SILICON VALLEY BANK COLLAPSE AND THE FED RESPONSE

At the end of last week, Silicon Valley Bank was closed by regulators, representing the largest bank failure since 2008. The weekend brought about concerns over other banks and the government stepping in to clear the financial system plumbing. With so much turmoil in such a short period of time we wanted to communicate with clients our thoughts and perspective on the recent news.

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Why did Silicon Valley Bank (SVB) collapse? SVB quickly gathered deposits from tech companies and the venture capital industry during the pandemic. SVB then invested those assets into high-quality Treasuries and other government backed mortgage bonds. Rates rose rapidly over the last year and SVB did not hedge against that risk. As a result, the price of their Treasury investments fell in value (as did all other bond prices last year). When clients rapidly withdrew their assets from SVB, the bank was forced to sell the aforementioned investments at a significant loss causing a liquidity imbalance.

Is this the same as 2008? In short, no. The 2008 crisis was driven by a wave of defaults across bad loans leaving banks insolvent. The current episode is largely due to a flight to quality, from regional banks to larger players with ironclad balance sheets and bank deposits leaving low paying interest accounts in search of higher yielding opportunities.

How is the government getting involved? The Federal Reserve and U.S. Treasury moved quickly over the weekend to extend protectionary coverage to depositors over the traditional FDIC limit of $250,000. This move to cover all depositors was welcomed, as it proves the government's desire to prevent further bank runs. Perhaps there will be failures with smaller, riskier banks, but regulators are doing as much as possible to ensure that both retail and corporate banking clients can be confident that funds will be available if needed.

Where do we go from here? After 2008, financial industry regulations got significantly tougher to prevent another financial crisis. At various points of turmoil over the last 15 years, regulators have stepped in more quickly than at points in the past to keep the financial system stable and liquidity flowing. This event seems to be no different, and government involvement in the financial sector will likely increase as some banks lean on the government to backstop uninsured deposits.

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While the ripple effects of the Silicon Valley Bank failure will take some time to be seen, there are a few initial takeaways.

- First, the FDIC insurance limit of $250,000 will likely be adjusted. Given that millions of dollars can be transferred in seconds on a cell phone, it seems likely that regulators will create a permanent solution to keep banking customers at ease above the current $250,000 threshold.

- Second, the rise in interest rates from 0.0% to 4.75% in such short order was bound to create issues within the economy and financial system. Whether the recent volatility in the banking system leads the Fed to stop hiking rates remains to be seen, but the bond markets are currently anticipating that it will. The 2 Year Treasury yield (a barometer of where interest rates will be over the next 24 months) fell from 5.0% last week to 4.2% as of Monday morning. Ten Year Treasury yields are currently at 3.5%. The bond market is betting that the Fed is done hiking rates even if they have not formally announced it yet.[1]

As we continue to navigate the high interest rate environment, we will continue to closely monitor financial system developments and remain vigilant in order to protect our client assets. We welcome you to reach out at any time if you have questions or want to discuss the current situation further.

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1: Bond yield data via Charles Schwab, as of 3/13/2023