Statement of

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before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND MONETARY POLICY AND THE SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS OF THE COMMITTEE ON FINANCIAL SERVICES

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Good morning, Chairman McHenry, Ranking Member Waters, Chairmen Barr and Huizenga (HY-ZENG-A), Ranking Members Foster and Green, and members of the Subcommittee on Financial Institutions and Monetary Policy and the Subcommittee on Oversight and Investigations. I am Adrienne Harris, Superintendent of New York's Department of Financial Services ("DFS" or the "Department"). Thank you for inviting me to today's hearing.

The Supervision and Closure of Signature Bank

On Sunday, March 12, 2023, Signature Bank ("Signature" or "the Bank") failed after experiencing a propulsive run on deposits on Friday, March 10. The run was instigated by the self-liquidation of Silvergate Bank on March 8, and then the failure of Silicon Valley Bank ("SVB") on March 10 following an unprecedented run on its own deposits. The resulting panic caused a run on Signature that was faster than any other bank run in history, save the run that had just taken place at SVB.[1]

The Bank narrowly survived through Friday night. DFS worked that weekend to assess the liquidity of the Bank and its ability to open the following Monday, March 13 in a safe and sound manner. Signature was unable to present a credible liquidity plan to meet its known outstanding deposit withdrawals, let alone the new deposit withdrawals it could expect on Monday following the events that had transpired and a weekend of panicked news coverage. In order to avoid a disorderly mid-day Monday shutdown and further contagion across the banking

[1] *See* Frank Salmon, Axios, *The Largest Bank Run in History*, available at: https://www.axios.com/2023/03/11/the-largest-bank-run-in-history.

system, on the evening of Sunday, March 12, DFS took possession of Signature and appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver.

Before its collapse, Signature was a full-service commercial bank chartered in 2001 by DFS's predecessor agency, the New York State Banking Department. Signature was subject to joint, continuous supervision and examination by DFS and the FDIC (the "Regulators"). The DFS and FDIC examination teams were in continuous contact with the Bank as part of the normal course of supervision, reviewing Bank data and examining operations on an ongoing basis.

The Bank's business model focused on providing high-touch service to mid-sized commercial companies. Its main lines of business were commercial real estate and commercial and industrial lending. While the Bank grew steadily from its founding, growth accelerated significantly between 2019 and 2021. A substantial portion of the growth was fueled by expansion into new business activities and deposit customer types, such as mortgage servicing and digital assets-related deposits, significantly increasing the level of uninsured deposits. Over that time, Signature's total assets more than doubled, growing from $51 billion at the end of 2019 to $118 billion at the end of 2021, primarily due to growth in uninsured deposits. At the end of 2019, Signature had 40 billion in deposits, out of which $33 billion were uninsured. By the end of 2021, deposits more than tripled, growing to $106 billion, of which $97 billion, or 92 percent of Signature's total deposits, were uninsured.

Signature's reliance on uninsured deposits posed a risk that the Bank had to manage carefully to ensure adequate liquidity while maintaining a safe and sound business. However, the Bank's growth significantly outpaced the development of its risk control framework. The

Regulators began to document liquidity-related regulatory concerns to the Bank beginning with the 2018 Report of Examination.

In 2018, the Regulators identified several breaches of the liquidity risk metrics established by Signature's Board of Directors (the "Board"). The Regulators considered the issue to be sufficiently material to warrant issuing a Matter Requiring Board Attention ("MRBA") to the Bank.[2] The Bank subsequently remediated this MRBA but the liquidity-related regulatory concerns only persisted and escalated.

In 2019, the Regulators downgraded Signature's liquidity rating from a '2,' representing a "satisfactory" rating, to a '3,' representing a "less than satisfactory rating"[3], and issued a new liquidity-related MRBA consisting of 18 supervisory recommendations. The liquidity-related supervisory recommendations identified material weaknesses in Signature's contingency funding plan and liquidity stress testing, including unsupported critical assumptions, particularly with deposit run-offs in adverse liquidity stress testing scenarios and internal controls.

In 2020 and 2021 Reports of Examinations, the Regulators required Bank management and the Board to promptly implement corrective actions to remediate the identified liquidity-related weaknesses that were languishing unresolved since 2019. The Regulators warned the Bank that it was imperative to hasten remediation efforts in developing and implementing an appropriate liquidity management framework and a contingency funding plan that was commensurate with the Bank's increasing liquidity risk profile and level of funding

[2] For any bank, MRBAs represent significant issues that necessitate immediate board attention, and boards are required to place high priority on remediating such issues. Remediation of all MRBAs is critical to the overall risk management and internal control processes of a bank.
[3] The Regulators used the CAMELS rating system to evaluate the condition of the Bank.

concentrations. The Regulators told the Bank it needed to adequately control its liquidity risk and limit potential adverse impacts on the financial condition of the Bank.

The management, while acknowledging regulatory findings, did not heed the Regulators' orders. The Bank was slow to remediate supervisory recommendations, and many issues identified by the Regulators remained unresolved when the Bank failed.

While the 2022 examination was still in progress when the Bank failed, on March 11, 2023, the Regulators issued an interim ratings downgrade letter to Signature. The Bank's Liquidity and Management component ratings and the composite rating were downgraded to a '5,' the lowest rating possible, from '3' and '2,' respectively.[4] The decision to downgrade the rating was driven in part by Bank management's continued failure to remediate several longstanding liquidity risk management deficiencies, the preliminary findings of the 2022 examination cycle, and Bank management's failure to adequately respond to the events of the preceding week, including the events of March 10 in particular.

Signature's failure to remediate the outstanding liquidity management issues undoubtedly contributed to its collapse. However, the immediate cause of the Bank's failure was an unprecedented run on deposits instigated by the self-liquidation of Silvergate Bank and the subsequent failure of SVB.

On Friday, March 10, Signature experienced a runoff of $18.6 billion in deposits in a matter of hours, reducing the Bank's deposit base by 20 percent. For context, this is ten times the volume of deposit withdrawals on a normal day. While some in the market perceived Signature

[4] *See* CAMELS Ratings Definitions, Appendix.

as a "crypto bank," the reality is deposits from crypto companies only accounted for around 20 percent of the bank's diverse deposit base as of March 2023. The 1,600 withdrawal requests received on that Friday, from across the bank's diverse depositor base, placed a significant strain on Signature's liquidity position. The percentage of digital asset customer withdrawals was relatively proportional to the percentage of digital asset customers in the deposit base overall. The Bank needed an emergency loan from the Federal Reserve Bank of New York ("FRBNY") late that night to close the resulting cash deficit of nearly $4 billion.

DFS's primary goal that day was to work with Signature to avoid a default that evening. Throughout the day and into the night, the Regulators worked closely with each other and Signature to find sufficient liquidity to satisfy the significant volume of customer withdrawal requests. The FRBNY loaned Signature $5.6 billion, secured by $6.5 billion of collateral Signature had already posted with the Federal Home Loan Bank ("FHLB"). The process of pledging that collateral held at the FHLB to FRBNY was significantly challenged, however, because Signature did not have existing arrangements in place to pledge any available collateral directly to the FRBNY. As an accommodation, and given the urgency of the situation, FHLB agreed to subordinate its interest in Signature collateral to the FRBNY in light of Signature's critical liquidity needs and its lack of timely viable alternatives.

The Federal Reserve also assisted Signature operationally. While Fedwire typically closes at 7 p.m. Monday through Friday, the Federal Reserve made the decision to keep the wire open until 11:30 p.m. on Friday. With this extension, Signature was able to process some 692 wires totaling approximately $14 billion and avoid a technical default on its payment obligations.

That left approximately 1,000 remaining wires, representing $4.6 billion left to process when the Bank opened on Monday, March 13.[5]

After avoiding a default on Friday, Regulators had time over the weekend to assess Signature's condition and come to a considered view as to whether the Bank could open safely on Monday.

DFS had one objective that weekend: to preserve the safety and soundness of the financial system. Three paths were identified for the Bank, in order of preference. The first was to find a way for Signature to open in a safe and sound manner on Monday and continue as a stable institution. The second was to find a purchaser for the Bank on an open bank basis. Third, DFS and the FDIC worked in parallel to prepare for the last resort scenario of taking possession of the Bank and appointing FDIC as receiver. It was critical that all regulators were aligned on decision-making and process so that in the event we were forced to take this third course of action, we would be prepared, and not have to scramble.

The Regulators spent the weekend collecting and evaluating information from the Bank in order to make a data-driven decision about the Bank's viability. During an early afternoon call on Saturday, March 11 with Signature executives and the Board, the Regulators made clear to the Bank that the Bank's viability was uncertain and that the Regulators needed timely, accurate, and complete information to assess the condition of the Bank. When Signature would not commit to providing information by a particular time, the Regulators pushed Signature to provide the data no later than 4:00 p.m. that day. Despite this frank conversation, Signature only

[5] Based on the information provided by Signature, DFS estimated Signature had $4.6 billion of deposit withdrawals left to process after Friday night. Signature's estimates of outstanding deposit withdrawals varied throughout the weekend. As of noon on Saturday, March 1, Signature estimated $3 billion in outstanding deposit withdrawals. As of Saturday evening, Signature estimated the amount to be between $1.6 billion and $2.3 billion.

started producing information in response to the Regulators' requests at 4:44 p.m. on Saturday, and even then, the data the Bank provided was incomplete. Regulators did not receive a comprehensive liquidity plan from Signature until Sunday, March 12 at noon.

Signature needed to provide reliable and realistic data concerning immediately available liquidity and deposit withdrawals to inform the analysis the Regulators and Signature needed to perform to understand the Bank's liquidity position. Once Signature began providing any data on these key issues, the Regulators found the data was inconsistent and that it continuously changed in material ways.

To open in a safe and sound manner on Monday, March 13, Signature needed to identify and pledge assets that were immediately acceptable to the FRBNY to raise the liquidity needed to meet outstanding and new withdrawal requests. Signature struggled over the weekend to identify readily pledgeable assets.

Signature held $18 billion in capital call loans that the Bank sought to pledge to the FRBNY. Signature knew, however, that the FRBNY would not accept these loans as collateral because of the involvement of foreign investors. Signature and its counsel had previously failed to convince the FRBNY to accept these loans as collateral. Over the weekend, Signature implored Regulators to intercede on the Bank's behalf with the FRBNY.

For other assets, such as the Bank's commercial real estate loan portfolio, Signature made assumptions regarding the immediate ability to convert these assets to cash, which the FRBNY noted would take weeks to assess. Although the Bank knew the FRBNY would not accept this collateral in the necessary timeframe, Signature continued to report to the Regulators that liquidity for these assets would be available as early as Monday, March 13.

Further, over the weekend, Bank executives insisted there were $5 billion in unpledged securities available for Monday. The Regulators repeatedly asked for details about those assets, which were not forthcoming. Finally, on a phone call at 10:00 p.m. on Saturday, March 11, without explanation, Bank executives reduced the estimate of unpledged securities from over $5 billion to just $900 million.

While Signature struggled to identify readily available liquidity, estimates of pending deposit withdrawals steadily increased. Between Saturday night and Sunday morning, Signature's deposit withdrawal estimate increased from $2 billion to $4 billion, and then nearly doubled again by Sunday evening with estimates ranging between $7.4 billion and $7.9 billion.

These withdrawal numbers excluded any additional, unknown deposit withdrawal requests that Signature would receive on Monday. Bank executives continuously insisted that additional deposit withdrawals would be minimal. But the idea that, in the first business day following an unprecedented bank run and a weekend of panicked news coverage, the Bank would not see significant unplanned withdrawals was at best improbable. The Regulators assessed that the Bank had to be prepared for another run of at least 20 percent of remaining deposits on Monday. Another run of that size would amount to approximately $11 billion on top of the pending withdrawal requests.

Signature advised the Regulators that its available liquidity on Monday would be bolstered by substantial deposit inflows from clients following SVB's failure. Given the run that Signature experienced following the failure of SVB, the Regulators assessed Signature's position that its liquidity would be aided by large deposit inflows from SVB clients to be overly optimistic.

Moreover, Signature claimed $5 billion of its projected $6 billion deposit inflow would come from a DFS-regulated virtual currency company. As a result of DFS's oversight of that entity, DFS had information that contradicted the Bank's representations. Specifically, that entity advised DFS that the amount being transferred from SVB to Signature was approximately half what Signature was representing and, because of delays caused by SVB being placed into receivership, the money would not be available until Tuesday at the earliest.

As of Sunday, March 12, Signature had $4.27 billion of certain liquidity available for Monday morning to cover known withdrawals ranging between $7.4 and $7.9 billion. See Signature's Projected Liquidity vs. Known Withdrawals Figure 1 below. Starting at noon on Sunday, the Bank began producing a comprehensive liquidity plan for the coming week, which included a breakdown of the sources and value of liquidity, inclusive of new deposit inflows. The liquidity plan provided by the Bank was constantly changing. Between noon and 3:09 p.m. that day, Signature provided four different liquidity plans. The listing of available liquidity changed from plan to plan with no explanation for the change and, as referenced before, Signature constantly represented that certain liquidity would be available Monday morning even though the Bank knew the FRBNY would take weeks to review the potential collateral.

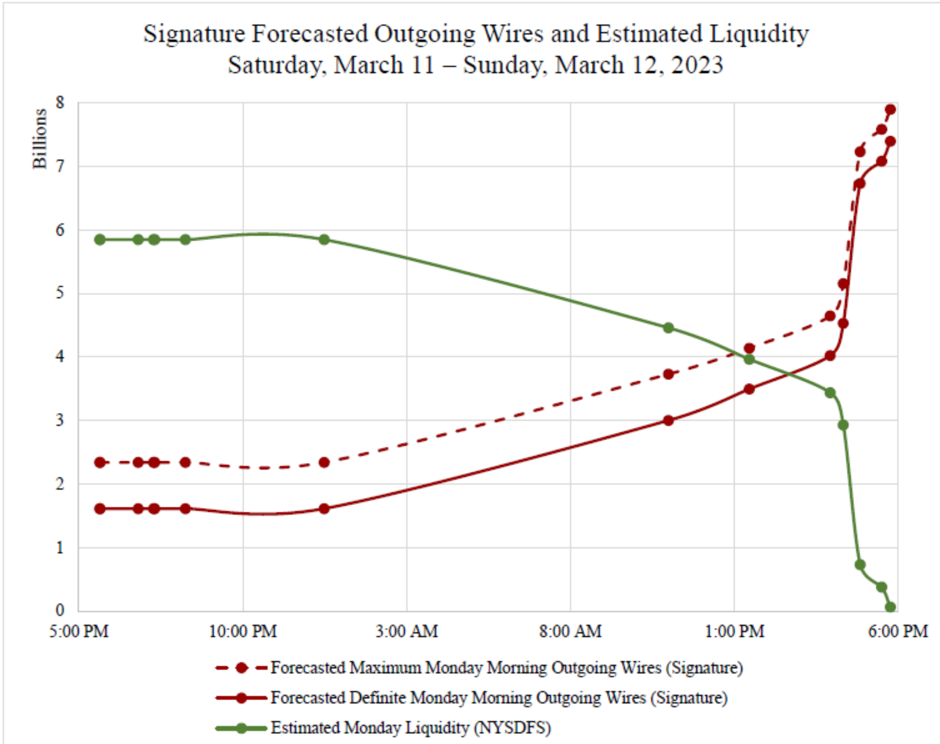

Figure 1. Signature's Projected Liquidity vs. Known Withdrawals

Based on the information the Regulators had obtained from the FRBNY regarding the Bank's pledgeable assets, and the Bank's unrealistic deposit inflows assumptions, the Regulators deemed these liquidity projections as inaccurate and unreliable. In fact, the last three liquidity projections provided by Signature bore the disclaimer that they were prepared "solely for information purposes" and Regulators "should not definitively rely upon it or use it to form the definitive basis for any decision, contract, commitment or action whatsoever, with respect to any proposed transaction or otherwise."

By Sunday afternoon, the Bank's inability to provide reliable data and a credible liquidity strategy to operate in a safe and sound manner on Monday led DFS to take possession of the Bank at approximately 5:30 p.m. and immediately appoint the FDIC as receiver.

The decision to take possession of a bank is one no regulator takes lightly. Over the weekend, DFS had begun to identify potential acquirers for the Bank but found that without federal loss-sharing, potential partners were not interested in acquiring Signature. Taking possession of the Bank was the option of last resort to avoid a disorderly mid-day Monday shutdown and stop any further panic and contagion across the broader banking system.

A confluence of events – the liquidation of Silvergate, the collapse of SVB, and rapidly spreading social media posts – led to a panic and an unprecedented outflow of deposits from Signature on Friday, March 10. The Bank was ill-prepared to handle the run. Signature's response to the crisis was hampered by a control framework and liquidity management plan which did not mature in line with the Bank's growth and deposit mix. Given the prevailing panic, and the size and speed of the deposit run that occurred at SVB, it is unclear whether, if Signature had opened on March 13 in a better liquidity position, the Bank could have survived a new-old fashioned bank run.

<u>DFS Actions and Recommendations Following Signature's Closure</u>

In addition to the work with Signature, beginning that weekend, I took two additional immediate actions. First, I instituted enhanced supervision of banks with higher risk profiles, which continues today. DFS has been monitoring the liquidity of these institutions on a daily basis, which entails frequent engagements with these institutions, as well as close coordination with our federal counterparts. We continue to work with the FHLB and the FRBNY to facilitate the process for accessing liquidity, including access to the Federal Reserve's Bank Term Funding Program.

Second, on Monday, May 13, I directed DFS's Office of General Counsel to review the collapse of Signature and produce a public report on the supervision and closure of the Bank. The report, released on Friday, April 28, identified recommendations the Department is implementing to modernize supervision of today's global financial system. I am proud of how quickly DFS and federal regulators acted to protect the consumers and small businesses banking with Signature, but in the aftermath of a crisis there is always an opportunity to learn and improve.

Current regulatory processes do not move at the speed and complexity of today's financial services sector. Recognizing this critical gap, since joining the Department in 2021, I have begun to rebuild the agency to improve its ability to effectively regulate financial services institutions, including a specific focus on staffing and examination capacity, as well as examiner training.

I have prioritized hiring since I was appointed to lead DFS in September 2021. The state's FY23 budget, enacted in 2022, fully funded DFS for the first time in its history, allowing the agency to hire staff that had been needed for years. Pursuant to my strategic staffing plan, DFS has overhauled its hiring process, onboarding 205 new staff and promoting 199 existing members of the team since January 2022. Furthermore, DFS has onboarded the first new class of financial services examiners since 2018, critical staff needed to increase capacity to examine banking organizations.

Even with DFS's recent hiring success, however, a long-running failure to maintain adequate staffing levels, combined with ongoing attrition[6] requires DFS to continue this important work of hiring in order to fully execute on its mission. As DFS continues to advance its recruitment, hiring, and retention strategies, it will do so bearing identified inefficiencies in the examination process in mind.

DFS has begun reviewing examiner training to ensure new and existing DFS examiners are receiving the most up-to-date training, including ensuring the examination team is kept current on new and emerging issues that may affect a bank's safety and soundness.

While DFS and the FDIC used the available tools to identify risks and require the Bank to take remedial actions, the Bank failed to fully address key concerns of the Regulators in a timely manner. DFS is currently developing new internal procedures for escalating supervisory areas of concern, revisiting the assumptions used to model and manage liquidity risk, and considering the addition of operational stress testing to ensure banks are ready to collect and produce accurate financial data rapidly in a crisis.

Furthermore, to better hold banking institutions responsible for regulatory failures, DFS will explore potential policy action and legislative recommendations to ensure DFS has additional necessary authority to hold executives accountable for critical management failures.

This critical review of DFS's supervision of Signature builds upon my longstanding commitment to data-driven policymaking, which includes examining and strengthening our processes and staffing to ensure we can meet the needs of consumers today and in the future.

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[6] Among other issues, including attrition to federal financial regulators who pay on average 30 to 50 percent more for similar roles.

Thank you and I look forward to your questions.