Ouch!

From Bloomberg yesterday:

If you had never heard of Silicon Valley Bank before this week, you likely have by now. SVB was home to cash belonging to half of all venture-backed startups in the US. So it came as a bit of a surprise when the bank suffered an $1.8 billion loss on securities sales and made plans to raise money by selling shares. Surprise turned into panic, which turned into a run on the bank. On Friday, SVB became the biggest US bank to fail in more than a decade. But that's not all. SVB's implosion came shortly after crypto lender Silvergate Capital said it planned to shut down. For both, part of the problem was an unusually fickle depositor base. But perhaps the bigger issue—and the threat to the broader financial sector—was rising interest rates. Those rates have left banks laden with low-interest bonds that can't be sold in a hurry without incurring big losses. If too many customers want their cash, and a bank needs to sell bonds to pay up, it risks a vicious cycle like the one that befell SVB. California state regulators took possession of the lender, and some observers say the meltdown shouldn't pose a risk of contagion as long as depositors are made whole. ...

Jerome Powell told lawmakers this week that the central bank was ready to speed up the pace of monetary tightening should inflation keep running hot. The US job market is too strong for the Fed Chair's taste, keeping wage-growth elevated. But while US payrolls rose in February by more than expected, cracks are emerging, including a spike in initial jobless claims last week as tech layoffs showed up in the data. Facebook-parent Meta is planning a new round of mass-firings as terminations announced by US employers quintupled in February from a year earlier. But still, US unemployment is at its lowest since Richard Nixon's first term in office.

The above resulted in a WSJ banner headline:

Tech Bank Fails, Rattles Markets

Startup-focused lender Silicon Valley is taken over by FDIC, dragging down financial stocks

*By **Rachel Louise Ensign, Corrie Driebusc** and **Meghan Bobrowsky***

Silicon Valley Bank collapsed Friday in the second-biggest bank failure in U.S. history after a run on deposits doomed the tech-focused lender's plans to raise fresh capital. ...

Insured depositors will have access to their funds by Monday morning, the FDIC said. Depositors with funds exceeding insurance caps will get receivership certificates for their uninsured balances, meaning businesses with big deposits stuck at the bank are unlikely to get their money out soon.

The bank is the 16th largest in the U.S., with some $209 billion in assets as of Dec. 31, according to the Federal Reserve. It is by far the biggest bank to fail since the near collapse of the financial system in 2008, second only to the crisis-era failure of Washington Mutual Inc.

The bank's parent company, SVB Financial Group, was racing to find a buyer after scrapping a planned $2.25 billion share sale Friday. Regulators weren't willing to wait. ...

The bank's troubles have dragged down the industry and unnerved stock investors overall. The blue-chip Dow Jones Industrial Average fell ... 1.1% .... The S& P 500 closed down ... 1.4%, while the Nasdaq Composite lost ... 1.8%. (The Russell 2000 culminated an ugly week with an additional 3% loss.)

All S&P 500 sectors closed lower, and the broad-based index had its worst week since September.

Treasury yields tumbled, with the yield on the 2-year note dropping 0.314 percentage point to 4.586%, its largest single-day decline since September 2008. The bank's collapse dragged down a swath of the industry. The KBW Bank Index fell 16% on the week, its worst weekly performance since March 2020. ...

SVB catered mainly to the insular ecosystem of startups and the investors that fund them. Its deposits boomed alongside the tech industry, rising 86% in 2021 to $189 billion and peaking at $198 billion a quarter later. The bank poured large amounts of the deposits into U.S. Treasurys and other government-sponsored debt securities.

Tech tumbled after the Federal Reserve began raising rates last year to curb inflation. Startups, as a result, drained their deposits with SVB faster than the bank expected. And new investment stalled, meaning fresh money wasn't coming into the bank.

Rising interest rates, meanwhile, dented the value of SVB's massive bond portfolio. The bank needed fresh capital.

SVB hired Goldman Sachs Group. this week to execute a private stock sale, with plans to announce it upon completion to avoid spooking investors, according to a person familiar with the offering.

Then Moody's Investors Service informed SVB that it planned to downgrade the bank's credit ratings, the person said. As a practice, Moody's informs issuers 24 hours in advance of a credit rating change.

Bankers and SVB executives feared a downgrade would harm the company more than a share sale, the person close to the deal said. They scrambled to bring on private-equity firm General Atlantic to anchor the deal with a $500 million commitment and announced the planned sale after the market closed Wednesday. Moody's downgraded the company later that evening.

SVB shares fell sharply after the market opened Thursday. The violent move in the stock alarmed customers, who began pulling their money out to avoid getting stuck with losses in the event of a failure.

Chief Executive Greg Becker tried to reassure customers on a call Thursday, telling them the bank was on solid footing. It didn't work. Venture-capital investors advised startups to pull their money out to avoid losses on deposits in excess of FDIC's $250,000 insurance cap. The bank had more than $151 billion worth of deposits that were over the FDIC limit at the end of 2022.

Rival banks were flooded with calls from potential customers looking to move their balances. ...

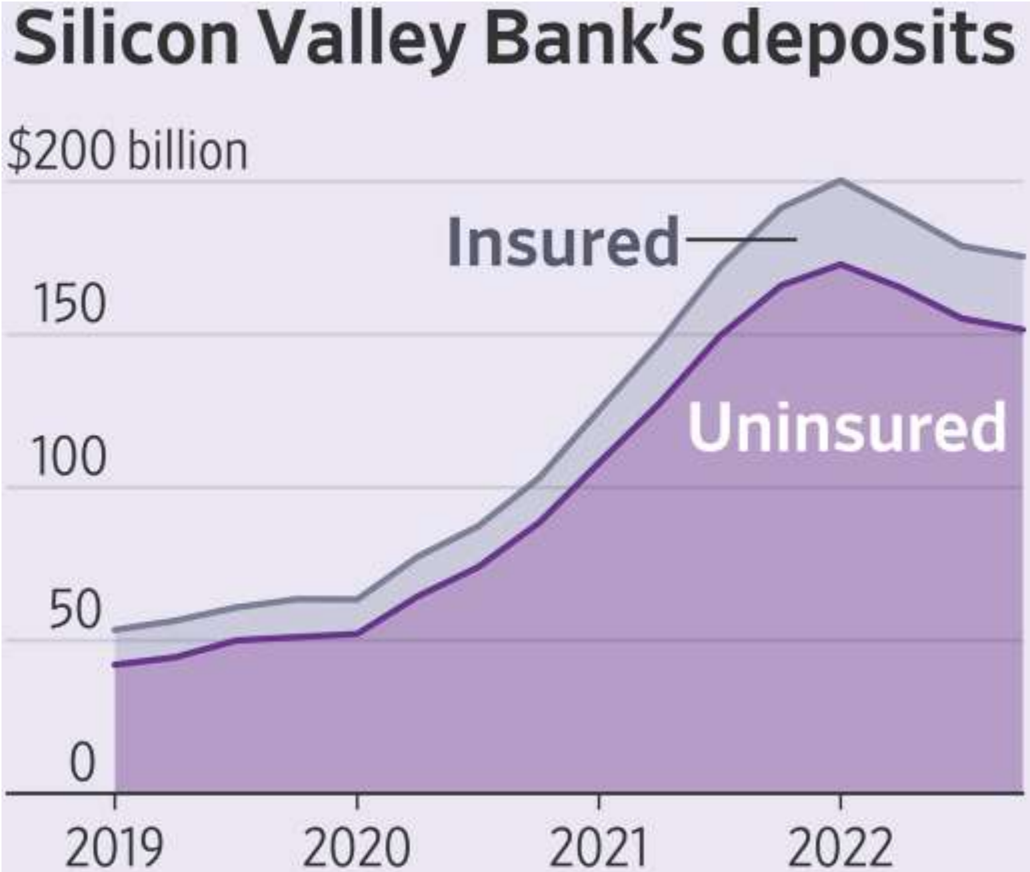
The share sale was canceled a few hours later. The bank told employees to "work from home today and until further notice," according to a copy of the email viewed by The Wall Street Journal.

Before 9 a.m. on the west coast, regulators had seized the bank.

More than two dozen people, some who identified themselves as customers, descended on the bank's Santa Clara headquarters Friday morning. An FDIC press release announcing the bank's closure was taped to a locked door.

"We are in a whole lot of trouble right now," one customer said on a phone call. "We shouldn't have had all our eggs in one basket," he added. (Not if your eggs total over $250,000.00.)

From today's What's News:



The race is on to contain the fallout from the failure of Silicon Valley Bank.

After the stunningly hasty collapse of SVB—the second-biggest bank failure in U.S. history in terms of assets—one big question this week is whether regulators can stem concerns about other small- and midsize banks, whose shares have been slammed by contagion worries. A plan that soothes nerves about access to uninsured deposits could shield the broader financial system. But failing to swiftly clarify how SVB's customers can access funds, make payroll and conduct business risks broader economic consequences and threatens to complicate the Fed's plans to tame inflation by raising interest rates.

How to Understand the Problems at Silicon Valley Bank

March 10, 2023

By Peter Coy

You're reading the Peter Coy newsletter, for Times subscribers only. A veteran business and economics columnist unpacks the biggest headlines.

If you're wondering why Silicon Valley Bank, one of the biggest lenders to tech start-ups, had to be taken over Friday by the Federal Deposit Insurance Corporation, one good place to look is the Federal Reserve.

The Fed has raised interest rates extremely rapidly over the past year to squelch inflation. So thanks to the Fed, banks are having to pay much higher rates on their deposits and other liabilities. But they're not earning much more on their assets, which include the loans they make and the Treasury bonds they purchase.

The real problem, though, for banks — not just Silicon Valley Bank — is not so much the higher rates as the rapidity of their increase.

Here's a professor from Silicon Valley — Darrell Duffie, a professor at Stanford's Graduate School of Business — to explain the crunch: "Normally interest rates go up really slowly and depositors hardly notice that they're not getting a very good rate relative to market rates."

Slowly moving, inattentive depositors leave their money in low- or zero-yielding deposits, making the banks very happy, Duffie explained. And when interest rates rise slowly, banks have plenty of time to replace low-yielding assets with higher-yielding ones.

Not now though, Duffie told me. "This time has been quite different because the Fed has raised rates very sharply," he said. "And it's still raising."

He's right: The top end of the target range for the federal funds rate has zoomed from 0.25 percent a year ago to 4.75 percent now, and most forecasters expect the Fed to increase it an additional half a percentage point or three-quarters of a percentage point in coming months. For speed, that rivals the bursts of rate increases by the Fed from 1979 to 1981 under Paul Volcker.

So banks are paying much more to borrow but haven't been able to increase the yields on their assets. For example, they can charge more for new loans, but they're stuck earning low rates on the vastly larger number of loans they issued in the past.

It's actually worse than that. To raise cash for withdrawals, banks are having to sell Treasury bonds whose market value has plummeted because of the Fed's rate-raising campaign. ...

Why Silicon Valley Bank, though? What made it especially vulnerable? One reason is that many of its loans are in the tech sector, which as you may have heard is hurting. Another, perhaps more important reason is that it relies heavily on deposits from institutions rather than individuals.

The people who run companies, investment funds and other institutions are always looking for the highest yield they can earn, so they're quick to yank money from a bank and put it in, say, a money-market fund. Also, institutions will rush to pull their money out of a bank if they think it might go bust. Even if they're convinced that the bank is solvent, they might take their money out because they fear others will pull their money out.

That's a classic bank run. True, institutions' deposits are protected by the F.D.I.C., but only up to $250,000, which is meaninglessly small for them. ...

Silicon Valley Bank is "the slowest antelope in the pack," Anil Kashyap, a professor at the University of Chicago's Booth School of Business, told me.

Stock prices of some other regional banks have fallen as well. In contrast, the nation's biggest banks — Bank of America, Citibank, JPMorgan Chase and Wells Fargo — have held up better because they rely more heavily on small individual depositors who pay less attention and move their money more slowly. ...

The big question now, for markets and regulators, is whether many other banks are about to falter. To prevent a cascading financial crisis, the F.D.I.C. could insure all of banks' liabilities, including all deposits without limit, as it did during the global financial crisis. But taxpayers wouldn’t like bailing out banks and their big depositors from their bad decisions. ...

Kashyap said, “I don’t think that the banks that are essential to the health of the economy are anywhere close to insolvent. The regulators care about the system, not any particular bank. Maybe this wakes everybody up.”

Or maybe if more banks get in trouble, the Fed might slow down its pace of rate increases. Until now it’s been watching for signs that higher rates were affecting the nonfinancial parts of the economy. Somewhat surprisingly, the job market has held up well: On Friday, the Bureau of Labor Statistics reported that payrolls grew by 311,000 jobs in February. The unemployment rate edged up, but only to 3.6 percent, still very low by historical standards.

The Fed chair, Jerome Powell, and his fellow rate setters will surely be asked about how their policies are affecting banks in the weeks to come.