least-cost resolution requirement for an insured depository for which the FDIC "has been appointed receiver."[31]

With the second Dodd-Frank amendment, Congress sided with the GAO's interpretation that the systemic risk exception does not provide broad, new authority to the FDIC. To clarify this interpretation, Congress amended the statute to expressly state that the FDIC may only provide assistance "for the purpose of winding up the insured depository institution for which the [FDIC] has been appointed receiver."[32]

The Dodd-Frank amendments to the systemic risk exception not only effectively prohibit the FDIC from establishing another TLGP, but further restrict the FDIC from using the systemic risk exception to provide open bank assistance. Although the least-cost resolution requirement limits the FDIC's ability to provide assistance to protect uninsured depositors and other non-depositor creditors, the systemic risk exception as crafted by FDICIA provided another means to provide such assistance. However, due to the Dodd-Frank amendments, the FDIC now can provide assistance under the systemic risk exception only "for the purpose of winding up" an insured depository institution in an FDIC receivership.[33] As a result, the use of the systemic risk exception to support an insured depository institution or to facilitate the merger of an insured depository institution prior to it entering receivership (as was done during the 2008 financial crisis) is no longer permissible after the enactment of the Dodd-Frank amendments. In each case, the institution would have to be placed into receivership before the FDIC could provide such assistance.

From a historical perspective, it could be argued that the Dodd-Frank amendments to the systemic risk exception merely clarified how Congress originally intended in FDICIA for the systemic risk exception to function. By restricting the use of the systemic risk exception, they advanced the policy established by FDICIA that uninsured depositors of failed banks should

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[30] Dodd-Frank, Section 1106(b)(1)(A).

[31] Dodd-Frank, Section 1106(b)(1)(B).

[32] Dodd-Frank, Section 1106(b)(1)(A).

[33] Dodd-Frank, Section 1106(b)(1)(B).

generally bear losses except in exceptional economic circumstances.[34] In addition, the Dodd-Frank amendments also mean that some market discipline is more likely to be imposed even when the systemic risk exception is used to protect uninsured depositors because uninsured depositors can only be protected when their bank is in receivership. It is far easier for the FDIC to impose losses on shareholders and unsecured creditors when the institution is in receivership than when it is a going concern. Again, this is consistent with FDICIA.

ALTERNATIVE AUTHORITIES

Despite its intent to combat too-big-to-fail with the Dodd-Frank amendments to the systemic risk exception, Congress nevertheless also sought to ensure that financial regulators still have sufficient authorities to respond to a financial crisis. Mirroring its approach in FDICIA that gave rise to the systemic risk exception, Congress included other provisions in Dodd-Frank that expanded the FDIC's authority to protect uninsured creditors and non-depositor creditors, including those at non-troubled insured depository institutions.

First, Dodd-Frank provided new, alternative authority for the FDIC to broadly guarantee the debts of solvent insured depository institutions and insured depository institution holding companies and their affiliates.[35] In 2020, this language was amended to also permit the FDIC to guarantee non-interest-bearing transaction accounts.[36] Thus, although the systemic risk exception can no longer be used to establish another TLGP, the FDIC could establish another TLGP using this debt guarantee authority, subject to compliance with its statutory approval process.

Like the systemic risk exception, an FDIC debt guarantee program requires prior approval by two-thirds votes of each of the FDIC board and the members of the Federal Reserve Board, the Secretary of the Treasury, and the president. However, the debt guarantee program also requires the approval of Congress.[37] The FDIC is prohibited from issuing guarantees under the program until Congressional approval is obtained. This limitation follows Congress' approach to the systemic risk exception: it provided authority but imposed substantial

[34] In FDICIA, Congress allowed for the protection of uninsured depositors and non-depositor creditors where doing so would reduce losses to the Deposit Insurance Fund. However, given the much lower deposit insurance cap then in place, such cases were likely to be the exceptions rather than the typical outcomes.

[35] Dodd-Frank, Sections 1104-1106.

[36] Coronavirus Aid, Relief, and Economic Security Act (CARES Act), Section 4008(a)(1).

[37] Dodd-Frank, Sections 1104-1105.

procedural hurdles to prevent its use except to address true systemic risks. Given the substantial liabilities an FDIC debt guarantee program could impose on the Federal government, Congress evidently decided that it still needed to approve any such program, though it sought to make it procedurally easier for it to do so if necessary.[38]

Second, Dodd-Frank established an Orderly Liquidation Authority (OLA) that allows the FDIC to resolve failing non-bank financial companies (including bank holding companies) that pose a systemic risk to the United States.[39] The invocation of the OLA requires similar prior approvals as the systemic risk exception.[40] Also similar to the systemic risk exception, OLA grants the FDIC authority to provide financial assistance once a non-bank financial company has been placed into receivership.[41] As a result, the FDIC could direct funds from the holding company level to support an insured depository subsidiary. However, the OLA's assessment provisions make providing financial assistance more complicated than using the systemic risk exception.[42]

Third, and most importantly, Dodd-Frank permanently increased the federal deposit insurance cap to $250,000.[43] (Congress temporarily increased it to that amount in 2008.)[44] This change technically left in place the FDICIA resolution framework and policy that uninsured depositors and non-depositor creditors

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[38] The most distinctive, and uncertain, aspect of the FDIC debt guarantee program provisions is the congressional approval process. Section 1105 of Dodd-Frank requires the use of expediated procedures to facilitate congressional consideration. Specifically, it creates a temporary period during which the resolution of approval cannot be filibustered in the Senate. With this procedural requirement, Congress sought to ensure congressional accountability for FDIC debt guarantee programs, while also ensuring that Congress could approve a program quickly enough to respond to a financial crisis. Of course, ensuring an expedited congressional review process does not ensure congressional support. Further, given the complexity and informal nature of Congressional rules, the effectiveness of the expedited procedures will remain an open question until they are tested. To date, Congress has authorized only one FDIC debt guarantee program under Section 1105, but it did not employ Dodd-Frank's expedited procedures to secure its approval. In response to the COVID-19 crisis, Congress approved the FDIC to establish a debt guarantee program in Section 4008 of the CARES Act, which Congress passed using traditional Congressional procedures. The FDIC never exercised its CARES Act authority, which lapsed on December 31, 2020. However, this authorization has set a precedent that Congressional approval would be sought – and could be obtained – for such a program.

[39] Dodd-Frank, Title II.

[40] Dodd-Frank, Section 203.

[41] Dodd-Frank, Section 210 (b)(4), (d)4), (h)(9) and (n).

[42] See Dodd-Frank, Section 210(o).

[43] Dodd-Frank, Section 335.

[44] The Emergency Economic Stabilization Act of 2008, Section 136.

would bear losses in most bank resolutions. In practice, however, the raising of the deposit insurance cap greatly alters the least-cost resolution requirement because paying insured deposits becomes far more expensive to the FDIC.[45] As a result, the FDIC can more easily provide assistance to insured depository institutions without violating the least-cost resolution requirement. For example, the FDIC provided more than $13 billion in assistance to resolve First Republic Bank without invoking the systemic risk exception.[46]

The increase in the deposit insurance cap appears to have dramatically changed how uninsured depositors fare in bank resolutions. Although FDICIA expressly sought to limit cases where uninsured depositors are protected from incurring losses, the number of resolutions where uninsured depositors have incurred losses has fallen sharply since the deposit insurance cap was raised to $250,000. According to the FDIC's recent report on options for deposit insurance reform, from 1992 (the year after FDICIA was enacted) to 2007, uninsured depositors suffered losses in 43 percent of bank failures.[47] That number fell to just 6 percent for the period from 2008 (the year the deposit insurance cap was increased) to 2022.[48]

It is important to note that in Dodd-Frank Congress also amended the Federal Reserve Board's 13(3) emergency lending authority. The amendments preserved the Federal Reserve Board's authority to provide liquidity to markets during a financial crisis, but required that any lending facility established under that authority have "broad-based eligibility" and prohibited participation by insolvent borrowers.[49] Further, the Federal Reserve Board was prohibited from using 13(3) to "aid a failing financial firm." One interpretation of these amendments to 13(3), combined with Dodd-Frank's substantial restrictions on the use of the FDIC debt guarantee program, is that Congress sought to allocate responsibilities among agencies by placing the resolution of failing firms with the FDIC and the provision of liquidity primarily with the Federal Reserve Board. The 13(3) amendments limit the Federal Reserve Board's ability to provide assistance to protect uninsured depositors and non-depositor creditors and thereby undermine the Dodd-Frank restrictions on the use of the systemic risk exception and the policy on the treatment of uninsured depositors and non-depositor creditors set by FDICIA. In effect, Congress has determined that

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[45] The Federal Deposit Insurance Corporation, FDIC Options for Deposit Insurance Reform (2023) (FDIC Report), at 26.

[46] https://www.fdic.gov/news/press-releases/2023/pr23034.html.

[47] FDIC Report at 22.

[48] Id.

[49] Dodd-Frank, Section 1101.

the FDIC, not the Federal Reserve Board, will be responsible for determining when uninsured depositors are protected. At the same time, Congress preserved the Federal Reserve Board's broad authority to provide liquidity to financial markets and otherwise respond to a financial crisis.

In sum, what authority Congress took away with amendments to the systemic risk exception in Dodd-Frank, it substantially preserved and even granted new authority in other provisions of the Act. The FDIC retains substantial authority to resolve failing institutions, including protecting uninsured depositors, especially due to the increase in the deposit insurance cap. A main exception being that post-Dodd-Frank, any failing insured depository must be placed into FDIC receivership before it can receive assistance under the systemic risk exception.

RESOLUTION OF SVB AND SIGNATURE

The FDIC's resolutions of SVB and Signature reflect the changes to the systemic risk exception enacted by Dodd-Frank. Consistent with the Dodd-Frank amendment to subclause (I) of the system risk exception, Secretary Yellen has indicated that her determination to invoke the systemic risk exception for SVB was due to her view that not protecting the uninsured depositors of SVB would have "risked contagion throughout the banking system."[50] According to the GAO's preliminary, statutorily-required review of the use of the systemic risk exception, it appears the Secretary reached a similar conclusion for Signature.[51] Hence, Secretary Yellen appears to have made specific determinations that compliance with the least-cost resolution requirement for the receiverships of SVB and Signature (rather than for the banking system as a whole) would pose a serious adverse risk to the banking system.

Consistent with the Dodd-Frank amendments requiring that assistance be provided only "for the purpose of winding up" an insured depository "for which the FDIC has been appointed receiver," the FDIC did not use the systemic risk exception to provide open bank assistance to SVB and Signature.[52] Instead, both SVB and Signature were placed into FDIC receivership before Secretary Yellen invoked the systemic risk exception. And, the FDIC provided assistance to protect the uninsured depositors of each institution as part of the winding up of each institution. In addition, although uninsured depositors were protected, shareholders and unsecured debtors were not protected consistent

[50] https://www.appropriations.senate.gov/news/minority/senator-collins-questions-secretary-yellen-about-treasurys-actions-on-banking-crisis.

[51] GAO Report (2023) at 29.

[52] Dodd-Frank, Section 1106 (b)(1)(A).

with the Dodd-Frank amendments' design to have market discipline be imposed, if possible, even when the system risk exception is utilized.

Despite concerns about a broader run on the banking system, financial regulators did not seek to establish another TLGP using the systemic risk exception, recognizing that the Dodd-Frank amendments now prevent such a program from being established under the systemic risk exception. Instead, the Federal Reserve promptly used its 13(3) authority to establish the Bank Term Funding Program to support solvent insured depository institutions experiencing liquidity problems.[53] This was consistent with Congress's implicit preference in Dodd-Frank that the FDIC focus on resolving failed institutions and that the Federal Reserve focus on providing liquidity to the financial system.

So far, financial regulators have not publicly indicated why they chose not to use the OLA in the case of SVB. However, it may be because Signature did not have a holding company, which would have prevented the use of OLA for its resolution. Dodd-Frank prohibits the use of OLA for depository institutions.[54] Financial regulators may have found it easier to handle both institutions in a similar fashion using the traditional resolution mechanism for banks under the FDIA rather than using the untested OLA just for SVB, particularly given the speed at which events transpired. Moreover, since the vast majority of SVB's assets were in its depository, the use of OLA probably would not have substantially changed the outcome of SVB's resolution.

With respect to future bank resolutions that present systemic risk, one important takeaway from the resolutions of SVB and Signature is that equity holders and unsecured creditors are more likely to incur losses if the systemic risk exception is invoked because the FDIC can no longer provide assistance under systemic risk exception outside of receivership. In this respect, the Dodd-Frank amendments have proven to be successful in increasing market discipline in bank resolutions as sought by FDICIA.

Yet, what is most notable from a public policy perspective is that the use of the systemic risk exception for SVB and Signature resulted in an outcome for uninsured depositors that is not exceptional. With FDICIA, Congress clearly established as policy that uninsured creditors should generally bear losses arising from the failure of a bank. As discussed above, while the systemic risk exception provided a carveout from this policy, Congress expected that in most bank failures uninsured depositors would not be protected. However, as the recent FDIC report notes, uninsured depositors have incurred losses in only 6 percent

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[53] https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312a.htm.

[54] Dodd-Frank, Section 201(a)(8) and (9).

of bank failures since 2008, due to in large measure, it appears, to the increase in the deposit insurance cap. Accordingly, using the systemic risk exception to protect the uninsured depositors of SVB and Signature merely resulted in the uninsured depositors of those banks being treated the same as the uninsured depositors in 94 percent of all bank failures since 2008. From this perspective, the systemic risk exception functions less like an emergency tool and more like an extension of deposit insurance, but funded with *ex post*, instead of *ex ante*, assessments. Congress may have sought to limit protection for uninsured depositors with FDICIA, but the combination of an increased deposit insurance cap and the systemic risk exception has allowed the FDIC to protect uninsured depositors far more than it did prior to the enactment of FDICIA. Going forward, the invocation of the systemic risk exception may still be an exceptional event, but the protection of uninsured depositors no longer is. Instead, the more exceptional cases will be bank failures where uninsured depositors incur losses, as the FDICIA's uninsured depositor policy has been in practice, quietly but effectively, repealed.