March 14, 2023

DISTRESSED BANK UPDATE – A NEW PARADIGM

To Our Clients and Friends:

Given the rapidly evolving events, we have established a **Distressed Banks Resource Center** *to provide resources and regular updates to our clients. The latest developments are available below and at the Resource Center.*

A New Paradigm. Silicon Valley Bridge Bank, N.A. – the successor-in-interest to Silicon Valley Bank – posted a website notice on Tuesday stating that it has "fully stepped into the shoes of the former Silicon Valley Bank". The notice further advised that all loans will now be administered by the new Silicon Valley Bridge Bank, N.A. and existing credit commitments will be honored. The website also contained a link to a 75 page "Transfer Agreement" between the FDIC, as receiver for Silicon Valley Bank (the state chartered now-defunct bank) and Silicon Valley Bridge Bank, N.A. (the federally-chartered new bank) that appears to transfer various assets and liabilities to the bridge bank to enable it to operate in the ordinary course in a manner similar to the predecessor bank for domestic operations. Additionally, Silicon Valley Bridge Bank CEO Tim Mayopoulos issued a statement asking depositors to return to SVB, affirming that depositors have full access to their money and that all new and existing deposits are fully protected by the FDIC (even beyond the typical $250,000 limit).[1] The website clarified that Silicon Valley Bridge Bank is not under FDIC receivership.

All of this implements a new paradigm that replaces the receivership model from the past weekend with a "fully functioning" bank that seeks to continue operations in the ordinary course. The Deposit Insurance Bank of Santa Clara that was established Friday, and the other trappings of FDIC receivership, are gone.

While Signature Bridge Bank, N.A.'s website does not contain similar documentation, its operations on Monday and Tuesday appeared to be in the ordinary course, with Signature Bridge Bank appearing to fund its loan obligations and process loan facility amendments and renewals, and its employees providing standard services.

What About Loan Covenants Regarding Deposits? A top question resulting from the new bridge bank paradigm is whether the bridge banks will enforce covenants under which borrowers promised to hold many or all of their deposits in the lender's bank. The FDIC issued a Financial Institution Letter FIL - 10-2023 emphasizing that it has the ability to enforce all contracts held in receivership[2] and, in a separate letter, stated that the bridge bank intends to enforce such contracts[3]. Notwithstanding such guidance, given the novel issues of public policy, it remains to be seen whether, in fact, SVB borrowers who moved deposits to other institutions will now be expected by the FDIC and Silicon Valley Bridge Bank to move those deposits back to Silicon Valley Bridge Bank, particularly given that it appears that regulators are pursuing the potential sale of SVB loans to third parties, as discussed below.

Will Letters of Credit issued by SVB be honored? The Financial Institution Letter issued by the FDIC states that "The bridge bank is performing under all failed bank contracts and expects all counterparties to similarly fulfill their contractual obligations." These bank contracts would presumably include the letters of credit issued by SVB and Signature Bank.

What Happens to Derivatives? All Qualified Financial Contracts of each of SVB and Signature Bank have been transferred to the applicable bridge bank established by the FDIC. The definition of "Qualified Financial Contract" includes, but is not limited to derivatives (e.g., swaps, options, forwards, etc.), repurchase, reverse repurchase, and securities lending transactions. As a result, the applicable bridge bank is now the counterparty to derivatives entered into with SVB and Signature Bank. Payments and collateral calls under derivatives contracts should function as normal between the counterparty and the applicable bridge bank entities of SVB and Signature Bank, as noted in the Financial Institution Letter mentioned above.

Given that derivatives contracts are often heavily negotiated, the terms of any derivatives trading documentation and the special provisions in 12 U.S.C. § 1821 should be reviewed to understand your specific rights with respect to your derivatives.

Cayman Islands Depositors. While the UK branch of SVB has been purchased by HSBC, there is no word on the fate of SVB's Cayman branch, which is outside of the U.S. receivership and treated separately under Cayman law. Those with deposits in SVB's Cayman branch may be continuing to experience challenges with the transfer of funds out of accounts. There is no indication from the Cayman regulators that they have taken possession of the Cayman branch, though they have the authority to do so. There also is an MOU between the Cayman regulators and the FDIC related to their ongoing cooperation and information sharing for the supervision and resolution of banks with branches in Cayman. Today's FDIC guidance states that, "All vendors providing services, except for the Cayman Islands Branch, should continue to provide such services." We note that unless Silicon Valley Bridge Bank is connected to SWIFT, it cannot accept foreign wire transfers.

SVB All or Nothing Sale Off the Table? On the heels of yesterday's Wall Street Journal report that a second auction round for SVB would be held, several national media outlets reported Tuesday that five top U.S. private equity firms are reviewing SVB books in order to potentially bid for purchasing SVB loans. In addition, SVB Financial Group, the parent company, hired Alvarez & Marsal as restructuring advisor and appointed William Kostouros of Alvarez & Marsal as Chief Restructuring Officer. Mr. Kostrouos previously served in an identical capacity for Washington Mutual. SVB Financial also disclosed that it is exploring strategic alternatives for itself, as well as SVB Securities (the investment bank) and SVB Capital (the investment management arm), with potentially a management buy-out being explored for SVB Securities. Accordingly, it is unclear whether a second auction for SVB will in fact be held, or whether the auction will be for separate businesses and loan portfolios of SVB Financial. Media reports also indicate that a group of creditors is organizing to represent their interests with respect to holdings in SVB Financial's bonds, which in total have $3.4 billion in face value of which reportedly over $1.5 billion has traded hands since Friday.

Signature Bank Bid Process. Bloomberg reports that the FDIC has opened a virtual data room for third parties to conduct due diligence in anticipation of potential bidding to purchase, presumably in part or all of, Signature Bank.

Capitol Hill Updates. Senate Banking Committee Chairman Sherrod Brown said his committee plans to hold a hearing, though they are still deciding on witnesses. Similarly, House Financial Services Committee Chairman Patrick McHenry said today that his committee would be talking with SVB and regulators to understand what led to the bank's failure. Separately, Senator Warren and Rep. Katie Porter have introduced companion bills to re-impose heightened regulations on small- and medium-sized banks.[4]

Government Investigations Reportedly Begin. Multiple media sources report that the SEC and Justice Department have opened investigations into events surrounding SVB's failure, while at least one state regulator (Massachusetts) has announced a formal investigation into stock trading by SVB executives prior to the bank's failure. The Federal Reserve is also investigating both its internal oversight procedures as well as risk management at SVB, according to media sources. Fed Chairman Jerome Powell stated in a Monday press release, "The events surrounding Silicon Valley Bank demand a thorough, transparent, and swift review by the Federal Reserve."

Public Company Disclosure Issues. Publicly traded companies should be aware that responding to questions from investors about the extent of their exposure to a bank in receivership, or now in a 'bridge bank,' could implicate the federal securities laws' selective disclosure rules, such as Regulation FD, and the administration of their insider trading policies. Any of such companies that have banking relationships with banks that have failed should consider whether a Current Report on Form 8-K is appropriate to address potential exposure risk, and whether an update to the company's risk factors or other disclosures is appropriate with the company's next periodic filing.

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[1] https://www.svb.com/news/company-news/update-from-silicon-valley-bridge-bank-ceo

[2] https://www.fdic.gov/news/financial-institution-letters/2023/fil23010.html

[3] https://www.svb.com/globalassets/bridge-bank/fdic-confirmation-that-bridge-bank-open-and-operating-new.pdf

[4] https://www.scribd.com/document/631425862/Warren-Porter-bank-bill#

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*Gibson Dunn's multidisciplinary task force members are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work, or the following members of the firm's ***** Distressed Bank Working Group**:*

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