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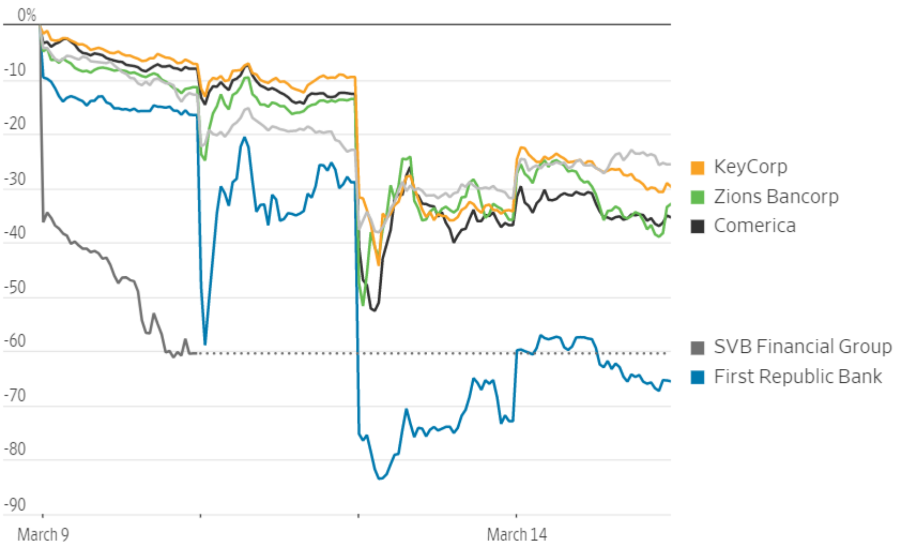
March 2023

Special Fund Insights:

The Fallout of Silicon Valley Bank and Signature Bank

Silicon Valley Bank's ("SVB") collapse triggered fears of broader financial contagion and sent shockwaves across public and private markets over the weekend. Share price of other US banks were severely impacted and fell approximately 11% last week, their largest weekly drop since the COVID-19 crash in March 2020. Bank stocks in other regions such as Europe and Asia also fell amidst the fears of systemic risk.

Bank stocks



Source: FactSet

What Happened at SVB?

Founded in 1983, SVB was the 16th largest bank in the US. SVB was a commercial bank headquartered in California with a customer base that was relatively concentrated towards venture capitalists and technology start-ups.

During the COVID-19 pandemic, the bank experienced a sharp surge in total deposits to just shy of $200 billion by the end of first quarter 2022. Most of SVB's deposits were uninsured as these were mainly corporate deposits which exceeded the Federal Deposit Insurance Corp's ("FDIC") $250,000 insurance limit.

Throughout this period, SVB also bought lots of those seemingly "risk free" or "safe" assets such as US Treasuries and Government-backed mortgage securities bringing its securities portfolio to increase by more than 4 folds by end of 2021. When the Federal Reserve ("Fed") started increasing policy rates in March last year, their fixed interest payments don't keep up with the rapid rise in interest rates and hence were no longer worth what the bank paid for acquiring them, leading to SVB's unrealised losses of more than $17 billion at the end of 2022.

At the same time, the deposit inflows of SVB turned to outflows as its clients burned cash and stopped getting new funds from fundraising campaigns. SVB faced a big withdrawal request amounting to $42 billion as of Thursday last week and was not able to raise the cash it needed to cover the outflows. This prompted the regulators to step in and seized the bank before it could open Friday morning. This was the second biggest bank failure in US history – only the 2008 collapse of Washington Mutual Inc during the global financial crisis of 2007-09 was bigger.

Signature Bank

Signature Bank, founded in 2001, was a New York commercial bank with a big business in providing banking services to law firms and real estate companies. Similar with Silvergate Capital Corp, Signature Bank had also recently taken on quite a number of cryptocurrency depositors, making it as one of the largest banks serving cryptocurrency firms.

Given its business model which caters to many private companies, Signature Bank had a relatively large number of uninsured deposits like SVB. The sudden collapse of SVB sparked Signature Bank's depositors to make big withdrawal requests.

The bank was put into receivership on Sunday and the FDIC has since transferred all the deposits and the assets of Signature Bank to Signature Bridge Bank NA, a full-service bank that will be operated by the FDIC and started marketing the institution to potential bidders.

The closure of Signature Bank made it the second crypto-friendly bank to fail in less than a week after Silvergate – a prominent figure in the crypto market that failed shortly after the collapse of FTX. Signature Bank's closing also underscores the challenges faced by small and midsize banks which often focus on niche lines of business and have a narrower base of customers.

Support from the Government

Swift and positive supports were provided by the regulators to contain the ripples from the fallout of SVB and Signature Bank and minimise systemic risk n the banking sector.

The Fed, US Treasury, and FDIC have issued a joint statement to ensure that all depositors of SVB and Signature Bank will be made whole, and no losses will be borne by taxpayers as the money for the recovery will be taken from the FDIC deposit-insurance fund.

Additionally, the Fed also set up a new lending facility called the Bank Term Funding Programme which allows banks to get loans with very generous terms in order to meet the needs of their depositors. Under this programme, banks are able to pledge treasuries, mortgage-backed securities and other qualifying assets as collateral for loans with interest rate fixed at the one-year overnight index swap.

Implications on the Broader Economy

Worries about banks' stability ricocheted throughout the sector and beyond. However, with the swift response from the government and regulators, the risk of contagion to the broader market is minimized and is unlikely to be catastrophic. While several small and midsized banks as well as those with concentrated customer base may come under greater pressure, the larger and quality name banks remain solid for the time being. We will continue to monitor for evidence of contagion that could signal a wider problem and threaten the real economy.

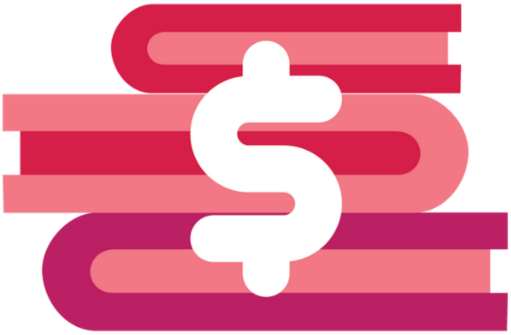
The SVB and Signature Bank fallout is complicating the Fed's fight against inflation. The Consumer Price Index ("CPI") data released this week signaled that US inflation is still stubbornly high. Although it was expected that the Fed would continue to raise interest rates to fight inflation, concerns over an increasingly fragile financial systems after the SVB and Signature Bank failures forces a rethink by the central bank on how much higher interest rates can go to strike the balance between fighting inflation and maintaining financial stability. The next Federal Open Market Committee ("FOMC") meeting is scheduled for March 21-22.

The SVB collapse has spurred attention towards how banks in the US are overseen by regulators. Bank regulators are in the hot seat for missing red flags such as the rapid increase in deposits as well as the bank's growing reliance on government-linked institutions that supports regional lenders. The swift response from the government to prevent a nationwide bank run has also intensified pressure for stronger oversight. As regulators and lawmakers ponder on whether existing rules for banks are sufficient in this changing world, this may result in regulatory and supervisory changes for financial institutions going forward..

AIA Singapore ILP Funds Exposure

As of today, AIA Singapore ILP Funds do not have any direct exposure to SVB or Signature Bank, and have negligible indirect exposure to these banks.

We will continue to monitor the situation and remain vigilant on any potential risks – including secondary risks such as the potential impact on our positions in the market which may be impacted by this event.



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