Debevoise & Plimpton | Insurance Industry Corporate Governance Newsletter

To Our Clients and Friends,

The banking sector was roiled over the weekend by the sudden downfall of Silicon Valley Bank and Signature Bank. This memorandum lays out the current status of those receiverships, the longer term effects of which will be determined over the coming weeks.

The uncomfortable echoes of the 2008-2009 crisis led us to reflect on the types of issues that insurance companies, both life and P&C, faced then and how those issues might factor into governance thinking now.

The issues we believe may be relevant include:

- Product design and policy assumptions. Are there any aspects of product design that could come under particular stress in an environment where liquidity is challenged and equity markets display increasing volatility? Are policy assumptions adequate in light of changing market conditions?
- Capital position. The risk in products is mitigated by reserves held against the liabilities, as well as required capital cushion. What is the company's access to capital in the event that liabilities require revaluation?
- Investments. Are investment portfolios exposed to SVB or Signature Bank either directly or in an indirect way? Are there other assets in the portfolio that could be impacted by the stress on banking stocks?
- Regulatory response. Understanding that the stress at SVB was exacerbated by a sudden loss taken in the bond portfolio, and that Signature Bank was exposed to crypto assets, are insurance regulators likely to look harder at the underlying market value of insurance company investment portfolios, require more stress testing, or take other actions that are focused on the asset-side impact of the changing economic environment?
- Disclosures. Are the company's public disclosures adequate to describe any of the above risks?

Overall, as of right now we expect that the SVB and Signature bank failures are unlikely to have a direct, material effect on the insurance sector, but we do expect that regulators and markets are likely to take note of the distress at these banks, and that boards and management of insurance companies will benefit from a clear understanding of the situation as it continues to develop.

What Happened

On Friday, March 10, 2023, the California Department of Financial Protection and Innovation closed Silicon Valley Bank ("SVB") and appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver. Initially, the FDIC established a limited-purpose bridge bank (the deposit insurance national bank or "DINB") and transferred insured deposits to DINB. Most of SVB's deposits (86%) were uninsured and were not initially transferred. Thereafter, there was significant uncertainty throughout the weekend as to the treatment of uninsured depositors, including when they might be able to recover some portion of their funds. There was also uncertainty about the treatment of other financial products, such as loans, letters of credit and money market sweep accounts. Then, on Sunday, March 12, 2023, the New York Department of Financial Services ("NYDFS") announced the closure of Signature Bank and appointed the FDIC its receiver as well.

On Sunday, the regulators sought stabilizing measures to calm markets before they opened on Monday. The Federal Reserve Board ("Federal Reserve"), U.S. Department of the Treasury ("Treasury") and FDIC (together, the "Agencies") released a joint statement with the purpose of "protect[ing] the U.S. economy by strengthening public confidence in our banking system." Critically, the statement announced that all depositors of SVB and Signature Bank would be made whole (whether the deposits were FDIC-insured or not). To do this, the Agencies invoked a rarely used provision, the so-called "systemic risk exception" of the Federal Deposit Insurance Act. To prevent further contagion, the Federal Reserve also announced that it had set up an emergency lending facility by which eligible banks would be able to borrow funds, on a secured basis, from the Federal Reserve, to "help assure banks have the ability to meet the needs of all their depositors." The Federal Reserve announced that Treasury approved of up to $25 billion from the Exchange Stabilization Fund as a backstop to the facility, similar to what was done during the pandemic. The Federal Reserve also loosened requirements for access to the Federal Reserve's discount window.

State of Play

Today, the FDIC announced that all SVB and Signature Bank deposits and substantially all other SVB and Signature Bank assets were transferred to newly created, full-service FDIC-operated "bridge banks" – Silicon Valley Bank, N.A. and Signature Bridge Bank, N.A, respectively. SVB and Signature Bank depositors now have full access to their funds, though we have heard reports of some delays in accessing accounts due to operational issues. The FDIC will now look to find buyers for the bridge banks or some portion of their assets while they continue to run the bridge banks in the interim. The FDIC released a new FAQ for SVB customers and an FAQ for Signature Bank customers. These FAQs provide guidance for customers reassuring them of access to accounts, loan payments and other issues.

Meanwhile, SVB Financial Group, the parent holding company of SVB, announced today that its board of directors appointed a restructuring committee consisting of five independent directors to explore strategic alternatives for the holding company and its SVB Capital and SVB Securities businesses, as well as its other assets and investments. There has so far been no bankruptcy filing.

Additionally, the Bank of England announced this morning that it had facilitated the sale of SVB's subsidiary, Silicon Valley Bank (UK) Ltd ("SVBUK"), to HSBC for a nominal £1.

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