



MEMORANDUM

TO: Federal Financial Analytics Clients
FROM: Karen Petrou
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As seems always the case when fear has the banking system in its maw, myths have proliferated that are now also magnified and amplified by viral social media. One such myth about Silicon Valley Bank has it that most of its depositors were high-wealth, high-tech folk whom the government should never bail out. In fact, many depositors had no choice but to park all their funds at SVB, a more-than-dubious practice at the bank that almost brought biomedical research to its knees. Had these depositors been forced to bear losses, treatments and cures for life-threatening and-changing diseases would have stalled, likely for years. We need not only to prevent future researchers from being put at such risk by a single bank, but also to change the biomedical-funding model from one at the mercy of high-cost equity investors to a stable sector for which lower-cost debt is readily at hand for any researcher with demonstrable ability to repay. Think what debt funding did for sustainable energy via green bonds and you'll see what a like-kind model for "biobonds" could do to speed urgently-needed treatments and cures.

The link between SVB and biomedical research is not the stuff of moral-hazard myth, but rather a complex tale of a specialized institution serving a sector that came to hold unique sway over a vital public good: lengthening life and easing suffering. Providing banking services to venture capital (VC) is a high-risk business unless a financial institution devotes expensive intellectual capital to the sector and then builds the large network of borrowers, investors, and capital-market customers necessary to generate generous, yet not prohibitive, fees and above-market interest rates. Since most VC deals are not just high risk, but also relatively small dollar, the business isn't generally one the biggest banks wish to develop and the expertise it demands is outside the reach of all but specialized small and midsized banks.

This is why SVB achieved such a concentrated, dominant position across tech and biomedical start-ups. There's absolutely nothing illegal, immoral, or even all that fattening associated with any of the ways a bank can succeed to the extent SVB achieved, but SVB wanted more, lots more.

Part of the way it thought it would via super-profitable, pure arbitrage in which it gamed the confluence of capital and liquidity standards in a large book of held-to-maturity government securities. As with most high-risk financial ploys, this worked until it didn't. And, because it was so risky, it didn't just one day after Silvergate's "voluntary" liquidation exposed this arbitrage strategy to market discipline ruthless in its reach because regulators had failed to demand any effective risk buffers.

The way SVB appears to have gathered deposits was yet another "gimme, gimme" strategy that eluded supervisors even as it entrapped depositors. As I was told and as Sens. Warren and Blumenthal are [investigating](#), the bank appears to have used "exclusivity clauses." These not only required any VC to house all the funds SVB mustered on its behalf as SVB deposits, but also that VCs in turn mandate that any company in which it investd via SVB funds do the same. Thus, many firms that might well have recognized risky deposit concentrations or just wanted to keep their funds closer to home were forced to put their financial fates solely in SVB's high-risk hands.

This is more than a problem for banks and the FDIC; it's a national threat because biomedical research is critical to national public welfare. Start-up biomedical firms depend on VC and were thus foils in SVB's larger game not because they always wanted high-cost, short-term, high-risk equity, but rather because debt financing for this sector has been

virtually absent.

As long as VC wanted to invest in biomedical research, biomedical research advanced in at least the fields where VCs saw fast, big profits. But even before SVB imploded, VC money evaporated from startup biomed in early 2022 as rates rose and market sentiment turned decidedly risk-off.

This leaves us with a national dilemma requiring urgent answers if we are not to squander years of research funded by philanthropies and the taxpayer that would now be heading into the clinic but for the absence of sustainable financing. One solution is to create the kind of federal guarantee long used to support other national priorities – deposit insurance just for one – and carefully backstop long-term, lower-cost loans to high-quality, early-stage biomedical researchers that are then sold into the secondary market. This program is called [BioBonds](#) and it could have been authorized last year by Congress had the [Foundation Fighting Blindness](#) and its pro bono lobbying team been able to get it the attention it deserves.

We've known for years that all too much high-quality biomedical research stays on the shelf solely due to financial shortages. We know this is even more urgent now because, without SVB, start-up biomed will find still fewer investors and be even more dependent on debt financing that simply doesn't exist. Many start-up biomed are good credit risks even if the drug or device they are developing never advances, but getting their story told one by one, bank by bank is an impossibility without a federal guarantee to jump start a new private-sector debt market.

SVB was the most important bank in this sector and SVB is gone. That is good riddance given its high-risk model, but its collateral damage extends beyond many other banks and the taxpayer, but also cures for cancer, blindness, and so much else that should never have had to depend on high-risk VCs and their ever-loving high-risk bank.