



# The swift collapse of Silicon Valley Bank

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*How did a bank at the heart of the innovation economy end up going bust?*

As I contemplate the run on Silicon Valley Bank (SVB) and subsequent seizure of Signature Bank, I cannot help but think that I have seen this movie before. In fact, I have. As I approach the completion of my 40th year in financial services, I remember that, as a young commercial banker in the early 1980s, I was taught the dangers of “borrowing short and lending long.” This is exactly what happened at Silicon Valley Bank. But what does borrowing short/lending long actually mean?

SVB’s ledger contained lots of short-term time deposits that matured in 3, 6, 9, 12 months, which it was on the hook to pay back to depositors. The bank was borrowing short. Banks fund themselves in a variety of ways, and among the most fundamental are deposits that come due at various times. This money is then loaned to customers or invested in assets. Banks make money from the difference between deposit rates and lending rates. SVB “lent long” by investing many of these deposits in longer dated U.S. Treasury bonds and fixed-rate mortgage bonds with a range of maturities that well exceeded the length of the time deposits.

Here’s the important point: It was not the quality of the assets held by SVB that was the issue — U.S. Treasuries and high-quality mortgage bonds are among the safest assets in the world — it was the length or maturity date of the assets. Bonds are very sensitive to interest rates. When rates rise, bond prices fall. SVB had invested in longer-dated bonds at much higher prices/lower interest rates than we are seeing now. When the Federal Reserve began raising interest rates, the price of Silicon Valley Bank’s bond portfolio fell — resulting in an unrealized loss on SVB’s books. This unrealized loss became very real when customers decided to access their money.

The foregoing description is also known as a “liquidity mismatch.” SVB was not alone in the practice of lending long, but at Silicon Valley Bank, this coincided with a surge in customer withdrawals. Many of these clients were startup firms that needed the capital because venture capital funding, which in earlier periods was more readily available, had dried up due to the increase in interest rates. Once word of this liquidity issue spread, the run on the bank began. In fact, a colleague of mine called this the first social-media-driven bank run in history. In the past, depositors queued outside the banks to access their money as word of a problem spread. Now it’s just an electronic message, and it only takes the press of a few buttons on a computer screen to access your money. The liquidity mismatch highlights the importance of financial institutions making sure they have access to cash to meet short-term needs, especially when bad things happen and



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customers become “nervous.”

While many will question regulators guaranteeing the deposits of SVB and Signature, it is a smart move. The banks’ U.S. Treasury/mortgage bond portfolios are “money good” over time, and it is unlikely that losses will be incurred over the long run. Regulators know that once the panic begins it is very hard to stop. The fall in the stock prices of smaller regional banks is evidence of the concern that customers and investors have.

**The road ahead**

As we’ve seen, the Federal Reserve has been raising rates to combat inflation. Many of us welcome the return to higher rates. First, the Fed must win the fight against inflation — that is job #1. Second, higher rates mean that there is actually a cost for money. Lots of investments look attractive when the cost of money is zero, and this can encourage speculation and uncomfortable levels of risk. My view is that the Federal Reserve will keep raising rates to tame inflation. However, as rates go higher, other unintended consequences may arise.

This is not a reason to panic, it is part of the business cycle and why long-term investing and a diversified investment portfolio matters. We will get through this just as we have in the past.

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