

***With the failure of Silicon Valley Bank (SVB) is dominating headlines, we would like to describe some key differences that contribute to the security of assets and provide some background on recent events.***

***GenTrust goes to great lengths to protect our clients' investments that are held by broker-dealers. Our firm takes the safety of client assets very seriously. Broker-Dealers operate quite differently than banks. SVB operated as a bank therefore deposits at SVB are insured by the Federal Deposit Insurance Corporation (FDIC). The current FDIC insurance coverage is up to \$250,000 per depositor, per insured bank, for each account ownership which consequently became an unsecured I owe you (IOU) of the bank upon its failure. In contrast, one advantage of having assets at a broker-dealer is that the assets are segregated and owned by / returned to clients in the event of the failure of the broker-dealer. Client's assets cannot be used to finance any debts of the broker-dealer. The value of account assets can go up and down with market movements, but those assets cannot be used to satisfy any debts of the broker-dealer.***

SVB's failure was the result of several factors unique to SVB, although it highlights an issue that impacts several financial institutions to varying degrees. We do not see this bank failure as a systemic banking issue akin to 2008 for several reasons discussed below. Following the failure of SVB, the Federal Reserve has stepped in and made depositors whole. In addition, they have created a broad lending facility to aid banks that may require access to funding. They stopped short of extending FDIC insurance to all depositors as that would require Congressional action. While it would seem likely that the FDIC would make whole deposits (over the FDIC insured amount) if further bank failures happen, there is nothing that guarantees that, so consumers are likely not going to take any chances.

Investment accounts at broker-dealers are different than bank accounts in various ways. Investment accounts hold investments like stocks and bonds on a client's behalf, segregated from others. While the holdings are subject to market movement, and a decline in market value, the assets belong to the client and not the broker-dealer. In the event of the bankruptcy of the broker-dealer, clients would be able to access their investments. Investments held in broker-dealer accounts are insured by the Securities Investor Protection Corporation (SIPC) for up to \$500,000 including \$250,000 for cash per account.<sup>1</sup> Money market funds are again owned by the investors and segregated from others and fall under SIPC coverage. Lastly, large broker-dealers will often carry additional insurance that provides excess SIPC protection.

Bank accounts like SVB are different. By depositing money in a bank, the depositor is allowing the bank to use those funds to issue loans and investments of their own in exchange for the convenience of holding the money and interest paid on the accounts. Bank deposits are insured by the FDIC (another government entity which provides this insurance) up to \$250,000 per depositor, per account. Importantly, deposits over the FDIC coverage limits are subject to losses if the bank where the deposits are held fails. Generally, to have complete backing of the US government against potential losses, depositors must keep the balance of their accounts below the FDIC coverage limits.

### What happened with SVB?

SVB was shut down by regulators Friday (March 10, 2023), citing both inadequate liquidity and insolvency. The firm experienced \$42 billion of outflows on Thursday (March 9, 2023) which represented approximately 25% of its total asset base (using 12/31/22 numbers). On Sunday (March 12, 2023) the Federal Reserve announced it was making depositors whole on the full value of their deposits (even if they exceeded FDIC insurance limits). This was fortunate for depositors as it wasn't always the case historically. The grid below shows the average amount of losses depositors suffered on bank failures at different points in time.

#### Some history on losses imposed on uninsured depositors when banks fail:

- 1980-1987: losses imposed at 24 % of resolutions
- 1988-1991: losses imposed at 14% of resolutions
- 1992-2007: losses imposed at 65% of resolutions
- 2008: despite deposit insurance limit increase from \$100,000 to \$250,000 and a temporary guarantee program for uninsured noninterest-bearing transaction accounts, losses still imposed at 28% of resolutions
- 2009-2013: losses imposed at 6% of resolutions

Source: FDIC Resolution Tasks and Approaches: Comparison of the 1980 to 1994 and 2008 to 2013 Crises

### How did this happen with SVB?

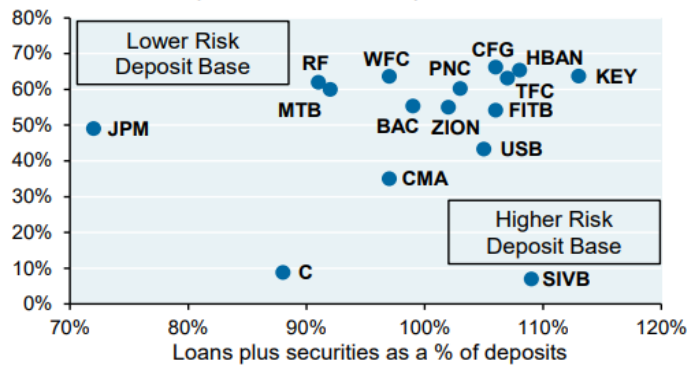
There were several characteristics unique to SVB that made it vulnerable to failure.

1. It held a large % of securities relative to its assets compared to other banks
2. Its deposit base was largely corporations/venture capital/tech related industries which acted very quickly to withdraw funds once it sensed danger versus more retail client bases of many

<sup>1</sup> <https://www.fdic.gov/resources/deposit-insurance/faq>

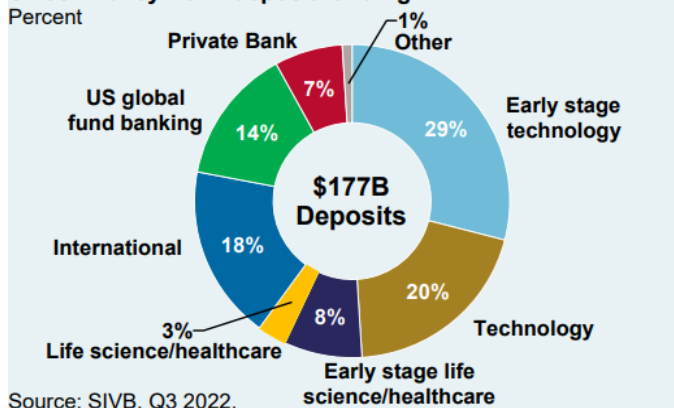
**US bank loan-to-deposit ratios**

Estimated retail deposit share of total deposits



Source: JPMAM. Securities include Hold to Maturity and Available for Sale categories. Q3 2022.

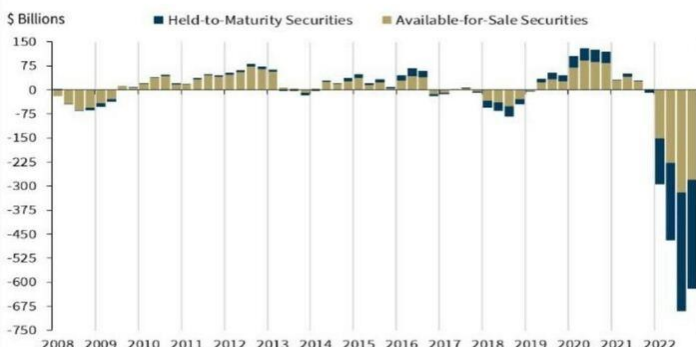
**Silicon Valley Bank deposit funding**



Source: SIVB. Q3 2022.

When SVB tripled their deposit base in '20-'21 they went out and made several low-rate loans and bought low-rate securities which have since lost value as interest rates have risen. In the last several weeks the markets began to focus on the size of the losses on these banks and what would happen if they needed to sell securities they were "holding to maturity", thereby creating an immediate capital shortfall.

**Unrealized Gains (Losses) on Investment Securities**



Source: FDIC. Note: Insured Call Report filers only.

If you marked-to-market the hold to maturity portfolio at SVB, the loss was greater than the company's equity. Coupled with the fact that once tech firms and Venture Capital (VC) funds caught wind of this they quickly pulled their deposits out, creating an even greater need to sell more securities at a loss in a downward spiral that is typical of a bank run. In today's day and age when news spreads so quickly, bank runs can happen in 24-48 hours as we witnessed this week.

To alleviate this situation from happening again, the Federal Reserve put in place a lending facility that allows banks to post these bonds that were worth less than par and borrow against them at low rates and on an amount equal to the par amount. This facility could have prevented what happened at SVB as they would have been able to meet withdrawals with loans from the Federal Reserve, however it also has other consequences. Most importantly, the facility allows banks to fund their capital at lower rates than they otherwise would be able to through the Federal Home Loan Banks (FHLB) system, thereby producing a large windfall stimulus to the banking sector. Given the current inflationary environment, this added stimulus would need to be addressed in some other fashion, potentially with even higher interest rates down the road.

**Are other firms in a similar position to SVB?**

Yes, several other regional banks also have negative equity (if securities were fully marked to market, their liabilities would exceed their assets). That does not mean that these banks will experience the same fate as SVB because it will depend on how sticky their deposit base is and how well they manage the sale of their securities portfolio.

Ironically, this may be good for larger banks. Capitalization of larger banks is significantly better than it was during '08. Banks with assets over \$250bn are also subject to enhanced regulation under the Federal Reserve (SVB was just below this limit with assets at roughly \$200bn). While there may be continued stress among regional banks, it is unlikely to spread to larger firms and the broader economy.

The US banking system is also unusually fragmented compared to banking systems elsewhere such as Europe where most of a given country banks with a small handful of the same banks. This less fragmented set-up makes similar bank runs like what happened at SVB less likely abroad.

## Important Disclosures

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