

# The SVB collapse: Reverberations & reactions



March 13, 2023

Global Portfolio Advisory Committee

The stunning demise of Silicon Valley Bank sent shock waves across the banking sector and broader financial markets. We examine regulators' fast action to stem the damage and what the "costs" of that may be, as well as highlight how the entire episode may cause the Fed to rethink its rate hiking plans.

U.S. regulators' decision to backstop the depositors of SVB Financial Group's Silicon Valley Bank came together just about as fast as SVB unraveled. Things move with lightning speed in the digital era—even the normally slow-moving regulators act quickly when they need to.

In the opinion of RBC Capital Markets, LLC's lead U.S. bank analyst Gerard Cassidy, the joint action of regulators on Sunday regarding SVB and their other decisions to support the banking system "reduces any contagion risk from the Silicon Valley Bank failure."

SVB was closed by regulators on Friday, culminating in the biggest financial institution collapse since the global financial crisis in 2008. The bank mainly provided financial services to technology startups, as well as to venture capital and private equity firms. This was a unique business model in the U.S. banking system, especially among banks that trade on the stock exchanges.

SVB grew significantly during the COVID-19 crisis when monetary and fiscal liquidity were flowing like water and venture-backed firms raised record levels of capital, causing the bank's deposits and assets to surge. Silicon Valley Bank ranked 16th in the country by assets at the end of 2022, according to the Federal Reserve.

Deposit withdrawals began at SVB in 2022 when venture funding started to dry up amid the Fed's unprecedented rate hike cycle, and withdrawals accelerated fiercely in the last couple of weeks. Because the bank's balance sheet was carrying significant unrealized losses in its bond portfolio, and its plan to raise funds in the public

market failed last Thursday, the subsequent rapid flight of large deposits out of the bank pushed the balance sheet of this 40-year-old bank into a very weak, untenable position. There is no precedent that we know of for such a fast takedown of a publicly traded U.S. bank.

## Fast and firm

RBC's Cassidy likens the actions of the U.S. Treasury, Fed, and FDIC to the "white hats" of classic western movies.

Not only will the FDIC-insured depositors of SVB be backstopped (those with deposits up to the standard \$250,000 level), but the three regulators collectively determined that uninsured depositors with accounts much larger than that will be made whole as well. That latter group represents roughly 90 percent of the bank's deposit base. Cassidy wrote, "This is an important element of the plan and should provide confidence to depositors in other institutions."

Another regional financial institution that came under siege last week, Signature Bank based in New York, was closed on Sunday. The regulators' decisions to backstop deposits apply to that bank as well. Interestingly, this bank mainly serviced the cryptocurrency industry.

Had regulators refrained from the controversial decision of backstopping SVB's large depositors, there was concern deposit flight would persist at other regional banks with great speed, including at some with more traditional business models. This could have created acute, cascading problems for the U.S. and global financial systems.

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Regulators also set forth [a number of other provisions](#) intended to support the stability of the financial system, including creating a “Bank Term Funding Program” that provides qualified U.S. financial institutions with short-term loans at easier terms. The Fed relaxed banks’ ability to access funding through its discount window—something it did during the financial crisis.

We think the collective actions will help shore up support for regional bank stocks and the U.S. banking group as a whole. Cassidy wrote, “We expect further turbulence in the bank equity markets [on Monday], but we also anticipate a stabilization of prices as investors realize that the liquidity squeeze caused by the run on deposits is over due to the actions announced by the Federal Reserve, U.S. Treasury, and FDIC.”

### But who pays?

While we don’t view this as an outright bailout like during the global financial crisis in 2008–09, we think this is indeed a rescue, so to speak. And it will likely have costs.

According to the [regulators’ joint statement](#), “No losses associated with the resolution of Silicon Valley Bank will be borne by the taxpayer ... Any losses to the Deposit Insurance Fund to support uninsured depositors will be recovered by a special assessment on banks, as required by law.”

We interpret this to mean the cost of deposit insurance for U.S. banks could rise, and could be spread across the banking system.

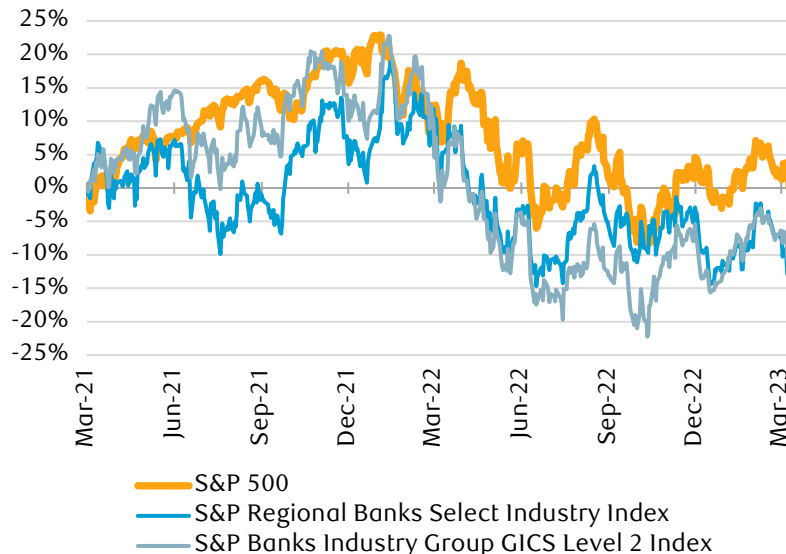
Well, if not American taxpayers, who would ultimately “pay” for this? At this early stage, we think it’s logical to assume higher deposit insurance costs would be factored into bank share prices and could result in higher fees on bank customers, potentially larger customers. But there actually may be no “cost” if SVB’s underlying assets are sold for a sufficiently high amount.

In the coming days and weeks—and likely longer—we expect there will be a lot of discussion and debate about the regulators’ decision to potentially offload the cost of the SVB crisis on the banking industry as a whole, and thus on their shareholders and customers. From our vantage point, very few major decisions that impact the banking sector—especially those during a crisis—are without controversy and devoid of politicization.

The finger-pointing in the SVB case has already begun in the financial press and social media and on Wall Street, but the facts surrounding the firm’s demise—and the classic issue of “who is to blame”—will likely take some

### U.S. bank stocks have meaningfully underperformed the S&P 500, especially lately

Percentage change since March 1, 2021



Source - RBC Wealth Management, Bloomberg; daily data. Final data points for S&P 500 and S&P Banks Industry Group as of midday trading on 3/13/23 at 11:30 Eastern time. Data for the S&P Regional Banks Select as of 3/10/23, the most recent available.

time to sort out. There may be plenty of blame to go around, including for the regulators and policymakers themselves, not to mention SVB’s management and perhaps even some of the firm’s clients.

### Collateral damage?

Given the still early stage of developments, there are many unanswered questions about the ripple effects of this SVB crisis such as:

- The vulnerability of the U.S. banking system to lightning-speed digital bank runs;
- The moral hazard of having the banking sector as a whole pay for extreme circumstances related to the collapse of one important bank;
- The effectiveness and appropriateness of U.S. regulators’ banking accounting rules and disclosures;
- The impact this episode and any related forthcoming changes to bank regulations would have on venture capital financing and funding of technology startups and those in other innovative industries;
- The broader economic consequences of this financial system problem, given this occurred as [some leading economic indicators](#) are already pointing toward a recession; and
- The potential impact on the Fed’s rate hike cycle.

While some of these questions will likely take time to sort out, we think the latter one regarding the Fed’s rate hike

cycle is already being answered. As the SVB crisis reached its apex late last week, market-based expectations of Fed rate hikes began to recede.

Prior to SVB's collapse, the Fed was balancing the still-strong labor market against persistent inflation. Now the Fed has to prioritize financial system vulnerabilities as well.

The Fed likes to state that it is "data dependent" when it comes to making interest rate decisions. We think the SVB crisis is a big data point that the Fed can't and won't ignore. In our view, it argues that the Fed should pause its rate hike cycle sooner rather than later, so as to let the financial system and economy absorb the significant hikes it has already implemented.

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