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TECHNOLOGY MARATHON

Fallout from the Failure of SVB and Signature Bank: Why it Matters to Tech Companies

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June 29| 2:00-3:00 pm ET

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Presenters

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Overview: Fallout from the SVB/Signature Bank Failures and Related Events

- What Happened and Why?
- Bank Regulatory Landscape after Bank Failures
- Cash Management Practices: Practical Considerations
- Partnerships with Banks: Third-Party Risk Management
- FDIC Advertising Regulations
- Why this Matters to Tech: What Next and How to Prepare?

SVB and Other Bank Failures: What Happened and Why?

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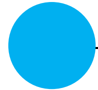
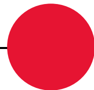
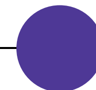
Timeline: SVB Failure and Related Actions







March 8

Silvergate Bank announced its volutary liquidation

March 10

Silicon Valley Bank ("SVB") declared insolvent, placed into FDIC receivership after disclosing a $1.8 billion loss, overnight withdrawals of ~$42 billion, and 60-plus percent loss of stock price

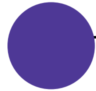
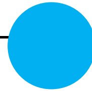
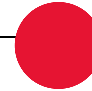
- Bridge Bank established
- U.S. vs. non-U.S. deposits/operations
- SVB vs. SVB Financial and non-bank operations
- Sold to First Citizens Bank & Trust Co.

March 12

Signature Bank declared insolvent, placed into FDIC receivership

- Bridge Bank established
- Assets/liabilities purchased by New York Community Bancorp/Flagstar Bank

Timeline: SVB Failure and Related Actions

March 12

Additional actions related to bank failures and financial stress included:

- Bank Term Funding Program established by Federal Reserve
- Systemic risk exception to FDIC's "least cost resolution" requirement invoked; provided FDIC insurance to all deposits at SVB and Signature Bank
- Congressional and administrative focus on systemic risk posed by non-G-SIBs, increases to deposit insurance limits, treatment of uninsured deposits, executive compensation clawback requirements, etc.

March 19

Credit Suisse, after experiencing significant stress, announced it would be acquired by UBS in a deal facilitated by the Swiss government.

- Acquisition closed June 12, 2023
- Questions regarding Credit Suisse AT-1 bond losses

May 1

First Republic Bank placed into FDIC receivership and its assets/liabiltities purchased by JPMorgan Chase Bank, NA

Bank Regulatory Landscape After Bank Failures

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Bank Regulatory Landscape

This year, we witnessed the failures of three mid-sized U.S. banks, which has impacted the priorities of the U.S. banking agencies.

- The federal government and the banking agencies have aimed to provide stability to the economy and reassurance that the underlying U.S. banking system is strong.
- Since the bank failures early this year, banking agencies have been focused on:
  - Banks and third-party relationships, particularly bank-fintech partnerships;
  - Ensuring banks and non-banks are accurately representing FDIC insurance; and
  - Uninsured deposits.

Key Issues

- Cash Management Options
  - Diversification
  - FDIC/SIPC coverage
- Third-Party Risk Management Guidance
  - Additional risk management/compliance requirements
- FDIC Advertising Rule
  - Accurate and complete disclosures
- Collateral Consequences
  - Trickle down of regulatory costs and burden
  - Treatment of uninsured deposits
  - Increased scrutiny of bank partnerships
  - Higher cost of credit due to bank capital/liquidity

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Cash Management Options

- Banks, broker-dealers, and other financial institutions offer various cash management options, such as:
  - Deposit accounts (savings/checking/money markets/CDs);
  - Brokerage "free balance" accounts;
  - Cash sweep programs; and
  - Repurchase sweep programs.
- Understanding which cash management option(s) your company utilizes, and who holds your cash, is <u>critical</u> to understanding and managing risk, especially when the bank or broker-dealer fails
  - For instance, a deposit account at a bank/IDI provides different protection and poses different risk than a cash balance in a brokerage account at a broker-dealer
  - Different cash management options provide different insurance protection (FDIC vs. SIPC)

Common Cash Management Options

Product	Description	Customer Fund Protections	Risks
Checking/Demand Deposit Account at a Single Bank	A checking account is a type of deposit account held at a bank that can often allow for unlimited numbers of withdrawals and deposits. These accounts are meant to be highly liquid and permit easy access to cash. However, they may pay little to no interest.	Cash in a checking account is federally insured by the FDIC up to the standard maximum deposit insurance amount (SMDIA), currently $250,000, per depositor, per insured institution, for each account ownership category (e.g., single ownership, joint ownership, or ownership by a corporation or partnership).	Cash in checking accounts and other deposit accounts of a depositor is only insured up to the SMDIA, per depositor, per insured institution for each account ownership category. Any amounts in excess will be considered an uninsured deposit claim.
Savings/Time Deposit Account at a Single Bank	A savings account is another type of deposit account held at a bank that often earns a modest amount of interest. However, there are often limitations on the number of withdrawals that can be made per month (although the extent to which these limits are enforced may vary).	Cash in a savings account is federally insured by the FDIC up to the SMDIA per depositor, per insured institution, for each account ownership category.	Cash in savings accounts and other deposit accounts (such as checking accounts) of a depositor is only insured up to the SMDIA, per depositor, per insured institution for each account ownership category. Any amounts in excess will be considered as an uninsured deposit claim.
Money Market Deposit Account (MMDA) Sweep at Single Bank	An MMDA is a type of interest-bearing deposit account held at a bank; very similar to savings accounts but likely pay a more competitive interest rate. These accounts may limit withdrawals to no more than six per month and may provide less liquidity as compared to a checking account, especially where the flexibility for unexpected or repeated withdrawals is required.	Like checking and savings accounts, cash in MMDAs is federally insured by the FDIC up to the SMDIA per depositor, per insured institution, for each account ownership category.	Like other deposit accounts, cash in an MMDA of a depositor is only insured up to the SMDIA, per depositor, per insured institution for each account ownership category. Any amounts in excess will be considered as an uninsured deposit claim.

This chart does is a summary only. For instance, it does not fully list or address the distinctions between different rights and capacities for deposit insurance, nor does it address separate rules regarding eligibility for deposit insurance and other matters that typically apply to deposit accounts that are maintained by a non-US branch of a depository institution.

Common Cash Management Options

Product	Description	Customer Fund Protections	Risks
Insured Cash or Deposit Programs	These programs are made available by banks, broker-dealers and other financial institutions as a means diversifying risk among financial institutions. In this type of program, a customer places a deposit with its financial institution which then distributes the funds to different destination banks, attempting to ensure that any customer's funds at a single destination bank are within the SMDIA. This structure typically benefits from so-called "pass-through" insurance where the benefits of the FDIC insurance at the destination bank "pass through" to the customer, assuming that the books and records at each level appropriately document and disclose the nature of the "pass through" relationship at each level of the program.	Similar to deposit accounts, this type of program can diversify a customer's risk such that the customer will receive the benefit of having deposits spread among different banks, in each case within the SMDIA. A customer with, for example, $1 million dollars in cash, could have deposits spread among four or more banks (e.g., the customer would have deposits of $250,000 at each of the four banks), thus reducing the risk that any portion of the deposits at any one institution is uninsured.	Because availability of FDIC pass-through insurance depends on the bank or other financial institution at each level maintaining accurate books and records of the ownership of funds and clear disclosure and titling of accounts, the customer is exposed to the risk that inaccurate or incomplete records may impact the availability of pass-through insurance. In addition, because deposit insurance coverage provides protection up to the SMDIA per depositor, per insured institution, for each account ownership category, customers in these programs should be mindful of deposits they may have at a destination bank that are separate and apart from deposits under this type of program. There may be delays in accessing funds because the FDIC typically will only provide funds to the institution that actually holds the account at the failed bank and then rely on that institution to further allocate payments to underlying deposit holders.
Repo Sweep Service	Under this type of program, idle cash in a deposit account will be removed from the account and invested in a repurchase (repo) agreement program that is meant to provide customers with interest income through short-term investments. The economic substance of these transactions is substantially the same as a collateralized loan.	Any cash that is swept out of a deposit account under a repo sweep program is not FDIC insured; cash that is remitted to the third-party custodian and paid to the repo counterparty will not be an insured deposit. However, the securities subject to the repo will not be part of the bank's receivership estate.	Customer cash that is swept back to the depositor's account at the bank after a repo has matured will be subject to FDIC insurance. As such, any amounts above the SMDIA in a cash deposit account at the bank at the commencement of the bank's receivership will be uninsured. Even if the receivership is commenced while cash is outside of the account, there may still be some delays before customers are able to access that cash as the FDIC establishes procedures and reviews the bank's books and records.

Common Cash Management Options

Product	Description	Customer Fund Protections	Risks
Intermediated Money Market Fund (MMF) Sweep	In a money market fund (MMF) sweep, uninvested cash (i.e., cash in a brokerage or deposit account) is automatically swept by a bank or other financial institution into a money market mutual fund.	MMF interests in these types of programs are not subject FDIC insurance. However, when structured correctly, the MMF interests will not be subject to a FDIC receivership when the financial institution is a bank. When the financial institution is a broker-dealer, the MMF interests are considered securities and are subject to coverage under the Securities Investor Protection Corporation (SIPC). That said, there may be some time before a customer can cause the redemptions and access the redemption proceeds.	MMFs are not risk free, and, in fact, investments in MMFs, being securities, are not covered by FDIC insurance when the financial institution is a bank. However, if the financial institution is a broker-dealer, SIPC coverage should apply. MMFs are themselves not without risks, and are subject to interest rate risk, liquidity risk, market risk, etc. Some MMF managers may also impose liquidity fees and temporarily suspend withdrawals (i.e., a gate).
TreasuryDirect	TreasuryDirect is a web-based system that allows investors to establish accounts to purchase, hold, and conduct transactions in US Treasuries online.	All US Treasury securities are issued in "book-entry" form—an entry in a central electronic ledger. Investors can hold Treasury securities in one of two systems: TreasuryDirect or the commercial book-entry system. TreasuryDirect is a direct holding system with a direct relationship with the Department of Treasury. When held through a broker-dealer, securities will be subject to insurance protections under SIPC. If held through a bank, the US Treasury securities will not be subject to FDIC protections (because they are not deposits) but should not be considered part of the receivership.	US Treasury securities are backed by the full faith and credit of the United States. However, US Treasury securities often have long maturity dates, and unless the security is specifically redeemable at any time by the US Treasury, the investor may wish to hold their securities until maturity or seek to sell them in the secondary market through an intermediary. In addition, TreasuryDirect has a “closed book period” of four business days prior to any interest/principal payment date. During that time, no changes can be made to remittance instructions. Accordingly, this can create a risk if the bank that the investor has on file with TreasuryDirect for purposes of receiving payments goes into receivership because it would result in funds being sent to the investor’s account at the bank and could result in delays and/or other issues in accessing those funds.

Partnerships with Banks: Third Party Risk Management

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Interagency Third-Party Risk Management Guidance

On June 6, 2023, the Federal Reserve, OCC, and FDIC issued updated third-party risk management (“TPRM”) guidelines for all banking organizations.

Guidance applies to all third-party relationships and is designed to assist banks with tailoring and implementing appropriate risk management practices.

It is very broad—it applies to any business arrangement between a bank and another entity, by contract or otherwise.

The banking agencies do emphasize that that not all relationships present the same level of risk, and therefore not all relationships require the same level or type of oversight or risk management.

TPRM Guidance Highlights

- The Guidance establishes a risk management framework for every stage of a third-party relationship—planning, due diligence, contract negotiation, ongoing monitoring, and termination—and provides examples of risk management considerations at each stage.
- Emphasizes that a banking organization is ultimately responsible for conducting its activities, including all activities conducted through a third party—in a safe and sound manner and in compliance with laws and regulations.
- Fintech partnerships: The guidance specifically includes bank-fintech partnerships, highlighting those that involve novel or complex structures, and in particular those relationships where the fintech may interact directly with and serve as the intermediary between the bank and the end customer.

What Does this Mean for Tech Companies?

In order to ensure compliance with the revised Guidance, bank partners may:

Point to the Guidance as the basis for additional information requests, such as:

- The tech company's relationships with additional third parties and its reliance on and oversight of those third parties,
- Information regarding governance structure, specific policies and procedures, and information security programs,
- Financial statements and information about key business personnel.

Increase scrutiny on relationships that involve "new or novel structures and arrangements," and in particular those interact with customers, due to the risk-based approach outlined in the Guidance

Require additional contractual provisions related to ongoing monitoring and oversight by the bank and examination and oversight by the banking agencies

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FDIC Advertising Regulations

The Federal Deposit Insurance Act (FDI Act) prohibits any person from misusing the name or logo of the FDIC or from engaging in false advertising or making knowing misrepresentations about deposit insurance.

In May of last year, the FDIC approved a final rule that elaborates on what constitutes false advertising under the FDI Act.

The final rule applies to all persons and entities and prohibits the following:

- Any statement that implies or suggests the existence of deposit insurance for an uninsured product,
- Any omission that would be necessary to prevent someone from being misled as to whether a product is insured or the extent of the insurance, and
- Any reference to the FDIC without a corresponding disclaimer that the products being offered are not FDIC insured, if they are not.

FDIC Advertising Proposal

- In December, the FDIC issued a proposed rulemaking updating the FDIC's signage and advertising requirements to reflect modern banking channels.
- The Proposal focuses on the FDIC signage requirements for a bank's branches and digital channels.
- It also clarified when specific statements or omissions would be a misrepresentation under the FDI Act.
  – Misrepresentations: A non-bank's use of the official FDIC advertising statement or the "Member FDIC" logo, unless that logo is next to the name an IDI.
  – Omissions: A material omission if a non-bank fails to disclose that (i) it is not itself an FDIC-insured institution and (ii) that non-deposit products are not FDIC-insured, are not deposits, and may lose value.

What Does This Mean For Tech Companies?

The FDIC is scrutinizing every reference to the FDIC and FDIC insurance and issuing cease and desist letters for false and misleading statements. A tech company must ensure that every statement related to the FDIC and the availability and extent of FDIC insurance is accurate and that it does not materially omit information (e.g., that it not an FDIC-insured institution).

Any entity offering pass-through insurance must identify the specific IDIs at which customer funds may be held, and it may also need to update disclosures to state that certain conditions must be satisfied for pass-through deposit insurance to apply.

Bank partners are likely to require additional information, including detailed information about how products are offered and product disclosures, and may also provide additional monitoring and oversight.

Why this Matters to Tech: What Next and How to Prepare??

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Why this Matters to Tech

- Coming out of the SVB failure and other recent events, U.S. federal banking regulators have re-focused on risks posed by:
  - Mid-size and large regional banking organizations (i.e., non-G-SIBs);
  - Uninsured deposit concentrations; and
  - Unrealized losses at banking organizations
- Increased regulatory focus can be expected to “trickle down” to customers and counterparties of banking organizations
  - Banks may pass through costs of additional capital/liquidity (e.g., higher cost of credit);
  - Banks may more closely scrutinize existing credits and other relationships;
  - Increased regulatory scrutiny of bank partnerships may result in compliance (and possibly examination) burdens

Why this Matters to Tech

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Increased regulatory focus can be expected to "trickle down" to customers and counterparties of banking organizations	• Banks may pass through costs of additional capital/liquidity (e.g., higher cost of credit); • Banks may more closely scrutinize existing credits and other relationships; • Increased regulatory scrutiny of bank partnerships may result in compliance (and possibly examination) burdens

What Next and How to Prepare?

- Be ready for “trickle down” of regulatory burden
  - Changes in bank capital/liquidity requirements
  - Treatment of uninsured deposits
- Be ready to review account agreements for:
  - Counterparty identification (bank vs. broker-dealer, etc.)
  - Account identification (money market account vs. MMF)
- Consider diversifying cash management options
  - Different accountholders/capacities
  - Different banks/broker-dealers
  - FDIC vs. SIPC insurance protection
- Consider extent to which current contracts with banks may be subject to repricing
  - Increased cost of credit
  - Potential for increased scrutiny on “leveraged loans”

What Next and How to Prepare?

- Be ready to review policies, procedures, and contracts with banks to determine compliance with TPRM guidelines, including:
  - Push-down of bank compliance obligations
  - Reporting/access to information
  - Agreeing to examination
- Be ready to review advertising materials for FDIC insurance considerations
  - Check for language that may misrepresent, including by implication, FDIC insurance coverage
- Consult with counsel for legal guidance—the earlier the better!

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Chris brings almost two decades of legal experience—including from the Federal Reserve and another leading global law firm—to bank and financial regulatory and reform matters, regularly advising clients on regulatory questions for banks, bank holding companies, and their affiliates, as well as other clients that interact with these entities. As a trusted adviser, Chris provides US and non-US banks and financial institutions with strategic and targeted bank and financial regulatory advice on a wide variety of matters. He advises both investors and sponsors with respect to the application of banking and financial regulations to asset/wealth management businesses.

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Kristin counsels US and international banks and other financial institutions on bank regulatory, supervisory, enforcement, corporate, and compliance matters before all major federal and state financial regulatory agencies. She advises clients on US banking laws and regulations, supervisory guidance, and interpretations as well as on US and international financial reform developments. Kristin also advises banks and other financial institutions on issues affecting their governance, structure, management, and operations.

Kristin has spent more than a decade handling an array of bank regulatory matters, most recently holding executive positions within a global financial institution's regulatory group, and she previously worked at a large insurance company and in another global law firm's financial services group. During her career, she has developed thorough knowledge of the regulation of banks and bank holding companies and has handled securities transactional work, debt deals, digital assets, and crypto initiatives.

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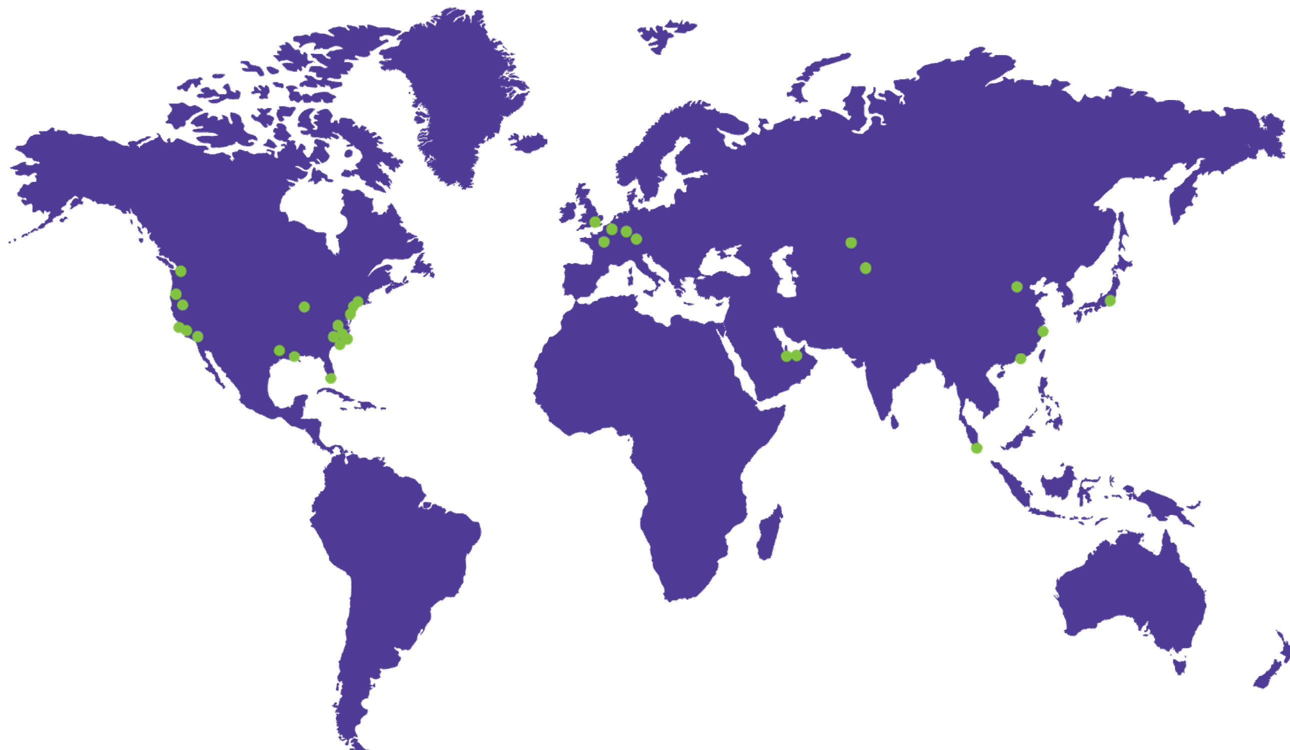

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