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INTERVIEW / WILLIAM RHODES: FED MISSED SVB AND MIDDLE BANKS MUST UNDERGO STRESS TEST

By Ricardo Leopoldo

São Paulo, 04/07/2023 - Federal Reserve supervision erred in not taking measures well beforehand to prevent the collapses of SVB and Signature banks in March, especially because they were problem institutions, one of which was poor risk management, he commented. in an exclusive interview with **Broadcast** William Rhodes, former president of Citibank and president of consulting firm William Rhodes Global Advisors. In the 1980s, he led international banking committees in restructuring the foreign debts of Latin American countries, including Brazil, Argentina and Mexico.

For Rhodes, the Fed needs to again carry out stress tests with medium-sized banks to not allow situations similar to those recorded by the SVB and Signature to occur, which could have caused the contagion to other financial institutions in the country.

In addition to advocating the return of Dodd-Frank legislation to what it existed before 2018, when deregulation of medium-sized banks occurred, Rhodes believes it is essential to adopt rules or legislation to hold executives and board members of banks that fail accountable in order to reduce the moral hazard.

William Rhodes pointed out as inappropriate the fact that the former SVB chairman was also a board member of the San Francisco Federal Reserve. “The Fed could even say that the executive was on the board and did not make policy. But this makes no difference, as their presence has an effect on what the official institution will do.” Follow the main parts of the interview.

Photo: Disclosure

Broadcast: How did the Federal Reserve in San Francisco and Washington fail to act sooner to prevent the collapse of SVB and Signature banks?

William Rhodes : One of the reasons is that it took the Federal Reserve six to eight months to raise yield when inflation was already very high, which caused it to rush to raise rates quickly in 2022. Several private banks tried to protect themselves when investing your resources in treasuries. What happened with SVB and Signature is that they didn't have risk management and a professional to take care of this area a few months before these institutions exploded.

The San Francisco Fed failed in the SVB case as it did nothing, despite inspecting the bank on several occasions and recording the status of its risk management.

I don't know what will be released in the report the Federal Reserve will present on May 1 on what happened with SVB and Signature oversight, but obviously failures have occurred.

Broadcast: What is your assessment of the fact that the former SVB chairman was also a member of the San Francisco Fed Board?

Rhodes : I don't believe this is a good procedure. Paul Volcker and I, my office colleague in the years before his untimely death, for many years used to say that a president of a regulated bank should not sit on the board of a regional Fed. I think several steps should be taken to eliminate this situation as quickly as possible.

The Fed may even say that the executive was on the board and did not formulate policy. But this makes no difference, for their presence has an effect on what the official institution will do.

Broadcast: Was the 2018 deregulation of Dodd-Frank legislation a mistake as it removed middle-market banks from the need to be stress tested by the Federal Reserve?

Rhodes : Yes, this was a clear mistake, because if it had been working as it had previously maybe what happened with SVB and Signature would have been avoided. I also believe that the directors of these two private banks, including the members of their boards of directors, should be held responsible for what happened to these institutions. I believe it's shameful to have someone like former Representative Barney Frank, whose name is on the Dodd-Frank Act, press for deregulation of middle-market banks because he was a member of Signature's board. And this bank also lacked proper risk management. Every financial institution needs to have a strong risk management culture.

Broadcast: How does the Fed need to quickly correct such oversight and enforcement errors?

Rhodes : The Fed needs to get back to stress testing middle-sized banks, without a doubt.

The Dodd-Frank legislation must be reinstated. And you need to hold their leaders and board members responsible for the collapse of banks, because these people, like Barney Frank, now just wash their hands of everything they did in these banks. If you check the websites of these institutions, it is not possible to know who the participants of their councils were. The UK currently has stricter rules on this matter, where bank board members sign documents in which they declare that they are responsible for what is happening to the institutions they run.

Such measures are even more important now than during the Great Recession, as we have the speed of social media today, where facts occur in nanoseconds and make banks collapse very fast. And this increases the problem of contagion to other financial institutions, which makes Jamie Dimon (president of JPMorgan), a first-class banker very worried.

Take the case of Credit Suisse. The bank had been in trouble for four years, but what really led it to its recent situation (sale to UBS) is what happened with SVB and Signature, as their customers became concerned that the already struggling institution could also get in. collapsing.

Broadcast: How can Dodd-Frank legislation be fully reinstated by Congress that is divided, as control of the Senate goes to Democrats and control of the House of Representatives to Republicans?

Rhodes : It won't be easy, because I've never seen such big differences between what the Republicans and Democrats in Congress stand for. But the Fed doesn't have to wait, as it has the ability to start stress-testing adoption fully without needing the Dodd-Frank imposition. It is very simple to change these tests. With them, when the Fed discovers that a bank has problems, it must take steps to solve them.

In SVB's case, the Fed should have taken action and limited its ability to operate when it saw difficulties growing, but they didn't.

Broadcast : Are you referring to the fact that the size of financial assets managed by SVB has more than doubled in the past two years?

Rhodes : Exactly. This was a Fed failure. Now its leaders say they have alerted the SVB. But warning was not enough, as they should have taken action, as they have done in the past with other banks such as Wells Fargo and Citi.

Broadcast: What standards need to be adopted to reduce moral hazard, especially to increase bank managers' responsibilities in the event of the failure of the institutions they manage? In this context, would it be timely to make improvements or reforms to Basel 3?

Rhodes : There should be regulation or legislation to hold executives at the highest administrative levels and board members accountable to prevent this situation from occurring.

About Basel 3, one of the criticisms of many Europeans is that the US has never fully implemented this international agreement. They were very frustrated when the Dodd-Frank legislation was modified. We have to ensure that the Basel 3 measures are applied to medium-sized banks in the country.

Broadcast: Jerome Powell, Fed chairman, even defended in Congress the deregulation of medium-sized banks adopted in 2018. Would it be appropriate for him to go public now to say that his position was not correct?

Rhodes : I think he's expecting the release of the May 1st report, which is being produced by the VP of oversight (Michael Barr). He's the first person to ask questions about what happened to SVB and Signature. Frankly I think Powell was leaving this issue to the oversight vice president, but he has ultimate responsibility because he's the Fed chairman.

Broadcast: Powell Failed?

Rhodes : Yes, I think that will be a problem. He likes to say that Paul Volcker is a symbol. But Volcker was worried about regulators who hadn't learned the lessons since the Great Recession, and he died with those thoughts in mind.

Broadcast: There have been many recent comments, including by Jamie Dimon, that the Federal Reserve has not incorporated the yield hike it adopted last year into the 2022 stress tests. The Fed should make the methodology of these tests very clear to society ?

Rhodes : Yes, certainly. It is very important for the Fed to be independent. But it is important to independently adopt policies and learn the lessons that flow from them. I hope that these facts that occurred in the US should resonate in a way in Brazil with President Luiz Inácio Lula da Silva, in the context of the country having a strong central bank with strong regulation.

Broadcast: Do you say that the Central Bank should consider these facts that occurred with banks in the US and review the regulations to ensure that they are appropriate for financial institutions in Brazil at this time?

Rhodes : Exactly. It's always good to learn from others' problems. There are lessons for everyone from these cases. In the US, reforms and the response by Powell and Federal Reserve leadership to implement regulatory changes as soon as possible will be important. I'll be looking forward to what's next with the May 1 report because there's no doubt that the Fed's and Jerome Powell's credibility is at stake.

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