SVB'S Collapse Offers Unexpected Opportunity for Private Credit and Private Equity

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Silicon Valley Bank's (SVB) sudden collapse rocked the tech community and financial markets last week. The second-largest bank failure in US history combusted in less than 48 hours, leaving depositors unsure about whether the government, Federal Reserve, another large banking institution, or a hedge fund would help rescue billions of uninsured deposits by the time business opened on Monday.

Rising fear of broader financial contagion led bank regulators to seize Signature Bank on Sunday – the third-largest bank failure in US history. However, in an attempt to prevent further contagion spurred by the failure of both banks, the Treasury and Federal Reserve stepped in over the weekend, ensuring depositors for both institutions would be made whole even if cash holdings were above the $250,000 FDIC-insured cap.

Authorities' main responsibility in the middle of a banking crisis is to slow down contagion through emergency liquidity and government backstops. It succeeded in its effort over the weekend, but trouble at Credit Suisse piled more pressure onto the banking sector Wednesday.

The situation clearly remains fluid, and while it's too early to draw definitive conclusions, nonbank lenders and Private Equity (PE) firms seem poised to grab venture debt market share in the wake of SVB's collapse.

Taking a step back, SVB carved out a distinct and riskier niche that catered to early-stage technology and science/healthcare companies. Venture Capital (VC) firms and their portfolio companies often turned to SVB for venture debt due to its attractive debt packages that were much cheaper than those offered by nonbank lenders. SVB was also more willing to lend to higher-risk growth companies that many traditional banking institutions would only lend to at a premium or avoided altogether.

While SVB's lending business is attempting to stage a comeback under FDIC-controlled Silicon Valley Bridge Bank, it's unclear whether the bank with find a buyer for its loan book. It's also likely that traditional bank lenders will take a more conservative approach that limits venture debt exposure while the dust settles.

This uncertainty opens the door for nonbank lenders and PE firms to fill a huge void in the venture debt market. Given that capital is the lifeblood for growth companies, and many of these companies are facing a triple whammy that includes (1) depressed valuations, (2) a more challenging fundraising environment, and (3) tech's most popular banking partner on life support, founders may be more willing to accept higher borrowing costs offered by private credit lenders. This is bullish for nonbank lenders and PE firms that were previously boxed out of venture debt opportunities by Silicon Valley Bank.

Additionally, companies will naturally gravitate to private lending companies given theheightened solvency concerns with banks and bank liabilities. Unlike banks, private creditvehicles do not have a deposit base that can just leave. This should create less competition andincrease returns for private credit – whether that's through higher cash flow, more points upfront, or larger equity kickers/warrants.

Regardless of direct exposure to Silicon Valley Bank, last weekend was one of the most uncertain periods in recent memory for the tech industry. Before the government took action on Sunday to protect all depositors at SVB, many in tech were grappling with questions about whether their business would survive the fallout. Fortunately, the industry breathed a collective sigh of relief on Monday when authorities announced that depositors would have access to all of their money, suffering no losses from SVB's collapse.

It's worth questioning whether the government would have mobilized such swift and decisive action if another regional or mid-market bank suffered the same fate. While it's hard to say with any level of certainty, my guess is "not likely". As Louis Gave recently put it:

The collapse of [SVB]…forced unprecedented government action. Not even the 2008 crisis led to an open-ended promise to make whole all deposits over US$250,000. The troubles at SVB and Signature clearly struck a chord…

SVB had the reputation of being a tech-friendly institution that offered a premium on deposits over its peers, with more liberal lending standards that catered to innovative technology companies. This made SVB the go-to bank for VCs and their portfolio companies, often to the detriment of larger, more traditional banking institutions and nonbank lenders. Moving forward, technology companies will think twice about their banking and lending partners, gravitating towards too-big-to-fail banks for deposits, and private credit lenders that don't have the same solvency concerns and liabilities as regional and mid-market banks.

Pulling it all together, the fallout from SVB's collapse will continue to ripple through the financial sector, but private credit and PE firms should benefit from the dislocation as tech companies look for new partners to fill the void left behind by Silicon Valley Bank.

Silicon Valley Bank failure (jpmprivatebank.com)

How SVB Was Doomed By a Bad Bet on Mortgage Securities and the Fed's Rate Hikes | Barron's (barrons.com)

Nonbank lenders pounce on venture debt market after SVB collapse | PitchBook

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