Assessing the Fallout Resulting from the Failure of Silicon Valley Bank

By Keaghan Ames, BGR Vice President, Financial Services Practice

March 17, 2023

One week later, the failure of Silicon Valley Bank (SVB) continues to reverberate.

By now, most are generally familiar with what happened: there was a significant run on deposits at SVB after shareholders and depositors learned that of underlying interest rate risk at the bank that required a capital infusion.

While the specific details around SVB's exposure and risk mitigation (including who it asked to step in and help) will not likely be revealed until the Federal Reserve releases its May 1 report, it is clear that the bank was not well positioned in its risk management practices, specifically its hedging strategy. The run on the bank, totaling approximately $42 billion in the span of a few business hours, lead the FDIC to place SVB in receivership and forced the FDIC, Federal Reserve, and Treasury into working through a series of difficult decisions over the weekend.

Ideally, the regulators would have found a buyer(s) at auction prior to the markets re-opening on Monday, the 13th. It is not yet public information as to who was invited to the Sunday auction but the prevailing sentiment in Washington is that the regulators were targeted on who was invited so as to not cause a run on the community bank sector (i.e., it's entirely possible that that the U.S. global systemically important banks were not invited to the auction for a variety of regulatory and policy reasons).

Barring Congressional action or the use of the systemic risk exception (SRE), the FDIC would have been prohibited from guaranteeing anything beyond the federal deposit insurance limit. Subsequently, the regulators announced they would be using the SRE for SVB and Signature Bank (the receivership of which was simultaneously announced) to "protect the U.S. economy by strengthening public confidence in our banking system."

Since opening on Monday, the markets experienced a week of turmoil, particularly the treasury markets. Furthermore, other banks ranging in size and jurisdiction, experienced varying degrees of volatility both directly related and correlated to the events of SVB. Some of the more direct impacts have been around whether large regionals and communities can support deposits whereas the correlated events have centered around the overall health of interest rates and fixed income markets.

As with any crisis, some policymakers in D.C. are not allowing this opportunity to go to waste. Many are retreating to their ideological corners in terms of who is to blame for this crisis: the far right blaming ESG and the far left blaming the roll back of certain tailored prudential regulations from the previous administration.

However, the majority of policymakers are using this as an opportunity to have meaningful conversations around two central policy points: (1) the health of our deposit insurance system; and, (2) what, if anything, can be done around the broader economic and capital markets issue that triggered these events in the first place.

For example, Congressman Patrick McHenry (R-NC), Chair of the House Financial Services Committee, has received praise from both sides of the aisle for taking a tempered approach and investigating what happened prior to making any policy decisions. Members of Congress have called for specific deposit reforms, including raising the FDIC's limit or introducing premiums on deposits exceed the FDIC limit or raising the limit. There have been several briefings between members of Congress and regulators in the last week. There will be more briefings and congressional hearings to come.

What's clear is that there are fundamental policy questions around our banking system that will be addressed in the coming months as the regulators and market continue to triage the aftermath of SVB. The answers to these questions will ultimately shape the future of the U.S. banking system and the health of the economy.