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Finance expert shares key takeaways from the collapse of Silicon Valley Bank

The banking issues could be "the last straw that pushes the economy into full recession," said finance expert Mark Williams.

By James Ritchie
Apr 13, 2023

Silicon Valley Bank was relatively unknown outside the tech industry and its home region, despite being the country's 16th-largest bank.

But with its collapse in March, the Santa Clara, California-based bank became a household name. The bank failure was the largest in the U.S. since 2008, and the second-largest in U.S. history.

SVB's public profile was relatively low because it operated differently from typical retail banks by serving a niche clientele of startups, founders, venture funders and others on the tech innovation scene. These distinctions contributed to its ultimate failure.

Mark Williams, master lecturer in finance at Boston University's Questrom School of Business, is a risk-management practitioner, academic and financial author with three decades of experience. He recently shared his thoughts with the Boston Business Journal about the bank collapse and the current state of the financial sector.

What happened to SVB?

SVB faced a cash crunch amid a tech slowdown, according to Williams. The company announced on March 8 that in order to raise money, it had sold $21 billion in securities at a loss. It also said it was planning to sell $2.25 billion of its treasury stock and had borrowed $15 billion.

These moves made customers nervous, and a bank run followed, with $42 billion in attempted withdrawals the next day. On March 10, the California Department of Financial Protection and Innovation closed SVB and appointed the Federal Deposit Insurance Corp. as receiver.

In late March, First Citizens BancShares struck a deal to buy $72 billion of the bank's assets out of receivership at a 23% discount. That still left the FDIC with $90 billion of SVB assets to dispose of.

What contributed to the collapse?

Williams, a former bank examiner for the Federal Reserve, said one factor was an overreliance on hot money," meaning short-term investment opportunities. These deposits are controlled by customers who will move their money to another institution when they find a better return.

"It meant that in times of trouble or uncertainty, deposits would bleed," Williams said.

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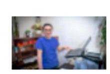
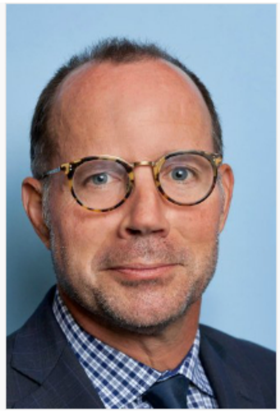


He also said the bank was "undercapitalized for its level of risk-taking" and did a poor job of managing interest-rate risk. Its depositor base was also highly concentrated, with many high-dollar accounts connected to the startup world.



Finance expert Mark Williams said it's "paramount that regional and smaller banks continue to send the reassuring message that they are well run, safe and sound and don't gamble with depositor money."

About 90% of SVB's accounts were uninsured; FDIC deposit insurance only covers deposits up to $250,000. The government nonetheless pledged SVB depositors would have access to "all of their money." Federal officials have said no losses associated with the resolution of the bank will be borne by taxpayers.

With its deposits, SVB had invested heavily in long-term instruments: U.S. treasuries and mortgage-backed securities. But as interest rates ticked up in 2022, the value of these investments fell.

When the tech industry hit a slowdown, more customers made withdrawals, and SVB found itself in a pinch. It had to sell off bonds at significant losses to liquidate the deposits. That series of events led to customer panic and the eventual bank run.

The bank was flush with deposits when tech was doing well during the pandemic.

However, "they failed to understand they were taking excessive risk," Williams said. "They failed to understand how best to manage that risk in an increasing interest rate environment. As rates went up, the hot money had to be paid more money to stay. It was an unstable and unsound bank."

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What does this failure mean for the financial sector more broadly?

- Silvergate Bank, which was well known in cryptocurrency circles, announced a liquidation on March 8.
- Signature Bank closed, according to an announcement on March 12. The FDIC said most of Signature's assets were being sold to Flagstar Bank.
- San Francisco-based First Republic Bank – the 14th-largest bank in the country by assets – reported distress. A group of large financial institutions deposited $30 billion to help stabilize First Republic.

The danger is a large-scale crisis of confidence among depositors and a ripple effect for banks. Even well-operated regional banks are at risk if customers look only to megabanks for stability – a trend that has already begun. The banking issues could be "the last straw that pushes the economy into full recession," Williams said.

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In a draft position paper, he noted the global banking system is built on trust.

Regulators in the U.S. and elsewhere, he said, "need to quickly do 'whatever it takes' to restore this important but sometimes fragile depositor-bank bond of trust."

Williams also wrote it's "paramount that regional and smaller banks continue to send the reassuring message that they are well run, safe and sound and don't gamble with depositor money."