Trust Company Oklahoma
INVESTMENT PERSPECTIVES

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GETTING BANKS BACK ON TRACK

Understanding Recent Bank Failures and How They Compare to 2008

Like most children, I watched many Disney movies. And while each film arguably has a lesson behind it, Disney likely never intended to give children an early study on banking. Yet, for me at least, Mary Poppins provided my earliest illustration of how banks function.

Dick Van Dyke's character Mr. Dawes Sr., of Dawes Tomes Mousley Grubbs Fidelity Fiduciary Bank, sings to the children about how critical the deposits of banking customers are for financial markets to operate and how those deposits are invested in businesses and other ventures.

The story of the Banks family reaches its climax when the children unintentionally start a run on the bank. Mr. Banks is fired, but in pure Disney fashion, everything is tied up nicely for the family. However, this is where artistic liberties take us away from the seriousness of a bank run.

Banks are a crucial piece of our financial markets. They give consumers a place to store their cash safely and give individuals and companies loans to buy houses and start businesses. When consumers become fearful in large groups and request their deposits in a short period of time, instability can occur in the form of bank runs.

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In March, we witnessed the second-largest bank failure in U.S. history when the FDIC took over Silicon Valley Bank (see Chart A on page 2). This failure followed the announcement that Silvergate Capital, a cryptocurrency clearinghouse, was shutting down. The weekend after the government took over Silicon Valley Bank, the government also took control of a second bank, Signature Bank. There are lingering concerns that other banks might fail.

To understand these events, remember that banks borrow short and lend long, meaning they borrow the funds of those with checking and savings accounts to invest in longer-term home loans, business loans, Treasurys, etc. Even the healthiest banks do not have enough cash to make all their depositors whole in a few days. To help protect depositors from the risks of the assets banks invest in, there are regulations in place, including requirements for banks to have a certain amount of cash on hand and FDIC insurance for depositors. This insurance is limited to $250,000 per depositor per institution.

History of Silicon Valley Bank

Silicon Valley Bank (SVB) was a regional bank that started in the early '80s. SVB had a history of investing its own money in venture capital (when it was legal), making it well-known for supporting venture capital investing and startups. The bank continued to grow through the years. The growth accelerated with the partial rollback of the Dodd-Frank Act in 2018, which no longer applied to smaller banks.

With interest rates low and the tech sector booming, SVB went from having $45 billion in assets in 2016 to $200 billion by the end of 2020. With this growth, most SVB clients had more than the FDIC insurance limits of $250,000 at SVB. Among those customers above the limit were many companies, including well-known startups such as Roku and Etsy.

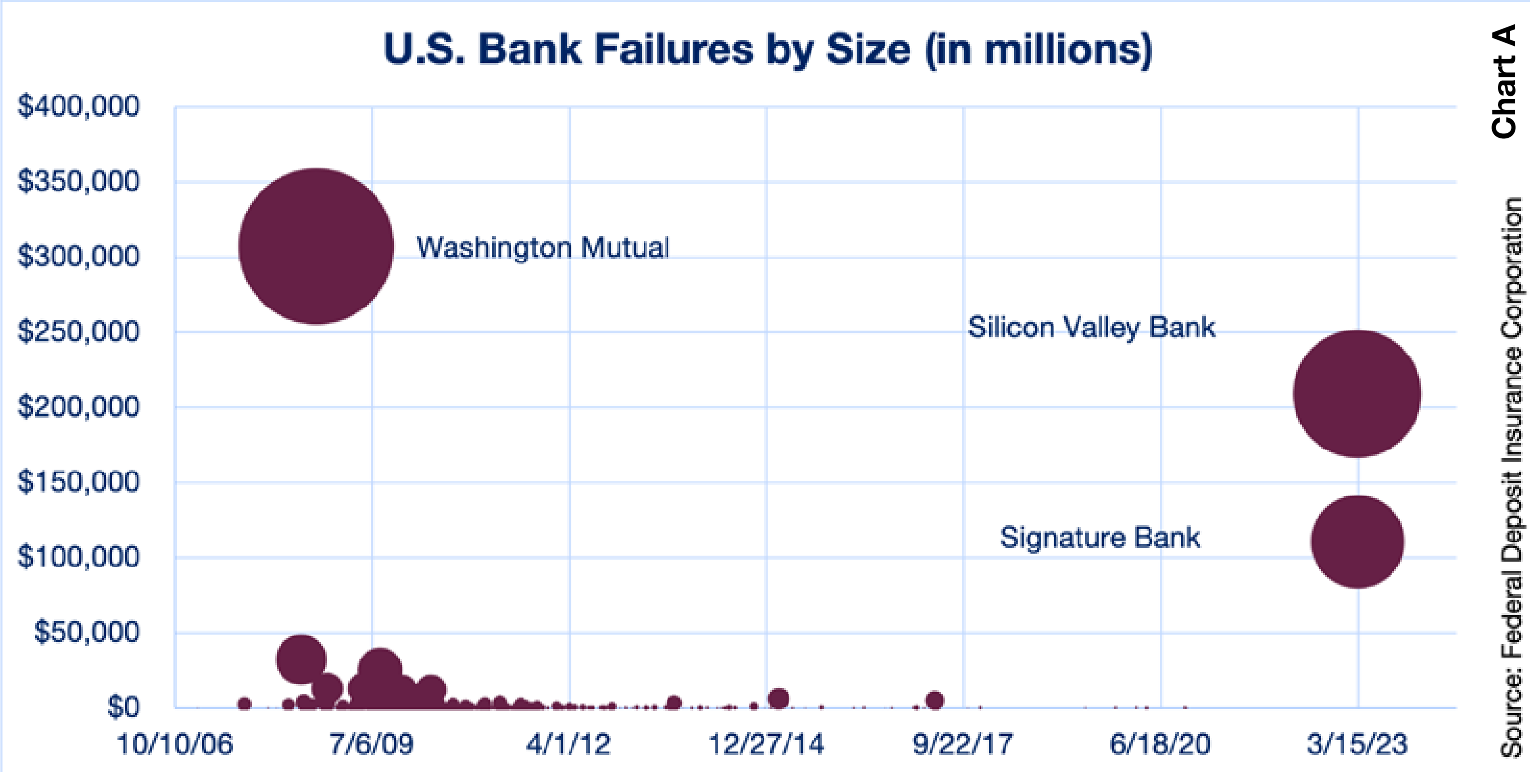
SVB invested some of its funds in 20- and 30-year U.S. Treasury bonds. When these investments were made, longer maturities earned more interest. However, once the Fed began raising rates, it put pressure on the tech and startup industries. Ideas that made sense when the debt was cheap were less attractive at higher rates. Tech companies started laying off workers, and some startups closed altogether, leading SVB customers to take cash out

Continued on page 2

MARKET RECAP

Despite the U.S. banking crises unsettling markets last month, the S&P 500 and Barclays Aggregate were up 7.5% and 3.0%, respectively, for the quarter.

	YTD	Past 6 Months	Past 12 Months
S&P 500	7.5%	15.6%	-7.8%
EAFE (International)	8.5%	27.3%	-1.4%



of the bank. SVB needed to raise cash by selling bonds out of their Treasury portfolio.

Silicon Valley Bank Collapse

On March 8, it was discovered that SVB had sold a $21 billion portfolio of U.S. Treasury Bonds at a $2 billion loss in one 24-hour period. This news made anyone with a stake in the bank nervous. They believed that if the bank had to sell a portfolio of this size this quickly at a loss to meet its obligations, it must be in terrible shape. Through social media, concerns were shared among customers, causing a contagion. Customers began to worry, and they proceeded to withdraw their funds from the bank, creating a bank run on SVB. Roughly $42 billion of deposits, approximately 24% of total deposits, were withdrawn on March 9.

Additionally, SVB's stock crashed that same day. By March 10, withdrawals were happening so quickly that the government stepped in and took over the bank. Its collapse left investors wondering if other banks would soon follow suit.

Following the announcement that the government was taking control of SVB, there were two schools of thought regarding what might happen next. The first was that the FDIC should only insure SVB depositors up to the standard limit. As one of the jobs of the FDIC, this is how the agency had dealt with many previous failed banks.

The second school of thought was that if the FDIC did not do something about the large number of uninsured deposits at SVB, it could cause panic for depositors at other banks and create a run on multiple banks. SVB is different from other banks because a disproportionate amount of its deposits were above the insured amount of $250,000. Per its last regulatory filing, 85% of its deposits exceeded the FDIC-insured limit. One reason behind this was SVB's relationship with many technology and biotech startups that used SVB as their business bank. If these companies were not going to be made whole, they were at risk of being unable to make payroll or fulfill other financial obligations, causing a massive ripple effect throughout the broader economy.

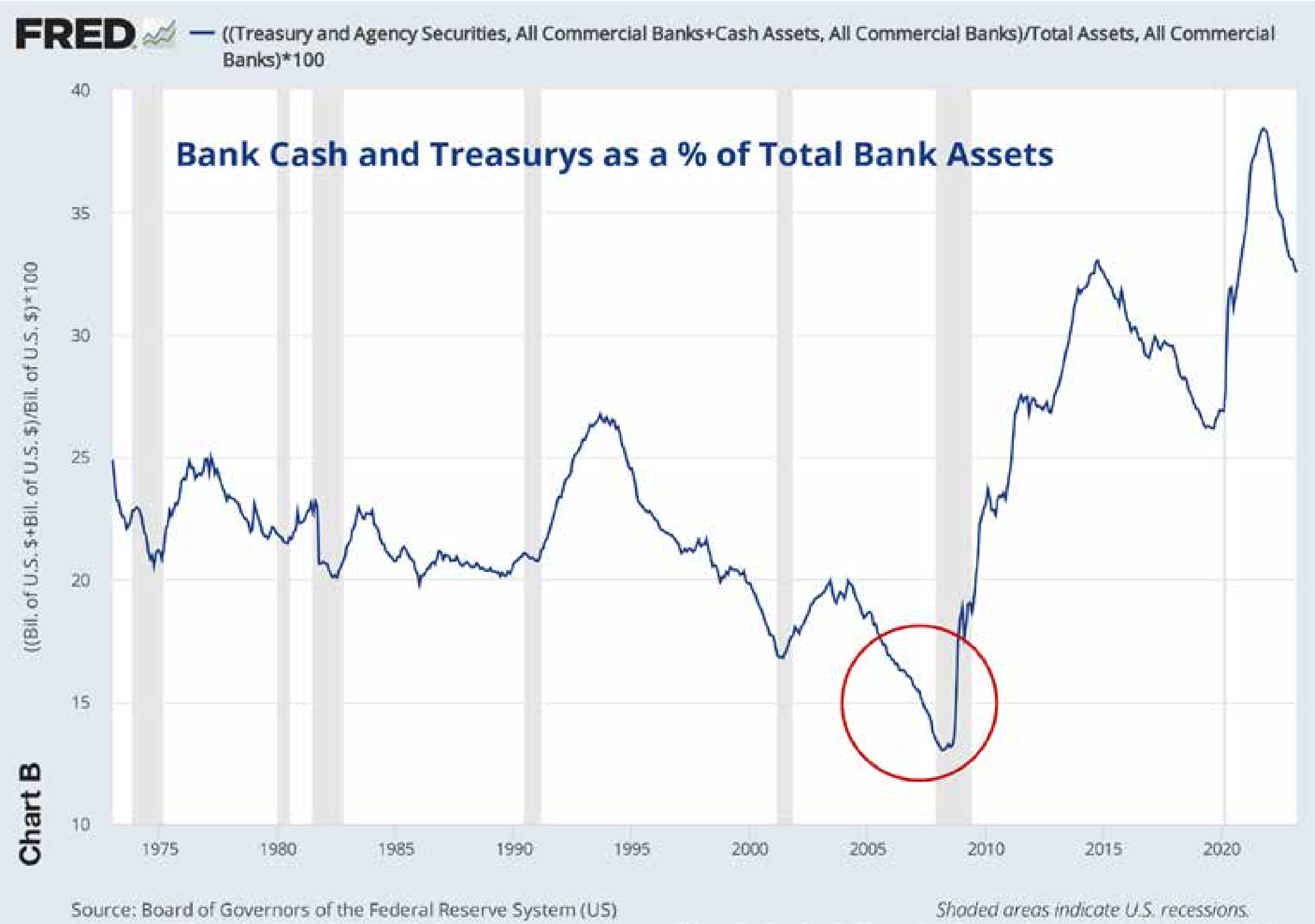
On March 12, the government responded to the escalating concern by taking significant action and making all of SVB's depositors whole, even those that exceeded the $250,000 limit. Additionally, the government took control of a regional bank in New York, Signature Bank, and has committed to making its depositors whole, too. The government hopes to prevent banks from making a fire sale of their bond portfolios as SVB did, causing panic among investors and depositors.

Making depositors whole requires banks to shoulder the costs as a group. Banks pay into a shared fund for deposit insurance. When a bank fails, depositors are made whole from that pool of money. So far, the current situation is effectively banks bailing out banks.

2008 vs. 2023

While many people have compared this year's bank failures to 2008, there are significant differences to consider when comparing the banking sector then versus now. In 2008, banks took on more liability by offering riskier loans and having fewer low-risk assets on their balance sheet. As you can see on Chart B (page 3), banks had the lowest amount of cash and Treasurys as a percentage of total bank assets in 2007 and 2008, meaning the banks were highly leveraged and at higher risk of becoming insolvent. Using the same chart, you can see that today banks have a much higher percentage of their assets allocated to Treasurys and cash, which are substantially safer assets.

The issues banks are facing today are different. Banks do not have the credit risk they had in 2008, but they face a lot of duration (interest rate) risk with their bond portfolios. Since the Fed has increased rates at one of the fastest paces ever, that has put much pressure on those longer-dated Treasurys that so many banks hold. Bond prices decrease when interest rates increase, meaning banks are carrying Treasurys with unrealized losses on their balance sheets. Bond price decreases are not an issue for banks when they can hold the assets to maturity and get their



money back. The problem arises when depositors start pulling out so much money that it exhausts the bank's cash on hand, causing them to sell Treasurys before maturity. This situation is why risk management is so important in banking. SVB is an example of where the client base is concentrated in a particular industry, causing the cash flow needs to exceed what the bank can provide.

What's Next

Initially, the FDIC took control of SVB and created a new entity called Deposit Insurance National Bank of Santa Clara to hold the bank's assets. Since the initial FDIC receivership, $72 billion in SVB assets have been sold at auction. The winning bidder, First Citizens Bancshares, acquired the SVB shares at a substantial 23% discount and with favorable financing terms, concessions which reflected the lingering fears about SVB and its assets.

While there could be additional bank failures, the fact that the FDIC stepped in so quickly with SVB and Signature indicates that they would do the same for other banks. During extreme situations, the government has a lot of power to stop panic and contagion.

The turmoil in the banking industry is a sign to the Federal Reserve that it may be time to slow rate hikes. However, inflation is still higher than the current Fed funds rate and needs to decrease more. The bank collapses have signaled the Federal Reserve that they might need to reevaluate their rate path.

Before these recent bank failures, the futures market was pricing in three to four rate hikes by 2024. Now, it is pricing in only one additional rate increase. In other words, the market indicated that the Fed would continue to try and slow the economy by increasing interest rates. Still, the events that have unfolded in the banking industry could send a message that they have gone far enough and that further increases could do more harm than good.

The Justice Department will investigate the SVB's collapse to determine if any executives acted in their own self-interest during the crisis. Additionally, they will review whether the bank took more risks than it should have. The 2018 regulatory rollback may also be reviewed to see if it opened the door for regional banks to be too lenient with risk management. In 2008, large banks were supported by the government and labeled as "too big to ignore." Some have labeled SVB as "too big to ignore." There have been other bank failures in the last decade, but none of this magnitude.

Regulation may increase again for regional banks. Funding costs may increase for the industry, there may be new requirements for banks with higher unrealized losses in their portfolios than peers, or banks could face more scrutiny for having a high percentage of deposits above the $250,000 FDIC insurance limit. That insurance limit could also change.

Consumers may change their preferences and move their funds to larger banks that face higher regulatory scrutiny and are considered "too big to fail."

In the film Mary Poppins, the Banks family received their happily ever after from a mysterious nanny. So far, the FDIC has played the role of Mary Poppins in 2023, rescuing SVB depositors.

KEY PROVISIONS OF THE SECURE ACT 2.0

The new law expands savings opportunities and provides a new option for unused 529 plan balances.

Michael Hopper
CFP®, CTFA
Executive Vice President & Chief Operating Officer

Late last year, President Joe Biden signed the "Consolidated Appropriations Act of 2023" into law. Tucked away in the omnibus spending bill's voluminous 1,653 pages were a group of retirement provisions colloquially known as the SECURE Act 2.0.

As my colleague Ryan Short noted last year, there was broad, bipartisan support for SECURE 2.0, and, as expected, Congress passed the bill before the end of 2022. Overall, the final version of SECURE 2.0 closely resembled many of the proposals advanced by both houses of Congress earlier in the year.

Most provisions of SECURE 2.0 lack the wide-ranging impact of the original SECURE Act; instead, much of the new law pertains to unique circumstances unlikely to apply to all Americans. Yet the new legislation still contains a number of significant provisions affecting most Americans, a few of which I highlight below.

Later Age for Required Minimum Distributions

Future retirees can keep their retirement assets growing tax-deferred for a little longer. Effective this year, the age at which individuals must begin taking Required Minimum Distributions (RMDs) from traditional IRAs and qualified plans increases from 72 to 73. Then, starting in 2033, RMDs will begin at age 75.

Overall, this change should give most Americans more control over the timing of retirement income distributions. Retirees who need income before their RMD age can still take penalty-free distributions from their IRA or qualified plan any time after age 59 ½. But for those who can afford to wait, the extra time before RMDs begin creates an extended window for making tax-efficient Roth IRA conversions. Additionally, the delay may allow some taxpayers to avoid higher Medicare Parts B and D premiums through the dreaded fee known as the Income-Related Monthly Adjusted Amount, or IRMAA.

Notably, SECURE 2.0 kept the age at which individuals can make Qualified Charitable Distributions (QCDs) from IRAs. Even though they may not be subject to RMDs, taxpayers at least age 70 ½ can still make gifts from IRAs directly to charitable organizations without including those distributions as income.

Increased Catch-up Contributions (With a Catch)

Catch-up contributions allow individuals aged 50 and older to make additional contributions to employer retirement plans such as 401(k)s and 403(b)s. As expected, SECURE 2.0 increased the limits for catch-up contributions for some plan participants. Beginning in 2025, participants ages 60-63 can contribute the greater of $10,000 or 50% more than the standard catch-up contribution amount to their plan.

However, there's a slight wrinkle to these higher limits. Because the government would like the tax revenues from Roth contributions to fund other parts of the SECURE 2.0 legislation, *any* catch-up contributions made by employees with wages of $145,000 or more must be Roth (i.e., made with after-tax dollars) starting in 2024. Participants with wages below the $145,000 threshold can still make catch-up contributions with pretax dollars.

Although many 401(k) and other qualified plans provide a Roth option for employees, there is no specific requirement to do so. Thus, there may be scenarios where higher-income employees might be limited to a Roth catch-up contribution when their plans do not provide that option. The new law recognizes this possibility. If a plan does not include a Roth contribution option when any of its eligible employees have earned over $145,000, then no participants are allowed to make catch-up contributions, regardless of their wages.

Interestingly, the Roth requirement on catch-up contributions only applies to individuals with *wages* over $145,000. As a result, self-employed individuals may continue to make pretax catch-up contributions, even if their self-employment income is over this limit.

529 Plan Rollovers to Roth IRAs

Perhaps the most intriguing inclusion in SECURE 2.0 involves 529 college savings plans. Previously, if a beneficiary of a 529 plan could not use the funds for education expenses, there were limited options for the unused balance. Beneficiaries could either transfer the funds to another family member or withdraw the funds and pay taxes and a 10% penalty on the earnings.

The new law adds an attractive alternative, albeit with a few caveats. Effective in 2024, 529 beneficiaries can make tax- and penalty-free rollovers from 529 plans to Roth IRAs, provided they satisfy specific criteria. First, individuals can only move up to $35,000 total from a 529 plan to a Roth IRA over a lifetime. Furthermore, the delivering 529 account must have existed for at least 15 years, and the amounts transferred must have been held in the 529 account for at least five years. Also, amounts rolled over to the Roth IRA each year cannot exceed the annual Roth IRA contribution limits.

Despite the various restrictions imposed, the ability to move 529 plan assets to a Roth IRA certainly helps to make 529 college savings plans a more attractive savings option.

Final Thoughts

SECURE 2.0 is not a panacea for the many challenges confronting Americans in retirement. Despite this limitation, though, the new legislation provides Americans with additional options in retirement, and addresses a number of long-standing issues created by earlier retirement laws.

REAL ESTATE TRENDS AMID PANDEMIC RECOVERY

Supply is high in Oklahoma, but buyers face market fears, inflation, and high mortgage rates.

While hard to believe, we are entering the second quarter of 2023. We faced unprecedented economic uncertainty just three years ago with the onset of the coronavirus pandemic. While much-needed economic stability was the hope of many, the future of the real estate market at large and the impacts of the pandemic continue to keep us agile and alert.

As the Fed consecutively raises rates in an attempt to tame rising inflation and with the recent banking uncertainty, worries of a similar 2008 housing market crisis leave some people wondering, "What can we expect of the current housing market?"

Amidst the newness and fear of the pandemic, we saw a dramatic shift toward the seller's market. The market saw a steady upward price momentum driven by a historically low inventory and exceedingly high demand in response to interest rates near an all-time low. Consequently, brokers began to expect multiple competitive offers, completely booked showing schedules, and cash offers to purchase properties sight unseen.

The seller's market circus was officially in town, and buyers exhausted from the competitive market seemed to be on the verge of offering up their firstborn children to secure a chance to be in the running. In fact, according to the National Association of Realtors (NAR), the rate of home appreciation from August 2021 to August 2022 was an impressive 7.7%.

Sean Connolly

Assistant Vice President

Homes are staying on the market longer as buyers struggle to find affordable housing.

Even though we barely had time to get our footing, things are trending in the opposite direction as the Oklahoma market begins to experience another significant shift and shows signs of cooling off. Homes are staying on the market longer as buyers struggle to find affordable housing because of rising inflation and 20-year high mortgage rates hovering near 7%.

Fears of a market crash are on the minds of many, and in September 2022, NAR reported that the number of homes sold dropped by 20.4%. The rate of existing home sales has fallen to its lowest level in 10 years. The supply of homes remains historically low; the inventory of unsold existing homes stands near three months' supply, where six months is considered a balanced market.

You may ask, "What does the rest of 2023 have in store for the housing market?" NAR Chief Economist and Senior Vice President of Research Lawrence Yun predicts that "Mortgage rates will continue to rise in 2023, but within two years, rates should dip back down to 5.5% or 6%."

Many sellers today will be left waiting for the market to turn around, although motivated sellers will likely move to sell and increase the monthly supply.

Our local housing market is less likely to see demand drop as much as other states. Low median home values may insulate Oklahoma from some of the pressures caused by higher mortgage interest rates and the nation's slowing economy.

Recent market data shows that states with lower average home prices than the national average are becoming more affordable and have higher sales per capita. In Oklahoma, data reflected 2,608 homes sold for a ratio of 64.8 sales per 100,000 population.

Finally, the nation is likely to fare better than years past, thanks in part to the stronger personal balance sheets of homeowners today. A typical mortgage borrower has excellent credit, substantial equity, and a fixed-rate mortgage. As a result, no foreclosure crisis is on the immediate horizon, and the return of a balanced market is still being determined as we move forward.

SPOTLIGHT

To learn more about this organization and how to assist in its mission, visit **SouthTulsaCommunityHouse.org**.

SOUTH TULSA COMMUNITY HOUSE

South Tulsa Community House (STCH) has been providing services in support of the community for nearly 30 years. As a social services agency, they help individuals and families combat hunger and poverty, and ultimately empower clients to independence.

The organization dedicates its assistance to those in the heart of the Riverwood community of south Tulsa who are victims of job loss, working individuals needing additional help, senior citizens, parents or grandparents with children, individuals with disabilities or illnesses, and people suffering from other crises.

STCH's food pantry offers supplemental food to individuals and families, as well as meals to seniors and veterans. Approximately 98% of the food pantry clients are considered extremely low-income (less than 30% of the median U.S. family income level).

STCH also provides access to a business center; hygiene items; bus tokens to help acquire or maintain benefits, housing, make appointments, and address legal concerns; and referral to additional resources.

Other services STCH provides include transportation assistance, access to medical services, and legal aid.

STCH has a variety of volunteer opportunities for people with all kinds of skills and talents. The organization also has a list of needed items they update each month for those looking to donate used or new items. They also rely on donations, which can be made online or in person, and designated contributions to a specific program.

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