Why First Republic failed. Are other banks to follow?

QUOTE: "While depositors are being protected, shareholders are losing their investments. Critically, taxpayers are not the ones who are on the hook." ̶ - President Joe Biden

By The Associated Press

First Republic Bank has become the second large regional bank with assets over $200 billion to fail in just a few weeks. Like Silicon Valley Bank, which was seized by the government on March 10, First Republic catered to a wealthy clientele, which helped it grow deposits rapidly but may have also contributed to its undoing. The bank's business model left it susceptible to a sudden rise in interest rates.

Since the collapse of Silicon Valley Bank — and Signature Bank the same weekend — investors have wondered who's next. First Republic quickly rose to the top of that list, but investors and analysts worried about banks such as Comerica and KeyCorp, which also had large numbers of accounts with deposits above the federally-insured level of $250,000.

First Republic grew rapidly through deposits from wealthy individuals and companies. It used those deposits to make large loans, including jumbo mortgages, when interest rates were at historically low levels in hopes of then convincing customers to expand into more profitable products like wealth management.

Many of the bank's accounts had deposits well north of the federally-insured $250,000. Once Silicon Valley Bank went under, clients pulled their money, fearful their deposits were in danger. First Republic said last week that depositors had withdrawn more than $100 billion, most of it during a few days in mid-March.

What's more, the large loans on First Republic's books dropped in value as the Federal Reserve rapidly raised interest rates last year. So, if the bank tried to sell the loans to raise capital, it would do so at a loss. Similar circumstances had doomed Silicon Valley Bank.

First Republic planned to sell off unprofitable assets, including low interest mortgages that it provided to wealthy clients. It also announced plans to lay off up to a quarter of its workforce, which totaled about 7,200 employees in late 2022. But those plans were seen as too little, too late, by analysts.

By the middle of last week, it became clear government intervention in First Republic was necessary. Treasury officials asked banks to submit bids for First Republic, and bankers and regulators worked through the weekend to find a way forward.

For now, analysts expect the banking system will be spared any more large bank failures, saying the problems at Silicon Valley, Signature Bank and First Republic were unique to those companies.

Other midsize banks suffered large withdrawals of deposits and were forced to borrow from federal programs to shore up their balance sheets, but none were hit as hard as First Republic.

Shares of most midsize banks fell Monday, but the drops were moderate compared to the steep double-digits losses for many of them on March 13.

First Republic's stock traded at $115 on March 8, then plummeted in the following days and weeks and closed Friday at $3.15. About $20 billion in market value has been wiped out. Trading in the stock was halted before U.S. markets opened Monday.

JPMorgan Chase, which has agreed to buy the deposits and most of the assets of First Republic, stressed that it is not assuming any of First Republic's corporate debt or preferred stocks.

After a bank's failure, bondholders are among the last to get paid — stockholders are at the very end of the line. The FDIC does not give estimates on how likely any creditor is to get repaid.

But the agency did say that its deposit insurance fund, which banks pay into, could take a $13 billion estimated loss as a result of First Republic's failure.

While conditions could change over time, that likely leaves nothing left over for investors to recoup. Stockholders at Silicon Valley Bank and Signature were wiped out.

The outcome was just fine with one interested observer.

"While depositors are being protected, shareholders are losing their investments," said President Joe Biden during a Rose Garden event focused on small businesses, when asked about the bank seizure. "Critically, taxpayers are not the ones who are on the hook."