SVB on the Run

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One might be forgiven for thinking that runs on a bank, and banking failures, are a thing of the Great Depression, not something you encounter in modern times. One would be wrong, thanks to the highly publicized failure of a once-obscure institution called Silicon Valley Bank, which collapsed on Friday and was taken over by federal regulators in order to protect the assets of its depositors. It was the largest failure of a U.S. bank since the 2008 economic crisis.

Is there a reason to be alarmed? Probably not. Silicon Valley Bank (SVB to insiders) was kind of unique in the banking industry. Unlike most banks that loan money to local residents, small businesses, and corporations, SVB lent to a very exclusive group of companies: tech startups and venture-backed healthcare companies. Over its 40-year existence, the bank grew with the tech industry, eventually, right before the collapse, becoming one of America's 20 largest lending institutions, with $209 billion in total assets at the end of last year.

Unfortunately, in addition to its loan portfolio, SVB also decided to speculate roughly $21 billion of its assets in long-term bonds which, as most of us know, were not paying very high-interest rates—an average of 1.79%. When interest rates doubled and then rose again, those bonds became much less valuable at exactly the wrong time: when venture capital firms were experiencing their own shortfalls and were drawing down the funds they held at SVB. The bank announced that it had sold a big part of its bond portfolio at a loss, and also, at the same time, proposed to sell $2.25 billion in new shares of the bank in order to cover those losses.

On this news, some of the venture capital firms decided that it would be safer to move their assets out of SVB, which triggered a disastrous run on the bank. The bank's share price went into a free fall, losing 80% of its value in a couple of wild trading days, and California regulators decided they'd seen enough. On Friday, they moved in to shut the bank down and place it into receivership.

The Federal Deposit Insurance Corporation guarantees any deposits up to $250,000, which means that most (if not all) of the ordinary people who banked with SVB will be made whole—by Monday, in fact. But some of the Silicon Valley companies may not be so lucky. Roku has filed reports saying that it had around $487 million parked at SVB, representing about 26% of its cash holdings. Gaming company Roblox may have been parking as much as $150 million at the bank. Rocket Lab USA reported at least $38 million of its assets were there as well. Those companies, and others, are going to have to wait to see if a buyer steps in and takes over SVB—which is likely, given that the bank has relationships with a coveted clientele. The alternative is a bankruptcy process that would probably return pennies on the dollar.

The news of an impending takeover sent a wave of anxiety into the markets as investors wondered whether this might be a sign of widespread weakness in the banking industry. The stocks of smaller and regional banks took a brief and probably short-term tumble in their share prices. However, the uniqueness of SVB, and its customer base, suggests that this is an isolated event. Nevertheless, we are likely to hear about a small number of other banks that might have overextended themselves with similar (unwise) investments in long-term loans paying low interest, who were blindsided by the speed of rising rates.

As you read this, analysts are also looking at whether any of the banks they cover might have put depositor money into cryptocurrencies—whose trading markets went into a still-unexplained turmoil on the SVB news. Also looking into the whole mess is Treasury Secretary Janet Yellen, who convened a meeting of regulators in order to carefully probe the soundness of the banking system. The most likely outcome is that the SVB mess is a healthy new examination of risks and exposures, which will give the regulators time to sort out hidden risks before they lead to more collapses.

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