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Silicon Valley Bank Receivership: Frequently Asked Questions

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SVB Update
March 12, 2023

Overview. Included in this Frequently Asked Questions are some general observations on the Federal Deposit Insurance Corporation (*"FDIC"*) receivership process for Silicon Valley Bank (*"SVB"*). The specifics of the receivership process are uncertain at this early stage and, hopefully, more guidance with respect to the issues discussed below will be provided by the FDIC over the next few days. These observations do not constitute legal advice about any particular situation and discrete questions should be raised to the Chapman lawyer with whom you work.

What happened? On Friday, March 10, 2023, as announced in a press release from the FDIC (the *"Initial Press Release"*), SVB was closed and the FDIC was appointed as receiver of SVB, which broadly means that the FDIC took control of SVB's assets and liabilities and will determine whether and how those assets and liabilities will be acquired, assumed, and/or liquidated. As an initial step, the FDIC transferred SVB's insured deposits to a new, interim institution called Deposit Insurance National Bank of Santa Clara (*"DINB"*). Under the Federal Deposit Insurance Act (the *"FDI Act"*), the FDIC is given wide latitude in unwinding and resolving the business of a failed institution, which may include either a sale to another or multiple banks or liquidation. The FDIC also has broad powers in this regard, including potential repudiation (i.e., cancellation or even modification) of agreements into which SVB has entered or other obligations of SVB, and may challenge fraudulent conveyances. Subject to certain exceptions, the receivership rules also provide that a party to a contract with SVB may not terminate, accelerate, or declare a default under such contract for a period of 90 days from the start of the receivership without the consent of the FDIC.

Federal Banking Agencies Action: Late Sunday, March 12, 2023, two federal banking agencies (the Federal Reserve and the FDIC) issued a statement dealing with SVB and the closure of Signature Bank. Depositors of SVB will have access to all of their deposits starting Monday, March 13, 2023, whether insured or uninsured. This will also be the case with Signature Bank deposits. This action was made under the systemic risk exception to the FDI Act and will be paid through a special assessment on other banks. The Federal Reserve will also make additional funding available to other depository institutions, in addition to borrowing available at the Federal Reserve's discount window, to stem any liquidity issues that might arise.

The following are some questions that have been raised and our related observations:

1. My borrower maintains its treasury business or collateral accounts with SVB. Can a borrower access these funds?

As stated above, the FDIC has stated that depositors will have access to all deposits, whether insured or uninsured, on March 13, 2023. It is still possible that another financial institution could assume, in whole or in part, the deposits of SVB, which would mean that assumed SVB deposit accounts would transfer to the acquiring institution.

2. What happens to payments of accounts receivable or other funds that are deposited into an SVB (now DINB) deposit account after the first day of SVB receivership? Are those post-receivership amounts also only insured up to $250,000?

Based on the most recent announcement of the regulatory agencies noted above, it appears that DINB/SVB accounts will be available for transactions beginning March 13, 2023, although there is not yet clarity as to how post-receivership deposits will be accounted for or as to whether post-receivership deposits in excess of the insured limit would be eligible for deposit insurance coverage. Given SVB's commercial focus, we expect the FDIC to provide further guidance to the public on this point, and we will actively monitor the FDIC's subsequent press releases for additional information.

3. If collateral for a loan is required to be deposited into an SVB deposit account and then automatically swept into a deposit account at another financial institution (i.e., not SVB), will the sweep continue to occur?

The FDIC has broad discretion to unilaterally alter contractual arrangements with depositors or borrowers, but it has historically tried to maintain normal operation of such arrangements to maximize the value of loan assets and recovery for depositors. In the short term, however, there may be delays incurred relative to the resumption or transfer of such operations.

4. Will SVB block a deposit account if a notice of control is delivered under a springing DACA?

The FDIC has broad discretion to unilaterally alter contractual arrangements with depositors or borrowers, or in this case, third party creditors, but it has historically tried to maintain normal operation of such arrangements to maximize the value of loan assets and recovery for depositors.

Notably, having a DACA on the deposit account and/or sending in a notice of control would not give the secured creditor access to an amount of deposits in the account above what the borrower is entitled to from an FDIC insurance perspective. Again, even if a notice of control is sent, there may be some delay in action upon it one way or the other.

5. May the Agent and lenders require that the borrower move its deposit accounts or require that receivables be funded into a non-SVB account for future transactions?

It may very well be that the borrower and lenders are aligned on the opening of new accounts at another financial institution. However, the loan and collateral document covenants will need to be reviewed to determine if (and what level of) formal consent or waiver should be documented to permit the movement of the accounts or redirection of receivable proceeds. Note that the borrower will need to coordinate noticing the account debtors to redirect payments to the new accounts.

6. Should amounts on deposit with SVB be excluded from calculating liquidity to determine compliance with a liquidity covenant or from cash netting to determine a net leverage ratio?

You will need to review the credit agreement's definition of liquidity, liquid assets or a similar definition to determine if immediate access to funds is a requirement thereunder or whether SVB deposits (including the portion in excess of available deposit insurance) would otherwise be excluded from the liquid assets definition or similar definition. Similarly, you will need to review the credit agreement's definitions with respect to the applicable leverage ratio to determine the impact on cash netting.

For purposes of analyzing whether liquid or cash assets remain unencumbered, note that the FDIC does not have a lien on the deposit by virtue of its receivership.

7. If a lender is in the process of refinancing an existing SVB credit facility, can the lender expect to receive a standard pay-off statement / pay-off letter and UCC releases from SVB?

While publicly the FDIC states that it is not in a position to carry on loan operations generally, in the past it has tried to preserve assets to maximize the recovery to depositors and loss to the deposit insurance fund. The FDIC has stated that borrowers should continue to make payments. If the loans are transferred to another institution, that institution would step into the shoes of SVB for this purpose. The availability or timing of payoff letters is uncertain at the present time. The FDIC does, however, provide lien release information on its website at the following link: https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/lien/index.html

Absent receipt of a customary payoff letter that includes the amount due at payoff and an explicit lien release, a new lender may need to assess the risk that the full payoff amount was not received and that the SVB liens have not been terminated. Some security agreements will provide for automatic termination of the liens upon receipt of the payment in full and termination of commitments.

8. Is SVB a defaulting lender under the terms of a syndicated credit agreement?

Generally speaking, the credit agreement will include a defaulting lender concept.

In the Loan Syndications and Trading Association (*"LSTA"*) form of credit agreement, a lender is a defaulting lender if it: "had appointed for it a receiver, custodian, conservator, trustee, administrator, assignee for the benefit of creditors or similar person charged with reorganization or liquidation of its business or assets, including the [FDIC] or any other state or federal regulatory authority acting in such a capacity."

In many credit agreements, the lender that meets the definition of "Defaulting Lender" only becomes subject to the Defaulting Lender provisions of the credit agreement at the time of notification by the Agent to the lenders. However, the Agent is not typically required to issue such notice and is in control of such determination.

In most credit agreements, the determination that a lender is a Defaulting Lender does not increase the several funding obligations of the other lenders.

An additional consideration is that the FDIC as the receiver of SVB has broad authority to repudiate contracts to which SVB is a party, which could include credit agreements, and there are certain restrictions on taking action on contracts to which SVB is a party. Under the FDI Act, which provides the FDIC with its receivership authorities and powers, in connection with the FDIC's authority to enforce contracts to which the failed financial institution is a party, a contractual counterparty may not, during the 90-day period beginning on the date of appointment of the receiver, exercise any right or power to terminate, accelerate, or declare a default under any contract to which the failed depository institution subject to receivership is a party, or to obtain possession of or exercise control over any property of the institution or affect any contractual rights of the institution without the consent of the FDIC as the receiver. Accordingly, any immediate action to declare SVB a "Defaulting Lender" under a credit agreement may not be recognized or permitted by the FDIC as the receiver of SVB without the FDIC's consent to such action.[1]

9. If SVB is the Agent on a credit facility, can SVB be replaced?

The effect of an Agent being a defaulting lender will vary by credit agreement and the agency provisions of your credit agreement will need to be reviewed. Under the LSTA form of credit agreement, the required lenders may, to the extent permitted by applicable law, by notice to the borrower and SVB, remove SVB and appoint a successor in consultation with the borrower. However, the FDIC's ability to avoid the contract could delay or impede such removal, as could the 90-day prohibition against actions that affect the contractual rights of SVB without the FDIC's consent described above.

10. Should the Agent continue to submit funding requests on SVB as a syndicate member (whether or not SVB has been declared a Defaulting Lender)?

A defaulting lender still has an obligation to fund its portion of the loan. In some credit agreements, the borrower has a right to unilaterally terminate a defaulting lender's unfunded commitment. In connection with such unilateral termination of the defaulting lender's unfunded commitment, the borrower must prepay the

defaulting lender's portion of any funded loans at par. Again, note that the Agent's and lenders' actions relative to SVB as a defaulting lender may be impacted by the FDIC's authority to repudiate the agreement and the 90-day prohibition against actions that affect the contractual rights of SVB without the FDIC's consent described above.

To the extent the defaulting lender's unfunded commitment cannot be or is not terminated, this can lead to an odd result of a borrower submitting a borrowing request for X dollars knowing it will only receive loan proceeds for X dollars minus the defaulting lender's pro rata share.

Generally speaking, during a receivership, the FDIC will not continue funding loans. The FDIC states on its website: "the role of receiver generally precludes continuing the lending operations of a failed bank; however, the FDIC will consider advancing funds if it determines an advance is in the best interest of the receivership, such as to protect or enhance collateral, or to ensure maximum recovery to the receivership. In very limited circumstances, the FDIC will consider emergency funding needs required to ensure the short-term viability of a borrower, to protect or enhance collateral value, or for public safety."

Thus, it is up to the FDIC whether to continue to engage in loan funding and related activities.

The FDIC has provided guidance on its website at the following link: https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/borrowers/index.html

11. Is the Agent required to front SVB's portion of a requested loan?

In most credit agreements, the Agent has no obligation to front loans for the syndicate; however, you should review the terms of your credit agreement to confirm.

If the Agent has an obligation to front for other lenders, the credit agreement will generally also provide that when a lender fails to fund, then the borrower must repay that non-funded portion of the loan that the Agent fronted on demand.

12. What are the other effects of having a defaulting lender in a credit agreement?

Below are additional items an Agent should consider:

- Voting
  - The defaulting lender's commitments or loans are disregarded for most voting matters.
- Future swingline loans and letters of credit
  - Generally speaking, no additional swingline loans or letters of credit are required to be made or issued, respectively, unless the swingline lender or letter of credit issuer is satisfied it has no fronting exposure to a defaulting lender. Some credit agreements have more borrower-favorable terms on these points to create access to swingline loans and letters of credit in defaulting lender situations.

- Fronting exposure
  - In many credit agreements, the swingline lender can demand that the borrower repay the defaulting lender's portion of the outstanding swingline loans.
  - In many credit agreements, the letter of credit issuer can demand that the borrower cash collateralize the defaulting lender's portion of the issued letters of credit. In some credit agreements, the fronting exposure from an outstanding letter of credit will be automatically re-allocated to non-defaulting lenders, to the extent possible under the terms of the credit agreement.
- Yank-a-Bank / Assignment
  - In some credit agreements, the borrower can require the defaulting lender to assign its loans and unfunded commitments. In those cases, it is common that the defaulting lender does not need to be a signatory to the assignment.
- Defaulting lender waterfall
  - The credit agreement will generally set forth a waterfall for how and when principal, interest, fees or other amounts received by the Agent for the account of the defaulting lender should be applied. The Agent should carefully review these provisions. Some credit agreements require borrower payments for the account of a defaulting lender to be segregated into a non-interest-bearing account and only applied per the waterfall at maturity.
- Fees
  - Commitment fee -- A defaulting lender is generally not entitled to receive commitment fees. Some credit agreements may state that the borrower does not need to pay the defaulting lender's portion of such commitment fees.
  - Letter of Credit fees – A defaulting lender is generally entitled to its letter of credit fees only if it has cash collateralized its fronting exposure. Otherwise, the borrower will pay that portion of the letter of credit fee to the other lenders or the letter of credit issuer, as applicable, who have taken on increased fronting risk.

Again, note that the Agent's and lenders' actions relative to SVB as a defaulting lender may be impacted by the FDIC's authority to repudiate the agreement and the 90-day prohibition against actions that affect the contractual rights of SVB without the FDIC's consent described above.

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1. Note that the FDI Act provides for different treatment of "qualified financial contracts" to which a failed financial institution is a party. The term "qualified financial contract" means "any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the [FDIC] determines by regulation, resolution, or order to be a qualified financial contract for purposes of this paragraph," each as further defined under the FDI Act.