MARSHALL & SULLIVAN
WEALTH MANAGEMENT

viewpoint

Spring 2023 newsletter

Is My Money Safe

With the news of couple recent bank failures grabbing headlines, we thought it appropriate to focus this month's newsletter on what has happened in the banking sector – particularly Silicon Valley Bank (SVB) and how our financial assets are safe guarded in times of crisis.

The Christmas movie "It's a Wonderful Life" did a pretty good job of explaining how banks work: people deposit their savings into a bank, the bank loans out some of the money to people in need, and the bank keeps the rest of their funds available to meet the withdrawal needs of their depositors. When everyone wants their cash at the same time, you end up with a run on the bank.

While this is a bit of an over-simplification, it does illustrate the basic function of a bank. Of course, in today's world, banks are considerably more complicated and subject to far more regulations than in George Bailey's time.

Today, many banks invest a portion of their assets in government bonds. They make interest off the bonds and the bonds typically match up with their lending portfolios and help satisfy regulatory capital requirements. Interest rates have been very low since 2009 and to increase profitability, some banks began buying longer-term bonds to garner higher yields. This worked fine until the Federal Reserve started raising interest rates. With rising rates, the bonds in bank portfolios declined in value. Fortunately, most banks hold these securities to maturity, and don't sell at a loss so this hasn't been an issue.

Silicon Valley Bank, however, was not your normal bank. SVB specialized in working with technology startup companies for both its deposit and lending operations. This meant it was highly affected by the fortunes of a single industry – technology – which is currently contracting, not growing. As a result, SVB suddenly had more funds flowing out of the bank than its maturing bonds could accommodate.

In the industry we call this a "duration mismatch", and it forces a bank to depend heavily on its ability to attract new deposits. So, instead of holding their bonds to maturity like other banks, SBV had to sell longer-term bonds and take a loss. Once the loss was reported some of their larger depositors began withdrawing funds. As liquidity concerns spread across the internet, SVB began to experience a run on the bank just like in the movie.

There was one major difference between the real-life SVB and the fictitious Bailey Building & Loan: SVB could not raise money fast enough and ultimately was forced to close their doors.

Fortunately, most banks have a much broader client base and are not reliant on the fortunes of a single industry. However, with interest rates rising so fast, we do think bank profits will be lower for the near term. But again, we see this as a drag on bank profitability, not a banking crisis.

Still, it begs the question: Is our money safe?

Bank deposits (checking, savings, certificates of deposit) are protected by the Federal Deposit Insurance Corporation (FDIC), an independent agency that is backed by the full faith and credit of the United States government. The FDIC insures up to $250,000 per depositor at each banking institution. So, if you spread your deposits between different banks and different account ownership types you can increase the protection considerably.

Brokerage assets (stocks, bonds, mutual funds, exchange traded funds, money market funds, etc.) are protected in a different way. The most important of which are the Securities & Exchange Commission's (SEC) safeguards that require client securities to be segregated from the brokerage firm's other assets. Beyond that, most brokerage firms are members of the Securities Investor Protection Corporation (SIPC) which provides direct client protections. Some firms, such as Charles Schwab, also maintain significant private excess SIPC coverage.

Obviously, these protections do not guard against market losses, but they do go a long way toward maintaining an orderly market and banking system.

If you would like to do a deeper dive into how your accounts are protected, please follow this link https://www.schwab.com/legal/account-protection or give us a call.

Greg Robinson, President
greg@msinvest.com

Davis Miracle, Vice President
davis@msinvest.com