Government backing crucial for JPMorgan takeover of First Republic Bank

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In a deal struck in the early hours of yesterday morning, pushed through before Wall Street opened for the day, the failed First Republic Bank has been bought by JPMorgan Chase after it had been taken over by the Federal Deposit Insurance Corporation (FDIC).

Regulations governing competition in the banking sector were pushed aside to get the deal done. Under normal circumstances, JPMorgan, which is already America's largest bank, would not have been allowed to buy First Republic under regulations that stipulate that no bank can hold more than 10 percent of insured deposits in the US.

The go-ahead to bypass the regulations was taken by the Office of the Comptroller of the Currency that operates in the US Treasury Department.

In the words of one unnamed person briefed on the situation, cited by the *Financial Times* (FT), JPMorgan "received a waiver because it was by far the best deal."

The takeover is being presented as a "private sector" solution to try to avoid giving the impression that this is yet another government bailout. But large amounts of public money are being outlaid.

JPMorgan chief executive Jamie Dimon only agreed to go ahead with the takeover—after he said the government had asked him to "step up"—when he received an agreement from the FDIC that it would take a hit.

Under the deal, JPMorgan will buy most of the company assets, including $173 billion in loans and $30 billion in securities as well as taking over $93 billion in deposits.

The FDIC will take a loss of $13 billion, adding to the losses of more than $20 billion it has already taken because of the failures of SVB and Signature. In addition, JPMorgan will receive a $50 billion line in financing from FDIC and will share any losses with it.

Government assistance has been crucial. According to a JP Morgan statement, it expected to make an immediate gain on the deal but, without government backing, it would have had to recognise losses running into billions of dollars as soon as it was completed.

The failure of First Republic, the 14th largest bank in the country, is the second largest in monetary terms in US financial history, a position previously occupied by the Silicon Valley Bank (SVB). It collapsed in March and was taken over after a bank run following the withdrawal of $40 billion in a single day with a further $100 billion lined up to be withdrawn.

Its demise, followed by the failure of the Signature Bank, set off the crisis in First Republic which had rapidly grown in recent years by making ultra-low interest rate mortgage loans to very wealthy individuals, in return for receiving their business accounts. But this model became unviable when interest rates rose.

In the first quarter, First Republic reported it was earning an average of 3.73 percent on its loans. But it was forced to borrow money from the Federal Reserve at the rate of 4.5 percent to maintain liquidity which meant it was receiving less money in terms of interest payments than it was paying out.

After it disclosed on Monday of last week that $100 billion had been withdrawn in the first quarter of the year, its share price plunged, reaching a low of $3.51 after trading at $147 earlier in the year and $115 at the beginning of March.

The FDIC then moved in to organise the takeover in which it sought to avoid declaring another "systemic exception," as it had with SVB and Signature, under which it would have to guarantee all uninsured deposits over the $250,000 limit. It managed to do this under the deal with JPMorgan in which it will take over all the deposits with First Republic.

Throughout the crisis the theme of official pronouncements, from Federal Reserve chair Jerome Powell and Treasury Secretary Janet Yellen down, has been that the US banking system is "sound" and the rescue operations reveal it is "resilient."

But, as the saying goes, facts are stubborn things, and they are speaking loudly. The fact is that three of the four largest-ever US bank failures in history have taken place over the past two months. The three latest failures are only eclipsed by the 2008 collapse of Washington Mutual.

The entire experience demonstrates that no official statements can be accepted as good coin. In mid-March, Yellen and Dimon launched a rescue package for First Republic under which 11 major banks, organised by JPMorgan, deposited $30 billion with it.

A group of regulators, led by Yellen, said, "This show of support by a group of large banks demonstrates the resilience of

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the banking system."

It failed almost immediately as it became clear that First Republic was heading for bankruptcy. However, some insiders had already seen the writing on the wall.

As the *Wall Street Journal* reported: "Top executives of First Republic sold millions of dollars of company stock in the two months before the bank's shares plummeted."

In addition, the bank paid millions of dollars to family members of its founder, James Herbert, for, among things, "consulting services related to interest rates and risk." The bank failed not least because its business model assumed the ultra-low interest rate regime of the Fed was going to continue indefinitely and collapsed when rates rose sharply.

This stage of the financial crisis has taken the form of problems associated with uninsured depositors—those holding more than $250,000 not covered by a legislated FDIC guarantee. There are moves to change this situation.

In a report to Congress yesterday, the FDIC recommended that it be given the power to expand the present insurance system to cover businesses. FDIC chairman Martin Gruenberg said in a statement accompanying the report that "growth in uninsured deposits" and large concentrations of them "increase the potential for bank runs and can threaten financial stability."

The FDIC said it favoured a system in which the deposits to be protected would be those used by businesses to pay employees.

But such a change would be the thin end of the wedge for broader measures, as the report implicitly acknowledged when it noted that such a system would bring greater complexity and investors would try to "game" it to gain greater protection.

Uninsured deposits are by no means the only danger. Another is the fall in the value of property and commercial real estate loans that have been hit by the interest rate rises and the fall in demand for office space because of COVID.

The same small and middle-sized banks at the centre of the present storm could be heavily impacted here as well because they account for more than two-thirds of all US commercial real estate lending.

In an interview with the FT published on Monday, Charlie Munger, the longtime associate of finance mogul Warren Buffet, said American banks were "full of" bad loans in commercial property.

In an article last week, the FT said senior executives at US banks were "becoming increasingly worried about falling commercial property valuations and the risks they pose to lenders' balance sheets."

In a conference call, Morgan Stanley chief executive James Gorman said, "In my view we are not in a banking crisis, but we have had, and may still have, a crisis among some banks."

Such a statement is meant to sound reassuring. However, it ignores the dynamic of a crisis which does not start with the failure all at once of all banks.

It develops, as the events of the past two months have shown, with a crisis at several or even a single bank which then threatens to spread via contagion to pose a "systemic risk" requiring a government-organised bailout.

That is, virtually any bank can become "too big to fail" because its collapse threatens to bring others down.

The logic of this process was set out in a statement issued by Jonathan McKernan, a member of the FDIC board reported on Bloomberg.

It was necessary to acknowledge, he said, that bank failures were inevitable in a "dynamic and innovative" financial system—dynamic and innovative being code words for the role of finance capital in devising new and ever more arcane and risky methods for speculation and profit making.

"We should plan for those bank failures," he continued, "by focusing on strong capital requirements and an effective resolution framework as our best hope for eventually ending our country's bailout culture that privatises gains while socialising losses."

That "culture" has been the basis of the financial system for the past century and more—at least since the Federal Reserve was established in 1913.

And the reforms he advocates, never carried out in the past, will not be implemented in the present crisis because the mass of wealth at stake, which the government and the state are committed to protect, has reached truly gigantic proportions, above all because of the Fed's injections of money into the financial system over the past decade and a half.

He certainly did not intend it, but his remarks on how the financial system actually operates and will continue to operate—hundreds of billions even trillions for the banks and financial speculators as workers battle to make ends meet—makes the case for the ending of the private ownership of the financial system as a key component of a socialist program advanced and fought for by the working class.

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