Clients&FriendsMemo

A Quick Take on a Sudden Change in the Banking Landscape

March 13, 2023

A lot of ink has been spilled in the last 72 hours regarding the historic developments involving Silicon Valley Bank and Signature Bank. Our quick summary of the facts and law is below. Cadwalader will continue to monitor these developments closely and will update you with additional insights.

We note that these are general views only and are not intended as, and should not be construed as, legal advice. Each individual person or entity's circumstances are different and would need to be taken into account in providing legal counsel. Please do not hesitate to contact your Cadwalader team or any of the Cadwalader attorneys listed below for advice that is tailored to your facts and circumstances.

Factual Background

i. On March 10, 2023, the California Department of Financial Protection appointed the Federal Deposit Insurance Corporation (the "FDIC") as receiver for Silicon Valley Bank ("SVB").

   a. SVB is the California bank subsidiary of SVB Financial Group. SVB is a member of the FDIC and the Federal Reserve System.

   b. To protect insured depositors, the FDIC created the Deposit Insurance National Bank of Santa Clara ("DINB"), and immediately transferred to DINB all insured deposits of SVB.

ii. Also on March 10, 2023, the Bank of England acting with the UK's banking regulator the Prudential Regulation Authority (the "PRA") announced that '*absent any meaningful further information*' it intended to apply to Court to place Silicon Valley Bank UK Limited ("SVBUK") into a Bank Insolvency Procedure under the Banking Act 2009, effectively shutting it down.

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iii. On March 12, 2023, the New York State Department of Financial Services appointed the FDIC as receiver for Signature Bank (“Signature”).

   a. The FDIC created Signature Bridge Bank, N.A. (“Signature Bridge Bank”), and immediately transferred all the deposits and substantially all of the assets of Signature to Signature Bridge Bank.

   b. The FDIC named Greg D. Carmichael (who recently served as president and CEO of Fifth Third Bancorp) as CEO of Signature Bridge Bank.

iv. On March 12, 2023, on the recommendation from the Boards of the FDIC and the Federal Reserve, the FDIC approved “systemic risk exceptions” (“SRE”) for SVB and Signature. Treasury Secretary Yellen, after consulting with President Biden, per the statutory requirements for an SRE, agreed to grant an SRE for the first time since 2008.

   a. The SRE allows for a resolution that fully protects all depositors, and is not limited to insured deposits (which previously were limited to $250,000 per depositor).

   b. All depositors of SVB and Signature will be made whole. Shareholders and certain unsecured debtholders will not be protected. The FDIC announcement emphasized that no losses will be borne by taxpayers, and any losses to the Deposit Insurance Fund will be recovered by a special assessment on banks, as required by law. Specifically, the SRE system provides that each insured depository institution that receives protection from the FDIC will be assessed a surcharge to cover the deposit amounts that were not actually insured as of the time SVB/Signature failed.

v. On March 13, 2023, the FDIC announced that it was transferring all deposits, both insured and uninsured, and substantially all assets of SVB to a newly created, full-service FDIC-operated “bridge bank” (the “SVB Bridge Bank”), and named Tim Mayopoulos as CEO of SVB Bridge Bank.

   a. The receiver for Silicon Valley Bank has also transferred all Qualified Financial Contracts (as defined in 12 USC 1821(e)) of the failed bank to SVB Bridge Bank.

vi. Also on March 13, 2023, the Bank of England in consultation with the PRA, HM Treasury and the Financial Conduct Authority announced that HSBC UK Bank Plc had acquired SVBUK.

a. SVBUK continues to be a PRA authorized bank, all services function as normal and customers can contact SVBUK through their usual channels.

Appointment of the FDIC as Receiver

i. The Federal Deposit Insurance Act (the "FDIA") governs the receivership of financial institutions whose deposits are insured by the FDIC.

  a. The laws of most states include provisions for state administered insolvencies of state chartered banks, but in practice the FDIC almost always is appointed receiver. Under applicable federal law, the FDIC may be appointed receiver for member insured state banks by appropriate state authorities.

  b. The FDIC is appointed receiver in order to liquidate or wind up the affairs of a failed insured depository institution.[1]

ii. Upon the appointment of the FDIC as receiver of a failed institution, the FDIC "steps into the shoes" of the institution. By operation of law, the FDIC as receiver succeeds to "all rights, titles, powers, and privileges of the [failed institution] . . . with respect to the institution and the assets of the institution."[2]

  a. When the FDIC is appointed as a receiver or conservator, it acts in a capacity separate from its corporate capacity as insurer, regulator or supervisor of insured banks.

  b. As part of its receivership powers, the FDIC may organize either a new depository institution, or a bridge depository institution.[3]

    i. As noted above, the FDIC has created SVB Bridge Bank, and has transferred all deposits and substantially all of the assets of SVB to SVB Bridge Bank, and the FDIC has created Signature Bridge Bank, and has transferred all deposits and substantially all of the assets of Signature to Signature Bridge Bank.

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1 12 U.S.C. § 1821(d) (2008). Due to changes to the FDIA made by Dodd-Frank, it is highly unlikely that a conservatorship would occur under the FDIA.

2 Id. § 1821(d)(2)(A)(i).

3 Id. § 1821(d)(2)(F).

Bridge Depository Institutions

i. A bridge depository institution or "bridge bank" is a full-service national bank chartered by the Office of the Comptroller of the Currency and controlled by the FDIC. The creation of a bridge bank allows the FDIC to rapidly take over a failed institution, while giving it time to determine how best to sell the failed institution's assets and business to one or more buyers. We note that in certain provisions of the FDIA, a bridge bank should not be considered an entity subject to receivership.[4] The FDIA does not explicitly provide that the bridge bank enjoys the rights and privileges of the receivership, therefore neither the general receivership powers nor the stay should be relevant to contracts that have moved to the bridge bank.

   a. Once a bridge bank has been chartered, the FDIC, as receiver, may transfer any assets and liabilities of the failed institution in default to the bridge bank.[5] The FDIC notices for both Signature Bridge Bank and SVB Bridge Bank state that "substantially all" assets of Signature and SVB have been transferred to the respective bridge banks. However, it remains to be seen what assets, if any, were not transferred to the bridge banks and may remain in the FDIC receiverships.

   b. The FDIC's transfer of any assets or liabilities of a failed institution to a bridge bank is effective notwithstanding any applicable assignment or consent right restrictions, and without any further approval under Federal or State law.[6]

   c. A bridge bank has all of the corporate powers of, and is subject to the same provisions of law as, a national bank.

   d. Congress has stated that in order to prevent unnecessary hardship or losses to the customers of any failed institution for which a bridge bank is established, the FDIC should (i) continue to honor commitments made by the failed institution to creditworthy customers, and (ii) not interrupt or terminate adequately secured loans which are transferred to a bridge bank and are being repaid by the debtor in accordance with the terms of the loan instrument.[7]

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[4] For example, a bridge depository institution shall not be considered to be a financial institution for which a conservator, receiver, trustee in bankruptcy, or other legal custodian has been appointed or which is otherwise the subject of a bankruptcy or insolvency proceeding for purposes of paragraph (9). 12 U.S.C.A. § 1821(e)(10)(c)(i) (West).

[5] Id. § 1821(n)(1)(B); 1821(n)(3)(a)(i).

[6] Id. § 1821(n)(3)(a)(iv).

[7] Id. § 1821(n)(3)(B).

e. A bridge bank's status is terminated upon the earliest to occur of the following: (A) the merger or consolidation of the bridge bank with a depository institution other than a bridge bank; (B) at the election of the FDIC, the sale of a majority of the capital stock of the bridge bank to an entity other than the FDIC or another bridge bank; (C) the sale of 80% or more of the capital stock of the bridge bank to an entity other than the FDIC or another bridge bank; (D) at the election of the FDIC, either the assumption of all or substantially all of the deposits and other liabilities of the bridge bank by a depository institution holding company or a depository institution that is not a bridge bank, or the acquisition of all or substantially all of the assets of the bridge bank by a depository institution holding company, a depository institution that is not a bank, or other entity as permitted under applicable law; (E) the expiration of a two-year period, with three one-year extensions; or (F) the earlier dissolution of the bridge depository institution by the Board of Directors of the FDIC, in its discretion.[8]

Creditors' Rights Under a FDIC Receivership

i. For assets and agreements that have not been transferred to the bridge bank, and remain in FDIC receivership (if any), the below restrictions apply.

a. 90-Day Stay. The FDIA includes a temporary stay of certain actions against a failed institution or its property. During the 90-day period beginning on the date that the FDIC is appointed as receiver, no party may exercise any right or power to terminate, accelerate, or declare a default under any contract to which the failed institution is a party, or to obtain possession of or exercise control over any property of the failed institution, or affect any contractual rights of the failed institution.[9]

b. Invalidation of Ipso Facto Provisions. The FDIC as receiver has the ability to enforce contracts, notwithstanding contractual provisions providing for termination, default, acceleration or exercise of rights upon insolvency or appointment of or the exercise of rights or powers by or receiver.[10]

c. Right to Disaffirm or Repudiate Contracts. The FDIC has the ability to disaffirm or repudiate contracts and leases to which a failed institution is a party if (i) the receiver, in its discretion, determines a contract or lease to be burdensome and (ii)

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[8] Id. § 1821(n)(9)-(12).

[9] Id. § 1821(e)(13)(C).

[10] Id. § 1821(e)(13)(A).

disaffirmance or repudiation is determined by the receiver, in its discretion, to promote orderly administration of the failed institution's affairs.[11]

i. If the receiver disaffirms or repudiates a contract or lease, damages are calculated as of the date that the receiver was appointed.[12]

d. Written Agreement Requirement. The FDIA requires that any agreement that forms the basis of a claim against the receiver must be (A) in writing, (B) executed by the failed institution and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by such failed institution, (C) approved by the board of directors of such failed institution or its loan committee, as reflected in the minutes of said board or committee, and (D) maintained continuously from the time of its execution, an official record of such failed institution (the "Written Agreement Requirements"). [13]

Treatment of QFCs in a FDIC Receivership

i. There are several statutory and regulatory exceptions from the foregoing FDIC receivership provisions in the case of qualified financial contracts ("QFCs"). The exemptions also address the transfer of QFCs to a bridge bank. As noted, the QFCs were transferred today to the newly created bridge banks.

a. The QFC provisions protect the exercise of certain "self-help" rights to terminate and liquidate QFCs, rights under security arrangements in connection with QFCs, and offset and netting rights in connection with QFCs.

ii. Types of QFCs. The FDIA defines "qualified financial contract" as "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 . . . ." [14] The definitions of each type of QFC under the FDIA are consistent with the Bankruptcy Code definitions.

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[11] Id. § 1821(e)(1).

[12] Id. § 1821(e)(3)(A)(ii).

[13] Id. § 1821(d)(9), (n)(4)(I) and 1823(e). This is generally a codification of D'Oench, Duhme & Co., Inc v. FDIC, 315 U.S. 447 (1942).

[14] Id. § 1821(e)(8)(D)(i).

The FDIA further provides:

iii. Eligible Counterparties. In contrast to the Bankruptcy Code, any party (as opposed to only certain types of counterparties) to a QFC can take advantage of the QFC provisions.

Liquidation, Termination, Netting; One-Day Delay

i. The FDIA QFC provisions expressly protect the exercise of liquidation, termination, netting and offset rights. However, a counterparty may not exercise such rights until either (i) 5pm (eastern time) on the business day following the appointment of the receiver, or (ii) after the counterparty has received notice that the contract has been transferred to a solvent institution, such as a bridge bank.

ii. The one-day delay gives the FDIC the opportunity to exercise its statutory right to transfer the QFCs of the failed institution to a solvent institution if it elects to do so.[15]

  a. The FDIC is required to notify a counterparty of a transfer of its QFCs to a bridge bank by 5pm (eastern time) on the business day following the appointment of the FDIC as receiver.

  b. "Business day" is defined as any day other than any Saturday, Sunday or any day on which either the NYSE or the Federal Reserve Bank of NY is closed.

    i. A counterparty has deemed to have received notice from the FDIC if the FDIC has "taken steps reasonably calculated" to provide notice to such counterparty by the 5pm deadline.[16]

  c. If the receiver elects to transfer a counterparty's QFCs to a bridge bank, it is required to transfer either all or none of the QFCs between a counterparty and its affiliates and a failed institution.[17] This is designed to preserve cross-collateralization, setoff and netting rights.

(vii) Treatment of Master Agreement as One Agreement— Any master agreement for any contract or agreement described in any preceding clause of this subparagraph (or any master agreement for such master agreement or agreements), together with all supplements to such master agreement, shall be treated as a single agreement and a single qualified financial contract. If a master agreement contains provisions relating to agreements or transactions that are not themselves qualified financial contracts, the master agreement shall be deemed to be a qualified financial contract only with respect to those transactions that are themselves qualified financial contracts.

Id. § 1821(e)(8)(D)(vii).

[15] See Id. § 1821(e)(9).

[16] Id. § 1821(e)(8)(D)(vii).

[17] Id.

d. Under the FDIA, a depository institution transferee cannot be a foreign financial institution or a branch or agency of a foreign financial institution unless the laws applicable to such financial institution, branch or agency related to QFCs are enforceable substantially to the same extent as under the FDIA.

The FDIC receiver's transfer of all QFCs to Signature Bridge Bank and SVB Bridge Bank qualifies as a transfer to a solvent financial institution for purposes of the statute. Upon the transfer of QFCs to a bridge bank, a counterparty's ability to terminate a QFC based solely on the appointment of a receiver for SVB should not be enforceable against the bridge bank.

Prohibition on Walkaway Clauses

i. The FDIA clarifies that, notwithstanding the foregoing, walkaway clauses in any QFC of a failed institution are not enforceable.[18]

a. The FDIA defines "walkway clause" to mean any provision of a QFC that suspends, conditions or extinguishes a payment obligation of a party, in whole or in part, or does not create a payment obligation of a party that would otherwise exist, solely because of such party's status as a non-defaulting party in connection with the insolvency of a failed institution or the appointment of a receiver.[19]

Disaffirmance or Repudiation

i. The receiver also has the right to disaffirm or repudiate QFCs that remain in the receivership estate (*i.e.*, those QFCs that have not been terminated by a counterparty or transferred to a bridge bank).

a. As noted above, the FDIA requires the receiver to disaffirm or repudiate either all or none of the QFCs between a counterparty and its affiliates and the failed institution.20

b. A counterparty's damages for repudiation are measured as of the date of the repudiation, not as of the date of the appointment of the receiver. [21] The counterparty's damages include "normal and reasonable costs of cover or other

[18] Id. § 1821(e)(8)(G)(i).

[19] Id. § 1821(e)(8)(G)(iii).

[20] Id. § 1821(e)(11).

[21] Id. § 1821(e)(3)(A)(ii).

reasonable measures of damages utilized in the industries for such contract and agreement claims."[22]

SVB UK

i. The Banking Act 2009 put in place post-GFC resolution powers for the Bank of England to deal with a failing bank, protect UK financial stability and public funds, and provide continuity of banking services.

    a. This 'Special Resolution Regime' gives the authorities a number of options, including bank insolvency and bank administration when there is the possibility to effect a partial transfer of business. There are also five stabilization powers available, which include transfer to a private sector buyer, (which is what has happened in this case), bail-in, transfer to a bridge bank, transfer to an asset management firm, and temporary public ownership.

ii. The sale of SVBUK was effectuated by The Silicon Valley Bank UK Limited Mandatory Reduction and Share Transfer Instrument 2023 (the "SVB UK Transfer Instrument"), which provides for a mandatory reduction of the capital instruments of SVBUK and transfers all of its ordinary shares.

    a. The SVB UK Transfer Instrument defines the Capital Instruments being as the £322 million perpetual subordinated notes and the £33 million subordinated debt notes due 2032 issued by SVBUK, and cancels these along with any liabilities owed including accrued interest. The instrument also transfers the issued ordinary shares in SVBUK to HSBC free from any liabilities or claims. Because the transaction was effected as a transfer of shares in the UK bank, with only adjustments being made to its regulatory capital, all of the other liabilities and assets of SVBUK remain with the same corporate entity, albeit no longer under the ownership of SVB.

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[22] Id. § 1821(e)(3)(C)(i).

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