

[Transcript] All-In with Chamath, Jason, Sacks & Friedberg / E119: Silicon Valley Bank implodes: startup extinction event, contagion risk, culpability, and more

Hey guys, I got a little friend here.
What?
Aw.
Yeah, I think I'm going to start a new podcast.
Is that a bulldog?
And I'm going to have a bulldog as my mascot.
You bought a bulldog?
Oh my God, you got my mascot.
Yeah, I took over your mascot.
Well, look at that.
Now you're actually likable, Sax.
Sax, are you trying to improve your image?
Yeah, I have to say, Sax is so unlikable
that he has gotten a bulldog.
Oh my God, Sax, show me his face again.
Is it him or her?
Him.
What's his name?
His name is Moose.
Oh my God.
Oh my God, you got a bulldog.
He's so cute.
It's me and my mascot, Jacob.
I'm going solo with my podcast.
I'm going to call it This Week in Technology.
It already exists.
Please don't start anymore.
All right, everybody, it's an emergency podcast.
Silicon Valley Bank has been taken over by the FDIC.
Sorry, is this Twist Livestream?
Am I on the Twist Livestream?
I mean, guys, if you couldn't just interrupt me well,
I'm never going to get through this.
It's a lot to get through.
The world needs to hear our opinions.
If you care about us, click like and subscribe.
Hit the like and subscribe button below.
Hit the like and subscribe button below.
Make sure you search for This Week in Startups
and write a review.
If you don't get enough JCal,
you can get me four more times a week.
The name of the other podcast is This Week in Startups.

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Thanks for the free promo, guys.
It is a huge day today in Silicon Valley.
We haven't seen a black swan-like event happen here
in a long time since 2008.
I thought the last time was when you published the book Angel.
Oh, God.
We have to get to work.
Chamath, I saved the jokes.
I'm trying to give you a cold open.
We did that already.
Okay, everybody, it's been a while, 36 hours here.
We're going to get into Silicon Valley Bank
imploding the FDIC has shut down Silicon Valley Bank.
And there's many different things we have to discuss with me today.
As always, the dictator himself, Chamath Palyahapatiya,
the rain man, David Sacks,
and the prince of panic attacks no more.
His wires cleared.
David Freberg, the Sultan of Science.
Welcome, boys.
How is everybody, just to start this off,
contextually the last 24 hours,
can you recall a time in our careers
where it's felt this acute or insane or intense?
2008 and COVID.
Okay, and I think that this is right up there.
Could be two, probably three,
in terms of the level of panic and concern.
The problem is we're in the middle of it.
We don't know what's going to happen this weekend.
So there's a lot of anxiety right now,
a lot of panic going on.
And a lot of, like, unlike COVID and 08,
really acute effects that many companies and investors
are actively dealing with right now,
like not just a few, thousands of companies
that are really in a state of, like, distress right now.
So it is, potentially, from a Silicon Valley perspective,
worse than 08 or COVID.
Oh, for sure. For sure.
I mean, this is basically a Lehman-sized event
for Silicon Valley.
Remember when Lehman Brothers went out of,

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they basically filed for bankruptcy in 2008,
started the whole financial crisis.
The federal authorities thought
that the best plan for Lehman was to file for bankruptcy.
They didn't try to save it.
And that basically led to a cascade
where the whole financial system almost collapsed.
I think that SVB, this is a Lehman-sized event
for Silicon Valley.
And there's two big things happening.
One is the impact on the startup ecosystem.
So you're seeing probably thousands of companies now
cannot make payroll in the next few weeks
because their money is trapped and tied up
at Silicon Valley Bank, which is now under receivership.
So if you wired your money out yesterday, you're good.
And a lot of people managed to do that,
but there are a lot of people who had wires in the hopper,
didn't make it today, logged into the website,
can't log in, their money's just frozen.
And we don't know when they're going to be able
to get their money out
or how many cents of the dollar you're going to get.
So basically the whole startup ecosystem is in peril.
I think Gary Tan called it an...
Extinction-level event.
Yes, exactly. That was a good term.
And just to be really clear, this is not big tech at risk.
I know there's a lot of people out there
who don't like the idea of bailing out big tech.
This is not Google. It's not Amazon.
Exactly. Those companies have plenty of cash. They're fine.
This is small companies.
Companies with 10 to 100 employees.
And you're looking at maybe thousands of them
just being wiped out for no reason.
They didn't do anything wrong because of this.
This could have a very damaging effect
on the startup economy and the whole United States economy.
This is little tech.
These are the future companies
that will keep the United States competitive
versus China and the rest of the world.

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And then the other big thing that's happening,
and it's all happening in real time,
is a regional banking crisis.
Because when depositors see that their money was not safe at SVB,
which was a top 20 bank,
that as far as everyone knows was in regulatory compliance.
Nobody has said that SVB wasn't compliant.
As far as we know, they had a regulator's seal of approval.
And now you find out your money was not safe
and it's not FDIC insured above \$250,000.
So the conversations we're all seeing in our chat groups
with leading investors is,
why the hell would you keep your money anywhere,
but JP Morgan or a top four bank?
And so I think that unless the Fed steps in here
over the weekend, we're going to see potentially
a run on the regional banking system,
a cascade like we saw in 2008.
Well, Sacks, let's just take a step back before,
because I think that you're right,
but we should talk about why that happens,
the contagion drivers.
And just so people know,
Silicon Valley Bank is used by 50% of venture backed startups.
And I would say the majority of venture firms
also have their money there.
So this morning I got a note from Fundamen LPN.
They had millions of dollars that they can't access
to invest in startups.
So Chamath, there are many products and services
that Silicon Valley provides.
One is banking services to startups.
Another is to venture capitalists.
They do the mortgages for venture capitalists
and for founders as well.
They provide those kind of white glove services.
But you also mentioned in our group chat,
they also provide loans to GPs,
general partners to people who run venture firms.
So the impact could also hit there.
Maybe you could explain what that is.
And then we'll get into what happened here.
It's important maybe actually just for Friedberg

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to just explain what's happening.
But maybe let me just do the lead-in
and then Friedberg can do the details.
But for those that are far away
and aren't even sure what's going on,
the basic problem that we have right now
is in the last 36 hours,
a key part of the financial plumbing of Silicon Valley
has basically been turned off.
And as a result,
billions of dollars of deposits
have basically been frozen.
It means that people can't pay their bills.
It means that people can't access their deposits.
It means that credit lines could be in default.
It means that payroll can't be met.
And so as a result,
we have this potential contagion on our hands.
But in order to understand it on a packet,
I think it's important to explain exactly
how this came to pass.
So let me just hand the ball to Friedberg
and then we can talk about some of the implications,
of which there are many.
Yeah, before Friedberg starts with the why,
just what that's happened as well.
This all started on Wednesday evening
when Silicon Valley Bank's CEO
published a letter to shareholders announcing
that the bank was rebalancing its balance sheet
by selling tens of billions of dollars
worth of mostly U.S. securities,
I'm sorry, treasuries.
And then they announced they would raise some money
and sell some shares in Silicon Valley Bank.
Then the shares in Silicon Valley Bank
as a publicly traded entity dropped 60% on Thursday,
then another 60% on Friday.
Of course, then the entire world got focused on this.
And then every venture capitalist started telling,
or I would say the overwhelming majority of venture capitalists
told their founders to get their money out of SVB.
Then you had a classic run on the bank.

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A small number of venture capitalists gave advice to say, hey, we should support Silicon Valley Bank. I understand that, but it turned out to be really bad advice. And then trading was halted on Friday morning, pending news, and then finally the FDIC shut down Silicon Valley Bank at noon on Friday. And there's a lot of speculation of what will happen over the weekend, but maybe you could walk us through technically what happened to Silicon Valley Bank and why they had this cash shortfall and we explained the run on the bank basically. But what led up to this? The irony is it really was and is, prior to the quote run, a financially solvent business. So I have a few slides. If you're on YouTube, you can see it, that we pulled one slide that was kind of made by us and the other set that come from Silicon Valley Bank's actual presentations. But if you look at their balance sheet, this is from the end of the year, 2022, you can kind of look at the stuff that they owe, their liabilities, which is what they owe their customers that sits in deposits. Because when customers give you cash in a deposit, you owe them that money back. So that sits as a liability. And then they had some other debt. So in total, Silicon Valley Bank at the end of the year had about \$195 billion in liabilities, \$173 billion of customer deposits that they owe to customers and \$22 billion of other debt. And then they take those customer deposits and they invest it in a number of securities. And the way that a balance sheet business like this bank would operate is, you know, the customers have access to their cash anytime they want. But in order for the bank to make money, they make longer duration investments. And those longer duration investments give them the ability to earn money on those longer duration investments more than they're paying the customers for the deposit. So if you look at their longer duration investments,

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they had about \$208 billion of total assets sitting on the balance sheet. So compare that to the \$195 billion that they owe customers and other debt holders. So, you know, the difference here between \$208 and \$195 is about \$13 billion. That's kind of the net what people would call book value of Silicon Valley Bank at the end of the year. And of the \$208 billion of assets that they had, \$74 billion were loans, and they've got a breakdown of the loan portfolio here in a minute. \$91 billion were these hold to maturity securities where they don't actually adjust the value of these on a quarterly basis. And \$26 billion is what triggered this panic, which is available for sale securities, mostly treasuries. And what happened is Silicon Valley Bank's deposits came in so quickly over the last couple of years that they went out and they bought a bunch of treasuries, you know, with the cash that they got. And the problem is that very quickly... Freedberg, it's actually MBS. They bought a bunch of MBS, 10-year-duration MBS. And important to note, of the \$208 billion that they have the book value of Freedberg, there was a whatever, 10% if it's in cash or something. So they do have some cash there. That's right. Yeah, sorry, it's a good point. If you go back, so like, you know, let's say that of the \$173 billion of customer deposits, you know, they've got \$14 billion of cash, and then they've got all these treasury securities they can sell, call it \$40 billion. So if 25% of customers said tomorrow, hey, we want our cash back, theoretically they could just dump those treasury securities, distribute the cash, and give it all back to customers. The problem is if suddenly more than 25% want to get their cash back, well, now they have a problem. And that is effectively what triggers the run on the bank. As soon as some folks think that others might be pulling money out, then everyone rushes to be the first money out the door. And that's what triggers a classic run on the bank.

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There was a statistic, I think, in the 1920s, there were several hundred banks that had runs every year for almost the entire decade. And this was like a regular kind of occurrence that happened in the 1920s that ushered in a lot of our modern securities laws that are meant to kind of create the necessary liquidity provisions and how these banks are able to operate to make cash available to customers. But what happened is... So much so by the way, Friedberg, that they made a movie. It's a wonderful life about a bank run. So basically, one of the bigger problems that Silicon Valley bank, they ran into two big problems. Number one is deposit decline, where VCs were not investing new money. And when they were not investing new money and startups were burning more money than Silicon Valley had modeled, they would be burning because they thought everyone was going to reduce spend and reduce burn, and they didn't. So deposits were going down while all these startups were burning money. No VCs were investing. So total deposits were on the decline. And while their bond portfolio, the assets that they hold on the balance sheet also declined in value. And I kind of just put a really simple illustration here on why. If you have a hundred dollar kind of face value bond that earns 2%, which is basically where these treasuries were a year ago, and you hold that for 10 years, that 10-year bond yields \$122. If the interest rate goes up to 5%, then that bond should yield \$163. So the value of the first bond actually goes down by 25% because of the market conditions. That's how significant the value changes with just a 3% change in the interest rates. And that's effectively what happened with that available for security segment of the Silicon Valley Bank portfolio balance sheet. They had this bond portfolio that suddenly got devalued and they had declining deposits. So when deposits start to decline, you got to make sure you have enough assets sitting on the balance sheet. So they sold a bunch of them, said we're going to raise more money. And at that point, everyone kind of perked their head up and said, oh my gosh, what's crazy is in Q4, by the way, Seeking Alpha, this website you guys know,

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they had actually done an analysis and said it's SVB about to blow up.
And they put together a bunch of slides that highlighted why this might be the case because they saw that deposits were declining, that their assets that they hold were basically declining in value because of the massive and very quick rise in interest rates and that SVB had bought a bunch of bonds that were long-durated bonds. So it led to a, you know, obviously a real short-term problem. If you look at the rest of SVB's loan portfolio, there's also a question of how distressed that all is. So 10% of their 70 billion plus dollars of loans is in venture debt. And venture debt is very questionable in this market, right? Because historically, the way venture debt makes money is that they assume that VCs are going to keep funding the companies that they're providing debt to. And if the VC stopped funding the companies, then the venture debt defaults. And so if you go to the last slide in this deck, you'll kind of see SVB's performance on their venture debt portfolio. Yeah, so look at this. This is the performance results on just the warrants that they get on their venture debt. So when you issue venture debt, you take a write down or you get paid back. And then you also get some warrants. You get a right to buy shares in the winners, in the startups that work. And so the way that SVB's made money on their venture debt portfolio historically is hopefully they get paid back on all their loans, some of them they don't. But then they'll make a bunch of money on selling their warrants or the companies going public are getting bought. And in Q4 of 2022, it just fell off a cliff and their venture debt portfolio really started to show distress. And that's 10%. Are these realized gains or these are marked to market gains? This is the net gains on their warrants. So they don't mark to market warrants. I think this is what they actually exercised and got out. So there was obviously a ton of exits in 2021. So they made \$560 million in profit on their warrants that they had in their venture debt portfolio in 2021. That number collapsed to 148 in 2022. And you better believe most of that was in the early part of 2022. So, you know, they didn't do a quarterly breakdown on this. This was like their full year numbers. But their venture debt portfolio, which is another \$7 billion a capital, also distressed certainly wasn't going to perform as everyone had modeled. So when you kind of start to add this all up and remember, you go back to the beginning,

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they only had \$15 billion of true net book value,
which is the difference between their assets and their liabilities.
And so if you really start to adjust, what are those assets really worth?
Are they really worth what they're holding them at the book at?
And if people start to pull money out and you got to sell them at a distressed price
in order to give people their cash that they're owed on deposits,
that's when you have a classic run on the bank problem.
And then everyone tries to be the first out the door.
And that's basically like what triggered this this week.
Can I give you guys my little version of all of this?
I think there are three buckets, but before I go into the three buckets,
I just want to say to all of the employees at these companies,
I think we, the four of us are so truly sorry for what's going on
and what you guys are going through.
And then to founders that are trying to navigate this, it must be unbelievably tough.
There are a few founders in our portfolio.
So, you know, from all of us, just know that we're thinking of you guys
and hopefully everybody ends up on the other side of this by Monday or Tuesday
with not a lot of damage.
So let's just put that out there as sort of like goodwill
and kind of good juju in the world for the next couple of weeks here.
This is going to be a really difficult weekend for people who are trying to navigate this.
I think it's well said.
Yeah.
I mean, I've got founders who are in really, really tough shape right now
trying to figure out how do I make payroll?
And it's a big question.
Okay.
So just putting a pin in that because we'll come back to it.
I think that this whole debacle, I guess, is maybe the best word.
There's a little bit of blame that you can put at the feet of three different groups of actors.
And I just want to get your guys' reaction to this.
So, group number one, and Friedberg just mentioned this,
is we, the four of us, have been talking for the last 18 months about the impact of rising rates.
And, you know, we talked a lot about, for example, like in our portfolio,
my partners and I walked into every company and made them have at least enough money to get
through mid-2025, right?
I've said this a bunch of times.
And so that was about having very difficult conversations about making sure that you were husband
in cash
so that you had enough to weather any storm that came on the horizon.
But it turns out that there was some group of VCs and companies that just didn't get that memo
and just kept spending like nothing had changed.

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But when other VCs have stopped giving you money and you're continuing to spend like it was 2020, that's what caused this mismatch.

And it was really the spark that lit the fuse.

So, I think it's a really sad commentary at some level about the lack of governance that we have inside of some of these companies

where folks are just not doing the job that they're supposed to at these board levels.

I think people, and we've talked about this, have made Venture too much of a popularity contest where they are, you know, glad-handing and smiling and not doing the hard work of holding folks accountable.

And so some handful of VCs and some handful of founders just didn't get this memo and it made what could have been a slower train wreck faster unnecessarily.

So, I think that that's worth talking about.

Then, I think if you look at what actually practically happened over the last year and a half at SVB was that

they were so desirous of profits that they basically had a duration mismatch.

So, what is that? Imagine you get a job and somebody's like,

hey, Freeberg, I'll pay you \$100,000 monthly over some number of months in normal pay every two weeks,

or I'll pay you \$200,000 but you only get paid once a year.

Well, the problem with that second thing is you still have monthly bills that you have to make up for before you get paid.

And so, most people wouldn't take that job even if they paid you a lot more because you have this durational mismatch.

You have to pay rent every month. You have to pay bills on a monthly basis.

You have credit card bills, all these things.

And so, you need to match the timing of your cash flows.

And so, I think somewhere along the way, the risk folks at SVB just made a really large miscalculation.

They basically went and bought 10-year risk in order to pay back money that could be called on a daily or weekly basis.

Obviously, in hindsight, that was not a good idea.

But more importantly, Chimac, they didn't adjust fast enough.

Well, they can't because they have these market-to-market assets that were just getting clobbered in the head as rates got raised.

And then the third thing is around regulators.

After the great financial crisis, we went through a period where there was hundreds of bank failures.

And then for the last decade, they've been virtually none. They've been like a few here or there.

And the last one was just during COVID.

And so, the regulators, I think, have done a really good job with Dodd-Frank and all of these other things to clean up the banking laws

and the reporting requirements and the capital structures so that runs on banks are more and more infrequent.

But they kept this crazy loophole around the accounting treatment of assets,

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and they allow these durational mismatches to appear in a bank's balance sheet.

And so, I think there's a piece here for the regulators, which is,

here's an opportunity that's glaring and obvious now and screaming about how we need to tighten some more of the transparency that's required.

It shouldn't be a group of armchair sleuths on seeking alpha that sniffed this out three months before it happened.

It should have actually been a regulator that said, hey, hold on a second, something is happening here that we don't like.

And so, we, I think, need to figure it out. But I think those are the three actors that are in play, and they each share a bit of the blame here.

Freeberg, Sax, what do you think? Who is to blame here most for this blow-up,

or is this just the extraordinary event of the rate hikes happening in such a short, compressed period of time?

No, I mean, look, I think that SVB's risk management was terrible, obviously.

They signed up for these long-dated securities when the market they serve is incredibly volatile, like Jamal says, duration mismatch, really good point.

I would also say that there's a weird regulatory treatment where, apparently,

if you buy these 10-year bonds, these 10-year mortgage-backed securities or 10-year treasuries, you don't have to recognize the loss until you sell them, which is just bizarre.

So, in other words, they should have been marking the positions to market.

And instead, they just were allowing these losses to accrue.

I don't understand how the regulators can allow that kind of system.

I also don't understand how the regulators can allow a bank to take customer deposits and loan them out to startups with this venture debt that we've been talking about on the show, where 10% of their portfolio is basically being loaned out to startups who have no credit.

That's crazy.

We talked on the show a few months ago.

Actually, it's a good time to play the clip here because what we saw,

and Saks and I seeing at the Series A level, you have a lot of times, founders would get this basically free money in their minds.

I raised 10.

I get five in venture debt.

I can extend my runway, but that money comes due.

And here's the clip for when Saks and I were talking about it just a couple episodes ago.

What I don't trust is whether the return models on venture debt that were created

over the last five to 10 years will be a good predictor of what the returns will be

in the next five to 10 years when a lot of the mortality that should have happened in the past now happens in the future.

Yeah.

I mean, this is just four or five episodes ago.

We kind of nailed it.

Startups have no collateral.

There's no security for that loan.

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How does that make sense to make a loan to a creditless startup?

That's true.

Guys, look, I disagree with you on this point.

Look, if you pull up the slide that breaks down.

So let's talk about venture debt for a second because I've actually invested in a venture debt fund and I've seen the economics on it.

The way that the venture debt model typically works is the lender loans money to the startup.

And what they underwrite is what the current VCs in the startup say they're going to do to support the company in the future.

So their ability to get paid back in the future is largely predicated not on underwriting the company and the performance of the business or the assets they have, but it's underwritten by the fact that the VCs are committed to continuing to put money in and hopefully see that this thing has a big outcome.

There is no commitment.

There is no commitment.

I get it.

No, let me tell you.

No, hold on.

Let me just finish.

Hold on.

Let me just finish.

I get it.

But the asset as an asset class, we can make fun of it all we want.

It's actually performed pretty well.

These guys have generated typically 18% as an industry.

And a bull market.

And yeah.

And a bull market.

You're right.

And the way that they generate those returns is that they're loaning money to the startups.

A bunch of those startups fail.

They don't get paid back.

And then the ones that succeed, they actually take warrants in the startups.

So they have some equity upside in the startup.

And that's the way the model works.

We can make fun of it all we want.

It actually works as an industry.

Let me tell you why that broke is it goes back to the point you made earlier in the show, which is the lender has this expectation that the VCs are going to keep investing.

Well, what if they don't?

We've been in a generally up and to the right bull market since the last crash in 2009.

So I believe that the data for all these models is skewed because it assumes, again, an environment in which companies keep raising up rounds.

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And as soon as you get into a crisis in which that breaks, then the whole asset class breaks. And I think this was completely predictable.

But even if you think that this asset class is legitimate, I don't understand why banking deposits could ever be used to fund it.

If you want to be a venture debt fund, go out and raise money from LPs.

Because what happens is when you raise it with customer deposits, you're creating systemic risk for the banking system.

100%.

And the regulation never allowed that.

Even worse.

100%.

The two assets are correlated because you're loaning it to people who are depositing it.

And in every other part of the private credit market, that is exactly what you do, what SAC said.

You can't use customer deposits to do some CLO deal or to back a PE play.

These are all LP capital that goes towards that.

This is the only sliver, as far as I know, where you take customer deposits to create very risky loans wrapped with warrant coverage.

And by the way, this stuff is never free.

Right?

So they make you keep your money there.

They make you have enough money to cover the size of the loan in the first place.

So it's not even that valuable because if they gave you \$8 million loan, you have to have \$8 million always on deposit.

Otherwise, you violate the, otherwise, you're, you know, you're breached the loan.

So there is no free lunch in venture debt.

There has never been.

And I still think venture debt is very much like venture capital, which is most of these gains are on paper.

Most of these gains haven't really been realized.

And now we're going to go through this sorting process when all of this stuff gets whacked.

I do want Saxey, your reaction to this though, which is the thing that started this was the fact that VCs, seeing the markets imploding, stopped giving companies money, but they didn't do enough work to help founders cut burn.

As we said it themselves, the burn stayed the same.

What is going on inside of these boards?

Well, I think that's crazy because listen, I mean, we started doing portfolio uppercase with our entire portfolio of founders in February last year, saying this is a regime change.

You got to cut costs.

We did another one in May.

You can watch them both on YouTube.

Okay.

And we were telling founders, cut your burn.

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Do it now.

Don't wait.

We were beating the drum on this so hard and in every board meeting and privately.

And I like, you know, and it takes multiple times, frankly, to get through.

I think your point, Tramoth, about not wanting to be unpopular with the founder crowd led some young capital allocators to maybe say, okay, yeah, let's try this ditch effort before we do, you know, another riff.

Let's try this new product.

Let's change our sales strategy.

I don't think it's young versus old.

I think it's experienced versus unexperienced.

No, I think it's experienced.

Okay.

That's better.

I think that's better.

I think there is an experience.

Listen, if you've never lived through a bear market, you don't know how bad it can get.

Tech is a boom bus cycle and the bus are really hard.

Really hard.

Really hard.

And if you've never lived through a regime change before, like there was in 2008, 2009 or in 2000.

And 2001.

Was the worst.

2001 to three.

And you're totally a parent.

You have no idea.

And, you know, and I think experience does matter and there aren't that many VCs around who live through the dot com crash.

No, probably 85% of not.

By the way, if you guys pull up just that slide on the loan portfolio at SVB, I just want to make the case.

I hear you, it's a risky, it seems like a risky investment to make, but what don't you guys agree that a balance sheet business like SVB or an insurance company or any business that has, you know, some amount of money coming in that sits on the balance sheet and then they invested for a period of time, there's a laddering of risk and there's a laddering of duration that you have.

And so if you look at Silicon Valley bank from their, from the update they did last week that figured all of this, if you look at SVB's loan portfolio, 70% are really the SVB's asset back loans, which are 56% of the portfolio is like, you know, prepayments on LP commitments and then 14% is private banking loans, which is loans against, you know, public securities that people have.

Only 10% of the portfolio is venture debt, which is \$7 billion.

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And you know, look, if the asset historically is performed at an 18% kind of rate of return, what is the venture debt portfolio going to look like in the distressed environment?

Is it negative 100%?

Is it negative 50%?

Negative 40%?

Negative 30%?

I mean, you guys can have a point of view on this.

But you look, I mean, for any business that's managing a large balance sheet of assets against, you know, a short kind of liability tree, they're going to have some riskier assets.

I think, you know, the question is, was 10% too much of the loan portfolio?

I think 1% is too much.

Yeah.

And I'll add to that, you know, one of the issues here that we saw qualitatively, and Sax and I both saw qualitatively, is the standard for giving these and the size of them got lower and lower.

In fact, the covenants went away, and this is what we kept having 100% to us.

It has no covenants.

They offer me no covenants.

I don't have to have a certain amount of cash.

I don't have a certain amount of revenue.

Those covenants were there for a reason to filter out the people who can't afford the house, right?

And this is exactly what happened in 2008 when people started giving those no recourse or no background check, mortgages, remember those where like you didn't have to do a background check to get a mortgage?

That's what happened in venture.

They just gave these, I saw it firsthand, willy-nilly, I begged founders to not take them, and I only won that discussion, Sax, one out of five times, because founders are like money.

We're having this debate, but there's no indication, and there were no losses in this portfolio to date that showed that venture debt's underperforming.

We're saying this is stupid.

What's the expression, past performance is no guarantee of future performance.

Because it's obvious to us on this podcast.

You guys are arguing about venture debt.

The real loss that happened at SVB was the fact that they bought a bunch of treasuries, and interest rates went from 2% to 5%.

Let me.

There's two things going on here.

Okay, Freeberg, when I see your chart and you talk about laddering this and laddering that and X% and all this kind of stuff, I think about the smartest guys in the room.

Okay, this is long-term capital management.

This is Enron.

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This is the 2008 bank failure.

They think they can basically do financial engineering to make this work.

You know why it doesn't work?

It's because, number one, they're not in fully liquid assets.

Number two, they're not marking to market every day.

If you're a deposit bank, you should be required to keep all of your assets in fully liquid securities that you mark to market every day.

It's that simple.

What do they do?

They put it in 10-year duration mortgage bonds.

We need to explain this.

Where the value got devastated with the rise in interest rates.

They didn't have to mark that to market and second, they put 10% of the portfolio in basically loans to creditless startups.

When there is a run on the bank, you have a roughly 30% gap between deposits and their actual, the value of their portfolio.

Yeah.

Listen.

That shouldn't be allowed.

The reason it's allowed is, frankly, I think regulators are completely asleep at the wheel.

Where's Powell?

Where's Yellen?

Two days ago, Powell was testifying in front of the banking committee and they asked him, do you see any systemic risks in the banking system because of the rapid rise in interest rates?

He said, no.

No systemic risk.

Sacks is right.

I agree.

The rise in interest rates is the key driver here.

It drove down venture investing.

It drove down valuations and it's driving down the value of long-durated bond portfolios, which by the way is the main stand, the standard of how a lot of these businesses invest and operate.

It caused distress and stress on the system.

My biggest concern is the contagion effect that arises next.

If you go in and you continue to assume interest rates climb and everyone's holding onto these bonds and they're getting written down, meanwhile, you owe people all this money in cash.

And the other thing that's happening, if you hold cash today, you're likely want a higher interest rate to compete with treasuries because you can invest in treasuries today and make four or five percent.

So let's pause for a second here.

I just want to make sure that the audience understands.

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And Yellen put out a statement today, Jack, just to finish the thought that they're monitoring the situation.

Yes.

They're sitting there like a bump on a log.

I mean, it's ridiculous.

They need to be out front on this.

They don't understand that this is a cascading situation.

So listen, either this weekend, either this weekend, they place SVB in the hands of a J.P.

Morgan.

They do basically a barrister or a wampoo.

They either do that this weekend or this thing keeps cascading next week.

And look, I could be wrong.

Maybe they're working on it right now behind the scenes.

First they are kudos to them, they'll have an announcement before the market opens on Monday.

But if they're not, and Yellen's just like, we're monitoring the situation, while three days ago she was in Ukraine, this is incompetence at work.

All right.

Hold on.

We'll figure out a way for you to dump this into January 6 next.

Take a pause.

He connected Silicon Valley Bank to Ukraine.

It was beautiful.

Yeah, exactly.

It was beautiful.

The peace here, that's important to understand.

What is our security treasury doing in Ukraine?

I mean, seriously.

Take it easy.

Take it easy.

That's what happened, just so people understand.

U.S. Treasuries were at 102, you get like a 2% a year.

They bought a bunch of those.

That was actually, when you think about it, you would say that's a safe bet.

The problem is those are locked up for 10 years.

And nobody anticipated on the Silicon Valley Bank team that the rate hike would happen so quickly, so violently.

Remember we saw the 25, 25, 50, 50, 75, 75, all those increases.

Now what happens to a 2% U.S. Treasury, when the interest rate goes up, is they get devalued.

They're not worth as much.

So if you did need to sell them, you would have to sell them at a discount.

If you held them to maturity, you would get that complete return.

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And what happened here is they needed to sell these early, and they sold them early and they took a massive loss, billions of dollars, and that's what lit the fuse.

That's the slide I showed, like the price.

I just want to make sure the audience understands that.

If they had sold these earlier, or if they hadn't bought these, they would have not had this problem.

Wait, wait, wait.

Go ahead, Chamath.

Now, why in that meeting did they have to decide to emergency sell?

It's because VCs stopped giving startups money.

So startups couldn't deposit more money into the bank, but they kept spending at the same rate that they were spending.

In other words, the deposits went down.

In the last 18 months, not enough folks read the memo.

Yes.

And by the way, the tragedy of that is, let's just say that you did get the memo and you did make the hard cuts, right now.

And let's say you're working on something and you can fill in the blank on the thing that you care about.

Okay.

So for the listeners, let's say it's climate change.

Let's say it's breast cancer research, whatever it is.

They said nothing to do with you four days ago.

You had your money in the bank.

You did everything you needed to do to go and, you know, figure out product market fit, you know, try to get to market, try to sell your product.

And all of a sudden, because of some other set of folks and actors who couldn't get their act together, now you're on the precipice of bankruptcy in 36, 48 hours.

That's crazy to me.

This is the challenge.

Sax, I think you could speak to this as well, is we did all this portfolio management over the last year.

These were the troubled companies.

And then you had the companies, a large portion who did the right thing.

They had a big war chest and they had set the burn at the right pace.

And now they, the other portion of our portfolio that had big war chests, they're now at risk.

So if you're a capital allocator right now, you're looking at a group of companies that you tried your best to save and they're, and they're angled and they're wounded.

And now the strong ones are wounded too.

This is cataclysmic for Silicon Valley.

If this does not get stopped this weekend, not only, and I don't want to be hysterical.

You're right.

This is the meteor hitting the dinosaur.

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It's an extinction level event.

You're right, Jake.

We have portfolio companies that had tens or, you know, millions or more in Silicon Valley bank.

And their account showed that their money was in the safest money market funds, money market funds with a publicly traded ticker symbol that were managed by BlackRock or Morgan Stanley.

Okay.

That's what their accounts showed them they had.

And then they're told all of a sudden, no, you're only protected up to \$250,000.

Something above that, that your, your money market fund is just an asset of SBB, which is in receivership.

You get a certificate.

Yeah.

And you get a certificate.

Do you see this announcement?

By the way, the California regulator made things worse.

The California regulators stepped in and they froze everything.

So our companies were in the process.

We have companies that submitted a wire yesterday.

By the way, we spent all day yesterday on the phone with our portfolio companies trying to get them out.

We had wire requests that went in for the deadline and for some reason we're in a queue.

They didn't get through.

And they didn't get out.

They didn't get through.

And then the California regulator steps in this morning and freezes everything.

And what did they announce?

They said, oh, you're good.

You're good for your insured amounts.

How much is that?

\$250,000.

For your uninsured amounts, which is everything above \$250,000, you're going to get a certificate.

A certificate?

What does that mean?

That means you're a creditor in bankruptcy.

So the mutual fund that you thought you owned was actually not hypothesized in your name.

It was in SBB's name at BlackRock.

And so our companies have been calling BlackRock and calling Morgan Stanley saying, hey, do you have my money market fund?

And they're like, no, sorry.

That's SBB.

So now they're sitting in a creditor line in bankruptcy.

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We've got to explain this.

These were called sweep accounts.

So what Silicon Valley Bank did with some of these large portfolio holders, let's say SACs and a bunch of other VCs gave you \$30 million, yes.

And they took your money and they said, you know what, just to be safe, we're going to take your money, we'll automatically sweep it and distribute it across two other accounts.

So we got this BlackRock over here for you, great.

We got this Morgan Stanley over here, great, whatever it is.

You could only get to those through the Silicon Valley Bank interface.

And so it was supposed to protect you, but there is no recourse, it seems.

Those are frozen too.

So the only thing you can do that's logical, and I had a mentor 30 years ago when I had the magazine and we started hitting millions of dollars in revenue.

And he said, I said, how much money do we have in the bank?

He said, which bank account?

And he had four bank accounts and he would load balance them.

And he did it every Friday.

God bless Elliot Cook.

He did it every Friday for me.

And I've always done that.

I've always had multiple bank accounts and load balance them.

But in this case, Silicon Valley Bank did it through one interface.

I have multiple startups today who did this exact thing, SACs.

And they couldn't even log into Silicon Valley Bank today to even see where they're at.

I mean, I think you can log in now.

Yeah, you're right.

Everything got frozen.

And the California regulator froze them and they brought in the FDIC.

So there's a couple of problems now with the working out of this.

This is basically a bankruptcy process, a receivership process.

It's that we've got all these companies that need to make payroll in the next few weeks.

And so these processes don't work at startup time.

If you could just figure out, over the weekend, okay, SVB lost 30 cents on the dollar and everyone's just going to be prorated and you're going to get 70 cents on the dollar and you are going to get your money on Monday, it would be a hit to the startup ecosystem, but people would recover and move on.

But the fact of the matter is it's not going to be on Monday.

It could take weeks or months to figure out how many cents on the dollar you have.

Are they liquidating Silicon Valley Bank?

Are they selling the debts?

Oh, yeah.

Is everybody getting laid off?

No, FDIC is going to liquidate everything.

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Well, you have two paths here.

Path number one is if you actually try to sell these assets, but the problem is who do you think the buyer is?

The buyer are the sharpest sharps on Wall Street who will purposefully underbid these assets.

And so that then takes you to path two, which is then the only other real solution is for the Fed to warehouse them and guarantee them.

And that's an equivalent version of what they had to do during the Great Financial Crisis, which was this thing called TARP, which is the Troubled Asset Relief Plan.

It was just a backstop and a mechanism so that these, at the time, those toxic assets, which were a bunch of mortgage-backed loans, could be cleared through the system over time, which effectively meant that the Fed basically warehoused that risk.

So I think what we need to see now is, is SACs, it could be 50 cents on the dollar.

It could be 60 cents if you want immediate liquidity.

You know, a friend in our group chat was mentioning that there was one claim, a company that had \$100 million inside of SVB was offered 60 cents on the dollar today for that claim.

Now that's a really, from a third party who said, I will take you, I will give you 60 million today in return for that certificate, plus the \$250,000 that says you're owed \$100 million, because they're willing to take the risk that they'll get, you know, 80 million, right?

And then they take the difference.

Now, the point is that if you're seeing today that kind of a discount, that's not a good sign, I think.

And it does speak to the fact that regulators have to step in.

Now, here's the other reason why I think it's important.

I think what regulators and I think the people, and there's a lot of them in Washington that want to listen to this, what this does is it torches years of U.S. innovation.

And you should not let that happen.

There are companies working on really important things for the United States and for the rest of the world.

And if the company fails because they can't make the product work, so be it.

We take that risk every day.

If the company fails because customers don't want to buy it, so be it.

If the product fails because a better product comes out, so be it.

But it shouldn't fail because we can't get money that is in a deposit.

That should not be why we torch hundreds of startups and what they're working on.

Maybe thousands.

Yeah.

This would be a lost decade.

A lost decade for Silicon Valley.

Jake, first of all, do you guys want to talk about second and third order effects just so folks really understand those?

Because I think it's important to highlight why it's not just about a couple hundred

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tech bros in Silicon Valley not being able to make payroll, but there's important downstream consequences.

For example, there are payment processing companies in Silicon Valley that use Silicon Valley Bank to store their capital and to move money around.

There are payroll companies that do payroll for many businesses, not just tech businesses, but many businesses in different parts of the economy that store their cash at Silicon Valley Bank and process money through Silicon Valley Bank.

Today it was announced that Rippling, one of those companies, could not hit their payroll cycle today because they had money tied up at Silicon Valley Bank.

Fortunately, they announced that they also have money at JPMorgan and other places, so they will be able to kind of get the payroll processed early next week and get everyone back on track.

But this is hundreds and potentially thousands of companies that use their payroll software to process and pay their employees.

And then there's all the payment processors.

We don't know how many of them have what level of exposure and a lot of infrastructure companies that move money in and through Silicon Valley Bank.

And so if they start to go down and then payroll doesn't hit the air conditioning company that's using the tool in Arizona and then the Stripe service isn't able to process e-commerce payments for a small business owner that runs a website, you can start to see how there can be very significant trickling effects.

And more importantly, like we saw in 08, perhaps to a different degree, but still a significant concern is the contagion of panic where people say if there isn't reliability in the things that I thought were reliable before, I start to have real questions in the soundness of the system overall.

And that's why it's so important to SAC said to step in, shore up the problem this weekend.

I don't think it's about bidding 50 cents or 60 cents on the dollar.

Every depositor needs to get paid 100% of their money and that cash needs to be made available to them by early next week.

And if that money is not available to them within the first 48 or 72 hours of the end of this weekend, then we are going to have a real crisis on our hands because then you will see a lot of people trying to move money away from any institution that stores their money in some sort of security that's not 100% liquid like cash.

And that's going to cause a massive run.

And so what has to happen, the only way this can happen is if someone takes over Silicon Valley Bank this weekend and that the federal government, unfortunately as much as I hate to say it because I absolutely hate the federal government having a role in this stuff, has to say we will guarantee 100% of those deposits to the company that takes over, the bank that takes over this portfolio and says, let the portfolio of assets run its lifetime.

See what you get paid, whatever the delta is, we'll make it up to you.

But we need to make sure that there's cash here today for all of these depositors to get paid tomorrow.

You had something you wanted to say.

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If not, I have something I want to say.

The other big thing that SVB was, was an on-ramp for a lot of investors including many US investors to get money into China.

And without commenting on whether that's right, wrong or indifferent, the point is that China has a very complicated capital market structure which requires you to basically use an offshore bank i.e. non-domesticated Chinese bank and to be able to get those dollars.

And so what would happen is Chinese startups that would raise money from US investors and abroad using these bank accounts.

And so this issue now doesn't just touch the United States innovation economy, it also touches China's innovation economy, which creates actually a complicated set of trade-offs for the US government and Treasury as they think about what they want to do in this heightening great power conflict that Saks talked about last week.

And I want to just make a very important nuance point here.

I know there is no bank that the public, specifically people who don't want to support rich people already like big tech or billionaires.

The reason to backstop this with public money is because we have a roadmap for this.

People don't know this widely, but TARP was just over \$400 billion.

It actually returned a \$15 billion profit to the American people.

This would require maybe \$25 or \$50 billion, 10% maybe, 5%, 10% of the totality of TARP would be enough to cover what's happening here with Silicon Valley Bank and work this out.

That's \$50 billion for the people listening in Washington or for the people who will say, hey, why are we bailing out big tech?

You're bailing out small tech, as Chumat said.

You're bailing out innovation on breast cancer, on renewable energy.

But most importantly, this can easily be structured so that the American people return 20%, 30%, maybe even double their money.

You could structure this so it is senior to everything else and is exactly what the government is supposed to do when there is a crisis.

That doesn't mean the people who run Silicon Valley Bank should have their equity worth a lot.

They should get wiped out.

They didn't do their job properly.

The equity, the people who ran the management team there, if they don't get anything, that's okay.

They understand that, but the people who had their money at deposit to pay the salaries and to pay for this innovation, it is unconscionable that we wouldn't backstop it.

I guarantee you the US government could get some warrants on those companies or warrants in ownership in Silicon Valley Bank and make at least \$0.50 on the dollar, maybe even double, and that's the way this bailout should be structured, and it has to be done this weekend.

You bring up a great idea.

I think if the US balance sheet does step in over the weekend, I'm going to say on behalf of the US taxpayer, you must get a piece of these companies.

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The reason why is that that's the way to make it fair for everybody that's not in tech who's on the outside looking in.

If you look inside of Twitter as an example, there's a lot of negative sentiment around even the idea of a bailout happening, and it's for this exact reason because I think people believe that it will benefit just a small sliver of people.

To step in and to save these companies, Jason, would still be really only helping, say, several hundred thousand or several, and the thing that that gets wrong, in my opinion, is that these companies, if they're allowed to germinate, should be building things that actually help everybody.

Yeah, including jobs and taxes.

So if you can view it that way, and if you can view a share of it, now, obviously, look, we have a very deep incentive for that to happen, but I think it's important to present the other side of it.

The other side would say, this industry has a little bit run amok.

It's not well-regulated.

You guys push the boundaries and get away with a lot, and there haven't been a lot of consequences.

You're saying the banking industry.

No, I'm saying the tech industry.

No, no, I'm saying the average person on the outside looking into the tech industry can make that claim.

And now, they would be pointing at big tech, but the problem is we all get swept in together under the same thing.

And then what they would say is, I don't think it's right to step in.

And I think that you have to give the US taxpayer an incentive if they are going to do it.

And I think the incentive should be that they should just get a share in all this innovation.

If they take over the venture debt portfolio, then they would have that, right?

The venture debt portfolio comes with warrants, so they would have that.

I think there's a big risk here that precisely because tech is unpopular, and people I think are confusing big tech with small tech, that the government doesn't step in here and the dominoes start falling, and we start getting all the systemic risks playing out.

Remember, the beneficiaries here aren't just the current generation of tech companies, and everyone they do business with.

It's also wherever the contagion goes next.

And we're already seeing, I think, multiple regional banks under pressure.

They're stocked down.

People asking questions.

We know people in our tech groups who are wiring money out as fast as they can, just because why take a chance?

And by the way, you have to understand the game theory around these bank runs.

People describe them as a panic, but that implies that it's irrational.

It's not irrational.

It's actually rational.

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And what this is really highlighted is that what you said earlier at the beginning, SACS, which is that the regulatory oversight is actually extremely pristine at the biggest banks.

But the smaller and smaller you get, there's a level of opacity and a lack of regulatory follow through that allows this stuff to build.

So the Wall Street Journal right now is reporting that US banks have 620 billion of unrealized losses just on treacheries.

I don't know what the unrealized losses are on these long dated mortgage backed securities.

Like I said, I have no idea why regulators allow banks to hold these bonds at their book value instead of marking them to market every day.

That's crazy.

And on the equity side, you have to do it.

Buffett talks about this all the time.

The equity side, you have to mark to market the equity portfolio at the end of every quarter.

And he sees these wild swings and he complains about it, but it's the right thing to do for exactly this reason.

Right.

So the game theory here, the banking system, the banking regulators have created this opacity in the system.

You've got all of these assets that are being held by these banks that are not marked to market so nobody really knows what the true level of exposure is.

So what's the response?

Why take a chance?

Does move your money to JPMorgan?

So I think there's a chance that if the federal government doesn't step in here, the whole regional banking system could be decimated and you're just going to be left with four too big to fail banks.

How does that benefit anybody that doesn't benefit the little guy?

Guys, there's a pretty good set of regulatory disclosures that happen, but I do think that the real question is, are the ratios right?

Should they really be allowed to invest in these types of assets with depositor capital?

And if so, with what percent of the depositor capital should they be allowed to do it?

And maybe that seems to be where the biggest issue is.

We've come a long way.

I mean, I just pulled up the statistic.

It's insane.

There were 505 banks that failed in 1921.

Banks continued to rise in the early 20s and averaged 680 banks per year failed between 1923 and 1929.

So obviously, coming out of 08, there was a lot of controversy around, hey, banks can't make money anymore.

It's too restrictive.

The disclosures and so on.

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The disclosures are actually quite good.

You guys can go to these sites that regulate the banks.

You can go to the SEC site.

You can get a very detailed schedule of every asset held by every one of these banks.

It's good transparency, I would argue.

But should they be allowed to invest in securities that are effectively not fully liquid, that are risky, that are long-dated with short-dated deposits, right?

It's a fundamental question about what banks are supposed to be doing.

In a world of computers that can calculate everything, the idea that you can't solve duration matching doesn't seem like one of those problems that's intractable in 2023.

I mean, if people can make an AI version of the podcast, they can do that.

Yeah.

I think that's the most extreme example.

How do you mark to market a loan to a Series A startup?

That just 100% depends on whether you're going to raise a Series B or not.

I'm a believer you can underwrite anything.

I think for the right interest rate, for the right premium, you can underwrite insurance, you can underwrite loans.

I mean, there's a lot of ways that you could kind of invest.

How do you mark that to market on a daily basis?

No, you cannot.

You're right.

That's my point.

Absolutely.

Yeah, yeah, yeah.

From a reporting perspective.

So you just close it.

How does that solve the problem?

They've got different tiers of regulatory capital guys, and so there are rules around what the ratios need to be and where you need to fall.

And so they bucket this stuff up differently, right?

If you're a bank and you want to buy securities, you want to invest in something that's not liquid and mark to market every day, you should have to package it up in some period of time and sell it.

If you want to make a loan to a venture-backed startup, package those up and syndicate that and sell it as a security, and if you can't do that, you probably shouldn't be investing in the asset class anyway.

Same thing with mortgage.

These mortgages already get packaged up and sold, right?

So it just doesn't make sense to me that customer deposits, that's what we're talking about, which you assume should always be 100% safe, right?

This is not a source of capital where anyone's ever expecting to lose money.

If you want to use risk capital to get some sort of outsized return, go raise that from

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LPs, but to take customer deposits and use it on risky non-liquid investments, it makes no sense.

It makes no sense.

There's one thing I could just help people frame this.

The aggregate amount of dollars in these bank accounts, I would estimate, equals 10% of the value of the startups they represent.

Would we all agree on that?

It's about 10% of the value of those startups, maybe 20.

If we were...

What?

How do you calculate that?

Thinking about the startups who recently did a round of funding, they diluted 10%.

That represents all of their treasury or half of their treasury.

So if that cash for the startup portion of this equals 10% of the value of the startups, I can guarantee you those startups with access to that capital again, Monday, will be able to outperform the backstop that the government would provide.

This sounds like Enron math to me.

No.

Okay.

If you...

One of your startups, just take any of your startups.

They have 30 million.

Listen, we don't have time here for the government to figure out how to be a partner or an investor in all these startups.

I'm sorry, we don't.

I'm not saying that.

They either have to step in or they don't.

If they do step in, you'll have systemic failure.

No, no.

But do the math with me here.

Of one of the companies, pick one of the companies that has...

You have a company that has 20 million there or 30 million there.

What does that represent if you were to take their valuation from last year when they raised that money and cut in half?

What does it matter?

It doesn't matter.

It matters to...

It doesn't matter who's the depositor.

It does not matter who the depositor is.

It matters to people to understand how much value is going to be lost and how easily recoverable it is if these companies are allowed in aggregate to deploy that capital.

That's the point you're not getting or I'm not explaining to you properly.

If allowed to deploy that, it's going to return a multiple and a venture multiple, two, three,

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four, five X.

But if we destroy that money, these companies are going out of business next month.

But Jacob, that money is their money.

That's their deposits.

I agree with you.

I'm trying to create a framing here for people to understand exactly how much value is going to be lost.

I think the better framing is that when you put your money in a FDIC-insured bank and you put it in a customer deposit that's supposed to be completely safe, that's paying you a couple of percent interest and that is reflected even as a money market fund on your account, you do not expect that money to be turned around by the bank and put in risky assets.

So you're saying raise the FDIC limits.

That makes no sense.

Raise the FDIC.

Like banks should not work that way.

Okay.

I think it's crazy that you could set up a bank account, okay, because you just want to write checks and you could lose that money because the bankers decided to loan it to some startup.

That's insane.

Or the bankers decided to buy a 10-year mortgage-backed security who doesn't understand interest rate risk.

That's not the way the system is supposed to work.

And you've got all these people on Twitter pushing back no bailouts or whatever.

That's the depositors' money.

I agree.

No bailout for SBB.

They should lose everything.

All those executives, their stock options are worthless.

All the stockholders of that company, their shares are worthless.

But the question is, should depositors lose money in these banks?

They just thought they're selling for a checking account.

I mean, are you kidding me?

And if you let that happen, there will be a cascade here because the logical consequence will be everybody's going to say, put my money in J.P. Morgan or Wells Fargo or Bank of America.

There'll be four banks.

That's it.

And all the regional banks are going to shut down.

That's what I had it to.

Well, tens of thousands of highly paid workers and not just tech workers are going to be out of jobs and they don't have jobs waiting for them at Amazon or Google to bail them out.

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And this is the start of a contagion if it doesn't get stopped.

I believe that.

What did they do wrong, J.Cal?

What did they do wrong?

Nothing.

They used what is considered one of the most reputable banks in the world.

They used the top 20 bank that the regulator said was in compliance.

So did they do something wrong or were the regulators asleep at the wheel?

I don't know.

In some way, I think this is Biden's fault or Zelensky's fault.

What do you guys think this means for VC?

It is a chilling effect.

I talked with some LPs in the last two days in the VC world.

I'll give you a couple of anecdotes.

I have a friend who runs a fund.

He looked at his portfolio.

They have \$350 million tied up at Silicon Valley Bank.

They need \$27 million for cash for the next 30 days.

So he's called his LPs and he's trying to get his LPs to front him money, to wire money, so that he can front his company's money so they can actually pay their operating expenses and cover their payroll.

And then I spoke with a couple of LPs in the last 48 hours.

They have gotten dozens of calls from various venture funds.

Everyone is asking the same question, can we do a capital call?

Can we get money delivered early?

Can we use that money to support our companies because their cash is stuck?

Coming out of this, the uncertainty that this creates in the investment environment, I think it's going to have a real chilling effect, not just with the GPs and their proclivity to sign term sheets right now and wire new money over, but also with the LPs as they're making capital commitments and actually following through with capital commitments that have already been made, given where's the capital actually going to land up?

That was never a question mark before.

It was never anything that anyone even considered that capital could be disappeared or locked up or tied up.

And the fact that this is adding this unique friction in the market is a layer on top of an already distressed and challenged environment for fundraising, for GPs, for LPs.

And it seems to be exactly the icing on the cake we did not need right now, no matter how this gets a result.

I think private markets and VC could seize.

I think you're going to see people pull term sheets, maybe half as many fundings are going to occur as people try to do triage.

Another VC friend of mine just sent me a text, he can't make payroll next week.

He has a fund.

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For a VC fund?

His VC fund, their employees cannot, he cannot pay his employees on Monday.

And so, yes, I do think funds could shut down coming out of this.

I think that companies that were, call it, you know, 75% distressed are done for now.

No one's going to step in and bridge them and fund them.

It's going to accelerate a lot of shutdowns because people are now cash is king, now cash is king.

Right?

It's like a big shift.

I think that was really well said.

I think you're right about all that.

Jacob, you tweeted that you think this is going to cause a 68 freeze in dealmaking activity.

I think that's more or less right.

You're right because, you know, all the VC's out there have to think about shoring up their existing portfolios.

Exactly.

What if you got companies that are now in distress that are perfectly good companies, you've got to focus on, maybe you're going to make new investments in that.

You're picking a few winners.

You're picking one or two winners, you know, and you're going to focus on that.

You're going to say, you know what, the rest of them could be good, but I can't.

It's going to be a tough decision.

I have three open deals right now that we're doing.

I now have to figure out how to get those deals done.

And I have four companies that are in this payroll situation in a major way.

So now I've got capital and I've got to, and we're not personally affected by the Silicon Valley bank thing, thank God, but now we have to do triage the known winners in your portfolio that did nothing wrong.

Or do you make the next three investments or four investments?

And I'm going to make good on those three investments, but next month, maybe not.

Maybe next month I'm taking off and I'm focusing on the portfolio.

And I think that's what's going to happen writ large.

We're in triage mode now, full on triage mode, if this doesn't get resolved, if they can't get those.

And then next month, what do you think?

This dark.

I had a meeting three weeks ago with a US LP.

And you guys know how I run this business here, but there's like a lot of risk management.

We think about this stuff a lot.

And the message that came back to me was, I don't think risk management is worthwhile in venture.

I didn't understand where that was coming from, because if you're investing your money across a very risky asset class, you have to be always thinking about how you could

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lose money.

And I think that venture has always romantically been described as like buying lottery tickets.

And so it doesn't matter if you lose.

But when you have that kind of attitude, you just become super complacent and you don't think about left tail risk.

You only think about right tail outcomes.

And this is an example of like left tail risk that came out of nowhere that could wipe out entire portfolios.

So you had folks invest into funds that spent a few years, probably 2019, 2020, 2021, really misallocating money, writing ginormous checks into companies that valuations that didn't make sense, who then went and burned it.

And now what little cash they had left may also be gone, which means those valuations are even more impaired, which means that the LPs that gave them the money are even more underwater.

And that cycle I think is really terrible.

So maybe this is the wake up call where now risk management is actually in vogue and cool and it's important to know this stuff.

I don't know.

We have breaking news while taping this, the Department of Financial Protection and Innovation of the State of California has published findings on SVB, we'll pull it up on the screen for the besties to respond to.

On March 8th, 2023, the bank announced a loss of approximately \$1.8 billion from the sale of investments.

We've talked about that already.

On March 8th, 2023, the bank's holding company announced it was conducting a capital raise.

Despite the bank being in sound financial condition prior to March 9th, 2023, investors and depositors reacted by initiating withdrawals of \$42 billion in deposits.

So that would be over 20%, I think of the total deposits from the bank on March 9th or even more 2023, causing a run on the bank.

Because of the close of business on March 9th, the bank had a negative cash balance of approximately \$958 million despite attempts from the bank with the assistance of regulators to transfer collateral from various sources.

The bank did not meet its cash letter with the Federal Reserve.

The precipitous deposit withdrawal has caused the bank to be incapable of paying its obligations as they come due and the bank is now insolvent.

This is what we said at the beginning, \$42 billion of withdrawals is 25% of total deposits but \$42 billion is greater than the \$14 billion of cash they had on hand and the \$26 billion of liquid securities that they had.

So you add those two up together, you're at \$40 billion.

And then to get more cash, they're going to have to sell a bunch of loan portfolios and selling loan portfolios, you've got to package them up, it takes weeks or months to do that and they're going to be sold to distressed prices.

So this is where a classic run on the bank problem actually causes a decline in the asset

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value of the business and the assets that they own because if you have to go and turn around and sell those assets in the market super fast, you're going to take a huge loss. You guys remember that movie Margin Call with Demi Moore and what's his name and they make this plan to go and market and they're like, we got to sell Patrick Swayze. No, not Patrick Swayze, no, Jeremy Irons, he plays the best character, he's like the chairman of the bank and they're like, we have to sell all this, but we're going to take a huge loss and they make this big trade that happens at the beginning of the morning. But that's what happens when you have to sell a lot of assets very fast. As you guys know, you end up selling them at a discount. So the rate at which deposits are coming out of the bank can actually impact the asset value held at the bank and that's fundamentally what a run on the bank causes. And the irony is, as they point out, the company was fundamentally financially sound. They had enough assets marked at the current market value or whatever to meet all of their obligations, but the rate at which assets started to get pulled out is what drove the company, the bank into distress. And if you think about it, it's an ironic point of view on Silicon Valley because Silicon Valley operates with such, we all joke about what a herd mentality and what an incredibly tied and deep network Silicon Valley is. We all got dozens and hundreds of texts and messages from friends, colleagues, coworkers yesterday, all relaying the news about what they were going to do. And as soon as that happened, that's how tightly intertwined Silicon Valley is. Within 24 hours, every CEO and every venture capitalist was on a chat group or on a message group with other people in the Valley. And once there was any indication of panic, the entire market flipped. And you guys saw this. We all saw this within 24 hours. At the beginning of the day yesterday, it was like, they'll get through it. It'll be fine. They just took a little mark down on their portfolio. They got plenty of assets. But then it's like, well, Founder's Fund said we should probably get out. Okay. Let's get out. Maybe we should get out before everyone else does. Well, if we got to get out before everyone else does, let's do it now. I'm getting out right now. I'm telling my best friend. I'm getting out right now. And then everyone tells their second best friend. And then all of a sudden the whole Valley knows it. And then the whole Valley is running for the door. And this is a really interesting and unique scenario. It's not like the classic consumer run on the bank where you're trying to pull cash

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out.

It's the Silicon Valley 24 hour cycle of we all got to do it because everyone else is doing like what we're seeing with investing cycles in Silicon Valley where everyone chases and these bubbles emerge.

The reverse I think happened yesterday where the herd mentality drove us all to rush for the door as quickly as possible.

I'm not sure that that might be why it's not as much of a contagion as you might expect elsewhere because places, other kind of regional banks don't have the same sort of interwindedness as we saw with all the depositors here in Silicon Valley bank.

I don't know.

I don't know.

So this is where I think that describing what happened as a panic kind of misses the fundamental rationality of the response.

So it does seem like a panic, but that doesn't mean that each individual decision maker's motivation is panic.

I actually think it's a rational upside downside calculation.

I mean, this is all game theory.

So if you think that there's a risk of other people pulling out their assets, and in fact, you're hearing that they are, you don't want to wait and be the last one to leave.

And so you think about it, there's no penalty or downside to taking your money out, right?

So the downside of taking your funds out immediately is zero, and the upside is you might save 100% of your money.

So it's a rational decision when confidence is lost to take out your money.

And in fact, it was rational.

There were a bunch of VCs, not a lot, but some of them between yesterday that, you know, SGB has been a great player in the ecosystem for 30 years.

We should show our support right now by not taking our money out.

Well, guess what?

What happened to them?

They got stuck, and now their money is frozen, and they're not sure whether they'll get, you know, pennies on the dollar or not, whereas the people who rushed for the exits yesterday got their money out.

It's a prisoner's dilemma.

It is a prisoner's dilemma, but here's the thing.

It's not even about anymore whether the institution is solvent.

It's about whether there's confidence.

And I think there is a risk now of contagion spreading to these other regional banks because people aren't sure, and there's already huge cash outflows leaving these other banks because why take a chance?

The game theory of it is, move your money out until this is over.

And if you're okay with, you know, moving it back in a few weeks, if it turns out not to be around the bank, that's fine.

So a lot of this can be self-fulfilling.

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You have to remember that runs on the bank free where you said this 100 years ago were extremely common.

Every decade, there would be a giant financial panic and there'd be a run on the bank, run on many banks.

And the only way that the federal government stopped it was by introducing FDIC, and they said to depositors, your money is safe.

And at that time, \$250,000 was enough.

The problem we have is that with these business banks, \$250,000 is not enough.

So all of a sudden, there's going to be a crisis of confidence.

If you think a business bank can go under, again, you're just going to leave all of these regional banks, you're going to go to the top four, and that's going to be it.

So I think that the situation right now is really dynamic.

And if the Fed does nothing and just says, oh, these depositors should have known better, the losses on them, then I think the rational reaction for depositors at all of these other banks would be just to leave.

Because I don't think depositors are in a good position to assess the liquidity and creditworthiness of a bank.

I just don't think they are.

I think stockholders are.

There are the people who should lose all their money if the bank goes under, but not depositors.

Any advice or takeaways for founders and capital allocators going forward?

Obviously, have your money in multiple bank accounts.

I sent you guys a list that was just published of all of the funds that custody at SVB.

And it's unbelievable, the list.

It's every single major VC in Silicon Valley.

Wow.

Where'd you get this?

I have my ways.

Oh, extracted from SEC filings.

Got it.

Okay.

Thank you.

Yeah.

This is amazing.

Wow.

Holy shit.

I mean, everybody's in there.

Excelsior, it's 500.

Sequoia.

We're going pretty fast here, but yeah.

Yeah.

Everyone's in there.

Yeah, everyone's in there.

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I mean, this is my point.

By the way, all these guys.

That we were, we were out a few months ago when we were talking about venture debt on the pod, I didn't believe that SVB should be in this business.

So I told, oh, look, there's craft.

There's craft.

No.

Well, hold on.

I'll tell you.

Does it say how much money we got in there?

Yeah.

Go to the right.

I'll tell you what happened is, so after the conversation we had on this, this show about venture debt, I'm like, I don't really like that SVB is in this business.

So I told my guys, step in accounts somewhere else.

So we did that.

We moved our firm accounts over and we were just using SVB to make, you know, warehouse loans or whatever.

So I thought they were just a lender to us.

So yesterday when all this stuff went down, I said to our guys, like, we're out of there.

Right.

They're like, well, actually we had about \$45 million that we were about to distribute to LPs.

And I'm like, whoa, that's crazy.

So we were able to sweep that to an account we used to make in kind distributions.

And then we got on the phone and we called as many portfolio companies as we could to get them out.

And we got a huge number of them out, but unfortunately some of them didn't get out.

Here's the thing that I think people in Washington don't understand.

We're doing this with the next set of banks.

The triage is still happening.

Guys, I will tell you, look, Saks, I appreciate the siren call, but I think the only way that what you're saying, because you're saying that triggers the next siren call and the contagion spreads.

I'm not blaming you.

I'm just saying it's a reality and you're right.

The game theory optimal way to play this as a depositor is to move your money out and get it somewhere that it's completely safe and you know, you have your cash secured or buy a security and a brokerage account where it's totally safe and it's registered with a securities exchange or something.

But in the meantime, for this to get resolved, there has to be a bear hug solution offered up this weekend.

I'll say it again.

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Yeah.

In order to stop the next set of siren calls to drive the next siren call, listen, this is the thing I hate about the run on the bank conversation is that if you warn people that there's a possible run on the bank happening, you're actually creating the run on the bank. That's why it's so pernicious when these things get started.

And yesterday, we were calling all of our portfolio companies because we were warning them because our obligation was to them, but we weren't, you know, I don't think we were putting out like a siren to the world.

And by the afternoon, it was really clear that if they listened and got their money out, they were in much better shape than ones who didn't listen.

So this is the pernicious thing is that every individual actor has to do what's in their best interest.

And we're not trying to start another run, but hold on, but we know things.

We know that people very close to us, big players, are withdrawing their money from other banks right now out of an abundance of caution.

So let me just finish my point.

My point is what you're saying makes a ton of sense.

And it's going to cause this, as you described, kind of pernicious escalatory problem.

And the only way to stop it is a bear hug, which may not cost the taxpayer anything if the Fed or some federal agency stepped in and said, we are going to backstop all of these banks with all of these deposits with cash, and we're going to guarantee it today.

And here's a \$500 billion facility.

And just by saying that, everyone stops trying to pull their money out, and you don't actually need to backstop it with any money.

It's already started.

So Nick, if you just, the link that I sent you in the group chat, can you just throw that link up there?

I think this is the best proxy for what Sax is talking about.

So sort of, I think very unemotionally, how would we know that there is a contagion that's a foot?

You would look at the equity layer of all these regional banks.

So what is this?

This is the iShares regional banks ETF.

And what you start to see is this decay and go to the one week view, Nick, please.

It just starts to fall off of a cliff.

And so why is this happening?

Well, it's happening because the equity tier of these banks are now increasingly worried that their equity will get wiped out.

And so that's why they're selling.

And so I think what David said is already a foot, unfortunately.

It starts at SVB, but forget the name for a second and take Silicon Valley out of it.

This is a top 20 bank that now is in the receivership of the authorities.

And so there does need to be something that needs to happen in really short order because

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what's to prevent bank number 35?

Let me just say it again.

If a federal agency comes in, if the Fed comes in and says, you know what, we are going to backstop all of these banks and we are going to put \$500 billion behind it and we're going to guarantee that all these deposits are going to be made whole.

It stops the panic.

At that point, you don't even have to put up any money because as soon as it's a first derivative problem, it's a feedback loop.

As soon as you stop people from doing the withdrawals, the whole market subsides and you don't actually need to.

You unplug it.

And I think that's what needs to happen this weekend.

That's what should happen today is they, number one, need to go get Silicon Valley Bank, hand it over to a big balance sheet and guarantee that balance sheet that they're going to make money by taking this thing on.

And number two, they got to make a statement.

We got another 500 billy for you.

Where's the president?

Where's Yellen?

We got to make a profit on it too.

They don't need to use any money to do it.

Right.

The thing that's missing in our system is that there's no FDIC for \$25 million accounts.

Like \$250 is not an effective amount for a business bank.

That's a personal account.

It's for a small business.

But businesses need confidence in our economy and our banking system or the whole thing starts to unspool.

So what the quid pro quo should be is you can get a \$25 million FDIC business banking account and the bank is highly restricted in what it can do with that money.

You can't put that money in Fagasi venture debt.

You can't put that money in laddered 10-year bonds that don't get marked to market.

It's only highly liquid, secure, marked to market assets.

And the downside of that for the bank is they'll make less money and pass on less interest to the business, the depositor.

The shareholders.

I agree with that.

But so what?

That's the way it should work.

How are stablecoins looking like a better option right now?

I mean, the crypto guys right now are like, what did you do?

They're not J.K.L.

They're not.

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They're not J.K.L.

So nothing can revive the crypto market as we're seeing today.

Even in a run on the bank, which is exactly what everybody was afraid of in a Bitcoin world, that thing is down 10%.

So what?

I just want to recap the end of the show here.

The reason for that, Jamal, is just that what we've seen is that liquidity is all correlated.

So when people are panicking about the state of their finances and worried about getting access to their cash, the first thing they dump is crypto because it is very liquid.

So everyone is trying to free up cash right now.

I just want to be clear as the end of the show here.

We were dancing around, is this going to be a contagion?

And I think what we know and what we're seeing is the next dominoes are already falling.

It cannot be a contagion.

It cannot be a contagion.

We have to stop it.

That's the point.

That's your feeling.

Yeah.

And I agree with you.

But I just want to make sure people understand.

We started this.

We didn't want to go there.

You know, I think with some reticence to going there.

Let's put it this way.

If you, if anybody, if you have initiated a wire in the last 24 hours, you are worried about contagion.

Yes.

If you're in D.C. and you have any ability...

Risk management matters.

And if you have any ability to influence what's going to happen this weekend, we strongly advise that if someone comes in and bear hugs the market this weekend and says, we will not let contagion happen with a very big slug of capital to support it that will likely not even be needed to support it.

Because once you say that, the contagion will stop.

They got a comment down.

Yeah.

Freeberg, we're going to know on Monday whether these regulators in the administration know what they're doing at all.

The other black swan problem is that this weekend, we will find out what some of the unintended second and third order consequences are going to be of SVB being in receivership this weekend.

We talked a little bit about the pipes problem, but there may be several other businesses

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and other institutions and companies that we don't know about that may trigger another set of cascading effects that are unrelated to a banking problem, but could drive some more significant business and economic problems that we're going to probably end up talking about next week.

Remember, we're obsessed with payroll, but there are other things that there's money goes towards, you know, mortgages or rents.

So the cascading effect of this, if people stop paying their rents, if people stop paying mortgages...

Real estate.

Real estate.

Biden visited Kiev instead of East Palestine, Yellen visited Kiev instead of Silicon Valley.

Do these people know what's going on here?

Come home.

They promised more financial assistance for Ukraine, and they're saying they're monitoring the situation here.

We're in the process of what could be a run of banking failure.

What's the bill for Ukraine?

The bill for Ukraine this month versus this ballot is, you know, probably the same.

So I think we have to really think this through, folks.

Yeah.

You're going to get...

Well, no, on Monday, whether these people have a clue or not.

No, they have to be on TV tonight or tomorrow.

This has to be a presser on Sunday.

Hold on.

I think a lot of these guys do know what they're doing.

So let me just say it to them in language they understand.

Folks, when you look at the equity tier of these regional banks, people are liquidating the equity tier because they know that that is the first domino to fall if banks go into the receivership.

Please act accordingly.

You can see it in the ETFs.

You can see it in the trade flows.

This is not a Silicon Valley problem anymore.

It is a regional bank problem, and it will get worse unless you do something to make it better.

Right.

And I...

And Jake, I'll just use the word bailout.

I don't like that word because...

No, not bailout.

Backstop.

Yeah.

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There were a big, you know, too big to fail banks in 2008 in the financial crisis who did get bailed out.

Those people should have lost the value if they were stopped.

Okay.

That was wrong.

That's not what we're talking about here.

SGB has wiped out already.

What we're talking about is protecting depositors.

These are people who trusted that when they put their money in a top 20 bank, that our regulatory system is compliant, that they will not lose their money.

When it says on their computer screen that my money is in a BlackRock or a Morgan Stanley Mutual Fund or Money Market Fund, rather, the safest instrument there is, that that money is where it's supposed to be.

But if regulators allow that bank to put their money in stupid assets that are not marked a market and that's why they shut down, that is not a good reason for depositors to not get their money.

100%.

We're taking care of depositors here and not bailing out stockholders.

Yes.

This is not for the executives at the banks.

It's for the depositors who did nothing wrong and nor did their employees and their customers and the innovation that they're working on.

All right.

This has been a great all-in podcast.

Sorry, we didn't have time to talk about the Shaman, QAnon Shaman.

I know that's a passion project for you, Saks, but you can announce your Kickstarter for him and your GoFundMe for the QAnon.

Free the Shaman.

Free the Shaman.

Where's the bulldog?

Give me that bulldog one more time.

The Shaman is an intersection of three of a very interesting Venn diagram.

He is very athletically fit, incredibly hairy and oddly fat-toed.

That's a trifecta that you rarely see.

You rarely see that.

Also cultural appropriation.

Yeah.

We have to keep that in mind.

Conspiracy theories.

I mean, this guy's got it all.

Are we going to play poker this weekend and just as the meteor is coming towards Silicon Valley?

It's kind of sad.

[Transcript] All-In with Chamath, Jason, Sacks & Friedberg / E119: Silicon Valley Bank implodes: startup extinction event, contagion risk, culpability, and more

He's kind of an odd... Seriously, the Shaman, what's his name is, Jake?

He doesn't seem like he's all that.

Sure.

No.

He's a guy who has diagnosed mental illness, but he's completely nonviolent.

He's completely nonviolent.

He actually believes in the philosophy of Mahatma Gandhi of no violence towards any creatures.

He's a vegetarian.

Yeah.

He's a bit of an odd duck.

He's a freeberg of Kunon.

He didn't assault anyone.

What just wandered through the Capitol apparently getting a tour from police officers were just guiding him through it.

He's the January 6 freeberg.

Hold on a second.

He got four years in jail for that because he became the face of an insurrection because he just looks so weird with the Viking horns and the face pain or whatever.

He also made some threats to the politicians too, but yeah.

It does seem like it might not be the appropriate sentence.

He wrote a note saying, we're coming for you, I think on... You have to look into the case, but he was sentenced by a Republican judge from Texas, and he had made threats, written threats and put them on the desks of folks, and he was one of the first people into the building.

I think they got him for that, but I agree with you.

Listen, it depends how we got into the building.

If he didn't break a door down or didn't smash a window, if he damaged property, that's one thing.

If he assaulted someone, that's one thing.

But if he just wandered through the Capitol, I think four years is kind of excessive, and I think the reason why the guy got four years is because of his mental illness, he's not able to defend himself the way that he should be.

This is just a fundamental civil liberties issue.

If you have any compassion at all, you shouldn't let a guy like that get scapegoated.

There's 400 people of the thousands of people who broke in who were violent and who got sentences of some degree.

They were all settled, like plea bargained, including his, they didn't go to trial.

I think we can all agree the violence that occurred that day should be punished, and the nonviolent stuff should be at speeding ticket.

We don't need to...

I think three categories, Jason.

I think violence, the assault on cops and so forth, punished most severely, then damage

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a property, and then...

Full extent of the law.

People who just trespassed or wandered through, who may not even have known they were trespassed

in.

Probation.

That's not jail time.

That's not a fill on me.

Yeah.

I mean, we want to promote peaceful protests.

If they had come with guitars and sang kumbaya, and we shall overcome, we'd be having a different discussion here.

Instead, they beat cops, and you can't beat cops up.

Sorry.

Those ones go to jail.

Yeah.

Period.

Full stop.

We're in agreement.

Okay, everybody.

It's been another amazing, all-in podcast.

Sorry, we couldn't get to all the news, but we felt that this required a big unpacking for the Sultan of Science, the dictator, and the Rain Man.

I am the Undisputed World's Greatest Moderator.

We'll see you next time on the All-In Podcast.

Not this week.

Not this week.

We'll let your winners ride.

Rain Man, David Sack.

And as said, we open source it to the fans, and they've just gone crazy with it.

We should all just get a room and just have one big huge orgy, because they're all just useless.

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We should all just get a room and just have one big huge orgy, because they're all just useless.