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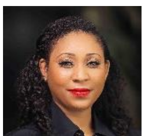

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Client Alert

The SVB Collapse: How Does It Affect the Nigerian Market?

Introduction

Not since the dark days of 2008 have the global markets seen a bank failure as large as the collapse of Silicon Valley Bank (SVB). The 16th largest bank in the United States by deposits and the go-to bank for Silicon Valley venture capital-backed tech companies now has the distinction of being the 2nd largest bank failure in U.S. history. The cliché goes that when the U.S. economy sneezes, the world catches a cold and with SVB providing financial services (and in some cases funding) to several African tech start-ups, it is inevitable that this particular U.S. bank failure will be felt in Africa, and certainly in Nigeria, home of the African tech giants.

In this client alert, we discuss SVB's takeover by U.S. regulators, the impact on liquidity within the global tech ecosystem and the implications for the Nigerian tech space.

What Happened?

SVB's collapse is understood to have been caused by an array of factors but prominent amongst them includes a bank run precipitated by a decline in available capital for startups as a result of the hike in U.S. interest rates. The rise in rates increased the cost of borrowing and forced depositors to fall back on bank deposits to meet their immediate liquidity needs. So, to fund withdrawal demands from clients (many of whom were uninsured depositors and therefore of a class quick to withdraw funds at the first sign of instability), SVB was forced to take several drastic steps including selling off its bond portfolio at a loss estimated to be as high as $1.8 billion.

SVB also announced the sale of common equity and preferred convertible stock estimated to be about $2.25 billion. This did not however, allay investors' fears that the bank was indeed facing financial challenges and on the brink of collapse. After the bank's attempts to raise additional capital to fund liquidity requirements failed, U.S. regulators moved in swiftly to protect depositors and manage the effect of the bank's collapse on the economy.

On 10 March 2023, the California Department of Financial Protection and Innovation announced the closure of SVB and appointment of the Federal Deposit Insurance Corporation (FDIC) as receiver. To safeguard depositors and mitigate customer losses, the FDIC has established the Deposit Insurance National Bank of Santa Clara (DINB) as a bridge bank into which all insured and uninsured customer deposits will be transferred pending when the FDIC is able to sell SVB to potential buyers.

Also on 10 March 2023 came the announcement from the Bank of England that it would be placing Silicon Valley Bank UK into an insolvency procedure, but by 7 a.m. on 13 March 2023, HSBC UK announced that it was buying SVB for £1 ($1.21). The deal is thought to have protected £6.7 billion in deposits and without any government support represents the most desirable outcome for a distressed bank of this size.

The Nigerian Perspective

Nigeria is home to some of the most successful Silicon Valley-backed startups. It is therefore not surprising that some of these startups maintained different forms of business relationships with SVB either as an investor or banker.

For such startups and even the more established tech companies, the collapse of SVB will be felt in the short term as it could impact on liquidity and therefore their operations. It is worth noting though that the extent of such impact would depend on their exposure particularly with respect to deposits held with SVB and whether such deposits will be treated as insured or uninsured deposits within the context of maximum deposit insurance coverage (MDIC) under U.S law.

In the absence of a bailout to cushion the effect of SVB's collapse on the Nigerian tech ecosystem (which by all indications is unlikely), Nigerian startups with significant exposure need to take immediate steps to mitigate the negative effects that could be occasioned by severe liquidity challenges. These could be operational in nature including affecting payroll and supplies, slowing down expansion plans, and in extreme cases credit defaults.

In addition to the operational concerns, for the investment funds within the SVB sphere of influence, there is a risk that they may be unable to meet their financial commitments affecting portfolio companies across the industry. It is also likely that SVB's collapse could have the ripple effect of higher cost of funding for Nigerian tech companies. In any event, it is important that the Nigerian tech ecosystem braces for impact as the effects of SVB's collapse could be far-reaching.

Financial Regulation

SVB's collapse on the heels of the FTX scandal late last year means that financial regulation across the world is once again under scrutiny, and the U.S. and U.K. regulators will almost certainly take another hard look at financial regulations, particularly around liquidity coverage and capital adequacy ratios.

The Nigerian tech industry shows no signs of slowing down, and that growth requires capital. If Nigerian financial institutions are serious about servicing and funding the very successful Nigerian tech space with its multitude of international investors, then they will have to demonstrate strong financial regulation compliance and so. there are some lessons to be learnt from this latest bank failure.

Specifically, liquidity coverage and capital adequacy ratios have to be strictly monitored and enforced by the Central Bank of Nigeria (CBN) and risk management strategies need to be reassessed periodically and aligned with the realities of the modern economy for example by factoring in the rise in demand depositors in order to avoid liquidity mismatches. The Nigeria Deposit Insurance Corporation (NDIC) also needs to consider increasing the MDIC limit and privatizing deposit insurance by establishing a regime for a voluntary deposit insurance system for deposits in excess of the MDIC in Nigeria. And finally, the importance of governance and supervision cannot be overstated.

Conclusion

The impact of SVB's collapse on the Nigerian tech space is essentially illiquidity the short-term and potentially, challenges in raising capital in the near future. In this instance, some Nigerian funds were quick to notify their portfolio companies who were then able to effect withdrawals of deposits from SVB, but this was not the case for many Nigerian tech companies whose only recourse now lies with the U.S. FIDC.

This latest bank failure once again shines a spotlight on financial regulation, but given the added context of the global tech industry, more questions need to be asked around the manner in which tech is funded and why traditional financial institutions appear unwilling to meet the capital needs of startups. A significant amount of global tech and venture capital funds were concentrated in a single financial institution and the effect of its collapse is reverberating across the globe. Now, if ever, is the time for the financial services industry to revisit its approach to funding innovation, and Nigerian financial institutions need to ensure that they are not left behind.