

The Collapse of Silicon Valley Bank and Signature Bank: What it Means for the Financial Ecosystem?

SPEAKERS:

- **Grant Butler**, Partner - K&L Gates
- **Sarah Fergusson Chambless**, Partner - Fenwick & West LLP
- **Dale Gibbons**, Chief Financial Officer – Western Alliance Bank
- **Robert Honeywell**, Partner - K&L Gates
- **Douglas Landy**, Partner - White & Case LLP
- **Jelena McWilliams**, Partner - Cravath, Swaine & Moore LLP
- **Edwin Smith**, Partner - Morgan, Lewis & Bockius LLP
- **Tess Virmani**, DGC & EVP - Public Policy - Head of ESG - LSTA

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A Banking System is a Superposition of Fraud and Genius... Agree or Disagree?

In a world of investment projects whose costs and risks are perfectly transparent, most individuals would be frightened. ... A banking system is a superposition of fraud and genius that interposes itself between investors and entrepreneurs... to encourage investment and make everyone better off.

Randy Waldman in 2011

Requoted by: Matt Levine, Bloomberg Opinions: Money Stuff, 2023

March 2023 - Timeline of Events

Silicon Valley Bank's Demise

<i>Date</i>	<i>What Happened</i>
March 8	<i>SVB Holdco announces \$1.8B loss on sale of entire AFS portfolio and plans to raise \$2.25B in capital.</i>
March 9	<i>SVB experiences a run on deposits fueled by its venture capital and other customers.</i>
March 9	<i>Silvergate Capital announces plans to wind down operations and liquidate Silvergate Bank.</i>
March 10	<i>The CA-DFPI closes SVB and appoints the FDIC as receiver.</i>
March 10	<i>The FDIC as receiver creates DINB, a new national bank, and transfers all SVB insured deposits to DINB.</i>
March 12	<i>The FDIC, FRB and Secretary of the Treasury make a “systemic risk exception” (SRE) determination.</i>
March 12	<i>The FRB establishes a funding facility that allows banks to receive par value for pledged securities.</i>
March 12	<i>Signature Bank is closed by the NYDFS and the FDIC is appointed receiver.</i>

SVB Bridge Bank is Established

<i>Date</i>	<i>What Happened</i>
March 13	<i>The FDIC forms SVB Bridge Bank and transfer of “all deposits—both insured and uninsured—and substantially all assets” of SVB to SVB Bridge Bank.</i>
March 13	<i>Silicon Valley Financial Group, the SVB Holdco, pursuant to its board of directors forms a restructuring committee to explore strategic alternatives for the SVB Capital and SVB Securities businesses.</i>
March 13	<i>The FRB announces Fed Vice Chair for Supervision to conduct a review of SVB failure.</i>
March 13	<i>Bank of England arranges for the sale of Silicon Valley Bank UK to HSBC UK Bank.</i>
March 13	<i>The German banking regulator BaFin orders a moratorium on the German branch of SVB.</i>

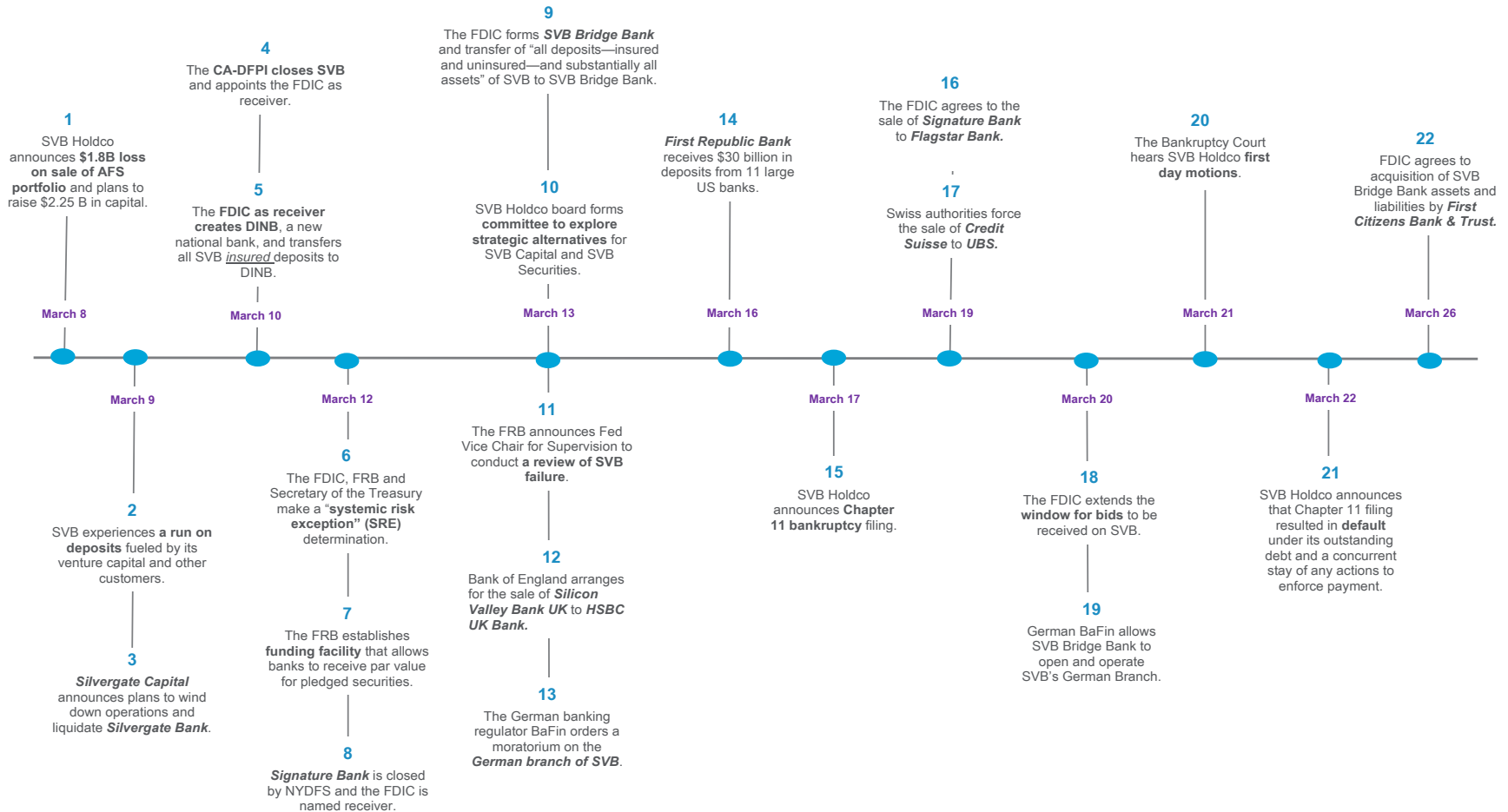
First Republic Bank Gets an Injection of \$30B in Deposits

<i>Date</i>	<i>What Happened</i>
March 16	<i>First Republic Bank receives \$30B in deposits from 11 large US banks.</i>
March 17	<i>SVB Holdco announces Chapter 11 bankruptcy filing.</i>
March 19	<i>The FDIC agrees to the sale of Signature Bank to Flagstar Bank.</i>
March 19	<i>Swiss authorities force the sale of Credit Suisse to UBS.</i>
March 20	<i>The FDIC extends the window for bids to be received on SVB.</i>
March 20	<i>German BaFin allows SVB Bridge Bank to open and operate SVB's German Branch.</i>

Bankruptcy Court Hears SVB First Day Motions

<i>Date</i>	<i>What Happened</i>
March 21	<i>The Bankruptcy Court hears SVB Holdco first day motions.</i>
March 22	<i>SVB Holdco announces that Chapter 11 filing resulted in default under its outstanding debt and a concurrent stay of any actions to enforce payment.</i>
March 26	<i>FDIC agrees to acquisition of SVB Bridge Bank assets and liabilities by First Citizens Bank & Trust.</i>

Silicon Valley Bank Failure Timeline



FDIC Receivership

When SVB went into FDIC receivership, contractual rights were impacted....

- Powers of the Federal Deposit Insurance Corporation as receiver (“FDIC-R”) of a failed bank and related stays under the Federal Deposit Insurance Act, 12 U.S.C. § 1821 (the “FDIA”)
- Effect on contractual rights
 - Borrower
 - Failed bank as lender in a syndicate
 - Failed bank as agent in a syndicate
 - Failed bank as depository bank under a DACA
 - Failed bank as issuer of a letter of credit for the account of the borrower
- Consequences of transfer and assumption by a bridge bank or later successor bank

Powers of the FDIC-R are Broad

- FDIC-R steps into the shoes of the failed bank and may exercise any right that the failed bank may exercise. 12 U.S.C. § 1821(d)
- FDIC-R may enforce any contract to which the failed bank is a party notwithstanding that the appointment of the FDIC-R is a default or creates a termination right under the contract. 12 U.S.C. § 1821(e)(13)(A)
- FDIC-R may repudiate any contract that it believes to be burdensome. 12 U.S.C. § 1821(e)

FDIA Imposes an Automatic Stay for 90 Days

- The FDIA imposes an automatic stay for 90 days following the appointment of FDIC-R on the power of any person, without the consent of FDIC-R, to terminate, accelerate, or declare a default under any contract to which the failed bank is a party or affect any contractual right of a failed bank. 12 U.S.C. § 1821(e)(13)(A)
- One business day stay on the right of a qualified financial contract counterparty to terminate and close-out on account of the appointment of the FDIC-R. 12 U.S.C. § 1821(e)(10)(B)

Contractual Rights of Failed Bank

Contractual Rights of a Borrower

- Right to borrow
- Obligation to pay
- Covenant to maintain cash deposits with the failed bank
- Right to set off loan obligations against deposits
- Common law setoff rights – requirements including mutuality

Contractual Rights of Failed Bank as Lender in a Syndicate

- Failed bank as a “Defaulting Lender” on account of:
 - Appointment of FDIC-R
 - Failure to fund
- Impact of the 90-day stay
- Distributions by the agent of payments by the borrower

LSTA MCAPs – Defaulting Lender Language

LSTA's MCAPs include Defaulting Lender Language (DLL)

The LSTA's Model Credit Agreement Provisions include DLL which defines, in relevant part, a “defaulting lender” as:

“Defaulting Lender” means... any Lender that ... (d) has.. (ii) had appointed for it a receiver... including the Federal Deposit Insurance Corporation or any other state or federal regulatory authority acting in such a capacity.

SVB Met the Definition of a Defaulting Lender when it Went into Receivership...

- Article 6 of the LSTA MCAPs then sets out the “Defaulting Lender Adjustments” and “Waterfall”.
- Under the LSTA MCAPs DLL, the trigger for SVB becoming a “defaulting lender” was met when SVB went into receivership; **HOWEVER**
- FDI Act has displacing provisions which work to ensure that the ipso facto consequences set out in a credit agreement, which would otherwise apply, are ineffective.

Contractual Rights of Failed Bank...cont'd

Contractual Rights of Failed Bank as Agent in a Syndicate

- Concern about funding in account of a failed bank and whether the agent will perform
- Ability to remove the failed bank as agent and appoint a successor agent
- Impact of the 90-day stay

Contractual Rights of Failed Bank as Depository Bank Under a DACA

- Concern about whether the depository bank will perform
- Ability to move deposit accounts and enter into a DACA with a successor depository bank
- Impact of the 90-day stay

Contractual Rights – Failed Bank as Letter of Credit Issuer

- Obligation of the borrower to obtain a replacement for a letter of credit no longer acceptable to the beneficiary
- Impact of the 90-day stay

Consequences of Transfer and Assumption by the Bridge Bank or Later Successor Bank

- Business as usual
 - Commitment to lend
 - Performance lender in a syndicate
 - Performance as agent in a syndicate
 - Performance as depository bank under a DACA
 - Performance as issuer of a letter of credit
- 90-day stay does not apply
- Caveat re “call-back” rights of FDIC-R with respect to contracts transferred to the bridge bank

Consequences of Transfer and Assumption by the Bridge Bank or Later Successor Bank

- Impact on
 - Borrower's right of setoff (deposits transferred with the loan)
 - Borrower's obligation to pay commitment and undrawn fees
 - Defaulting Lender provisions
 - Right to remove the failed bank as agent
 - Obligation to maintain cash deposits with the bridge or successor bank
 - Termination and close-out rights of a qualified financial contract counterparty
 - Transfer consent and "Eligible Assignee" provisions
 - Rights to transfer accounts to a replacement DACA bank
 - Letter of credit replacement obligations

Venture Debt Industry – What Now?

SVB's Collapse Left a Hole in the Venture Debt Industry

- SVB had nearly \$7 billion of outstanding loans to new venture companies when it collapsed.
- Its absence is being felt by those in the \$32B venture debt industry ...

What can we expect next?