Silicon Valley Bank: What went wrong?

On March 10, 2023, regulators shut down the premier banking institution for tech startups and venture capitalists. While Silicon Valley Bank is technically a regional bank (meaning it's regulated differently than major Wall Street firms), its relationship to the tech sector raised immediate concerns about contagion. In other words, people worried the collapse of a bank in Silicon Valley would spill over onto Main Street.

So, what caused Silicon Valley Bank (SVB) to fail?

At the highest level, the bank's investment portfolio took a hit, meaning it didn't have enough money to pay account holders. As a result, depositors tried to pull their money out, leading regulators to shut it down prior to a full-on bank run.

A quick primer on banks

To understand what happened, it's important to understand how banks work. When you give a bank a deposit, your money is considered safe because the Federal Deposit Insurance Corporation (FDIC) insures that money up to a certain amount — $250,000.

After you deposit that money, however, it doesn't just sit in a vault. The bank puts the bulk of its deposits to work by investing it with the goal of passing returns on to account holders in the form of interest payments.

SVB invested client deposits primarily in long-term treasuries. As interest rates rose, these investments were worth significantly less on paper, creating a precarious situation for the bank and its depositors. Firms began to pull their money out of the bank, putting more pressure on its reserves and leading to its closure.

After SVB shut down, the government began discussing a "bailout." We're putting bailout in quotes since the government insists it's not. There are key differences between how regulators are stepping in to help SVB and how they helped in 2008.

When banks like Bear Stearns and Lehman Brothers teetered, government intervention focused on investors, the stock market, and the banking system overall. This time, regulators are focused on making sure *depositors* get their money back.

Talk to me about FDIC

When you deposit money at a bank, you might remember seeing a note or icon telling you the money is FDIC insured. That means that the Federal Deposit Insurance Corporation protects the money you deposit in the unlikely event that the bank fails.

In fact, the government created the FDIC and a similar institution, the Federal Savings and Loan Insurance Corporation (FSLIC) in the wake of the Great Depression. If FSLIC sounds familiar to you, you were probably around for the Savings and Loan Crisis of the 1980s.

While many younger Americans are unaware of this backstory, anyone who lived through the crisis is keenly aware of the technical details, but at a high-level, FSLIC was forced to repay more than $100 billion in assets in the wake of bank failures. It was ultimately absorbed by the FDIC. The complicated backstory of this type of deposit insurance means some Americans don't put much faith in the term "FDIC-insured."

Beyond that, the FDIC only insures deposits up to $250,000. Large companies using SVB to manage payroll and other operations may have kept more than that amount with the bank; money which would be at risk unless the government stepped in.

Systemic risk and moral hazard … again

There are two ideas at play here. First: Just because money isn't FDIC insured doesn't mean it's gone. It just means it isn't guaranteed.

Second, if that money *does* go away, it doesn't impact any account holders with less than $250,000 in the bank.

What it *may* impact is payroll and operations at companies who kept accounts at SVB. If these companies can't pay employees or vendors, it could have a ripple effect. Politicians call this "contagion." Investors call it "systemic risk."

Advocates of a bailout said SVB was a domino that could hurt an economy already at risk of recession. Opponents pointed out that insuring all bank deposits could create moral hazard — banks might take riskier actions with depositor money in the future if they know the government will ultimately protect those deposits.

The government is attempting to thread the needle on this issue by stating unequivocally that it is NOT bailing out SVB. The bank will not be purchased or revived, and no attempt will be made to protect its investors.

(It's worth noting that another bank, Signature Bank, followed a similar trajectory to SVB, but with a much lower profile.)

How the SVB collapse affects you

As rare as it is, a bank collapse of this magnitude can and should raise alarm bells. However, the biggest thing to remember is that your bank deposits (up to $250,000) are FDIC insured and protected. The SVB collapse **does not** mean your funds are at risk.

For some perspective, SVB is a regional bank, meaning that as important as it may have been in a certain sector of the economy (tech and VC) it still held less than 1% of bank assets at the end of 2022.

In the wake of its collapse, some are lobbying for stricter regulations on regional banks. On the other hand, supporters of regional and community banks point out these institutions often serve specific groups, neighborhoods, industries, unions, and the like.

Bottom line? Don't move your savings from the bank to that spot under your mattress just yet. Most banks are in a healthy financial position, and SVB's shocking collapse created more scrutiny on banks and their reserves. Many financial institutions aim for a more diverse holdings to minimize risk — just like individual investors.

If you have additional questions about this developing story and how it might impact your money, please reach out.

Sources:

1 Analysis: What Silicon Valley Bank collapse means for the U.S. financial system

2 Liabilities & Equity: All U.S. Banks