Silicon Valley Bank and Signature Bank Crisis

Why in news?

Silicon Valley Bank collapsed with astounding speed, leaving investors on edge about whether its demise could spark a broader banking meltdown, like the 2008 financial crisis.

What is Silicon Valley Bank (SVB) crisis about?

Silicon Valley Bank (SVB)

- Established in 1983, it is a California based bank that lends to early stage technology and biotech start-ups, and manages funds of venture capitalists.
- Just before collapsing it was *America's 16th largest commercial bank*.

> *Banks fail as they lend long term, whereas, their deposits are short term. They cannot call back their long-term loans easily, whereas their short-term deposits have to be paid on demand.*

SVB collapse

- **Monetary Policy –** The era of easy monetary policy has enabled tech companies of all sizes to raise and deploy funds, and SVB benefited from this boom.
- **Global Inflation –** The recent Ukraine war fuelled global inflation levels and that led central banks to tighten monetary policy aggressively.
- **Government Bonds –** SVB ploughed billions into *US government bonds* during the era of near-zero interest rates.
- **Interest rate hike –** The Federal Reserve hiked interest rates aggressively to tame inflation.
- **Fall in bond price –** When interest rates rise, bond prices fall, so the jump in rates eroded the value of SVB's bond portfolio.
- **High borrowing costs –** At the same time, the Fed's hiking sent borrowing costs higher, meaning tech start-ups had to channel more cash towards repaying debt.
- **Withdrawal of deposits–** The start-ups struggled to raise new venture capital funding which forced companies to withdraw deposits held by SVB to fund their operations and growth.

Impact of the crisis

- **Dump bank stocks –** Shock from Silicon Valley's miseries echoed through parts of the banking sector, and investors started to dump bank stocks.
- However, *the nation's largest banks appeared insulated from the fallout*.
- **Strong buffer –** Most analysts point out that US and European banks have much stronger financial buffers now than during the global financial crisis.
- **Unique existence –** SVB was large but had a unique existence by servicing nearly exclusively the technology world and VC-backed companies.
- **Affects start-ups –** At a time the start-ups needed financial backing, one of its biggest supporters has collapsed.
- **Balance sheets –** If central banks become concerned that SVB's problems are indicative of a broader weakness in corporate balance sheets, they can raise the rates.
- **Survive recession –** The stress tests of the largest banks and financial institutions showed that all of them would survive a deep recession and a significant rise in unemployment.
- **Impact on US dollar rates –** Both US economy and the US currency is expected to face investors' anger in near term.

Silicon Valley Bank's downfall is the largest failure of a financial institution since Washington Mutual collapsed at the height of the 2008 financial crisis more than a decade ago.

Response from the US Government

- **Prompt interventions –** The SVB's fallout was followed by regulatory interventions involving coordination between the Treasury Secretary, the banking regulator and the resolution authority.
- **FDIC –** The bank was closed by the California banking regulator and placed under the receivership of Federal Deposit Insurance Corporation (FDIC).
- **Bridge bank –** The FDIC seized the assets of the bank, created a bridge bank called the Deposit Insurance National Bank of Santa Clara and transferred all insured deposits of SVB to the bridge bank.

Bridge bank is an entity to temporarily take over the liabilities and operations of a failed bank till a buyer is found.

- The bridge bank, in this case, will ensure continuity of all banking activities.
- **BTFP –** To prevent the run on banks and meet the demands of depositors, the US Fed has set up an additional funding facility for banks called the Bank Term Funding Program (BTFP).
- Under this facility, *loans of up to 1 year* will be provided to banks and other depository institutions.
- Those taking advantage of the facility will be asked to *pledge high-quality collateral* such as treasuries, agency debt, and mortgage-backed securities.

- **Exchange stabilisation Fund –** The Department of the Treasury will make available up to $25 billion from the Exchange Stabilisation Fund as a backstop for the BTFP.
- All insured depositors have access to their insured deposits.
- The uninsured depositors will receive their pay-outs as the FDIC sells the assets of the SVB.

What led to the collapse of Signature Bank?

- **Signature Bank –** It is a New York financial institution with a big real estate lending business and had recently made a move towards cryptocurrency deposits.
- That ended up being a fateful decision because the bottom fell out of crypto assets after the collapse of FTX.
- Another cryptocurrency-focused bank, Silvergate Bank, was forced to voluntarily close, leading to the fallout of SVB.
- To some extent, Signature Bank is a victim of the panic around Silicon Valley Bank.

What is the impact of the Signature & SVB crisis on India?

- **Most preferred by Indians –** The collapse of the bank triggered a nerve wracking crisis for Indian start-ups that preferred SVB to park their funds.
- **Loss of employment –** Not having access to money would mean firing a large number of employees.
- **Recession in West –** If the West slips into a recession, it will impact Indian financial markets and growth rates.
- **Regulated by RBI –** This crisis won't have much impact on Indian treasuries, since they are regulated by Reserve Bank of India.
- **Forex market –** Those who have position in dollar may have to face the beating, since US dollar has retraced from 3-month highs.
- **Mutual funds –** Debt funds won't have much impact unlike for Indian mutual fund investors who have exposure in international mutual funds and international hybrid mutual funds.
- **India better placed –** Unlike the concentration of deposits of SVB, 60% of deposits of Indian banks are held by households.
- **Asset side –** On the asset side, 60% are held in the form of loans and investments constitute 25% of the assets.

What is the way forward?

- **Need for counter-cyclical tools –** The SVB saga underscores the need to have adequate *countercyclical macro prudential tools* to provide a buffer against losses on account of rising interest rates.
- **Resolution Corporation -** The legal framework should provide for oversight of the bank by the RBI and a Resolution Corporation.
- It should have the authority to monitor risks, intervene early and resolve through the globally-recognised resolution tools such as *sale of business and bridge institutions*.
- **Need for framework –** Important lesson emerging from the SVB crisis is the need to enact pending banking reforms & for a prompt resolution framework so depositors don't face a moratorium on their deposits.

- **FRDI Bill –** *The Financial Resolution and Deposit Insurance (FRDI) Bill* that provides for establishing a resolution authority, which would have powers to undertake prompt resolution for banks need to be reintroduced.

Quick Facts

2008 Financial Crisis

- The 2008 financial crisis began with *cheap credit and lax lending* standards that fuelled a housing bubble.
- The 2008 financial crisis developed gradually, when home prices began to fall in early 2006.
- In early 2007, subprime lenders began to file for bankruptcy.
- In June 2007, two big hedge funds failed, weighed down by investments in subprime loans.
- In August 2007, losses from subprime loan investments caused a panic that froze the global lending system.
- In September 2008 *Lehman Brothers collapsed* in the biggest U.S. bankruptcy ever.
- When the bubble burst, the banks were left holding trillions of dollars of worthless investments in subprime mortgages.
- *The Great Recession* that followed cost many their jobs, their savings, and their homes.

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