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What Does the Nation's Second Largest Bank Failure Mean for Business?

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In what is now the second largest bank failure in United States history, the California Department of Financial Protection and Innovation closed embattled San Francisco-based First Republic Bank shortly after midnight (Pacific Daylight Time) this morning and appointed the Federal Deposit Insurance Corporation as receiver. The failure surpasses the Silicon Valley Bank and Signature Bank failures in March that were in part caused by runs on the banks and that riled the financial sector.

First Republic's Assets Sold to JPMorgan Chase

In anticipation of a closure of First Republic, last week regulators quietly solicited bids from banks that were interested in acquiring First Republic and conducted an auction on Sunday. JPMorgan Chase Bank, N.A. (JPMorgan), submitted the winning bid to acquire substantially all of First Republic's assets immediately following the appointment of the FDIC as receiver. The transaction included a payment by JPMorgan of $10.6 billion and the assumption of all First Republic deposits (approximately $92 billion), both insured and uninsured. The parties also entered into a loss sharing agreement with respect to certain commercial and residential loans, including a large portfolio of riskier jumbo residential loans held by First Republic. The FDIC provided JPMorgan with $50 billion in financing to facilitate the acquisition. The FDIC estimates that the deposit insurance fund will lose approximately $13 billion in the transaction making account holders whole. These losses will be recouped by special assessments on all FDIC-insured banks and savings banks and will not be borne by taxpayers.

JPMorgan, the largest bank in the United States, is now bigger. In fact, due to its existing dominant market position, JP Morgan had to obtain special approvals from regulators to permit it to acquire First Republic. The consolidation is substantial and will undoubtedly raise concerns about the competitive marketplace and impact on regional banks. JPMorgan has reopened First Republic's 84 branches today as JPMorgan branches to ensure customers have full access to their deposits.

The quick action by regulators represents the latest effort by federal policymakers to maintain consumer confidence in the US banking system, which has now suffered three major bank failures in the past two months. President Biden announced today: “Let me be very clear, all depositors are being protected, shareholders are losing their investments, and critically, taxpayers are not the ones who are on the hook.” Senator Elizabeth Warren, despite recent acknowledgments by the Federal Reserve that its own failures of supervision have contributed to recent collapses, called for additional regulation: “The failure of First Republic shows how deregulation has made the 'too big to fail' problem even worse. A poorly supervised bank was snapped up by an even bigger bank—ultimately taxpayers will be on the hook. Congress needs to make major reforms to fix a broken banking system.” (Christina Wilkie, Lawmakers praise First Republic sale, but efforts to pass new bank rules are fizzling, CNBC, Politics (May 1, 2023)

Why Did First Republic fail?

Following the failure of Silicon Valley Bank (SVB) and Signature Bank in March, First Republic was suddenly in the spotlight as a bank with an uncertain future. Some of the reasons include:

- Like SVB (and some other banks), First Republic had large unrealized losses on its balance sheet because it held a sizeable portfolio of long-term government securities with a low coupon rate, acquired before the Federal Reserve began aggressively raising interest rates in an effort to curb inflation. Since those securities pay interest at a rate well below current rates for new government securities, they are only saleable at a significant discount to their face value.
- First Republic, SVB, and Signature each grew rapidly in recent years, at rates exponentially higher than most banks. This growth occurred when interest rates were close to 0%. While this rapid growth may have immediately benefitted shareholders, it left these banks more vulnerable and in a riskier position, particularly when interest rates rose as a consequence of action by the Federal Reserve.
- The three banks also had an unusually high number of uninsured deposits (generally, amounts deposited at a bank that exceed $250,000). When depositors questioned the continued viability of the banks, they raced to withdraw their deposits before the banks failed, in a classic "run on the banks” evocative of similar runs in the Great Depression.
- First Republic catered specifically to high-net-worth individuals and was noted for holding an unusually large portfolio of illiquid “jumbo” residential mortgage loans. These are loans which exceed applicable mortgage limits and are not eligible for federal loan guarantees or sales in the secondary market through Freddie Mac, Fannie Mae, or FHA programs.

Is There a Systemic Banking Crisis?

Banks periodically fail, and often in close sequence, such as the domino of bank failures in the Great Depression in the late eighties and early nineties and between 2008 and 2010. There is no assurance that more banks will not fail, though most analysts consider the majority of the nation's banks—from the largest banks to the smallest community banks—well positioned to remain in business. First Republic's troubles appear to be a delayed reaction to the turmoil that resulted in March with the collapse of SVB and Signature Bank, rather than the beginning of a new phase of the crisis.

However, cautious bank customers can take some proactive steps to mitigate their risks:

- Has your bank grown very quickly? If so, that bank may be on a riskier foundation, and at a minimum, you may want to look more closely at its financial condition.
- Banks are required to file reports of condition and income (commonly known as call reports) with regulators and they are available for everyone to review online. This enables you to compare the condition and performance of different banks. Call reports can be reviewed at https://cdr.ffiec.gov/public/ManageFacsimiles.aspx
- Do your deposits exceed FDIC insurance limits? You may be able to get fully insured by utilizing a CDARS (Certificate of Deposit Account Registry Service) or cash sweep service at your bank, under which excess deposits are placed at another bank. This enables you to maximize your deposit insurance coverage.

The US financial system will continue to experience challenges as the availability of credit restricts due to interest rate increases, general economic concerns created by recent bank failures, political signals of increased regulation, and more conservative approaches by credit providers. Reduced access to credit is likely to slow the growth of businesses, particularly early-stage companies whose future development or expansion depend on investment.
