Bailout 2.0

by Charles B. Wendel

We've already read that venture capitalists are saying SVB and the venture capital industry have not been bailed out. And the President and Treasury Secretary have stated that no taxpayer dollars are involved. Those are lies.

Apparently, the FDIC will make whole all deposits, no matter their size, bailing out big depositors, helping not only start-ups but VC investors. Andrew Ross Sorkin in today's *New York Times* refers to banking as now a "government run business" and mentioned that "costs for businesses and consumers will go up in the short term. That, of course, comes on top of higher interest rates." An FDIC fund may help to pay off all depositors, but that fund will need to be replenished by higher costs passed on to customers. Basic economics. Taxpayer dollars.

The failures of SVB and Signature Bank differ in many ways. As of Monday morning, questions still exist about what happened at Signature. The roots of the SVB debacle are clearer.

A month ago, who would have guessed that Silicon Valley Bank, the leading banker to tech-focused startups and investors, would disappear. After all, on February 8th, Jim Cramer of CNBC had recommended SVB as one of the biggest winners so far in 2023: "This company is a merchant bank with a deposit base that Wall Street has been mistakenly concerned about!" Mistakenly?

Maybe Greg Becker, until recently the CEO, might have guessed. On February 27th he sold $3.7mm of his SVB stock (maybe a pre-planned sale). Post his stock sale, the *LA Times* reported that Becker then "asked the bank's clients, including venture capital investors, to support the bank the way the bank has backed its customers over the last 40 years." Again, he made his heartfelt plea after he sold his stock.

While the story of what happened to SVP will take some time to nail down, contributing factors include:

- High amounts of uninsured deposits, 90+%
- Quickly rising interest rates and increased "hot" money
- Unrealized losses from a mismatched portfolio becoming realized losses; bad ALM policies. The Financial Times: "Ultimately, it committed a cardinal sin in finance. It absorbed enormous risks with only a modest potential pay-off in order to bolster short-term profits." In banking, greed is not good
- Poor communication by senior management
- No Chief Risk Officer in recent months (one may have been hired in January)
- Customer self-interest eroded any customer loyalty and clients quickly exited the bank
- Withdrawal of a quarter of the bank's deposits in one day
- The bank lost its focus on key performance areas, instead becoming a woke bank (theory of Tucker Carson and *The New York Post*: "While Silicon Valley Bank collapsed, top

executive pushed ‘woke’ programs.” One tweeter comment suggested, “Maybe other banks will take a look at this failure and realize they need to do actual banking instead of virtue signaling.”

It is fair to note that while the bank appears to have underinvested in risk management, as provided by Vivek Ramaswamy on Twitter, SVB had an intense focus on all things ESG:

- Sustainable Finance Group: Develops strategy and monitors progress against SVB’s Climate Commitment
- Investments Group: Reviews updates from our businesses on sustainability and investing-related initiatives and client engagement
- Climate Risk Group: Recommends, monitors and supports implementation of climate risks
- Operational Climate Group: Monitors implementation of operational greenhouse gas reduction initiatives
- ESG Communications and Disclosures Group: Recommends ESG disclosure strategy
- Risk Group: Develops, monitors and supports implementation of ESG risk strategy and policy
- DEI Governance Group: Oversees and manages DEI disclosures and response to external inquiries
- Green Team: Focuses on internal sustainability interests and active

A more intense focus on banking basics may have been appropriate. Just saying.

While the bank failed due to mismanagement, in no way was SVB a “typical” commercial bank. The Financial Times wrote that the bank provided services “to half of all venture-backed tech and life sciences companies in the US.” It facilitated start-ups and was eager to seek potential upside from its clients’ success. That focus compounds the potential domino-like problem created by SVB’s downfall.

One report summarized this aspect: ‘Many startup founders and executives worried how a collapse of Silicon Valley Bank would affect Silicon Valley’s infrastructure. The bank could try to liquidate its stakes in portfolio companies, which would further drive down the already flailing valuations of many startups. Those lower valuations in turn would further weaken the balance sheets of other banks, hedge funds and crossover funds that hold the same assets.” That was not something VCs wanted to see happen.

Mark Cuban, among other billionaires, called for government action: “ The Fed should IMMEDIATELY buy all the securities/debt the bank owns at near par, which should be enough to cover most deposits.” And there is no doubt that some companies would have been crushed or needed more VC support) if they could not gain access to the millions they deposited in good faith at SVB.

The near-term crisis may be over but what now?

- Can all banks take deposits of any size without concern about ALM?

- Given bailouts, why shouldn't a depositor put money into the riskiest banks, paying the highest rates?
- Will customers simply shift more business to the big banks?
- What does this mean for other regional and community banks?

Right now, the questions are piling up.

Over the next few days, we will learn more about the market's reaction to what has happened, and bank management should focus on scenario planning ASAP.

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