

## What causes a bank to fail?

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The weather isn't the only thing heating up. The news cycle has been plastered with headlines:

The first indictment ever of a former President of the United States.

Politicians and non-politicians starting to throw their hats in the ring for the 2024 Presidential Election.

And, of course, the closing of Silicon Valley Bank, Signature Bank, and Silvergate Bank.

Any time we hear of a bank failing it is natural to have concerns. We do not want to minimize the recent events, but felt it would be good to help our readers have a better understanding as to the why they failed.

The first to fail was Silvergate Bank. This bank began as a savings and loan, but in 2014 it sought regulatory approval to do business with cryptocurrency firms. This proved to be successful, as the bank increased its assets by servicing cryptocurrency exchanges and other companies involved in the cryptocurrency business who could not secure financing from



more conservative banks. By the end of 2022, 90 percent of the bank's deposits were cryptocurrency related.

The problem began when former FTX CEO Sam Bankman-Fried was arrested after the company filed for bankruptcy. The bank had over \$1 billion in deposits tied to him. Consequently, clients began making requests to withdraw their deposits in large numbers.

Signature Bank shares a similar story. It began to serve customers in the cryptocurrency industry in 2018. By 2023, Signature was second only to Silvergate Bank in providing services to the industry. The same thing

happened here: Depositors in large numbers began requesting to withdraw their deposits.

As for Silicon Valley Bank, it had a lion's share of its business serving companies and individuals in the tech industry. Silicon Valley is an area south of San Francisco known for its concentration of technology companies like Apple and Facebook. The bank had a tremendous increase in deposits during the pandemic since many tech companies' revenues grew substantially as we were forced as a society to adopt new technology during the shutdown.

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FROM FRONT PAGE

Higher interest rates raise borrowing costs, and some of the bank's clients started pulling money out of their accounts to meet their liquidity needs. On March 8, SVB made an announcement that it had sold over \$21 Billion in securities, borrowed \$15 Billion, and was going to hold an emergency sale of some of its treasury notes to raise another \$2.25 Billion. Of course, this caused a lot of clients to request to withdraw their deposits.

Let's talk about how banks work. They work on "spread." You deposit money in the institution, and they pay you interest on your deposits. The longer maturity you allow it to be invested, the higher the interest you can earn.

The bank takes those deposits and lends part of the money out for loans and the other into U.S Treasury notes. They will charge more on the loan

than they are paying in interest on your deposits, and the bond portfolio of Treasuries will be higher as well. The bank's gross profit comes from interest earned minus interest paid out.

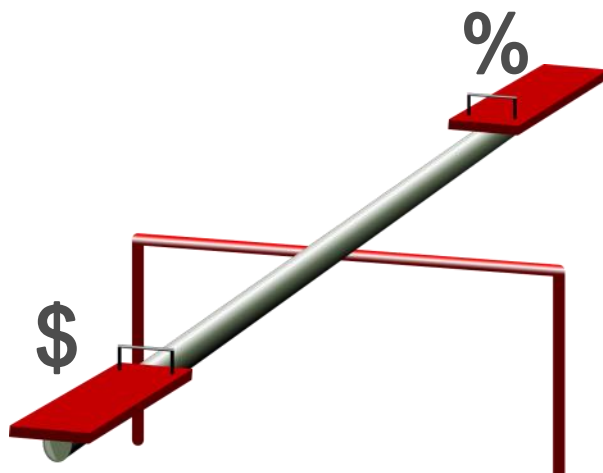
To understand one more element to this story I need to explain the relationship between Treasury notes (and other fixed income instruments) and the Federal Reserve's Fed Funds Rate.

Illustrated is a teeter-totter. When one side of the teeter-totter goes up, the other side goes down. The very ends of the board swing much higher and lower than near the pendulum. The same thing is true with fixed income instruments: When interest rates go up, the value of the bond you own goes down. Say you owned a bond that was paying 2 percent and you needed to sell it. If the going rate was 4 percent, who would buy your bond? To close the

deal, you must discount the price to effectively give the buyer a 4 percent rate.

In all three instances, these banks held Treasury notes. And since the Federal Reserve has raised interest rates from zero to 4.5 percent since March of 2022, the value of these notes was down a lot! These banks were forced to sell these notes for huge losses because clients were requesting withdrawals.

These losses were too great, and FDIC shut them down. They covered all deposits of clients in these banks, even those over the \$250,000 insurance limit.



## It's so much more than a 3-day weekend

While Memorial Day weekend is often the perfect time to take a short trip or kick off the start of summer with friends and family, it's much more than a day off. It's one in which we remember and honor fallen servicemembers who've sacrificed their lives to protect our country.

Many also use the occasion to remember loved ones who've passed, both military and civilian. A national moment of remembrance takes place at 3 p.m. local time, and some lower their flags to half-staff from dawn until noon.

However you observe the holi-

day, I hope you are able to take the opportunity to honor those who have given their all in service to our country. And if you have served in the military, I thank you for your service and the sacrifices you've made to defend our nation.

—Timothy A. Phillips

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