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MARKET SIGHT LINES

The Recent Banking Turmoil: Risks and Opportunities "Hiding in Plain Sight"

By Michael O'Keeffe, *Chief Investment Officer*

My team and I are very fortunate to work with many Stifel thought leaders, such as Stifel Chief Economist Dr. Lindsey Piegza, as she offers views on the state and direction of the economy, and Stifel Chief Washington Policy Strategist Brian Gardner, who provides insights on things like the debt ceiling debate. In many ways, our most important thought leader, who is also an industry leader, is Stifel's Chairman and CEO, Ron Kruszewski. Ron is known for his balanced, logical, and no-nonsense views on challenges and opportunities in our industry and beyond. Recently, he has offered some important perspectives on the recent banking sector turmoil.

In this week's Sight|Lines, we share some important views from Ron about the recent banking sector turmoil and related risks and opportunities "hiding in plain sight."

THE TAKEAWAY: RECENT BANKING RISKS WERE "HIDING IN PLAIN SIGHT," AND SO TOO IS THE OPPORTUNITY TO LEVEL THE PLAYING FIELD FOR ALL BANKS, BIG AND SMALL.

As we look back, the risks that led to the recent bank failures were pretty obvious. But now we run the risk of a regulatory overreaction and a loss of confidence in regional, mid-sized, and community banks. And yet there is an opportunity to level the playing field to let all banks compete. In summary:

- Silicon Valley Bank and Signature Bank failed as a result of a classic "run on the bank crisis" after both banks grew in the wake of historically high accommodative monetary policy and fiscal stimulus.
- Deposits exceeded loan demand, so these banks invested in "low-risk" government securities without fully considering the possibility of significantly higher rates or the new speed of withdrawals.
- Now, a follow-on risk is the potential for a regulatory overreaction and a possible loss of confidence in regional, mid-sized, and community banks, which are important to consumers and the U.S. financial system.
- An implicit two-tiered banking system favoring institutions "too big to fail" is unfair, as all banks are important to the U.S. economy and our competitive position in the world.
- One way to level the playing field? Insure all business deposits, and have all banks, large and small, pay their fair share of Federal Deposit Insurance Corporation (FDIC) insurance premiums.

The Federal Reserve (Fed)'s hawkish shift over the last year has driven market interest rates higher, uncovering risks in the current environment. One such risk "hiding in plain sight" has led to some bank failures, which creates the potential for a regulatory overreaction that will amplify the inequity of our de facto two-tier banking system. We can level the playing field to rebuild confidence in our banks and support fair competition in the bank sector.

IN-DEPTH: RECENT BANKING SECTOR RISKS WERE "HIDING IN PLAIN SIGHT," AND SO TOO IS THE OPPORTUNITY TO LEVEL THE PLAYING FIELD FOR REGIONAL, MID-SIZED, AND COMMUNITY BANKS.

Hindsight is often 20/20, and as we look back, the risks that led to the recent bank failures were apparent. We now run the risk of an overreaction by regulators, which can even lead to a loss of confidence in the banking sector. That said, there is an opportunity to level the playing field and let all banks compete. Going deeper:

- Silicon Valley Bank and Signature Bank failed as a result of a classic "run on the bank crisis":
    - Both banks grew through a period of historically high accommodative monetary policy and fiscal stimulus. Deposits exceeded loan demand, and these banks invested in "low-risk" government securities because of the low credit risk, high liquidity, and low capital requirements.
    - But they weren't ready for the almost 5% jump in short-term rates we've experienced over the last year, nor for the new speed at which withdrawals can happen with today's mobile technology.
    - So far, these risks have been idiosyncratic, meaning specific to these two companies, and on reflection, these risks were "hiding in plain sight."
- Now we run the risk of a regulatory overreaction that could amplify the inequity in our already de facto two-tier banking system:
    - This could lead to a loss of confidence in the perceived safety of uninsured deposits at regional, mid-sized, and community banks, which play an important role in local communities.
    - Larger, "too big to fail" banks will continue to benefit as deposits flow in due to their perceived safety.
- We can change this market dynamic by leveling the playing field:
    - One approach would be to have the FDIC insure all business deposits, which make up the majority of uninsured deposits in today's banking system.
    - All banks, large and small, should pay their fair share of FDIC insurance premiums. By doing so, the largest banks would pay their fair share of such premiums instead of paying nothing for the implied unlimited protection they now enjoy being "too big to fail."
- This solution is logical and balanced and, in some ways, is "hiding in plain sight."

CONCLUSION

Stifel is fortunate to have numerous thought leaders, and in many ways, our most important thought leader is our Chairman and CEO, Ron Kruszewski, a known industry leader who regularly offers balanced, logical, and no-nonsense views. And he has recently shared such views on the recent banking sector turmoil.

Michael P. O'Keeffe, CFA
Chief Investment Officer
michael.okeeffe@stifel.com
www.stifelinsights.com

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