Market update: What happened to Silicon Valley Bank?

The ongoing situation with Silicon Valley Bank has understandably led to many questions. While the bank's failure is certainly a disappointing and noteworthy event, Mesirow's clients should be assured that we are actively monitoring the situation and believe that overall exposure to the bank failure is minimal. That said, we do believe the situation has created an opportunity to reassess how clients manage their cash balances.

What happened to Silicon Valley Bank?

Silicon Valley Bank ("SVB") was closed on Friday, March 10, 2023 by banking regulators following a “run” on the bank by its depositors. In our opinion, this bank was particularly susceptible due to its client concentration in tech start-ups and other venture capital-oriented firms combined with poor internal risk management.

The bank's management missteps were exacerbated by a sharply rising interest rate environment, which caused a decline in value of the bonds that SVB held on its balance sheet. As SVB's depositors began to withdraw funds, the bank had to sell these depreciated assets at a loss to generate cash. These realized losses reduced SVB capital ratios and created a need for the bank to raise more capital, which ignited a panic among the bank's depositors and created a “run” as they rushed to withdraw their funds from the bank. Last Thursday alone, SVB's depositors and investors attempted to pull $42 billion from the bank!

As a result, the bank could not meet this significant increase in withdrawal requests and many clients were not able to access their cash. Of particular concern at SVB was that many of the bank's clients are businesses and firms that had balances well above the FDIC's $250,000 insurance limit. Some estimates have suggested that over 85% of SVB's deposits were uninsured, a level much higher than that of most banks. In excess of the FDIC insurance, depositors could have potentially lost access to their cash balances and/or suffered losses as SVB sought to liquidate assets to meet redemptions.

What did Federal regulators do to help?

On the evening of Sunday, March 12, 2023, the Federal Reserve and Treasury Department announced steps to ensure that all depositors at SVB would have access to their full account balances, both insured and uninsured, thus ensuring that its many corporate clients could maintain operations such as paying employee salaries, bills, and funding day-to-day operations. The joint announcement also indicated that if other banks fail, the deposit customers of those banks will also be able to access their full balances.

As part of this announcement, the Federal Reserve announced a new Bank Term Funding Program ("BTFP"), which provides liquidity by allowing banks to pledge government securities as collateral at par value, even if the market value of those securities has dropped below par (which many have due to rising interest rates in 2022), thus helping banks to avoid selling those holdings during times of stress in order to meet client demands.

Bank customers should note that the new Federal Reserve program does not increase the $250,000 FDIC insurance limit, but instead provides banks with access to liquidity should they be faced with abnormally high levels of customer withdrawals.

Is my bank and bank account safe?

Yes, you should consider your bank accounts as relatively safe from any potential bank failures in the near future. Bank accounts below $250,000 will continue to be insured by the FDIC. While the Federal Reserve is making SVB depositors whole and has indicated a desire to see that depositors are made whole above the limit, balances above $250,000 are not insured by the FDIC and there is no guarantee of how the government may treat these balances in the future.

We suggest that our clients work with their Wealth Advisor to explore cash management options if they are carrying large deposit balances in traditional banks. Further, as interest rates have moved up, the yield on Money Market Funds, Treasuries, Certificates of Deposit, and other fixed income options have increased, while the interest rates on most deposit accounts have not as of yet.

What should we do with our cash?

The silver-lining to higher interest rates is that cash, and some bonds, can now earn an attractive risk-adjusted return for the first time in many years. With short-term Treasury rates still north of 4%, investors have several options for how to manage their cash and liquidity needs. Those options include:

- **Money Market Funds** — Money market funds invest cash in very short-term securities with the goal of maintaining value and earning a slight return. All of Mesirow's money market sweep options for clients with our primary custodian invest solely in Treasury and Government Agency securities.
- **Treasury Securities** — Treasury securities, especially those with extremely short maturities, are reasonably stable assets. These securities may see declines in value if short-term interest rates increase, but the shorter maturity bonds are much less sensitive to higher rates than longer-term bonds. Building short-term Treasury bond ladders can be a profitable and prudent way to manage excess cash balances, while holding securities backed by the full faith and credit of the US Government.
- **Short-Term Bond Funds** — Short-term bond funds are excellent options for excess cash that may not be needed for one to three years. These bond funds may provide additional return over traditional government securities by investing in corporate bonds or extending duration slightly to generate additional income. Short-term bond funds will likely experience incrementally more volatility than money market or Treasury securities, but we expect that active management in this space can add value over time.

We believe that a focus on long-term investing, including an appropriate asset allocation and emphasis on high-quality investments trading at reasonable valuations, will continue to help clients meet their financial goals and help insulate from the risks of short-term shocks.

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