ANALYSES

Did Silicon Valley Bank's Bankruptcy Trigger a New Global Crisis?

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15May 2023

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On 10 March, the collapse of SVB became the largest bank failure since the 2008 financial crisis. [AFP]

The collapse of Silicon Valley Bank (SVB) on 10 March 2023 has resulted in the most significant financial crisis in the United States since 2008. The bank, which was established in 1983 and specialised in technology was successful, particularly during the pandemic. However, following the announcement of its difficulties by then-CEO Greg Becker, panic spread throughout the markets, leading to the bank's closure by the U.S. government.

This event raises concerns about the present global financial system, especially given the current challenging context of post-Covid 19 inflation and the ongoing Russian-Ukrainian war. Could this bankruptcy trigger a new global crisis? Additionally, what implications does this event have for the global financial system?

Poker inspiration

The story goes that Silicon Valley Bank (SVB) was conceived during a poker game between Bob Medearis, a Bank of America executive, and Bill Biggerstaff, a Wells Fargo executive. The aim was to serve the entrepreneurial technology community that lacked access to debt financing and banking services at the time.

Founded in 1983, SVB became the 16th largest bank in the US. From 2019 to 2022, particularly during the Covid-19 pandemic, the Silicon Valley-based bank catering to start-ups serving the technology and venture capital sector, tripled in asset size. (1) The bank directors chose to invest in treasury bonds, deemed as the 'safest investment asset on earth'. (2)

However, last year, the U.S. Federal Reserve raised short-term interest rates at the fastest pace since the early 1980s to combat rising inflation, which hit its worst level since the early 1980s, resulting in the target rate falling within a range of 0.25% to 0.50%.

According to a regulatory filing quoted by Bloomberg, on 9 March, some investors and depositors attempted to withdraw $42 billion from SVB, resulting in one of the biggest banks runs in the U.S. in over a decade. To fund these withdrawals, SVB sold a $21 billion bond portfolio, primarily consisting of U.S. treasuries, which had decreased in value. Furthermore, the bank announced plans to sell $2.25 billion worth of common equity and preferred convertible stock to make up for the shortfall. Despite efforts to find alternatives, the bank's collapsing stock price made it impossible to raise the required capital. As a result, regulators decided to shut down the bank, as reported by Reuters. (3)

On 10 March, the collapse of SVB became the largest bank failure since the 2008 financial crisis, which was caused by the bankruptcy of "too big to fail" Lehman Brothers and was the worst since the 1929 stock market crash. Prior to its collapse, SVB had approximately $209 billion in assets and $175.4 billion in deposits. The bank disclosed a loss of $1.8 billion after-tax from investment sales.

U.S. President Joe Biden, along with his administration and the Federal Reserve System, intervened immediately in response to the collapse of Silicon Valley Bank because they saw "a serious risk of contagion", according to U.S. Treasury Secretary Janet Yellen. This intervention was necessary as U.S. banks, including JP Morgan, Bank of America, Wells Fargo and Citigroup, lost over $100 billion in stock market value in just two days. Additionally, European banks lost approximately $50 billion in value, as calculated by Reuters.

Ensuring American supremacy

Silicon Valley is considered the heart of the American economy and its supremacy. In his first remarks following the measures taken, the president pledged to do "whatever is needed" to prove that the banking system is safe. (4) This assurance was necessary to protect uninsured customers at Silicon Valley Bank and Signature Bank, who were impacted by SVB's collapse. Pacific Western and First Republic Bank were also affected. As of 13 March, all insured depositors had access to their deposits.

With the approval of the Treasury Department, the Federal Reserve Board has established the Bank Term Funding Programme (BTFP). This programme allows banks to receive additional liquidity in case of unexpected depositor demands. The Board has stated that the BTFP will provide an additional source of liquidity against high-quality securities, removing the need for institutions to sell their securities quickly during stressful times.

Furthermore, Biden has proposed new measures to safeguard workers, small businesses, taxpayers and the financial system. He has stated that this is an essential aspect of how capitalism operates.

According to Reuters, the Nasdaq, Dow Jones Industrial Average and S&P 500, which are all heavily invested in technology, experienced a 1% decrease in value. Bank stocks were hit the hardest during and after Biden's announcement. As a result, global stocks plummeted, and oil prices reached their lowest level in 15 months. However, on 6 April, Saudi Arabia and other OPEC+ oil producers announced a reduction in their production.

Reuters also reported that major U.S. banks lost around $90 billion in stock market value on the same day. Europe, Asia and the Middle East were all affected by the market downturn, with most stock markets ending lower.

In response, Biden called for a thorough investigation into the matter and for those responsible to be held accountable, asserting that no one is above the law. This call for accountability came wake of the 2008 financial crisis, in which only one American banker was sentenced to jail. (5)

Shareholders of SVB Financial Group, including Becker himself and Daniel Beck, are facing lawsuits for allegedly concealing the impact of rising interest rates on the bank. The lawsuits also name KPMG LLP, SVB's auditor, and underwriters, including Goldman Sachs Group Inc., Bank of America Corp., and Morgan Stanley & Co. According to Forbes and Bloomberg, the allegations centre around misstatements leading to the bank's collapse.

Barron's and Forbes have reported that Becker sold $3.6 million in stocks two weeks before the bank's collapse, suggesting that bank officials may have known about the bank's troubles before it reported a nearly $2 billion loss. Furthermore, Becker may have acquired the same number of shares at a significantly lower price, raising questions about his knowledge of the bank's situation.

A preventable disaster?

According to The New York Times, on 7 March, Becker spoke at a conference hosted by Morgan Stanley at the Palace Hotel in San Francisco. He expressed to the audience, comprising investors, Wall Street analysts, and technology executives, that the tech industry's future was promising, and Silicon Valley Bank would continue to thrive within it. The New York Times also quoted a bank analyst who said, "Nothing happened inside the Valley that didn't involve Silicon Valley Bank." (6)

However, the following day, Becker sent a video message to employees, acknowledging that the bank's collapse was due to the "incredibly difficult" 48 hours that had just passed. This raises the question of whether the disaster could have been prevented.

Senator Bernie Sanders highlighted in a statement the irony that Becker, the CEO of the Silicon Valley Bank, also served on the board of directors of the Federal Reserve Bank of San Francisco, responsible for regulating it.

Senator Elizabeth Warren accused Becker, along with other high-powered executives, in a statement of lobbying Congress to weaken the Economic Growth, Regulatory Relief and Consumer Protection Act.

In 2018, former President Donald Trump signed into law the biggest rollback of bank regulations since the Dodd-Frank Act was enacted in 2010, freeing smaller banks with assets under $250 billion from the most stringent oversight according to TIME magazine. Trump claimed in a post on Truth Social that the economy would suffer a depression greater than the 1929 Great Depression, and pointed to banks starting to collapse as evidence. (7)

Some people are questioning whether the Federal Reserve Chair and Vice Chair, Jerome H. Powell and Randal K. Quarles, allowed excessive deregulation during the Trump administration. Newsweek has highlighted the role of Joseph Gentile, who is listed as the investment bank's Chief Administrative Officer on SVB's website. Gentile had previously served as the Chief Financial Officer of the Fixed Income Division at Lehman Brothers.

For Sanders, the United States cannot continue to have socialism for the wealthy and rugged individualism for everyone else. On 28 and 29 March, Michael S. Barr, the vice chair for supervision of the board of governors of the Federal Reserve System, testified before the U.S. Senate Committee and House of Representatives. He called SVB's failure a “textbook example of mismanagement” and stated that the Federal Reserve was fully responsible for supervising and regulating the bank. Supervisors discovered liquidity risk management deficiencies in the bank during 2021 and 2022, leading to supervisory findings and meetings with the bank's senior management in 2022. The Board of Governors of the Federal Reserve System released a 118-page report on 28 April, which reached the same conclusions. (8) The Federal Reserve Bank of San Francisco was preparing SVB for stricter oversight when a decision from Washington halted the process, as reported by The New York Times.

During a hearing at the Financial Services and General Government Appropriations Subcommittee to justify the treasury's fiscal year 2024 budget request, Secretary Yellen testified that the systemic risk exception was invoked due to Silicon Valley Bank's catastrophic run, which created potential fear in the financial system. She also reassured the committee that the financial system is now stronger than it was 15 years ago.

At the National Association for Business Economics' 39th Annual Economic Policy Conference on 30 March, Yellen received a lifetime achievement award. During her acceptance speech, she mentioned that her career has spanned almost two decades at the Federal Reserve and used the fire analogy to analyse current events. The analogy explains how a financial crisis can spread from one company or institution to other interconnected companies or institutions, leading to a wider financial crisis. She called for stronger regulation of the non-bank or shadow bank sector, including money market funds, hedge funds and crypto assets like stablecoins. Additionally, she suggested re-examining banking regulations and supervisory rules for smaller and mid-sized banks with assets below $250 billion.

Yellen ended her remarks by stating that the United States has always paid its bills on time since 1789, and that it should stay that way. She urged Congress to raise or suspend the debt limit without conditions and without waiting until the last minute.

In its Quarterly Economic Report for January 2023, SVB noted that the Federal Reserve had significantly increased the federal funds rate.

From a success story to bankruptcy

SVB was a bank that catered to the innovation economy, with a claim to have helped numerous individuals, investors and innovative companies achieve exceptional outcomes. SVB claims on its website that nearly half of all U.S. venture-backed technology and life science companies chose it as their banking partner, and that 44% of U.S. venture capital-backed technology and healthcare initial public offerings (IPOs) in the year-to-date were also banked with SVB. SVB was named one of America's best banks in 2022 by Forbes.

But what was the reason behind so many start-ups choosing to bank with SVB? According to The Wall Street Journal, more than half of SVB's loans were granted to venture and private-equity firms supported by limited-partner commitments. Limited partners usually include institutional investors such as pension funds, endowments and foundations, as well as wealthy individuals or family offices. Limited partners have limited liability and are responsible only for the amount of capital they contribute to the fund. (9) If the firm fails to repay the loan, the limited partners could be held responsible for repaying the debt. This practice can inflate a venture fund's internal rate of return (IRR) metric by investing just before calling investors for cash, but it is also a legal yet questionable practice. By investing in a company just before calling in limited partner capital, the fund can make it seem like the investment has already generated a high return, which in turn inflates the fund's IRR. This could be misleading to potential investors who are evaluating the fund's performance and may make investment decisions based on this inflated IRR.

Several U.S. companies had deposited approximately $5 billion with SVB and utilised its credit facilities. In Europe, about 16 tech and life sciences companies disclosed exposure to SVB in the United Kingdom and United States of around $190 million, according to Reuters.

BlackRock, which was among the top 10 buyers of SVB's shares, conducted a risk control assessment in January 2022, as reported by the Financial Times. The Federal Deposit Insurance Corporation (FDIC) chose BlackRock's unit to sell the investments that it had taken over from SVB to recover some of the money owed to depositors and creditors, Reuters explained. The CEO of the world's largest asset management firm, Larry Fink, published a letter in the Financial Times, in which he expressed concerns about a slow-rolling crisis in the U.S. financial system.

The collapse of SVB has shown that even banks that are not "too big to fail" can have a significant impact on the global economy.

Global impact

At an event in Washington co-hosted by Meridian International Center and Politico, Head of the International Monetary Fund (IMF), Kristalina Georgieva said that the collapse of Silicon Valley Bank in the United States and the takeover of Credit Suisse by UBS in Europe show how hard it is to fight inflation. Central banks have to try to control prices while also making sure the financial system stays stable. (10)

In addition, the World Bank has also issued a warning stating that the world may be on the brink of a global recession in 2023. The IMF has projected that the global economy will experience a growth rate of less than 3% this year, down from 3.4% in 2022. On 6 April, Georgieva highlighted that the global economy is facing its weakest outlook in over three decades due to the ongoing impact of the pandemic, the Russian-Ukrainian war and high levels of inflation.

The current situation once again raises questions about the strength of the dollar itself. Financial Times contributor Brendan Greeley aptly asks: "What is the limit? Who gets to make dollars?" (11) These concerns are being echoed by many countries, including those in the Arab region.

According to Standard & Poor's, five out of the 19 banks rated in the region have more than 5% of their assets invested in the United States. Most of these assets are high-credit quality instruments or held with the U.S. Federal Reserve Bank. (12)

According to SVB, "500 Startups MENA founders choose Silicon Valley Bank". Saudi Arabia was the largest single funding source for U.S. startups in 2018, with Crown Prince Mohammed bin Salman directing at least $11 billion of Saudi money into U.S. startups since mid-2016, either directly or through SoftBank Group Corp., as estimated by the Wall Street Journal based on data from research firm PitchBook.

The recent collapse of SVB has had a significant impact on the financial sector in the MENA region, dominating most sessions and workshops of the Financial Sector Conference held in Riyadh in March, as noted in a press release. This highlights the need for greater caution and regulation in the financial sector, particularly in relation to the dollar and its potential impact on global markets.

During a digital event hosted by Qatar's Embassy in Washington D.C., the U.S.-Qatar Business Council, and the Silicon Valley Forum, Fahad Al-Dosari, Qatar's Commercial Attaché to the United States in 2020, stated that the Qatar-U.S. business relationship is worth more than $200 billion overall. (13)

Standard & Poor's anticipates that Qatar, Kuwait, Saudi Arabia and the United Arab Emirates will provide extraordinary support to their banking systems in times of need. In contrast, Oman's and Bahrain's capacity to intervene in the event of a system-wide shock is limited.

The Cooperation Council for the Arab States of the Gulf (CCEAG) are known for their vast financial surpluses. After the 2008 crisis, Europe called upon them to rescue its struggling banks and corporations, as noted by Samir Aita, the president of "The Circle of Arab Economists". (14) They still do. Furthermore, Islamic banks, one of the fastest-growing segments with the highest growth rates in the global financial industry, have demonstrated greater resilience during crises. An abundance of research has found that banks that apply sharia, which restricts loans and investments not based on tangible assets, perform better during times of crisis (15).

A failing system

FDIC Chairman Martin J. Gruenberg has reported that the expected cost of resolving the collapse of SVB will be $20 billion for the Deposit Insurance Fund.

Moreover, an analysis published on 13 March revealed that "10% of banks have unrecognized losses larger than those of SVB". (16) The analysis further discloses that almost 190 banks, with assets totalling $300 billion, are at risk of impairment if only half of their uninsured depositors withdraw their funds. This implies that the market value of a bank's assets, after accounting for any losses or depreciation, would not be enough to repay all insured deposits following these withdrawals. The authors also emphasised that the recent declines in bank asset values have significantly increased the vulnerability of the U.S. banking system to uninsured depositor runs.

In a different study conducted five years ago, an assessment of 135 unicorns, or start-ups valued at over one billion dollars, found that 65 of them should have been valued at less than $1 billion. (17) Additionally, in the year preceding their initial public offerings, 66% of companies that went public in 2017 were unprofitable on a per-share basis. This percentage is the highest since the peak of the dot-com bubble in 2000.

It may still be too early to fully comprehend the implications of the recent bank failure, which is the largest since the 2008 financial crisis. However, it is becoming increasingly apparent that this crisis is yet another indication of the fundamental flaws within the current financial system.

The "dotcom bubble" burst, the Enron and Madoff scandals and the Goldman Sachs Commodities Index (GSCI) causing a global food crisis are all examples of the systemic risks that are inherent in the banking and financial system. Despite this, many of the institutions and individuals who are currently commenting or getting involved in the issue are neither trusted actors nor free of political motivations. These include rating agencies, businessmen who are blaming "the bank run", billionaires who have seen their wealth and numbers grow during the Covid-19 pandemic and BlackRock, who may emerge as a winner in the current crisis just as it did in the aftermath of the 2008 crisis. The four largest U.S. banks have also reported significant profits, which is not surprising since they helped design and perpetuate a system that benefits them at the expense of the poorest people (18).

While political leaders may attempt to reassure their citizens, this crisis is about more than just economics. It is about the urgent need to reform the global financial system.

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