Jon Moulton's Diary

Good-bye Silicon Valley Bank, hello bailout

Veteran financier Jon Moulton has been involved in buyouts, turnarounds and venture capital since 1979 with firms such as CVC, Permira, Apax, Alchemy and, most recently, Better Capital, where he has been the chair since 2009

'I would have been a victim if the US Government had not bailed out SVB. I'm grateful but actually feel a little guilty'

Time to be humble. Silicon Valley Bank gave many a private equity soul a harrowing few days.

SVB funded companies, held cash deposits for a very large number of portfolio companies, was involved in fund financings of various types and looked after cash and investments (notably fine wine it seems) for many a wealthy private equity soul.

The collapse was, as usual in banking failures, very fast. Confidence drained in few days. Mercifully the US Government decided that it would pick the bill up in full. If it had not, then thousands of serious problems would have hit private equity companies. The most immediate issue would have been companies who had their cash deposits frozen and simply would not have had cash to pay staff or suppliers.

This monster government bailout (tens of billions in scale) was odd as the US banking rules deem as systemic, and therefore in need of a bailout, banks which have assets of more than $250bn – but SVB had $212bn.

Perversely, the CEO of SVB had lobbied for banks of SVB's size not to be closely regulated, and in this, at least, he was successful.

Partly because of the impact on the venture capital industry, the no-bailout rule was rapidly discarded when the crisis came and the run on the bank exploded.

Breaking rules

This upset many central bankers in other countries who had been hectored by the USA not to bail out their bad banks, and now saw the USA breaking its own rules.

Belatedly, I have had a look at SVB's financial filings. There are only 20 pages of densely printed risk factors totalling some 20,000 words that address risks in painful detail. Too much turgid disclosure is really not helpful and the lawyers' practice of putting it all in, effectively hides the real issues.

The collapse in the value of short-dated debt investments they held following an increase in interest rates seems to be the most common explanation for the precipitous collapse. Not a complex risk you would think.

PE and VC firms flocked to SVB and ignored the concentrated risks because the bank courted their custom and capital

I admit I might have missed it in a lapse of concentration as I attempted to avoid sleep while reading the risk factors. This critical point that they incurred losses as rates rose is not apparent. Indeed, the bank spoke of the benefits of higher rates for the bank's profits.

Perversely the fact that most of their deposits were not government guaranteed meant that once fear entered the situation the rush to the door meant that liquidity evaporated very quickly as assets had to be sold to make calls.

Ignoring risks

Why did the PE industry take such a risk in concentrating banking with SVB? Well, it flocked to SVB because it was the foremost bank chasing the business from the PE industry while lots of others were wary of the industry because of its obvious risks. I am entirely certain that virtually all the PE industry would not have thought about the risk in the bank and would bet my residual manhood that, at most, a handful read the risk factors in the filings.

For those who do not appreciate these risks, there were 563 bank failures in the USA between 2001 and a few days back. Some 157 failed in one year, 2010. Small US banks are inherently risky.

I would have been a victim if the US Government had not bailed out SVB. I'm grateful but actually feel a little guilty – private equity lives by the capitalist sword and it seems to me we should suffer for our own negligence. I will not let it interfere with my sleeping though.

Many of the funds my family office has invested in have published letters to investors explaining their new controls. These are best read while listening to a soundtrack of stable doors closing.

The episode serves as a reminder. Private equity is fallible too.

And again, many thanks to the US of A.

$212bn

The assets of SVB – technically too little for a government-backed bailout according to US banking rules but one occurred anyway

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