Client Letter from Fidelity

Silicon Valley Bank: What happened

Here's what SVB's failure could mean.

On Friday, Silicon Valley Bank (SVB) was closed by regulators, marking the largest US bank failure since the Global Financial Crisis in the late 2000s (and second largest in US history). Then, on Sunday, state regulators in New York closed Signature Bank, in an attempt to prevent any further disruption that might threaten the broader economy.

Here are the potential implications and what investors might expect.

What happened to SVB and Signature Bank?

Several factors led to the precipitous collapse of SVB. Most of SVB's clients include tech and venture capital companies, in addition to executives for these firms. In an effort to attract clients, SVB offered relatively higher rates on deposits compared with many larger rivals. To help fund these higher rates, SVB bought longer-term, higher-yielding bonds when it was cash rich. But that was before the Fed began aggressively hiking rates and the venture capital market experienced some turbulence. The value of most of those bonds SVB purchased has declined substantially (bond values generally decrease as interest rates increase), resulting in big investment losses.

"This is a classic asset-liability mismatch, triggered by higher rates, and compounded by leverage, "according to Jurrien Timmer, director of global macro at Fidelity. "Some banks have offered to pay higher rates to their depositors, but as the Fed has raised rates and bond values decreased, banks like SVB are taking losses on their bond assets."

Complicating the situation, SVB kept a lower level of deposits on hand and invested a greater percentage of its capital in order to try and pay its relatively higher rates. Consequently, SVB has been on looser footing than most other banks.

Additionally, some have speculated that SVB developed a reputation for having not-as-strict lending standards. It is speculated that the quality of loans to some riskier venture-backed companies with deposits at SVB has deteriorated over the past year. Many of those firms have come under significant financial pressure as rates have risen and securing capital has become more difficult compared to the low interest rate environment from just a couple of years ago.

After SVB announced recently that it lost $1.8 billion in asset sales, the bank failed to secure additional investment capital and many customers rapidly withdrew deposits. Everything culminated with Friday's seizure by regulators.

"There's an old adage that says the Fed tightens until something breaks," Timmer adds. "It looks like we have a sense of what is breaking during this Fed cycle."

Like SVB, Signature Bank’s clients included many tech and venture capital companies, and in the aftermath of SVB’s failure, those clients similarly rushed to withdraw their funds from Signature, triggering its collapse.

What it means for SVB and Signature Bank depositors

While there was initially a lack of clarity over what might happen to SVB and Signature Bank depositors who held more than what the FDIC standard insurance will cover ($250,000 per depositor ,per bank, for each account), the Fed, FDIC, and Treasury issued a joint statement over the weekend confirming that depositors would have access to all their money starting Monday, March 13.

What it means for investors

Obviously, investors in SVB have taken a huge hit, and regional bank stock prices were noticeably lower on Friday after news broke of SVB's failure. But the spillover implications for other financial companies, markets, and the economy may be limited.

"The good news is that this seems to be an isolated incident, or at least a problem that may be limited to some smaller banks," Timmer adds. "In my view, this does not appear to be a situation that could become systemic, like the sub-prime mortgage collapse did in 2007."

Matt Reed, manager of the **Fidelity Select Financial Services Portfolio** (FIDSX), thinks the impact on the financial sector and broader market will be limited as well.

"SVB was a unique bank that grew rapidly in a very specific niche industry, while the broader banking system is regularly stress-tested, has added meaningful liquidity and capital over the past decade, and has worked to manage balance sheets conservatively," Reed says. "While markets are likely to worry, it doesn't look like there is meaningful spillover into the broader banking system and the economy."