WE'VE SEEN THIS MOVIE BEFORE

Another bank crisis. So what went wrong at Silicon Valley Bank (SVB), and what can you do as a private individual to protect yourself financially in the future?

As usual, there's plenty of blame to go around. The Fed kept interest rates near zero for almost 15 years, creating a borrower's market versus a lender's market.

You could borrow money at as low as 2% annually up until recently. At the same time, you might have earned next to nothing on your money market account.

Given this environment, some banks leveraged their deposits in various ways in an attempt to increase profits. Some banks even took advantage of loose regulations to invest their reserves longer term, resulting in a potential liquidity problem.

SVB did all the above and more. The bank catered to high-tech venture capital firms and start-ups. During the COVID-19 pandemic, these firms did very well, and deposits at the bank increased from $61.76 billion at the end of 2019 to $189.20 billion at the end of 2021.

A large percentage of these deposits exceeded the FDIC limit and represented working capital for many of these firms. By definition, working capital is a short-term investment objective, but SVB invested much of its deposits in longer-term Treasury bonds in an attempt to generate higher yields (i.e., higher profitability on the capital it held from depositors).

While Treasuries are very safe investments from a credit risk perspective, they pose substantial duration and interest rate risk. And unlike the collateral mortgage obligations purchased by banks in 2008, if SVB had been able to hold those Treasury bonds for a number of years until they matured, they would have received their capital back.

However, as economic conditions soured over the last year—with tech companies particularly affected—many of the bank's customers started drawing on their deposits. SVB didn't have enough cash on hand, so it began selling some of its bonds at steep losses, thus spooking investors and customers.

Ultimately, to fund the redemptions, SVB was forced to sell a $21 billion bond portfolio and recognize a $1.8 billion loss, which it needed to fill through a capital raise (this was too late and unsuccessful). Compounding SVB's problems was an apparent lack of risk management oversight by its board and risk management team. SVB was without its senior-most risk officer for about eight months in 2022, and only in January 2023 brought on a new chief risk officer.

Bottom line, in order to profit, SVB exposed its depositors to excessive risk. You could certainly say the bank was mismanaged, but it's worse than that since the CEO and executives of the bank paid themselves bonuses and sold stock just days before the run on the bank. Shame on them; they knew.

Unfortunately, SVB provides only one example of a lack of oversight and mismanagement within the banking industry. Signature Bank has already collapsed, and as of this writing, liquidity issues are showing up at First Republic, Credit Suisse, and may be a problem in hundreds of other regional banks.

That said, it only makes sense to protect the assets you've worked so hard to accumulate. Here are several tips on how to do that:

- Don't put all your money in one place regardless of how safe it appears. With bank accounts, you should not exceed the FDIC limit of $250,000 per individual or entity (or $500,000 for a joint account).
- Don't make the same mistake the banks made. Cash is cash and investments are investments. If you think you may need the money within a year or so, keep it in cash.
- Don't worry about getting a return on your money over a short period of time. It's easier now when you can earn 4% or 5% on your money, but the same advice was true when you were earning virtually nothing on cash.
- Don't invest too aggressively or too conservatively. Invest based on your financial goals, timelines and risk tolerance. Consider hiring advisors for an objective opinion and make sure they are fiduciaries, who will place your interests above their own.

We need our financial institutions, but they have to answer to their boards of directors and their shareholders first. Customers are sometimes taken for granted, and banks tend to make the same or similar mistakes over and over again.

Don't let those mistakes interfere with your financial future.

This **Industry Insight** was written by Garrett S. Hoge.

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