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Industry Insights

US banking failures and the potential impact on the D&O market

Neale Stevenson • May 15, 2023

It is too early to discern the impact which failures of three, (at latest count), banks in the US will have on the wider D&O market. But there are some early lessons. Silicon Valley Bank (SVB) demonstrated what a run on a bank looks like in the age of digital banking. It is very, very fast. That SVB's client base comprised some of the world's leading tech companies with cutting edge systems will have contributed. Nonetheless, at the slightest hint of collapse, the money moved out instantly. The news of SVB's difficulties spread rapidly on social media among a highly attuned audience and they reacted. This should now be regarded as the norm. When a collapse happens, it happens rapidly.

Long standing factors caused the demise

However, the factors which ultimately led to the demise of Silicon Valley Bank, Signature Bank and First Republic have been bubbling away for quite some time. Firstly, interest rates have looked to be on the rise for well over a year. While the height which they have reached was not predicable, that they would rise – was. Secondly, the failure after a run by uninsured depositors has, rightly, drawn attention to the US's bank liquidity requirements.

A divergence from global banking standards

In 2019, US regulators determined that most banks with between $50 billion and $250 billion in assets would no longer be subject to the liquidity coverage ratio (LCR) or net stable funding ratio (NSFR) which was applied to the larger, more systemically important banks. So, a divergence from global banking standards. It is not a significant leap to suggest that had these standards been applied to SVB and others, then they may not have faced such difficulties. However, given the adherence to these standards in the rest of the world, talk of a global banking crisis seems overblown.

What went wrong?

Silicon Valley Bank was the partner of choice for US tech firms. Startups and innovative new business gravitated to the brand. It was the 16th-largest bank in the United States at the time of its failure and was the largest bank by deposits in Silicon Valley. A crucial lender for early-stage businesses, the company was the banking partner for nearly half of US venture-backed technology and healthcare companies that listed on stock markets in 2022. Yet, this focus meant that it was also acutely exposed to a change to the fortunes of the sector and its collective view. SVB came under pressure as higher interest rates made it harder for its customers to raise money through private fundraising or share sales. More of the bank's clients were withdrawing deposits in a trend that escalated throughout March. This was in addition to firms choosing to invest their money elsewhere; in government bonds or in safer, non-interest rate impacted commodities. Finally, investors scrambled to withdraw their money following warnings from Peter Thiel's Founders Fund and other tech sector giants.

Many of the issues listed above - lack of sufficient funds, insufficient measures to hedge against rising interest rates and overconcentration in a particular depositor or deposit type - are, worryingly for the US's middle market banks, not isolated to Silicon Valley Bank - some issues are, however, such as leaving its Chief Risk Officer role vacant for nine months.

The impact on the D&O market

For the D&O market, the recent spate of banking failures in the US should serve as a wake-up call. That claims will be brought against banking executives seems inevitable. It is clear that the regulation is not sufficient for those banks not required to adhere to LCR or NSFR. Unless those banks outside of the net can demonstrate that they are regulating themselves to a similar standard, they may find themselves tarred with the same brush and perceived as being part of a riskier subset, with their ability to secure cover on similar terms to previous years constricted.

Increased claims against financial officers a risk?

As we have seen in previous financial turmoil, these events can lead to increasing claims against financial officers as the adequacy of their banking policies comes under scrutiny. Following the 2008 Financial Crisis, the market saw an uptick in claims and notifications against D&O policies. Legal actions against companies and directors for not diversifying their allocation of company assets could arise from investors as they attempt to recover their losses. Brands like Roku, Vox, Buzzfeed and Roblox all held significant deposits with SVB. The value of those assets have since been guaranteed by the FDIC. While this action averted the immediate threats to these businesses, SVB was a key source of funding for the tech sector. Its collapse may mean that the financing for growth plans and operations is more difficult to secure, with the potential for a knock-on effect on the results and performance of some tech businesses.

The important role for insurers

Insurers can also do more to highlight the growing risks in the US banking sector. They can also examine the asset mix and deposit base with greater scrutiny. Changes in the macro-economic environment provided the trigger for the US bank which have collapsed and being cognisant of economic and legislative developments and how these could impact individual accounts is more important than ever. If further banks collapse, then a hardening of D&O rates seems a distinct possibility.

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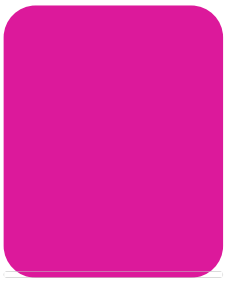

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