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D+T Perspective

Failure of Silicon Valley Bank (SVB)

March 2023

Summary

- Last week, liquidity concerns around Silicon Valley Bank ("SVB") drove the stock price of its parent company, SVB Financial Group, down 60% on Thursday.
- On Friday, the FDIC shut down SVB, taking control and moving all assets to a newly created bank, Deposit Insurance National Bank of Santa Clara.
- Weakness spread to the overall financial sector, down 8.5% for the week, as well as the broader markets, with the S&P 500 down 4.5% for the week.
- Yesterday, the FDIC took control of a second bank (Signature Bank) and announced emergency measures to ease depositors' fears, including guaranteeing all deposits of both banks.

Banking Business Model

- At a high level, banks borrow money from depositors (the bank's liabilities) and invest these monies in a combination of loans and securities (e.g. loans to businesses, individuals, and purchases of Treasuries, Agency Mortgage Backed Securities, etc.). These loans and securities make up the bank's assets.
- Banks in the United States are required to carry FDIC insurance. This insurances guarantees deposits up to $250k per depositor per institution. Amounts in excess of $250k are uninsured and are therefore subject to loss in the event of bank failure.

Who is SVB?

- As of 12/31/22, SVB was the 16th largest commercial bank by asset size.
- Based in Santa Clara, California, the bank primarily served technology focused startups and venture capital firms.
- As of 12/31/22, 89% of SVB's liabilities were deposits.

What happened?

- During the pandemic, venture capital firms and tech startups were flush with cash, which led to SVB's assets almost doubling by 2021, and quadrupling since 2018. SVB invested most of their deposits in Treasuries and other government debt securities, whose value declined as interest rates have risen.
- As rates have risen, a combination of other factors led to SVB having less than forecasted deposits/reserves, forcing them to raise additional capital via security sales within their investment portfolio. To name a few of these factors:
    - Across the financial sector, some depositors have pulled money out of traditional banks, seeking higher returns in alternative options – money market funds, CD's, and ultra-short bond funds.
    - As the tech sector has been battered, the bank's traditional clients have gone from having excess cash (SVB deposits) to burning through cash for internal needs (SVB withdrawals).
    - Some venture capital firms advised startups to pull their money out of SVB, citing liquidity concerns.
- Initially, the bank attempted to increase their liquidity position by issuing $2.25 billion in common and preferred stock. By Friday, it was clear there was no market for these securities, and the FDIC was forced to step in to prevent further losses and broader market implications.

Is there risk of contagion?

- SVB and Signature Bank are unique cases. For both banks, deposits were a large portion of their liabilities, and their client base was concentrated among startups, venture capital firms, and cryptocurrency issuers.
- While rising rates have led to losses for securities held on bank balance sheets, many large banks have stickier deposits (a higher percentage of retail clients), are well capitalized, and have ample liquidity to meet withdrawals.
- In addition to guaranteeing deposits (both insured and uninsured) of SVB and Signature, the Federal Reserve announced the Bank Term Funding Program on Sunday. This program will allow a bank to swap safe assets (Treasuries or Agency MBS) with the Fed for cash for up to one year. In doing so, regulators provided a meaningful backstop against further liquidity concerns.
- While the Bank Term Funding Program will ease concerns liquidity concerns for mid-size banks, we expect banks with under $250 billion in assets to see increased regulation in the future.

Market Reaction

- While the Financial Sector, especially Regional Banks, has been hit hard, the Fed's response over the weekend has helped quell broader concerns at the moment, with the S&P 500 flat for the day (as of this writing)
- In Fixed Income, the concerns of broader weakness across the bank sector and economy has led to a flight to quality, with the 10-Year Treasury Yield dropping from 4% on Thursday to 3.46% on Monday. This negative stock-bond correlation highlights the role of high quality Fixed Income in a diversified portfolio.
- We continue to advocate for diversification and encourage long-term investors to stick to plan. As we've noted in prior commentary, equity markets tend to bottom prior to the economic data, and 2022's performance has set the table for higher future returns, albeit with higher volatility and uncertainty.

Is cash as part of my portfolio safe from an event similar to SVB?

- Much of the focus over the weekend was on depositors at SVB. SVB was unique because 86% of their deposits were in excess of the insured limit ($250k provided by the FDIC).
- We have been in touch with our custodian partners today and over the weekend. While confident in their financial position and available sources of liquidity, out an abundance of caution, we have completed a review of cash balances across **all client portfolios** to ensure deposit balances fall below the FDIC's $250k limit (per custodian).

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