Insights: Alert

Silicon Valley Bank and the Impact of FDIC Bank Receiverships

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On March 10, 2023, the California Department of Financial Protection and Innovation announced that it had closed down Silicon Valley Bank ("SVB"), a financial institution known for its services to start-ups and the venture capital industry, and that it had appointed the Federal Deposit Insurance Corporation ("FDIC") as SVB's receiver. The FDIC concurrently issued a press release announcing that it had formed the Deposit Insurance National Bank of Santa Clara ("DINB") and transferred to the DINB all insured deposits of Silicon Valley Bank in order to protect depositor funds.

This series of events has prompted questions on the impacts on bank-held funds when an institution fails and is placed under FDIC receivership. The following is a high-level discussion of certain notable effects of a bank receivership and the treatment of certain assets and liabilities in the receivership context. This Alert does not constitute legal or financial advice, nor does it purport to be a complete analysis of all possible effects of a receivership. Persons impacted by a bank receivership are encouraged to consult their attorney and/or financial professionals for advice on their specific situation.

Insured Deposits

The FDIC is the federal agency tasked with providing deposit insurance for insured financial institutions in the United States. Specifically, the FDIC insurance covers certain deposit accounts in an amount of up to $250,000 per depositor for the aggregate of all deposits held by the depositor in an insured bank, per each account ownership category. To illustrate, a bank customer may be insured up to $250,000 for all deposit accounts under their name at a particular bank that are grouped under the "single account" ownership category and insured up to a separate $250,000 for deposits held in the "joint account" ownership category at that same bank. The extent of a depositor's recovery can therefore depend on how their funds are held at the insured bank and on how the account is reflected in the receivership bank's books and records, among other factors. The FDIC website offers information on the deposit insurance account ownership categories and their specific requirements: https://www.fdic.gov/resources/deposit-insurance/financial-products-insured/index.html.

With respect to the insured depositors of SVB, the FDIC's press release stated that "insured depositors will have full access to their insured deposits through DINB no later than Monday morning, March 13, 2023." SVB depositors can therefore anticipate being able to draw on their insured deposits early next week.

Uninsured Deposits

Uninsured deposits generally refer to deposits held in FDIC-insured accounts that exceed the deposit insurance amount of $250,000 per account ownership category. The FDIC press release noted that "[t]he FDIC will pay

uninsured depositors an advance dividend within the next week. Uninsured depositors will receive a receivership certificate for the remaining amount of their uninsured funds. As the FDIC sells the assets of Silicon Valley Bank, future dividend payments may be made to uninsured depositors." The "advance dividend" referred to above is a payment made to an uninsured depositor after a bank or thrift failure. The amount of the advance dividend represents the FDIC's conservative estimate of the ultimate value of the receivership.

FDIC law and policy provide that, after FDIC administrative expenses, repayment occurs in the following order of priority: (1) insured deposits, (2) uninsured deposits, and (3) all other creditors. Owners of uninsured deposits may recover some portion of their uninsured funds from the proceeds from the sale of receivership bank assets, but the timing and extent of recovery from the sale of assets can be uncertain. As assets are sold, depositors who had uninsured funds usually receive periodic, pro rata payments on their outstanding claim.

Custodial/Sweep Accounts

Depending on the specific language in the customer agreements governing custodial or sweep accounts held at SVB, assets in those accounts may not be bank deposits and may remain available, in full or in part, during the receivership. The customer agreements should be reviewed carefully to determine the impact of the receivership, if any, on your custodial or sweep accounts.

Borrowers

The FDIC press release instructed SVB borrowers to continue making payments on their loans. As receiver, the FDIC typically seeks to sell the loans of a bank in receivership to healthy lending institutions. In the event that a loan is sold, the FDIC or the new lender notifies the borrower if their loans have been sold and provides new payment instructions. Generally, receiverships do not alter the contractual repayment obligations of borrowers, nor does the sale of a loan to another lender generally impact repayment requirements.

In the case of lines of credit or other arrangements where a borrower seeks a draw of funds, the FDIC may consider providing such funds on a case-by-case basis. Alternatively, the FDIC may also seek to exercise its rights under the Federal Deposit Insurance Act to repudiate its funding obligations with respect to the loan if it determines that the funding obligations are burdensome to the receivership and will promote the orderly administration of the receivership. As the ordinary course lending activities of a bank are impaired during a receivership process, borrowers with ongoing credit needs may wish to consider alternative forms of funding.

While all possible impacts on bank-held funds are outside the scope of this Alert, parties affected by a bank receivership can take initial steps to prepare for a receivership process:

- Depositors and borrowers alike can familiarize themselves with their bank agreements and pertinent bank records.
    - For depositors, bank agreements and files corroborate the extent of applicable deposit insurance.
    - For borrowers, their agreements with the bank can identify rights they can exercise in the event of a lender's default (though the receivership process can limit the effect or applicability of contractual remedies or provisions);
- Creditors or potential creditors of a bank in receivership should be aware that the claims submission process is implemented in the days and weeks after a bank closure. Keeping track of developments in the receivership process, as well as timely complying with the claims process that is implemented, is important. Information on

the SVB claims process, including a link to the FDIC Claims Portal, can be found here: https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/silicon-valley.html#claim

The government is under increased pressure to find a solution for uninsured depositors. During the 2008 financial crisis most bank failures resulted in an arranged sale with government assistance and the uninsured deposits were transferred to a healthy bank. In those cases, the sale was arranged and completed almost simultaneously with the appointment of the FDIC as a receiver. In the case of SVB, that has not happened as of the date of this release. However, given the potential impact of SVB's failure on other regional banks and the urgency of this situation given the large amount of uninsured deposits, based on press reports, the federal banking regulators are soliciting bids to quickly arrange a sale of SVB or it's assets to one or more banks or to institutions that may be willing to purchase the uninsured deposits only, at a discount, in either case resulting in more rapid liquidity for holders of uninsured deposits. This is an evolving situation and should be monitored closely over the next few days.

Update as of March 15, 2023: We will continue to provide updates in this space as developments occur. In the interim, we direct you to the following resources:

- The FDIC's list of frequently asked questions regarding SVB: https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/silicon-valley-faq.html; and
- The FDIC's press release regarding the establishment of a bridge bank to operate as a national bank until final resolution - sale of assets: https://www.fdic.gov/news/press-releases/2023/pr23019.html
- Silicon Valley Bridge Bank: Existing credit facilities are being honored and the bridge bank is making new loans: https://www.svb.com/news/company-news/update-from-silicon-valley-bridge-bank-ceo
- Silicon Valley Bridge Bank: Legal Obligations of Vendors to Perform under Existing Contracts: https://www.fdic.gov/news/financial-institution-letters/2023/fil23010.html

If you have any questions regarding this alert, please reach out to your contact at Kilpatrick Townsend.

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