OFR
OFFICE OF FINANCIAL RESEARCH

FINANCIAL RESEARCH ADVISORY COMMITTEE

TOPIC: Risks from the banking sector

SUMMARY

The OFR is requesting that the Financial Research Advisory Committee discuss how the OFR should approach assessing risks from banks.

BACKGROUND

In 2022, in aggregate, the U.S. banking sector was well capitalized and maintained risk-based capital ratios well above regulatory minimums. Under the Federal Reserve Board of Governors' 2022 stress test, banks had sufficient capital to absorb more than $612 billion in losses and continue lending to households and businesses. Post-stress, common-equity tier-1 risk-based capital ratios remained well above the required minimum levels.

Higher interest rates are a double-edged sword for banks. Net interest income for banks should moderately increase after having risen 15%-20% in 2022, and that should help offset revenue pressures from declines in noninterest expenses and reduced fee income. Bank loans also grew approximately 9% in 2022, driven by growth in commercial and industrial loans, multifamily real estate, and credit card usage.

Elevated interest rates can impact the level of bank deposits because customers have higher-yielding alternatives. In aggregate, banks saw a decline in deposits through the end of 2022. Banks will need to increase the interest rates they pay in order to retain depositors. The Federal Deposit Insurance Corporation (FDIC) reports that unrealized losses on securities totaled $620.4 billion, or approximately 28% of bank equity capital, at the end of 2022. Interest rate increases eroded the value of the fixed-income assets in banks' securities portfolios.

In early March 2023, three regional banks failed over the course of five days. Silicon Valley Bank, the largest of the three, was taken over by its regulator for liquidity and insolvency issues, which were related to liquidity issues stemming from losses on its bond portfolio. Federal government agencies invoked the systemic-risk exception to stabilize depositor runs at regional banks. The Federal Reserve Board also implemented a new lending facility that allows depositories to borrow the par value of pledged securities, regardless of their market value.

QUESTIONS

1. Are there any qualitative or quantitative measures that could best serve as early-warning signals of stress at individual banks, in particular sectors (such as regional banks), and in the banking industry as a whole?

2. In your opinion, what was the magnitude of the impact of social media and technology (such as changes in payment systems) in amplifying the March bank runs?

3. Do certain types of banks have outsized exposures that warrant higher price volatility?