KLAROS GROUP

Dual Banking System

Briefing for California Assembly Committee on Banking & Finance

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Introduction and Disclaimer

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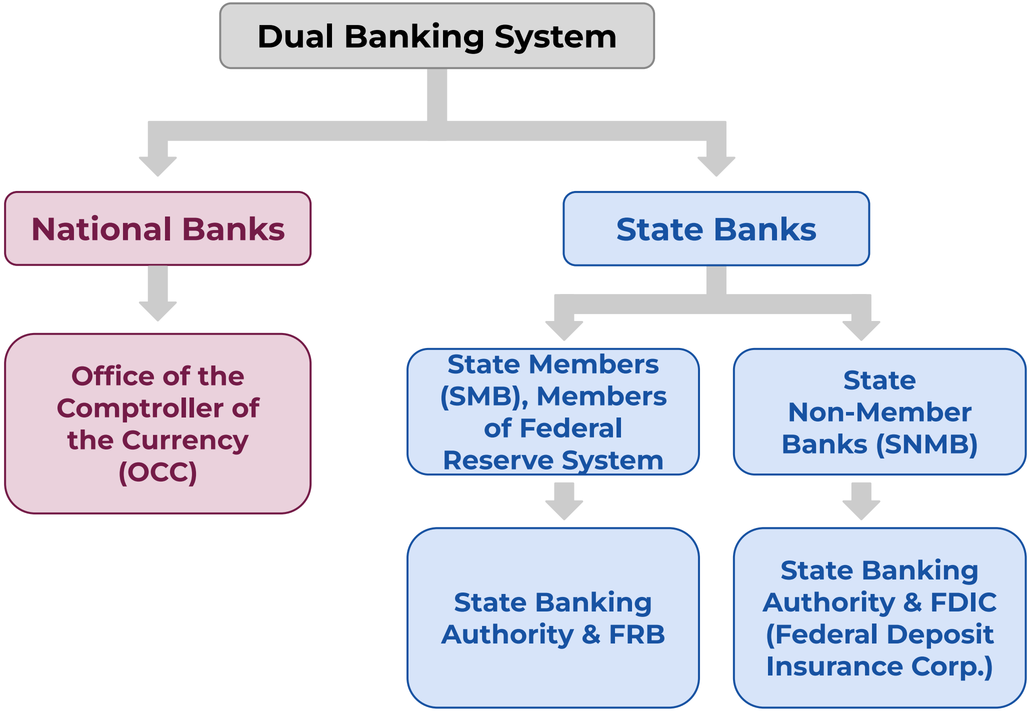
- Only speaking about **publicly available information**
- **Views are my own** and not those of Klaros Group or my partners

Dual Banking System

- Refers to the **parallel state and federal banking systems** that have co-existed in the U.S. for more than 200 years
- Federal system based on federal banking charter and **oversight by federal supervisors**
- State system characterized by state chartering and **oversight by state *and* federal supervisors**

Dual Banking System and the DFPI



- **California Department of Financial Protection & Innovation (DFPI)** licenses and regulates state-chartered banks like SVB, First Republic, and Silvergate
- **Federal Reserve (FRB)** is the primary federal regulator of a state bank that is a member of the Federal Reserve System
- **FDIC** is the primary federal regulator of a non-member state bank
- **SVB and Silvergate** were member banks regulated by the Federal Reserve Bank of San Francisco
- **First Republic** is a non-member bank regulated by the FDIC

Bank Holding Company (BHC) Regulation

The FRB regulates BHCs like Silicon Valley Financial.

BHC → has a → **Controlling stakes in banks** but **Does not offer banking services**

BHC structure:

BHC

Bank | **Subsidiary** | **Subsidiary**

DFPI Coordination with Federal Banking Agencies 1/2

- “**The Department has cooperative examination agreements with both the FDIC and the Federal Reserve Bank** (FRB), whereby examinations are conducted on an alternating basis.”
- “We make every effort to have minimal disruption on bank operations. The use of cooperative examination agreements between state banking supervisors and the FDIC and FRB essentially assures that a **state bank will have only one regulatory examination on either a 12- or 18-month cycle** since each agency relies on the alternating examination agreement.”
- “Our alternating examination program with the federal regulators **minimizes the intrusion of examiners into institutions that are well-managed and well-capitalized**, freeing up staff to concentrate on financial institutions in need of closer supervision.”

DFPI Coordination with Federal Banking Agencies 2/2

- "**The Department enjoys a good working relationship** with the FDIC, FRB and NCUA. We interact well with other regulatory agencies both state and federal on those occasions when our regulatory paths cross, providing mutual assistance when possible and necessary."
- "Generally, **federal regulators will consult with the state banking supervisor** as to an appropriate remedy for problem issues involving state-chartered financial institutions, since the state supervisor is the chartering agent for the financial institution. This state/federal consultation process often results in greater overall flexibility on the part of the regulators."

But DFPI has Broader Role and Fewer Resources

- Unlike the FRB and FDIC, **DFPI is also the primary regulator of nonbank financial service providers** in the state
  - DFPI oversees approximately 20 different types of financial licensees
- **FRB of San Francisco has 200+ more employees than the DFPI** and the ability to draw on personnel from other districts and Washington, DC
  - This provides advantages in managing larger, more complex banks that operate in multiple states, like SVB, or banks with specialized business models, like Silvergate
- Thus, **Federal banking agencies often take a lead role in the supervision of complex or specialized state banks**
- The **DFPI plays a critical role in public messaging** and reinforcing confidence in all state banks

Effects: Sale of Silicon Valley Bank Deposits and Assets to First Citizens Bank

Acquired certain assets and assumed certain liabilities of Silicon Valley Bridge Bank, N.A. from the FDIC

Acquisition details

- We acquired **total assets of $110.1 billion** with a **$16.5 billion discount bid on assets**, consisting of**:**
  - **$72.1 billion** in loans
  - **$56.5 billion** in deposits
  - No investment securities acquired
- Option to purchase all bank branches and corporate locations.
- Retaining employees in the acquired revenue-producing businesses and those necessary to manage operations to support those businesses.
- FDIC received a value appreciation instrument from First Citizens BancShares, Inc. valued at up to $500 million (payable in cash) and exercisable until April 14th, 2023.

Downside protections

- Transaction structured to **limit liquidity and credit risks** to First Citizens:
  - Asset discount and loss share agreement with the FDIC provides downside protection against credit risk.
  - Five-year loss share agreement stipulates that the FDIC will reimburse First Citizens for 50% of losses on commercial loans in excess of $5 billion.
  - Entered into a liquidity facility with the FDIC to provide additional contingent funding if needed.

Integration

- All regulatory approvals received and transaction has closed.
- All branches now operating as a division of First Citizens Bank.
- All depositors will continue to have access to their funds.

Preliminary Acquired Assets & Liabilities (1)

($ in millions)

Assets		
Cash	$	35,264
Gross loans		72,114
Earning assets	**$**	**107,378**
Other assets		2,704
Total assets	**$**	**110,082**

Liabilities		
Deposits	$	56,491
Borrowings (2)		34,605
Other liabilities		2,536
Total liabilities	**$**	**93,632**
Discount bid on assets	**$**	**16,450**

First Citizens BancShares®

(1) Assets and liabilities as of March 24, 2023 as provided by the FDIC. Subject to change based on closing balance sheet. Asset and liability data does not include purchase accounting marks.
(2) In connection with the acquisition, First Citizens entered into a five-year $35 billion note payable to the FDIC bearing an annual interest rate of 3.50%. Amount is estimated based on the March 24, 2023 balance sheet provided by the FDIC. Subject to change based on closing balance sheet.

Effects: First Citizens Bank Did Not Assume SVB's Community Benefits Plan

- **SVB negotiated the agreement as it was seeking regulatory approval to buy Boston Private**, a Boston-based private bank and wealth manager
- SVB pledged **$11.2 billion**
  - $5 billion in small-business loans
  - $4.8 billion in community development loans
  - $1.3 billion in LMI residential mortgages
  - $75 million in charitable donations
- **$9 billion was to be invested in California**
- In 2022, the first year of the agreement, SVB:
  - Launched a **fixed-rate program for LMI applicants to buy or refinance homes**
  - Increased its community development lending, with **more than 60% going to affordable housing**
  - Co-founded an **"action opportunity fund" to provide technical assistance and loan support** to diverse, immigrant and women-owned businesses
- **First Citizens likely to negotiate at least partial compliance with SVB's agreement** but full compliance may not be in the cards
  - SVB had $174 billion in deposits in December 2022 - First Citizens acquired the $56.5 billion that remained