Flaherty & Crumrine Manager Commentary

Bank Update | March 21, 2023

Over the past two weeks, the preferred and contingent capital securities market has been roiled by the liquidation of Silvergate Capital Corp, and the receiverships of Silicon Valley Bank and Signature Bank NY. On March 19, Credit Suisse Group was taken over by UBS Group at the behest of Swiss bank regulators and included a full write down of CS's contingent capital ("CoCo", or additional tier-1) securities. These events were triggered by deposit withdrawals straining the banks' liquidity, despite strong regulatory capital positions at each of these banks.

While it is still very early in these resolutions, in the case of the U.S. banks, the normal priority of losses will apply, with common equity absorbing losses first, followed by preferred securities, subordinated debt, and more senior claims thereafter.

The Credit Suisse situation was different: common shares received CHF 3 billion of UBS common stock, while its CoCos received nothing. Although the terms of the securities appear to give Swiss regulators that authority, it was a shock to the broader CoCo market and led to sizable declines in market prices there today. In response, both the European Central Bank and the Bank of England made clear statements that CoCos in their jurisdictions rank ahead of common equity and behind tier-2 capital (a form of subordinated debt), prompting a partial recovery of earlier declines. Among jurisdictions in which the Fund has purchased CoCos, Switzerland's approach to "bail-in" is unique.

Central banks have extended significant liquidity to banks to accommodate deposit outflows or other liquidity needs. In addition to the discount window, which accepts a broad range of collateral, the Federal Reserve established a new Bank Term Funding Program that allows borrowers to pledge certain collateral at par value without "haircuts" to market value that apply at the discount window. Borrowing from these facilities expands the Fed's balance sheet and enhances overall bank liquidity. In addition, the Federal Home Loan Bank system continues to provide funding against mortgage collateral.

Investors have expressed concern over regional bank deposits. We note that regional banks have consolidated, diversified, and grown their deposit and loan bases significantly since the 2008-09 financial crisis. They are often the go-to banks in their regions.

As of year-end 2022, U.S. banks' regulatory capital levels remained strong and loan quality was high. Non-performing loans and charge-offs were historically low, and the ratio of loan-loss provisions to non-performing loans was at a record high.

It is difficult to predict when greater stability will return to bank's deposit positions and to the preferred market, and we cannot rule out additional bank failures. Banks likely will need to raise the interest rates they pay over coming months to retain deposits. That would reduce net interest margin (NIM) earned by banks, which expanded significantly in 2022 as interest rates on loans outpaced that on deposits with the Fed rapidly raising short-term rates. We expect higher deposit rates to be an earnings headwind in 2023—but not a threat to financial stability.

The table to the right shows the **Destra Flaherty & Crumrine Preferred and Income Fund's** (the "Fund") U.S. regional and community bank and non-U.S. AT1 CoCo exposures as of February 28, 2023, including issuer-level exposures on the four banks discussed here. The Fund owned CS, SIVB, and SBNY through acquisition or receivership, as applicable.

U.S. Regional & Community Bank and Non-U.S. AT1 CoCo Exposures

Issuer	Weighting
Silvergate Capital Corp	**0.0%**
Silicon Valley Bank	**0.5%**
Signature Bank NY	**0.4%**
Credit Suisse	**1.6%**
U.S. Regional Banks	**13.2%**
U.S. Community Banks	**4.0%**
Non-U.S. AT1 CoCos	**22.1%**

Data is as of 2/28/2023 and is subject to change on a daily basis.

Past performance is no guarantee of future results.

Not FDIC–Insured, Not Bank Guaranteed, May Lose Value

PREFERRED OUTCOMES

Flaherty & Crumrine Incorporated is the veteran, dedicated preferred securities manager. Independent, employee controlled adviser, founded in 1983, making them one of the oldest and most experienced firm specializing in the management of preferred securities.

The Destra Flaherty & Crumrine Preferred and Income Fund is a Fund that provides:

- **Access:** Connection to a broad universe of preferred security types to capitalize on the entire preferred market.
- **Experience:** Flaherty & Crumrine manages over $4.5 billion in preferred assets, with one of the most experienced and successful preferred teams in the industry.
- **Active Management:** Indexing in the preferred market is not enough. The Fund's sound security selection derived from a disciplined investment process has demonstrated its ability to generate superior performance in both good times and bad.
- **Yield:** The Fund may offer attractive yields with potential tax advantages versus other asset classes.
- **Diversification:** The Fund has proven to be an exceptional diversifier with low correlations to major stock, bond and alternative asset classes, and an attractive compliment to almost any portfolio.

Destra Capital Investments

443 N. Willson Avenue
Bozeman, MT 59715

877.855.3434

www.destracapital.com

member FINRA/SIPC

DEST_INV-COM-F&C BANKS MAR 2023