Trillium Statement on SVB Financial Exposure

13 March 2023

The Trillium Sustainable Opportunities Fund and Trillium ESG Global Share Fund had direct exposures to SVB Financial Group (SIVB), a company that was placed in FDIC receivership on Friday 10 March 2023. This statement is intended to provide context on why we owned the bank and what we may see more broadly among financial companies from here.

Banking System Background

By design, banks gather together small amounts of deposits, generally from a broad and diversified base of depositors, and then perform a useful social function: by pooling together the deposits, they are able to both offer most depositors liquidity and easily accessible funds while simultaneously being able to extend longer-maturity loans to borrowers. The ability to perform this function depends upon the trust of depositors and the extremely small likelihood that all depositors will want their funds at the same time. Modern banking history, since the 1800s, is full of examples of bank runs, where depositors suddenly lose patience, and modern bank regulation has developed as a way to provide greater confidence to borrowers. This includes the Federal Deposit Insurance Corporation (FDIC) which insures deposits up to $250,000. The Great Financial Crisis resulted in more stringent regulation for banks, especially for the largest banks which are deemed to be systemically important. This regulation helps ensure the stability of the system, but is still not perfect, because the critical function of banks is to provide a bridge between depositors with short term horizons and borrowers with long term horizons. When interest rates change dramatically over short periods of time, banks ability to perform this function becomes more and more challenging.

The central fact of modern banking history is that when Central Banks raise rates, and especially when they raise them aggressively, *something* always breaks. Frequently, what breaks is part of the banking system.

What Happened?

SIVB has a unique and concentrated business model, whereby the preponderance of deposits come from ‘Innovation Economy’ companies, their management teams, and the VC/PE funds which fund and own them. As interest rates have risen since the beginning of 2022, this segment has been suffering from a continued cash burn as these entities have been reluctant to undergo funding rounds which would potentially reduce valuations. These higher-than-expected outflows put the bank in a position where they were going to need to sell some of their bonds at a loss in order to shore up funding sources. Instead of doing this incrementally over multiple quarters, the management team decided to ‘rip off the band-aid,’ taking a hefty (but accounting-wise manageable) loss all at once. It should be noted that this was **not** a credit issue;

despite the slowdown across the space clients were still solvent and reserves were more than adequate to deal with credit normalization trends.

Timing, however, was not on their side as their announcement coincided with yet another Crypto bankruptcy, and from there the Silicon Valley rumour mill and broader market panic seem to have taken over. Calls from management to clients meant to re-assure them appear to have had the opposite effect; the final straw here seems to have been the call from several prominent figures in the tech space for companies to take their business elsewhere causing a run-on deposits.

Will The Contagion Spread?

While there is likely to be a pricing overhang across the regional banking space for some time, the specific conjunction of business concentration, asset/liability mix and (potential) regulatory interference are idiosyncratic to SIVB. The bank held 17% of assets as available-for-sale as of their last reporting (much of this in Treasuries purchased when rates were significantly lower) compared to an industry average closer to ~3%. Furthermore, the risk of further unrealized losses on bond portfolios is not an issue for the large US or European banks, who must mark-to-market these bonds on a quarterly basis anyways.

What's Next for SIVB?

As at 13 March 2023 trading is still halted on SIVB, with a press release on Friday morning also halting the planned capital raise. As of 11:45 AM on Friday, the California Department of Financial Protection and Innovation took possession of Silicon Valley Bank, citing inadequate liquidity and insolvency, and appointed the FDIC as the receiver for all insured assets. The highest probability outcome at this juncture appears to be an FDIC-mediated sale to another buyer, likely one of the Universal banks (BAC, C, JPM), or an investment bank with scale such as Goldman. The equity shares likely have no value.

Trillium Sustainable Opportunities Fund

The Trillium Sustainable Opportunities Fund had roughly a 1.7% position prior to the sell-off and we have written down the value within the Fund to zero. Although we note our overall exposure to traditional banks is lower than the benchmark, which serves as a bit of an offset. We have worked to balance our exposure to more “risk-on” companies with trades over the last year. Some of our names may be pressured in a more volatile market environment, but in general we are willing to have some exposure to higher beta companies as we look for exposure to longer term, above peer growth trends tied to sustainable solutions. In the case of SIVB we thought the bank was an important gear in the innovation economy, helping to support start-up companies. The company was recognized for its economic development program focusing on affordable housing in urban areas, providing over $500 million in investments and $1 billion in loans since 2002, supporting 8,922 affordable-housing units in the Bay area. In addition, the company launched an Access to Innovation program focused on improving educational and job opportunities for diverse talent, as well as creating investment opportunities for minority entrepreneurs in the “innovation economy” as it notes that less than 1% of venture funding goes to African American founders. Unfortunately, the bank's positioning during this period of rising rates required a reset of bond exposure that ultimately caused an exodus of client deposits beyond what the bank could withstand. We will continue to review the portfolio for risk exposures that may be exacerbated in the current volatile economic environment.

Trillium ESG Global Share Fund

The ESG Core Equity Fund had roughly a 0.58% position prior to the sell-off, and we have written down the value within the Fund to zero. We had believed that SIVB was an important gear in the innovation economy, helping to support start-up companies. The company was recognized for its economic development program focusing on affordable housing in urban areas, providing over $500 million in investments and $1 billion in loans since 2002, supporting 8,922 affordable-housing units in the Bay area. In addition, the company launched an Access to Innovation program focused on improving educational and job opportunities for diverse talent, as well as creating investment opportunities for minority entrepreneurs in the “innovation economy” as it notes that less than 1% of venture funding goes to African American founders. Unfortunately, the bank’s positioning during this period of rising rates required a reset of bond exposure that ultimately caused an exodus of client deposits beyond what the bank could withstand. We will continue to review the portfolio for risk exposures that may be exacerbated in the current volatile economic environment.

For more information

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