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Luxury brands and the banking industry: Russian Roulette anyone?

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The game of Russian Roulette is known by many and stolen scenes in movies such as The Deer Hunter as well. Simply put, spin the revolver and hope for the best.

It is a sinister game that produces anxiety and temporary relief. How does this relate to the banking industry and luxury brands?

The spin

Remove the deviousness and the similarity will be clear deposit monies greater than the United States' FDIC limit, cross your fingers and hope your money is secure.

Banks provide a service and are paid for their services through a variety of bank fees and floats.

A depositor provides a bank with its money and that money is used to pay existing depositors. Money is fungible after all. No one sets aside the money that you deposited to be used just for you.

A bank account does not function like a safe deposit box where your money is kept segregated and available to you when you claim it.

A deposit, therefore, becomes a large IOU from the bank a loan of sorts from you to the bank. The bank can use the money deposited for any legal reason, as long as it is available to you when needed.

The money that is deposited is used to fund loans to other depositors and pay interest to other depositors, among other things.

A bank account is convenient unless and until a bank closes, is in receivership or otherwise fails. This is where the Russian Roulette comes in bank customers have anxiety and no control.

Banking on?

The FDIC insures deposits up to $250,000 per depositor, the same amount since at least since 2010.

An increase is long overdue. However, will an increase solve the issue that caused the demise of Silicon Valley Bank ("SVB"), Signature Bank ("Signature") and the others that will fall? Unlikely.

The failures of these banks were made inevitable by the poor investment choices of the bank.

SVB invested in long-term bonds and sold its bonds at a loss when the Fed increased interest rates.

Signature bank invested heavily in cryptocurrency.

As a depositor, you may believe that the bank has a fiduciary duty to you, but a bank's fiduciary duty is limited to certain circumstances such as trust administration and bill paying service.

No fiduciary duty attaches to a mere deposit. Banks are entitled to make money and to have flexibility in how they administer services and work.

However, permitting banks to invest depositor monies in risky investments that cannibalize the bank's financial health and ruin depositors' businesses is another story.

Luxury brands are particularly vulnerable to bank collapses because without the debt financing that they offer, they may be left with little options to support their businesses.

Factoring occurs when a business sells its accounts receivables to a third party at a discount, enabling them to immediately unlock cash.

Factoring, however, is very expensive.

Equity lines of credit are still available to companies with good credit, but lines of credit likely pale in comparison to the monies needed by luxury companies and, with a floating rate, make budgeting difficult for brands.

Despite the challenges, brands have options.

A single banking relationship is essential for companies seeking debt financing and other loans because banks typically require that a substantial majority of the company's money is maintained at the bank.

Therefore, depositors should protect themselves.

Swap talk
At the very least, luxury brands with less than $50 million in deposits should obtain an ICS insured cash swap account. This allows a company to have a single business relationship but its assets, up to $50 million, housed in multiple institutions in amounts up to the FDIC insurance limit.

Although the money is held in a variety of institutions, the company depositor receives a single bank statement and has a single point of contact.

As of the date of this writing, there are thousands of banks that are part of the ICS Network.

In every instance where an ICS Network member bank has failed, all claims for deposit insurance were paid by the FDIC.

At SVB, more than 85 percent of the monies held were uninsured. The author has no crystal ball to determine when or if uninsured monies will be returned to depositors.

Only time will reveal that but, had the depositors used a cash swap account with SVB, they would have already been made whole through FDIC insurance.

HINDSIGHT IS 20/20.

Now that we can see through the rearview window, what actions will we take as depositors and what actions will the government take to help avoid depositor losses?

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