Silicon Valley Bank Failure - is your Money Safe?

The financial world was shaken by the collapse of Silicon Valley Bank on Friday, 10th March.

While U.S. regulators stepped in to try to prevent contagion, shockwaves are still rumbling through the economy, and many consumers have concerns about the health of global financial system, stock markets and housing markets.

If you're among them, don't panic. Here are some thoughts about the fallout from the largest U.S. bank failure since the Great Recession.

What Happened with SVB?

On Friday 10th March, Silicon Valley Bank (or SVB) officially failed and was taken over by U.S. regulators.

SVB had built a business lending money to startups and companies backed by venture capital firms, and like many other banks, it kept most of its customers' deposits in traditionally safe investments like Treasury bonds.

However, as the Federal Reserve has steadily increased interest rates in its attempts to bring down inflation, the market values of those bond investments fell. At the same time, declining economic conditions prompted many of SVB's customers to withdraw their money.

SVB was forced to sell many of their bonds at well below face value, (incurring huge losses) to meet those withdrawal requests, and that triggered a fear-induced scramble among other depositors, now worried about the health of the bank, to pull their money out.

Signature Bank was also shut down by regulators as its depositors panicked, too.

US Government Response

The Federal Deposit Insurance Corporation (FDIC) announced it would guarantee all deposits at both banks.

The FDIC went beyond its normal $250,000 limit (more on that later) to prevent the crisis from worsening. Some considered this a bailout. Others argued that, because the rescue money doesn't come directly from taxpayers and is intended for depositors, not the banks, it didn't technically qualify as such. Whether it constituted a 'bail-out' or not seems irrelevant to me though.

The situation made investors especially nervous about other banks, with Credit Suisse in the spotlight. When Saudi National Bank, the largest shareholder of Credit Suisse announced it would not invest any more money in Credit Suisse this week, shares plummeted. As I write (18th March) it is looking likely that UBS will take over Credit Suisse.

First Republic, a mid-size regional bank in the United States, was also caught up in the crisis.

When its' depositors saw what was happening to SVB and Signature Bank, many began to withdraw their money. As a result, other major banks, including JPMorgan, Citigroup and Bank of America agreed to deposit money at First Republic to stop the run and restore confidence. The coming week will tell.

Is my Money Safe?

Despite all the worrying headlines, retail banking customers have good reason to feel confident about the safety of their money. The FDIC insures almost every U.S. bank, and most banking systems globally have similar depositor protection in place.

The level of protection guarantee varies from country to country. The UK provides for £85,000, whilst the EU protects €100,000. These protections do not usually cover investments in stocks, bonds or crypto though.

Will these Bank Failures Impact the Economy?

Experts agree that the turmoil in the banking world is unlikely to lead to a major economic disaster.

"As long as the FDIC is doing their job of assuring that banks are adequately capitalized and properly managed, there is no reason for this mini-panic to have a significant impact on our economy," Gregory Germain, professor of law at Syracuse University's College of Law, said in a recent statement.

He also acknowledged, however, that the recent chaos in the banking sector exposed some "fragility" in the economy. As the U.S. Fed works to bring down inflation by continuing to raise interest rates, it must be careful not to inflict too much damage on the economy in the process.

In a client research note this week, analysts from Goldman Sachs raised their probability forecast that the U.S. will enter a recession over the next year from 25% to 35%, "reflecting increased near-term uncertainty around the economic effects of small bank stress."

What about Stock Markets?

Bank stocks plummeted last week in the wake of SVB's collapse.

Some have since recovered losses, but markets were still trending downwards a week later (17th March).

The turmoil in the banking sector might "nip a nascent market recovery in the bud," Invesco commented earlier this week. Analysts from Morgan Stanley noted that "the picture is pessimistic about where growth is likely headed, especially for earnings."

What will Happen to Mortgage Rates?

It won't just be investors watching the Federal Reserve's response to the banking crisis closely. Homebuyers will pay attention, too.

Before SVB's collapse, the Fed had signaled that it would keep hiking interest rates, but this week's events could prompt it to re-evaluate.

Clearly, any easing of interest rates, or even tempering of interest rate increases will be gratefully embraced by mortgage-holders. Falling rates on Treasury bonds (which tend to be more popular with investors as economic conditions worsen) also suggest lower future rates.

2008 all Over Again?

It would be easy to assume that the global banking system is about to go through another crisis, akin to that of 2008.

However, at the moment, it does seem quite different this time.

Most people would argue that investing only in new tech start-up companies, and venture capital strategies is much too risky for the typical portfolio, and yet this was the profile of virtually all of **Silicon Valley Bank**'s customer base.

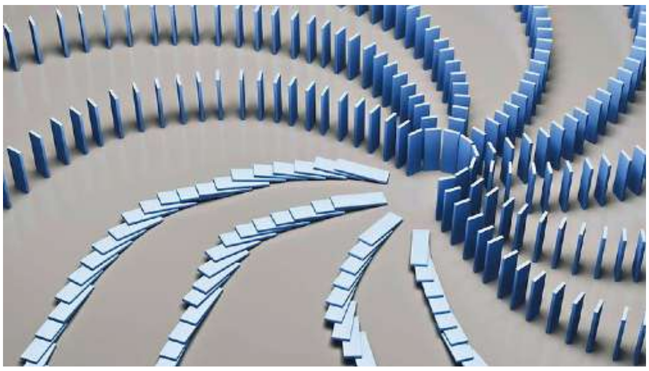
Large deposits derived from start-ups where equity was sold to provide cash funding made up SVB's deposit accounts, and because of this, over 90% of deposits were above the FDIC's $250k protection limit. Additionally, with such large accounts, held by go-getting new companies, SVB had to offer better-than-average but safe returns on these deposits.

Hardly surprising, then, that billions of dollars' worth of Treasury bonds were bought. The forced sale, at a huge loss, of these bonds was therefore bound to create a run on this bank.

The Banking 'Domino Effect'

Signature Bank ran the payment system Signet, which allowed crypto companies to instantly transfer money in and out of crypto at all times. Signet plays a crucial role in several large exchanges, including Coinbase.

Since 2019, Signet and its main competitor, Silvergate Bank's SEN, have been responsible for moving more than $2 trillion in and out of crypto, according to Forbes.



But after the fall of FTX, Signature sought to distance itself from crypto, especially since the exchange platform had been one of its clients.

This really meant that a lot of Signature clients moved their business to **Silvergate Bank**.

But Silvergate was hit hard during crypto's decline in value last year, and announced on 9th March that it would be winding down operations. Following Silvergate's demise, JPMorgan predicted that some of its customers would migrate over to Signature Bank, only for Signature to fold on 12th March.

Although the stress experienced by Credit Suisse is somewhat different, it is clear that Silvergate Bank, Signature Bank and Silicon Valley Bank all focussed heavily on niche markets and very specific customer bases, and this ultimately seems to have led to their respective downfalls.

As any investor knows, diversification is key. Putting all of their eggs in one basket is folly, and it seems these banks have done exactly this.

There is hope, therefore, that the more mainstream banks, for the majority of the global banking system, are diverse enough in their operations that this contagion will fizzle out, and that we will not see another 2008 financial crisis.