FedFin Daily Briefing

Monday, April 10, 2023

FRB-NY Study: When Franchise Value Flies Out the Window

In a timely Friday post ahead of earnings season, the Federal Reserve Bank of New York's staff posted an assessment of the impact of higher interest rates on bank franchise value. This is judged by both going concern valuations (i.e., the economic value of equity, known as EVE) and how much tangible common equity (TCE) is left after liquidating a gone concern. Stylized models are developed of "traditional banks" – i.e., those where sticky core deposits constitute most liabilities and assets are principally adjustable-rate – versus "alternative banks" with large holdings of floating rate liabilities along with large books of fixed-rate assets. Traditional banks are subject to TCE losses as rates rise from zero to six percent, but their EVE is sustained by favorable liability valuations. In contrast, alternative banks are exposed to both significant drops in TCE and EVE. Both traditional and alternative banks liquidation valuations decline faster than going-concern EVEs as rates rise, but both bank models at least remain solvent. However, these are stylized scenarios that assume deposits remain relatively constant; if a run occurs and the bank lacks cash – i.e., what's been happening – then both bank models see their TCE value wiped away. The study does not address market capitalization; we would note that, while this is relevant in terms of either TCE or EVE, it has a major impact on depositor psychology and the likelihood that seemingly sticky funds fly out the door.

Warren, AOC Challenge SVB's Large Depositors

Following her request and that of Sen. Blumenthal (D-CT), Sen. Warren (D-MA) and Rep. Ocasio-Cortez (D-NY) yesterday sent a series of letters to fourteen of SVB's largest corporate depositors seeking to get at any abuses that may have precipitated the $42 billion run the day before the bank failed on March 10. The letters thus demand explanations for what they call a "mutual backscratching dynamic," any actions related to deposit withdrawals, and the rationales behind large uninsured deposits. The letters also take serious issue with reports of "coddling" and "white glove" treatment of some of SVB's largest VC depositors, arguing that this may have contributed to "reckless" uninsured deposit placement based on inappropriate perks or preferences. The letters also seek any communications with regulators without indicating if there is any reason to expect this. The goal of the letters with regard to the pending debate on uninsured-deposit coverage, viral runs, and exclusivity clauses is unclear, but very awkward questions for SVB executives and/or these companies is possible at forthcoming hearings. Responses are requested by April 24.

Recent Files Available for Downloading

The following reports and analyses have been sent to retainer clients recently. Copies are also available to retainer clients on the Archives section of Federal Financial Analytics' website: www.fedfin.com or clients may obtain the reports/analyses by e-mailing info@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about *GSE Activity Reports*, click here.

- **UDAP8:** Following its usual practice of setting standards by edict, the Bureau of Consumer Financial Protection has laid out an extensive framework that brings a wide range of consumer-finance actions and inactions within the scope of enforcement sanctions governing acts or practices that are not only unfair or deceptive, but also abusive.

- **GSE-040623:** FHFA, Fannie, and Freddie yesterday updated the sometimes-controversial equitable-finance plans FHFA approved last year.

- **GSE-040323:** We have written from time to time about covered bonds.

- **REFORM219:** With Thursday's White House announcement, we know that the Administration will do its best to support Fed and FDIC efforts to color recent events as a failure of Republican-led rulemaking, not also one of agency supervisory acumen, speed, and even competence.

- **REFORM218:** Today's HFSC hearing on recent bank failures was more partisan than yesterday's Senate Banking session (see *Client Report* **REFORM217**).

- **REFORM217:** Today's Senate Banking hearing was extremely well-attended by Senators on both sides of the aisle clearly looking first to understand what precipitated recent bank failures, who is to blame, and what should be done next.

- **RESOLVE50:** As noted yesterday, the FDIC's recent rescues have had several unusual features with implications not only for future policy, but also for pending special assessments to replenish the DIF for the $22.5 billion estimated costs to the Deposit Insurance Fund.

- **RESCUE79:** Recent editorials and other media have often said that the FRB and/or FDIC have powers or taken actions that is not the factual case as we understand it.

- **GSIB21:** In this report, we assess the implications of recent events on two assumptions underlying current U.S. and global policy affecting GSIBs and those considered domestic SIBs: first, all are likely to be well insulated from illiquidity and/or insolvency and, when this is not the case, then orderly resolution without taxpayer bailout can be readily deployed.

- **LIQUIDITY33:** Among the most vexing issues in the wake of SVB's failure is the extent to which social media may have led to the first "viral run," a run akin to the meme-stock volatility that lead the SEC and others to fear a new form of "flash-crash" risk.

- **GSE-032023:** In this report, we build on FedFin's in-depth reports about recent bank failures to detail new risks for all of the innocent bystanders in the U.S. mortgage market along with a not so-innocent bystander: the Federal Home Loan Banks.

- **REFORM216:** In this report, we continue our policy postmortem of SVB/SBNY and, now, so much more.

- **DEPOSITINSURANCE118:** As promised in our first post-SVB impact assessment (see *Client Report* **RESOLVE49**), this report begins a series of analyses of specific policy issues.

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