You may have seen the headlines on SVB (Silicon Valley Bank) in the past few days. Here is a quick summary of what had happened, which is essentially a risk management failure in SVB's funding and investment management to withstand macro events.

The below provides an overview of what we are aware of thus far.

Background of Silicon Valley Bank (SVB)

SVB is a 40-year-old bank, based in California and almost exclusively focused on lending to technology companies and startups. The vast majority of SVB's 40,000 customers were technology companies.

It is large and publicly listed. Due to its size, not only is it focused on the technology sector; much of the technology ecosystem (startups, VC funds, etc.) have exposure to SVB. Example: approximately 50% of US public last year had a relationship with SVB. Some companies have SVB as their single banking relationship.

As their customers are primarily tech companies and startups, many of which had raised multimillion-dollar funding rounds, their cash balances are much higher than regular consumer investors. Looking at end 2022, SVB had >USD 200bn in assets. Of their customer assets (which are SVB liabilities), the vast majority, >95%, had greater than USD 250k on deposit with SVB.

While the Federal Deposit Insurance Corporation (FDIC) guarantees deposits of USD 250k and below on accounts, the vast majority of SVB accountholders have deposits in excess of USD 250k.

With all these deposit monies over the past few years, SVB chose to invest in long- to very long-maturity US government and other securities for greater yield. They chose securities with higher yields assuming that they would "Hold to Maturity" (HTM). As interest rates had steadily risen in 2022 and macro events challenged risk appetite, the current value of these very long maturity bonds have dropped. <u>While these generally include higher-quality securities at maturity – it is a long time to maturity.</u> The mark-to-market losses on this book approx. the USD 15bn range – which also gets very close to the equity of shareholders of SVB itself. This puts the bank at major risk of insolvency.

To be clear, a bank that is profitable can remain operational even as its position moves closer to insolvency – the operations contribute to the bank's financial position and it can work its way out of a hole. But that only applies if depositors and stakeholders still have confidence in the bank.

Crumbling Confidence

Last week, the SVB group sold about USD 21bn of their assets to shore up liquidity, which meant it had to realize a loss on those securities, c. USD 2bn. The bank also engaged Goldman Sachs to raise money via some preferred securities (c. USD 2bn). This triggered a Moody's downgrade, and well-known investors (ex. Peter Thiel) and other VCs began advising clients to withdraw deposit money from SVB, causing a bank run.

Late Last Week and the Weekend

After USD 42bn in withdrawals received over a 24-hour period, Federal Regulators were appointed to take over the bank. Parent SVB Financial's price-to-book value had crashed from 2.4 times a year ago to 0.5 before regulators stepped in.

Shares of SVB were halted on the stock exchange. The US 10-year and other bonds received more interest from investors as a safe haven to park monies.

Late Saturday US time, the US Federal Reserve announced that all investors can access their deposits. This includes insured (<USD 250k) and uninsured deposits (>USD 250k). Despite the issues related to the loss of confidence in SVB, the Fed has moved quickly to look to contain this issue and not have it spread to other regional banks in the US.

As mentioned above, SVB was "aggressive" in the way it invested their monies – often long dated securities, possibly to be held to maturity in order to maximize yield.

It is noteworthy in reviewing other US regional banks that are more traditional in nature (non-tech startup focused), First Republic Bank, East West Bank (US), PacWest Bank, that their longer-term debt investments are a much smaller fraction vs. their deposit base – thus, they are nowhere close to being in the same position as SVB was in terms of losses on their investments vs. deposits and any demand for deposits.

What Happens Next

At this stage, and especially after the Fed announcement that all depositors will have access to their deposits, it is not expected that this will lead to a systematic banking loss of confidence. Though it bears watching to review the institutions that one has banking exposure towards, as well as investments and their exposures.

As for Silicon Valley Bank itself, a buyer may appear. While the US government itself has ruled out taking over SVB, its role servicing the tech sector is valuable. Despite the downturn, tech remains more highly valued on a forward p/e basis than any other sector in the S&P 500.

There are likely furious discussions on which some of the larger banks may take parts of the SVB business. Possible candidates may possibly include JP Morgan, Citibank, Bank of America, etc.

This is a fluid situation, and more updates are sure to come. This information has included information from the financial media and is offered on an "educational and informational purpose only" basis to keep you informed.

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