Technology sector

Silicon Valley Bank profit squeeze in tech downturn attracts short sellers

California institution that serves start-up scene under scrutiny over investments that have left it with unrealised $15bn loss

Greg Becker, chief executive of Silicon Valley Bank: 'There will be more headlines about failure rates and [tech industry] lay-offs. Whether this volatile period is 12 months or 18 months, our goal is to be able to make sure we're resilient to support clients through this' © FT montage/Bloomberg

Tabby Kinder in San Francisco, **Dan McCrum** in London and **Antoine Gara** and **Joshua Franklin** in New York FEBRUARY 22 2023

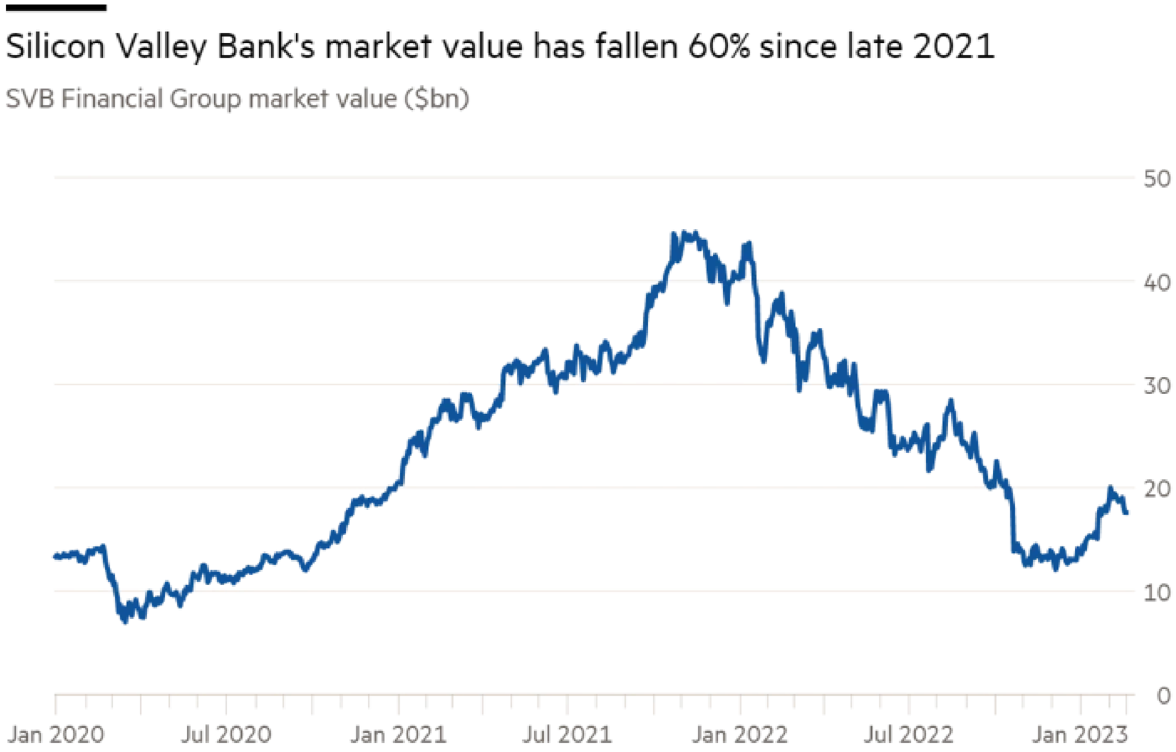
Silicon Valley Bank, the Californian institution central to financing US start-ups, is facing scrutiny over an investment decision made at the peak of the tech boom that is squeezing its profitability just as the industry faces its worst downturn in decades.

The bank serves about half of all venture-backed US tech and life sciences companies and has total assets worth $212bn, making it the 16th-largest bank in the US. Founded 40 years ago, it has grown into a fixture in global tech, having banked groups such as Cisco, Ring, Beyond Meat and Shopify in their earliest stages.

It is being rocked as tech start-ups face the biggest collapse in their value since the dotcom bubble burst in the early 2000s. SVB's market capitalisation has fallen from a peak of more than $44bn less than two years ago to $17bn today.

But some analysts, shareholders and short sellers point to another problem of its making: a move to put $91bn of its assets into a poorly performing bond portfolio that has since amassed an unrealised $15bn loss.

"[This year] will be a challenging year [for the tech industry] . . . we're really only scratching the surface," Greg Becker, SVB's chief executive, told the Financial Times.



Source: Refinitiv

"There will be more headlines about failure rates and [tech industry] lay-offs. Whether this volatile period is 12 months or 18 months, our goal is to be able to make sure we're resilient to support clients through this."

The bank derives its income from a variety of business lines: fund and asset management; investing in companies alongside VC firms such as Andreessen Horowitz and Sequoia Capital; underwriting tech IPOs; and even providing billions of dollars of financing for vineyards and wineries — the pet projects of Silicon Valley entrepreneurs.

But SVB's core business is centred on banking deposits of cash raised by tech start-ups, and lending to the venture capital and private equity firms that back them. At the peak of the tech investing boom in 2021, customer deposits surged from $102bn to $189bn, leaving the bank awash in "excess liquidity".

At the time, the bank piled much of its customer deposits into long-dated mortgage-backed securities issued by US government agencies, effectively locking away half of its assets for the next decade in safe investments that earn, by today's standards, little income.

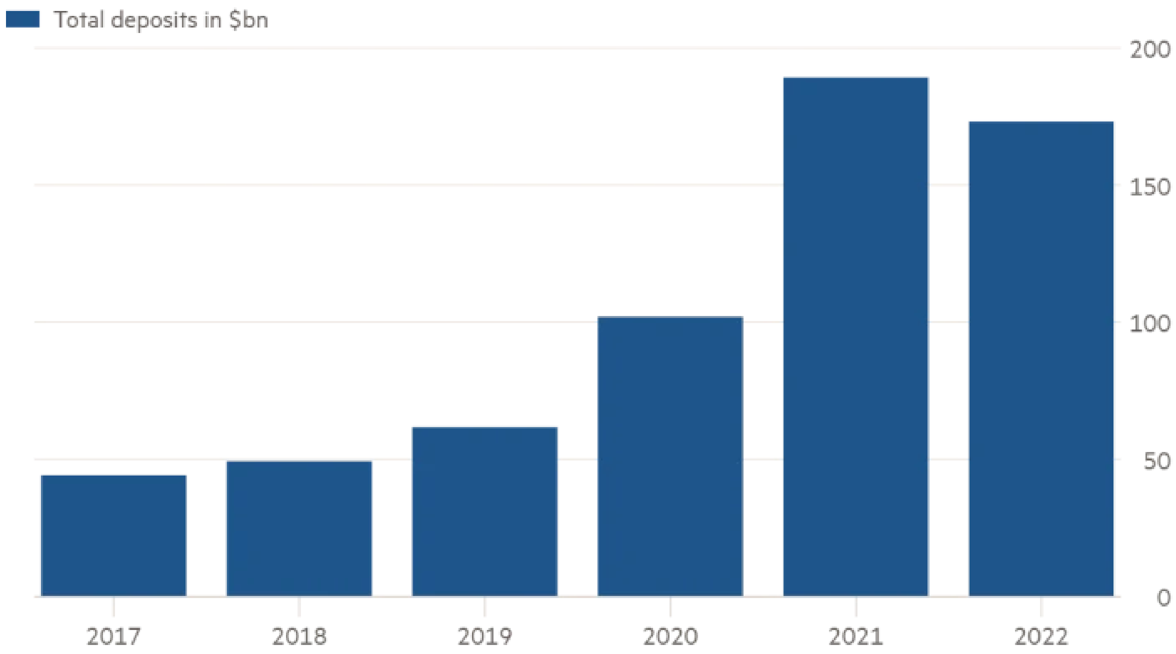
Becker said the "conservative" investments were part of a plan to shore up the bank's balance sheet in case venture funding of start-ups went into freefall. "In 2021 we sat back and said valuations and the amount of money being raised is clearly at epic levels . . . so we looked at that and were more cautious."

That decision also created a "stone anchor" on SVB's profitability, said Oppenheimer research analyst Christopher Kotowski, and it had left the bank vulnerable to changing interest rates.

SVB can borrow against the value of its bond portfolio to raise liquidity if required: Becker said it had borrowed $13.5bn this way in the first nine months of 2022.

"We can comfortably say we have so much liquidity available to us in case something happens. We think deposits will stabilise, but if not, we can protect ourselves if we need to."

Tech boom helps Silicon Valley Bank grow deposits



Source: S&P Capital IQ
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The challenge is the impact on SVB's net interest income, the difference between what it earns from interest on assets such as loans and what it pays on deposits. The yield on the investments, which accounts for 44 per cent of the bank's assets, is much lower than prevailing interest rates.

While interest rates were low, several big banks parked more deposits into government debt accepting the lower rate of return during a time of economic uncertainty

However, SVB's relative exposure far exceeds its peers. It had $120bn of investment securities — which include its $91bn mortgage-backed securities portfolio — at the end of 2022, far exceeding its $74bn total loans.

By comparison, Bank of America had $863bn of debt securities, including $633bn of held-to-maturity assets, less than its approximate $1tn of loans and leases. San Francisco-based First Republic, SVB's closest rival in Silicon Valley, had $55bn in investment securities including $28bn of held-to-maturity debt securities, compared to $167bn in total loans.

SVB's large portfolio of securities — the single biggest asset category on its balance sheet — relative to the amount of loans the bank makes is having an outsized impact on its net interest income.

JPMorgan Chase, Bank of America, Citi and Wells Fargo together generated interest income for the final quarter of 2022 of almost $60bn, up 30 per cent from a year earlier. Meanwhile, SVB has told investors to expect a "high teens" percentage decline in 2023 from the $4.5bn it earned in net interest income last year.

"Interest rates had been so low for so long that lots of people thought they'd be low forever," said one equity analyst. SVB "made a bigger than average bet on that."

Becker said: "We expected rates to go up, [but] not as much as they have."

The bank is committed to holding its $91bn portfolio of bonds to maturity, an important accounting designation that shielded its profits from turmoil in financial markets last year, as long-term bond yields rose sharply above the 1.64 per cent yield of the portfolio.

But that also meant that at the end of last year the "held-to-maturity" assets were valued at their purchase price of $91bn on SVB's balance sheet, rather than their $76bn market value.

The unrealised $15bn loss disclosed by SVB is almost as much as the group's $17bn market capitalisation, and greater than the total profits reported by the bank over three decades. Since 1993, SVB has never had a lossmaking year, declaring a cumulative $11.1bn in net income since then.

Becker said he has "no intention of using or selling" the securities, which would force SVB to recognise the loss. He said the bank has about $90bn of off-balance sheet funds — such as cash paydowns on its securities portfolio and borrowing capacity of around $70bn — it could tap if necessary.

But the investment decision has attracted the attention of short sellers who are betting that its shares, which have lost 50 per cent of their value since the start of 2022, will fall further.

Shareholder returns have suffered. SVB reported a 12 per cent return on common equity in 2022, down from 17 per cent the prior year and its lowest return since 2016.

The share price of smaller rival Silvergate, a California-based lender that was caught up in the crypto market downturn, collapsed last year after the bank said it was forced to sell held-to-maturity assets to meet a rush of $8.1bn of customer withdrawals. Losses on the sale of the securities came to $718mn.

SVB's cautious move to put its assets in a low-yield bond portfolio, however, was based on Becker's prediction for a swift end to the coronavirus pandemic-era tech boom. That has proved correct.

SVB's deposits fell every quarter in 2022 and the bank is forecasting a "mid single digits" percentage decline in deposits this year, from $173.1bn at the end of 2022.

"Venture capital and private equity funds with large investment profiles are raising less, depositing less, and investing less, while companies are burning through what cash they have," said one former SVB executive. "SVB will be disproportionately affected."

SVB had previously used buoyant conditions to launch ambitious plans to become a full service bank.

Under a strategic expansion led by Becker, who took over as chief executive in 2011, it acquired investment bank Leerink Partners in 2019 and wealth manager Boston Private in 2021.

Those deals almost tripled its headcount to about 8,500 by mid-2022 as it sought to challenge Wall Street on tech IPOs. It was to have a role on the flotation of social media platform Reddit, according to a person close to the deal, which has been delayed due to market conditions.

Last year, after completing its $900mn acquisition of Boston Private, SVB parted ways with Anthony Dechellis, the former chief executive of the private bank. Dechellis, who had been tasked with heading the bank's burgeoning private banking and wealth management arm, left after just 10 months. It has taken a cumulative charge of $179mn in 2021 and 2022 on the Boston Private acquisition.

In the first quarter of this year, some analysts have become more optimistic. Wells Fargo analysts noted in January that its cheap stock "seems like the deal of the century" despite the stress on its income model. It said the bank was "well positioned to see future funding recovery" as squeezed tech companies draw on credit lines during the downturn.

Becker said SVB's position will improve, as inflow of venture funding finds its floor and start-ups undergo aggressive cost cutting to avoid burning too quickly through cash reserves.

"Whether that takes nine, 12 or 15 months to turn around, for us it's not the best-case scenario but it's one we're comfortable with. We have ample liquidity to support lots of scenarios that may get worse and worse."