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## 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.
- **BTFF** - 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 (BTFF).
- 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.

### References

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