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Notes on Banking & Economics

March 18, 2023

- *'Only when the tide goes out do you discover who's been swimming naked.'* — Warren Buffett
- *'For every complex problem there is an answer that is clear, simple, and wrong.'* — H. L. Mencken

- **PERSONAL NOTE TO FRIENDS**
  - I've been doing a lot of reading on this over the past few days. There is a lot that I don't yet understand, but it is definitely complicated. Here's what I think I know so far:

1. Biden's out-of-control spending brought on a sharp rise in inflation.
2. Federal Reserve policy of "dealing" with COVID reduced interest rates to essentially zero.
3. Essentially free money and increased deposits allowed the banks to invest in various types of debt obligations, including Treasuries.
4. The Federal Reserve, slow to figure out what was going on (as usual!), finally started to raising interest rates to reduce inflation.
5. The rising interest rates caused existing debt obligations to lose value.
6. Silicon Valley Bank (SVB) had an inadequate risk program, but they were certainly "woke". When they finally realized the problem, they sold off approximately $20 billion in debt obligations, and took a $1.8 billion loss.
7. News of the loss caused depositors to start to withdraw money (think of the Bailey Savings & Loan). SVB did not have adequate liquid assets to meet the demand, and was closed by state and federal regulators.
8. The collapse of SVB has caused a panic review of the situation of other banks. Regulators closed Signature Bank, which was heavy into crypto. An interesting side note: one of the directors of Signature Bank is former Democratic Congressman Barney Frank, co-author of the Dodd-Frank banking regulation bill.

   - Lots more to come. Biden is trying to arrange a bail-out without calling it a bail-out, and (of course) pushing for more regulation, since the regulators did such a good job the first time. Also, the Fed is now in a Scylla-Charybdis situation, mostly of its own creation. Inflation stubbornly refuses to go down, but the expected 0.5% increase at next week's Fed meeting may further impact banks. Whatever happens, count on the Democrats to screw it up.
   - Perhaps SVB was simply following the "new regulations". Being "woke" and into ESG (**E**nvironmental **S**ocial and **G**overnance) is now more important that being fiscally responsible. The Biden administration will bail out its ideological partners, leaving the rest of us to pay the tab.

- **BEFORE THE CRASH (SVB & SIGNATURE)**
  - Moody's gave SVB an A rating, repeating the same mistakes as in 2008.
    - SVB a key player in tech startups and venture capital.
  - SVB Management
    - CEO: Director at SF Fed
      - Sold $5.3M in stock on February 27th.
    - CFO: Former analyst at Freddie Mac
      - Sold $874,000 in stock on February 27th.
    - Chief Admin Officer: Former CFO of Lehman Brothers
      - Lehman collapsed in 2008, due to subprime meltdown.
    - No head of risk assessment for nine months. Position finally filled in January, 2023.
    - Head of Europe, Middle East and Africa (based in UK) was busy organizing month-long PRIDE campaign and "Lesbian Visibility Day".
    - Over the two weeks before closing, management sold about $5 million in stock.
    - NBC News, March 13: "An ex-SVB manager, who worked on risk initiatives and asked not to be identified, said the bank remained technologically stagnant even as it was a haven for startups that had an eye for cutting-edge software and products. As she described it, 'the backend of the bank is all bubblegum and wires.'"
    - ABC News, March 14: 'It is abundantly clear that SVB was terribly mismanaged. Their executives appeared to be more focused on diversity and ESG than managing their own risks. But why didn't the SF Fed see this before it was too late? Was it because their CEO was on the board of directors of the SF Fed?
    - Bonuses were paid hours before the shutdown.
  - Excessive government spending brought on inflation.
  - Fed had been purchasing MBS (Mortgage Backed Securities) and lost $438 billion.
  - Rising Fed rates had lowered value of MBS and other debt obligations.
    - Excessive government spending increased the money supply, leading to inflation
    - Being drunk leads to a hangover.
    - Trying to "cure" inflation by spending money is like trying to put out a fire by pouring gasoline on it.
  - FDIC says that banks are sitting on $620 billion of unrealized losses (they are holding the instrument but are not selling them).

- **THE CRASH**
  - SVB, with $212B in assets, is second biggest bank failure since 2001. Washington Mutual failed in 2008, with $307B in assets.
  - SBV sold $21 billion of low interest securities, and lost $1.8 billion.
    - Started a run on the bank.
  - Signature Bank said they were in a "strong, well-diversified financial position" just before being closed.

        - Former Congressman Barney Frank, co-author of the Dodd-Frank bank regulation bill, was on the board of directors.
    - Silvergate Bank, which was heavy into cryptocash, closed voluntarily.
        - Signature was also one of the two main banks for crypto.
    - California Governor Gavin Newsom had ties to SVB
        - Three private wineries, and loans to his wife.
        - Newsom lobbied the Biden administration for a bailout

- **THE BAILOUT & FUTURE EVENTS**
    - By March 17, banks had borrowed $11.9B from the Fed under the new Bank Term Funding Program (1 year loan)
        - Banks also borrowed $159B from the Fed's traditional discount window (90-day loans).
        - These programs have added $297B in debt to the Fed's balance sheet. This reverses the Fed's efforts to reduce its debt.
    - Next FED meeting March 21-22
        - Prior to the crash, 0.25-0.5% rate increase widely expected.
        - Now the FED is caught in a Hobson's Choice of their own making.
            - See the InvestTech paper
        - Current inflation is 6.4%, but food and energy are higher.
    - Current 30-year fixed mortgage rate is averaging 6.55% (MND), down 0.21% in past week.
    - "Too Big To Fail" (TBTF) is a bad idea.
        - SVB and Signature were $300B out of a $23T US banking system.
            - If the banks' are so safe (says the government) why do we need a bailout?
            - Typical government over-reaction, coupled with a burning desire to have the "experts" manage everything.
        - It costs a lot, and no one knows how much
        - It encourages risk taking and bad management. The riskiest investments pay the most, and the government will bail us out if the investments go bad.
    - Americans have rung up $180B in credit card debt in 2022, a 15% increase from 2021.
    - First Republic Bank had to get a $30B loan from several other banks to remain solvent.
    - Swiss Bank Credit Suisse has problems.
        - Will borrow up to US $54B from the Swiss Central Bank.
    - Moody's has lowered banking system ratings from "stable" to "negative".
    - Alan Greenspan in 2005: "Any onset of increased investor caution elevates risk premiums and, as a consequence, lowers asset values and promotes the liquidation of the debt that supported higher prices," he said. "This is the reason that history has not dealt kindly with the aftermath of protracted periods of low risk premiums."
    - Carl Icahn, March 15, 2023
        - "The economy is breaking down".

        - “Restoring faith in the banking system through the bailout of SVB sends citizens a message that there is no accountability for their actions, that the government will step in and save the day”.
        - "You can't have the country feeling that it doesn't matter if they save. That they could spend all the money they want, they could do whatever they want, because the government will bail you out."
    - Vivek Ramaswamy, Republican candidate for President:
        - “When Biden’s Treasury Secretary, Janet Yellen, announced that all tech companies who deposited funds at SVB, even those who recklessly parked obscene amounts of money there without diversifying, would be made whole, the federal government sent a clear message to the American people: There are alternative rules if you are part of the favored class.”
        - “The normal rules of the road are clear: The first $250,000 is insured by FDIC. After that, the customer is liable for loss. But Silicon Valley wanted a different set of rules for itself.”
        - See his paper. https://www.washingtonexaminer.com/news/watch-2024-candidate-vivek-ramaswamy-says-he-would-not-bail-out-the-silicon-valley-bank
    - Steve Forbes, March 17, 2023:
        - “The American people would be delighted to put the Biden administration on a six-to-nine month vacation. It’s far less costly than what they’re doing now”.
        - “… The Biden administration puts up obstacles to deal with supply-side problems, and the Federal Reserve thinks you have to depress the economy to bring down inflation”.
    - Anil Kashyap, Economics Professor, University of Chicago:
        - “Saying the taxpayer won’t pay anythingignores the fact that providing insurance to somebody who didn’t pay for insurance is a gift.”
        - “There Is No Such Thing As A Free Lunch”.
        - Banks will charge higher fees and interest rates to recover their contribution.
        - 94% of SVB’s deposits were uninsured by FDIC, and 90% in Signature.
    - Raghurram Rajan, Economics Professor, University of Chicago, and former head of India’s central bank:
        - “Why is it sensible capitalism for somebody to take a risk, and then be protected from that risk when that risk actually happens?”
        - “It may be good in the short term…..but it is problematic for the system long-term”.
    - Liberals blame Trump for collapse
        - You can’t make this stuff up!
        - Signed bill in 2018 that was passed by both houses of Congress, including a number of Democrats.
        - Trump has been out of office for 2+ years. If the Biden administration didn’t like it, why didn’t they fix it?
        - California has its own bank regulators, the <u>Department of Financial Protection and Innovation</u>. Of course, California’s Governor Newsom is a Democrat.
        - Why didn’t the Left complain about the performance of the bank managers?

- Greg Becker, president of SVB, lobbied in 2015 to reduce Dodd-Frank.
- Do we really need to regulate everything?
- At Signature Bank, former Congressman Barney Frank was on the board of directors.