US banks

How the Federal Reserve's rescue package for US banks differs from 2008 bailouts

Regulators have moved to bail out depositors of SVB and Signature Bank without the help of taxpayers

Customers queue outside a Massachusetts branch of the now-defunct Silicon Valley Bank on Monday © AP

Brooke Masters and **Mark Vandevelde** in New York and **Colby Smith** in Washington 2 HOURS AGO

Within three days, the Federal Deposit Insurance Corporation and state regulators in California and New York took control of Silicon Valley Bank and Signature Bank and guaranteed all their deposits, beyond the usual $250,000 federal insurance limit.

The Federal Reserve also announced a new lending facility, backstopped by the US Treasury department, that other banks can draw on to help them meet demands from depositors.

The moves are intended to prevent contagion throughout the US banking sector after the now defunct Santa Clara-based SVB, whose clients were mostly venture capital funds and tech start-ups, suffered mass deposit withdrawals last week.

Here is how the Fed's intervention works and how it differs from the bailouts during the 2008 financial crisis.

How do the Fed's lending facilities work?

Lenders will be able to draw on the Fed's lending facilities for up to a year by pledging collateral such as government bonds, which will be valued at face value. Such credit lines have been the tool of choice since the 2008 crisis and were used extensively when central banks stepped in to stabilise markets in the early days of Covid-19.

The pandemic-era interventions expanded the scope and scale of the Fed's reach in an unprecedented way, eventually enmeshing the central bank in the markets for corporate credit and municipal bonds and creating a direct lifeline to help small and midsized businesses.

In a testament to their effectiveness, just a fraction of the multitrillion-dollar support available via these lending facilities was deployed, as the promise alone of the Fed's support quelled the panic.

On Sunday, the Fed sought to have a similar effect, going so far as to say it was "prepared to address any liquidity pressures that may arise".

What problems were regulators trying to solve?

Many banks have large depositors whose balances exceed the $250,000 cap beyond which deposits are not covered by the FDIC insurance mechanism. If they flee, more lenders will face the same pressure to sell assets at a loss.

The extended deposit guarantee is aimed at preventing more bank runs, by convincing customers to stay put because they will be protected even if another bank fails.

The Fed's offer to lend against high-quality bonds at par is aimed at helping other banks to meet withdrawals without selling securities at a loss. Depositors at other banks can now be more confident about avoiding being caught up in a similar panic.

This also responds to a specific problem at SVB and other big institutions: many of them have billions of dollars tied up in securities that can only be sold right now for less than the bank paid for them. If they are held to maturity, they would be worth par. The Fed's lending reduces the risk that banks' paper losses, estimated to be above $600bn at the end of 2022, will crystallise into actual losses.

More broadly, the spectre of savers losing money on their deposits at a large US bank would have shaken confidence in the financial system and increased the risk of widespread flight.

Sunday's show of force was meant to stop that destructive cycle in its tracks.

Why is this different from the taxpayer-funded rescues in 2008?

FDIC and Treasury officials have been keen to stress that the assets of SVB and Signature will be used to cover the initial government outlays to give depositors access to their money.

This may be enough to plug the hole, because SVB's losses were paper losses on government bonds, not bad loans or complex securities, as happened in the great financial crisis. SVB also had a broker-dealer and an investment banking arm, and the sale of those divisions may also generate money to repay the federal assistance.

If that still does not cover the hole, US officials said on Sunday night: "Any losses to the deposit insurance fund to support uninsured depositors will be recovered by a special assessment on banks."

The other difference is that the government has said that investors who hold the shares and bonds of SVB and Signature will lose their money unless there are excess funds after the depositors are repaid. With the exception of Lehman Brothers, that generally did not happen in 2008, because of fears that losses on bank shares and bonds would spread contagion.

"People are saying the whole banking system is in peril. I don't see it at all," said Lloyd Blankfein, who ran Goldman Sachs in 2008. "The largest banks are much more highly regulated and have been subjected to rigorous stress tests."

Why are shares in other banks still sinking?

Sharp moves in the shares of some banks suggest that investors are not fully convinced that Sunday's rescue package will end the fallout from SVB's failure. Beyond that, even the soundest banks are likely to face higher costs and tougher regulation, even if Sunday's rescue succeeds in alleviating the crisis of confidence that had threatened to spiral in recent days.

Whether by offering higher interest rates for depositors, or tapping wholesale money markets instead, analysts expect banks to take few chances as they shore up their funding position — and that means smaller interest margins.

Regulators are also likely to revisit their assumptions about the systemic importance of medium-sized financial institutions, further crimping the profits of a sector that had successfully argued it should be spared the tough oversight meted out to the biggest banks.

What future issues does this intervention create?

Pressure will mount on the FDIC to guarantee all depositors at all US banks, no matter how large their accounts, lest investors and depositors flee those that are unprotected.

This would extend a protection that has always been focused on retail customers to businesses and raises the possibility that the ultimate cost will fall back on the taxpayer.

"This bailout of taxpayer money today signals to businesses in the future that the Fed will bail them out tomorrow," said Aaron Klein, of the Brookings Institution.

The emergency lending facility's decision to accept securities at par also reduces the pressure on banks to be prudent with their investments and liquidity management, which runs counter to decades of efforts to make banks safer.

If bank share prices continue to fall and drag the broader market with them, the Fed may feel pressure to stop raising interest rates at a time when inflation is still well above the 2 per cent target rate.

"What is going on is pure panic," said Christopher Whalen, a veteran bank analyst and head of Whalen Global Advisors. "If we get more bank failures, I think we could see the Fed drop rates."

Additional reporting by Joshua Franklin and Stephen Gandel in New York

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