Holland & Hart

# What's Happening with Silicon Valley Bank and Signature Bank? Answers to Fundamental Questions



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***Key Takeaways***

- The Federal Deposit Insurance Corporation (FDIC) has established (i) a deposit insurance national bank to assume the insured deposits of Silicon Valley Bank (SVB) and (ii) a bridge bank to assume the insured deposits of Signature Bank (Signature).
- FDIC deposit insurance up to $250,000 is available for checking accounts, savings accounts, certificates of deposit (CDs), negotiable order of withdrawal (NOW) accounts, money market deposit accounts, as well as cashier's checks and money orders issued by insured banks, including SVB and Signature.
- The Federal Reserve Board, Treasury Department, and FDIC have taken extraordinary measures so SVB and Signature account holders will have full access to insured and uninsured funds on deposit.

***Are SVB and Signature in bankruptcy?***

No. Banks and other federally insured financial institutions (such as savings banks, savings associations, and credit unions) are not permitted to be debtors in a bankruptcy case. Instead, federal law establishes a different scheme, called “receivership,” for winding up the affairs of failed banks.

***How does a bank receivership work?***

The receivership process is started when a failed bank is closed by its “chartering authority” to prevent further risks and losses to depositors and the FDIC deposit insurance fund. For state-chartered banks, the chartering authority is the state banking regulator which issued the bank charter and is the primary regulator. For federally chartered banks and savings associations, the chartering authority is the federal Office of Comptroller of the Currency, a division of the Department of the Treasury.

In the case of SVB, which was a California state-chartered bank, the chartering authority is the California Department of Financial Protection and Innovation, which issued  a closure order on Friday March 10. In an unrelated case, the New York State Department of Financial Services, as chartering authority to Signature, issued its closure order as to Signature

on Sunday, March 12.

Once the chartering authority closes a bank, it appoints the FDIC as receiver. This appointment gives the FDIC various options to wind up the affairs of a failed bank. Unlike a bankruptcy case, there is no judge or trustee overseeing the case. Under its "resolution process," the FDIC will assess the value of the failed bank, market it, solicit and accept bids for the sale of assets, determine which bid is least costly to the deposit insurance fund, and work with the winning bidder through the closing process. The FDIC aims to complete the resolution process very quickly, often within a day or over a weekend, to minimize disruption to customers of the failed bank and the communities in which the bank has branches.

***What Can the FDIC Do?***

As receiver of a failed bank, the FDIC has the option to use one of three types of resolution processes:

1) A *purchase and assumption transaction*, where one or more healthy financial institutions purchases certain assets and assumes certain liabilities of the failed bank. This is the most common method used to resolve a failed bank, and it provides the FDIC and the acquiring institution great flexibility to structure a transaction and maximize the recovered value of the failed bank. For example, an acquiring bank may acquire all or only the insured portion of the deposits of a failed bank. In addition, to reach a deal with the acquiring bank and maximize recovered value, the FDIC may agree to assume a portion of losses associated with some of the assets purchased by the acquiring bank, such as loan write-offs. A purchase and assumption transaction may be created in either a privately negotiated sale or an auction.

This type of transaction is relatively seamless for customers of a failed bank, as they are typically notified that the acquiring bank has assumed their deposit accounts and acquired their loan accounts. Of the 564 US bank failures since October 1, 2000, the vast majority have been resolved through a purchase and assumption transaction, including the acquisition of all assets and deposits (including uninsured deposits) of the failed Washington Mutual Bank by JPMorgan Chase Bank, NA—the largest bank resolution in US history. Approximately 80% of bank resolutions in recent years have been through purchase and assumption transactions.

2) A *deposit payoff* may be used if the FDIC determines that it is less costly to simply pay out claims for insured deposits than to accept an offered proposal for a purchase and assumption transaction, or if no institution bids to acquire the failed bank. In this resolution, the FDIC, in its capacity as deposit insurer (rather than regulator or receiver), determines the amounts and identities of account holders of insured deposits and pays the claims directly to them. Alternatively, a healthy institution is paid by the FDIC to act as its agent and pay the insured deposits to customers of the failed bank. The FDIC has historically used a deposit payoff in around 20% of resolutions.

3) The FDIC establishes a "*deposit insurance national bank*" (or *DINB*) to

assume the insured deposits of the failed bank. This process is authorized under the federal Banking Act of 1933, a law enacted during the Great Depression when many banks failed. It has rarely been used in recent years. A DINB is a new national bank which has a limited life and powers. With a DINB, account holders of the failed bank have only a limited time to move their deposit accounts to a new bank or other financial institution, and the FDIC establishes the rules and timelines on a case-by-case basis for each DINB.

In the case of SVB (the second largest bank failure in US history), the FDIC created a DINB. This tells us that the FDIC was unable to successfully locate a bank willing to acquire the assets and assume deposit liabilities of SVB. The FIDC likely had difficulty in valuing SVB in light of the massive withdrawals of deposits on Thursday, March 9, 2023, and deteriorating asset quality due to SVB's significant holdings of long-term bonds with below-market coupon rates and determined that a DINB was more cost effective than a full payoff of insured deposits. In the case of Signature, the FDIC transferred all of Signature's deposits and substantially all of its assets to the newly created Signature Bridge Bank, N.A., which will be marketed to prospective acquiring banks in a purchase and assumption transaction.

***Which accounts are covered by FDIC deposit insurance? How much is covered?***

FDIC deposit insurance covers checking accounts, savings accounts, certificates of deposit (CDs), negotiable order of withdrawal (NOW) accounts, and money market deposit accounts at the bank, as well as cashier's checks and money orders issued by the bank. Premiums for this insurance coverage have been paid by the bank at which the account was held, and accountholders are not liable for deposit insurance premiums. CDs stopped accruing interest as of the date of closure, and the FDIC is waiving any applicable early withdrawal penalty.

FDIC deposit insurance *does not* cover stocks, bonds, mutual funds (including money market mutual funds), exchange traded funds (ETFs), cryptocurrencies, non-fungible tokens (NFTs) and other crypto assets, life insurance policies, annuities, municipal securities, safe deposit boxes or their contents, or US Treasury bills, bonds or notes. In addition, the value of stocks and other securities issued by the closed bank or its holding are not covered by FDIC deposit insurance.

In general, accounts are insured up to $250,000 per depositor for each “ownership category.” More information on which accounts are insured, and to what extent, can be estimated by using the FDIC's Electronic Deposit Account Estimator (EDIE) at https://edie.fdic.gov. This tool will assist account holders in determining the extent of any uninsured funds on deposit.

***What happens to balances exceeding deposit insurance limits?***

Typically, holders of any uninsured portion of deposit accounts at a closed bank may not get access to all of their uninsured funds. The FDIC

generally issues receivership certificates and dividends to uninsured depositors. Dividends provide accountholders with a portion of their uninsured balances when, and if, the receiver successfully liquidates assets of the failed bank.

However, in the case of SVB and Signature, the Federal Reserve Board, Treasury Department, and FDIC issued a joint statement on the evening of March 12, 2023, taking a “systemic risk” exception to the usual FDIC resolution practice and promising that accountholders at SVB and Signature will have full access to all insured *and uninsured* funds on deposit. The costs of this exception will be borne by future assessments on banks, not by taxpayers.

Readers should be aware that there is no assurance that such an exception will be made for any future bank failures or that deposit insurance limits will be increased. For this reason, accountholders at any bank should manage their deposit accounts to minimize risk by keeping balances within FDIC deposit insurance limits at each bank, or consider supplementing FDIC deposit insurance with private deposit insurance.

***What should deposit accountholders be doing?***

Accountholders should select one or more new financial institutions and start the process of opening accounts there to replace SVB accounts. (Since Signature Bridge Bank is set up to continue doing business as usual with Signature's customers pending a purchase and assumption transaction, Signature's customers do not need to take such steps.)If you are a SVB customer who is not already a customer of a new bank, it will take some time to open an account, as the bank is required by law to obtain information about you through a “know your customer” process, and that can take days or weeks to complete.

According to the FDIC, SVB customers should move quickly to change direct deposit instructions (including paychecks and Social Security payments), notify customers to make payments to a different bank, and replace ATM/Debit cards and automatic payment/bill pay services. These functions will cease to be available as of an undetermined date in the near future.

SVB customers should deplete any remaining available balances, close existing accounts, and move balances to the new bank.

***How are borrowers affected?***

All revolving lines of credit and credit card accounts at SVB are frozen, meaning borrowers will no longer be able to take revolving credit advances or use credit cards. SVB borrowers will need to open up new lines of credit and/or credit card accounts with a different financial institution.

Important note: SVB and Signature borrowers must continue making scheduled payments on their loans as they have done before, sending checks sent to the same address and payee as in the past. The FDIC will try to sell all loans, and borrowers will be provided with information and any

new payment instructions when their loans are assigned.

As of March 12, 2023, the FDIC has indicated that borrowers *may* be able to offset their deposit account balances (both insured and uninsured portions) against loan balances. However, no details or processes have emerged as to how that will be done.

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