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The Rise and Fall of Silicon Valley Bank: Implications for Financial Regulation

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In the fast-paced world of Silicon Valley, where entrepreneurship and innovation meet finance, the downfall of Silicon Valley Bank (SVB) in March 2023 sent shockwaves throughout the technology and banking industries. The downfall of SVB, once heralded as the pioneer in financing tech start-ups and ventures, highlights broader glaring issues within the financial sector and underscores the need for regulatory reforms to safeguard against future crises.

Rise of SVB

SVB Financial Group (SIVBQ), a lender with a focus on start-ups, became the largest bank to collapse since the 2008 global financial crisis. Its sudden failure stunned global markets, leaving billions of dollars of investors' money stranded. Founded in 1983, SVB was the 16th largest bank in the US by end-2022. SVB provided business banking services for companies, especially venture-backed fintech and healthcare start-up companies. Established nearly four decades ago, the bank evolved into the single most crucial financial institution for the emerging tech scene, serving c.50% of all venture-backed companies in the US and 44% of the venture-backed healthcare and technology firms that went public in 2022. The COVID-19 pandemic witnessed a steep increase in the number of clients for SVB, as several venture-backed start-ups thronged the markets, driving SVB's stock price to an all-time high.

The unravelling

Even though many might attribute SVB's failure to global headwinds in the financial markets, consensus indicates that the collapse may have been an unforced, self-inflicted error. Beneath the surface of rapid expansion and high-profile clientele, cracks began to appear. Mismanagement, risky lending practices and overexposure to volatile technology markets led to SVB's downfall. As the bank collapsed under its own weight, questions started arising concerning regulatory oversight and the broader implications for financial stability.

Subsequent events (Aftermath)

SVB buyout

- First Citizen Bank purchased the majority of SVB's deposits and loans; it acquired total assets worth c.USD110bn, loans of c.USD72bn and deposits of c.USD56bn.
- First Citizen Bank acquired all SVB's assets, except for securities and other assets worth USD90bn, which were retained in the Federal Deposit Insurance Corporation (FDIC) receivership.
- The UK arm of SVB, Silicon Valley Bank UK Limited, was acquired by HSBC UK Bank plc for GBP1bn. Fair value of assets acquired was USD11.4bn, while the fair value of liabilities acquired stood at USD9.8bn.

Impact on customers and investors

- With the bank now defunct, regulators announced a maximum relief to each account category per bank per depositor of USD250,000 through the encashment of the insurance value of the bank deposits by the FDIC. However, later the Federal Reserve (Fed) invoked a systemic risk exception, and even the uninsured depositors were compensated.
- Adding to investors' woes, the FDIC could only protect depositors, leaving shareholders and unsecured debt holders trapped.

Impact on the bond market

- After the bank run of SVB, bond funds encountered continual net cash outflows spanning almost three weeks, affecting the entire sector uniformly.
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In response to the crisis, authorities promptly introduced the Bank Term Funding Program (BTFP), which aimed to prevent additional deposit bank runs. BTFP offers an additional liquidity source to depository institutions against high-quality securities (such as US Treasuries, US agency mortgage-backed securities and US agency securities), which assures that all depositors' needs can be fulfilled by banks and they need not sell those securities in times of stress.

Impact on global markets

- In the aftermath of SVB's collapse, investors worldwide have slashed their holdings in FIs, spanning markets worldwide, resulting in a collective market value loss of USD465bn in the MSCI EM Financials Index and the MSCI World Financials Index.

- US regional banks had a major hit, as the KBW Regional Banking Index (KRX) dropped 7.7%. The regional bank indices are still down 12% on the year, but they climbed up to the SVB's collapse level in December 2023.

- Major banks in Northern Asia had minimal risk of a large-scale deposit withdrawal that caused the downfall of SVB, given these banks' robust deposits, diversified asset portfolios and strong liquidity.

Regulatory response

In the wake of SVB's collapse, regulators swiftly moved to address systemic vulnerabilities to prevent future disasters. Key regulatory changes instituted include the following:

- **Enhanced risk management:** Regulators imposed stricter guidelines on risk assessment and management practices, particularly for banks with high exposure to specialised industries, including fintech and health.

- **Increased capital requirements:** To bolster financial resilience, regulators had a relook at the Basel III guidelines and prompted regulators to adopt overly stringent capital measures. US bank regulators have introduced sweeping proposals to increase capital requirements for the largest banks by c.16%, equating to c.USD200bn. The proposed changes to implement the final components of the Basel III agreement (Basel III endgame) have a target date of applicability of 1 July 2025.

- **Fed and FDIC oversight:** The FDIC will likely review and potentially adjust deposit insurance coverage limits to reassure depositors and maintain confidence in the banking system.

- **Strengthened oversight:** Regulatory bodies have ramped up oversight and supervision of banks operating in high-risk sectors, conducting more frequent audits and stress testing.

- **Bank Term Funding Program (BTFP):** BTFP functioned as a last-resort lender, established in March 2023 after the collapse of SVB. It aimed to assist banks with significant unrealised losses on government bonds, coupled with the risk of massive withdrawal of deposits. Under this programme, banks could avail funding against high-quality securities (such as US Treasuries, mortgage-backed securities and agency debt) at their face value. These loans were offered for up to one year, carrying an interest rate of a one-year overnight index swap rate +10bps. However, BTFP was a temporary support to banks and ceased extending new loans on 11 March 2024.

- **Swap lines:** Overseas banks often engage in borrowing and lending in US dollars. During financial stress, these overseas banks may encounter challenges in meeting the demand for the US dollar. Foreign central banks can print only their respective currencies (yen, euros, British pounds, Swiss francs) to support their regional banks; they cannot print US dollars. In response to the global financial crisis, the Fed initiated a series of agreements with overseas banks, facilitating currency swaps where the Fed exchanged US dollars for foreign currencies. Until March 2023, these swaps were conducted weekly. However, the Fed announced plans of transition to daily swaps, at least until the end of April 2023, aiming to enhance the effectiveness of swap lines.

The collapse of SVB reverberated across the financial landscape, affecting not only Silicon Valley but the broader banking sector as well. Regional banks faced heightened scrutiny, and investors became more risk-averse, reshaping the dynamics of tech financing.

The calm after the storm (SVB, now a unit of First Citizen Bank)

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After the collapse (April to December 2023), SVB's tech and healthcare banking team disbursed **over 500 new loans, valued at over USD3bn.**

- Roughly **81%**of pre-collapsed clients continued with the bank.

- The bank has seen thousands of clients coming back who had left the bank. Additionally, SVB onboarded hundreds of new clients.

- Around **80%** of bankers and relationship advisors stayed with the bank.

- Since May 2023, the bank has hired c.200 employees, adding to its over 1,500 employees.

The road ahead

As the dust settles, the lessons learned from the collapse of SVB serve as a cautionary tale. While innovation remains the lifeblood of Silicon Valley, financial institutions must navigate turbulent waters responsibly. Regulatory reforms aim to strike a balance between fostering creativity and ensuring financial stability, setting the stage for a more resilient and sustainable banking ecosystem. Regulatory frameworks must adapt to mitigate risks and safeguard against future disruptions. The legacy of SVB serves as a catalyst for change, promoting a re-evaluation of banking norms and regulatory practices in pursuit of a more stable financial system.

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