Silicon Valley Bank Collapses

March 2023

The collapse of **Silicon Valley Bank** ("SVB"), along with another niche lender, Signature Bank, have caused headline news, along with a bout of volatility throughout equity and bond markets.

Specifically, there has been a notable and sharp sell off in many regional U.S. Banks, while at the same time the broader bond market witnessed an increase in value, as investors sought the relative safety of bonds and yields, and yield expectations therefore declined.

What is SVB and what happened?

Quite unsurprising given its name, SVB was a specialized bank mainly focused on the technology sector and, in particular, venture capital ("VC"), tech start-up and biotech firms; doing business with approximately 50% of all U.S. venture-backed technology and life-sciences companies. It was the 16th largest bank in the U.S. with approximately $200 billion in assets.

As these companies drew record amounts of investment capital in 2020 and 2021, SVB's deposits also grew dramatically, which SVB could not lend out to traditional sources such as commercial loans and mortgages. Instead, SVB invested in assets, such as long-term U.S. Treasuries, to maximize returns – while paying a floating rate on its deposits. This created a troubling mismatch in the exposure of their liabilities and assets.

Given the rapid rise in interest rates over the last year, the previously high-flying tech sector was amongst the hardest hit; funds dried up, and those companies started to withdraw deposits to meet their cash needs. As a result, SVB was forced to sell its longer duration assets at significant losses (when interest rates rise, bond prices generally decline; the greater the duration, the greater the impact) to fund these withdrawals.

On March 8, the parent of SVB, SVB Financial Group, announced it had sold $21 billion in securities resulting in a $1.8 billion loss and that they would raise an additional $2.25 billion of equity capital to secure their balance sheet. This created panic in the tight knit communities in which its customers participate, resulting in over $40 billion in withdrawals on March 9 alone. On March 10, the Federal Deposit Insurance Corporation ("FDIC") took control of the bank.

Uniqueness

Both the deposit base and the investment portfolio of SVB appear relatively unique in terms of the American banking sector. Additionally, given the nature of its customers, about 95% of SVB's deposit balances were not covered by the FDIC (which covers deposits of up to $250,000), further fueling SVB's issues. Finally, given SVB was below a certain size, it was not subject to some of the U.S. Federal Reserve's stricter liquidity requirements which govern larger banks, allowing it to operate in a more unconstrained manner.

The Response

On March 12, policy makers announced that all depositors at both SVB and Signature Bank would not lose money, even on deposits in excess of $250,000. The Fed and the Treasury also ensured that depositors would be able to continue to withdraw money from their accounts.

The Fed also created a new lending facility for banks, not forcing bonds to be sold at a loss in order to meet liquidity needs, greatly reducing systemic risk.

What May Come Next?

While it is likely the banking sector will remain volatile in the near term, with the potential for some additional firms to announce they are also under stress, the actions announced by policymakers should help to reduce the risk of another "run on the bank." The challenges at SVB were relatively unique, and a perfect storm of factors led to its swift collapse.

Secondary risks include a continued ripple through the economic system, leading to more cautious lending and a resulting slowdown in spending and growth. While such a slowdown is potentially negative to the growth outlook broadly, this may also influence inflation expectations and thus result in less hawkishness from the Fed (and other central banks). This may ultimately result in fewer interest rate increases than the market had otherwise expected.

There could also be regulatory changes, which could include changes to liquidity requirements, and could create some additional uncertainly for banks.

Finally, there is also the possibility that despite strong policy action to stabilize the sector, and notwithstanding any new regulatory initiatives; depositors could remain weary and move money out of smaller banks in favour of larger banks.

Conclusion

While the swiftness of the SVB's collapse was unsettling, it is not that unique in the history of the American banking system. With hundreds of banks in operation, and some focused narrowly on certain sectors or geographies, it is bound to happen, especially as monetary policy is being tightened.

At this juncture, it appears that the collapse of SVB and Signature Bank is more about their specific exposures and internal risk management practices, rather than broader systemic issues that were experienced through the 2008 great financial crisis.

The responses announced by the FDIC, the Fed and Treasury should help provide some measure of stability and containment.

Please contact your BMO financial professional if you any questions or would like to discuss your investments.

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ID7869 (03/23)