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Special Market Update: Overview of Current U.S. Banking Situation

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Summary

- On Friday, March 10, the Federal Deposit Insurance Corporation (FDIC) closed Silicon Valley Bank (SVB) after the bank failed to raise new capital to cover large deposit outflows, a traditional "run on the bank."
- This is one of the top 20 largest banks in the U.S. and its closure marks the second largest in U.S. history, behind the Washington Mutual closure in 2008. Over the weekend, another bank, New York-based Signature Bank, also failed.
- Monday, March 13, the Federal Reserve (Fed), Treasury Department and FDIC moved quickly to state that depositors in these banks will have access to all their money and no losses associated with the resolution will be borne by taxpayers. Additionally, emergency loans will be offered to banks to stave off additional failures.
- Tuesday, March 14, no other banks have closed, and the markets have rebounded. Based on what we know today, the Fed has announced sweeping backstops in the form of the Bank Term Funding Program (BTFP), through which it will offer loans of up to one year to banks that put up investable securities as collateral. This should prevent further banks from closure.

What Happened to SVB?

- SVB was a highly unique bank for early-stage businesses (venture-backed tech and healthcare companies) with a small focus on stickier retail client deposits like traditional banks. **SVB was not diversified.**
- It had more than $170 billion in deposits; over $150 billion was uninsured (over $250,000 FDIC insurance threshold), according to J.P. Morgan's Eye on the Market.
- Due to weak loan demand over the past few years, more than $120 billion of deposits was invested in U.S. Treasuries and Mortgage-Backed Securities (MBS), securities that took significant losses as interest rates increased in 2022.
- SVB was in a league of its own in terms of investments as a percentage of total deposits. **SVB was a high-risk bank.**
- In 2023, venture capital firms have become more conservative as a potential recession has loomed and consequently, startups began to run down their bank deposits at SVB.

- SVB was forced to liquidate their investment portfolio, locking in losses and requiring them to suddenly need to raise capital.
- This was a red flag for depositors, which, according to [Bloomberg's "SVB Races to Prevent Bank Run as Funds Advise Pulling Cash,"] prompted legendary venture capital investor Peter Thiel to advise companies to pull money from SVB, which exacerbated the run on the bank and ultimately, the bank closure.

The Good News

- SVB and Signature Bank were not classified as systematically important banks by regulators, meaning their failures would not have a significant impact on the entire financial system through counter-party risk (i.e., they are not "too big to fail").
- Thus, big national banks should not be meaningfully impacted. Smaller, regional banks could be more vulnerable as depositors will require a higher level of due diligence from their banking institutions going forward.
- What depositors will find is that banks generally are in a much stronger financial position than in 2008, due to regulation and subsequent capital buffers that have been built up—today's banks are higher quality and generally have healthier financials with stronger balance sheets (i.e., less debt).
- One key takeaway, this incident exposes companies and business models that appeared liquid and solvent when rates were zero, but they're now feeling the pressure under higher rates.

It brings to mind a classic quote from Warren Buffett:

"A rising tide floats all boats, only when the tide goes out do you discover who's been swimming naked."

An additional silver lining: This situation with SVB has sparked market volatility and the Fed may take a step back from raising rates by half a percentage point next week, which would help to support the markets.

As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it's more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

Should you need help navigating client concerns, don't hesitate to reach out to Dynamic's Investment Management team at (877) 257-3840, ext. 4 or investmentmanagement@dynamicadvisorsolutions.com.

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