CLIENT ALERT

Observations on Bank Rescue and Funding Program

MARCH 13, 2023

In a surprising and ground-breaking Joint Statement issued late Sunday afternoon, March 12, 2023, the U.S. Department of the Treasury (**Treasury**), the Board of Governors of the Federal Reserve System (the **Federal Reserve**) and the Federal Deposit Insurance Corporation (**FDIC**) jointly approved actions enabling the FDIC to complete its resolution of one recently failed bank "in a manner that protects all depositors." At the same time, the agencies announced a similar systemic-risk exception for Signature Bank (New York, NY), which the New York Department of Financial Services closed earlier on Sunday. As a result, the agencies announced that all depositors of these two institutions will be "made whole"—with depositors of the failed bank in California having access to all of their funds starting Monday, March 13, 2023 (it was unclear when depositors of Signature Bank would have access to their funds). The Joint Statement emphasized that:

- no losses associated with the resolution of either failed bank will be borne by the taxpayer, because losses will be borne by the Deposit Insurance Fund of the FDIC;
- any losses to the Deposit Insurance Fund to support uninsured depositors will be recovered by a special assessment on banks, as required by law; and
- shareholders and "certain" unsecured debtholders of both failed banks will not be protected.

BANK TERM FUNDING PROGRAM

Also on March 12, 2023, and importantly, the Federal Reserve announced the creation of the Bank Term Funding Program (**BTFP**), which is intended to provide liquidity to any depository institution in the United States. Taking into consideration its size and scope, the BTFP is unprecedented in American banking history, and is a product of the deep concern U.S. federal economic policy advisors and financial regulators had following the bank failures and one voluntary liquidation (Silvergate Bank) of the last few days. Under the BTPF, each Federal Reserve Bank would be a lender and would be authorized to make advances to Eligible Borrowers (defined below) within their Federal Reserve District, taking as collateral certain bank-permissible securities to secure borrowings under the BTFP. The key features of the BTFP are:

- *Eligible Borrowers*: Any U.S. federally insured depository institution (including a bank, savings association, or credit union) or U.S. branch or agency of a foreign bank that is eligible for "primary credit" (*see* 12 C.F.R. § 201.4(a)) is eligible to borrow under the BTFP. Under the "primary credit" authority of the Federal Reserve, a Reserve Bank "may extend primary credit on a very short-term basis, usually overnight, as a backup source of funding to a depository institution that is in generally sound financial condition in the judgment of the Reserve Bank. Such primary credit ordinarily is extended with minimal administrative burden on the borrower."

- *Eligible Collateral*: Eligible collateral includes any collateral eligible for purchase by the Federal Reserve Banks in open market operations (*see* 12 C.F.R. §201.108(b)), provided that such collateral was owned by the borrower as of March 12, 2023.
- *Advance Size*: Advances will be limited to the value of eligible collateral pledged by the Eligible Borrower.
- *Rate*: A fixed one-year overnight index swap rate plus 10 basis points, set the day the advance is made.
- *Collateral Valuation*: It appears that the FDIC is approving a 100% advance rate for the loans (i.e., no discount to face value). The collateral will be valued at par. The margin will be 100% of par value.
- *Prepayment*: Borrowers may prepay advances (including for purposes of refinancing) at any time without penalty.
- *Advance Term*: Advances will be made available to Eligible Borrowers for a term of up to one year.
- *Fees*: None.
- *Recourse*: Advances made under the BTFP are made with recourse beyond the pledged collateral to the Eligible Borrower.
- *Program Duration*: One year (until March 11, 2024). We expect the Federal Reserve to extend the BTFP another year, and possibly longer, if economic circumstances warrant such extension.

Based on our experience with the Main Street Lending Program (**Main Street**) launched by the Federal Reserve Bank of Boston under the authority of the CARES Act in 2020, we believe the Federal Reserve Banks will develop standard documentation with customary representations and warranties; affirmative, negative and reporting covenants; conditions; and standard events of default. The documentation would likely be non-negotiable and administered in a manner to permit prompt closings and fundings, as was the case with Main Street. As of this writing, it was not known when the Federal Reserve Banks would make the form documentation available to the Eligible Borrowers in their districts.

OBSERVATIONS AND RECOMMENDATIONS

1. If you are a depositor of one of the failed banks and you do not hold deposit accounts at another U.S. institution, you will need to establish an account at another U.S. institution to receive deposit distributions (whether secured or unsecured) that the FDIC, as receiver, will cause to be distributed.

2. Any bank failure is a reminder that the deposit insurance limit of $250,000 available to each depositor at each bank means just that. This is a good time to review your company's cash assets and determine whether to reduce deposit concentrations from one or two depository institutions and spread them to three or even more institutions. It is also important to keep in mind that U.S. depository institutions with over $250 billion in assets are subject to rigorous capital rules and stress-testing. Although stronger capital rules and audits do not make a bank "too big to fail" or "failure proof," these are banks that typically have a diversified customer base, diversified products and services, and serve broad geographic areas, thereby reducing their liquidity risk profile and thus making them less susceptible to failure.

   There remains a possibility that congressional action might result in the FDIC being reauthorized to insure non-interest-bearing deposit accounts for an unlimited amount of coverage – similar to the Temporary Liquidity Guarantee Program (TLGP) that ultimately stabilized the U.S. banking system during the 2008 financial crisis. The TLGP was made possible by the Troubled Asset Relief Program or TARP congressional authority given to the FDIC in 2008. Political concerns that Congress is once again bailing out the U.S. banking system might stymie this possibility.

3. Lending customers should note that, while assets are under receivership, they should not rely on the FDIC as receiver to continue lending under existing commitments. Further, while the FDIC as receiver is likely to continue to provide administrative services it may be obliged to provide under existing credit facilities, we would not expect flexibility from the FDIC with respect to ongoing requests such as waivers, extensions, or other amendments.

4. In instances where a failed bank was the sole lender under an existing working capital facility, to the extent needed, borrowers should work with finance attorneys to identify any flexibility in their credit documentation to provide for liquidity solutions in the near term, which may take the form of either additional debt or equity contributions, with a view toward how those arrangements are ultimately unwound when the loan portfolio is sold or the borrower is able to refinance. Receivership status does not alleviate the borrower of its obligation to comply with the terms of its credit facility, and the FDIC retains the right to enforcement of loans in default, so it remains important for borrowers to observe the limitations under their credit documentation, as well as payment obligations thereunder.

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If you have any questions or concerns regarding the contents of this Alert, please do not hesitate to contact us at the Winston Bank Receiverships Task Force.

John Huang, Founding & Managing Partner, YuandaWinston, also contributed to this client alert.

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