## Client Update – Recent Market Events

In response to the recent events surrounding the recent failure of Silicon Valley Bank and Signature Bank we would like to share an update and some thoughts.

### Regulators Take Action

Following the failure of Silicon Valley Bank (SVB), regulators moved to close Signature Bank of New York (SBNY) on Sunday, March 12, 2023. Concurrent with the closure of SBNY, the government issued a joint statement[1] from the US Treasury, Federal Reserve, and FDIC, outlining a new lending program meant to support depository institutions. The Federal Reserve created the Bank Term Funding Program (BTFP)[2] which makes "additional funding available to eligible depository institutions to help assure banks have the ability to meet the needs of their depositors.[3]" The BTFP will make loans available to eligible institutions for a term of one year and accepting certain qualifying collateral such as Treasuries and U.S. Agency mortgage-backed securities. The program is designed to reduce the need for banks having to sell those assets during times of stress – such as a deposit run. Qualifying collateral will be valued at par when participating in the BTFP. Also noted was that equity holders and most general creditors would be wiped out, along with management removed, as part of the receivership process of SVB and SBNY.

### The Importance of the BTFP

The Bank Term Funding Program accomplishes a number of things, first and foremost of which is that it prevents what was quickly turning into a larger banking issue and calms depositors and financial markets. In the case of SVB and SBNY, all depositors will be made whole and the BTFP assures that banks have additional access to funding that limit, if not eliminate, the need for a fire sale of high-quality assets. This should mark an important step in restoring confidence for depositors and we do not have reason to believe that another bank run of this magnitude is likely to take place with the new funding program in place.

### Problems Remain

*For the Fed*

The conundrum for the Fed just increased multi fold. In the span of 48 hours, markets went from digesting Fed Chair Powell's continued hawkishness to a bank rout in markets culminating in the 2nd (SVB) and 3rd (SBNY) largest bank failures ever. While inflation is on the forefront, functioning markets and financial system are clearly front and center for the Fed now. Now the Fed finds itself as both the firefighter and the arsonist as the very policy meant to combat inflation is causing banks to fail. Banking crises tend to be disinflationary/deflationary inducing events and it is plausible the Fed now pauses to reassess, perhaps the mission is being accomplished and SVB and SBNY were the collateral damage. Markets have down shifted expectations and now expect the Fed Funds rate to be 4.3% by September — a week ago that figure stood at 5.7%. We will now have to wait until March 21-22 for the Fed's next decision, which until last week included a significant chance of a 50bps rate hike.

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[1] *https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312b.htm*
[2] *https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312a.htm*
[3] *https://www.federalreserve.gov/monetarypolicy/bank-term-funding-program.htm#:~:text=The%20Bank%20Term%20Funding%20Program,needs%20of%20all%20their%20depositors.*

*For banks*

The general thinking here is that recent actions helps to stave off bank liquidity events centered around having to dispose of assets (as deposits are withdrawn) that would otherwise mature at par, but due to the rise in interest rates have suffered short term losses. *Most banks do not hold nearly as many US Treasuries and US Agency mortgage-backed securities as assets as SVB had – that is a difference worth noting as that was a significant contributor to its demise*. This does leave banks, smaller concentrated banks in particular, with having to raise capital, sell assets, or merge with larger banks. Banks in sum are likely to have to raise deposit rates to limit deposit flight which will result in lower earnings. So as we noted in our initial response to the SVB crisis, will likely result in some not so trivial earnings revisions downward for many banks, especially the regionally focused banks. Notwithstanding the relief rally following the funding program announcement, the way forward for banks, and markets on whole, seems choppy at best. Though, as always, we will be in communication with clients to ensure that client portfolios are aligned with objectives within the context of our expectations for capital markets.

In recent days we received a number of inquiries and have included a few important FAQs.

**Should I worry about Schwab or Fidelity?**

Importantly, we are not concerned about the banking system in whole. Schwab and Fidelity are both high quality institutions with broadly diversified client bases, revenue streams, and risk controls and we do not have concerns about the safety, soundness, or solvency of either. Any funding pressures related to their depository operations have been mitigated with the announcement of the BTFP.

*On Schwab specifically*

Schwab, unlike Fidelity, is publicly traded and experienced a -24% decline last week and continues to see pressure as of this writing. The company reinforced its strong liquidity position noting the firm has over 34 million account holders with some $7.4 trillion of client assets with the company having access to $100 billion in cash flow and $300 billion available in lending facilities. Its depositor base is similarly well diversified, of which 80% are FDIC insured—Schwab does not present an issue in the way SVB did.[4]

**Are my publicly traded assets safe?**

Yes, investor assets (e.g., common stocks, bonds, mutual funds, and ETFs) held at Schwab, Fidelity, or any other custodian held in investor name are protected by SIPC[5]. Those assets cannot be used in the liquidation process of a

[4] *Bloomberg LP, Schwab*

[5] *SIPC protects against the loss of cash and securities – such as stocks and bonds – held by a customer at a financially-troubled SIPC-member brokerage firm. The limit of SIPC protection is $500,000, which includes a $250,000 limit for cash. Money market funds are considered securities under SIPC and included in the protection up to $500,000. SIPC protects the total securities in an account up to $500,000, not each individual security.*

failed institution (Note: this includes money market mutual funds). That said, the equity and debt of impacted banks are subject to the market and in the case of SVB or SBNY, the resolution process is likely to result in little to no recovery for these investors.

**What about private market assets?**

Private market assets such as Private Equity (PE) and Venture Capital (VC) are also held in client name. Silicon Valley Bank was a significant bank to the PE and VC universe with funds and portfolio companies both exposed to SVB to varying degrees. The recent announcement of the BTFP protects the deposits of the firms, funds, and companies they serve, preserving the necessary plumbing required to service not only funds, but their portfolio companies. Given the fluid nature of recent news, operational items such as capital calls, we will continue to update those investors on the resumption of that process.

**Is my cash safe?**

Yes, deposits held on bank balance sheet and noted as FDIC insured will be subject to the maximum insurability amount of $250,000 per depositor, per FDIC insured bank, per ownership category.[1] If you have deposits that exceed the limits, generally speaking those deposits fall into the uninsured category. For depositors, particularly uninsured deposits, it is good hygiene to understand and know the banks you choose to utilize, even before considering the demise of SVB and SBNY. In general, we do not have concerns over the banks that clients utilize but would welcome a conversation with Clearstead to discuss further. Again, the announcement of the BTFP removes what concerns we may have had for deposit safety. As noted, cash held in money market mutual funds have always been safe from liquidation events related to bank failures and we recommend holding Government or Treasury money market funds, not prime money market funds which, while generally considered safe, in many cases hold short term securities outside of government or treasury securities that we do not see as necessary given the modest increase in yield for the additional risk taken.

**As always, please contact us with any questions or concerns. We thank you for your trust.**

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