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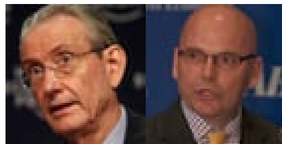
Comment/ Opinion

How China can learn from the mistakes in US banking culture and oversight

- As China looks to reform its banking regulations, it can avoid US pitfalls, such as letting regional banks lend excessively to one sector or allowing skewed boards
- Importantly, the siren call of lobbying for looser banking rules and regulations must be ignored



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The recent and still-reverberating regional banking troubles in the United States require a frank assessment of the failures and faults by many actors. Central bankers and supervisors in other jurisdictions could learn lessons from America's mistakes, in matters related to bank culture, regulation and supervision.

On bank culture, a topic on which the Group of Thirty has opined repeatedly, the lessons are clear. A firm's culture, demonstrated by the board and leadership, determines risk appetite. The culture signals to mangers what to do and how to do it.

Silicon Valley Bank (SVB) and Signature Bank adopted cultures that were closer to their borrowers' than the conservative norms which they ought to have been following. SVB leaders had a venture capital arm and signalled its culture via its own investments trading. Signature served crypto clients and bank insiders reportedly invested heavily in crypto.

The companies became too close to their customers. They adopted risk-taking inappropriate to their social and economic roles. When the easy money stopped, these banks faced dangers similar to those of their overleveraged and concentrated customers.

Similar cultural mistakes may happen in China if local regional banks lend excessively to one sector (such as real estate or information technology) and ape their borrowers' risk-taking behaviours. Chinese supervisors should be alert to such cultural and strategic errors.

In America, the banks' boards appear to have failed to oversee the management and rising risks. SVB's management was rated "deficient' by regulators the year before its collapse. The SVB board was dominated by venture capitalists of a particular risk-taking Silicon Valley mindset.

SVB took inappropriate risks in the lead-up to its collapse. Photo: Reuters

Moreover, SVB did not have a chief risk officer for eight months. Why was this critical leadership post left vacant at a time of stress? The failures in regional US banks underscore the central role that a strong and assertive board must play in ensuring bank stability.

Board composition matters and risk management matters. Such failures could also happen in China if board composition is skewed, or if risk management roles are left unfilled or under-resourced. Boards must be effective stewards, not the friends and enablers of CEOs, or worse still, amplifiers of corporate strategic mistakes.

If culture and leadership are crucial points of possible failure, so too are regulatory errors.

In the US, bank lobbyists opened up a regulatory gap in 2018, supported by then US president Donald Trump and his appointees, which helped cause the current financial volatility. We saw a weakening of Dodd-Frank rules on capital, supervision and risk-taking for mid-sized banks.

These changes allowed SVB and Signature Bank to operate in ways that put the companies at risk and weakened necessary oversight.

As China embarks on a banking regulatory redesign, the American lessons are clear: do not listen to the siren call of lobbying for looser banking rules and regulations.

Banking giants that are too big to fail are not the only points of danger. Failures in smaller institutions can spread and infect other companies and markets. Indeed, this is often how wider banking crises start. Make sure that regulatory oversight of regionally significant firms is maintained, not weakened.

Supervisory lessons are also evident. In the US, regional Federal Reserve banks dropped the ball. SVB's CEO was on the board of the San Francisco Federal Reserve. This is a potential conflict of interest.

It is time to stop this practice. We should remember the late Paul Volcker's maxim that a central banker is a supervisor, not a bankers' friend. The two cannot cohabit.

The Federal Reserve Board also failed to ensure that monetary policy staff understood the role and challenges of their supervisory colleagues, and vice versa. The spillovers of the former on the latter are real, and each side must know the effects of what the other is planning and executing.

Michael Barr, vice-chair for supervision at the US Federal Reserve, speaks during a Senate Banking, Housing, and Urban Affairs Committee hearing in Washington, DC, on March 28. Photo: Bloomberg via Getty Images

As a result, the US central bank did not test for interest rate risks – precisely the risk both failed banks confronted as rates rose. The banks should have known the Fed was going to raise rates swiftly to deal with high inflation. For SVB and Signature Bank, this meant disaster.

When SVB's profits dived and panic struck, it was transmitted rapidly via social media; digital banking accelerated the collapse and SVB's depositors tried to withdraw practically all deposits in just two days.

A key lesson for the People's Bank of China and other Chinese supervisory authorities is not only that regulations need to be adjusted and toughened, but also that supervisors at central banks must assume less, and stress-test more banks, more thoroughly, and act on the results.

Their monetary staff must understand supervisory teams' pressures, and both sides must work to ensure they test and act fast when risks of failure arise.

The global tremors of America's latest banking failures continue to be felt. Shocks in other markets may not be over and contagion dangers remain, as we can see with First Republic Bank, Credit Suisse and Deutsche Bank.

China's regulators should look and learn – on culture and conduct; on firm leadership and board roles and composition; on regulatory rigour; on supervision, stress testing and monetary policy spillovers.

Chinese regulators can thus potentially avoid similar mistakes when – not if – banking crises occur at home.

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