Proskauer

Current Issues Relating to Silicon Valley Bank Closure

March 11, 2023

Update 3/13/23: On March 12, 2023, Signature Bank was closed by New York State's Department of Financial Services.

Also on March 12, 2023, the Treasury, the Federal Reserve Board, and the FDIC jointly announced that additional funding would be provided to ensure both Silicon Valley Bank and Signature Bank have the ability to make their deposit account holders whole, including deposit account balances exceeding the FDIC's insurance limit, by Monday, March 13, 2023. The Federal Reserve Board also announced the creation of a new Bank Term Funding Program offering discount window loans to banks and other eligible depository institutions as a source of liquidity in times of stress.

Overview

On Friday, March 10, 2023, Silicon Valley Bank ("SVB") became the largest U.S. bank since the Great Financial Crisis to enter into receivership with the Federal Deposit Insurance Corporation ("FDIC"). SVB is a major provider of depository services and liquidity to companies, investment funds, investment managers and their related entities. In addition, SVB is a prominent lender to many of the same entities through subscription or capital call facilities, net asset value facilities and management company, GP and co-invest lines.

SVB's parent company, SVB Financial Group, filed an 8-K with a mid-quarter performance update and overview of proposed strategic actions on Wednesday, March 8, 2023, which caused customer confidence in the bank's liquidity to fall. On Friday, the California Department of Financial Protection and Innovation closed SVB, and the FDIC was appointed as receiver. Receivership is an out-of-court process, and the FDIC has a historical mandate to protect the entire financial system, not only the directly affected bank and its counterparties, and faces far less judicial oversight than the parties representing a debtor under the Bankruptcy Code. The FDIC created the Deposit Insurance National Bank of Santa Clara ("DINB") to hold the insured deposits of SVB during the receivership process.

Set forth below is a brief discussion of the FDIC's treatment of existing SVB accounts and credit facilities, recommendations on potential next steps for those impacted by the closure and some useful links for further information.

Deposit Accounts

Holders of products such as checking accounts, savings accounts and certificates of deposit are insured by the FDIC for the first $250,000 per account holder in each ownership category or type of account.[1]

Deposits in excess of $250,000 per account holder per ownership category are not insured, but become preference claims senior to general creditors and rank behind only administrative fees. The preferred claimants include the FDIC for the first $250,000 (through subrogation rights arising from the payment of the $250,000 to insured depositors, up to the balance of their account) and the original account holder for any remaining amounts over the threshold.

The FDIC stated Friday that depositors would obtain access to the insured portion of their funds no later than Monday morning, March 13. Depositors with amounts above $250,000 in a single ownership category will receive certificates of receivership, which will entitle them to dividends payable from the proceeds of selling the bank's assets in proportion to their uninsured claims. The FDIC announced its intention to provide a partial advance dividend on those certificates next week as the value of available assets becomes clearer. Payments beyond that dividend will be made as the FDIC liquidates SVB's assets.

The FDIC’s preferred method of monetizing the assets of failed banks in recent years has been to sell the assets and liabilities as a package to a healthy bank that is capable of continuing the operations of the failed bank. This preserves some going-concern value and reduces disruption for bank customers. The method used here (which, for example, could include the sales of pools of loans) will depend on the particular circumstances, including the amount and liquidity of the assets.

Other Accounts and Investment Products

Certain products adjacent to SVB’s deposit account offerings, such as the SVB Cash Sweep Program, are designed to transfer excess funds to accounts that are not FDIC-insured, such as money market funds or other uninsured products. Certain of the SVB group’s investment products may be with non-bank affiliates of SVB that are not currently under receivership. Such products would not be subject to the deposit account process described above. Account holders should review their account agreements to determine the type of accounts they hold and whether the accounts are held with the bank or with a non-bank affiliate or other custodian.

Credit Facilities

The FDIC, through the DINB, will service SVB’s existing loans until a purchaser is found for those loans, either individually or as a package. New contact information and payment details during the receivership are expected to be made available by the FDIC to borrowers in the coming days.

Borrowers are still required to repay loans on the original schedule contemplated by the loan documents, subject to possible set-off rights discussed below, and to make interest and other payments as required. Most loan documents provide for scheduled repayment (not repayment on demand), so the FDIC is not able to force borrowers who are not in default on their loans to involuntarily prepay the facilities, though most loan agreements allow borrowers to voluntarily prepay their outstanding balances.

However, the FDIC is not required to continue funding borrowing requests on existing facilities, even if SVB would otherwise have been required to fund. Borrowers who submit borrowing requests that are not honored could sue the DINB for damages, but successful claimants would have general unsecured claims ranking at the bottom of the priority of payments, ahead only of the bank’s equity.

Borrowers who also hold deposit accounts at SVB (often a requirement of SVB loan documents) may have the ability to set-off amounts in those accounts against the outstanding balance of their loans, but only to the extent that (i) their loan documents do not contain waivers of such rights, as many do and (ii) the borrower and the person holding the deposit account are the same entity.

Other actions under credit facilities may be hindered or prevented as a consequence of SVB's closure. In particular, in credit facilities where SVB is acting as administrative agent, requesting funding of loan proceeds from non-SVB lenders in a syndicate may be complicated or delayed. In addition, payoff of SVB credit facilities and documentation of lien releases may be difficult to obtain in a timely manner. Borrowers should review credit documentation, ideally in coordination with their other relationship lenders in the syndicate, for potential ways to navigate some of these hurdles through the use of defaulting lender and lender replacement provisions, or pursuant to an amendment or refinancing process. Counterparties will need to consider the effects of the 90-day moratorium in the Federal Deposit Insurance Act of 1950 on exercising any right or power to terminate, accelerate, or declare a default under any contract to which a lender in receivership is a party, absent consent of the FDIC.

SVB UK

Update 3/13/23: On March 13, 2023, the UK government announced that it had facilitated a private sale of SVB's UK arm, Silicon Valley Bank UK Limited ("SVB UK") to HSBC UK Bank Plc. SVB UK operates as a separate, ring-fenced entity. This announcement supersedes the Bank of England's announcement of March 10, 2023 that it intended to seek a Bank Liquidation Procedure for SVB UK. Clients with accounts at SVB UK should have full access to their accounts and the Bank of England has confirmed that all deposits with SVB UK are safe and secure as a result of the sale. SVB UK has announced that it is continuing to operate as usual and that its clients should not notice any significant changes.

What to Do Next?

- Review SVB account documents to determine the type of accounts and the identity of the SVB counterparty to assess the accessibility of funds in those accounts.

- Assess short-term funding needs and develop a plan to ensure access to sufficient cash to meet ongoing payment obligations (including at portfolio companies, subsidiaries and other affiliates), particularly payroll obligations. A number of states have statutes that impose civil or criminal liability on employers and/or individual owners, officers, directors or managers for failure to pay wages. For more on payroll delays, please see proskauer.com.
- Assess upcoming investments, including sources of cash and timing, and consider alternative financing arrangements (if permitted) and/or capital contributions. For asset managers, prepare for the potential for capital call defaults by limited partners whose cash may be held in an SVB account or themselves have credit facilities with SVB. Asset managers should carefully review their funds' limited partnership agreements (or other governing documents) and discuss the default provisions with counsel.
- Review letters of credit issued by SVB, which will likely need to be replaced by a letter of credit from another bank. For example, if a lease agreement requires delivery of a letter of credit to secure future lease payments, the lessee may be in breach until the SVB letter of credit is replaced.
- Open new bank accounts if possible. For asset managers, clearly communicate to investors both to (i) provide updated account information where future capital contributions should be made, and (ii) confirm the current account information for any pending or future distributions, dividends or other amounts.
- Be on alert for potential fraudulent activity and be careful not to disclose (and instruct all employees not to disclose) account numbers and other confidential information to unknown sources.

The SVB situation is continuing to evolve and we expect to see material developments in the coming days. We are closely monitoring these developments and will provide updates to the extent relevant. In the meantime, we recommend that our clients take the appropriate measures to protect their positions. We remain available to provide guidance as the situation develops.

Relevant Links

- FDIC: https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/silicon-valley.html
- FDIC Claims Portal: https://resolutions.fdic.gov/claimsportal/s/
- Treasury Announcement: https://home.treasury.gov/news/press-releases/jy1334

- Joint Announcement: https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312b.htm
- Bank Term Funding Program Announcement: https://www.federalreserve.gov/newsevents/pressreleases/monetary20230312a.htm

Proskauer's cross-disciplinary, cross-jurisdictional practices have particular expertise with the complexities involved in financing and asset management. We are focused on supporting and addressing client concerns and are prepared to discuss navigating the current situation. If you have any questions, please contact your attorney team at Proskauer.

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[1] The fourteen FDIC ownership categories are: (1) single accounts; (2) joint accounts; (3) revocable trust accounts; (4) irrevocable trust accounts; (5) certain retirement accounts; (6) employee benefit plan accounts; (7) business/organization accounts; (8) government accounts (public unit accounts); (9) mortgage servicing accounts for principal and interest payments; (10) accounts held by a depository institution as the trustee of an irrevocable trust; (11) annuity contract accounts; (12) public bond accounts; (13) custodian accounts for Native Americans; and (14) accounts deposited by an IDI pursuant to the Bank Deposit Financial Assistance Program of the Department of Energy.

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