March 13, 2023

Silicon Valley Bank Failure and U.S. Banking Risk

Late last week, California and New York state regulators seized the assets of Silicon Valley Bank (SIVB) and Signature Bank (SBNY). These state-chartered FDIC-insured depository institutions were declared insolvent and illiquid, and actions were taken to protect depositors. This prompted fear, withdrawals, and sell-offs in the shares of other regional banks.

This note addresses exposures for One Capital Management clients and risks that remain in the banking system.

- **No Direct Exposure to Failed Banks.** One Capital Management ("OCM") has no direct client exposure to Silicon Valley Bank or Signature Bank deposits, shares or bonds in portfolios. OCM has no material indirect exposure to either institution. We studied the indirect third-party exposures obtained through diversified holdings within ETFs. The equity allocation exposure in One Capital Management portfolios was limited to 0.00960% via our allocation to U.S. Mid Cap Growth stocks.

- **Bank Deposits are Safe.** The U.S. Federal Reserve Bank on Sunday evening announced it will make available additional funding to financial institutions through its new Bank Term Funding Program (BTFP). This program fully protects depositors of all eligible U.S. financial institutions, in amounts insured by the FDIC and larger uninsured amounts. This means that deposits are safe regardless in which bank they are held. This includes Silicon Valley Bank and Signature Bank as well as other major banks, regional banks, and affiliated custodial banks such as Charles Schwab Bank, BNY Mellon and others.

- **Bank Share and Bond Values Continue to Fluctuate.** While the Fed has backstopped depositors across the entire U.S. banking system, the value of equity shares and unsecured bonds of both regional and money center banks continues to fluctuate. OCM holds positions in JP Morgan, Bank of America, and Citigroup in its large-cap equity models. These large banks are stable, profitable and may benefit from consolidation in the sector as depositors choose to seek the perceived safety of larger banks. Regulation may also develop to further protect depositors at U.S. banks. OCM is monitoring developments in the financial sector with an eye to preserving capital and identifying investment opportunities.

Source: Bloomberg, One Capital Management, LLC, Blackrock, J.P. Morgan

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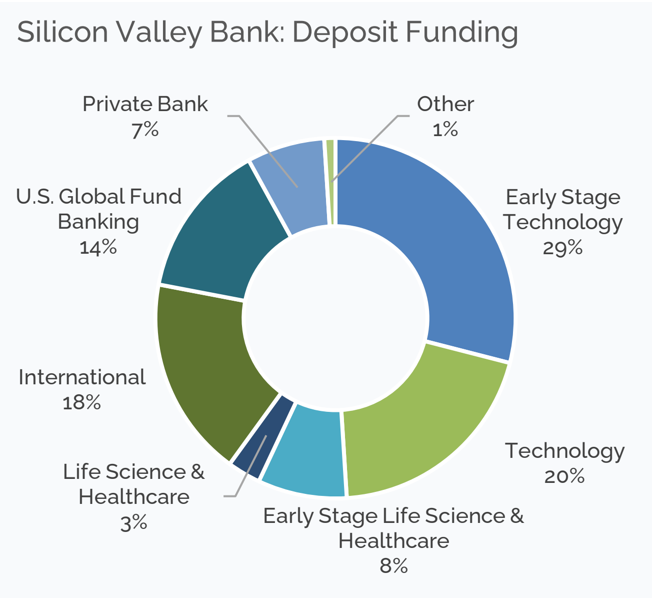
Silicon Valley Bank was in a league of its own: a high level of loans plus securities as a percentage of deposits, and extremely low reliance on stickier retail deposits (Private Bank) as a share of total deposits.



Bottom line: Silicon Valley Bank carved out a distinct and riskier niche than other banks, setting itself up for large potential capital shortfalls in case of rising interest rates, deposit outflows and forced asset sales. All of which began as the Federal Reserve started their aggressive rate increase campaign in 2022 and depositors demanded their cash in March 2023.

The irony of Silicon Valley Bank is that most banks have historically failed due to credit risk issues. This is the first major one where the primary issue was a duration mismatch between high quality assets and deposit liabilities.

With the U.S. government back-stopping banks, the fear of failure has been removed.

Source: Bloomberg, One Capital Management, LLC, Blackrock, J.P. Morgan

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