Silicon Valley Bank: The collapse of the "Startups' Bank"

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Overview

On the 10th of March 2023, the banking regulators of California shut down Silicon Valley Bank ("SVB") and appointed the Federal Deposit Insurance Corporation (FDIC) as the receiver for the later disposition of its assets.

SVB was the prominent banking partner of major players in the innovation economy, catering to clients operating in the technology industry including startups, venture capitals and employees of tech firms.

SVB's failure marks the most substantial collapse of a financial institution since the 2008 financial crisis. Being the 16th largest bank in the United States with total assets just shy of $210 billion, this event had significant ramifications, causing considerable disturbance in the global markets, and resulting in the stranding of billions of dollars in funds belonging to customers, companies, and investors.

What is the background of SVB?

SVB was founded in 1983 in California and was a fond supporter of the tech industry as it provided banking facilities to almost half of all venture-backed startups in the United States by 2022. Apart from startups, SVB had significant deposits from crypto companies and platforms including Circle and BlockFi.

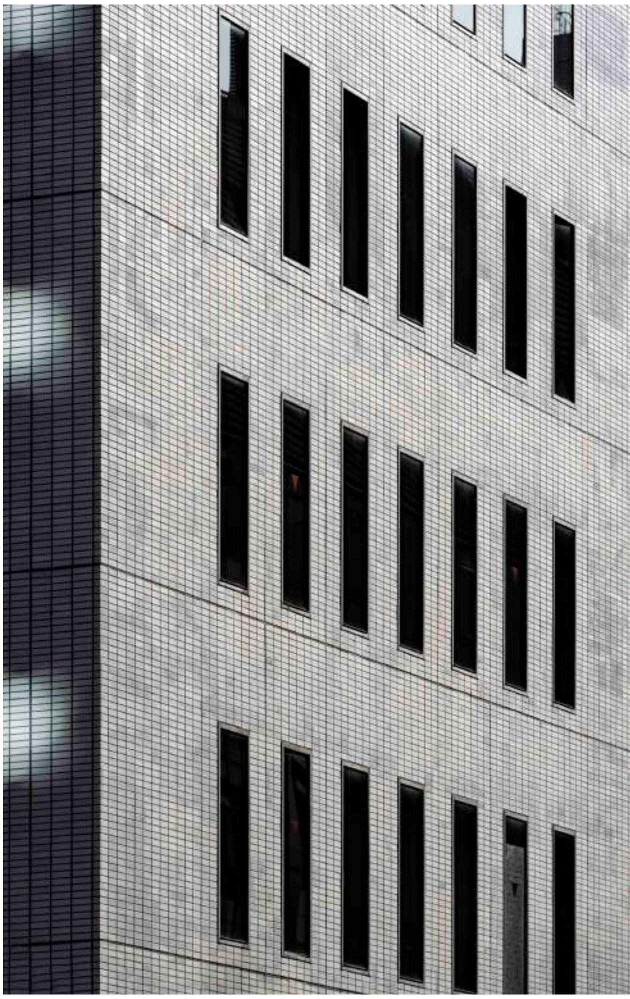
What went wrong?

As is the case with hundreds of banks around the world, SVB invested in billions of dollars' worth of bonds, with funds mainly deriving from customer deposits accumulating over the years. Following the financial crisis of 2008, interest rates in the United States were significantly low. Simultaneously with the hike in the interest rates by the US Federal Reserve aiming to combat inflation, start-ups' funding was reduced and investments in private equity and venture capital were reduced, leading many startups to use their own bank balances and savings. All these consequently marked an important drop in the deposits at SVB.

Two days prior to its collapse, SVB sold north of $21 billion in held securities at a loss of $1.8 billion in an attempt to increase its liquidity. Additionally, in order to reach the desired liquidity to meet clients' withdrawal needs and fund new lending, the bank was in discussions to sell more than $2 billion of its own shares.

The news broke out quickly which caused SVB stock price to plunge. This consequently triggered various VC's to swiftly withdraw massive amount of funds from their accounts at SVB, while also advising their portfolio companies to do the same. This was followed by a bank run from depositors attempting to withdraw more than $42 billion from the bank.

With effectively no liquidity to meet this demand, the regulators of California intervened to shut down SVB.



Will there be a domino effect?
This incident is expected to have an impact particularly on the banks associated with Silicon Valley. As it was witnessed, customers spooked by the collapse of SVB withdrew billions of dollars in deposits from Signature Bank which led regulators to take it over to protect both depositors and the financial system in general.

However, we remain optimistic that the effects will not escalate to the level of the global financial crisis that occurred over a decade ago. Various measures have already been implemented to address this problem and avoid contagion to the international financial system, including HSBC's acquisition of SVB's UK division.

What's next?
Even if the contagion effects of SVB's and Signature Bank's failure can be contained, this serves as a reminder of the importance of the effective risk management and prudent investment strategies in the financial industry by banks themselves. Regulators on the other hand, should work on strengthening the financial regulatory framework to avoid similar incidents in the future. The pace at which financial stability and depositors' confidence will be regained, remains to be seen.

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