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Strategic Considerations in the Rapidly Changing Banking Environment

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On March 10, 2023, the California Department of Financial Protection and Innovation and the Federal Deposit Insurance Corporation (FDIC) closed Silicon Valley Bank (SVB) after a deposit outflow created a severe liquidity strain at SVB. On March 12, 2023, the New York Department of Financial Services and FDIC closed Signature Bank (Signature) for similar reasons. This followed an announcement earlier in the week by Silvergate Bank (Silvergate) that it was beginning a voluntary liquidation process.

In the past week, several other U.S. and international banks have explored government funding and other options to deal with similar deposit and liquidity issues.

U.S. government officials have argued that the liquidity issues of SVB, Signature, and Silvergate are not indicative of the health of the U.S. banking system, given such banks' exposure to and concentration in venture capital-funded customers, especially customers in the crypto industry. However, many financial institutions face the same asset-liability mismatch that caused issues at SVB and these other banks.

Uninsured Depositors

As part of the resolution for SVB and Signature, the Federal Reserve and Department of the Treasury stepped in to guarantee deposit liabilities in excess of the statutory maximum insured amount of $250,000. Federal banking regulators have justified this extraordinary measure on the basis of needing to maintain depositor faith in the banking system. However, there is no guarantee that federal banking regulators will step in to make uninsured depositors whole in the event that another insured institution fails before a buyer can be arranged by the FDIC.

Federal Reserve Lending Facilities

In the wake of the failure of SVB and Signature, the Federal Reserve announced that it would institute the Bank Term Funding Program (BTFP) to provide additional liquidity to allow depository institutions to meet their deposit obligations. Under the terms of the BTFP, eligible depository institutions may receive loans from the Federal Reserve in an amount up to the value of pledged collateral for a term of one year. Any collateral that is eligible to be purchased by the Federal Reserve in open market operations may be pledged under the BTFP, and the collateral will be valued at 100 percent of par value, rather than the market value of such collateral. This will allow depository institutions to realize some of the value of their securities portfolios without being forced to actually liquidate such securities, many of which are subject to severe unrealized losses as a result of recent interest rate increases.

Rapidly Evolving Situation

The banking market has seen continued turmoil this week. On March 16, Crédit Suisse announced that it had secured a $54 billion loan from the Swiss National Bank, the central bank of Switzerland, and a consortium of large banks announced a plan to place $30 billion in deposits at First Republic Bank to secure its liquidity position.

The current uncertain financial environment means that financial institutions should revisit their risk assessments for transactions with other financial institutions, as well as the effectiveness of their back-up liquidity plans. Customers with large uninsured deposits should also perform their own risk assessments to ensure they understand their risk exposure.

Baker Donelson continues to monitor events as they progress. Please reach out to any of the authors, John H. Rowland and D. Taylor Tipton, or your Baker Donelson attorney if you have questions.