Risks and Regulations: The Silicon Valley Bank Collapse

By Lily Fang , Kaisa Snellman and Claudia Zeisberger , INSEAD, and David G. Munro , Volatility Research & Trading

Risky investments and a lack of regulatory oversight contributed to the failure of Silicon Valley Bank.

Silicon Valley Bank's (SVB) recent collapse marked the **largest failure** of a United States bank since Washington Mutual in 2008. Formerly the darling of the region's tech start-ups, the bank announced it had sold off a significant number of securities **at a loss** and was **planning to raise US$2.25 billion** through selling new shares in order to shore up its balance sheet.

This triggered mass panic among prominent **venture capital (VC) firms**, leading to a run on the bank. SVB's stock plunged by **60 percent** in a single day, prompting regulators to step in and shut it down. Although a bailout by the US government has ensured all depositors will get their money back and seems to have quelled fears of **a contagion effect**, there will undoubtedly be ramifications across the tech and financial industries.

The beleaguered bank's disintegration startled us all. But how will the collapse affect tech start-ups and individual investors? We share our views on the repercussions.

While not the cause, this will deepen the tech winter

Lily Fang, Dean of Research, Professor of Finance and the AXA Chaired Professor in Financial Market Risk

SVB was an important player in the tech ecosystem and was the main banker for tech start-ups – taking deposits and making loans. We have already been in a tech winter for a year, and the unravelling of SVB will simply deepen that winter, though it is not the cause, nor will it have a severe effect.

Despite these tech links, the SVB collapse was a classic case of an asset/liability duration mismatch and a rapidly rising interest rate. To get better returns on its investments, SVB put its assets in long-dated government bonds, which were supposed to be risk free. Its liabilities were demand deposits that start-ups could withdraw at any time. As the United States Federal Reserve System aggressively raised rates to fight inflation, the long-duration assets lost significant value whereas the liabilities hardly budged.

Suddenly faced with more liabilities than assets, SVB attempted to raise more capital. This triggered the panic among start-up founders who stampeded to withdraw their cash and, in doing so, ruined the bank. As with all bank runs, it is a prisoner's dilemma – if everyone co-operates and stays put, everyone will be safe; if everyone rushes, everyone suffers.

There are at least four rich ironies in this saga. First, regarding the immediate cause of the collapse: the run on the bank. VCs are supposed to be wise advisers to their portfolio companies. VCs also had close working relationships with SVB. In this case, it is in fact the VCs that panicked and instructed their founders to withdraw cash quickly. VCs are financiers and should know the consequences of a panic-driven run. Why did they feed it?

Second, regarding who is at fault and regulatory oversight. Where was the regulator? The irony is that since 2018, SVB's CEO Gregory W. Becker – along with other leaders of medium-sized banks – has lobbied hard to fly under the radar of the Dodd-Frank Act. They successfully lobbied to increase the regulatory oversight threshold from US$50 billion to US$250 billion; that is, only banks with assets over US$250 billion would come under the sharp eye of the Dodd-Frank Act. Regulators were therefore largely in the dark about the bank's issues.

Third, regarding the "bailout". Ironically, when the Fed and the United States Federal Deposit Insurance Corporation (FDIC) issued a guarantee of all SVB deposits – including those beyond the US$250,000 FDIC insurance limit – the Fed had to invoke the "systemic risk" exception that was supposed to apply only to those "systemically important'' banks with assets over US$250 billion – the same threshold SVB worked so hard to avoid. Therefore, SVB got the better end of the stick, twice: First it dodged regulatory oversight, and then, once in trouble, it got bailed out from the regulatory protection. This raises enormous moral hazard problems in the long run.

But the Fed's main objective is to make sure there is no contagion. It implemented the backstop not to save the rich Silicon Valley VCs and founders, but to protect the banking system. Nevertheless, in doing so, it did save the rich Silicon Valley VCs and founders.

Fourth, regarding the deeper origin of the collapse. This is deeply rooted in the excess liquidity and flood of cash that the world has received from years of easy monetary policy. The influx of deposits that SVB got from tech start-ups, which the bank fatefully invested in long-term bonds, consisted of rich proceeds from SPACs or IPOs or bloated VC funds. The tech winter that started last year, while painful, is part of a healthy dieting process to get rid of the excess. SVB's collapse resulted from rising interest rates – precisely the tough medicine that the Fed has belatedly been trying to administer to the economy. Ironically, SVB's collapse will make the Fed consider whether to continue administering that medicine.

It is worth emphasising that fundamentally, the effect of SVB's meltdown should not be very severe. The exposure is limited, the banking sector is generally quite healthy and the economy is still doing well. This was not caused by the bad quality of SVB's loan book. It was a problem of poor investment decisions and a lack of risk oversight. Mega banks, such as JPMorgan and Citi, are in fact benefiting from new customers and deposits. However, smaller regional banks with a similar asset/liability duration imbalance as SVB could be more at risk.

For investors, the takeaway from this incident is to diversify, diversify, diversify. Do not put all your deposits in one bank. Some bold investors would have scooped up bank shares during the recent dip. If they bought carefully with good due diligence – and into a bank with a solid balance sheet and operating income – they may emerge as a winner.

Your bank is not your "bro"

Claudia Zeisberger*, Senior Affiliate Professor of Entrepreneurship and Family Enterprise*

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It's cute that SVB was once a start-up – every corporation was. But that was 40 years ago. The fact that SVB invested in and lent to their clients is a neat, circle-of-financial-life concept that may have given start-ups that fuzzy feeling of camaraderie and friendship, but it is no reason to have left uninsured cash or securities with them.

Of the 20 investments SVB made since November 2022, 15 of them were debt financing. Chances are they likely gained brownie points for aggressively lending to companies in the start-up ecosystem. Crunchbase lists a total of 835 SVB investments, 257 of which they led.

However, it is crucial to remember that they are still a bank. They are not your "bro". SVB's loans to start-ups were risky – probably much more so than those of the larger, more stodgy banks. Investors should have placed their deposits with them because they provided fast, efficient and cost-effective services that were useful to their client base, not because the bank was one of them.

On the risk side, banks always have duration mismatches. They borrow short and lend long. But the longer-duration loans are usually collateralised residential mortgages or securitised corporate loans that are diversified either by industry or geography. Not many financial institutions would put 50 percent of their assets in risky mortgage-backed securities at historically low interest rates. The savings and loan crisis of the late 1980s to the early 1990s and the 2008 global financial crisis provide excellent examples of mortgage-backed securities experiments gone bad. It's never a question of if, but when.

The burning question is why an institution would hold more than US$250,000 in a current account at a bank when they could easily park larger amounts in liquid, risk-free, higher-yield, short-term US Treasury Bills (T-Bills)? They could have placed the T-Bills (or other assets such as Treasury Notes, corporate paper and equities) with a secure custodian bank. Here, assets are held in your name and do not enter the bank's balance sheet. Hedge funds do this at the request of their investors, as do pension plan trustees.

Another question is why the FDIC uniformly sets insurance at US$250,000 regardless of the risk profile of the bank. An aerobatic pilot pays more for life insurance than an airline pilot. Homeowners in forest fire or tornado zones pay more to insure their homes than residents living in areas that have a lower risk of natural disasters. Teenagers fork out more for car insurance than their parents. Insurance companies assess risk and price it accordingly.

Curiously, the FDIC doesn't think that way.

Why not set a minimum deposit insurance rate for all banks – let's say US$100,000 – and insure up to US$10 million of deposits for banks that place their excess cash in risk-free, three-month T-Bills, while providing no additional insurance for those who opt for long-dated mortgage-backed securities? Setting a market price for deposit insurance based on risk could go a long way towards protecting depositors from similar incidents in the future.

The elephant in the SVB post-mortem room is the absence of risk-tech. Faster, cheaper and more efficient banking services abound thanks to advances in technology. But it seems no one embraced or deployed risk-tech. App-based real-time visibility into duration risk, asset quality and deposit concentration would have enabled all interested parties to view risk in real time and act on it as the risk environment changed. Of course, it is difficult to quantify risk and assign market prices for unlisted equities and loans. But the tech crowd is pretty resourceful and innovative, and we are certain they could craft a solution if pointed in the right direction.

Perhaps risk-tech is the opportunity that emerges from bank run crises.

Was Silicon Valley Bank ruined by diversity? Nice try

Kaisa Snellman*, Associate Professor of Organisational Behaviour and Academic Director, INSEAD Gender Initiative*

The recent collapse of SVB escalated into an argument about ideology faster than you could say "regulatory oversight".

It all started when *The Wall Street Journal* published an op-ed blaming the bank's downfall on its diversity and inclusion policies. In his column, Andy Kessler wrote: "In its proxy statement, SVB notes that besides 91 percent of their board being independent and 45 percent women, they also have 'one Black', 'one LGBTQ+' and 'two veterans'. I'm not saying 12 white men would have avoided this mess, but the company may have been distracted by diversity demands."

Conservative politicians and pundits quickly jumped on the bandwagon. The Chairman of the House Oversight Committee, James Comer, called SVB "one of the most woke banks", suggesting that its stance on sustainability and diversity was the reason for its failure. Fox News anchor Tucker Carlson offered a careful risk analysis of the US banking sector and concluded that diversity and inclusion standards are why "big banks are now increasingly incompetent".

Did SVB collapse because one of its 11 directors was Black? Or was it because of the five white women on the board? Of course not.

There is no evidence to suggest that SVB was "distracted" by diversity demands or that diversity (or a lack thereof) played any role in the events. The real story is complicated. SVB's investments lost value when interests rates continued to rise. And when they tried to raise additional capital to make up their losses, customers panicked and sprinted to withdraw their deposits.

But wait. Aren't companies with women on the board supposed to perform better than companies whose boards are all-male? We have all seen the claims that diverse management teams perform better and run more profitable businesses than all-male teams. But these claims originate from reports by consulting companies or think tanks, not academic research.

Peer-reviewed scientific studies find that companies do not perform better when they have more diverse boards. Nor do they perform worse. Meta-analyses summarising hundreds of original studies show that the relationship between board diversity and return on assets is effectively non-existent or so small that it has no practical meaning. Moreover, correlation does not mean causation. There is no evidence suggesting that putting women or members of underrepresented groups on a board would improve – or worsen – company performance.

This does not mean we should stop caring about diversity and inclusion. We should – because it is the right thing to do. If anything, we should use this as an opportunity to move the discussion away from diversity statements and platitudes and ask what the companies are actually doing to level the playing field.

In terms of the US banking sector, it is time to have tough conversations about oversight and regulation. But this has nothing to do with how many women or members of other underrepresented groups sit on a board.

Find article at
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