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Silicon Valley Bank: A Timeline and Summary of Events

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On Friday, March 10, the Federal Deposit Insurance Corporation (FDIC) shuttered Silicon Valley Bank (SVB) and seized its deposits in the second-largest bank collapse in U.S. history. In this alert, we've mapped out the events and decisions leading up to this past week's collapse, and what we can expect to see in the coming days.

What Happened: Macro Banking Conditions

- From 2020 into 2022, U.S. banks saw their deposits grow, due to a variety of factors, including:
  - Paycheck Protection Program loans
  - Government stimulus checks
  - Low interest rate environment
  - Favorable equity markets for companies:
    - Historically high valuation multiples
    - High levels of liquidity among investors
    - Favorable IPO/SPAC market conditions
- Banks invested these deposits in "safe" government-backed securities while maintaining their regulatory capital requirement.
  - Banks were reaching for a higher yield in a low interest rate environment, and with the resulting increase in earnings per share (EPS), they migrated their government securities portfolios toward higher-yielding government or government-backed securities, which generally correlate with longer-dated maturities.
  - The long-term maturities of government-backed securities misaligned with the short-term liabilities of deposits.[1]
- The Federal Reserve commenced steep interest rate hikes in Q2 2022. Bond yield moved inversely to interest rates, and government securities and government-backed securities with long-dated maturities declined in fair market value (FMV).[2]
- Accounting rules allow banks to use the book value of certain securities rather than mark-to-market (even if these securities were classified as available for sale). Upon the sale of such securities, the book value changes to the sale price or proceeds amount, effectively marking the prior security to market or FMV.[3]
- The financial press is reporting that the FDIC stated in congressional testimony in December 2022 that at the end of 2019 the gap between book value and FMV at financial institutions was $8 billion in the aggregate. The FDIC is reported to have indicated that as of 2022, such gap was $620 billion.[4] Given there have been two interest rate rises in 2023, the gap is likely to have increased.

What Happened: Silicon Valley Bank

- SVB's business model was to make loans to startup companies and require such companies to sign documentation pledging all of their assets as collateral to SVB. In addition, such documentation required borrowers to maintain all of their accounts and excess cash with SVB.

- A successful startup typically raises multiples more in equity financing than debt financing. As a startup receives and deposits the proceeds of its equity raise with SVB, SVB takes these deposits and lends a fraction of the monies out to the startup and other borrowers.

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[1] https://www.fidelity.com/learning-center/personal-finance/silicon-valley-bank-collapse
[2] https://www.fidelity.com/learning-center/personal-finance/silicon-valley-bank-collapse
[3] https://www.wsj.com/articles/silicon-valley-bank-svb-financial-what-is-happening-299e9b65?mod=series_bankmeltdown
[4] https://www.fdic.gov/news/speeches/2023/spmar0623.html

- The startup considers the equity capital plus the loan proceeds to be its runway. As its runway decreases, the startup typically does another equity raise, thereby replenishing its deposit on hand at SVB.

- In Q3 2022, equity capital raising for startups became more difficult and decreased in amount and frequency. However, startup burn rates did not decrease in a compensatory manner. Deposits on hand at SVB began to decrease. Such decrease accelerated in Q4 2022 into January-February 2023.[5]

- SVB took steps to raise cash for deposit withdrawals.

    - SVB Financial Group pursued a capital raise.
    - Moody's notified SVB Financial Group that it was downgrading SVB Financial Group. Moody's typically notifies a company 24 hours before a downgrade.
    - On Wednesday, March 8, SVB Financial Group publicly announced its capital raise.[6]
    - On Wednesday, March 8, SVB sold approximately $21 billion in long-dated government securities, resulting in an accounting loss of approximately $1.8 billion.[7]
    - Moody's announced its downgrade of SVB the evening of March 8, after the market closed.[8]
    - Certain venture capitalists and other prominent/influencer/celebrity startup investors began to urge their portfolio companies, other affiliates and, through social media, their followers to withdraw their funds from SVB.[9]
    - On Thursday, March 9, customers of SVB attempted to withdraw $42 billion.[10]
    - On the morning of Friday, March 10, the California bank regulator shuttered SVB and assigned it to the FDIC as the receiver.[11]

Regulators Respond

- Sunday evening, March 12, 2023 at approximately 6:37 PM EST, a statement was released by Secretary of the Treasury Janet L. Yellen, Federal Reserve Board Chair Jerome H. Powell, and FDIC Chairman Martin J. Gruenberg informing Silicon Valley Bank and Signature Bank depositors and other customers that they would "have access to all of their money starting Monday, March 13." In addition, they stated, "No losses associated with the resolution of Silicon Valley Bank will be borne by the taxpayer."

What to Expect Next

- We expect there to be glitches in the execution of the joint Treasury, Federal Reserve and FDIC action. Misalignment of transaction volume and technology may produce intermittent outages or slow performance of critical systems.

- We expect it to take weeks and months for account holders at SVB, Signature Bank or any other bank of common concern to migrate their cash management system to other financial institutions, depending on the complexity of the current relationship. That migration will continue to drive capital flows in and out of various financial institutions. We hope this anticipated migration does not feed rumors that lead to a run on another financial institution.

- We expect a near term drop in the value of many bank stocks. While not giving financial advice, we mention this because it is reported in the press that many depositors viewed a significant drop in stock price as a reason to withdraw their monies from a bank. Given the various macro issues at play, that rationale should be appropriately scrutinized.

- We expect an uptick in cybercrime and other attempts at fraud. We caution our clients to be particularly vigilant.

- We expect increased regulation of mid-tier banks. This will increase the complexities and associated cost for such banks and their customers. Given mid-tier banks small business and community focus, we anticipate such efforts will be affected and transaction definitive documentation will become more complex.

- We expect enforcement action. The public will demand someone(s) held responsible. Some prominent entities or individual may be paraded through the town square. However, it is just as likely that mid-tier or previously unknow actors become the subject of regulators' and prosecutors' focus.

To see our prior alerts and other material related to the collapse of Silicon Valley Bank, please visit our resource page by clicking here.

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[5] https://www.wsj.com/articles/silicon-valley-bank-svb-financial-what-is-happening-299e9b65
[6] https://ir.svb.com/news-and-research/news/news-details/2023/SVB-Financial-Group-Announces-Proposed-Offerings-of-Common-Stock-and-Mandatory-Convertible-Preferred-Stock/default.aspx
[7] https://www.reuters.com/business/finance/what-caused-silicon-valley-banks-failure-2023-03-10/
[8] https://www.wsj.com/livecoverage/stock-market-news-today-03-09-2023/card/svb-stock-price-tumbles-after-share-offering-credit-downgrade-CbYmNK3ilf7s7KEciYqI
[9] https://www.cnbc.com/2023/03/10/silicon-valley-bank-collapse-how-it-happened.html
[10] https://www.cnbc.com/2023/03/10/silicon-valley-bank-collapse-how-it-happened.html
[11] https://www.reuters.com/business/finance/what-caused-silicon-valley-banks-failure-2023-03-10/

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