FDIC'S SUPERVISION OF FIRST REPUBLIC BANK

SEPTEMBER 8, 2023

FDIC FEDERAL DEPOSIT INSURANCE CORPORATION

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Executive Summary

Introduction

On May 1, 2023, the California Department of Financial Protection and Innovation (CADFPI) closed First Republic Bank (First Republic), San Francisco, California, and appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. As of March 31, 2023, First Republic had total assets of $232.9 billion and total deposits of $104.5 billion. First Republic was the fourteenth largest bank in the country, and the second largest bank supervised by the FDIC, and its failure constituted the second largest bank failure in United States history. As of May 1, 2023, the FDIC estimated the cost of First Republic's failure to the Deposit Insurance Fund (DIF) to be approximately $13 billion.[1] The exact cost will be determined when the FDIC terminates the receivership.

The FDIC was First Republic's primary federal regulator. In May 2023, FDIC Chairman Martin J. Gruenberg commissioned the FDIC's Chief Risk Officer to conduct an internal review of the agency's supervision of First Republic.

Background

First Republic was a state non-member, commercial bank and trust company with no holding company, headquartered in San Francisco, California. Established in 1985, the bank focused on offering banking services to high net worth (HNW) individuals, including residential real estate lending, private banking, business banking, wealth management, trust, and brokerage services. Single-family residential (SFR) loans were the primary loan product and included nonconforming jumbo mortgages with interest-only repayment terms. First Republic used these products to acquire HNW customers and expanded the banking relationship by providing trust and wealth-management services, among other personalized banking products.

Causes of Failure and Material Loss

The primary cause of First Republic's failure was a loss of market and depositor confidence, resulting in a bank run following the failure of Silicon Valley Bank (SVB) and Signature Bank on March 10 and 12, 2023, respectively. Examination products reported that First Republic had historically been a respected, well-run bank and was responsive to supervisory feedback and recommendations. Reports of examination (ROEs) noted that the bank grew consistently, but implemented and maintained infrastructure, controls, and risk management processes commensurate with its size and risk profile. Notwithstanding, there were attributes of First Republic's business model and management strategies that made it more vulnerable to interest rate changes and the contagion that ensued following the failure of SVB. Those attributes included:

- Rapid growth and loan and funding concentrations.
- Overreliance on uninsured deposits and depositor loyalty.
- Failure to sufficiently mitigate interest rate risk.

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[1] The FDIC recorded a loss of $15.6 billion associated with First Republic's failure on May 31, 2023. See footnote 4 on page 6 for additional information about the loss estimate.

First Republic had balance sheet characteristics that were similar to SVB's, mainly high levels of uninsured deposits and substantial differences in the fair value of loans versus loan book values (SVB had substantial unrealized losses resulting from the fair value of its securities). First Republic also operated in the same geographic market as SVB and had venture capital clients. Following SVB and Signature Bank's failures, First Republic experienced dramatic and severe contagion effects causing immediate liquidity stress due to significant uninsured deposit outflow, which depleted the bank's on-balance sheet liquidity. The continuous withdrawal demands required the bank to borrow substantial amounts from the Federal Home Loan Bank (FHLB) and the Federal Reserve Discount Window. On March 16, 2023, a consortium of 11 major U.S. banks placed $30 billion in deposits at First Republic that slowed the rate of deposit outflows. However, an April 24, 2023 earnings call, which disclosed that First Republic lost over $100 billion in deposits during the first quarter of 2023, prompted a negative market response, a significant decline in the bank's stock price, and a resumption of significant deposit outflows. Given the deterioration in the bank's condition, lack of progress in restoring confidence, and dim prospects for improving the bank's condition, the FDIC and CADFPI downgraded the bank to problem status on April 28, 2023. The bank's rating downgrade caused it to drop to Secondary Credit status for Federal Reserve Discount Window purposes, which effectively eliminated First Republic's ability to continue borrowing money from the Federal Reserve Discount Window.

The FDIC's Supervision of First Republic Bank

In supervising First Republic, Division of Risk Management Supervision (RMS) staff in the FDIC's San Francisco Regional Office (SFRO) and San Francisco Field Office employed a continuous examination process (CEP) that included assigning a dedicated team of examiners, conducting targeted reviews, and issuing annual roll-up ROEs. The Large Bank Supervision (LBS) Branch in headquarters also reviewed and provided feedback on examination products and provided nationwide oversight of CEP institutions. Due to its size, RMS senior leadership received quarterly updates from the dedicated examination team and met with First Republic's Chief Executive Officer (CEO) quarterly. The FDIC generally assigned positive examination ratings to the bank and identified relatively few Supervisory Recommendations (SR) or areas for improvement. [2]

Examination Ratings Assigned: From 2018 through March 2023, the FDIC assigned a Composite "2" CAMELS rating[3] to First Republic, indicating that the overall condition of the bank was satisfactory. [4] The FDIC assigned "1" component ratings for Asset Quality and Management, indicating that both were strong, and increased the Liquidity component rating to "1" in the 2021 ROE, indicating that liquidity levels and funds management practices were strong. The FDIC assigned "2" component ratings for Capital, Earnings, and Sensitivity to Market Risk, indicating that those areas were satisfactory. Examination products were detailed and provided narrative support for the ratings assigned.

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[2] The scope of our review did not include consumer compliance related reviews and SRs.

[3] Bank examiners review and evaluate an institution's condition using the Uniform Financial Institutions Rating System, also known as CAMELS (Capital, Asset quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk). CAMELS ratings are scored on a scale of "1" (best) to "5" (worst). Examiners assign a rating for each CAMELS component and an overall Composite rating.

[4] On March 31, 2023, the FDIC lowered First Republic's Composite rating to "3" and then to a "5" on April 28, 2023.

First Republic's primary interest rate risk mitigation strategy relied on continual growth to produce a consistent volume of loans priced at current interest rates. Each examination report restated First Republic's growth and repricing strategy as key to mitigating interest rate risk. We concluded that RMS could have been more forward-looking in assessing how increasing interest rates could negatively impact the bank, given its concentration of lower-rate, longer-duration loans and dependence on low-cost funding and continual growth. RMS could have done more to effectively challenge and encourage bank management to implement strategies to mitigate interest rate risk starting in the second half of 2021, although we acknowledge examiners would have likely encountered pushback from the bank because growth was strong and interest rates were low at that time. In addition, RMS could have pursued a more urgent supervisory response, such as potentially downgrading the Sensitivity to Market Risk component and/or issuing SRs urging management to develop strategies to mitigate interest rate risk when it learned in August 2022 of First Republic's interest rate risk scenario results that were far outside of Board-approved parameters. Importantly, examiners did not learn until November 2022 that First Republic's Board agreed with bank management's recommendation to not take action to respond to the interest rate risk scenario breaches.

FDIC's decision to increase First Republic's Liquidity component rating to a "1," signifying strong liquidity levels and well-developed funds management practices, in the 2021 roll-up ROE, was too generous and was inconsistent with First Republic's high level of uninsured deposits which ROEs identified as a funding concentration and Supervisory Plans noted were potentially unstable. Greater criticism of First Republic's vulnerability to interest rate risk and reliance on a high level of uninsured deposits, may have also prompted a downgrade to the bank's Management component rating in the 2021 roll-up ROE.

Given the size and scale of First Republic's operations, we concluded there were opportunities for the FDIC to take a more holistic approach to supervising the bank to include greater involvement of LBS Branch and headquarters leadership to assist the region in effectively challenging bank management's strategies and assumptions and bringing a broader horizontal perspective and understanding of risks facing the banking industry that the dedicated team otherwise might not have. The FDIC established and recently revised the responsibilities of a Large Bank Operating Committee (LBOC) to coordinate oversight of CEP institutions between the regional and headquarters offices that should help to achieve a more holistic approach to large bank supervision.

Continuous Examination Process Implementation: From 2018 through March 2023, the FDIC issued four annual roll-up ROEs and 54 targeted review Supervisory Letters. The dedicated team prepared comprehensive Supervisory Plans, which included planned staffing requirements needed to complete targeted reviews and ongoing monitoring activities, as determined by risk assessments of the bank. The FDIC completed all planned targeted reviews and completed CEP deliverables, such as quarterly Ongoing Monitoring Reports (OMR) and quarterly Large Insured Depository Institution (LIDI) reports. The SFRO communicated the results of targeted reviews to bank management through exit meetings and transmitted Supervisory Letters and annual roll-up ROEs to the Board and management. The dedicated team also held quarterly meetings with bank management. The dedicated team issued roll-up ROEs timely when compared to the CEP median and CEP procedures, and generally completed targeted reviews timely and issued supporting Supervisory Letters within the 45 day benchmark.

Examination Resources: We received mixed views from officials that we interviewed with respect to the adequacy of staffing resources assigned to examine First Republic. We observed that over the 4-year period of our review, First Republic doubled in size while actual examination hours declined by 11 percent. While we would not expect examination hours to parallel asset growth and while there could be explanations such as examination efficiencies, on the surface, this trend appears counterintuitive and may have warranted greater explanation in annual Supervisory Plans.

Almost all of the officials we interviewed indicated that staff levels were adequate and that dedicated team absences were generally filled by other examiners with large bank experience or supervisory examiners (SE). However, one official raised concerns about the extent of dedicated team vacancies and the few number of Large Financial Institution (LFI) examiners that were assigned to targeted reviews. Importantly, all officials that we interviewed indicated that, regardless of their views on the adequacy of staffing, the dedicated team completed target reviews and issued supervisory letters and ROEs timely and that examination products were high quality.

Conclusion and Matters for Further Study

We have previously reported that the events of mid-March 2023 were unprecedented. The speed with which depositors withdrew funds from SVB, Signature Bank, and First Republic was unexpected and a surprise to the regulators and the banking industry. In reviewing the FDIC's supervision of First Republic, the internal review team had the benefit of 20/20 hindsight. We attempted to act as if March 2023 had not happened and evaluated supervisory activities against FDIC examination guidance based on events and information that was available to RMS at that time. We cannot say whether taking earlier supervisory action such as criticizing interest rate risk or liquidity risk management would have prevented First Republic from failing given the significance and speed of deposit withdrawals. However, meaningful action to mitigate interest rate risk and address funding concentrations would have made the bank more resilient and less vulnerable to the March 2023 contagion event.

Our report includes several matters for further study related to examination guidance and processes.

Introduction

On May 1, 2023, CADFPI closed First Republic and appointed the FDIC as receiver of the bank. As of March 31, 2023, First Republic had total deposits of $104.5 billion and total assets of $232.9 billion. First Republic was the fourteenth largest bank in the country, and its failure constituted the second largest bank failure in United States history. As of May 1, 2023, the FDIC estimated the cost of First Republic's failure to the DIF to be approximately $13 billion.[5] The exact cost will be determined when the FDIC terminates the receivership.

In May 2023, FDIC Chairman Martin J. Gruenberg commissioned the FDIC's Chief Risk Officer to conduct an internal review of the agency's supervision of First Republic and produce a written report. The Chief Risk Officer assembled a team independent of the FDIC's RMS to perform the work. The resulting internal review report provides information about the cause of First Republic's failure and evaluates the FDIC's supervision of the bank from the 2018 examination cycle through its failure on May 1, 2023. Appendix 1 contains details on our objectives, scope, and methodology. Appendices 2 thorough 5 provide detailed information about the FDIC's supervision of First Republic. Appendix 6 contains a list of acronyms.

Background

First Republic was a state non-member, commercial bank and trust company with no holding company, headquartered in San Francisco, California. Established in 1985, the bank focused on offering banking services including residential real estate lending, private banking, business banking, wealth management, trust, and brokerage services, principally to HNW individuals.

The bank operated within two business segments: Commercial Banking and Wealth Management. The Commercial Banking segment provided private banking for consumer and business clients. The Wealth Management segment was supported by the First Republic Trust Company and four wholly-owned subsidiaries, including First Republic Investment Management and First Republic Securities Company. A fifth subsidiary, First Republic Lending Corporation, held a large majority of the bank's tax-exempt loans to private schools and non-profits. First Republic operated primarily in major cities on the U.S. west and east coasts: San Francisco/Silicon Valley, New York City, Los Angeles, Boston, San Diego, Portland, Palm Beach and had expanded operations to Jackson Hole, Wyoming and Bellevue, Washington. Table 1 presents selected First Republic financial information.

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[5] The FDIC recorded a loss of $15.6 billion associated with First Republic's failure on May 31, 2023. The $2.6 billion increase over the May 1, 2023 loss estimate was largely the result of an increase in insured deposits between the April 13, 2023 balance sheet information used to formulate prices for acquiring the bank, and May 1, 2023 financial information, the date of the bank's failure. As with all failed bank receiverships, losses will be periodically adjusted as assets are sold, liabilities are satisfied, and receivership expenses are incurred.

Table 1: First Republic Financial Information (amounts in billions).

	12/31/18	12/31/19	12/31/20	12/31/21	12/31/22	03/31/23[a]
Total Assets	$99.2	$116.3	$142.5	$181.1	$212.6	$232.9
Cash and balances due from depository institutions	$2.8	$1.7	$5.1	$12.9	$4.3	$13.2
Total Loans[b]	$75.9	$90.8	$112.6	$135.0	$166.9	$173.3
Total Deposits	$79.1	$90.1	$114.9	$156.3	$176.4	$104.5
Uninsured Deposits	$51.7	$59.0	$80.3	$116.7	$119.5	$50.8
• Percentage of Total Assets	52%	51%	56%	64%	56%	22%
• Percentage of Total Deposits	65%	65%	70%	75%	68%	49%

Source: First Republic Call Reports.

[a] – Includes $30 billion in uninsured deposits placed at First Republic on March 16, 2023, from a consortium of 11 large banks, to stabilize First Republic's deposit outflows and show support for the bank.

[b] – Excludes loans held for sale.

According to examination products, First Republic focused on originating high-quality loans for existing and new clients and its lending activities provided an opportunity for its bankers to also introduce other services to these clients, which developed into comprehensive relationships as a result of the delivery of superior client service. Clients were typically educated, urban, coastal, HNW professionals with a conservative financial profile. First Republic attained an approximate 20 percent penetration in its target markets of HNW households with $10 million or more in investable assets.

An important aspect of First Republic's franchise was its ability to gather deposits, which provided the bank with a stable, low-cost source of funding. First Republic focused on growing core deposits by expanding relationships with existing clients and acquiring new deposit clients, both business and consumer.

Examination products noted that First Republic's client-centric business model offered personalized, high-touch service that achieved high client satisfaction, encouraged clients to do more business with the bank, and generated new client referrals. First Republic's culture and business model remained consistent over the decades. First Republic provided HNW clients and their business and philanthropic interests relationship-based and personalized banking, trust, and wealth management services. First Republic sought clients who viewed the bank as a trusted adviser, leading to long-term client relationships that drove organic growth and significantly reduced client attrition.

Causes of Failure and Material Loss

First Republic experienced a lack of market and depositor confidence following the sudden failure of SVB and Signature Bank during the weekend of March 10, 2023, which resulted in significant uninsured deposit outflows and loss of liquidity with CADFPI ultimately closing the bank on May 1, 2023. While examination products indicated the bank had generally been considered a respected, well-run bank, there were attributes of First Republic's business model and management strategies that made it vulnerable to the contagion that began on March 10, 2023. Those attributes and strategies included rapid growth in assets and deposits, loan and funding concentrations, unrealized losses, an overreliance on uninsured deposits, and a failure to sufficiently mitigate interest rate risk.

Reputation and Responsiveness to Regulatory Concerns

First Republic had historically been viewed by FDIC officials as a generally sound and well-managed institution. The bank had a moderate risk profile according to FDIC officials and examination reports and had consistently pursued a longstanding business model. FDIC officials indicated that First Republic was large but not particularly complex. In a January 2023 investor presentation, First Republic noted that its loan mix had stayed consistent for the past 20 years, with approximately 60 percent of loans being SFR loans or home equity lines of credit. The presentation noted the bank's loans had exceptional credit quality and that the bank had only experienced 8 basis points (bps) of cumulative net losses on all loans originated since First Republic was founded in 1985. First Republic was averse to pursuing higher risk lines of business and regularly published a list of "Business Activities Not Undertaken," which included activities in which First Republic did not currently intend to engage.

First Republic focused on offering banking services to HNW individuals, including residential real estate lending, private banking, business banking, wealth management, trust, and brokerage services. SFR loans were the primary loan product and included nonconforming jumbo mortgages with interest-only repayment terms. First Republic used these products to acquire HNW customers and expanded the banking relationship by providing trust and wealth management services, among other personalized banking products. FDIC officials stated the bank was experienced at providing these mortgage products and had offered them for years. FDIC officials also stated that First Republic did not have peer banks with a similar business model.

FDIC examination products commented favorably on First Republic management and operations noting that both remained consistent over the decades. FDIC supervisory plans noted that First Republic experienced significantly lower annual client attrition and greater client satisfaction and loyalty compared to the banking industry average. Examination products also commented favorably on First Republic's corporate culture noting that it consisted of diverse and experienced staff delivering personalized service with an entrepreneurial spirit to solve client needs. Examiners also noted that the bank's comprehensive incentive structure rewarded relationship managers over the long term for increasing deposits, building relationships, and collaborating with other bankers and wealth managers. Additionally, punitive compensation-related claw-back provisions reinforced stringent credit quality and ethical business practices. Examiners also noted that minimal employee turnover facilitated long-term relationships between client-facing teams and clients, resulting in exceptional service.

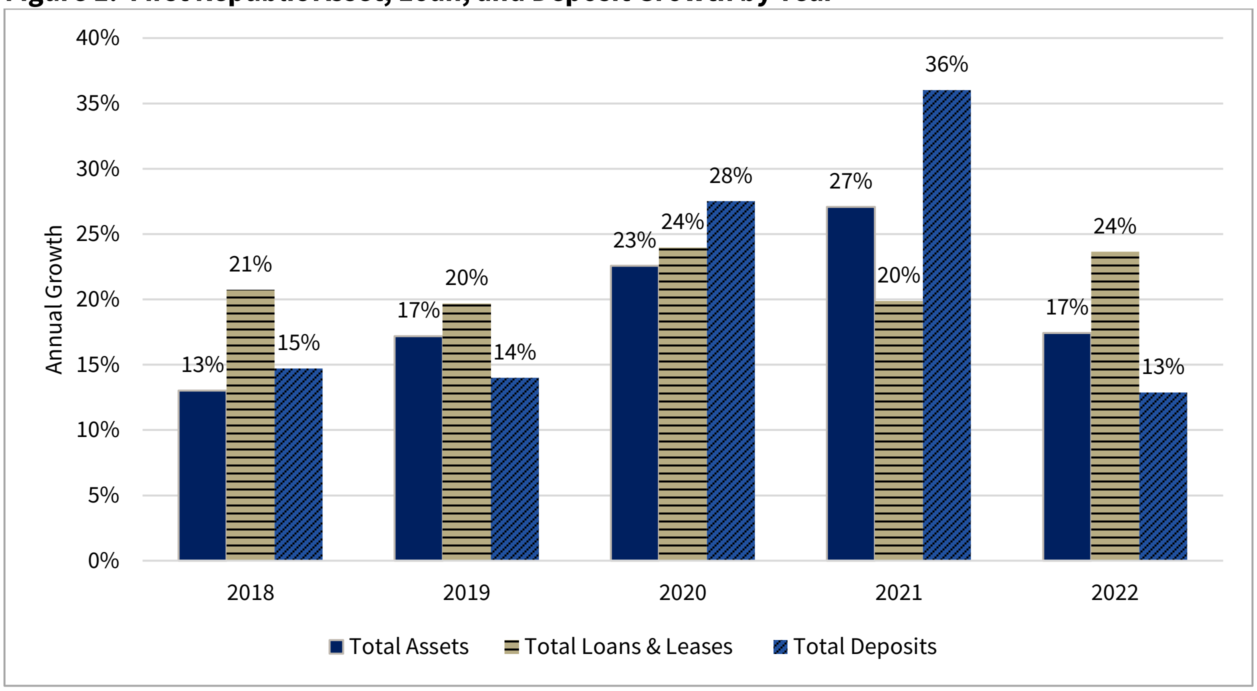
FDIC consistently rated bank management "strong" and the bank "satisfactory" overall. First Republic had few SRs during the period of our review. FDIC examination staff indicated that bank management was responsive to supervisory feedback and recommendations, quick to remediate findings, and easy to work with.

While First Republic grew consistently, examiners concluded that the Board and bank management implemented and maintained infrastructure, controls, and risk management processes commensurate with the bank's growth and risk profile. Notwithstanding, there were aspects of First Republic's business model and management strategies that made it more vulnerable to interest rate changes and the contagion that ensued following the failure of SVB and Signature Bank.

Rapid Growth and Concentrations

First Republic grew consistently and more rapidly than its peer banks over our period of review. From 2018 through 2022, First Republic's total assets and loans and leases grew at an average rate of 21 and 22 percent, respectively. While First Republic's growth was not as aggressive as SVB or Signature Bank, which experienced annual asset growth rate of 45 and 31 percent, respectively, First Republic grew about twice as rapidly as its peer banks. Uniform Bank Performance Reports (UBPR) showed that peer institutions experienced average total asset growth of 11 percent and average total loan and lease growth of 9 percent from 2019 through 2022.[6] First Republic's average total asset growth was in the 78th percentile of its peers and loan growth was in the 81st percentile. Figure 1 presents First Republic asset, loan, and deposit growth information for our period of review.

Figure 1: First Republic Asset, Loan, and Deposit Growth by Year



Source: First Republic Call Reports and Internal Review Team analysis.
Note: Excludes loans held-for-sale.

First Republic continued to experience growth during 2022 even as growth at peer banks stalled.[7] A January 2023 Investor Presentation reported that First Republic experienced loan growth of 23.6 percent in 2022 and deposit growth of 12.9 percent in 2022. While the bank experienced deposit growth during 2022, the rate of deposit growth slowed throughout the year.

First Republic also had significant asset and funding concentrations. Asset concentrations are pools of assets that share common risk characteristics or have heightened sensitivity to similar economic, financial, or other risk factors. An institution's asset quality, earnings, or capital can be disproportionally affected by a single or localized economic event or market conditions if the

[6] UBPR presents information for 25 to 31 peer banks from 2018 through 2022.
[7] A January 2023 Investor Presentation showed negative 5 percent deposit growth for the fourth quarter of 2022 for a group of First Republic peer banks.

institution holds significant asset concentrations. Therefore, having risk management systems that ensure early identification of problems in these portfolios is a prudent risk management practice.

Funding concentrations are funding types that share common risk characteristics or have heightened sensitivity to similar economic, financial, or other risk factors. The primary risk of a funding concentration is that an institution may have to replace funding quickly, or at unfavorable terms, or both. This risk may become more pronounced if the bank's condition, or the condition of the party or parties providing the funds, deteriorates, which can significantly reduce the availability of funding.

Concentrations are not inherently bad, but do add a dimension of risk which institution management should consider when formulating plans and policies. To reduce risks associated with funding concentrations, banks generally benefit from considering the correlations between sources of funds and market conditions and having available a variety of short-, medium-, and long-term funding sources. The board is responsible for setting and clearly articulating a bank's risk tolerance in this area through policy guidelines and limits for funding diversification.

The 2021 annual roll-up ROE reported SFR loans secured by 1-4 family residential properties as a significant concentration. These loans totaled 79.2 billion and represented about 61 percent of the loan portfolio and 485 percent of Tier 1 capital plus the Allowance for Credit Losses (ACL). However, the report concluded that the risks associated with concentrations remained appropriately managed, with multiple risk mitigants and historically strong credit quality and performance. This loan type was a key component of First Republic's business model, which included financing homes for HNW clients as an introductory product and gateway to other business and personal cross-selling opportunities. First Republic's 2021 Annual Report noted that 61 percent of the SFR loans were interest-only loans.

FDIC officials told us that during the extended period of low interest rates, First Republic borrowers preferred low rate loans with longer maturities. The December 2022 OMR noted that starting in 2016, borrowers began shifting their loan maturities from 5/1 adjustable rate mortgages to longer term maturities. By December 2021, 30-year fixed-rate loans and 10/1 hybrids represented 75 percent of new SFR volume and 66 percent by the 3rd Quarter 2022. Many existing loan customers also refinanced their loans to lower rates with extended maturities. The 2021 annual roll-up ROE noted that in 2020 and 2021, refinancing accounted for the majority of SFR originations. The December 2022 OMR noted that SFR refinancing activity was decreasing in 2022, and at 35 percent of lending activity, was the lowest level in the past 10 years. As discussed later, rapid interest rate increases during 2022 created a significant asset/liability mismatch for the bank.

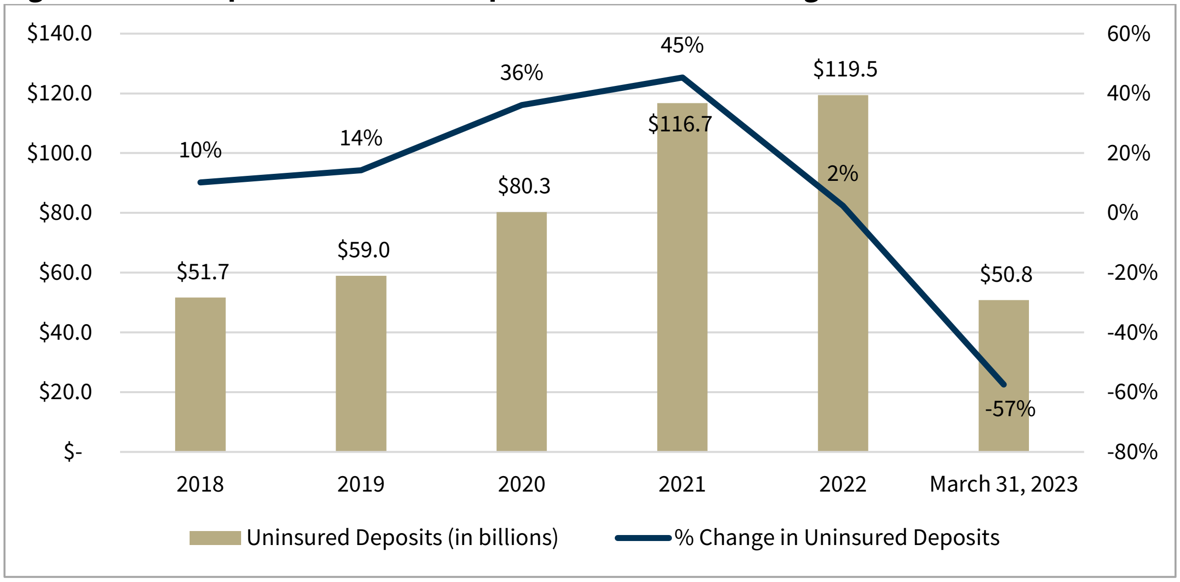
Overreliance on Uninsured Deposits

First Republic's business model was heavily reliant on uninsured deposits, which also represented a funding concentration and ultimately a volatile funding source after the failure of SVB. FDIC's *Risk Management Manual of Examination Policies* notes that while some deposit relationships over $250,000 remain stable when the institution is in good condition, such relationships might become less stable due to their uninsured status if the institution experiences financial problems. Additionally, deposits identified as stable during good economic conditions may not be reliable funding sources during stress events. First Republic's uninsured deposits ranged from 51 to 64 percent of total assets from 2018 through 2022. In an April 2023 report, the U.S. Government

Accountability Office (GAO) noted that the median uninsured deposits to total assets percentage for a group of peer banks ranged from 31 to 41 percent from 2018 through 2022.[8]

Uninsured deposit balances almost doubled from year-end 2019 through year-end 2021 as shown in Figure 2, as clients generally held larger liquidity positions compared to the pre-pandemic economic environment. First Republic's relationship-based business model and service excellence continued to attract HNW clients and their businesses with large balances.

Figure 2: First Republic Uninsured Deposit Growth 2018 through March 2023



Source: First Republic Call Reports and Internal Review Team analysis.
Note: The March 31, 2023, figures include $30 billion in uninsured deposits from a consortium of 11 large banks.

Based on First Republic's Call Report filings, uninsured deposits represented 64 percent of total assets, as of December 31, 2021. ROEs indicated uninsured deposits were diversified and had characteristics that examiners viewed as an indication of continued stability.[9] High-rate deposits represented less than 1 percent of total deposits at year-end 2021.

First Republic monitored large and uninsured deposit account stability using key risk indicators (KRIs), risk dashboards, and a client engagement initiative that focused First Republic executive communication with clients holding large balances. First Republic's Uninsured Deposits Dashboard provided management with a comprehensive assessment of deposit stability on a quarterly basis. First Republic also utilized a Net Promoter Score (NPS) survey that measured client loyalty and the likelihood of client referrals. The 2021 roll-up ROE noted that the 2021 NPS increased by more than five percent from the prior year and was double the U.S. Banking industry average. Bank management was confident that its depositor base was loyal and believed that a depositor run was

[8] *Bank Regulation: Preliminary Review of Agency Actions Related to March 2023 Bank Failures*, GAO-23-106736, April 2023. The GAO report presented uninsured deposit information for 19 banks that each had total assets between $100 and $250 billion at year-end 2022. The peer banks excluded SVB and Signature Bank, both of which failed in March 2023 with high levels of uninsured deposits. As of year-end 2021, SVB and Signature Bank reported uninsured deposits to total assets of 80 percent and 82 percent respectively.
[9] See page 29 for a description of these characteristics of deposit stability.

highly unlikely. Appendix 3 presents detailed information about the composition of First Republic's deposits, including uninsured deposits, over time.

Failure to Sufficiently Mitigate Interest Rate Risk

First Republic pursued a business model that worked well in a low interest rate environment but bank management and the Board did not take adequate steps to mitigate interest rate risk. First Republic's primary business model emphasized the origination of SFR loans and other real estate-secured loans to professionals, business executives or entrepreneurs who were buying or refinancing homes in metropolitan communities, refinancing existing household debt, or investing in their firms. First Republic competed for deposits and loans by seeking to provide a higher level of personal service than was generally offered by larger and non-bank competitors and by offering competitive interest rates.

FDIC officials indicated that First Republic consistently grew year after year and normally about 50 percent of the bank's loans would reprice to prevailing interest rates. FDIC officials indicated that each year about 30 percent of First Republic's floating-rate loans would reprice, and the bank would make new loans totaling about 20 percent of the overall loan portfolio at prevailing interest rates. This strategy worked as long as there was deposit growth and strong demand for loans.

An important aspect of First Republic's franchise was its ability to gather deposits, which provided the bank with a stable, low-cost source of funding. First Republic focused on growing core deposits by expanding relationships with existing clients and acquiring new deposit clients, both business and consumer. Most clients also had deposits at the bank and most of the deposits were in the form of non-interest bearing checking accounts. As a result, First Republic had a low cost of funds which allowed it to make low-rate loans.

A March 2022 investor presentation stated that "First Republic's asset growth rate, stable and large checking account base (68 percent) and meaningful loan repayment rates provide considerable protection and income gains in rising rates." The presentation noted that 73 percent of the bank's total liabilities were non-rate sensitive and that from 2019 to 2021, an average of 53 percent of total loans repriced to market rates each year.

In March 2022, the Federal Reserve began raising interest rates to reduce inflation to its two percent target. Rising interest rates quickly created an asset/liability mismatch for the bank. First Republic's assets were concentrated in longer-term loans that generated low interest income, while deposits required to fund those loans were short-term. Starting in the September 2022 time frame, customers began moving from non-interest bearing accounts to Time/Certificate of Deposit (CD) accounts, shifting the cost structure from minimal to higher cost accounts.[10] This shift increased First Republic's interest expense and compressed net interest margin (NIM).

First Republic's loan originations increased in the first and second quarters of 2022 to $17.8 and $22.0 billion, respectively, the bank's best quarters ever. Originations then declined to approximately

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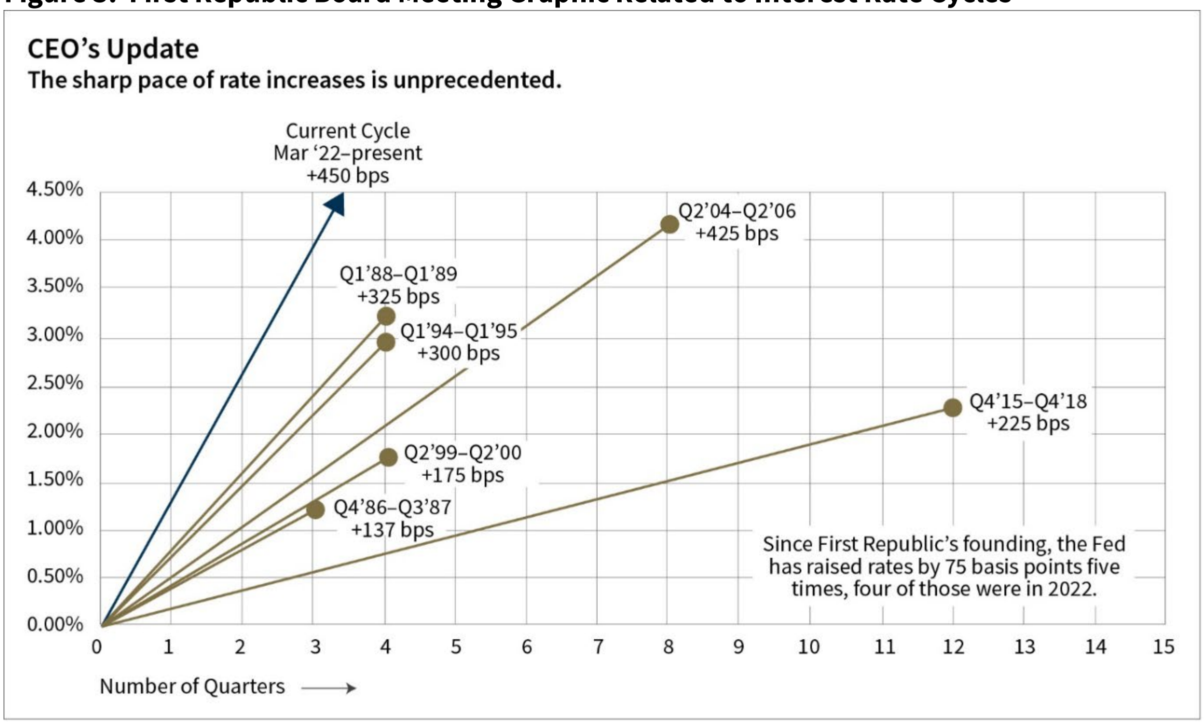
[10] The 4th Quarter 2022 FDIC Quarterly Banking Profile reported that average funding costs of FDIC-insured institutions increased 53 bps from the prior quarter to 1.17 percent. Higher deposit interest expense was responsible for 76.3 percent of the quarterly increase in average funding costs.

$18.0 billion in the third quarter and $15.6 billion in the fourth quarter. In April 2023, examiners analyzed First Republic's rate sheets from January 2022 to March 2023 and noted, "It appears that while the loan base rates were adjusted to make shorter duration SFR mortgages more attractive, clients continue to prefer fixed-rate loans in a rising rate environment, and management did not increase pricing sufficiently high to discourage loan growth."

FDIC officials indicated that First Republic's balance sheet structure created an asset/liability mismatch, based on the speed and rate of interest rate increases. FDIC officials noted that the asset and liability imbalance was not unique to First Republic, and that a number of banks, including First Republic, did not anticipate the level and velocity of the rate increases or the July 2022 inversion of the yield curve. An FDIC official indicated that banks did not expect interest rates to rise by 500 bps as quickly as what transpired and banks were not modeling for such an increase.

In 2023, First Republic identified Interest Rate Driven Earnings Pressure—the risk of elevated pressure on the bank's earnings driven by rapid and steep rate hikes by the Federal Reserve to combat inflation—as one of the top risks in its Enterprise Risk Inventory with an increasing risk trend. The February 2023 First Republic Board Meeting CEO's Update identified the following challenges facing the bank: checking migration, deposit pricing and competition, loan demand, slower repayment of the loan portfolio, and the inverted yield curve. The Board meeting materials included the graphic in Figure 3 showing that the sharp pace of the 2022 interest rate increases had been unprecedented.

Figure 3: First Republic Board Meeting Graphic Related to Interest Rate Cycles

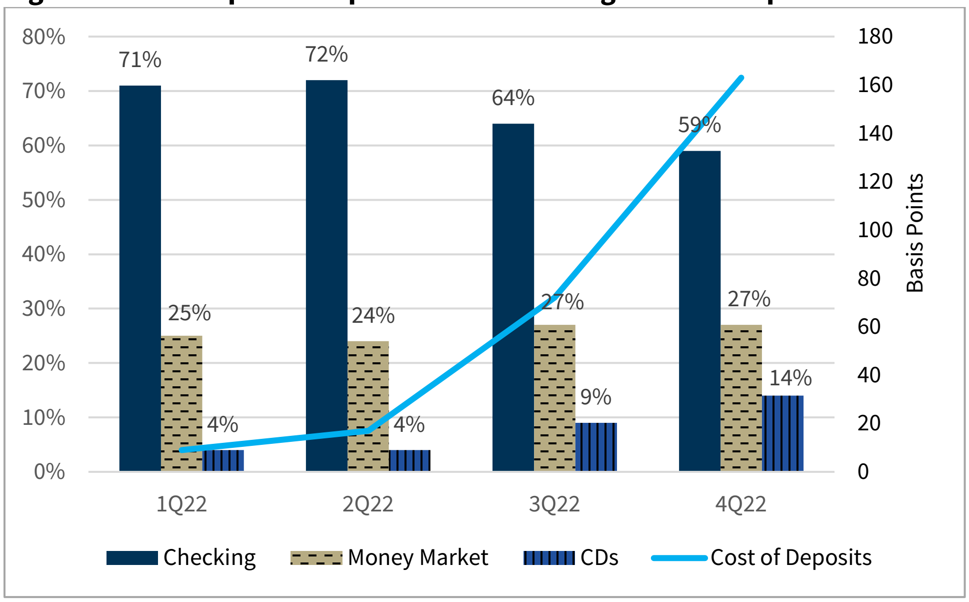


Source: February 2023 Board Presentation Materials.

Additionally, during 2022, as rates increased and the yield curve inverted, First Republic's depositors began moving from non-interest bearing deposit accounts to interest-bearing time deposits, such as CDs. This migration increased First Republic's cost of funds. For example, from June 2022 through

January 2023, CDs grew from 4 to 14 percent of total deposits and the bank's rate paid on total deposits increased from 9 to 163 bps as shown in Figure 4. While total deposits grew during 2022 by 12.9 percent, checking deposit balances decreased by $8.3 billion and CD accounts increased by $17.9 billion.

Figure 4: First Republic Deposit Mix and Average Cost of Deposits -- 2022



Source: February 2023 Board Presentation Materials.

In addition, as interest rates increased, the fair value of First Republic's securities and loans decreased. Table 2 below presents the fair value of First Republic's securities and loans as of year-end 2022 and 2021. Available-for-sale securities were recorded at fair value in the financial statements. First Republic recorded held-to-maturity securities and loans at amortized cost and carrying value, respectively. Accordingly, fair value losses did not impact bank earnings; however, the fair value amounts for these securities and loans were disclosed in notes to the financial statements.[11]

[11] First Republic did not elect the fair value option for its held-to-maturity debt securities or loans. ASC 825-10, *Financial Instruments*, allows entities to voluntarily choose to measure certain financial assets and liabilities at fair value (fair value option). Had it elected the fair value option for any particular loans, First Republic would have measured such loans at fair value on the balance sheet with any unrealized gains/losses reported through earnings.

Table 2: First Republic Fair Value Losses

(Dollars in Millions)	Amortized Cost or Carrying Value	Fair Value	Net Unrealized Gains (Losses) or Fair Value Declines
As of December 31, 2022			
Available-for-Sale Debt Securities	$3,817	$3,347	($470)
Held-to-Maturity Debt Securities	$28,348	$23,587	($4,761)
Loans, Net of ACL	$166,084	$143,925	($22,159)
As of December 31, 2021			
Available-for-Sale Debt Securities	$3,425	$3,381	($44)
Held-to-Maturity Debt Securities	$22,292	$23,422	$1,130
Loans, Net of ACL	$134,262	$129,269	($4,993)

Source: First Republic December 31, 2022 10-K Report.

As shown, the difference between the fair value and carrying value on loans had increased to $22 billion by the end of 2022. Unrealized losses in securities that exceeded capital was a key factor in the loss of confidence and failure of SVB. First Republic's loan portfolio unrealized fair value losses garnered similar attention with news articles noting that the unrealized losses exceeded First Republic's equity levels. These fair value declines, along with First Republic's high level of uninsured deposits, were characteristics that appeared to cause depositors and the public to view First Republic similarly to SVB.

First Republic's Monitoring of Interest Rate Risk

According to First Republic's Interest Rate Risk Management policy, the Chief Financial Officer owned interest rate risk. First Republic's Asset Liability Management Committee (ALMCO) was responsible for monitoring interest rate risk and escalating breaches of thresholds defined in the Risk Appetite Statement to the Treasury Risk Officer, who determined if further reporting to the Bank Enterprise Risk Management (BERM) Committee or the Directors' Enterprise Risk Management (DERM) Committee was necessary. The BERM, which reported to the DERM, reviewed interest rate risk information, at least quarterly, and reported on breaches to the DERM. The DERM, which was a committee of the Board, approved risk limits for the bank through delegated authority from the Board, reviewed interest rate risk information quarterly, and informed the Board of significant interest rate risk matters. First Republic established risk tolerance and risk appetite metrics for monitoring interest rate risk and used two primary approaches, net interest income (NII) and economic value of equity (EVE), to model changes to income and net worth given various interest rate increase and decrease scenarios.

NII simulation is a modeling technique that projects the changes in asset and liability cash flows, expressed in terms of NII, over a specified time horizon for defined interest rates scenarios. A bank uses income simulations to forecast NII under varying interest rate scenarios to learn about the sources and levels of interest rate risk inherent in its balance sheet and to identify which of its assets and liabilities are the source of potential earnings volatility under different scenarios. Earning simulation models can be either static or dynamic. Static simulation models are based on current exposures and assume a constant balance sheet with no new growth. In contrast, dynamic simulation models rely on detailed assumptions regarding changes in existing business lines, new business, and changes in management and customer behavior.

Economic value-based methodologies, such as EVE, measure the degree to which the economic values of an institution's positions change under different interest rate scenarios. The economic-value approach focuses on a longer-term time horizon, captures all future cash flows expected from existing assets and liabilities, and is more effective in considering embedded options in a typical institution's portfolio. In general, most economic value models use a static approach in that the analysis typically does not incorporate new business; rather, the analysis shows a snapshot in time of the risk inherent in the portfolio or balance sheet.

First Republic conducted a dynamic NII model analysis that included growth assumptions and a static EVE analyses that did not include growth. First Republic reported scenario analysis information quarterly to the ALMCO, BERM, and DERM, and ultimately the full Board. During 2022, the NII analysis showed declining NII estimates for increasing interest rate scenarios as actual rates continued to increase. However, NII estimates for the various interest rate scenarios were within First Republic's risk tolerance and risk appetite thresholds as shown in Table 3.

Table 3: Selected First Republic NII Simulation Estimates

Scenarios	September 2022 – Shock Year 1		December 2022 – Shock Year 1		Risk Tolerance/ Appetite
	NII % Change	NII (billions)	NII % Change	NII (billions)	
+400 bps	1.99%	$5,231	-12.47%	$4,033	+/- 25/30
+300 bps	1.89%	$5,226	-9.10%	$4,189	+/- 20/25
+200 bps	1.70%	$5,216	-6.03%	$4,330	+/- 15/20
+100 bps	1.46%	$5,204	-3.06%	$4,467	+/- 10/15
Base NII		$5,129		$4,608	

Source: First Republic ALMCO Interest Rate Risk Summary Memoranda to the Board

However, First Republic began identifying risk tolerance and risk appetite breaches associated with the EVE projections in the second quarter 2022. The EVE projection showed that interest rate increases in the 100 to 400 bps range would reduce the value of First Republic's equity by an amount greater than its risk tolerance or risk appetite thresholds, except for risk appetite in the 100 bps increase scenario. The ALMCO discussed the breaches in August 2022 and noted that with future rate increases planned and expectations that funding duration would continue to shorten, the EVE risk profile was likely to stay liability sensitive and possibly deteriorate further in the short term. The ALMCO unanimously approved no further action on the EVE risk profile breaches at the August 2022 meeting. The BERM discussed the breaches in August 2022 and the DERM and the Board discussed the breaches in September 2022. Based on minutes from these meetings, the BERM, DERM, and Board agreed with the ALMCO's decision to take no further action and continue to monitor the breaches.

First Republic identified greater risk tolerance and risk appetite breaches associated with the EVE projections in the third and fourth quarter of 2022. The EVE projections showed a significant decrease in the market value of First Republic's equity and that interest rate increases would further reduce the value of the bank's equity, in some cases resulting in First Republic having negative equity. For example, the December 2022 EVE analysis projected that a 200 bps increase in interest rates would reduce the economic value of First Republic's equity by 117 percent, resulting in negative equity. Table 4 presents information about the EVE projections and impact on the value of First Republic's equity.

Table 4: First Republic EVE Projections

Quarter End	Market Value of Equity (in millions)	Scenario			
		+100bps	+200bps	+300bps	+400bps
March 2022	$16,715	-5%	-12%	-20%	-29%
June 2022	$13,588	-16%	-33%	-50%	-66%
Sept 2022	$8,103	-41%	-82%	-120%	-156%
Dec 2022	$6,928	-59%	-117%	-172%	-224%
Risk Tolerance/Appetite		15/20%	20/25%	25/30%	30/35%

Source: First Republic internal documents and FDIC OMRs.

The ALMCO discussed the September 2022 breaches in October 2022 and again unanimously approved no further action on the EVE risk profile breaches. The BERM, DERM, and Board discussed the breaches in November 2022 and agreed with the ALMCO's decision to take no further action and continue to monitor the breaches. The December 2022 breaches were also presented to the ALMCO, BERM, DERM, and Board in February 2023, but the minutes for these meeting were not finalized before First Republic failed. A December 31, 2022 Interest Rate Risk Summary memorandum to the First Republic Board, dated February 1, noted that:

> "The EVE analysis as-of December 31, 2022 points to a significantly liability-sensitive Economic Value of Equity position. The further increase in liability sensitivity from the September 30, 2022 results is driven primarily by shorter liabilities duration, which is primarily a result of increases in interest-bearing deposits and short-term wholesale funding and declines in non-interest bearing checking balances.
>
> The spot Economic Value of Equity is estimated at $6.9 billion, or lower than the $8.1 billion September 30, 2022 estimate. An instantaneous parallel positive 2% shock in rates would result in a (-116.9%), or (-$8.1 billion) decrease in EVE, which translates into a negative economic value of equity."

FDIC indicated that during 2022, as interest rates were increasing, it was not uncommon for banks to experience EVE model decreases. However, the magnitude of First Republic's EVE decrease was more significant than decreases experienced by other large institutions. As discussed later, FDIC officials were concerned with First Republic's lack of urgency in responding to the EVE breaches and equity value projections. FDIC officials indicated that bank management and the Board should have reacted more quickly and taken action to improve the bank's equity position.

First Republic's Consideration of Options for Mitigating Interest Rate Risk

First Republic did not take sufficient actions to mitigate interest rate risk. For an institution of its size, sophistication, and risk profile, the bank should have taken additional proactive measures to mitigate interest rate risk. During our interviews as part of this review, FDIC officials offered several possible areas for potential risk mitigation, however, First Republic's business model, size, and asset and funding concentrations may have complicated their practicality.

- First Republic could have more aggressively changed its loan pricing and loan product offerings to reduce asset duration. The bank attempted to price loans at higher interest rates and to make more floating-rate and shorter-duration loans; however, its customers continued to prefer lower-rate, longer-duration loans. First Republic could have also discontinued offering longer-duration loans, such as 30-year fixed-rate mortgages, but their HNW clients could have also pursued such loans from competitors.

- First Republic could have raised more capital. FDIC officials told us that periodically, the bank would announce relatively modest capital raises to maintain a connection with the market to facilitate future capital raises. Notably, in February 2023, First Republic successfully sold 2.875 million shares, which resulted in $397 million in proceeds to the bank, net of underwriting discounts and commissions and before expenses payable by the bank. The underwriters of the common stock offering exercised in full their option to purchase additional shares. The positive reception of First Republic's February 2023 capital raise was in sharp contrast to SVB's ill-advised capital raise a few weeks later which was negatively received and prompted the depositor runs and contagion that ensued. After SVB failed, news outlets and articles discussed First Republic's "capital hole" or "hole in First Republic's balance sheet" that resulted from the unrealized fair value losses in First Republic's loan portfolio. Greater levels of capital heading into the March 2023 turmoil may have reduced depositor and investor apprehension. While First Republic also successfully completed a common stock offering in August 2022, earlier or additional exploration of capital increases may have been prudent when bank management and the Board identified the significant EVE breaches.

- First Republic could have possibly engaged in hedging activities to offset interest rate risk. FDIC examination officials told us that, consistent with its overall philosophy of not engaging in overly complex strategies or transactions, First Republic did not engage in hedging activities. FDIC officials opined that by the time the need for hedging became evident, such derivatives contracts may not have been available on a commercially reasonable basis to the bank. Additionally, the size of First Republic's SFR loan portfolio, an asset concentration for the bank, may have made hedging options financially impractical.

- First Republic could have sold loans before interest rates increased. Doing so would have reduced the risk of unrealized fair value losses on the loan portfolio that the bank experienced. While First Republic sold approximately $85 million in loans from 2021 through the first quarter of 2022, it had no loans sales from the second quarter of 2022 through year end 2022 and no loan sales through bulk sales or securitizations in 2021 and 2022. An FDIC official indicated that FDIC met quarterly with First Republic's securitization team and would be told by the team that the pricing for the SFR loans was too low to securitize and would require the bank to sell the loans at loss. First Republic's last sponsored SFR loan securitization was in 2020, which was its first sponsored SFR loan securitization since 2002. Another FDIC official noted that the market for jumbo loan sales was not vibrant during the pandemic, which likely limited this strategy as an option.

Despite the challenges with these potential mitigation strategies, multiple FDIC officials told us that First Republic should have had more effective strategies in place to mitigate interest rate risk, especially given its size. Some FDIC officials surmised that bank management's view going into 2023 was that growth was going to slow, there would be no refinancing, and there would be reduced originations—2023 would be a difficult earnings year for the bank, but the bank would get through it.

A First Republic ALMCO presentation entitled *Interest Rate Risk* based on the June 30, 2020 balance sheet, indicated that bank management and the Board understood how interest rate increases could negatively impact the bank and included the following takeaways and considerations.

- Current balance sheet position will need a carefully planned exit strategy if rates start rising.
- Past episodes (e.g. Taper Tantrum) are a reminder such rate shifts can be swift.
- Asset sensitivity provides protection from rising rates, but is expensive when rates are immobile.
- NII asset sensitivity uptick includes new volume assumptions, which can mask balance sheet position.
- The expected increase in NII from a positive rate shock may not meet expectations as low cost checking migrates into interest-bearing products or leaves altogether.

Several of these takeaways became realities in 2022. The rate increases were swift, NII growth assumptions did not materialize, interest bearing deposit rates increased significantly, and many deposits left the bank. However, First Republic did not have a carefully planned exit strategy.

Contagion from SVB Failure and Significant Deposit Outflows

The CADFPI closed SVB on March 10, 2023. Contagion effects from SVB's failure began to spread through traditional media, social media, and short sellers to other banks with perceived similar risk characteristics, notably, those with high levels of uninsured deposits, concentrations of customers in the venture capital and tech industries, and high levels of unrealized losses or fair value declines embedded in their securities and loan portfolios. Contagion effects initially manifested in large declines in stock prices and then in deposit outflows. For First Republic, deposit outflows became deposit runs and exposed other weaknesses that could not be overcome. May 2023 testimony from the FDIC Chairman[12] concluded that while First Republic was initially able to manage liquidity to meet withdrawal requests, management's strategic decision to retain a long-standing business model with a significant asset/liability mismatch during a period of rising interest rates contributed to a loss of confidence in the bank on the part of depositors, and, ultimately constrained options for the bank to restructure its balance sheet by selling assets or raising capital.

Similar to SVB, First Republic reported significant unrealized fair value-related losses. While SVB reported unrealized losses on securities, First Republic reported significant differences between the fair value and amortized cost or carrying value of its loans. On March 10, 2023, reports began to highlight, and social media and short seller forums began to amplify, banks and bank holding companies, including First Republic, with high levels of uninsured deposits that also had notable differences between the fair value of loans reported in public financial statements and the loans' amortized cost.

On the day the run on SVB began, March 9, 2023, First Republic received a material net inflow of deposits, likely some of which was from SVB customers, as both were headquartered in the San Francisco Bay Area market. While First Republic did not have a venture capital business line featuring

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[12] *Oversight of Financial Regulators: Financial Stability, Supervision, and Consumer Protection in the Wake of Recent Bank Failures*, before the Committee on Banking, Housing, and Urban Affairs, United States Senate, May 18, 2023.

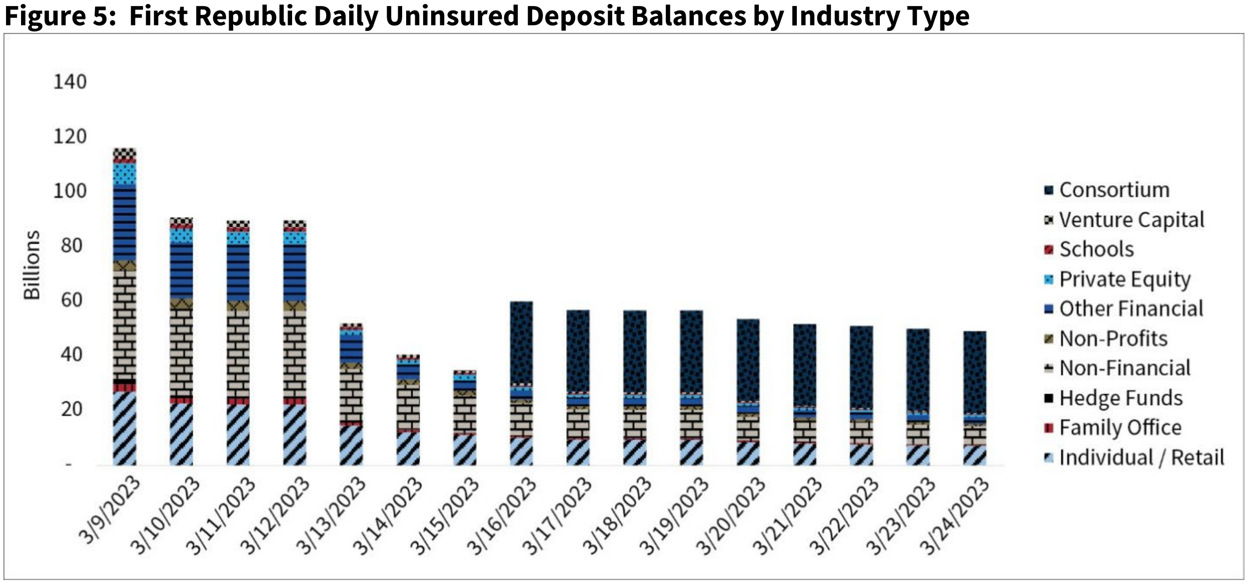
commercial loans to startups, by virtue of its market and business model, it served customers employed in and related to the venture capital and tech industries.

On March 10, 2023, however, with the failure of SVB, the deposit trend reversed and the bank began experiencing significant deposit outflows due to contagion effects from SVB and subsequent wider-spread stresses at regional banks with higher levels of uninsured deposits. First Republic's share price declined by over 50 percent intraday in the wake of significant negative short seller and social media attention, with trading halted several times. Immediately following SVB's failure, the venture capital/private equity community, as well as several large money center banks, began messaging through social media and direct advice to their clients to pull funds from First Republic. Deposit outflows reached approximately $25 billion at the end of the day, or approximately 17 percent of total deposits, requiring significant draws on the bank's FHLB and Federal Reserve lines. The bank received additional liquidity through the Federal Reserve's Discount Window on Sunday, March 12, 2023.

On Monday, March 13, 2023, negative short seller and social media attention continued and accelerated, resulting in an additional 62 percent decline in the bank's stock price. Trading was again halted several times. Depositor withdrawal demands were significant, with approximately $40 billion in deposit outflows. Outflows continued that week, albeit at somewhat of a lesser pace.

The bank began working with outside firms on March 15, 2023, to raise capital and implement steps to restructure its balance sheet and business model, which now reflected significant reliance on more costly borrowings to replace lost deposits. On March 16, 2023, a consortium of 11 major U.S. banks placed $30 billion in uninsured deposits at First Republic to reflect confidence and support in the bank and overall banking sector and in an effort to help stem the contagion effect of the SVB and Signature Bank failures to the wider banking system. With the $30 billion in consortium deposits, other deposit withdrawals slowed and then stabilized during the week ending March 24, 2023. First Republic had experienced $96 billion in deposit withdrawals from March 10 through March 24, 2023. Figure 5 shows First Republic uninsured deposit balances by day, by industry type.

Figure 5: First Republic Daily Uninsured Deposit Balances by Industry Type



Source: RMS Examination work papers.

First Republic established a Go-Forward Plan, dated March 20, 2023, that was approved by the bank's Board and shared with the regulators. The plan involved seven core goals to reestablish the bank's long-term sustainability to include

1. paying back Federal Reserve borrowings and bank consortium deposits;
2. further strengthening the bank's capital position by raising additional external capital;
3. reducing the balance sheet size;
4. right sizing operations through employee and expense reductions;
5. rebuilding deposit relationships;
6. revamping loan origination activities; and
7. improving risk management programs, particularly related to liquidity and interest rate risk.

The Go-Forward plan also contained financial forecasts that included key assumptions and drivers. A March 31, 2023, FDIC problem bank memorandum noted that the plan represented significant changes to the bank's structure, business model, and operations and involved a high degree of execution risk considering the market volatility and strained public perception toward the bank that existed at that time.

On April 24, 2023, First Republic reported its financial results for the first quarter of 2023. The disclosure of a significant loss of deposits prompted a negative market response, a significant decline in the bank's stock price and a resumption of deposit outflows of more than $10 billion between Wednesday, April 26 and Friday, April 28, 2023. The FDIC also noted that the bank had not been successful at executing any major component of the Go-Forward Plan. Given the further deterioration in the bank's condition with the additional deposit loss, and the lack of progress and prospects for improving the bank's condition, the FDIC and CADFPI downgraded the bank to problem status on April 28, 2023. The downgrade shifted the bank's borrowing status with the Federal Reserve to Secondary Credit, which eliminated remaining capacity to meet liquidity demands due to additional collateral haircuts.

On May 1, 2023, CADFPI closed First Republic and appointed the FDIC as receiver. The FDIC entered into a purchase and assumption agreement with JPMorgan Chase Bank, National Association, Columbus, Ohio, to assume all of First Republic's deposits and substantially all of the bank's assets.

The FDIC's Supervision of First Republic Bank

The FDIC issued Supervisory Letters and annual roll-up ROEs that generally assigned positive CAMELS ratings to First Republic and identified relatively few SRs or areas for improvement.

Supervisory Activities and CAMELS Ratings Assigned

Due to its size, complexity, and risk profile, the FDIC supervised First Republic under a CEP, which included elements such as supervisory planning, targeted reviews, ongoing monitoring, LIDI reporting, and an annual roll-up ROE. The FDIC assigned a dedicated examination team to oversee the institution and conduct CEP activities. All examination activities were conducted jointly with the CADFPI.

Financial institution regulators and examiners evaluate an institution's safety and soundness using the Uniform Financial Institutions Rating System (UFIRS). Under the UFIRS, RMS evaluates a bank's performance in six components represented by the CAMELS acronym: Capital adequacy, Asset quality, Management practices, Earnings performance, Liquidity position, and Sensitivity to Market Risk. Each component, and an overall Composite score, is assigned a rating of "1" through "5," with "1" indicating the strongest performance and having the least degree of supervisory concern and "5" indicating the weakest performance and having the greatest degree of supervisory concern.

Between 2018 and First Republic's failure in May 2023, the FDIC and CADFPI issued 54 targeted review Supervisory Letters and four roll-up ROEs. The ROEs addressed Safety and Soundness, Trust, Bank Secrecy Act (BSA), Information Technology (IT), Compliance, and Community Reinvestment Act (CRA) reviews and resulted in the Safety and Soundness ratings shown in Table 4.

Table 4: First Republic Safety and Soundness Examination Ratings

Rating Type	2018	2019	2020	2021
Composite Rating	2	2	2	2
Capital Component Rating	2	2	2	2
Asset Quality Component Rating	1	1	1	1
Management Component Rating	1	1	1	1
Earnings Component Rating	2	2	2	2
Liquidity Component Rating	2	2	2	1
Sensitivity to Market Risk Component Rating	2	2	2	2
Examination "as of" Date	12/31/2018	12/31/2019	12/31/2020	12/31/2021
ROE Issuance Date	05/13/2019	05/07/2020	05/06/2021	05/04/2022

Source: Annual roll-up ROEs.

On March 31, 2023, FDIC and CADFPI notified First Republic of an Interim UFIRS downgrade of 323344/3 (CAMELS/Composite). On April 28, 2023, FDIC and CADFPI notified First Republic of a further Interim UFIRS downgrade of 434455/5. Detailed information about Supervisory Plans, targeted reviews, ongoing monitoring efforts, examination findings, and SRs appears in the Supervisory History section in Appendix 2.

Supervisory Recommendations and Enforcement Actions

The SFRO made recommendations to address First Republic's safety and soundness conditions and weaknesses. FDIC officials indicated that First Republic was responsive to recommendations and implemented corrective action timely.

The FDIC's *Large Bank Supervision Procedures* provide that targeted reviews can result in, among other actions, issuing one or more SRs or Matters Requiring Board Attention (MRBA).[13] An SR refers to FDIC communications with a bank that are intended to inform the bank of the FDIC's views about changes needed in its practices, operations, or financial condition. A principal purpose of SRs is to

[13] See July 16, 2016 Statement of the FDIC Board of Directors on the Development and Communication of Supervisory Recommendations for a full description of SRs and MRBA. https://www.fdic.gov/regulations/examinations/supervisory/guidance/recommendations.html.

communicate supervisory concerns to a bank so that it can make appropriate changes in its practices, operations, or financial condition and thereby avoid more formal remedies in the future, such as enforcement actions.

Most SRs are generally correctable in the normal course of business. However, SRs involving an issue or risk of significant importance that would typically require more effort to address than those correctable in the normal course need to be brought to the attention of the board and senior management through MRBA comments. Therefore, MRBAs are a subset of SRs. In certain cases, examiners may determine that MRBAs are necessary, given the significant level of supervisory concern. Where possible and when applicable, examiners are encouraged to bring significant risk management deficiencies to the institution's board even if those deficiencies are not yet reflected in the institution's financial condition and performance ratios.

As shown in Table 5, the FDIC communicated 16 safety and soundness SRs to First Republic through targeted review Supervisory Letters from 2018 through First Republic's failure on May 1, 2023. In addition, Appendix 4 presents a more detailed presentation of the SRs issued to First Republic.

Table 5: First Republic Supervisory Recommendations 2018 – 2022

Examination Cycle	Supervisory Recommendations			New Supervisory Recommendation Target Areas
	New	Closed	Outstanding	
2018	9	3	6	• Dodd-Frank Act Stress Test – Model Risk Management (MRM) (2) • Operations Risk – Business Process Controls and Information Security Program (2) • Market and Funding Risk – Liquidity Stress Testing (LST) (4) and Liquidity Reporting
2019	1	7	0	• Deposit Stability – LST
2020	2	1	1	• Stress Testing – Capital Stress Testing (CST) • Commercial Real Estate – Loan Analysis Worksheets
2021	2	1	2	• Stress Testing – Deposit Outflow Calibration Model • Secured Commercial Lending – Risk Assessment of Pandemic-Impacted Borrowers
2022	2	2	2	• Market and Funding Risk – MRM (2)
Total	**16**	**14**	**2**	

Source: FDIC annual roll-up ROEs and Supervisory Letters.

During the period of our review, the targeted review Supervisory Letters did not elevate any SRs to MRBAs and the FDIC did not pursue any enforcement actions against First Republic. The FDIC communicated an MRBA related to First Republic's implementation of its 2023 Go-Forward Plan as part of a March 31, 2023 ratings downgrade memorandum.

Evaluation of the Sensitivity to Market Risk Component Rating

The FDIC rated the Sensitivity to Market Risk component "2" in each roll-up ROE signifying that market risk sensitivity was adequately controlled. FDIC downgraded the Sensitivity to Market Risk component rating from "2" to "4" on March 31, 2023 and from "4" to "5" on April 28, 2023 with the issuance of a letter notifying First Republic's Board of Directors that the FDIC was downgrading certain UFIRS components and the Composite rating and providing the basis for those downgrades.

The *RMS Manual of Examination Policies* provides that, when evaluating this component, consideration should be given to: management's ability to identify, measure, monitor, and control market risk; the institution's size; the nature and complexity of its activities; and the adequacy of its capital and earnings in relation to its level of market risk exposure. *RMS Manual of Examination Policies* notes that for many institutions, the primary source of market risk arises from nontrading positions and their sensitivity to changes in interest rates.

Sensitivity to Market Risk is rated based upon, but not limited to, an assessment of the following evaluation factors:

- The sensitivity of the financial institution's earnings or the economic value of its capital to adverse changes in interest rates, foreign exchanges rates, commodity prices, or equity prices.
- The ability of management to identify, measure, monitor, and control exposure to market risk given the institution's size, complexity, and risk profile.
- The nature and complexity of interest rate risk exposure arising from nontrading positions.
- Where appropriate, the nature and complexity of market risk exposure arising from trading and foreign operations.

The FDIC assigned First Republic a Sensitivity to Market Risk component rating of "2" from 2018 through March 31, 2023. The *RMS Manual of Examination Policies* defines a "2" and "3" Sensitivity to Market Risk Component rating as follows:

"2" Sensitivity to Market Risk Component Rating Definition	"3" Sensitivity to Market Risk Component Rating Definition
A rating of "2" indicates that market risk sensitivity is adequately controlled and that there is only moderate potential that the earnings performance or capital position will be adversely affected. Risk management practices are satisfactory for the size, sophistication, and market risk accepted by the institution. The level of earnings and capital provide adequate support for the degree of market risk taken by the institution.	A rating of "3" indicates that control of market risk sensitivity needs improvement or that there is significant potential that the earnings performance or capital position will be adversely affected. Risk management practices need to be improved given the size, sophistication, and level of market risk accepted by the institution. The level of earnings and capital may not adequately support the degree of market risk taken by the institution.

Annual roll-up ROEs from 2018 through 2021 generally concluded that:

- Sensitivity to Market Risk was moderate and the bank's program for managing interest rate risk was adequate.
- Consistent asset growth and repricing, combined with a corresponding growth in low-cost deposits, remained key to the bank's stable interest rate risk profile.
- First Republic interest rate risk simulation analysis indicated a low-to-moderate impact to earnings and capital from all plausible scenarios and IRR simulation results were all within the bank's risk limits.

The 2020 ROE noted that management was keenly aware of the impact of all potential interest rate scenarios and had demonstrated flexibility to changing conditions during the 2020 pandemic.

Further, the interest rate risk management program included effective Board guidance and communication, informative management reporting, and continual evaluation and enhancement of systems for monitoring and controlling risk. The 2020 ROE noted that with the flat long-term rate forecast, management had responded by extending the duration of both assets and liabilities yet was also considering stabilizing duration sometime in 2021.

FDIC's 2022 Supervisory Plan noted that: "The balance sheet indicates a well-matched duration of assets and liabilities. Competition for high-net worth clients and their business interests is intense, which presents a challenge for management to adjust the repricing structure to manage interest rate risk through deposit incentives and loan pricing. The robust growth has contributed towards a relatively stable NIM over time as assets and liabilities have quickly repriced and under varying interest rate environments. A sustained slowdown in growth could cause a mismatch of assets and liabilities and negatively impact the NIM."

The 2023 Supervisory Plan, issued in September 2022, noted that the Liquidity Monitoring Tool and Interest Rate Risk Outlier indicated "Elevated" risk and reflected the need for focused monitoring through ongoing monitoring and a thorough assessment of the elevated risk areas in the Market and Funding Risk Targeted Review. Factors causing the elevated descriptor included a high percentage of uninsured deposits to total assets and increased asset duration.

As discussed earlier, First Republic began identifying risk tolerance and risk appetite breaches associated with the second quarter 2022 EVE projections. The dedicated examination team became aware of the second quarter breach in August 2022 and learned from Board meeting minutes received in November 2022 that the bank had decided not to take action, but to monitor the situation. FDIC became aware of the more severe third quarter breach in November 2022 and learned from Board meeting minutes received in February 2023 that the bank again had decided not to take action, and instead monitor the situation. FDIC officials explained that the ALMCO Materials communicating the EVE information had to go through multiple risk management committees before being presented to the Board. As a result, the dedicated examination team did not receive information about the Board's response to accept the risk presented by the EVE breaches until months after the breaches had occurred.

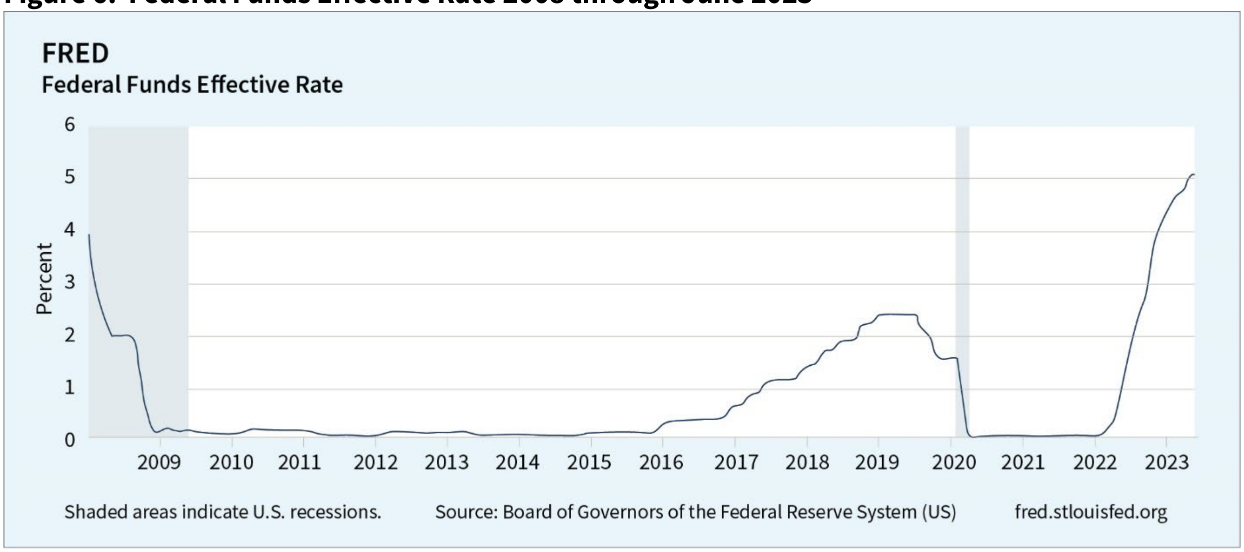
While the second quarter 2022 LIDI report, issued in October 2022, did not address the EVE breaches, it did include the EVE percentage change from the base of -50 percent in the +300 bps scenario and changed the EVE risk trend from stable to increasing. The EVE breaches were first mentioned in the third quarter 2022 LIDI report, issued in January 2023, which noted that the EVE breaches had occurred for two quarters. The third quarter 2022 LIDI report also noted that first line personnel were not contemplating any IRR strategy changes and the bank's Enterprise Risk Management (ERM) team decided to continue to measure and monitor the metrics at the ALMCO. Finally, the third quarter 2022 LIDI report noted that the breaches had been escalated to the ALMCO and presented to the BERM and Board.

SFRO officials told us the examination team planned to downgrade the Sensitivity to Market Risk component rating in the 2022 roll-up ROE, which would have been issued in May 2023. However, the March 2023 liquidity event occurred and First Republic failed before the FDIC could complete and issue the 2022 roll-up ROE.

Internal Review Team Assessment: First Republic's primary interest rate risk mitigation strategy relied on continued strong growth and a consistent volume of loan-repricing at current interest rates. While Supervisory Plans made limited reference to potential interest rate risk, each examination report restated First Republic's growth/repricing strategy as key to mitigating interest rate risk.

As shown in Figure 6 below, with the exception of a 3-year period preceding the Pandemic, interest rates had been extremely low for an extended period of time, until the Federal Reserve began raising rates in 2022. The Federal Reserve initially signaled that inflation appeared transitory, but gradually increased its interest rate projections as inflation proved to be entrenched. At the end of 2021, the median estimate for the Federal funds rate for 2022, included in the Federal Open Market Committee Summary of Economic Projections, was .9 percent. The median estimates for 2022 continued to increase throughout 2022, from 1.9 percent in March 2022, to 3.4 percent in June 2022, and finally to 4.4 percent in September 2022 and December 2022. Actual rate increases during 2022 were closer to 425-450 bps and the velocity of the rate increases was sudden. While there was uncertainty regarding the extent and velocity of interest rate increases, there was general consensus that rates would increase.

Figure 6: Federal Funds Effective Rate 2008 through June 2023



Source: Board of Governors of the Federal Reserve System.

We concluded that RMS could have been more forward-looking in assessing how increasing interest rates could negatively impact the bank, given its concentration of lower-rate, longer-duration loans and dependence on low-cost funding and continual growth. RMS could have done more to effectively challenge and encourage bank management to implement strategies or changes to mitigate interest rate risk.

Starting in 2021, First Republic's EVE risk profile began declining to the point that several rate increase scenarios approached the bank's risk tolerance levels. Table 6 presents First Republic EVE information for a +300 bps scenario in comparison to banks in FDIC's LIDI program, generally banks with total assets over $10 billion.

Table 6: First Republic EVE Reductions to Equity Compared to other LIDI Institutions

	4Q20	1Q21/ Corrected	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22
+300 bps Scenario	14%	9% / -19%	-20%	-17%	-11%	-20%	-50%	-120%
+300 bps LIDI Median	7%	4%	3%	5%	2%	-2%	-4%	-6%
First Republic Risk Tolerance/Risk Appetite = 25%/ 30%.								

Source: ALMCO Materials and FDIC LBS Branch. LBS provided the LIDI Median information during our internal review. This information was not available to the dedicated examination team during 2021 and 2022.
Note: In March 2021, First Republic updated a loan prepayment model that significantly affected the bank's EVE projections and First Republic issued revised EVE projections. We do not know if this update should have also been applied to prior periods.

While the EVE projections were within First Republic's risk tolerance until second quarter 2022, they were significantly lower than the median results of other banks in the LIDI portfolio. While still negative, the EVE projections improved in the fourth quarter of 2021, before declining again. The first quarter 2022 ALMCO materials, dated April 26, 2022, projected a decline of 20 percent of First Republic's equity in a plus 300 bps scenario. The ALMCO materials concluded that the increase in EVE sensitivity was primarily driven by lengthening of assets as a result of slower prepayments as well as a decrease in cash balances. Further, the materials noted that the duration of equity had shifted to a liability-sensitive profile mostly due to asset duration extension.[14]

In addition, we concluded that RMS could have pursued a more urgent supervisory response when it learned in August 2022 that First Republic's second quarter 2022 EVE results were far outside of Board-approved parameters and learned in November of the Board's response to accept the risk presented by the breaches. The Market and Funding Risk Targeted Review, conducted in September 2022 and issued in October 2022 did not mention the EVE breaches or concerns about interest rate risk. The dedicated examination team planned to address the EVE breaches and likely downgrade the Sensitivity to Market Risk component rating in the 2022 roll-up ROE, which would have been issued in May 2023. In our April 2023 internal review of the *FDIC's Supervision of Signature Bank*, we recommended that RMS continue to evaluate the CEP and implement necessary changes to ensure the CEP provides efficient, effective, and timely risk-based feedback to large banks, including interim CAMELS ratings, when appropriate.

Evaluation of the Liquidity Component Rating

The FDIC rated the Liquidity component a "2" in the roll-up ROEs from 2018 through 2020. The FDIC upgraded First Republic's Liquidity component rating from "2" to "1" on May 4, 2022 with the issuance of the 2021 roll-up ROE. The FDIC downgraded the Liquidity component rating from "1" to "4" on March 31, 2023 and to "5" on April 28, 2023 with the issuance of letters to First Republic's Board of Directors informing them of the downgrades and the supporting bases.

The *Risk Management Manual of Examination Policies* provides that, in evaluating the adequacy of a financial institution's liquidity position, consideration should be given to the current level and prospective sources of liquidity compared to funding needs, as well as to the adequacy of funds management practices relative to the institution's size, complexity, and risk profile. In general, funds management practices should ensure that an institution is able to maintain a level of liquidity sufficient to meet its financial obligations in a timely manner and to fulfill the legitimate banking

[14] This basically means that as rates increase, loan prepayment time frames tend to become extended, because borrowers prefer to retain their lower rate loan.

needs of its community. Practices should reflect the ability of the institution to manage unplanned changes in funding sources, as well as react to changes in market conditions that affect the ability to liquidate assets quickly with minimal loss. In addition, funds management practices should ensure that liquidity is not maintained at a high cost or through undue reliance on funding sources that may not be available in times of financial stress or adverse changes in market conditions.

Evaluation factors that should be considered in assessing liquidity include:

- The adequacy of liquidity sources compared to present and future needs and the ability of the institution to meet liquidity needs without adversely affecting its operations or condition;
- The availability of assets readily convertible to cash without undue loss;
- Access to money markets and other sources of funding;
- The level of diversification of funding sources, both on- and off-balance sheet;
- The degree of reliance on short-term, volatile sources of funds, including borrowings and brokered deposits, to fund longer-term assets;
- The trend and stability of deposits;
- The ability to securitize and sell certain pools of assets; and
- The capability of management to properly identify, measure, monitor, and control the institution's liquidity position, including the effectiveness of funds management strategies, liquidity policies, management information systems, and contingency funding plans.

The FDIC assigned First Republic a Liquidity component rating of "2" in the 2018, 2019, and 2020 roll-up ROEs and a "1" in the 2021 roll-up ROE. The *Risk Management Manual of Examination Policies* defines a "1" and "2" Liquidity component rating as follows:

"1" Liquidity Component Rating Definition	"2" Liquidity Component Rating Definition
A rating of "1" indicates strong liquidity levels and well-developed funds management practices. The institution has reliable access to sufficient sources of funds on favorable terms to meet present and anticipated liquidity needs.	A rating of "2" indicates satisfactory liquidity levels and funds management practices. The institution has access to sufficient sources of funds on acceptable terms to meet present and anticipated liquidity needs. Modest weaknesses may be evident in funds management practices.

The 2018 through 2020 roll-up ROEs concluded that liquidity levels and funds management practices remained satisfactory. The ROEs noted several factors that mitigated liquidity risk including an adequate level of HQLA, ample untapped borrowing capacity and effective liquidity risk management tools. Examination reports also referenced First Republic's established network for selling mortgage loans, but noted that loan sales were only $80 million in 2021, compared to $1.2 billion in 2020 and $289 million in 2019.

First Republic experienced record deposit growth in 2020 and 2021, and RMS upgraded the Liquidity component rating to "1" in the 2021 ROE, issued in May 2022, based on significant increases in liquidity levels. The ROE concluded that liquidity levels were strong and that funds management practices were mature and effectively integrated into the liquidity management framework. However, the dedicated examination team changed the 12-month outlook for the Liquidity component rating to "Negative" in the third quarter 2022 OMR due to increased funding costs, resulting from interest rate increases. The fourth quarter 2022 OMR maintained the negative outlook and stated that the dedicated team would discuss a Liquidity component rating downgrade when processing the 2022 roll-up ROE, which would have been issued in the May 2023 timeframe.

Uninsured Deposits Concentration: RMS Supervisory Plans identified First Republic's concentration of uninsured deposits as a key risk. The 2020 plan noted that because many wealthy clients had large deposits, First Republic's aggregate deposit base was substantially uninsured and potentially unstable and that, since uninsured depositors generally are attentive to the bank's financial health and reputation, any negative media attention could result in a magnified adverse impact. Notwithstanding, the plan noted that First Republic's uninsured deposit concentration remained consistent with prior years and did not represent inordinate risk given the various risk mitigants and history of deposit stability. The 2023 Supervisory Plan noted that the Liquidity Monitoring Tool identified that First Republic had "Elevated" risk because of the high percentage of uninsured deposits to total assets.

Each examination report identified uninsured deposits as a funding concentration. ROEs concluded that management effectively monitored the stability of uninsured accounts and noted that risk mitigation centered on well-developed large depositor client relationships, which typically involved multiple service offerings that tended to reduce the portability of the deposit accounts. The 2021 ROE indicated that the top one percent of client relationships (balances greater than $6.6 million) were composed of 2,900 unique client relationships and represented approximately $73.3 billion of uninsured deposits. These relationships possessed several characteristics that indicated a strong likelihood of continued stability, including an average account tenure of 8 years, 24 services per relationship, and 59 percent of relationships having loans or private wealth management accounts.

The 2021 ROE indicated that First Republic's Liquidity Management Working Group (LMWG) had identified and discussed a breach of the Uninsured Deposits to Total Deposits KRI caution level of 70 percent and concluded that no mitigating action was needed given high liquidity levels in the industry overall.

The 2021 ROE concluded that, overall, the deposit base was diversified between business and consumer, had a significant number of products and services per relationship, had minimal reliance on institutional deposits, and contained a high proportion of checking accounts. Risk management practices appropriately monitored and controlled potential liquidity risk.

A 2021 *Stress Testing Supervisory Letter*, which supported the 2021 ROE, identified concerns with the bank's management of model changes to its Deposit Outflow Calibration Model. These concerns involved how First Republic's Treasury Team evaluated and communicated the impact of model changes to bank risk committees and the Board. Examiners estimated that recent model changes re-categorized approximately $19 billion in deposit inflows received during the Pandemic from being considered short-term to long-term deposits, which had the effect of decreasing aggregate deposit outflow projections under each time horizon of the LST Realistic Worst Case scenario by nearly $17 billion, or 12 percent of total assets. Without these changes, the bank would have breached the qualitative Risk Appetite Statement metrics for the 90+ and 180+ day funding horizons during the fourth quarter of 2020. The FDIC made an associated SR that remained outstanding when the FDIC issued the 2021 roll-up ROE.

Internal Review Team Assessment: We concluded that RMS' decision to increase the Liquidity component rating to a "1," signifying strong liquidity levels and well-developed funds management practices, in the 2021 roll-up examination, was too generous and was inconsistent with First Republic's high level of uninsured deposits which ROEs cited as a funding concentration and Supervisory Plans cited as potentially unstable. The Risk Management *Manual of Examination Policies* notes that insured deposits and borrowings secured by highly liquid assets are more likely to be stable than uninsured deposits or borrowings secured by non-liquid assets. Uninsured deposits should not automatically be considered volatile; however, the historical and projected stability of uninsured deposits should be assessed. RMS considered the historical attrition rate of uninsured deposits; however, historical attrition did not end up being an effective predictor of deposit flight in the wake of SVB's failure.

We have previously noted that the speed with which depositors withdrew funds following SVB's failure was unexpected and surprised banks and the regulators. Banks, such as First Republic, employed LSTs that were based on deposit outflows occurring over a 30, 60, and 90-day period, and that did not contemplate $40 billion in outflows in a single day. In retrospect, it does not appear that banks or banking regulators had sufficient appreciation for the risks that large concentrations of uninsured deposits could present in a social media-fueled liquidity event. A senior RMS official noted that the 2022 interest rate environment—the almost 500 bps increase and inverted yield curve—and the March 2023 uninsured deposit instability, represented a paradigm shift for First Republic and other banks. Previous strategies for increasing the "stickiness" of deposits no longer held true.

In our April 2023 internal review of the *FDIC's Supervision of Signature Bank*, we recommended that FDIC consider the need for enhanced examination guidance related to supervising banks that are overly reliant on uninsured deposit funding or have concentrations in uninsured deposits. RMS should factor in its experience in supervising First Republic in assessing the need for enhanced examination guidance.

Evaluation of the Management Component Rating

The FDIC rated the Management component "1" in each roll-up ROE. The FDIC downgraded First Republic's Management component rating from "1" to "3" on March 31, 2023 and from "3" to "4" on April 28, 2023 with the issuance of a letter to First Republic's Board of Directors describing the basis for the downgrade.

The *Risk Management Manual of Examination Policies* states that the quality of an institution's management, including its board and executive officers, is a critical factor in the successful operation of an institution. The board has overall responsibility and authority for formulating sound policies and objectives for the institution, for effectively supervising the institution's affairs, and for promoting the institution's welfare. A vital part of the directors' responsibilities is to set the strategic plan of the institution. Management must deal with ever-changing economic and market conditions, competition, innovation, and emerging and unforeseen risks. An effective strategic plan must be dynamic and updated as circumstances change. Executive officers, such as the President and CEO and the Chief Lending Officer, have primary responsibility for managing the day-to-day operations and affairs of the bank.

The capability and performance of management and the board of directors is rated based upon, but not limited to, an assessment of the following evaluation factors:

- The level and quality of oversight and support of all institution activities by the board of directors and management;
- The ability of the board of directors and management, in their respective roles, to plan for, and respond to, risks that may arise from changing business conditions or the initiation of new activities or products;
- The adequacy of, and conformance with, appropriate internal policies and controls addressing the operations and risks of significant activities;
- The accuracy, timeliness, and effectiveness of management information and risk monitoring systems appropriate for the institution's size, complexity, and risk profile;
- The adequacy of audits and internal controls to promote effective operations and reliable financial and regulatory reporting; safeguard assets; and ensure compliance with laws, regulations, and internal policies;
- Compliance with laws and regulations;
- Responsiveness to recommendations from auditors and supervisory authorities;
- Management depth and succession;
- The extent that the board of directors and management is affected by, or susceptible to, dominant influence or concentration of authority;
- Reasonableness of compensation policies and avoidance of self-dealing;
- Demonstrated willingness to serve the legitimate banking needs of the community; and
- The overall performance of the institution and its risk profile.

The FDIC assigned First Republic a Management component rating of "1" from 2020 through March 31, 2023, reporting that board and management performance remained satisfactory. The *Risk Management Manual of Examination Policies* defines a "1" and "2" Management component rating as follows:

"1" Management Component Rating Definition	"2" Management Component Rating Definition
A rating of "1" indicates strong performance by management and the board of directors and strong risk management practices relative to the institution's size, complexity, and risk profile. All significant risks are consistently and effectively identified, measured, monitored, and controlled. Management and the board have demonstrated the ability to promptly and successfully address existing and potential problems and risks.	A rating of "2" indicates satisfactory management and board performance and risk management practices relative to the institution's size, complexity, and risk profile. Minor weaknesses may exist, but are not material to the safety and soundness of the institution and are being addressed. In general, significant risks and problems are effectively identified, measured, monitored, and controlled.

The 2018 through 2021 roll-up ROEs generally concluded that Board oversight, management performance, and overall governance was strong. The ROEs cited long-term, stable financial performance as well as maintenance of well-developed risk management infrastructure, internal audit, and control functions. The ROE noted that corporate governance was effective, the ERM program effectively identified, monitored, controlled, and prioritized risks across the enterprise, and the internal audit program was appropriate for the bank's activities and risk profile.

First Republic experienced several leadership changes in early 2022 that the dedicated examination team monitored closely. In July 2021, the bank announced that its Board had extended the contract of its Founder, Chairman, and CEO, through December 2022, following which he would serve as Executive Chairman. The Board also entered into a contract with the bank's President to become President and Co-CEO, sharing Chief Executive responsibilities with and reporting to the Founder, Chairman, and now Co-CEO. However, in November 2021, First Republic's Board created an ad hoc CEO Search Committee and later announced it had engaged an executive search firm to recruit and select a CEO. In December 2021, the bank announced that the Founder, Chairman, and Co-CEO would take a medical leave of absence for a period expected to be six months, beginning in January 2022, and further announced that the Board had appointed First Republic's CFO to the position of President, effective January 2022.

In January 2022, First Republic announced that the President and Co-CEO appointed in July 2021 had resigned, effective December 2021 and that the CFO, who had previously been named President, had also been named Acting Co-CEO and a Board member, effective January 2022. Also in January 2022, the Executive Vice President/Chief Operating Officer resigned suddenly due to personal reasons following a family tragedy. In March 2022, First Republic announced that the Founder, Chairman, and Co-CEO would end his medical leave of absence in April 2022 and serve as Co-CEO and Chairman of the Board. A week later, also in March 2022, First Republic announced that the Founder, Chairman, and Co-CEO transitioned to Executive Chairman and that the bank's former CFO transitioned to the position of CEO, and continued to serve as President and a member of the Board. The 2021 ROE reported that the Board's actions successfully stabilized leadership at the bank.

Internal Review Team Assessment: Greater criticism of First Republic's interest rate risk management and reliance on potentially unstable funding sources,[15] may have also prompted a downgrade to the Management component rating in the 2021 roll-up ROE. The dedicated examination team considered the appropriateness of the Management "1" component rating given First Republic's leadership changes. Additional consideration of risks associated with First Republic's continual growth strategy heading into an uncertain interest rate environment and heavy reliance on uninsured deposits could have tipped the scales in favor of a Management rating downgrade. A downgrade or associated SR could have further encouraged First Republic management to take action to mitigate risks. Moreover, reflecting examination criticisms in the Management component rating would have been appropriate since the growth and funding strategies were the actions of a sophisticated management team.

In examiners' judgment, bank management was strong and had a good track record, had mature risk management and control systems, and was responsive to examiner feedback. As a result, the dedicated team appeared to have confidence in bank management and accepted management's strategies and assumptions. In hindsight, there were opportunities to challenge management more, such as management's view that growth in loans and deposits would serve as a natural hedge to interest rates and the Board and management's acceptance of the risk in response to the 2022 EVE breaches.

[15] Uninsured deposits were 75 percent of total deposits as of December 31, 2021, and exceeded the bank's caution level of 70 percent.

There were also opportunities for a more holistic approach to supervising the bank. First Republic was the second largest FDIC supervised bank and the 14th largest bank in the country when it failed. SFRO supervised the bank under the CEP, RMS assigned a large bank specialist from Washington, and senior RMS headquarters officials received periodic Examiner-in-Charge (EIC) briefings and met with the bank's CEO quarterly. However, based on our interviews and document review, there appeared to be significant reliance on the EIC, dedicated team, and Case Manager to provide the preponderance of examination information and critical analysis, including surfacing any safety and soundness concerns, for RMS regional and headquarters consideration. For banks of First Republic's size, RMS should consider whether there are opportunities for LBS and headquarters leadership to better assist in: effectively challenging bank management's strategies and assumptions; bringing a broader horizontal perspective that the dedicated team otherwise might not have; and constructively questioning examination focus, scope, and conclusions based on headquarters officials' broader understanding of risks facing the banking industry.[16]

In the case of First Republic, the bank's business model was well known to LBS and RMS headquarters leadership, thus headquarters could have also challenged management's lack of sufficient interest rate risk mitigation strategies. Further, LBS has financial and condition information for all institutions in the LIDI program, including information such as EVE estimates, that may have been useful to the regions and dedicated teams for benchmarking or perspective. With respect to examination team focus, there is a risk that dedicated examination teams can become so focused on completing CEP steps, such as, supervisory plans, quarterly ongoing monitoring, quarterly LIDI reviews, and planned targeted reviews, that they may not sufficiently observe how the risk landscape has changed or clearly see the big picture. For example, some FDIC officials suggested that perhaps the dedicated team was too focused on First Republic's models and model validation efforts and did not provide sufficient attention to the bank's practices and actual interest rate risk position. LBS reviews and provides comments on the annual supervisory plan and quarterly LIDI reports, but for banks the size of First Republic, more frequent headquarters interaction with respect to examination focus, given reaI-time changes in the economy and banking environment, may be appropriate.

In May 2022, RMS established the LBOC to address the continuing growth and complexity of FDIC-supervised large banks.[17] The LBOC was intended to coordinate oversight of the CEP between the Washington and Regional Offices, including facilitating dialogue on key issues related to CEP supervisory priorities, supervisory findings, and policies. LBOC responsibilities include discussing:

- The transition in examination processes to and from a point-in-time to CEP based on Regional Office recommendations related to the annual Supervisory Planning Process.
- Matters related to regional staffing to promote consistency across regions and with risk-focused, forward-looking supervision and to support near and intermediate-term workload and staffing needs.
- Horizontal analyses prepared by LBS, supervisory findings related to risk topics and areas, and ongoing supervisory priorities.

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[16] In addition, for FDIC-supervised banks of First Republic's size, greater involvement of the Division of Complex Institution Supervision and Resolution or the Division of Insurance and Research resources or perspectives may be appropriate.
[17] LBOC membership includes senior Washington office leadership and Regional Directors with the LBS Associate Director serving as Secretary and responsible for meeting agendas.

- Recommended changes to policies and procedures, training initiatives, and supervisory priorities.
- The condition of and supervisory strategy related to individual institutions subject to the CEP to promote consistency across the regions and encourage discussion of supervisory methods and best practices.

RMS headquarters leadership indicated RMS recently made changes to the LBOC to make it more effective and increase interaction and dialogue. The LBOC could provide a forum for a coordinated and holistic approach for supervising the largest state nonmember institutions. The regions will also need to be open to receiving such information, being effectively challenged, and acting upon feedback.

LIDI Program Ratings

The LIDI Program is designed to provide a comprehensive analysis of the risk profiles of insured depository institutions with total assets of at least $10 billion. The timely and thorough analysis of these institutions helps the FDIC:

- Identify, monitor, and control the largest risks to the DIF.
- Support discretionary adjustments to deposit insurance premium assessments.
- Inform potential resolution-planning decisions and estimate potential losses.
- Identify emerging risks and trends in the banking industry.
- Document and communicate risks to senior FDIC management.

Each quarter, a regional Case Manager[18] prepares a report for the LIDI program, which includes LIDI analyses and ratings for their assigned institutions. LIDI ratings are designed to reflect a large bank's potential risk to the DIF and specifically incorporate assessments of risk of failure assuming stressed conditions (Vulnerability to Stress) and FDIC losses assuming failure (Loss Severity) using the rating scale in Table 7. The LIDI rating also includes an "Outlook" component (i.e., Positive, Stable, Negative) that projects where the LIDI Rating appears likely to be in 12 months based on currently available information.

[18] The Regional Office assigns a Case Manager to be a bank's primary risk management contact.

Table 7: LIDI Program Ratings Definitions

Rating	Definition
A	Institutions pose a low risk to the DIF under stressed conditions. Such institutions have strong financial performance and represent the lowest level of risk of loss to the DIF.
B	Institutions pose a moderate risk to the DIF under stress conditions. Such institutions generally have satisfactory management and financial performance, are well diversified, and would not create a material loss to the DIF in the event of failure.
C	Institutions generally represent a heightened risk to the DIF under stress conditions. Such institutions exhibit one of the following: risk management weaknesses that warrant supervisory attention; vulnerable to a stress event due to their balance sheet composition (e.g. elevated loan or funding concentrations, marginal level of liquid assets, etc.); or cause a material loss to the DIF in the event of failure.
D	Institutions represent a higher risk to the DIF under stress conditions. Such institutions will exhibit more than one of the following: risk management or financial condition weaknesses that warrant supervisory attention; more vulnerable to a stress event due to their balance sheet composition (e.g. high loan or funding concentrations, low level of liquid assets, etc.); or cause a material loss to the DIF in the event of failure.
E	Institutions are very high-risk and in troubled condition. Such institutions will have a very weak financial condition and a high degree of performance variability. Further, these institutions exhibit significant uncertainty regarding their ongoing viability or a pronounced risk of loss to the DIF.

Source: *LIDI Report Instructions*.

During the period of our review, the Senior Case Manager prepared quarterly LIDI reports, as required, that were reviewed by the Assistant Regional Director (ARD) and LIDI Analyst. From the first quarter of 2018 through the fourth quarter of 2020, the Senior Case Manager assigned a "C" LIDI rating with either a stable or positive outlook, indicating the bank represented a heightened risk to the DIF under stress conditions. In the first quarter of 2021, The Senior Case Manager changed the LIDI rating to a "B" with a stable outlook, indicating First Republic represented a moderate risk to the DIF under stress conditions. The Case Manager maintained the "B" stable LIDI rating and outlook until the second quarter of 2022. LBS recommended and the Case Manager agreed and decreased the outlook from stable to negative. In the third quarter of 2022, LBS recommended a rating downgrade and the Case Manager agreed and lowered the LIDI rating and outlook further to "C" negative, indicating that First Republic represented a heightened risk to the DIF under stress conditions. Finally, in the fourth quarter of 2022, the Case Manager lowered the LIDI rating and outlook to "D" negative, based on the events of the weekend of March 10, indicating First Republic represented a higher risk to the DIF under stress conditions. RMS officials indicated there were no LIDI ratings disagreements between LBS and the dedicated examination team. Table 8 shows First Republic LIDI Ratings and Ratings Outlook.

Table 8: First Republic LIDI Ratings and Ratings Outlook

Quarter and Year	LIDI Rating and Outlook
1st Quarter 2018 – 3rd Quarter 2019	C Stable
4th Quarter 2019	C Positive
1st Quarter – 3rd Quarter 2020	C Stable
4th Quarter 2020	C Positive
1st Quarter 2021 – 1st Quarter 2022	B Stable
2nd Quarter 2022	B Negative
3rd Quarter 2022	C Negative
4th Quarter 2022[a]	D Negative

Source: First Republic LIDI Reports.
[a] The 4th Quarter 2022 LIDI rating and outlook reflect the events of the weekend of March 10, 2023.

Continuous Examination Process Implementation

The FDIC supervised First Republic under a CEP that included elements such as supervisory planning, targeted reviews, ongoing monitoring, LIDI reporting, and an annual roll-up ROE. The FDIC assigned a dedicated examination team that operated onsite at the bank and included examiners from CADFI.[19]

The FDIC's *Large Bank Supervision Procedures* provides guidance for conducting CEP activities. Under the CEP, the dedicated examination team is led by a dedicated or designated EIC. For each CEP institution, the size and composition of the dedicated examination team is based on the size, complexity, and risk profile of the bank. A Field Office Supervisor is responsible for staffing the team and may assign additional resources or specialists as needed. The regional office also assigns a Case Manager to be a bank's primary risk management contact. The Field Office Supervisor and Case Manager report to an ARD who has responsibility for a portfolio of assigned banks. In addition, the LBS Branch provides nationwide oversight and quality control of significant examination activities at CEP institutions. Appendix 5 presents information about CEP roles and responsibilities.

As shown in Table 9, the dedicated team, Senior Case Manager, and SFRO management generally completed required CEP planning and examination activity deliverables. Detailed information about CEP deliverables appears in the Supervisory History section in Appendix 2.

[19] Due to the pandemic, examiners performed their work offsite from March 2020 until September 6, 2022.

Table 9: Completed First Republic CEP Deliverables

CEP Deliverable	2018	2019	2020	2021	2022	2023
Supervisory Plan	Y	Y	Y	Y	Y	Y
Targeted Reviews						
• **Planned Reviews**	10	12	12	12	9	9
• **Completed Reviews**	10	12	12	12	9	0
• **Scope Memos**	10	12	12	12	9	1
• **Summary Conclusion Memos**[a]	10	12	12	11[b]	9	0
• **Supervisory Letters**	10	12	12	11[b]	9	0
Supervisory Recommendation Logs[c]	4	4	2	2	2	0
Quarterly Ongoing Monitoring Reports	4	4	4	4	4	N/A
Quarterly LIDI Reports	4	4	4	4	4	N/A
Roll-up ROE	Y	Y	Y	Y	N	N/A

Source: Internal review team analysis of CEP deliverables.
[a] Summary Conclusion Memos include work programs and InTREx (Information Technology Examination) modules.
[b] The results of the 2021 IT (Part 2 of 2) targeted review were reported in the 2021 roll-up ROE, instead of through a Summary Conclusion Memo and targeted review Supervisory Letter.
[c] The SR Logs for 2018 and 2019 were bank-prepared, while the 2020, 2021, and 2022 SR logs were FDIC-prepared.

In 2018, First Republic was included in an LBS new commercial loan underwriting horizontal review and in 2019 the bank was included in an LBS internal audit horizontal review and new loan underwriting horizontal review. LBS horizontal reviews planned for 2020, 2021, and 2022, did not occur due to adjustments related to the pandemic, staffing issues, or competing priorities.

The FDIC's *Large Bank Supervision Procedures* provides guidance for conducting CEP activities and sets expectations for planning, examination activities, and communication.

Supervisory Planning

The *Large Bank Supervision Procedures* state that the initial step in the supervisory process is to develop an annual Supervisory Plan, which is an important tool in identifying and prioritizing risk and effectively allocating required resources. Supervisory Plans are prepared by the EIC and submitted to the Case Manager, reviewed and approved by the ARD, and submitted to the applicable LBS analyst for review and comment. The EIC coordinates with field or regional officials responsible for providing staff to ensure availability of examination resources. Effective pre-planning for targeted reviews should include the development of a comprehensive strategy to identify risk and assess the effectiveness of risk management controls. Each targeted review should be supported by a comprehensive Scope Memo.

We confirmed the dedicated team prepared comprehensive Supervisory Plans, which included planned staffing requirements needed to complete targeted reviews and ongoing monitoring activities, as determined by risk assessments of the bank. The Supervisory Plans identified key risks related to First Republic's operations and business strategy. For example, the 2022 Supervisory Plan, developed from June 2021 through August 2021, noted:

- First Republic has a moderate risk profile, and management proactively addresses and monitors key risks. Prominent risks associated with the business of catering to HNW individuals and their business interests include competition, deposit instability, reputation, operational capacity, scalability, and management succession. Competition to attract and retain private banking and wealth management clients is significant.

- Many clients maintain significant deposits, and depositor concentration is high. Although the aggregate deposit base is substantially uninsured and potentially unstable, depositors typically have additional products with the bank, which provides management with greater oversight and customer retention. Through a Client Engagement Initiative, senior managers stay in touch with clients holding large balances to monitor and anticipate potential deposit balance changes. First Republic's strong financial profile also helps reassure uninsured depositors and mitigate reputational risk.

- Operations are moderately complex based on the inherent risk in the business activities of HNW clients, very high growth rate, and the interconnectedness among the various business lines. The balance sheet is centered in loans and deposits, with limited off-balance sheet activities and no exotic derivatives. SFR and commercial real estate (CRE) loans are collateral type concentrations, and uninsured deposits is a funding concentration.

- A sustained slowdown in growth could cause a mismatch of assets and liabilities and negatively impact the NIM. The Supervisory Plan noted that "…[t]he balance sheet indicates a well-matched duration of assets and liabilities. Competition for high-net worth clients and their business interests is intense, which presents a challenge for management to adjust the repricing structure to manage interest rate risk through deposit incentives and loan pricing. The robust growth has contributed towards a relatively stable NIM over time as assets and liabilities have quickly repriced and under varying interest rate environments."

Examination Activities

The *Large Bank Supervision Procedures* state that examination activities include targeted reviews and ongoing monitoring. Examination deliverables include the:

- Examiner Conclusion Memo prepared by each examiner after concluding examination work;
- Summary Conclusion Memo prepared by the lead examiner within 15 days of concluding examination work;
- Target Conclusion Letter or Supervisory Letter, prepared by the lead examiner after every targeted review and transmitted to the bank's CEO and board within 45 days of the exit meeting;
- Quarterly LIDI report prepared by the Case Manager, due 55 days after the end of each quarter;
- OMR, which summarizes ongoing monitoring activities, due within 45 days of the quarter end;
- Quarterly Supervisory Letters, an optional letter transmitted to the bank's CEO and board, due within 60 days of the end of the quarter;
- Supervisory Letters transmitted to the bank's CEO and board to communicate closure of SRs or results from ongoing monitoring activities; and
- Roll-up ROE, prepared annually addressing Safety and Soundness, Trust, BSA, and IT reviews. The ROE should generally be issued to the bank within 150 days of the examination "as of date."

As discussed earlier, the SFRO issued 54 targeted review Supervisory Letters and four annual roll-up ROEs during our period of review. Targeted reviews frequently addressed areas such as commercial lending, corporate governance, stress testing, IT, operations risk, deposit stability, trust services, private wealth management, retail lending, and BSA.

The EIC developed Supervisory Plans for each examination cycle that identified planned targeted reviews for the year. Dedicated examination teams are allowed to deviate from the Supervisory Plan during the year; however, any significant deviations should be approved by the ARD. We observed from 2018 through March 2023 that no targeted reviews were cancelled or delayed until future examination cycles. On March 16, 2023 the SFRO determined that the 2023 supervisory plan and strategy would need to be reassessed based on the events of the weekend of March 10, 2023.

Communication of Supervisory Activities

The FDIC's *Large Bank Supervision Procedures* provides guidance for communication of supervisory activities and notes that external communication with bank management and the board must be clear and frequent to ensure a timely discussion of risks and remediation of supervisory issues. Each targeted review should include a pre-planning meeting, an entrance meeting, periodic update meetings, and a final exit meeting. If the review involves one or more MRBAs, a meeting with the board, or committee thereof, is appropriate. Generally, the EIC, with Regional Office support, as deemed necessary, should 1) conduct quarterly meetings with bank management to obtain status updates on bank performance, strategic initiatives, audit findings, and 2) generally conduct annual meetings to ensure the board, or an appropriate committee thereof, is apprised of the examination cycle findings and ratings and to communicate expectations and supervisory program priorities for the upcoming year. Findings from a targeted review or ongoing monitoring activities may also trigger the need to meet with the board before the end of the examination cycle.

The SFRO generally communicated the results of targeted reviews to bank management through exit meetings with bank management and through Supervisory Letters to the board and management. The SFRO transmitted written ROEs to First Republic's Board and management. The dedicated team also held quarterly meetings with First Republic management.

ROE and Supervisory Letter Timeliness

During the period of our review, the FDIC issued four annual roll-up ROEs summarizing First Republic examination and ongoing monitoring activities. The annual cycle ended on December 31, the examination "as of date." As shown in Table 10, the FDIC issued First Republic roll-up ROEs timely when compared to the CEP median and the CEP procedures.

Table 10: Report of Examination Timeliness

ROE "as of date" (12/31/20XX)	Issuance Date	Days from "as of date" to ROE Issuance Date		
		CEP Median	First Republic	Difference
2018 Roll-up ROE	05/13/2019	168	133	-35
2019 Roll-up ROE	05/07/2020	168	128	-40
2020 Roll-up ROE	05/06/2021	152	126	-26
2021 Roll-up ROE	05/04/2022	167	124	-43

Source: Internal review team analysis of ROEs and transmittal letters.

We also confirmed that the dedicated examination team generally completed targeted reviews timely and issued supporting Supervisory Letters within the 45 day benchmark. Timeliness information for targeted reviews and Supervisory Letters appears in Appendix 2.

FDIC Staffing Resources

We received mixed views from officials that we interviewed with respect to the adequacy of staffing resources assigned to examine First Republic. Most officials we interviewed indicated that staff levels were adequate. However, one official raised concerns about the extent of dedicated team vacancies and the few number of LFI examiners that were assigned to targeted reviews. Importantly, all officials that we interviewed indicated that, regardless of their views on the adequacy of staffing, the dedicated team completed target reviews and issued supervisory letters and ROEs timely and that examination products were high quality.

Supervisory Plans estimated the examination hours required to conduct planned targeted reviews and ongoing monitoring. We obtained reports showing actual hours expended on examination activities and compared that information to Supervisory Plan estimates as shown in Table 11.

Table 11: Planned and Actual Examination Hours

Examination Cycle	First Republic Assets (in billions)	Planned Hours[a]	Actual Hours[a]	Percentage of Planned Hours Actually Used	Planned Hours Per Billion $
2018	$76.5 as of 3/31/17	19,040	17,328	91%	249
2019	$90.2 as of 3/31/18	21,785	14,198	65%	242
2020	$101.8 as of 3/31/19	23,500	21,817	93%	231
2021	$123.9 as of 3/31/20	24,424	16,974	69%	197
2022	$155.8 as of 3/31/21	20,402	15,367	75%	131

Source: Call Reports, Supervisory History, and field office staffing information.

[a] Planned hours and actual hours do not include time in travel status. Further, in 2020, 2021, and 2022, travel time was not recorded for First Republic targeted reviews due to the pandemic and how the reviews were staffed.

As shown, actual examination hours fell short of planned hours in each examination cycle. FDIC officials told us that historically Supervisory Plans had been aspirational, reflecting more of a one-size-fits all approach where all possible targeted reviews were discussed, with the understanding that they would not all be completed. RMS clarified its supervisory planning instructions in 2021 and has been communicating with examiners that planning should be consistent with risk-focused supervision principles, whereby Supervisory Plans should be risk-focused based on the unique characteristics of the institution examined and not based on an effort to examine all possible areas over a certain period of time.

Supervisory Plans also include a metric, planned hours per billion dollars of total assets. This metric declined from 2018 to 2022 for First Republic. Officials explained there are attributes that could explain this decrease such as economies of scale in conducting examinations as banks increase in size, First Republic's consistent business model that did not change year-to-year, and the fact that First Republic's growth was centered in SFR loans which are not particularly complex to examine. We would not expect changes in planned or actual examination hours to mirror the growth of the bank and we understand there could be economies of scale and familiarization with bank activities that could reduce required examination hours. However, over the 4-year period depicted in Table 11, First Republic doubled in size while actual examination hours declined by 11 percent. On the surface, this trend appears counterintuitive and warranted greater explanation in Supervisory Plans.

The dedicated team assigned to examine First Republic was authorized seven positions in 2018 and 2019 and authorized eight positions starting in 2020. The dedicated team experienced vacancies of one or two positions during portions of examination cycles in 2020, 2021, and 2022. We received differing views on the extent and impact of vacancies from FDIC officials that we interviewed. Almost all officials interviewed stated that examination resources were adequate. SFRO officials noted that dedicated team absences were generally not long term and were filled by other examiners with large bank experience or SEs. Several officials also noted that the periodic assignment of specialists, such as Division of Insurance and Research economists to help evaluate First Republic's complex financial models, as an example of successfully augmenting the dedicated team with the right expertise when needed.

However, one official raised concerns about the extent of dedicated team vacancies and the number of LFI examiners that were assigned to targeted reviews. The official indicated that dedicated examiners with LFI experience were sometimes not available or were detailed to other bank examination efforts and that a number of staff assigned to certain First Republic targeted reviews were non-commissioned examiners.[20]

Other SFRO officials contended that the composition of staff assigned was sufficient and noted that non-commissioned examiners could include both pre-commissioned examiners and examination staff with specialties, such as loan review specialists. These officials also noted that the number of commissioned staff assigned to First Republic was in line, year-to-year, with the volume of commissioned examiners in the San Francisco Field Office. While all officials acknowledged that the dedicated team consistently delivered high-quality and timely work products, the one official who raised staffing concerns noted that doing so required significant effort from the team.

Conclusion and Matters for Further Study

We have previous reported that the events of March 10, 2023 were unprecedented. The speed with which depositors withdrew funds from SVB, Signature Bank, and First Republic was unexpected and a surprise to the regulators and the banking industry. In response, the federal banking regulators are actively reviewing existing regulatory requirements such as capital standards and the appropriate asset threshold for enhanced prudential standards. FDIC also conducted and issued an *Options for Deposit Insurance Reform* study on May 1, 2023 that examined three options for deposit insurance reform. The regulators are also continuing to closely monitor institutions displaying stress or vulnerability in the wake of the March 2023 liquidity event.

In reviewing the FDIC's supervision of First Republic, the internal review team had the benefit of 20/20 hindsight. It is much easier to suggest what examiners should have done, once one has a full understanding of the events that actually happened and how they diverged from historical norms. In conducting this internal review, we attempted to act as if March 2023 had not happened and evaluate supervisory activities against FDIC examination guidance based on events and information that was

[20] We received information from multiple sources late in our engagement regarding the number and composition of examination staff assigned to targeted reviews. We could not readily reconcile the information and did not have time to sufficiently evaluate the information or benchmark the staffing mix against other CEP dedicated teams.

available to RMS at that time. We cannot say whether taking earlier supervisory action such as criticizing interest rate risk or liquidity risk management would have prevented First Republic from failing, given the significance and speed of deposit withdrawals in the wake of the contagion sparked by SVB's failure. However, meaningful action to mitigate interest rate risk and address funding concentrations would have made First Republic more resilient and less vulnerable to the March 2023 contagion event.

Our April 28, 2023 report on the *FDIC's Supervision of Signature Bank*, communicated a number of matters for the FDIC's consideration or further study. Several of those matters are relevant to the First Republic failure. We also identified several additional matters for the FDIC's consideration or further study.

Area	Matters for Further Study
Guidance	1. Reiterate expectations and examiner resources for evaluating interest rate risk management during the CEP. 2. Previously reported – Consider the need for enhanced examination guidance related to supervising banks that are overly reliant on uninsured deposit funding or have concentrations in uninsured deposits. 3. Evaluate whether CEP examination teams should place greater consideration and emphasis on unrealized losses and declines in fair value (in securities and in loans) and whether additional information fields should be required in Call Reports.
Processes	4. Previously reported – Continue to evaluate the CEP and implement necessary changes to ensure the CEP provides efficient, effective, and timely risk-based feedback to large banks, including interim CAMELS ratings, when appropriate. 5. Previously reported – As part of item 4, evaluate existing CEP required deliverables and level-of-effort to prepare deliverables in relation to benefits derived. Look for opportunities to streamline program requirements and written deliverables. 6. Explore opportunities for LBS to provide horizontal and trend LIDI information to examination teams for benchmarking and to provide a broader large bank perspective. 7. Explore potential processes and information sources for real-time monitoring of large bank reputational risk profiles. Potential information sources could include bank share price tracking websites, short seller activity, and social media discussions. 8. Confer with other CEP teams to see if they also experience delays in receiving information about bank board of director decisions and explore alternatives for obtaining decision information sooner.

Appendix 1: Objective, Scope, and Methodology

Objective

In May 2023, FDIC Chairman Martin J. Gruenberg commissioned the FDIC's Chief Risk Officer to conduct an internal review of the agency's supervision of First Republic. The Chief Risk Officer assembled a team independent of the FDIC's RMS to perform the work. The objective of this internal review was to provide information about the cause of First Republic's failure and evaluate the FDIC's supervision of First Republic.

Scope and Methodology

The scope of the review included an evaluation of the regulatory supervision of First Republic from 2018 until its failure on May 1, 2023.

To evaluate the FDIC's supervision of First Republic, we assessed whether the supervisory approach and actions taken with respect to the bank, specifically related to Management, Liquidity, and Sensitivity to Market Risk, were commensurate with its risk profile and relevant regulations, policies, and guidelines. Specifically, we:

- Identified and reviewed RMS policies and procedures, including the *RMS Manual of Examination Policies*, the *Formal and Informal Actions Procedures Manual*, *Large Bank Supervision Procedures*, the *LIDI Report Instructions*, and *Case Manager Procedures* that were relevant to First Republic and the supervisory actions taken with respect to the bank;
- Analyzed Supervisory Plans, ROEs, LIDI reports, Supervisory Letters and summary conclusion memos that would affect the Management, Liquidity, and Sensitivity to Market Risk components of the CAMELS rating, to identify the timing and nature of supervisory actions taken to address management, liquidity, and interest rate risks at the bank;
- Reviewed FDIC- and RMS-prepared documents on First Republic's supervision and failure;
- Interviewed FDIC officials who had supervisory responsibility for First Republic, including officials and examiners in the SFRO, to obtain clarification and context regarding key supervisory activities and determinations;
- Interviewed RMS headquarters senior officials and officials from the LBS Branch;
- Participated in interviews with CADFPI examiners and senior officials in Supervision and Legal to obtain their perspectives on the supervision of First Republic.

We conducted our work from May 23, 2023 through July 31, 2023. Due to the time constraints of our review, we acknowledge that other reviews of First Republic's failure and FDIC's supervision may identify additional findings and recommendations beyond those identified in this report.

Appendix 2: Supervisory History

During the period of our review, 2018 through First Republic's failure on May 1, 2023, the FDIC supervised the bank under the CEP. The FDIC developed annual Supervisory Plans, conducted targeted reviews, conducted ongoing monitoring, and issued a roll-up ROE for each annual examination cycle.

2018 Examination Cycle

The FDIC prepared a Supervisory Plan that outlined ongoing monitoring activities and planned onsite targeted reviews for the 2018 supervisory cycle. The Supervisory Plan allocated 13,380 FDIC hours for onsite targeted reviews and 5,660 FDIC hours for ongoing monitoring activities. For this supervisory cycle, the plan included 10 targeted reviews, a resolution plan review, one horizontal review (loan underwriting), and the roll-up examination. As noted below, the dedicated team issued 10 Supervisory Letters in 2018 based on results of targeted reviews.

The 2018 examination cycle commenced March 12, 2018, and included ongoing monitoring and 10 targeted reviews.

Targeted Review	(A) Start Date	(B) Exit Meeting	B – A Elapsed Days	(C) Issue Date	C – B Elapsed Days
Corporate Governance Review	3/12/18	3/30/18	18	4/26/18	27
DFAST CST Review	4/16/18	5/23/18	37	6/20/18	28
Operations Risk Review	5/14/18	6/26/18	43	7/18/18	22
IT Review (Part 1 of 2)	7/9/18	7/26/18	17	9/24/18	60
Commercial Lending Review	7/9/18	8/2/18	24	9/6/18	35
Market and Funding Risk Review	9/4/18	9/20/18	16	10/18/18	28
Retail Lending Review	10/1/18	10/25/18	24	12/3/18	39
IT Review (Part 2 of 2)	10/22/18	11/29/18	38	1/30/19	62
Trust Services Review	10/29/18	11/21/18	23	1/10/19	50
Anti-Money Laundering (AML) Review	11/5/18	11/29/18	24	1/10/19	42

The findings from these targeted reviews and ongoing monitoring activities formed the basis for the conclusions and CAMELS ratings assigned in the 2018 roll-up examination report, which FDIC issued on May 13, 2019. The exit meeting with bank management was held on May 7, 2019. The meeting with the Board occurred on May 15, 2019. Assigned CAMELS ratings and narrative summary of the Management, Liquidity, and Sensitivity to Market Risk component ratings follow:

Composite Rating	Capital	Asset Quality	Management	Earnings	Liquidity	Sensitivity to Market Risk
2	2	1	1	2	2	2

Management: The 2018 ROE upgraded the management component to strong based on highly functioning governance, administration, and risk control functions across all key business areas and operations. The ROE noted sustained strong business and financial performance and maturation of the critical areas of succession planning, ERM, AML, internal audit, and funds management programs.

The ROE concluded that both the AML and IT programs were strong and that the Trust program was satisfactory. At the conclusion of the examination cycle, there were no outstanding MRBAs and several SRs in areas such as stress testing and market and funding risk.

Liquidity: The ROE concluded that liquidity levels and management practices remained satisfactory. The ROE noted that several factors mitigated the risk of an adverse effect on liquidity from the concentration in uninsured deposits: the relationship-oriented deposit base; comprehensive deposit stability modeling; strong credit ratings; and the demonstrated stability of the level and composition of deposits despite the recent risk in market rates. The ROE reported that liquidity increased because of the rule change that allowed municipal bonds to be included in HQLA. The ROE noted that the Uninsured Deposits Dashboard provided a comprehensive assessment of deposit stability quarterly. Uninsured deposits remained a funding concentration. The ROE reported that uninsured deposits represented 65 percent of total deposits, which was below the average of 70 percent for select peer banks with similar business models, and 61 percent of total assets as of December 31, 2018.[21] At the conclusion of the examination cycle, there were no outstanding MRBAs and several SRs related to LST.

Sensitivity to Market Risk: The ROE concluded that sensitivity to market risk remained moderate, and interest rate risk management remained satisfactory. The ROE noted that stress testing appropriately considered plausible scenarios for changes in market rates, none of which were forecast to have a material adverse effect on the current satisfactory levels of earnings and capital. Additionally, the ROE stated that the key to the moderate interest rate risk was the consistent large asset growth that generated a sizable volume of assets and liabilities with current market pricing. The ROE also noted that the most severe scenario, a 200 bps downward parallel rate shock, resulted in an approximate 15 percent NII decline over two years, which was well within the established risk appetite limit. Lastly, the ROE noted that management was in the process of transitioning to a new ALM platform. At the conclusion of the examination cycle, there were no outstanding MRBAs or SRs related to sensitivity to market risk.

2019 Examination Cycle

The FDIC prepared a Supervisory Plan that outlined ongoing monitoring activities and planned onsite targeted reviews for the 2019 supervisory cycle. The Supervisory Plan allocated 15,690 FDIC hours for onsite targeted reviews and 6,095 FDIC hours for ongoing monitoring activities. For this supervisory cycle, the plan included 12 targeted reviews, two horizontal reviews (audit and underwriting), and the roll-up examination. As noted below, the dedicated team issued 12 Supervisory Letters in 2019, based on the results of targeted reviews. The Supervisory Plan also noted that the dedicated team would continue to include seven dedicated examiners. While the dedicated team was authorized seven examiners in 2019, one position remained open for a portion of the supervisory cycle.

The 2019 examination cycle commenced January 22, 2019, and included ongoing monitoring and 12 targeted reviews.

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[21] Uninsured deposits as a percentage of total assets reported in examination reports differed from information presented in Table 1 of this report. Examiners used a call report item that included the total balance of any account greater than $250,000.

Targeted Review	(A) Start Date	(B) Exit Meeting	B – A Elapsed Days	(C) Issue Date	C – B Elapsed Days
Private Wealth Management Review	1/22/19	2/7/19	16	3/11/19	32
Commercial & Industrial Lending Review	2/19/19	3/7/19	16	4/4/19	28
Corporate Governance Review	4/1/19	4/18/19	17	5/31/19	43
Stress Testing Review	4/22/19	5/9/19	17	6/5/19	27
CRE Lending Review	5/20/19	6/6/19	17	7/2/19	26
IT Review (Part 1 of 2)	6/10/19	7/18/19	38	8/27/19	40
Operations Risk Review	7/8/19	7/25/19	17	8/12/19	18
Deposit Stability Review	9/3/19	9/19/19	16	10/9/2019	20
Trust Services Review	9/23/19	10/17/19	24	11/26/19	40
IT Review (Part 2 of 2)	10/15/19	11/8/19	24	12/17/19	39
Retail Lending Review	10/21/19	11/7/19	17	12/17/19	40
AML Review	11/4/19	11/25/19	21	12/19/19	24

The findings from these targeted reviews and ongoing monitoring activities formed the basis for the conclusions and CAMELS ratings assigned in the 2019 roll-up ROE, which was issued on May 7, 2020. The exit meeting with bank management was held on April 30, 2020. The meeting with the Board occurred on May 13, 2020. Assigned CAMELS ratings and narrative summary of the Management, Liquidity, and Sensitivity to Market Risk component ratings follow:

Composite Rating	Capital	Asset Quality	Management	Earnings	Liquidity	Sensitivity to Market Risk
2	2	1	1	2	2	2

Management: The 2019 ROE concluded that management and overall governance of the organization remained strong because of the cohesive business strategy, long-term stable financial performance, entrenched culture of risk awareness, and highly-developed risk management infrastructure. The ROE noted that management slowed the growth rate of expenses in the latter half of 2019 in response to current and projected unfavorable market interest rate conditions. The ROE concluded that both the AML and IT programs were strong and that the Trust program was satisfactory. At the conclusion of the examination cycle, there were no outstanding MRBAs or SRs.

Liquidity: The ROE concluded that the liquidity position and funds management program were satisfactory. Additionally, the ROE listed a versatile collection of liquidity sources, including high quality on-balance sheet liquidity, diversified borrowing capacity supported by high quality mortgages, an established network for selling mortgage loans, and historical access to the capital markets. The ROE also noted that aggregate deposits exhibited low volatility during the temporary upward rate cycle in early 2019. Uninsured deposits continued to be a funding concentration at 59 percent of total assets as of December 31, 2019. The ROE reported that the largest 1 percent of deposit relationships accounted for nearly 53 percent of total deposits. At the conclusion of the examination cycle, there were no outstanding MRBAs or SRs related to liquidity.

Sensitivity to Market Risk: The ROE concluded that interest rate risk was moderate, and the program for managing sensitivity to market risk was satisfactory. The ROE noted that the average asset duration was naturally lowered by continual large growth in new loans priced at market rates.

Additionally, the ROE stated that continued low market interest rates or a yield curve inversion would be adverse to earnings and capital formation. The ROE also stated that rising interest rates were projected to have a low to moderate adverse effect on EVE largely because of the substantial fixed-rate capital funding combined with substantial low-cost checking deposits with low rate sensitivity. Moreover, the ROE reported that none of the interest rate scenarios were projected to have a material adverse effect on earnings or capital, and all exposures remained well within the Board's established risk appetite limit.

The ROE stated that management was aware of the possibility of large, abrupt spikes in market interest rates; the possibility of another yield curve inversion; or the continuation of the current relatively flat, low-rate environment. The ROE also stated that the base scenario of the business plan assumed a prolonged low-rate environment with no material detriment to NIM or earnings. The ROE assessed that the interest rate risk management program included effective Board guidance and communication, informative management reporting, and continual evaluation and enhancement of systems for monitoring and controlling risk. At the conclusion of the examination cycle, there were no outstanding MRBAs or SRs related to sensitivity to market risk.

2020 Examination Cycle

The FDIC prepared a Supervisory Plan that outlined ongoing monitoring activities and planned targeted reviews for the 2020 supervisory cycle. The Supervisory Plan allocated 16,320 FDIC hours for onsite targeted reviews and 7,180 FDIC hours for ongoing monitoring activities. For this supervisory cycle, the plan included 12 targeted reviews and the roll-up examination. In response to the pandemic, in July 2020, a revised Supervisory Plan for August 2020 through December 2020 was included in the Supervisory Plan for 2021. The revised Supervisory Plan noted that the six remaining targeted reviews would be completed in 2020. As noted below, the dedicated team issued 12 Supervisory Letters in 2020, based on results of the targeted reviews. The original and revised Supervisory Plans noted that the authorized dedicated team would increase by one to eight dedicated examiners. The dedicated team remained fully staffed throughout 2020.

The 2020 examination cycle commenced January 1, 2020, and included ongoing monitoring and 12 targeted reviews.

Targeted Review	(A) Start Date	(B) Exit Meeting	B – A Elapsed Days	(C) Issue Date	C – B Elapsed Days
Commercial & Industrial Lending Review	2/18/20	3/5/20	16	4/21/20	47
Corporate Governance Review	3/30/20	4/22/20	23	6/8/20	47
Stress Testing Review	4/20/20	5/14/20	24	6/9/20	26
CRE Lending Review	5/18/20	6/11/20	24	7/7/20	26
IT Review (Part 1 of 2)	6/8/20	7/8/20	30	7/29/20	21
Operations Risk Review	7/13/20	8/5/20	23	8/26/20	21
Deposits Review	9/8/20	10/1/20	23	11/2/20	32
Trust Services Review	9/21/20	10/14/20	23	12/3/20	50
Private Wealth Management Review	9/21/20	10/14/20	23	11/2/20	19
IT Review (Part 2 of 2)	10/13/20	11/4/20	22	12/17/20	43
Retail Lending Review	10/19/20	11/19/20	31	12/10/20	21
AML Review	11/2/2020	11/24/20	22	12/17/20	23

The findings from the targeted reviews and ongoing monitoring activities formed the basis for the conclusions and CAMELS ratings assigned in the 2020 roll-up ROE, which was issued on May 6, 2021. The exit meeting with bank management was held on May 5, 2021. The meeting with the Board occurred on May 13, 2021. Assigned CAMELS ratings and narrative summary of the Management, Liquidity, and Sensitivity to Market Risk component ratings follow:

Composite Rating	Capital	Asset Quality	Management	Earnings	Liquidity	Sensitivity to Market Risk
2	2	1	1	2	2	2

Management: Board oversight, management performance, and overall governance was deemed strong. The ROE cited long-term, stable financial performance during the pandemic as well as maintenance of well-developed risk management infrastructure, internal audit, and control functions. The ROE noted that corporate governance was effective, the ERM program effectively identified, monitored, controlled, and prioritized risks across the enterprise, and the internal audit program was appropriate for the bank's activities and risk profile. The ROE concluded that both the AML and IT programs were strong and that the Trust program was satisfactory. At the conclusion of the examination cycle, there were no outstanding MRBAs and one outstanding SR related to CRE lending.

Liquidity: The ROE concluded that liquidity levels and funds management practices remained satisfactory. The ROE noted that record deposit growth provided ample funds to support record loan growth. The ROE stated that, in response to the pandemic, management increased liquidity and risk monitoring and began to draw down funding beginning in 2020. FHLB advances increased by $5.7 billion at the relatively lower prevailing rates, with peak advances of $18.3 billion. The higher-cost 2020 FHLB maturities were paid down over the remainder of the year. The ROE also noted secondary sources of liquidity, including FHLB borrowings, a comprehensive mortgage loan sales network, and strategically effective capital markets activity.

Uninsured deposits continued to be a funding concentration at 66 percent of total assets as of December 31, 2020. The ROE reported that the top 1 percent of client relationships represented approximately $52 billion of uninsured deposits. The ROE stated that management used early warning indicators, liquidity-related KRIs, and a LST that incorporated client-level activity over a 10-year lookback period to forecast aggregate behavior within segmented deposit categories. The ROE also reported that, during the real-world stress induced by the pandemic, deposit levels were not only stable but also exhibited record growth. At the conclusion of the examination cycle, there were no outstanding MRBAs or SRs related to liquidity.

Sensitivity to Market Risk: The ROE concluded that sensitivity to market risk was moderate, and the program for managing interest rate risk was satisfactory. The ROE noted that the balance sheet indicated a well-matched duration of assets and liabilities, which sufficiently protected interest income and the market value of equity from large swings in interest rates. The ROE also noted that continual growth in new loans priced at market rates naturally lowered the average asset duration. Additionally, the ROE stated that a yield curve inversion or low market interest rates would be adverse to earnings and capital formation. The ROE noted that simulation analysis indicated a low-to-moderate adverse effect on EVE from decreasing interest rates and positive results from increasing rates due in large part to substantial, low-cost, and stable checking deposits.

The ROE also stated that the Federal Reserve's response to stabilize the market in early 2020, followed later by its rate outlook to be "lower for longer" to assist with pandemic economic relief, provided more clarity to management's forecasting. Moreover, the ROE reported that, with the flat long-term rate forecast, management responded by extending the duration of both assets and liabilities yet was also considering stabilizing duration sometime in 2021.

The ROE concluded that management was keenly aware of the impact of all potential interest rate scenarios and had also demonstrated its flexibility to changing conditions during the 2020 pandemic. The updated 2021 Business Plan Base Scenario entailed a prolonged low-rate environment, with no material detriment to NIM or earnings. Stress testing considered plausible scenarios for changes in market rates, none of which were forecast to have a material adverse impact to earnings or capital, and exposures remained well within the Board's established risk appetite limits. The interest rate risk management program included effective Board guidance and communication, informative management reporting, and continual evaluation and enhancement of systems for monitoring and controlling risk. The ROE noted that management transitioned to a new ALM platform in the first quarter of 2020 which was expected to provide greater support and integration for CST, LST, and strategic planning. At the conclusion of the examination cycle, there were no outstanding MRBAs or SRs related to sensitivity to market risk.

2021 Examination Cycle

The FDIC prepared a Supervisory Plan, issued in July 2020, which outlined ongoing monitoring activities and planned targeted reviews for the 2021 supervisory cycle that was included in the revised 2020 Supervisory Plan. The Supervisory Plan allocated 24,424 FDIC hours for targeted reviews and ongoing monitoring activities. The Supervisory Plan noted 12 targeted reviews, with 6 deemed high priority, two horizontal reviews, and the roll-up examination. As noted below, the dedicated team issued 11 Supervisory Letters in 2021 based on results of the targeted reviews.

The Supervisory Plan noted that the dedicated team would continue to include eight examiners. The dedicated team was authorized for eight examiners in 2021 but had seven examiners from January through March 2021, and eight examiners for the remainder of 2021. Dedicated team absences were generally filled by other examiners with large bank experience or SEs. The actual number of dedicated examiners who were available and participated in each targeted review and ongoing monitoring fluctuated due to reassignments to other community bank reviews, LFI reviews, SFRO details, or various leave requests.

The 2021 examination cycle commenced February 1, 2021, and included ongoing monitoring and 11 targeted reviews.[22]

Targeted Review	(A) Start Date	(B) Exit Meeting	B – A Elapsed Days	(C) Issue Date	C – B Elapsed Days
Commercial & Industrial Lending Review	2/1/21	2/25/21	24	3/24/21	27
IT Review (Part 1 of 2)	3/8/21	4/14/21	37	5/24/21	40
Corporate Governance Review	3/22/21	4/15/21	24	5/24/21	39
Stress Testing Review	4/19/21	5/7/21	18	6/17/21	41
CRE Lending Review	5/17/21	6/10/21	24	7/1/21	21
Operations Risk Review	7/12/21	7/29/21	17	8/23/21	25
Deposit Stability Review	9/7/21	9/30/21	23	10/27/21	27
Trust Services Review	9/27/21	10/19/21	22	12/13/21	55
Private Wealth Management Review	9/27/21	10/14/21	17	11/22/21	39
Retail Lending Review	10/18/21	11/10/21	23	11/30/21	20
AML Review	11/1/21	11/23/21	22	12/31/21	38

The findings from these targeted reviews and ongoing monitoring activities formed the basis for the conclusions and CAMELS ratings assigned in the 2021 roll-up ROE, which was issued on May 4, 2022. The exit meeting with bank management was held on May 3, 2022. The meeting with the Board occurred on May 11, 2022. Assigned CAMELS ratings and narrative summary of the Management, Liquidity, and Sensitivity to Market Risk component ratings follow:

Composite Rating	Capital	Asset Quality	Management	Earnings	Liquidity	Sensitivity to Market Risk
2	2	1	1	2	1	2

Management: The 2021 ROE concluded that Board oversight, management performance, and corporate governance remained strong and resilient under challenging circumstances. The ROE cited a smooth transition out of the pandemic environment, successful implementation of a new core processing system, and a continued culture of teamwork and collaboration during personnel changes at the leadership level. The ROE noted that the bank continued its long-term, stable financial performance with an influx of deposits, record loan growth, and prudent capital increases. The ROE concluded that both the AML and IT programs were strong and that the Trust program was satisfactory. At the conclusion of the examination cycle, there were no outstanding MRBAs and two

[22] The results for one targeted review, IT Review (Part 2 of 2), were reported in the roll-up ROE. Due to a scheduled core conversion in late 2021, the dedicated team obtained approval from the SFRO to risk scope the review and not issue a formal Supervisory Letter. This targeted review is not reflected in the table because a targeted review Supervisory Letter was not issued to communicate the results of the review.

outstanding SRs related to CRE lending and LST.

Liquidity: The ROE upgraded liquidity to strong based on significant increases in liquidity levels. The ROE noted that record deposit growth increased both on- and off-balance sheet liquidity sources. Deposits grew by $41 billion to $156 billion as of December 31, 2011. The ROE also noted ample secondary liquidity sources, including FHLB and Federal Reserve discount window borrowing capacity and off-balance sheet customer transaction accounts, which provide a substantial buffer for seen and unforeseen liquidity events. The ROE stated that loan sales were only $80 million in 2021, compared to $1.2 billion in 2020 and $289 million in 2019. The ROE concluded that funds management practices were mature and effectively integrated into the liquidity risk management framework.

Uninsured deposits continued to be a funding concentration at 74 percent of total assets as of December 31, 2021. Large and uninsured deposits increased by 43 percent in 2021 as clients generally held larger liquidity positions compared to the pre-pandemic economic environment. The ROE reported that the LMWG identified and discussed a breach of the Uninsured Deposits to Total Deposits KRI caution level of 70 percent and concluded no mitigating action was needed given high liquidity levels in the industry overall. The ROE also noted that management's analysis indicated that the level of uninsured deposits was lower than business model peers. Lastly, the ROE reported that the top one percent of client relationships (balances greater than $6.6 million) were composed of 2,900 unique client relationships and represent approximately $73.3 billion of uninsured deposits. Several mitigating factors were cited: average account tenure of 8 years, 24 services per relationship, and 59 percent of relationships having loans or private wealth management accounts.

At the conclusion of the examination cycle, there were no outstanding MRBAs and one outstanding SR related to LST, which was issued as part of the Stress Testing Review. Specifically, this SR directed management to account for the Deposit Outflow Calibration Model's uncertainty and stress magnitude by taking several actions to address concerns over recent changes to this model. Examiners estimated that these recent changes re-categorized approximately $19 billion in deposit inflows during the pandemic from short-term to long-term balances, thereby decreasing aggregate outflow projections under each time horizon of the LST's Realistic Worst Case scenario by nearly $17 billion, or 12 percent of total assets. Without these changes, during the fourth quarter of 2020, the bank would have breached the qualitative Risk Appetite Statement metrics for the 90+ and 180+ day funding horizons (all else being equal).

Sensitivity to Market Risk: The ROE concluded that sensitivity to market risk, primarily interest rate risk, remained moderate and adequately controlled. The ROE noted that consistent asset growth and repricing, combined with a corresponding growth in low-cost deposits, remained key to the stable interest rate risk profile. Additionally, the ROE stated that risk management practices remained satisfactory. Simulation analysis indicated a low-to-moderate impact to earnings and capital from all plausible scenarios and interest rate risk simulation results were all within the bank's risk limits as of December 31, 2021. At the conclusion of the examination cycle, there were no outstanding MRBAs or SRs related to sensitivity to market risk.

2022 Examination Cycle

The FDIC prepared a Supervisory Plan that outlined ongoing monitoring activities and planned targeted reviews for the 2022 supervisory cycle. The Supervisory Plan allocated 20,402 FDIC hours for targeted reviews and ongoing monitoring activities. For this supervisory cycle, the plan included nine targeted reviews, with three deemed high priority, and the roll-up examination. As noted below, the dedicated team issued nine Supervisory Letters in 2021 based on results of the targeted reviews.

The Supervisory Plan noted that the dedicated team would continue to include eight examiners. The dedicated team was authorized for eight examiners in 2022 but had only six dedicated examiners assigned in the fourth quarter of 2022 (the two vacancies were left unfilled strategically to offer to other LFI examiners that were being displaced from the loss of another large institution in the same territory). Dedicated team absences were generally filled by other examiners with large bank experience or SEs. The actual number of dedicated examiners who were available and participated in each targeted review and ongoing monitoring fluctuated due to reassignments to other community bank reviews, LFI reviews, SFRO details, or various leave requests.

Targeted Review	(A) Start Date	(B) Exit Meeting	B – A Elapsed Days	(C) Issue Date	C – B Elapsed Days
Retail Lending Review	2/7/22	3/1/22	22	3/16/22	15
Corporate Governance Review	3/14/22	4/7/22	24	5/12/22	35
IT Review	3/14/22	4/19/22	36	6/1/22	43
Commercial & Industrial Lending Review	5/16/22	6/14/22	29	6/29/22	15
Operations Risk Review	7/11/22	8/4/22	24	9/13/22	40
Market and Funding Risk Review	8/29/22	9/28/22	30	10/14/22	16
Trust Services Review	9/26/22	10/26/22	30	12/8/22	43
CRE Lending Review	10/11/22	11/4/22	24	12/12/22	38
AML Review	10/31/22	11/22/22	22	12/12/22	20

The 2022 roll-up examination was in process when First Republic failed on May 1, 2023.

Quarterly OMR – 6/30/2022: The OMR reported that the EVE simulation showed breaches for nearly all risk appetite thresholds and tolerances in upward rate shocks as of June 30, 2022. The OMR also reported that that the dynamic NII simulation showed a risk tolerance breach in the downward 200 bps rate ramp as well as risk appetite and tolerance breaches in the downward 200 bps rate shock. Additionally, the OMR reported that the BERM and DERM had not met yet to respond to the breaches.

Market and Funding Risk Supervisory Letter: The August 2022 review consolidated two targeted reviews, Stress Testing and Deposit Stability, and assessed capital planning and stress testing; LST and deposit stability models; ALM models; and investment portfolio composition and risk management. Two Senior Financial Economists from FDIC's Division of Insurance and Research assessed the four quantitative models scoped for this review: Deposit Outflow Calibration, Unfunded Commitment Drawdown Calibration, Deposit Repricing Beta, and Deposit Volume. Examiners also evaluated the five expert judgment models that support the LST and assessed the interest rate risk model system capabilities and outcomes. The review identified a number of weaknesses related to MRM.

Liquidity Stress Test and Deposit Stability Models

The review identified two examples where the Treasury team substantively changed the Deposit Outflow Calibration model in production before either MRM completed a change validation or the Model Risk Officer provided documented approval. In these two examples, examiners also identified shortcomings in the MRM team's effective challenge in response to these substantive changes.

First, during the LMWG meeting on January 26, 2022, the Treasury team shared several enhancements to the LST that were placed into production beginning with the Q1 2022 LST production run. Based on information in the model documentation and corresponding validation, these updates should not have materially affected aggregate outflows. However, the Treasury team's model sensitivity test capturing the effect of these enhancements as of September 30, 2021, showed a $1.2 billion increase in excess liquidity under the 90-day horizon of the Realistic Worst Case scenario, which is a Risk Appetite Statement metric. Placing these enhancements into the Q1 2022 production LST more than doubled excess liquidity from approximately $700 million to $1.9 billion under the 90-day horizon of the scenario. In February 2022, MRM began revalidating the Deposit Outflow Calibration model but had to suspend validation work in April because of subsequent changes to the model and again in June once MRM identified the root cause of why the enhancements outlined above caused unexpected significant downstream effects. Specifically, the Treasury team did not recalibrate deposit outflow coefficients, an oversight which represented a substantive model change and rendered the Q1 2022 production output conceptually unsound. The Treasury team remediated this issue by recalibrating the deposit outflow coefficients for the LST production run as of Q2 2022.

Second, during the LMWG meeting on July 27, 2022, the Treasury team implemented several additional substantive changes to the Deposit Outflow Calibration model, such as the addition of the Family Office segment and the placement of new knots in the Non-Profit segment. Although the corresponding meeting deck acknowledged that these updates were pending final approval from MRM, the appendices show that the Treasury team also placed these changes into production beginning with the Q2 2022 LST run.

Asset Liability Management Models

The review also identified shortcomings in MRM's effective challenge in response to substantive changes to the Deposit Repricing Model. Due to unintuitive interest rate risk model results in Q1 2022, the ALM team asked MRM in April 2022 to review the planned management overlay to the Deposit Repricing Model to use an average of the Cycle 1 (2004-2010) and Cycle 2 (2014-2020) models, beginning with the Q1 2022 interest rate risk model production run. Given time constraints and MRM's inability to reproduce the results independently, MRM requested that the ALM team complete a sensitivity test comparing this overlay with the originally planned switch to the Cycle 1 model. During the ALMCO meeting on April 26, the ALM team disclosed that the management overlay was in production and shared the results of the sensitivity test, which showed significant increases in NII in rising rate scenarios. For example, the overlay under a positive 200 bps rate shock added more than $600 million to NII in Year 2, changing the NII projection from approximately a 1 percent decrease to a 9 percent increase. MRM agreed that the ALM team's decision to apply a management overlay was reasonable and incorporated an independent validation of this overlay into the ongoing Quantitative Risk Management interest rate risk model revalidation, which was finalized on May 17, 2022. Ultimately, MRM raised this issue in the revalidation as a Level 3 Finding, urging the ALM team to take several additional steps to remediate the issue. Once the ALM team completed these additional steps, MRM closed this finding on August 15, 2022 as part of ongoing monitoring.

Examiners deemed that the actions taken by the ALM team were appropriate in substance, and MRM had recently updated the ERM-03 MRM Policy to clarify documentation and governance requirements for future model overlays. Nevertheless, the Model Risk Owner did not provide documented approval for the Deposit Repricing model overlay, which qualified as a substantive model change under the ERM-03 MRM Policy. More importantly, examiners assessed that it was likely that this model overlay would remain in place going forward and should be subject to other control mechanisms.

The Market and Funding Risk targeted review resulted in two new SRs, one related to the Treasury team, and another related to MRM to ensure appropriate governance of substantive model changes and to control model risk. This targeted review also closed a prior SR related to deposit outflow uncertainty and stress magnitude.

Quarterly OMR – 9/30/2022: The OMR noted that the outlook for the liquidity rating had turned negative due to increasing funding costs.

The OMR reported that the dynamic NII simulation results remained within all risk tolerance and appetite thresholds, whereas EVE simulation results showed breaches for all risk appetite thresholds and tolerances in upward rate shocks as of September 30, 2022. The OMR also reported that the ALM team escalated these breaches to the ALMCO, presented them to the BERM, and presented them to the Board. The OMR noted that, on August 16, 2022, examiners met with ERM personnel to discuss the breaches and gain their viewpoints and planned response. In response to the Q2 and Q3 breaches, ERM decided to continue to measure and monitor the metrics at the ALMCO.

The OMR also reported that, subsequent to the 2022 Market and Funding Risk Review, the ALM team removed all Deposit Repricing Model management overlays because they observed increased deposit repricing and shifts in deposit mix.

Quarterly OMR – 12/31/2022: The OMR noted that the outlook for the liquidity rating remained negative due to increasing funding costs. Additionally, the OMR noted that the dedicated team planned to discuss a potential liquidity rating change given the less favorable operating environment for funding costs.

The OMR reported that the dynamic NII simulation results remained within all risk tolerance and appetite thresholds, whereas the EVE simulation results continued to breach all risk appetite thresholds and tolerances in upward rate shocks. The OMR also reported that the ALM team escalated these breaches to the ALMCO, presented them to the BERM, and presented them to the Board. The OMR noted that ERM opted to continue measuring and monitoring these metrics at the ALMCO level.

Additionally, the OMR noted that second line personnel at the ALMCO meeting on October 26, 2022, recommended that management communicate the breaches to BERM and DERM again and explain that they were likely to continue until inflation and rates came down or deposit mix shifted back towards checking.

As part of ongoing monitoring activities in December 2022, examiners corresponded with the ALM team via email to reconcile the relatively neutral dynamic NII simulation over the two-year horizon with the significantly liability-sensitive EVE results over the life of the balance sheet. The ALM team responded that several factors explained this divergence:

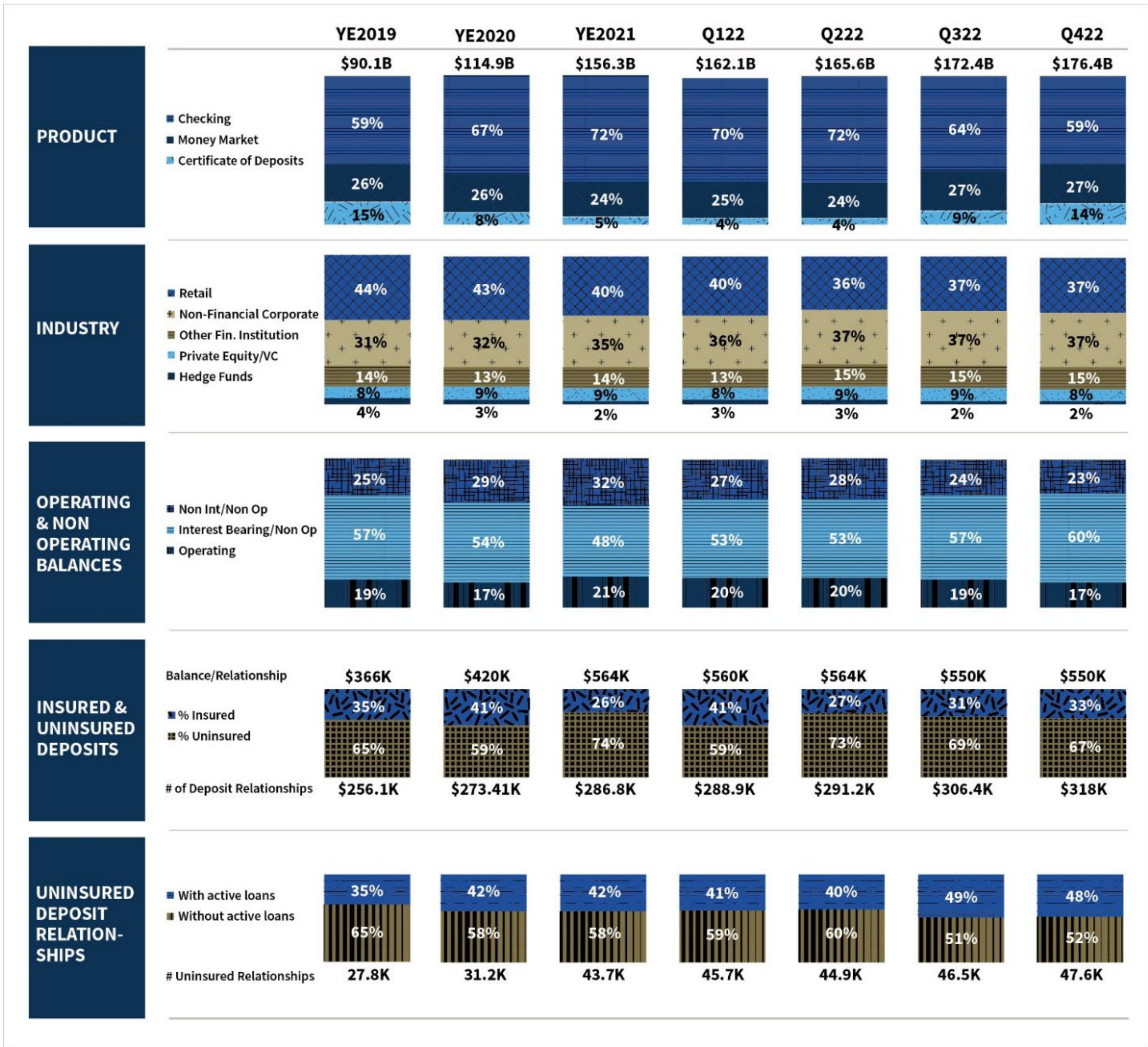
- The dynamic NII simulation incorporated projected asset growth, which acted as an important interest rate risk hedge to rising interest rates;
- The NII simulations (whether static or dynamic) only had a two-year horizon, whereas EVE was measured over the life of the balance sheet;
- NII was deterministic while EVE was stochastic (although this should not have caused systematic bias in the EVE results in one direction or another); and
- NII was based on income sensitivity, whereas EVE was based on value sensitivity.

To estimate the relative contributions of the above factors, the dedicated team obtained additional information from the ALM team, including an updated Key Rate Duration analysis as well as the full static NII simulation results as of September 30, 2022. The static NII simulation results indicated that the balance sheet was moderately liability sensitive but still within all risk appetite thresholds and tolerances.

2023 Draft Retail Lending Targeted Review: On March 9, 2023, the dedicated team submitted a draft Supervisory Letter for the 2023 Retail Lending targeted review to the SFRO. The Regional Office had not processed the Supervisory Letter when First Republic failed. The draft targeted review proposed two new SRs, one related to risk grading for non-owner occupied SFR for investment loans, and another related to underwriting borrowers with pre-existing adjustable rate mortgages or hybrid interest-only loans.

Appendix 3: First Republic Deposit Composition

The graphic presents information about the composition of First Republic's deposits, including uninsured deposits, over time from February 2023 DERM materials.



Appendix 4: SRs and MRBAs from Targeted Reviews

2018 Examination Cycle: Nine SRs were opened and no MRBAs were opened for First Republic.

SR (#02-2018-1) - Effective Challenge for Qualitative Models
Management should ensure that independent model validation reports for models relying substantially on qualitative inputs demonstrate appropriate effective challenge. All pertinent contributions to the review and challenge process should be documented, regardless of whether they arise from the MRM Group, or another second line or independent source.

SR (#02-2018-2) - Qualitative Model Inventory and Definition
Management should amend MRM policies and procedures to remove materiality thresholds and CST criteria as determinants of a qualitative model. All models should be retained in model inventory regardless of size, complexity, data source, or nature of the model mechanics.

SR (#03-2018-1) - Business Process Control for a Wholly-Owned Subsidiary
Management should ensure that account control and account reconciliation are delegated to different individuals for all transaction accounts used in a wholly-owned subsidiary that provided administrative support for student loan payments and college savings plan contributions made by client employers on behalf of their employees.

SR (#03-2018-2) - Information Security Program for a Wholly-Owned Subsidiary
Management should strengthen the information security program at a wholly-owned subsidiary by improving/clarifying policies and plans.

SR (#06-2018-1) - LST Brokered and High-rate Deposits
Management should ensure that the LST scenario assuming a below well-capitalized condition appropriately considers the regulatory restrictions on renewing high-rate or brokered deposits. Reports to the Board or Committee of the Board should clearly indicate the impact of potentially losing access to these funding sources.

SR (#06-2018-2) - LST Assumptions Review and Approval
First-line management should establish a formal process to periodically review and approve model assumptions used in the LST. Furthermore, the MRM group should enhance their process standards for reviewing model assumptions.

SR (#06-2018-3) - LST Ongoing Monitoring
First-line management should develop a formal ongoing monitoring plan for the current LST model (LST-1) that confirms that the model is appropriately implemented and performing as intended. Also, before implementation of the forecasting of deposit flows model (LST-2), management should have a robust ongoing monitoring plan in place and begin conducting ongoing monitoring when the model is put into production. In addition, MRM should thoroughly review and assess management's ongoing monitoring plans for both models.

SR (#06-2018-4) - LST Model Documentation
First-line management should document the LST-2 model in accordance with the bank's established model documentation standards.

SR (#06-2018-5) - Intra-Period Liquidity Reporting
Management should reassess the practice of using month-end balances to calculate the KRIs used for liquidity risk monitoring. Management should also review the complete population of liquidity KRIs to identify whether using other intra-period data would more accurately portray the bank's liquidity risk to executive management and the Board.

At the end of the 2018 examination cycle, **SR #02-2018-1**, **SR #02-2018-2**, **SR #06-2018-1**, **SR #06-2018-2**, **SR #06-2018-3**, and **SR #06-2018-4** remained open.

2019 Examination Cycle: One SR was opened and no MRBAs were opened for First Republic.

SR (#08-2019-1) - LST Scaling Assumptions
Management should validate the scaling factors used for the Deposit Outflow Calibration model in the LST framework by taking certain MRM-related actions.

At the end of the 2019 examination cycle, no SRs or MRBAs remained open for First Republic.

2020 Examination Cycle: Two SRs were opened and no MRBAs were opened for First Republic.

SR (#03-2020-1) - CST Sensitivity Testing
Develop a plan to incorporate sensitivity testing in the CST to evaluate the impact of assumptions on outcomes.

SR (#04-2020-1) - Loan Analysis Worksheets - Borrowing Entity Description and Analysis
Devise a plan to ensure that forms used for loan approval clearly and consistently distinguish between various parties to the loan.

At the end of the 2020 examination cycle, **SR 04-2020-1** remained open.

2021 Examination Cycle: Two SRs were opened and no MRBAs were opened for First Republic.

SR (#04-2021-1) - Deposit Outflow Calibration Model Uncertainty and Stress Magnitude
Management should account for the Deposit Outflow Calibration Model's uncertainty and stress magnitude by taking certain MRM-related actions.

SR (05-2021-2) - Assessment and Valuation of COVID-related Loan Modifications
Management needs to document a complete assessment of the fundamental risk characteristics in specific CRE-secured, COVID-related modified loan groups.

At the end of the 2021 examination cycle, **SR 04-2020-1** and **SR 04-2021-1** remained open.

2022 Examination Cycle: Two SRs were opened and no MRBAs were opened for First Republic.

> **SR (#06-2022-1) - Treasury Team Reporting of Substantive Model Changes for Independent Validation**
>
> The Treasury team should update first line of defense ongoing monitoring policies and procedures related to models under their purview to ensure that no substantive model changes, as defined by the MRM Policy, are implemented in production prior to either obtaining a change validation from MRM or securing documented Model Risk Officer approval for a policy exception.
>
> **SR (#06-2022-2) – Effective Challenge in Response to Substantive Model Changes**
>
> MRM should update the MRM Policy to ensure effective challenge over substantive changes to models.

During the 2022 examination cycle, the two SRs open from the 2020 and 2021 examination cycles were closed. The 4th quarter 2022 OMR noted that the two SRs open during the 2022 examination cycle were "corrected, need FDIC review." Dedicated examination team staff notified us that they were waiting for quantitative specialists from FDIC's Division of Insurance and Research to review First Republic's corrective actions to the SRs, before they were formally closed by FDIC.

On March 31, 2023 FDIC issued an Interim Uniform Financial Institution Rating Downgrade memorandum to First Republic's Board of Directors, which notified them of a MRBA.

> Recent financial market disruptions have exposed weaknesses in the institution's risk management processes. These weaknesses raise concerns regarding the institution's ability to meet its ongoing funding needs under current market conditions. While First Republic developed a 2023 Go-Forward Plan that identifies strategic actions executive management is taking to reestablish long-term sustainable operations, the institution's business model now relies heavily on debt and other noncore funding sources to support a low yielding, long duration portfolio. As a result, the institution's earnings have been materially impacted and, if not reversed, could adversely impact capital. Also, immediate action is required to strengthen the institution's liquidity and financial position. Therefore, the FDIC and CADFPI are issuing the below MRBA.
>
> The Board and senior management should take all steps to implement the 2023 Go - Forward Plan. The plan should continue to consider all options to restore market confidence in the institution's business model. The Board and senior management should also improve risk management practices and conserve cash resources as the 2023 Go -Forward Plan is being implemented.

When First Republic failed, **SR (#06-2022-1)**, **SR (#06-2022-2)** and the **MRBA** remained open.

Appendix 5: CEP Roles and Responsibilities

Table 12 presents CEP roles and responsibilities.

Table 12: CEP Roles and Responsibilities

Dedicated Team	Case Manager	ARD	LBS
• Prepares the annual Supervisory Plan. • Prepares scope memos, entry letters, information request lists, exit meeting agendas, examiner conclusions memos, and supervisory letters for targeted reviews. • Conducts ongoing monitoring activities and prepares OMRs. • Maintains SR logs. • Prepares the ROE. • Provides periodic updates to regional and headquarters management on risk trends and other matters related to the institution. • Meets with various members of LFI management on a recurring basis.	• Works with dedicated team in directing supervisory efforts. • Participates in periodic meetings with dedicated team and LFI management. • Reviews Supervisory Plan and shares plan with the appropriate Federal and State Agencies. • Reviews significant deviations/changes to scope memos. • Reviews SR logs and OMRs. • Prepares LIDI reports. • Reviews and processes Supervisory Letters and ROEs. • Communicates significant events. • Schedules quarterly meetings with LBS and interagency staff. • Maintains internal tracking and documentation systems.	• Reviews and approves the Supervisory Plan. • Approves significant deviations from the Plan throughout the examination cycle. • Reviews and approves LIDI reports. • Signs Supervisory Letters and ROEs.	• Provides feedback and recommendations on draft LIDIs, ROEs, and Supervisory Plans. • Provides quarterly LIDI analysis, quarterly banking results, horizontal reviews of emerging risk, and other ongoing analysis. • Analyzes and reports SR trends across institutions.

Source: *Large Bank Supervision Procedures*, updated January 2018.

Appendix 6: Acronyms

ACL	Allowance for Credit Losses
ALMCO	Asset Liability Management Committee
AML	Anti-Money Laundering
ARD	Assistant Regional Director
ASC	Accounting Standards Codification
BERM	Bank Enterprise Risk Management Committee
bps	Basis Points
BSA	Bank Secrecy Act
CADFPI	California Department of Financial Protection and Innovation
CAMELS	Capital, Asset Quality, Management, Earnings, Liquidity and Sensitivity to Market Risk
CD	Certificate of Deposit
CEO	Chief Executive Officer
CEP	Continuous Examination Process/Program
CRA	Community Reinvestment Act
CRE	Commercial Real Estate
CST	Capital Stress Test/Testing
DERM	Directors' Enterprise Risk Management Committee
DIF	Deposit Insurance Fund
EIC	Examiner-in-Charge
ERM	Enterprise Risk Management
EVE	Economic Value of Equity
FDIC	Federal Deposit Insurance Corporation
FHLB	Federal Home Loan Bank of San Francisco
GAO	U.S. Government Accountability Office
HNW	High Net Worth
InTREx	IT Risk Examination Program
IT	Information Technology
KRI	Key Risk Indicators
LBOC	Large Bank Operating Committee
LBS	Large Bank Supervision Branch
LFI	Large Financial Institution
LIDI	Large Insured Depository Institution
LMWG	Liquidity Management Working Group
LST	Liquidity Stress Test/Testing
MRBA	Matters Requiring Board Attention
MRM	Model Risk Management
NII	Net Interest Income
NIM	Net Interest Margin
NPS	Net Promoter Score
OMR	Ongoing Monitoring Report

RMS	Division of Risk Management Supervision
ROE	Report of Examination
SE	Supervisory Examiner
SFR	Single-Family Residential
SFRO	San Francisco Regional Office
SR	Supervisory Recommendation
SVB	Silicon Valley Bank
UBPR	Uniform Bank Performance Report
UFIRS	Uniform Financial Institutions Rating System