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Failed-Bank Response Team: Borrower and Lender Perspectives

Depositors of Silicon Valley Bank (SVB) and Signature Bank and other market players have taken some comfort that federal agencies—including the Federal Deposit Insurance Corporation (FDIC), the U.S. Department of the Treasury, and Board of Governors of the Federal Reserve System (collectively the "Agencies")—will cover deposits in excess of $250,000 (which would otherwise be uninsured); have set up bridge banks for the transfer of SVB and Signature Bank deposits in order to make such deposits available; and are establishing a new Bank Term Funding Program that will offer loans to eligible institutions. These actions have seemingly obviated some of the immediate need for such institutions to sell assets with longer-term maturities quickly and at losses to meet bank customers' withdrawal demands. In addition, many hope this will minimize the risk of a "contagion" effect from SVB's and Signature's failures, preventing them from spreading more broadly throughout the financial sector.

How quickly things have developed with SVB and Signature underscores the need for careful evaluation and balancing of risks and preparation for opportunities. Below are a few of the areas that we encourage borrowers and lenders in commercial financing transactions to consider when evaluating any potential exposure to the SVB or Signature fallout, along with opportunities arising in the current environment.

Lockbox and Cash Management Services

Many loans require cash management structures. Generally, cash management structures require borrowers to deposit all revenue from the collateral for the loan into accounts at a "cash management bank," which is controlled by the lender as the secured party, either upon origination of the loan or upon the occurrence of a future event specified in the loan documents. If cash management services are currently performed by banks that are, or may become, troubled (together with any other lending

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institutions and other capital providers, "Affected Institution(s)"), careful consideration should be given to the advantages and disadvantages of maintaining the relationship, including unwinding the governing agreements and how to protect cash flow. Such measures, it should be stressed, must be taken in strict compliance with the governing loan and servicing documents. Due weight to the messaging of the Affected Institution should be factored into the analysis as the bridge banks initially are attempting to reassure customers that it is "business as usual."

Liquidity Needs

Opportunities may arise in the form of loan and other asset purchases and sales, whether from an Affected Institution or other market participants in need of liquidity. Institutions should consider how to quickly mobilize a team with the experience and resources to quickly and cost-effectively assist in realizing these opportunities given the volume of diligence and analysis that will be needed under tight time frames.

Defaulting Lender

Many credit agreements include "defaulting lender" provisions. These provisions typically contain remedies available to a borrower when a lender has failed to fulfill its funding or other obligations under the credit agreement. The "defaulting lender" mechanism is arguably better suited to situations where there is a problem with one lender in a larger syndicate of lenders because the "defaulting lender" provisions may reallocate defaulting lender exposure to non-defaulting lenders (up to the maximum commitment of such lenders), or one of the existing lenders may be more likely to voluntarily step in and assume the obligations of the defaulting lender.

The "defaulting lender" provisions are harder to operate in the context of a bilateral or participated facility. For bilateral loans, participated loans or other credit agreements that do not include "defaulting lender" provisions, borrowers may need to seek other legal remedies, such as monetary damages resulting from a

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contractual breach. Such remedies will depend on the specific terms of the applicable loan documents and may also be limited due to certain powers of the FDIC when acting as a receiver, which includes the ability to repudiate contracts under certain circumstances.

Letters of Credit

A company that is the beneficiary of a Letter of Credit ("LoC") or other credit support issued by an Affected Institution should consider alternative instruments should the ability to draw on the LoC be adversely affected. Similarly, a company with a LoC or other guaranty issued by an Affected Institution will need to consider the possibility that the ultimate beneficiary may require a replacement LoC or guaranty. It is imperative each borrower review its credit agreement and other loan documentation to determine whether replacement credit support may be needed.

Escrow Deposits and Reserve Accounts

A bank entering receivership raises many complicated questions about deposit accounts and other reserve accounts being held at such bank (e.g., Tax and Insurance Reserves, Tenant Improvement Allowance Reserve, or CapEx Reserves). Assets in accounts that are ***not*** considered bank deposits may remain partially or fully accessible during a bank receivership. How these accounts are treated depends on the specific language included in the applicable customer agreement and the account's precise name. As a result, clients should be aware that processing of payroll and other banking services could be impacted by the receivership.

Members of the Response Team are standing by to help answer your questions. Of note, Frost Brown Todd also has an experienced team of finance and real estate attorneys focused on the needs of borrowers and lenders in commercial financing transactions that may be directly and indirectly impacted by the bank closures. This team will produce articles and alerts focused on this subset of the finance industry, in order better partner with our clients to identify, analyze and address the immediate and long-term risks, opportunities and challenges ahead.

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Please reach out to the authors of this article for more information and assistance as it relates to commercial financing matters. You can also visit our Failed-Bank Response Team page for more insight into the latest financial market developments.

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