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U.S. Bank Failures: What Happened and What We're Watching

March 13, 2023

On March 10, regulators announced the closure of Silicon Valley Bank, an institution that specialized in providing banking and financial services to the technology and life sciences industries as well as private equity and venture capital firms. "Nearly half" of U.S. venture-backed technology and life science companies bank with Silicon Valley Bank, according to the company. With more than USD 200 billion in assets, Silicon Valley Bank is the second-largest bank failure in U.S. history, eclipsed only by the collapse of Washington Mutual in 2008.

Shares of SVB Financial Group, the holding corporation for Silicon Valley Bank, declined 67% last week, before trading in the stock was halted Friday morning, March 10. The speed with which the failure occurred—only two days after announcing a proposed issuance of common stock and convertible preferred shares to shore up its balance sheet—appeared to surprise investors and pressured equity markets as well as bank stocks of all sizes.

On March 12, New York state banking regulators announced the closure of Signature Bank, which will be placed into receivership with the Federal Deposit Insurance Corp (FDIC). As of the market's close on March 10, the stock had given up about 38% of its value this year, with Signature Bank's shares encountering significant selling pressure as SVB Financial Group's struggles came to light. Signature Bank's weakness appeared to reflect concerns about its exposure to the U.S. dollar-denominated operating deposits of companies involved in cryptocurrency and other digital assets. Signature Bank's collapse is the third-largest bank failure in U.S. history.

Statement on Current Positioning

While we cannot comment on active trading, we will furnish clients with the most recent, legally available holdings information. As part of our investment process, we keep all portfolio holdings under constant review and monitor them closely.

Q: What precipitated the failure of Silicon Valley Bank?

SVB Financial Group's woes stemmed, in part, from putting roughly USD 90 billion of its deposits in long-dated securities, including mortgage bonds and U.S. Treasuries. These securities declined in value as the Federal Reserve increased interest rates, paper losses that would not matter if these bonds were held to maturity. However, had the bank been forced to sell this portfolio of securities at the current market, the magnitude of the potential losses could have wiped out its entire capital.

Meanwhile, SVB Financial Group's concentrated exposure to venture capital-backed technology and life science companies—a growth driver when funding was readily available for start-ups in these areas—became a meaningful headwind. The slowdown in venture capital funding led to startups spending down the cash in their accounts, reducing the bank's deposits and forcing it to sell about USD 21 billion of the longer-dated securities in its portfolio at a loss.

The bank holding company had planned to issue USD 1.25 billion in common shares and USD 500 million worth of convertible preferred stock to offset the loss and shore up its balance sheet.

However, news of the deal and the bank's challenges shook customers' confidence in the bank and led to an acceleration in deposit outflows. Given the perceived risk, some prominent private equity and venture capital firms reportedly encouraged their portfolio companies to withdraw deposits from the bank, placing SVB Financial Group under even more pressure. A filing from California's Department of Financial Protection and Innovation disclosed that Silicon Valley Bank's customers had initiated withdrawals for USD 42 billion on Thursday, March 9. This run on the bank left it with a negative cash balance of USD 958 million, according to the same regulatory filing.

On March 10, SVB Financial Group reportedly pulled its share offering. The FDIC announced the bank's closure and placed it into receivership to protect insured depositors.

Q: How did the market react to Silicon Valley Bank's collapse?

Bank stocks in the U.S. came under pressure March 9 and March 10, as investors worried about deposit outflows and liquidity crunches at other financial institutions. The S&P 500

Bank Index ended the week down more than 10%, while certain names perceived as having exposure to similar risks suffered larger pullbacks.

Q: What factors were behind the failure of Signature Bank on March 12?

Like SVB Financial Group, Signature Bank's deposit mix included a concentrated customer base and a higher proportion of uninsured deposits. The reputational damage that the company appeared to suffer from providing banking and financial services to the cryptocurrency industry also may have shaken customers' confidence in the bank, making it prone to withdrawals.

Q: How did federal regulators and agencies respond to shore up confidence in the banking system?

On March 12, the Department of the Treasury, the Federal Reserve Board, and the FDIC issued a joint statement announcing actions to shore up confidence in the U.S. banking system and declaring that all depositors at Silicon Valley Bank and Signature Bank would be made whole. Any losses incurred by the FDIC's Deposit Insurance Fund would be recovered by a special assessment on banks.

The Fed also created a new Bank Term Funding Program (BTFP), backed by USD 25 billion from the U.S. Department of the Treasury. This lending facility would accept Treasury securities and mortgage bonds, as well as "other qualifying assets." These loans would last up to one year and, critically, would value the pledged collateral at par, as opposed to its current market value.

This emergency funding vehicle aims to provide a source of liquidity to banks to ensure that they do not need to sell their held-to-maturity securities at a discount. These efforts are designed to help restore confidence in banks that might be sitting on large, unrealized losses in their held-to-maturity securities portfolios after the Fed began raising interest rates.

Q: What do the emergency actions announced by federal regulators and agencies mean for investors in SVB Financial Group and Signature Bank?

In their joint statement, federal regulators emphasized that equity holders and some unsecured bondholders in the two failed banks would not be protected.

Q: What are our analysts and portfolio managers watching next?

Our portfolio managers will continue to rely on the expertise of our research analysts to identify potential risks and opportunities in individual banks as well as other areas of the market that may be affected by the effects of the Fed's monetary tightening. To the extent that the Fed keeps rates elevated for longer, for example, some banks could see their deposits decline more than others. Certain types of customers are more likely to shift their funds to accounts with higher interest rates or investment vehicles that offer the prospect of favorable yields. Accordingly, we are paying close attention to the characteristics of individual banks, deposit mix and the potential read-through for their earnings.

We are also working through the possible implications of Silicon Valley Bank's failure for the venture capital industry and what these developments could mean for private and public companies in the technology sector and elsewhere that serve this ecosystem.

Q: What are the potential implications for money market funds?

Doug Spratley, a fixed income portfolio manager for T. Rowe Price Associates, Inc., believes that the banks that U.S. money markets are approved to buy so far have been largely immune to the problems that have cropped up. These banks also generally have better capital and reserves positions to handle outgoing deposits. He also notes that if other banks have liquidity problems like SVB Financial Group and Signature Bank, they would be allowed to use the BTFP, too. He believes the most impact money market funds face is the change in the path of future interest rates. Interest rate futures contracts indicate that market participants' expectation for where the Fed funds rate could peak during the U.S. central bank's tightening cycle have declined over the past week.

Q: What are the potential implications for banks outside the U.S.? What are our international analysts watching next?

Our analysts in Asia, Europe, and emerging markets continue to scrutinize the companies they cover for potential weaknesses related to the economic and rate environment. A global credit analyst for T. Rowe Price Associates, Inc., noted that competition for deposits tends to be lower in Europe. He also believes that nuances in how banks are regulated could help to limit the kinds of risk that SVB Financial Group and Signature Bank encountered. Meanwhile, a Tokyo-based equity analyst at T. Rowe Price Associates, Inc., believes that banks in Japan have limited funding and liquidity risks due to their balance sheets and the rate environment in Japan. T. Rowe Price Associate's global research analysts are monitoring potential funding and liquidity risks closely at the banks in their coverage universes.

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