FLASH COMMENTARY

March 14, 2023

Banking Headlines

The closures of Silicon Valley Bank (SVB) and Signature Bank in recent days has been dominating the headlines of the financial press. It's important to realize that Silicon Valley Bank had an unusual business model and client base that sets it apart from larger commercial banks. 52% of SVB's deposits were from venture capital (VC) and private equity (PE) related businesses and funds. Very few banks have a depositor base as concentrated as SVB's was to a particular industry segment, specifically corporate deposits from VC and PE firms. Thus, SVB's demise is much more akin to the recent Silvergate Bank / FTX situation, than a wide-spread contagion reminiscent of the 2008 financial meltdown.

Fund-raising has been challenging for VC firms over the last nine months. Most venture-based companies are not profitable and have very high "cash burn rates"; they have little free cash flow to fund operational outlays as they invest in staff salaries, marketing, R&D, etc. The shortfall in VC fund-raising has induced VC companies to withdraw cash from SVB. In order to maintain capital ratios prescribed by regulation, SVB was forced to sell assets (Treasury and mortgage-backed bonds) held at cost on their balance sheet. With the bond market declining in excess of -10% over the last fifteen months, the realized mark-to-market losses incurred by SVB's liquidation efforts created a negative feedback loop as it sought to maintain capital ratios after meeting client withdrawal requests. SVB depositors panicked following a major restructuring of the bank's balance sheet last Wednesday. The bank's deposit base became threatened by a self-fulfilling "run on the bank" as large PE and VC firms rushed to withdraw uninsured deposits.

In a move to prevent a contagious melt-down in the banking industry, Treasury Secretary Janet Yellen gave the FDIC approval to fully protect depositors' funds at both Silicon Valley Bank and Signature Bank, which was seized by regulators in New York on Friday. The costs associated with protecting customers will be paid by a special assessment on other banks. Taxpayers will not be on the hook. In addition to the FDIC's actions, the Federal Reserve launched a loan program to help banks satisfy depositor withdrawals, with a $25 billion backstop.

A number of companies spent the weekend seeking out loans and looking for ways to reduce cash burn, knowing that payroll is due this Wednesday, in a lot of cases. The $73 billion loan book of SVB is now up for grabs. When Washington Mutual collapsed during the global financial crisis, it was sold to JP Morgan for $1.9 billion. A big bank buyer could likely emerge for SVB's assets. SVB's CEO Greg Becker said in a video to employees on Friday that he was working with the FDIC to find a buyer for all or part of the bank. SVB's assets could be particularly attractive for a bank hoping to gain market share among venture and PE firms. JP Morgan is currently rumored to be among one of the top suitors as they would welcome a foothold into the Silicon Valley tech ecosystem. If a buyer only purchases select portions of SVB's portfolio, uninsured depositors may have to wait longer for their funds. Either way, the FDIC will pay uninsured depositors an advance and continue to make dividend payments as it sells SVB's assets.

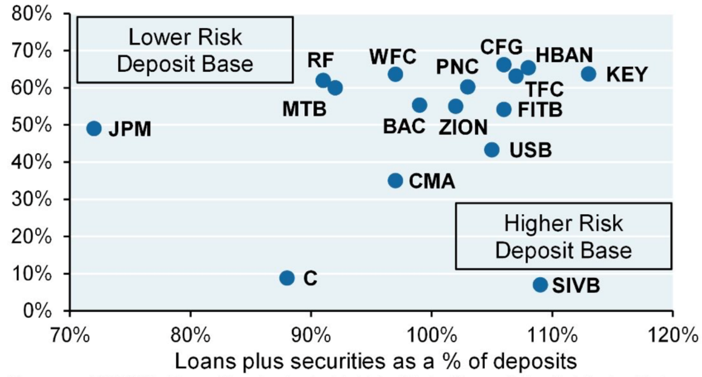
Overall, the banking industry is in reasonably healthy condition, and SVB's woes are likely to be limited to a narrow portion of the overall U.S. economy. This incident is highly unlikely to result in any systematically significant downturn among the banking sector writ large.

March 11, 2023

One of these things is not like the other, and that thing is Silicon Valley Bank.

US bank loan-to-deposit ratios

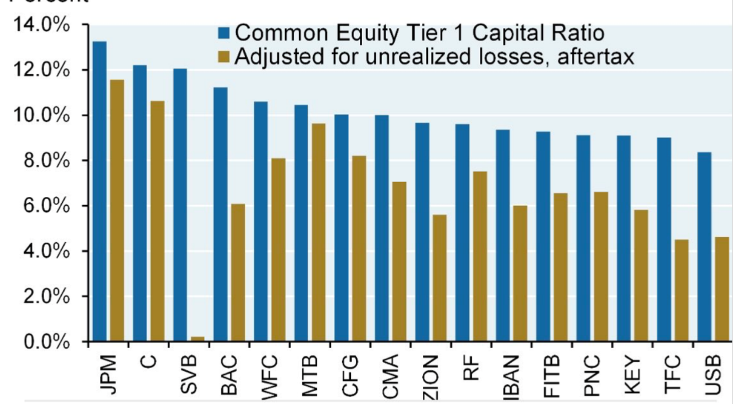
Estimated retail deposit share of total deposits



Source: JPMAM. Securities include Hold to Maturity and Available for Sale categories. Q3 2022.

Impact of unrealized securities losses on capital ratios

Percent



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