

## Silicon Valley Bank Crisis [UPSC Notes]

Silicon Valley Bank's recent failure puts \$175 billion in customer deposits under FDIC control.

This article will go in length about the Silicon Valley Bank Crisis which will be useful in the Economic segment of the [IAS Exam](#).

### Silicon Valley Bank Crisis

- The Silicon Valley Bank, a prominent lender to some of the biggest names in the technology industry, has become the largest bank to fail since the 2008 financial crisis.
- The California Department of Financial Protection and Innovation shut down the bank on 25th February, after the bank tried to persuade clients not to withdraw their money over concerns it was running low on available cash.
- The Federal Deposit Insurance Corp. was appointed as the receiver.

#### Bank caught by higher interest rates:

- Silicon Valley Bank bought huge amounts of [bonds](#) over a year ago with cash from high-flying startups.
- The bank kept a small amount of the deposits on hand and invested the rest to earn a return. However, the Federal Reserve began raising interest rates last year to cool [inflation](#), and at the same time, startup funding started to dry up, putting pressure on many of the bank's clients.
- Clients then began to withdraw their money, forcing the bank to sell off some of its investments at a time when their value had declined.
- In its surprise disclosure on Wednesday, February 23rd, the bank said it had lost nearly \$2 billion.

#### Failure of the bank causing worries regarding other banks:

- Silicon Valley Bank is small in comparison with the nation's largest banks, but the failure of any bank can lead to a bank run if customers or investors panic and start pulling their deposits.
- The failure of Silicon Valley Bank raised concerns that other banks could face similar problems. Shares of some banks, including First Republic Bank and Signature Bank, were down more than 20% on Friday, February 25th.

#### Young companies scramble to get their money out of the bank:

- Nearly half of venture capital-backed technology and life-science companies, including Lightspeed, Bain Capital, and Insight Partners, relied on Silicon Valley Bank for banking services.

- As a result of the bank's failure, some entrepreneurs whose funds are frozen at the bank are turning to loans to make payroll.

## Lessons from SVB Collapse

The collapse of SVB which focused on lending to startups in Silicon Valley offers lessons for Indian startups and policymakers.

### Why are startups operating in India redomiciled outside the country?

- Startups predominantly operating in India redomicile overseas due to **pressure and preconditions set by investors abroad**.
- The investors are cautious of the **Indian tax and regulatory regime** and find it difficult to move their capital inside and outside India.
- The startups also rely on overseas investors due to a lack of capital availability in India. Eg: LIC has almost no stake in the startup ecosystem.
- Start-ups also open bank accounts outside India **due to difficulties in transacting in foreign currencies in India**. Startups which operate at the global level also face difficulty in transferring their foreign earnings inside the country and outside the country.
- Also, the **RBI has put numerous compliance requirements** to raise capital from overseas investors.

### What needs to be done?

- One solution for startups with global business can be replicating the **EEFC account procedure** which is allowed for information technology service companies where foreign currency can be deposited and remitted easily through Indian banks.
- Another solution can be like how overseas investors from countries who are members of the International Organization of Securities Commissions (IOSCO) are able to freely participate in the Indian stock market; similar arrangements can be made for investors in Indian startups to buy and dispose of shares. KYC and verification can be done by depositories along with the holding of shares.
- One of the major solutions can be **GIFT City** in Gujarat which is free from the restrictions of RBI. GIFT City and Indian banks can aid in transferring funds of startups which have accounts with SVB without much restriction.
- GIFT City can help in reducing the friction in the movement of capital, simplify the regulatory framework and can create ease of doing business environment for startups.
- Finally, any startup which has significant business interest in India must register within the country as they can understand the domestic economic environment better and can control resources efficiently.