TENON FINANCIAL
RETIREMENT PLANNING & INVESTMENT MANAGEMENT

Retirement Planning Insights

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Tenon Financial Happenings
- The final newsletter

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- Bank and brokerage failures

Tenon Financial Happenings

The end of Retirement Planning Insights

It's with a heavy heart I announce to you all that this will be the final edition of Retirement Planning Insights.

Just kidding…**APRIL FOOLS'!**

I've been wanting to do that since I started this newsletter over three years ago. I don't know why I held off this long though. Maybe it was because this didn't really have much of a following back then, especially in the first year. Now, there are almost 5,000 subscribers, which means there is a much larger audience (on which this joke can fall flat!)

Also, after thinking this through some more, I realize the joke is probably stale by the time many of you are reading it. Even though this newsletter came out on April 1st, I bet most of you didn't take a look at it until later in the month. Oh well.

Yes, my sense of humor is really THIS bad. But that's what makes me me, and I'm sticking with it!

In more serious news, I wanted to thank everyone who has thus far expressed interest in setting up an introductory call with Tenon Financial and its new advisor, Michelle Wu.

I introduced you all to Michelle in **last month's edition of Retirement Planning Insights.** Since then, there have been more people than expected who reached out. Now that Michelle has gotten "settled in," she and I recently started setting up calls with people who e-mailed us.

Our goal is to take on two to three new relationships a month. We want to be intentional and pragmatic in making sure we grow at a healthy and manageable pace.

With that said, depending how many of the people who thus far reached out end up being mutually good fits and decide to start working together, it may take us some time to work our way through the list. But rest assured we will be in touch with everyone who e-mailed us. Thank you all very much for your consideration; we greatly appreciate it!

If you're interested in learning more about Tenon Financial's services and fees, check out our website **here.**

Finally, I'm excited to let you know that Michelle and I will soon have new pictures of us up on the **Tenon Financial website.** The current photos of me were taken in 2018, about a year before I actually started the company. As for Michelle's current picture, it was from a family trip in 2017.

Now that we're working together, it makes sense to get new pictures that are current, have the same look and feel, etc. The new photos should be up on the site before the May edition of Retirement Planning Insights.

Until then, have a happy April (with no more fools)!

-Andy

Retirement Planning Happenings

What happens when banks, brokerages or mutual fund companies fail

First Silicon Valley Bank. Then Signature Bank. Then First Republic Bank…

In mid-March, there was a flurry of bank failures that came seemingly out of nowhere.

To be fair, First Republic Bank didn't "fail" like Silicon Valley and Signature did (they were both taken over by the government). Instead, First Republic received a $30 billion bailout from a consortium of other banks. But still, if not for that massive injection of capital, First Republic would have almost certainly been forcibly taken over by the government, too.

You're probably thinking something along the lines of, "why are all of these banks suddenly going under, and do I need to be concerned about MY bank???" And in the same vein, you may also be wondering something to the effect of, "what happens if the broker where I have my investment accounts goes under???" Or, "what happens if the company who manages my mutual funds goes under???"

These are all great questions. Thankfully, the answer is that you likely don't need to be as concerned as you probably are.

Stepping back, it's important to know there are fundamentally different structures between banks vs. brokerage and mutual fund companies with regards to ensuring customer assets are kept safe.

Surprisingly, brokerage and mutual funds companies have inherently safer structures than banks with regards to the safekeeping of client accounts.

Let's first start with banks. When you deposit money into a bank account such as a checking account, savings account or certificate of deposit ("CD"), you technically no longer own that money. In reality, you give that money to the bank and they then own it.

Wait, what?! Yes, you read that correctly. Whenever you make a deposit at a bank, you are actually giving the bank your money and they then become the owner of it. All you ultimately own at that point is an IOU from the bank, where they agree to give you back the money when you ask for it. And along the way, they will pay you some amount interest on it.

Once that money is deposited at the bank, they are basically free to do with it as they please. Well, that's not entirely true. There are banking regulations and that place some restrictions on what the bank is allowed to do with it. For example, they can't take all depositor money and invest it into something super speculative like crypto assets.

But still, the point is that the bank isn't required to keep all deposits sitting in a vault or otherwise readily available and unencumbered. The bank can tie up at least some of depositor's money into things that can't quickly or easily be liquidated.

The core business of a bank is to take in deposits and use those deposits to turn around and lend them out to people who need loans to buy a house, buy a car, finance a college degree, etc.

Banks make money by charging a higher loan interest rate than the rate they pay to depositors on their accounts. The difference is interest rates is called an "interest rate spread."

For example, assume a bank charges 6.00% on money it lends out for a mortgage, but only pays 1.00% on the savings account deposits it uses to make that loan. That 5.00% interest rate spread is what the bank keeps for itself.

Also, in addition to using depositor money to make loans, some of the money taken in from deposits could be invested in securities such as U.S. Treasury bonds. And like virtually all investments, those bonds could potentially go up or go down in value.

After reading the last few paragraphs, you may be thinking that because banks use depositor money to make loans or invest in securities, they potentially don't have enough money available to give back to depositors if/when enough depositors were to ask for their money back at the same time. And if you were thinking that, you would be 100% correct.

Wait, what (again)?! Yes, you (again) read that correctly. If every depositor were to try to take out all of their deposits at the same time, the bank simply wouldn't be able to meet those requests because it wouldn't have enough money.

How is this possibly okay?! The underlying principal of our banking model is that not EVERY depositor will look to empty out their accounts at the same time. And the vast majority of the time, this is true.

Think about you and your own bank accounts; how often do you take out really large amounts from them? And even if/when you do, what are the chances that the bulk of other depositors at that bank are also taking out really large amounts from their

accounts? In reality, it simply doesn't happen. Other than in the case of bank run. So let's talk about bank runs.

Simply put, a bank run is when depositors collectively try to take out more money than their bank has. However, these withdrawal request aren't just from peoples' normal course of day-to-day activities and withdrawal needs. Instead, they're fear-driven desires to take out ALL of their money, based on thinking or hearing rumors that the bank may be troubled and others are starting to take out their money. Basically, in a bank run, people don't want to be the last one holding the bag and want to get out before others do.

A bank run is a self-fulfilling prophecy. Once there is enough steam behind people trying to quickly take out large amounts of deposits, the news spreads, momentum gathers and hysteria ensues.

At some point – and this could happen VERY quickly – there will be more withdrawal requests than the bank can satisfy.

With a bank run, a bank can quickly go from being seemingly fine to becoming unable to meet withdrawal requests. At that point, the government has to step in and take over…or let the bank truly fail and potentially leave depositors hung out to dry.

Realizing a strong banking system in which depositors have faith is an absolute necessity for a functioning capitalist economy, the government provides a certain amount of deposit insurance to help alleviate the concern of depositors' money simply disappearing if/when a bank runs into trouble.

The Federal Deposit Insurance Corporation, or FDIC, is an entity backed by the full faith and credit of the U.S. government that provides insurance on certain amounts of bank deposits. If a bank can't meet depositor requests, the FDIC ultimately will.

The FDIC insurance limit is typically $250,000 per person, per institution. For example, if you have a checking account in your name at Bank of America, the first $250,000 of money in that account would be insured by the FDIC. And you can separately open another checking account at Wells Fargo and similarly have that FDIC insured up to $250,000.

For people with joint accounts, the $250,000 limit applies per person. For example, a married couple with a joint savings account at Chase Bank would have that account insured up to $500,000.

For more information about FDIC insurance limits, and a helpful calculator to see how much of your deposits are insured across your bank(s), **here is a link** to the FDIC's Electronic Deposit Insurance Estimator, or EDIE, website.

To sum up about banks, deposits you give to them aren't actually yours anymore. You simply have a promise from the bank that they'll give the money back to you when you ask for it. But, in the event the bank isn't willing or able to give it back, you're backstopped by the FDIC, but only up to a certain amount.

Let's now turn our attention to what would happen in the event of a failure of a brokerage company.

When you have an investment account such as a regular brokerage account, an IRA, a Roth IRA, etc. you need a broker - otherwise known as a custodian in this case - to hold your account.

Stocks, bonds, mutual funds, exchange traded funds, etc. exist almost exclusively in electronic form. Even though they rarely exist in physical paper form anymore, they still nonetheless need to be "held" somewhere. Brokers are in the business or providing these holding places via acting as custodians of investment accounts.

However, the way brokers hold your investment accounts is VERY different from how banks hold your bank accounts. When you own shares of stock in a brokerage account, YOU still fully own those shares; the broker doesn't. The broker is simply a third party who's holding them for you.

Why does this matter??? Well, in the case of a bank getting into financial trouble, you run the risk of not getting back the deposits you gave them (at least for deposits in excess of FDIC insurance limits), because those deposits belong to the bank and the bank could have spent them, tied them up into other things, etc.

On the other hand, if a broker gets into financial trouble, your investments in your account at that broker are thankfully separate and distinct from the firm's own finances. That means your investments don't get commingled with the broker's own assets or liabilities, and therefore aren't at risk of getting spent, used for other things, etc. (It should be noted that the broker CAN actually use your assets for its own purposes, but only if you borrow money on "margin" from the broker, or opt into a "fully paid lending" program. However, these scenarios typically don't apply to most people).

If/when your broker were to fail, your investment accounts would live on and ultimately get transferred to another broker to hold. As such, the risk of you not being able to get your investments back is exceptionally slim. The only real chance of not getting back your investments is in the case of an outright fraud, where the broker illegally took out your investments, fabricated fake monthly statements, etc.

However, even in the case of your investments going "missing" in a case like this, there is at least *some* government backstop. Specifically, the Securities Investor Protection Corporation, or SIPC, provides up to $500,000 of protection against loss of cash and securities within investment accounts (of the $500,000 limit, up to $250,000 of it applies to cash held within the account).

It should be noted that SIPC insurance only protects against your investments going missing. It doesn't protect against the decline in value of investments within your account(s).

For example, assume you own 100 shares of Amazon in your brokerage account at Charles Schwab, and the current value of those shares is $100,000. If Charles Schwab were to go bust, you can rest assured you still own your 100 shares of Amazon, even if they go missing (because SIPC would step in an cover you in that case).

BUT, you still bear the risk of the price of Amazon declining. For example, if the price drops 70% because some really bad news just came out about the company, your shares would now only be worth $30,000. SIPC does not guarantee or make you whole for the $70,000 loss in value of the shares in that case.

Finally, let's turn our attention to mutual funds. In a nutshell, they are loosely similar to brokerage accounts.

For example, assume you own $50,000 of Fund ABDCX managed by Vanguard. The actual assets owned by the fund are not assets of Vanguard. Instead, they are held in a third party custodian account somewhere, separate and distinct from Vanguard.

Therefore, even if Vanguard were to have financial troubles and potentially go under, the assets and investments in Fund ABDCX would still live on and not get tied up in whatever financial troubles Vanguard may be having.

But keep in mind the value of the assets in Fund ABDCX – and therefore the price of Fund ABDCX – can still decrease, similar to the previous example of Apple shares decreasing within the Charles Schwab account.

Therefore, even though you don't really have to worry about your fund or the assets within it going missing, that doesn't mean you're insulated against a decline in value of the fund.

To sum up about brokerages and mutual funds, your investments held by them are separate and distinct from the broker holding the account or mutual fund company managing the fund. If the broker or mutual fund company go bust, there isn't really risk of not getting your investment back, barring outright fraud. But even then, SIPC helps minimize the impact of loss.

So, should you be concerned about your bank, brokerage company or mutual fund??? Generally speaking, no.

However, it's good practice to keep the size of your bank deposits within FDIC limits. And when opening investment accounts or investing in mutual funds, try to stick to companies that are large, well-known, have a long history of operations and are widely deemed to be reputable so as to minimize the chances of your investments being at risk because of fraud.

For more information about understanding bank failures, check out **Episode 67** of the Retirement Planning Education Podcast. And for more information about brokerage and mutual fund failures, check out **Episode 68.**

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