THE COLLAPSE OF SVB: WHAT IT MEANS FOR PRIVATE EQUITY & VENTURE CAPITAL FIRMS

After a massive run on deposits, the fall of one of the largest banks has flooded news streams. This sudden bankruptcy has incited a sweeping panic among individual investors, as well as private equity, venture capital firms and their portfolio companies. Silicon Valley Bank's collapse not only raises speculation about the future of banking, but also begs the question – what can be done to protect high-value investments amid uncertainty?

If you are directly impacted by the SVB collapse, discuss your situation with your trusted investment, legal, and/or financial advisors before taking any action.

We have created highlights of what happened with SVB and provided some actionable steps that may be able to help protect your investments as the aftermath of this bank failure unfolds.

Q What caused the collapse of such a prominent bank?

SVB is the largest bank to collapse since 2008. An entity once widely known to assist technology startups that were undesirable for other banks is now known as the second-largest bank failure in U.S. history.

How did this happen? Because of SVB's role in the startup economy, it was heavily reliant on its ability to loan money. SVB was flush with deposits when interest rates were low because startups had higher valuations, leading to favorable rates in borrowing. But when these companies started to feel the pressure of the hardening economy, the valuations of their organizations began to decline.

The reason this was detrimental for SVB is two-fold. The investments the bank was making with customer deposits lost value with the increased interest rates and their public announcement to raise over 2 billion in capital to make up for these losses caused a mass panic. This led to a classic bank run where investors raced to pull out their money – causing SVB's stock to plummet by over 60% and resulting in a complete capital collapse.

The chain of events that led up to this bank failure can be attributed to poor risk management partially tied to a lack of diversification in the portfolio of investments.

Q How does the fall of SVB impact the private equity (PE) and venture capital (VC) spaces?

While asset management firms are affected by this collapse, new and emerging portfolio companies may be hardest hit, as these companies rely so heavily on banks like SVB to serve as vital support for the startup ecosystem. PE and VC firms may also experience changes relative to credit line needs in the form of borrowing. Though we're all still waiting to see how events develop, other regional banks are stepping forward to fill a lending void created by SVB's demise and add stability to the marketplace.

What can be done (if anything) to protect investments from the risk of financial institutions failing?

Fortunately, there is an availability of excess FDIC insurance. This comes in two types: a portfolio policy that protects the whole portfolio of deposits, or an individual account. Excess FDIC insurance is available for fewer markets than in the past but is still obtainable for both portfolios and individual accounts.

Due diligence is also vitally important. As we saw with FTX, thoroughly conducting proper due diligence can be the difference between capitalizing on a favorable opportunity or losing valuable investment funds. Ensure that you carefully evaluate both the long and short-term performances of any organization in which you're entrusting your investment dollars.

Be on the lookout for bad actors to surface following SVB's demise. Within hours of the FDIC seizing SVB, communications from credible looking "fake" financial institutions were circulated to SVB account holders looking to prey upon those affected. Stay aware of suspicious interactions, such as phishing scams, and apply a system of checks and balances before transferring funds anywhere.

How are underwriters responding?

In the D&O space, underwriters are watching in real-time how events are unfolding but we are seeing some core questions developing. In general, questions surround what exposure companies had to SVB, any warrants involved in venture debt and potential impact on valuations. For public companies, underwriters may question materiality and appropriate disclosures. Cyber liability insurers remain diligent in underwriting the strength of a company's multi-factor authentication, transfer of fund protocols, and general checks and balances.

How can we help?

Having decades of experience helping PE and VC firms manage their risks means that we've seen countless impactful events and are able to provide recommendations about due diligence best practices to help protect your investments. And because sometimes even the greatest level of preparation can't protect us from the unknown, we can also help you plan for unfortunate outlier events that come to fruition.

As you navigate this period of uncertainty, our VC, PE, and Financial Institution experts are here to answer your questions.

Contact Us

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