Rodney's Take

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Do Bankers Believe Their Own B.S.?

We're a long way from the Great Financial Crisis, and yet we still haven't made much progress in de-risking the banking sector. The banks that were deemed "too big to fail" and, therefore, must undergo greater scrutiny have done nothing but get bigger. Assets at JPMorgan Chase grew from $2 trillion in 2009 to $3.6 trillion at the end of last year. Meanwhile, the "held-to-maturity" (HTM) asset class for bank investments, those that don't have to be marked to market, gave banks a way to hold securities that were falling in value on their balance sheets without taking a hit. That works… until it doesn't. When the losses more than eat up the bank's capital, as they did in the case of Silicon Valley Bank (SVB), depositors aren't keen on taking IOUs instead of cash.

SVB and Signature Bank of New York (SBNY) held hundreds of billions of dollars in uninsured deposits when they went under, so the Fed and FDIC did what comes naturally: they caved. Instead of making the banks and uninsured depositors who allowed this charade to continue suffer the consequences, they came up with yet another backstop, the Bank Term Funding Program (BTFP). Treasure Secretary Yellen and Fed Chair Powell have been coy about whether this new facility will apply to other banks that show up with the same problem, but how will they defend the bailout of millionaires, billionaires, venture-cap funds, and crypto bros but not Main Street depositors who have uninsured deposits?

To be sure, the central bank is already taking steps to ward off the next iteration of this crisis. Several large banks deposited $30 billion at First Republic Bank (FRC), the next institution likely to fail. The $30 billion is uninsured, so this looks like a grand gesture of confidence in FRC. But is it? It's not like the $5 billion that came from JPMorgan Chase was out of Jamie Dimon's personal account. In fact, if you're a JPMorgan client, the funds came out of *your* account. JPMorgan didn't buy FRC stock or make a loan to the bank, it and the other banks just moved large chunks of their clients' deposits from their books to FRC. The move gives FRC more cash with which to meet withdrawal requests, but it still leaves FRC on the hook to send the deposits back… if it can.

And if it can't, we all know what will happen. Once again, the Fed will take over the underwater securities, just as it did with SVB and SBNY, give FRC cash for their uninsured depositors (including the big banks), and memory-hole the losses on the massive, $8.6 trillion Fed balance sheet. For those keeping score at home, this is already happening. From March 8 to March 15, the Fed expanded its balance sheet by $300 billion, lending $143 billion to SVB and SBNY and the rest to undisclosed banks.

Treasury Secretary Yellen testified last Thursday to the Senate Finance Committee that our financial system is sound. If you can call a global backstop that's propped up by the printing press "sound," then I guess it is. If you can call banks switching deposits from one hand to another to hide losses "sound," then yep, it is.

Maybe that's why the people who run these institutions get paid so much. After all, SVB CEO Greg Becker (now ex-CEO) pulled down $9.9 million last year, while SBNY Chief Joseph DePaolo pocketed a cool $8.6 million. They're both part of the "sound" financial system. Of course, they're lightweights in the grand scheme of things. Jamie Dimon was paid a fat $34.5 million last year to oversee a business that the government proactively props up (because it's too big to fail). I can think of a few people who could oversee a government-backstopped business for one tenth of that number.

The funniest—or saddest—part of this story is that the recent bank failures likely will self-correct. A lot of the underwater securities causing the problems are interest-rate sensitive things, like long-maturity Treasury and agency bonds. The latest dustup probably changed the Fed calculus on raising rates this week and might have brought forward their pause in raising rates and eventual pivot to lower rates. Those expected moves and the general flight to quality pushed the 10-Year Treasury bond yield from 4% to 3.5%, giving the underwater securities a boost in price. I'm certain that bankers across the country and our federal regulators are patting themselves on the back for a job well done.

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Got a question or comment? You can contact us at info@hsdent.com.