Negotiation Strategic Plan

Minerva University

SS51: Complex Systems

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Silicon Valley Bank (SVB) bank run

Overview

Normally, a bank invests the majority of the money it holds in interest-bearing assets, such as loans and securities. They only hold a fraction of deposits as cash (liquidity) to handle withdrawals. If this cash ran out (i.e., liquidity shortfall), the bank would sell some of its assets (e.g., securities) to fulfill the needed withdrawals. The news spread in newspapers is as follows (Flitter et al., 2023). The Silicon Valley Bank (SVB) had 94.4% of the deposits invested in securities (government bonds). In 2022, there was a decrease in the share prices of tech companies in silicon valley which meant that many startups would draw money from the bank. SVB ran out of cash to fulfill these withdrawals, so they started selling their government bonds. However, because of the inflation, there was a steep increase in the interest rates in the federal bank, so the value of the bonds they held decreased because people could buy bonds with higher interest rates directly from the government. This meant that SVB had to sell their old bonds at a loss, which caused more panic among clients, eventually triggering what is known as a 'bank run.' The FDIC stepped in to handle the situation, with the intent of preventing further contagion.

Federal Deposit Insurance Corporation (FDIC)

FDIC is a corporation whose primary goal is to ensure economic stability and "public confidence in the nation's financial system." (FDIC, 2020b). Their two main values are fairness and effectiveness, as mentioned in their reports (2020b). They achieve fairness by respecting the individuals and caring about the customers' interests and effectiveness through quick interventions to deal with situations that pose a risk to the wider economy. They approach the

goal through some operations like providing deposit insurance and supervising financial entities for the protection and safety of customers.

For example, they took over Almena Bank in 2020 after the closure –another bank failure in the U.S. They ensured that the money of depositors was immediately available and that existing loans would not be affected by collaborating with another bank. Their official statement reads, “No one lost any money on deposit as a result of the closure of this bank. All deposits, regardless of dollar amount, were transferred to Equity Bank.” (FDIC, 2020a).[1]

Strategic Context

During a period of rapid inflation in the U.S., the Federal Reserve responded to the bank run crisis by increasing interest rates (see Figure 1). Silicon Valley Bank (SVB) had most of its capital invested in security bonds, which are usually considered a safe investment. However, due to inflation and the Federal Reserve’s anti-inflationary measures, SVB’s assets were losing their value rapidly. This led to all of its clients withdrawing their money at once. Most of SVB's clients had significantly higher deposits than the insurance coverage limit of $250,000, as SVB was a tech startup-oriented bank.

[1] #purpose - AA - The goals, values, and guiding principles (implicitly) of the FDIC are explained and connected together. Particular actions are given to show how the organization achieves its purpose. The example of Almena bank was given to emphasize the connection between the purpose and the practical actions the organization does.

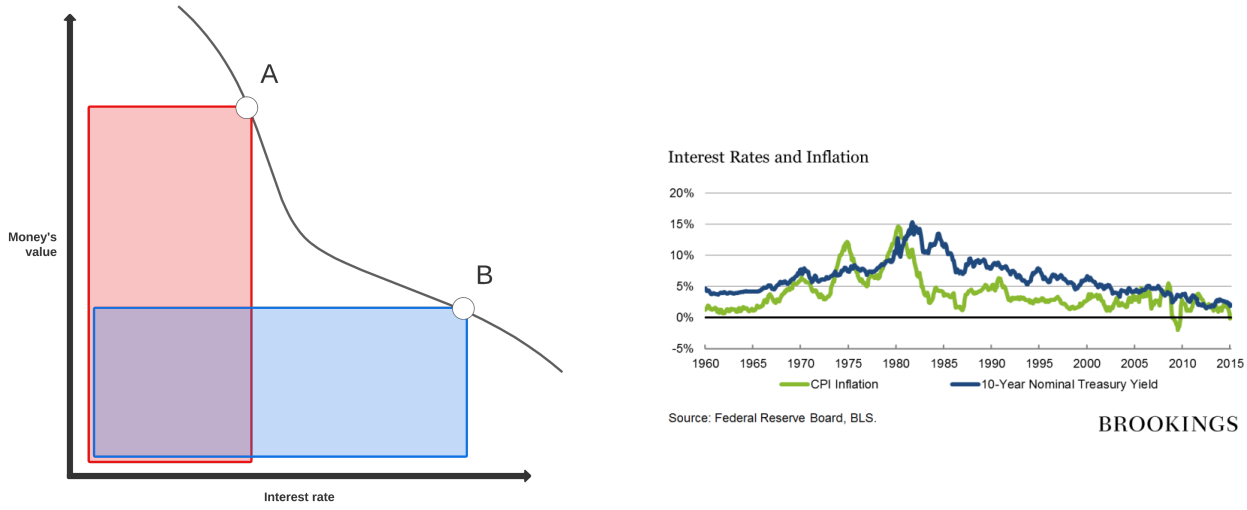

Fig 1. *The illustration on the left depicts the relationship between "money's value" and interest rates to maintain the equilibrium for the "intrinsic value"; the value of a money is inversely associated with inflation (i.e., the more inflation, the less money is worth). "Intrinsic value" is shown as the area between contained in the rectangles, highlighting how as the monetary value decreases, the interest rates must increase to keep the intrinsic value constant. On the right, there's a chart extracted from* Bernanke, B. S. (2015, March 30) *showing the relationship between interest rates and inflation in the U.S. between 1960 and 2015.*

Given the accelerated capital loss rate, the limited insurance policies, and the clients' lack of trust, SVB's assets were frozen. The strategic challenge can be stated as follows: "What should the Federal Deposit Insurance Corporation do to minimize the impact on the economy: bail out SVB by guaranteeing insurance for all of its clients' deposits regardless of the amount (i.e. paying the clients), or let private companies take the losses, which could potentially lead to a broader contagion effect among other financial institutions?"

SVB's clients faced a coordination game with strategic complementarity, where the

optimal strategy for one player might be to replicate another player's strategy. Clients had varying beliefs about the bank's solvency, which could affect their decision to withdraw their deposits or the timing of their withdrawals. The players' behavior was based on rational expectations and consistent with the equilibrium outcome.[2]

Negotiation

The strategic challenge under study will be addressed through principled negotiation, which focuses on the merits and principles underlying the parties' positions, rather than their comparative advantages. By doing so, the FDIC has an opportunity to engage in a collaborative problem-solving process, which can lead to more comprehensive and sustainable solutions. To start, the FDIC should find common ground by emphasizing the shared interest in stabilizing the economy and maintaining public trust in the financial system. This could include exploring potential areas of collaboration with other regulatory agencies or financial institutions.

Acknowledging the client's concerns —and the taxpayers'— and their desire to recover their capital is crucial while recognizing insurance policies' limitations show the need for a balanced approach. In light of this, creative negotiated solutions could be explored, such as partial payouts or extended payment plans.

Finally, emphasizing accountability, transparency, and penalties is essential for rebuilding trust and preventing similar crises in the future. This could involve creating new regulations or

[2] #strategize - AR - This application of #strategize is effective as it identifies the key strengths and weaknesses of the situation, including SVB's reliance on security bonds, the limited insurance coverage, and the clients' lack of trust. It also formulates a clear strategic challenge and articulates a guiding policy for the FDIC to minimize the impact on the economy. The analysis of the coordination game with strategic complementarity demonstrates a deep understanding of the clients' behavior and beliefs, which informs the specific actions needed to achieve the desired outcome.

strengthening existing ones, improving reporting requirements and disclosure standards, and increasing penalties for non-compliance.

BATNAs

Should the negotiation fail, the FDIC will have to decide how much to pay back the bank's clients. Because of current regulations, the minimum payout is 250,000$ per account (the insured amount). However, resistance from clients is expected if the payout does not cover all of their deposits, which risks further contagion to other banks (which the FDIC would also have to handle). That being said, FDIC's BATNA is to make a decision without ensuring that bank clients are on the same page with it, thus taking the additional risk of further decreasing trust in the banking system, taking all the blame if a further fallout happens, and insuring deposits from other banks. Since government structures are generally risk-averse, FDIC will be willing to increase the amount of money given out if it minimizes any of those risks.[3]

Trust is not the only strategic resource that can be used. As a government agency, we can leverage our existing connections to other banks, or even bail out clients entirely. However, we need to make sure that our solution is not pyrrhic and be aware that the client's BATNA might include asymmetric warfare-like actions (i.e., purposefully publicizing the incident to decrease trust in the economy with the hope that the FDIC will give in and bail everyone out).[4]

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[3] #negotiate - DMT - We mention reasons for attempting a principled negotiation approach, as well as possible common ground (not damaging America's economy is a common goal). We analyze our BATNA, the 'gap' between it and a negotiated outcome. We specify the trade-offs we are willing to make in an attempt to reach a mutually-accepted agreement.

[4] #strategize - DMT - We employ game theory to devise a strategy that allows us to reach a good agreement while being able to adapt if the other stakeholder negotiates in bad faith. We mention our strategic resources, and think about the opponent's possible actions in case the negotiation fails (their BATNA, which might be even used as a threat).

Policies

As stated previously, the FDIC will use a principled approach to negotiation, as everyone involved would feel the effects if further contagion happens (unstable economy is not good for any company, especially start-ups). Because one of them is a government agency, the two parties have some initial trust to base the negotiation on. However, the strategy needs to be adapted in case one the other party acts in a way deemed unreasonable.[5] As such, we can disincentivize them from going rogue by releasing 'punishment' rebuttals to unreasonable claims (e.g., respond with a bad counter-offer to a bad offer) and incentivize the negotiation to remain amicable by responding generously to good offers.[6]

Nudging

FDIC can initially use anchoring to nudge the negotiation in its favor to not compensate the client's deposit fully. To offer a reason for the FDIC's initial offer (only insured money) while keeping the negotiation on good terms, it can be mentioned that the bet that SVB took on bond interests staying low was public knowledge. The clients were aware of the associated risks and that the FDIC only insures up to $250,000 per account. Through emphasizing the client's responsibility, the FDIC is nudging them to accept an outcome other than getting their full deposits back, as it outlines that the possibility of a collapse should've been thought about which

[5] https://ncase.me/trust/

[6] #carrotandstick - DMT - As mentioned, our strategy involves responding to bad offers with bad counter-offers, thus 'punishing' the other side if negotiation is not done in good faith. Also, good offers will be met with good counter-offers, which can be viewed as a reward. Thus, knowing our strategy reveals a system that incentivizes collaboration and equal compromises to both sides while disincentivizing attempts at tricking one party.

accords with the toolkit of providing information about potential consequences.[7]

[7] #nudge - JK - We explained why emphasizing client's responsibility and the possible consequence of a collapsing banking sector can nudge them indirectly towards accepting only given insurance ($250,000) or a compromise.

Further predictions

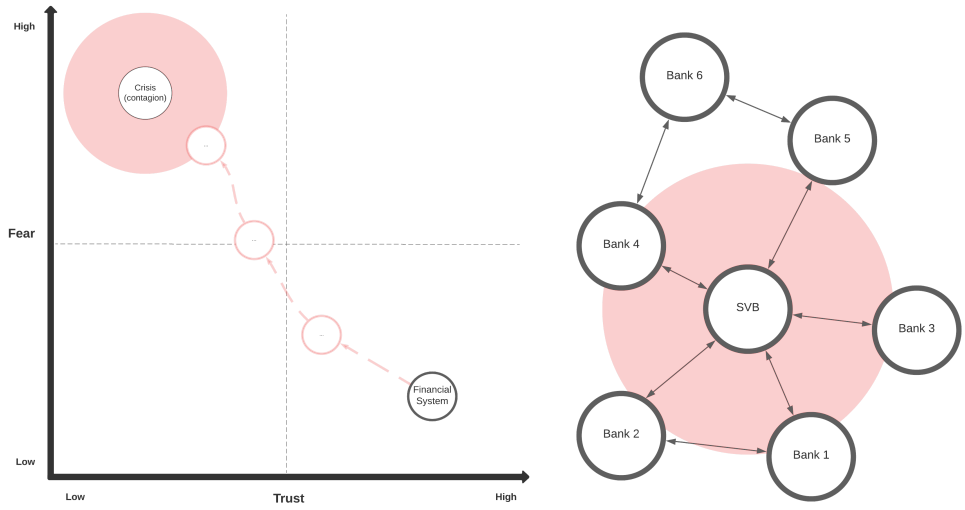

Fig 2. *The left illustration showcases the phase space formed by trust in the banking system and the fear that surrounds it. It shows the trajectory that leads to a partial or total collapse of the banking system. The right illustration shows a network formed by bank institutions (nodes), where edges represent relationships such as investments or trust. The red attractor shows the extent to which institutions are affected by the collapse of SVB; as panic increases, the attractor area also increases, effectively affecting more financial institutions.*

Although it's difficult to fit the various types of bank clients into one type, it is known that most of the clients were rapidly growing tech companies in Silicon Valley, so we predict their negotiation strategy will be aimed at getting all their money compensated by the FDIC. They will highlight that not getting their money back will likely lead to collapse in the tech industry of Silicon Valley, which will cause a significant increase in unemployment and collapse of other industries outside the region, potentially bringing about a global economic crisis. This will shape our approach in providing the subsidies to protect their deposit, because fear and

suspicion about their deposit's safety left unsolved will likely lead to more bankruns, which further increase the public's fear and uncertainty about the banking sector. If such a regime shift happens, a partial or total collapse of the banking sector is possible.[8]

Word Count: 1395 words

[8] #complexcausality - JK - We identified the relationship between fear/trust in the banking sector and bank runs. We've described a feedback loop that leads to a snowballing effect, where a bank run has the potential to trigger more bankruns.

AI usage documentation

We did not use any AI tools (e.g., ChatGPT, GPT-3, Jenni AI) for this assignment.

Individual contribution

Alaa Abbas: Overview and section about the FDIC.

Alen Rubilar Muñoz: Sections about the strategic overview and negotiation.

Jiyun Kim: Nudging and future predictions.

Thomas Dancaescu: Sections about BATNAs and Policies.

We wrote the footnotes for our individual sections. We all looked over the whole assignment and made suggestions on parts we thought could be improved.

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