Oxford Analytica

Public Webinar – Moment of Reckoning: Tech After the Silicon Valley Bank Collapse

Introduction

Technology-focused Silicon Valley Bank (SVB) collapsed on March 10. Two days later New York State financial regulators closed crypto lender Signature Bank. Several major technology firms such as Roblox and Roku and Circle had massive exposure to SVB, and the bank's overseas subsidiaries were bankers to tech firms in a range of countries, including China, India, Israel, Sweden and Germany. SVB's collapse has revived difficult memories of the 2008-09 financial crisis, and generated fear of another major hit to a global economy already grappling with the war in Ukraine, the cost-of-living crisis and rising interest rates.

Oxford Analytica-Fiscal Note's special webinar on March 16 examined the global impact of the SVB collapse.

Impact of the SVB collapse on the global financial system

The contagion risk of SVB remains material but the US banking system has significantly limited risks of a spreading crisis. The situation of SVB was idiosyncratic, which limits the extent to which this will become a systemic crisis. The US financial system is well-capitalised and robust, certainly much more so than in the 2008 global financial crisis. There is no real counterparty risk with SVB for other banks. However, there is a risk of contagion spreading deeply into the tech sector because tech firms, rather than other banks, were the ones exposed to SVB.

SVB's failure leaves a large hole in the Silicon Valley ecosystem that would not be readily filled. It has ramifications across the tech sector. The immediate worries for tech firms that lost access to their working capital have been assuaged by the Biden administration's promise to make all SVB depositors whole. However, the longer-term issue will be about where the tech venture funding comes from in SVB's absence as capital sources have been drying up because of rising interest rates and a fall in tech stock valuations.

US political response, and scope for legislative and regulatory change

Democrats and moderate Republicans in Congress agree with the intervention from Biden's administration. They insist that the intervention stopped what could have been a much worse crisis. It is notable that such views are being expressed across party lines.

There are voices of criticism directed towards the banking sector regulators and the 2018 banking deregulation legislation. Regulators are being criticised for their inability to identify factors that led to SVB's collapse. Progressive democrats have been openly critical of the 2018 deregulation law that rolled back some of the most stringent banking standards and requirements that came out of the 2008 financial crisis. They have introduced legislation that would repeal the 2018 law although it is unlikely to move forward.

Scrutiny of smaller, regional banks is likely to intensify. But the extent to which that scrutiny would be backed up by legislative change remains to be seen because it's a politically contentious issue. A shift in the position that the regulators have taken so far is expected but a reversal of the 2018 de-regulation law is unlikely, and the final position is going to be somewhere in the middle.

Implications of the SVB collapse on emerging market tech sectors

SVB was a major banker to a lot of companies from emerging markets such as China and India, primarily start-ups and scale-ups. The tech start-up and scale-up ecosystems in such emerging markets are going to be affected by the contagion arising out of the SVB. These were ecosystems that were already under strain because the demand post-pandemic was softer, securing financing was becoming harder and due diligence by venture investors was sharpening well before SVB's collapse.

Since the tech sector in emerging economies is not as robust as its US counterpart, many of these firms now face an existential crisis and many may cease to exist without a government bailout. As capital and revenue sources become harder to secure and operating environments become tougher, the next phase of growth is likely to be slower but probably more sober.

Q&A

***Megha*: Is this the beginning of the next global financial crisis?**

Paul: SVB's collapse? Probably not. Whether the current events surrounding Credit Suisse turn into a broader financial crisis is a separate question. In SVB's case, regulators have learnt the lessons of the 2008 financial crisis and have acted very quickly to head off what is a liquidity crisis, from becoming anything worse. The contagion risk is limited and more likely to spread through tech firms rather than the banking sector.

Caitlin: There are fears obviously that this could be the next global crisis and yet there are important differences between the crisis that is unfolding now and what we saw in 2008-09.

***Megha:* Why do you think there is this political fear that we are seeing in the US administration and the political elite that we are at the brink of something bigger and more devastating?**

Caitlin: The fear, was that this could lead to contagion and there would be a run on other similarly sized banks as depositors pull their money en masse. This was before the regulators stepped in and said they would cover the deposits and set up a facility that would extend aid to similarly sized banks. The mood now appears to be that the situation has been contained.

***Megha:* Both of you have touched on the difference between the SVB collapse and the 2008 crisis. What is different about the contagion risks that are generated because of the SVB collapse and what we saw back in 2008?**

Paul: What we see now is a liquidity crisis and what we saw in 2008 was poor asset quality and counterparty risk crisis and they are fundamentally different things that require fundamentally different responses from the authorities to deal with them. In the case of SVB, the risk to the financial system comes from bank runs and so the right point for addressing the problem was getting depositors to stop being nervous about having their funds in banks, which is what the measures taken seem to have successfully done so far. The risk in the 2008 crisis was because of the substantial exposure of one bank to another and the risk was that the entire financial system would collapse because all the banks would collapse. The fundamental core of the difference is that in SVB's case, the root cause of the collapse was a failure to manage interest rate duration risk whereas that was not the core problem in 2008.

Megha: **What is your best estimate of where the next weakest links lie in the present crisis***?*

Paul: Corporate debt is an area of risk in the present environment of rising interest rates. At one point it was largely an emerging markets problem, but it is very much a problem for entities in developed economies as well. Companies that loaded up on debt when money was effectively free are finding it burdensome as servicing the debt becomes more expensive with soaring interest rates. Interest rate exposure and how the company management is dealing with it is something that investors should be paying close attention to. The spread between corporate bonds and equivalent government securities should indicate the extent of the risk premium that investors are asking for and that should signal where there might be trouble.

Megha: **Do you think that the debate we are seeing about the SVB affair is way too coloured by the memories of the 2008 crisis to be fully relevant to what the issue at hand is right now?**

Caitlin: Yes, the debate around the SVB is heavily influenced by the 2008 crisis. What is interesting from this perspective is that the messaging seems to be really coloured to the response we saw from ordinary people to the bailouts that followed the 2008 crisis. The Biden administration is making a real effort to convey that this is not a bailout 2.0. Similarly, on the far right of the Republican party, there has been an effort to characterise it as a bailout, the costs of which will be passed on to consumers in the future.

Megha: **Could you articulate for us what is the core position of the Republicans and Democrats on this that people need to know about?**

Paul: I do not think there is a core position in either party. Both parties are divided and there are a lot of overlapping and conflicting political currents at play here.

Megha: **Despite ideological, practical, and electoral differences, is there any room for compromise on regulations, legislation or even tweaks to the existing policy?**

Caitlin: Bipartisan cooperation for legislation is highly unlikely. The Federal Reserve Vice Chair for Supervision Michael Barr is currently undertaking a review of the Federal Reserve's supervision of SVB, and the report is expected to come out in May. That is where we should expect to see the likeliest factors for action on this matter.

Megha: **Who is likely to be left carrying the biggest blame here for the SVB affair?**

Paul: The bank shareholders and unsecured bondholders have already taken the financial blame. The bank's management will also come out of this with a significant portion of the blame. Class action suits are being filed against them already, and the SEC and the Department of Justice have already launched their investigations into the bank's management as well, although that is not necessarily an indicator of wrongdoing.

Megha: **What constructive role do you think the Federal Reserve can play in this context?**

Caitlin: It is hard to say at this point what interventions could be when we do not know what went wrong or even have a clear answer on whether there were things that the bank's regulator should have caught earlier on. So, we should know more about this in a month when Michael Barr's report comes out.

Megha: **To what extent does the regulation of smaller regional and sector focussed banks need to be tightened in the wake of the SVB affair? Will it be tightened?**

Paul: Clearly too much attention has been paid to the big banks and not enough attention to the small banks, so the Federal Reserve needs to recalibrate how it strikes this balance. There were ongoing discussions in the Federal Reserve on whether the balance was struck right in focussing on larger banks and whether there was a need to tilt the balance even before the SVB collapsed. These discussions have accelerated after the collapse, but we will not know any specific details on this until we have the outcome of the Federal Reserve's report in May.

Megha: **If we have a Republican president in 2024, will the conversation about suitable changes to the financial sector be different? How would it be different? And what if we have another Democrat in the Whitehouse?**

Caitlin: If we have a Republican president, we are likely to see a liberalisation of financial services and banking regulation. But it depends on who is holding the House and the Senate, and with what margins.

Paul: The democratic agenda around tech should be the same as now, with a focus on issues such as antitrust, privacy and content moderation policies rather than financial regulation. As Caitlin points out, much depends on who controls Congress. But in this context, it is important to note that Democrats were still unable to pass any regulation around tech even when they controlled Congress during the first 2 years of Biden's presidency.

Megha: **To what extent could the SVB affair be a catalyst for a shift in US policy conversation about critical policy areas including privacy, artificial intelligence and crypto assets?**

Paul: Not very much. The biggest change in terms of how the tech sector is governed will come from two areas of policy initiative: antitrust and content moderation, and national security concerns. Those pressures for change are going to be strong but different and that regulation is going to operate independently of any fallouts from SVB.

Caitlin: I would agree with Paul. Not much makes it through Congress when it comes to tech regulation, whether there is bipartisan support or not.

***Megha*:** **In terms of major emerging markets looking to the US as a dominant innovator, what kind of traction does a change of policy, or lack thereof, have on wider tech markets?**

Paul: National security policy changes will have a very significant impact. There are discussions now that would support outward investment by US companies needing a CFIUS review of the kind applied to inbound investment in critical areas with national security implications. It will increasingly force tech companies in emerging markets to choose if they are going to align with the US sphere or China-sphere.

Megha: Will tech sector companies benefit in the same way from taxpayers' money as was the case in the bailouts following the 2008 crisis?

Caitlin: In the context of the response that we have seen to SVB's failure, the money is coming from FJC’s deposit insurance fund, which is funded through a fee assessed on banks, so some of those costs may be passed on to the consumer in the future, but it is not a taxpayer bailout in the same way that we saw following the 2008 crisis.

Megha: **What impacts do you see of the SVB affair, or the tech turmoil more broadly, on the med-tech and biotech ecosystems?**

Paul: SVB’s failure leaves a huge hole in the tech venture system. It was a banker to 40% of the venture tech ecosystem, including the life sciences. They are likely to find it more difficult to secure financing although biotech appears to be an area where the funding pressures are least acute. But it will certainly impact the innovation potential in these areas.
