Why Did Silicon Valley Bank (SVB) Fail? And Its Impact On India?

Largest Bank Failure In The US Since The Global Financial Crisis 2008

The Silicon Valley Bank (SVB) failure in March 2023 had an enormous impact on the worldwide financial sector. The second-largest failure in American banking history was caused by its collapse. It was swiftly followed by the collapse of New York-based Signature Bank, a bank that had a significant presence in the bitcoin sector. The biggest failure of a financial institution occurred when Washington Mutual collapsed at the height of the financial crisis more than 10 years ago. There is no one explanation for why the $212 billion tech lender abruptly failed, causing the worst financial crisis since 2008. Was it the result of regulation rollbacks during the Trump administration, poor risk management by the bank, sudden interest rate increases following a decade of extremely cheap borrowing costs, or even a mix of all three, as some claim?

What Is Silicon Valley Bank?

Silicon Valley Bank (SVB), a regional bank in the US with its headquarters in Santa Clara, California, was regarded as the 16th largest bank in the US prior to the financial crisis. SVB, a bank founded in 1983, was seen as particularly trendsetting because it was one of the first banks to focus on start-ups and venture capitalists. 56% of its loans to VCs and PEs were secured by their limited partners as of December 2022. SVB Financial Group, which has operations in ten nations outside of the US, including India, owns SVB.

How Did Silicon Valley Bank (SVB) Fail?

Due to concerns over asset liability management (ALM) mismatch, which led to solvency troubles for the bank, the collapse of SVB is fairly unusual. The bank's deposits more than quadrupled to $198 billion between December 2019 and March 2022, above the industry average growth rate of 37%. Yet after Covid, there were very few opportunities to use the money. Deposits were therefore directed towards investments with two different types of instruments: those with a shorter period that are available for sale (AFS) and those with a longer duration that are held to maturity (HTM). By the end of 2022, SVB's cost of deposits increased to 1.19% compared to the industry payout of 0.04%. As a result, the bank decided to have a bigger share of HTM instruments compared to AFS, which is what banks all over the world, including India, are doing to manage yields and mark-to-market (MTM) losses. The SVB said in December that it intended to raise money by selling a portion of its AFS portfolio. While the former was successful and raised $21 billion, Silvergate Capital's notification of voluntary insolvency on March 9 prevented SVB from accessing the market, which led to the run on the bank, which was unavoidable.

Why Are Banks Prone To Failure?

Intermediaries include banks. They accept deposits, which serve as both their primary source of funding and primary obligation. These deposits are subsequently used by banks to make loans to borrowers and to invest in a variety of fixed-income instruments, including government bonds. The fact that demand deposits can be redeemed at request is the first area of vulnerability. In other words, depositors have the ability to instantly withdraw all of their funds from the bank. Time deposits can often be withdrawn right away, but doing so usually comes with a cost, such as missing out on interest payments. The second cause of risk is the lack of liquidity in bank assets like loans and securities. In other words, it is expensive to quickly convert them to cash. What transpires, though, if numerous depositors request money withdrawals at the same time? In order to cover withdrawals, the bank would therefore need to sell its holdings. The problem with having to sell securities is that their value might have decreased given that the bank bought them. Simply because interest rates have risen since then, this may have occurred. Fixed-income instruments' price declines in response to an increase in interest rates. This can imply that there aren't enough assets for the bank to cover its deposits. This is where shareholder capital steps in; by serving as a cushion, it helps to absorb the decline in the value of securities. What transpires, though, after this cash is depleted? The bank is currently insolvent.

Will SVB affect India?

SVB has stakes in Bluestone, Carwale, InMobi, and Loyalty Rewardz through its parent company. Thus, it cannot be ruled out that there will be a direct influence on the Indian start-up and/or new economy. Moreover, YCombinator, one of SVB's principal clients, has invested in over 19 start-ups in India. Thus, a second-order impact cannot be ruled out. The start-up industry was already feeling the effects of the financial winter, which might get worse.

What Happens Next To SVB?

Financial anxiety subsided when Wall Street came to First Republic's aid and supported the struggling mid-sized bank as its clients fled. But, the break might only last a short while. A recession is now expected to occur in the coming year to a greater extent, according to Goldman Sachs, which attributes this to regional banks' decreased lending. In the interim, it is evident that as their examinations continue, investigators are expected to find further issues at the institutions. These informational disclosures could increase depositors' and investors' fears.

The Way Forward For SVB

The failure of Silicon Valley Bank continues to resonate, affecting bank stocks, revealing latent pressures, knocking on to Credit Suisse, and sparking off a political blame-game. There are ongoing federal investigations, pending litigation, and undoubtedly upcoming financial problems. It should be less likely that banks with less cash and more securities on their books will have a liquidity shortfall due to significant withdrawals prompted by unexpected panic because the U.S. government decided to support all SVB and Signature deposits, regardless of size. Yet, the banking crisis is far from over because there are still over $1 trillion in uninsured bank accounts.