

Silicon Valley Bank's Mistake was to invest their excess deposits in highly liquid and ultra safe Treasury bonds. Easy to sell at a moment's notice – until the Fed began their rapid and historic interest rate increases. Sunday's latest entry to the Fed's alphabet soup of bailout facilities, the Bank Term Funding Program lending program which, in theory, "will make loans on high quality collateral" (by which the Treasury simply means collateral that has already incurred mark-to-market losses of over \$600 billion).

The Bank Term Funding Program is basically another bank bailout facility because no matter what you may read elsewhere, one which gives banks full credit for unrealized losses on their Held to Maturity bonds, losses which amount to nearly a quarter trillion dollars at just the Big 4 banks. The facility will allow banks to take advances from the Fed for up to a year by pledging Treasury's, mortgage-backed bonds, and other debt in their portfolios as collateral. By allowing banks to pledge their bonds - not just at current market price but at cost (or at par) - banks can meet customer withdrawals without having to sell their bonds at a loss, which is what Silicon Valley Bank had to do last week, sparking the run.

The biggest draw of this facility is that banks can borrow funds equal to the par value of the collateral they pledge, according to the Fed's announcement. This means that the Fed won't look to the market value of the collateral, which in many cases reflect big unrealized losses due to the jump in interest rates.



That is a Huge Gift for the banks which are sitting on some \$620 billion in unrealized losses on all securities (both Available for Sale and Held to Maturity) at the end of last year, according to the Federal Deposit Insurance Corp. It also means that just the Big 4 banks are getting a \$210 billion bailout.

Additionally, the Fed will not demand that banks pledge collateral in excess of the advances they are taking, which is typically the case when banks borrow from, say, the Federal Home Loan Bank system. And if banks can't repay all the advances in a year's time? The Treasury Department is providing \$25 billion of credit protection to the Fed just in case. "The Federal Reserve does not anticipate that it will be necessary to draw on these backstop funds," the Fed said in its announcement Sunday night.

In a nutshell, this is how the Treasury, Fed, and FDIC hope to mitigate stress on the bank asset side. At the same time, on the liability side (where the deposits are), the regulatory trio hopes that by making whole all depositors - including uninsured corporate depositors with more than \$250,000 in deposits, they will contain the contagion aspect of the current bank crisis. Does this mean that now, nationally, all uninsured deposits are implicitly backstopped by the FDIC?

Yes it does.



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AVALAN

WEALTH MANAGEMENT INSIGHTS



Silicon Valley Bank

The impact of Silicon Valley Bank (SVB) on Avalan client portfolios is minute. The bank was held in our total market index funds, and was determined by our gifted analyst, Jeff Hall, to represent less than .05% of holdings in our highest equity exposure portfolios. Our sole venture investment fund, the Private Shares Fund (PIIVX), only invests in late-stage, cash flowing companies that have little or no relationships with SVB.

What Happed with Silicon Valley Bank was caused by an unusual set of circumstances. Founded in 1983, it followed a plan of securing long term relationships with venture capital firms and the companies they invest in. The Bank loaned to younger tech companies that are a little risky, but also have the potential to grow and become huge clients. The strategy was very successful through all the ups and downs of the tech world and had amassed total deposits of almost \$50 billion by 2018. During the tech boom of 2020 and 2021, clients were flush with cash and Silicon Valley's deposits rose to nearly \$200 billion.

The influx of cash was so sudden that it overwhelmed the bank's ability to find loans and investments to fund. Loan issuance takes time. So, SVB did what most banks by placing the surplus into the most liquid and safest investments in the world: US Treasury bonds. While these bonds only paid 1.5% to 2%, they were safe. And they paid more than the short-term rates offered by the Federal Home Loan Bank's 0.25%.

AVALAN'S Key Takeaway:

Silicon Valley Bank's collapse is not a harbinger of another 2008.

The US has never Defaulted on its Bonds and the strategy had produced strong returns since the 2008 Financial Crisis. In 2022 that all changed, and Treasury bonds fell as much as 20% in one year.

The problem for Silicon Valley Bank began in 2022, when their early-stage high-tech companies went from making big deposits to making withdrawals. As financial conditions began to tighten, they were no longer able to raise the level of investment funds that they did in 2020 and 2021. Normally, Silicon Valley Bank, would cover withdrawals by simply selling their ultra safe Treasury bonds. But, as 2022 went on and interest rates rose, the value of the bonds being sold were producing bigger and bigger losses.

When they reported their most recent loss, they announced they would need to sell more stock to bolster their capital. Unfortunately, that started a two-day spiral of high-tech firms panicking and withdrawing their money. And quickly led to the bank having to be shut down because selling all their Treasury bonds to meet demand would create huge losses.