FINANCIAL WISDOM

- WEALTH BUILDER -

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A Short Conversation About Banks

The recent tremors in the US banking system (collapse of Silicon Valley Bank - SVB) have caused some Canadians to question how developments in the US might affects their own savings. The key thing to understand is that there are **BIG differences** between Canadian and US banking systems.

A Google search for "How many banks are there in the US?" reveals that there are over 4,000 FDIC insured commercial banks versus some 50 or less in Canada – the six large banks, plus Credit unions and some others. The reality is that the US banking system has been consolidating for several decades.

To maintain public "confidence", the US Federal Government stated that all bank deposits would be protected above the FDIC insured level of $250,000. So, at this point, the crisis has been contained.

Which raises the question of what precisely is a "bank deposit"? To put it simply, a "bank deposit" is an account – where cash can be withdrawn instantly (subject to any daily limits) – such as chequing and savings accounts. Banks normally keep about 7% of their "deposits" as liquid cash to satisfy normal day-to-day withdrawal needs. The rest of a bank's assets (customer deposits) are normally used to earn revenue as reserves, mortgages, business loans and so on.

If a US bank experiences larger than expected withdrawals over a short period of time, then the bank may be forced to liquidate "reserves" such as US Treasury bonds. And that is where the problem occurred for SVB.

SVB experienced a sudden demand for cash and was forced to sell assets that had dropped in value due to rising interest rates in 2022. And then the Regulators stepped in to take control of the bank. This is a very simple overview.

Canadians were largely unaffected by the SVB situation. Bank mortgage rates in Canada adjusted only very slightly over the weekend following the collapse of SVB. There was some general talk amongst Canadian financial regulators about measures that could been taken (if necessary) to maintain public "confidence" in the Canadian banking system.

It is also important to understand that Canadian banks such as Royal Bank, or Scotiabank, are comprised of multiple corporations - **not one monolithic entity**. Many of them have separate retail operations, mutual funds, securities, international, foreign exchange, merchant banking, custodial companies, etc.

Furthermore, if any investor concerned about the security of their child's RESP, it is important to realize that an RESP is not a "bank deposit". An RESP is not subject to an "SVB type" of bank run. Nor are any other types of investment accounts.

Each Canadian investment account (RRSP, RRIF, RESP, etc.) is subject to regulatory oversight and various insurance programs to protect against fraud and business operational risk (the sponsoring company goes out of business). The main risk these investment accounts have is "market or economic risk" – from the normal fluctuating values of equity markets.

Questions about your investments? We're here to help.

Wayne Hissa, CFP

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