RESOURCE CENTER

Access to Capital

On Friday, March 10, the Federal Deposit Insurance Corporation (FDIC) was appointed receiver of SVB, which had banking relationships with nearly half of U.S. venture-backed technology and life sciences companies.

UPDATE: *On the evening of March 12, the U.S. Department of the Treasury, Federal Reserve and FDIC issued a joint statement noting that Silicon Valley Bank (SVB) depositors "will have access to all of their money starting Monday, March 13." Furthermore, "no losses associated with the resolution of Silicon Valley Bank will be borne by the taxpayer."*

Regulators also announced that a backstop would be created for Signature Bank of New York, which was closed by its state chartering authority on March 12. The press release states: "All depositors of this institution will be made whole."

More details and analysis to come. This followed a tumultuous week for SVB where announcements of a $1.8 billion loss from a sale of securities and a stock offering by its parent company intended to buttress its balance sheet unexpectedly precipitated a modern day "run on the bank." According to an order filed by California's banking regulator, SVB customers initiated withdrawals of $42 billion in deposits on March 9, approximately 25% of SVB's deposit base.

The failure of SVB has created turmoil in a venture capital community already bruised from a brutal market pullback over the past year. In particular, depositors are scrambling to deal with liquidity, payroll and other operational and legal issues arising from uncertainty surrounding the amount and timing of uninsured SVB deposits that they ultimately will recover.

A cross-practice team of Pillsbury finance, emerging companies, venture capital, employment, bankruptcy, banking/FDIC regulatory, insurance recovery and crisis management lawyers has been working around the clock helping entrepreneurs, venture capitalists, officers, directors, lenders and other constituencies navigate the rapidly evolving situation. Below we synthesize key discussions addressing the most frequently asked questions we have received and select other issues that many will face in the near term. Our team will continue to monitor market conditions and publish additional bulletins as new information becomes available and new issues crystallize.

As always, if you want to discuss these issues further, your relationship lawyers or any of the lawyers listed below are available to your team.

Emergency Funding Techniques

Companies with uninsured deposits may not be able to access any of those deposits for several days or longer, and it is unclear how much of those deposits will be available in the short-term or ultimately. In its release announcing the SVB receivership, the FDIC committed to paying uninsured depositors an "advance dividend" the week of March 13, with the possibility of making future dividend payments as it sells SVB assets.

Companies with immediate need for liquidity to meet current obligations such as the funding of payroll or other liabilities may want to consider:

Entering into a short-term bridge debt financing

- Similar to traditional bridge debt that companies use to finance between financing rounds, with potentially some material differences.
- Terms for consideration include, among others:
  - Mandatory prepayment tied to receipt of FDIC "dividend payments"
  - Security, such as a blanket lien on all assets, or potentially a lien tied solely to FDIC receivership certificates/dividend payments
  - Interest rate
  - Outside maturity date, for example 3 months, 6 months or 1 year
  - Whether the debt is convertible into a future financing round or other security. We would note traditional bridge debt used in venture capital transactions is virtually always "mandatorily convertible" into a future "qualified financing" of equity
- Typically, where appropriate, the fastest and most expedient path for obtaining bridge debt funding would be to approach current investors, who are already familiar with the company and its capital structure. We understand that in certain cases, investors have their own liquidity issues, including because their funds might also have been at SVB, so may not be able to support their portfolio companies where they otherwise would. In light of the market disruption, we have been approached by PE funds, hedge funds and other third parties, as well as their intermediaries, offering to provide this type of financing on an expedited basis.

Selling deposit claims/"receivership certificates"

- Terms for consideration include, among others:
  - The price—a buyer offers to purchase a company's claims in respect of its former SVB deposits at a discount to face amount
  - Whether there is any "structure" entitling the seller to obtain additional recoveries beyond the initial purchase price. For example, if the deposit is sold at $0.70 on the dollar, but ultimately recovers in full, sharing in the excess over, say, $0.90. We are aware of outright purchase of depositor claims and other structured arrangements being offered by hedge funds, PE funds and other third parties

Consummating a traditional SAFE financing

- Terms for consideration include, among others:
  - Conversion price discount to the future priced equity round, such as 15% or 20%
  - Conversion cap, including whether the conversion price is subject to a "cap", at what level, and whether or not the cap is on a "pre-money" or "post-money" basis
- This type of financing would be particularly attractive for a high-quality company that plans to pursue a traditional preferred stock offering in the next 12 months.

Consents

Companies should keep in mind that incurring new debt, selling depositor claims, issuing SAFEs or entering into any of these other types of arrangements will likely require board consent and often certain investor consents as well, depending on the company's governing and financing documents. For example, venture-backed companies typically have a debt incurrence covenant in their certificate of incorporation, requiring preferred stockholder approval for debt incurred above an agreed "basket" level. A company may have other debt arrangements that could impact any of the foregoing liquidity sources. A close review of a company's governance and financing documents will be needed to ensure compliance.

Public Company Communications

On Friday March 10, 2023, approximately 150 companies filed or furnished current reports on Forms 8-K and 6-K regarding SVB. The vast majority of these reports indicated that the applicable issuer either had no money or securities on deposit with SVB, or that it had an immaterial amount of cash or securities on deposit at the bank. However, public companies experiencing more significant challenges because of the situation at SVB should consider whether disclosure is appropriate under Item 7.01 or Item 8.01 of Form 8-K, or on Form 6-K, based on the facts and circumstances of that company. Additionally, management at public companies should keep in mind Regulation FD when communicating about the effects of the situation on the company, as Regulation FD requires that a reporting company simultaneously disclose to the public any material, non-public information disclosed to market professionals or securityholders.

Whether disclosure is needed on Form 8-K or Form 6-K, and guidance on Regulation FD, is fact-specific.

Payroll Concerns

The FDIC has indicated that "[a]ll depositors will have full access to their insured deposits no later than Monday morning, March 13, 2023" and that it "will pay uninsured depositors an advance dividend within the next week."

"Insured deposits," however, are only up to $250,000, which may not be sufficient to cover a company's payroll obligations. California's wage and hour laws require employers to make timely payment of wages on regularly scheduled pay days. Failure to do so can result in fines and penalties that increase if the failure is deemed to be willful. Employees working in other states are covered by their state's wage and hour laws, but all states have certain basic requirements for timely payment of wages, with varying degrees of latitude.

The unexpected nature of SVB's sudden closure at the end of last week, and many employers' inability to access funds needed for payroll as a result, may be viewed as mitigating circumstances by the California State Labor Commissioner and other relevant state agencies, although this is by no means certain. We recommend that affected employers:

- Communicate transparently with employees about payroll status – either that the company will be able to make timely payment, or that it is taking steps to facilitate being able to do so
- Follow up with additional details as they are known
- Consider alternative payroll funding options (e.g., a bridge loan)
- Consider, after the FDIC provides additional information on Monday (as we expect), whether the duration of any delay on timely payroll distributions is significant enough to warrant putting employees off work
- Review your insurance policies for potential coverage if payroll is delayed

FDIC Receivership

Upon the appointment of the FDIC as receiver for SVB, the FDIC created a new "bridge bank" called Deposit Insurance National Bank of Santa Clara. Upon the closing of SVB on Friday, March 10, 2023, all FDIC insured deposits at SVB were transferred to the newly-created bridge bank. The FDIC has advised that all insured depositors will have full access to their insured deposits no later than Monday morning, March 13, 2023. The FDIC further announced that it will pay uninsured depositors an advance dividend within the next week. Uninsured depositors will receive a receivership certificate for the remaining amount of their uninsured funds. The FDIC has not indicated the expected amount of the advance dividend. It has indicated that as it sells the assets of SVB, future dividend payments may be made to uninsured depositors.

In many failed bank situations, the FDIC has arranged for another bank to take over the failed bank immediately upon imposition of the receivership. This did not happen in the case of SVB. Whether a buyer for the institution as a whole or parts thereof (such as its 17-office branch network) will emerge remains to be determined.

In a receivership, the FDIC steps into the shoes of the failed institution and evaluates and prosecutes or defends third party claims by and against the institution. Outstanding loans made by the failed institution will remain outstanding in accordance with their terms and if the borrowers are holders of uninsured deposits at SVB, it may be possible for them to set off the loan obligations or a portion thereof against any uninsured deposit liabilities.

In an FDIC receivership, claims are to be paid by the receiver from available assets in the following order: (a) secured claims, such as secured advances from the Federal Home Loan Banks or the Federal Reserve Bank; and (b) unsecured claims in the following order: (i) administrative expenses of the receiver; (ii) certain administration expenses of the institution; (iii) claims for wages and salaries; (iv) claims of governmental entities for unpaid taxes other than federal income taxes; (v) claims for withdrawable accounts and all other claims accrued and fixed before the receivership (giving preference to deposits where provided by state law); (vi) claims other than those accrued or fixed at the time of the receivership; (vii) claims of the U.S. for unpaid federal taxes; (viii) general unsecured creditor claims; and (ix) claims by holders of non-withdrawable accounts, including stock.

Ordinary commercial and individual demand deposit checking accounts should fall within the "withdrawable accounts" category. However, customers should review closely what types of accounts they may have to determine the priority of their claim in the receivership.

Sweep Accounts in a Bank Failure

Customers may have "sweep accounts" at a financial institution which has failed and become the subject of an FDIC receivership. A specific discussion of sweep accounts in this context is merited. Sweep accounts are are basically of two kinds: (a) "external" sweep accounts; and (b) "internal" sweep accounts. They are called sweep accounts because funds in the customer's ordinary bank account or accounts are, by agreement between the bank and the customer, "swept" (usually each day) from the bank account to either (a) investments in money market mutual funds (or similar investment vehicles) in the case of an "external" sweep account; or (b) to another type of account within the bank (e.g., a Eurodollar account at a foreign branch of the bank) in the case of an "internal" sweep account. Money market mutual funds are a type of investment company that invests mainly in U.S. Treasury and other obligations of the federal government.

The FDIC has generally taken the position that customer funds at a failed bank which were swept into a money market mutual fund before the bank failure remain the assets of the customer and are not part of the receivership estate. This is wholly consistent with the fact that when the sweep occurs the deposit totals of the bank are reduced by the amount of the sweep. In other words, both the deposit liability and the cash associated with it are removed from the bank's balance sheet and are now represented by the investment in the securities of the money market mutual fund which are owned by the customer.

Different treatment can result in the case of an "internal" sweep account where the funds are moved to a different type of account within the bank. As noted, an example would be a Eurodollar account in a foreign branch of the bank. The FDIC's regulations treat "internal" sweep accounts as creating an unsecured general creditors claim, which is not a deposit in a receivership. This has two negative features: (a) the provisions of the FDIC Act giving bank depositors certain "preferences" in a bank failure do not apply if the obligation is not a deposit; and (b) general unsecured creditors in bank failures usually fare very poorly in terms of their recovery.

The FDIC has publicly suggested in guidance that a customer's account associated with a sweep product normally will be transferred to another bank (which could include an interim or "bridge bank") acquiring the failed bank, and as a result the funds held with the money market mutual fund would be available to be swept back into the customer's deposit account at the new bank on the business day following the failure. This would be the optimum result for the customer. We would caution that the FDIC has broad powers in the administration of failed bank receiverships and this result cannot be assured in all cases. If the transfer of these accounts to a successor bank, including a bridge bank, were to be delayed, it will be necessary to deal with FDIC personnel administering the receivership to obtain control of the funds. Under most sweep arrangements, the bank acts as agent of the customers relative to the mutual fund and the customer cannot practically deal directly with the mutual fund. Recovery of funds from the money market mutual fund is subject to its continuing solvency.

To ascertain a customer's rights in respect of sweep accounts in a failed bank situation, careful review of the underlying account documentation is critical.

What Depositors Should be Ready to Do Monday Morning

As noted above, by Monday morning, March 13, insured depositors should have access to their insured deposits, which generally is limited to $250,000 per account owner across all the account owner's accounts. The FDIC provides a calculator to help determine the insured amount of your deposits.

You should be able to access your insured deposits at SVB branch locations, and through on-line services.

On Monday morning, you should confirm access to your insured deposits, and to the extent you have not done so already, confirm whether any amounts above your insured deposits may in fact not be part of the receivership and, subject to administrative processes, otherwise available to you.

What Borrowers Should be Ready to Do Monday Morning

The FDIC as receiver has not yet transferred SVB's loans to another institution. The FDIC advises that loan payments should continue to be made as usual. Under certain circumstances, you may be able to have the uninsured portion of your deposits set off against money owed to SVB.

How to Submit a Claim

If your deposit was more than the insured limits or if you have not been paid for goods or services provided to SVB, you should register and file claims with the FDIC as receiver. The FDIC's Claims Portal also allows you to (i) change your mailing address; (ii) request that insured deposits or dividends be sent electronically to your account at another bank; (iii) schedule a call with an FDIC Claims Agent; (iv) check on the status of a filed claim; and (v) contact the FDIC about a unique situation or question. If you opened a business account with an employer identification number (EIN), you will need to login to the FDIC's Claims Portal and create a case using the start a new claim button. The FDIC will review your case and reach out if your deposit exceeds insurance limits.

Insurance Recovery

Companies facing material impacts from the SVB failure, including liquidity issues such as the ability to meet payroll or loan obligations, or to continue operational or research activities, may be at risk of third-party claims from investors, shareholders, government agencies or employees, among other risks. Your company's insurance programs may be available to mitigate some of these risks. While D&O (Management Liability) coverage is not likely to extend to the losses incurred on deposit accounts of the insured at a failed bank, it may cover claims resulting from the losses. We advise an immediate review of available coverage, including D&O, Fiduciary Liability (Employee Benefit Plans), EPLI (Employment Practices) and any available financial institution bonds.

You should first consult with your insurance broker to confirm what policies are in place and to secure a current set of policies. Following that, we recommend a legal review by counsel to determine known potential exposures and available coverage for such exposures.

In appropriate situations, it may be advisable to provide your D&O insurers with a "Notice of Circumstances Which May Give Rise to a Claim." Such notices are optional but are provided for in your policies to ensure that any future Claims that relate to the circumstances noticed are deemed to have been made on the date of the notice. This could alleviate the potential for actual Claims against you to be excluded in subsequent renewals. The wording of such notice should be reviewed with counsel and your broker to satisfy your particular policy's requirements.

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