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Asset Management

Failure of Silicon Valley Bank

Not a Contagion Event

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Silicon Valley Bank, the main operating subsidiary of SVB Financial Group (SIVB), a banking leader in the venture capital (VC) and technology sectors of the economy, has been closed by the California Department of Financial Protection and Innovation which has appointed the Federal Deposit Insurance Corporation (FDIC) as receiver. SIVB has undergone sudden, significant funding and market confidence stresses that called into question its ability to continue as a going concern.

The issues at SIVB were driven by a confluence of events, including:

- ongoing soft market conditions in its VC and tech space, which put pressure on earnings
- constraints on deposit flows as VC and tech clients withdrew those funds to finance their operations, given their own constrained outside funding
- sharply higher interest rates which put market value pressure on the bank's large, high quality securities portfolio

SIVB compounded market worries about incurring securities losses to help fund deposit outflows by surprising the market earlier this week announcing it had liquidated its $21 billion available-for-sale securities portfolio, mostly treasury and agency paper, at a loss of $1.8 billion, and that it planned to issue $2.25 billion in common and convertible preferred stock to offset that loss. These surprising, material and sudden actions shocked the market and caused acute market distress, which led to SIVB's heightened deposit outflows and collapse of market confidence.

Not a Banking Sector Event. The confluence of SIVB's key VC/Tech customer base, that base's unique stresses, the bank's large securities portfolio, the sharply higher interest rate environment's effects on that portfolio, and the ill-timed and failed securities sale and planned recapitalization were unique to SIVB. *Given these factors, we do not see SIVB's failure as suggestive of any broader banking sector weakness.*

Not an Insurance Sector Event. While insurance companies may have material unrealized accounting losses on their investment portfolios due to the rapid rise in interest rates, assets are high quality (*e.g.,* investment grade fixed income that accretes back to par over time) and, unlike bank deposits, insurers generally do not have confidence-sensitive funding sources. Premiums and reserves that fund investments are broadly duration matched and paid out for events such as property losses, liability claims and death in the case of life insurance. Annuities often have high surrender charges and/or market value adjustments in place that limit outflows. The fact that insurers are rarely required to realize investment losses is a key reason why they have generally performed well through various cycles.

We do not see the failure of SIVB being a contagion or systemic risk event for the strongly capitalized banking and insurance industries.

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