

# Silicon Valley Bank: What does its failure mean for markets and the economy?

By [Andre Reichel](#)

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Silicon Valley Bank (SVB) failed on Friday, 10 March, sending markets into a tailspin and putting the banking sector on edge, with the share prices of regional US banks falling particularly sharply. But what exactly happened?



Source: Wikipedia.

The California-based bank's client base was skewed towards technology start-ups, which - being flush with funding in 2020 and 2021 - had made significant deposits.

SVB invested a large proportion of these deposits into Treasury notes and other quasi sovereign securities. As the US Federal Reserve (Fed) raised interest rates sharply, the value of these securities fell. At the same time, higher interest rates also caused funding for start-ups to start drying up, and these companies began to withdraw deposits from SVB.

As a relatively small regional bank, SVB was subject to lower capital and liquidity standards than larger systemically important banks. It did not have hedges in place to manage the risk inherent in hiked interest rates.

To meet client demand for funds, SVB sold \$21bn of securities on 8 March, incurring a \$1.8bn loss. This news spread rapidly and caused other clients to try to withdraw their deposits from SVB, leading to a run on the bank.

The US Treasury and Fed announced on 12 March that the Federal Deposit Insurance Corporation would provide emergency funding to protect SVB's depositors, and those of troubled Signature Bank. In the UK. To this end, the Treasury announced the sale of SVB's UK arm to HSBC for a symbolic £1.

## How healthy is the banking sector?

This swift action by the authorities means that depositors won't lose out. However, it raises broader questions about the health of the banking sector, the consequences for start-ups, and the likely path of US interest rates.

The question remains, however, why was the risk of SVB's failure not spotted sooner? A law passed in 2018 rolled back regulations on small and mid-sized US banks. Greater regulatory scrutiny could potentially have headed off some of the risks before it became a crisis.

Another contributing factor was the rapid growth of SVB.

“ *NEW COVER: How Silicon Valley Bank, a regional bank for a specific industry, became a case study of everything that can suddenly go very wrong in the financial system* <https://t.co/WOHhnGX3wk> [pic.twitter.com/P3GpOwGQeH](https://pic.twitter.com/P3GpOwGQeH)— Businessweek (@BW) [March 16, 2023](#) ”

There are understandably questions over why SVB's own management, as well as regulators, didn't spot the potential risks around the business.

One answer is SVB's rapid growth. Three years ago, SVB was a relatively small bank. Its balance sheet tripled very quickly as a result of the money flowing into the tech and venture-capital sectors during the pandemic. But the mindset of management didn't keep up with the fact that the bank had become a very different, much larger business in a short space of time.

## Is the crisis now contained?

Given the lack of regulatory scrutiny of smaller US banks, there are concerns that other banks could yet face similar problems to SVB. David Knutson, Schroders Capital's head of fixed income product management, says, “The question remains whether any other US banks are at risk. Some smaller community banks with concentrated deposit franchises may be vulnerable.

“We are looking carefully at the impact that quantitative tightening – that is the Fed's unwinding of its bond-buying programme - along with the rapid rise in rates is having on deposit flows through the system. We feel very comfortable with the liquidity at the largest US banks. We continue to monitor the situation, particularly in terms of the availability and demand for credit.”

“ *Interest rates do two things: they go up and they go down. Executives at Silicon Valley Bank forgot this finance fundamental because they were too focused on their bottom line. SVB's collapse is just one more example of why capitalism needs guardrails to work.* [pic.twitter.com/7500Jg8Q2T](https://pic.twitter.com/7500Jg8Q2T)— Katie Porter (@katieporteroc) [March 16, 2023](#) ”

The facility put in place by the US authorities has been designed to shore up the banking system, as well as protecting depositors at SVB. It's too soon to say if the crisis is over. Some banks may still be vulnerable but, importantly, a backstop is now in place. Even if another smaller bank fails, the wider system is protected.

What we will see is that some of these smaller banks will rearrange their business models to reduce the risk of a similar situation unfolding.

## What's the impact on European and Asian banks?

The news of SVB's collapse came late on Friday, missing European trading hours. European bank shares saw sharp falls when markets reopened on 13 March.

Justin Bisseker, European Banks analyst, says, "The share-price decline of European banks on Monday – after a tidy resolution to the situation over the weekend - speaks to the degree of nervousness in markets.

"It's true that US regulation may need to tighten, which could impact banks' profits and shareholder returns. However, that's an issue for US regional and smaller banks, not for Europe. European and UK banks are much more tightly regulated now than they were before the global financial crisis.

"Any calls for lighter touch UK regulation should now cease, but neither the Bank of England nor the banks themselves were pushing for this anyway."

“ *Fears of a recession are growing on Wall Street, as stress in the banking sector following the collapse of Silicon Valley Bank and worries over the fate of Credit Suisse darken the outlook for the economy and markets*  
<https://t.co/1k6jX7HvOc>— Reuters (@Reuters) [March 16, 2023](#) ”

For Asian banks too, the direct impact is minimal given differences in regulation and business models. Asian banks are well-regulated and subject to strict liquidity and funding requirements. Asian banks also have fairly traditional business models where the loan book is much larger than the investment book, some of which had already been reflected in their capital.

As a result, higher net interest income from the higher interest-rate environment could more than absorb mark-to-market losses on the investment book.

## Where will start-ups deposit their money now?

The reason so many start-ups banked with SVB was because it gave them access to a wider range of business services than many larger banks would typically allow to such small companies.

There is a question mark over what start-ups will do with their deposits now. There are signs that some fintechs saw a pick-up in volumes recently as a result of the turmoil at SVB.

Tim Creed, head of private equity investments at Schroders Capital, says, "It has been widely reported that a number of companies transferred capital from SVB to digitally-enabled fintechs like Revolut during last week's uncertainty. The speed of the transfers demonstrates how efficient tech-enabled companies with great user interfaces are at opening new accounts, as they are able to operate 24/7."

“ *Good Morning Patriots!!!*

💎💎 *At first Janet Yellen said NO bailout for Silicon Valley Bank.*

💎💎 *But hours later, protecting his rich donors, Joe redefined the term "Bailout" to "Backstop", saying Feds will step in.*

💎💎 *That, of course, made Oprah happy.....but*

*at taxpayer expense. 💎💎💎💎 [pic.twitter.com/nhjyV86x6](https://pic.twitter.com/nhjyV86x6)— John D (@jtd\_gameon12) [March 16, 2023](#) ”*

Looking ahead though, start-ups may now prefer to seek out the security offered by traditional lenders. Bisseker said: "SVB's failure may well mean that depositors prioritise safety over other factors when choosing a bank.

This would tend to be an advantage for the larger lenders. And at the same time, reduced competition for deposits could

mean that banks feel less obliged to pass on rising base rates in full to their deposit holders, benefiting the banks' profitability."

Fintechs, cryptocurrencies and other forms of decentralised finance could be longer-term beneficiaries if SVB's failure sparks further financial innovation. Thousands of people in Silicon Valley suffered through a very nervous weekend. At least some of them will be motivated to think even harder about how to replace traditional banks with fintech alternatives.

## ABOUT THE AUTHOR

Andre Reichel is the global sector specialist in financials at Schroders Capital.

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