

Silicon Valley Bank – your questions answered

12 March 2023



We're aware that news of the failure of Silicon Valley Bank (SVB) in both the US and the UK has dominated the headlines over the last couple of days. We have a team of experts working with our clients who have business with SVB to advise them on the issues in this fast-moving environment. We've seen the recent news that HM Treasury and the Bank of England are looking for solutions to minimise the impact on UK tech firms, and that a number of lenders have been invited to see if a deal can be reached in short order to take over SVB's UK business.

We understand this is a difficult time for many firms across the tech sector, as well as funds who have fund finance facilities with SVB. From a fund finance perspective, insofar as there has been any discussion on insolvency in the fund finance context, much of it has focussed on fund borrowers with Abraaj and JES Global Capital mentioned. Hardly any of the discussion has been on the lenders. Till now. We understand SVB provides fund level capital lines of credit, NAV facilities and GP-co investment facilities in addition to facilities to portfolio companies backed by fund guarantees.

We've been advising on a number of issues arising from the Bank of England's announcement that they intend to apply to the Court to place Silicon Valley Bank UK Limited (SVBUK) into a Bank Insolvency Procedure from Sunday evening (12 March 2023).

We set out below some questions we've been fielding from corporates and funds¹. We've also prepared an initial analysis of the macro market factors that caused SVB's problems and some of the wider market consequences we anticipate – see Appendix.

FAQs

1. What is a Bank Insolvency Procedure?

Essentially, this is a liquidation process for Banks. Liquidators will be appointed with two objectives:

- i. to work closely with the Financial Services Compensation Scheme (FSCS) to ensure that, as soon as is reasonably practicable, each eligible depositor has either their accounts transferred to another financial institution, or receives compensation from or on behalf of the FSCS; and
- ii. to wind up the affairs of the bank to achieve the best result for SVB's creditors as a whole.

¹ The commentary in this note reflects the information we have from public sources at 12am on 13 March 2023. Any comments made may be superseded by further Government and regulatory announcements.

2. Do we still owe the debt to SVBUK that we've drawdown under our facility agreement?

Yes, although it's possible that sums owed may be reduced by insolvency set-off where you have a claim against SVBUK.

3. Do we have to make the interest and principal payments and pay commitment and other fees and commission when they're due?

Most facility agreements will have a provision requiring payments by borrowers to be made without set-off. However, insolvency set off is mandatory, cannot be contracted out, and arises by operation of law. In view of this, urgent legal advice should be sought on whether insolvency set-off will apply before any payment is made.

It looks like the insolvency process will relate to Silicon Valley Bank UK Limited, which had the loans and deposits transferred from the UK branch of the US entity last year. We're aware of two other UK SVB entities - SVB Capital (UK) Limited which was recently incorporated, and SVB Financial Group UK Limited which its 2021 accounts describe as providing sales and marketing. Deposit taking is regulated under FSMA so that would have to be SVBUK. However, corporate lending (ie non-consumer lending) is not subject to authorisation, so any other SVB entity could make loans (although we think this unlikely). If there are different entities in play (other than loans and deposits with the US branch which were transferred to the UK Limited company) then insolvency set-off may not apply.

In addition, as a practical matter, borrowers should also consider ways in which they can reduce their liabilities under the facility agreement, eg cancelling undrawn commitments and reducing any commitment fee payable.

4. Can we still drawdown monies under our Revolving Credit Facility with SVBUK?

Generally speaking, no, not at the moment if SVBUK are the only lender. The Bank of England statement confirms; *"In the interim, the [bank] will stop making payments or accepting deposits"*. If they are part of a syndicate of lenders, the provisions of each facility agreement will need to be considered on a case-by-case basis.

5. Can SVBUK demand repayment of the monies we owe under the facility agreement ahead of the termination date?

No, not unless there is an event of default outstanding under the facility, but it will be prudent to review the provisions of the facility agreement itself, especially the Mandatory Prepayment/Illegality provisions.

6. Can we access the monies in our bank account with SVBUK to pay employees, suppliers or the investors in our fund?

Not at the moment and, beyond the limited amount of money which may be able to be recovered under the FSCS, it's likely that it will be a number of months before the liquidators are in the position to pay any dividend to unsecured creditors (which will include depositors). Depending on the value of recoveries made by the liquidators, depositors may not recover their funds in full.

Given the prospects of a significant delay and/or shortfall in recovering funds on deposits from the liquidators, consideration should be given as to what your immediate liquidity needs are (especially for authorised firms who are required to have 'adequate resources' at all times as part of their on-going conditions for authorisation), whether alternate funding is available and whether or not you're able to make required payments as they fall due. In circumstances where it's not clear that sufficient funds will be available, urgent advice should be taken on what steps should be taken by directors or LLP members to comply with their duties and consider what steps should be taken in the short term to mitigate the position of your various financial stakeholders.

Reports confirm that HM Treasury and the UK Government are working on plans *"to ensure that the short-term operational and cash flow needs of SVBUK customers are able to be met"*, which may provide a much-needed liquidity lifeline to affected customers.

It may also be possible to monetise any claim against SVBUK by selling it to a distressed or special situations investor.

7. If we can't access monies on deposit with SVBUK are they protected?

SVBUK entering into a Bank Insolvency Procedure would mean that 'eligible depositors' are paid out by the Financial Services Compensation Scheme (FSCS) as quickly as possible up to the protected limit of £85,000 or up to £170,000 for joint accounts. Any deposits above this limit/not covered by FSCS will not be protected and will rank as unsecured debts claims in the insolvency.

- **When will we be paid?** The FSCS aims for seven days but it will likely be longer in complex cases.
- **Who is an eligible depositor?** This isn't as straight-forward a question as you would hope, but individuals and smaller companies will generally be eligible depositors. Larger corporates won't usually be covered by FSCS protection, nor will regulated financial services firms such as credit institutions, investment firms, collective investment schemes, financial institutions (which includes authorised payment institutions and fund managers) amongst others (definition of eligibility is under Chapter 2 of the Depositor Protection Chapter of the PRA's Rulebook).

- **How do I claim if I am eligible?** If eligible, you don't need to do anything – FSCS will compensate you automatically.
- **What if we've deposited client money with SVBUK?** Client money deposits held with SVBUK are subject to CASS 7 which creates a statutory trust and a fiduciary relationship between the firm and its client. Client money is held by the firm as legal owner but remains in the beneficial ownership of the client. If SVBUK is placed into insolvency, it will give rise to a CASS 'secondary pooling event'.

8. How would an insolvency of SVBUK impact the ongoing capital and liquidity/resources requirements of authorised firms?

If a firm breaches its ongoing capital/liquidity requirements due to the failure of SVBUK, it should tell the FCA as soon as possible – considering the requirements of Principle 11. The FCA may, in the circumstances, allow the firm some time to find a solution but that any period of forbearance will be very limited.

9. Can we open new bank accounts with another bank?

This depends on the provisions of the specific facility agreement (especially where SVBUK are providing bilateral facilities). Some agreements may contain provisions that all banking business needs to go through SVBUK but there is usually a 'carve out' for situations/jurisdictions where SVBUK do not operate.

10. Can SVBUK transfer my loan to another lender or fund without my consent?

This depends on the provisions of the specific facility agreement. Most bilateral agreements will be freely transferable or, at most, include a consultation period. Some syndicated facilities may contain a consent mechanic but this is not particularly common. Some may contain a prohibition on transfer to a competitor or vulture fund/distressed debt fund. Again, it depends on the specific provisions of the facility agreement. If SVBUK or part of its business is sold, the provisions will need to be reviewed on a case-by-case basis. Based on our experience, it's quite possible that the liquidators may seek to realise value for creditors by looking to sell loans on either a single name or portfolio basis.

11. What impact do the 'Bail-In Provisions' have to my loan agreement?

At the moment, HM Treasury and the UK Government appear to be ruling out a bail-out of SVBUK. However, in the event of a government backed bail out of SVBUK, any loan made by SVBUK to a customer is an asset of SVBUK and will not be 'bailed in' - only a liability of SVBUK would be affected.

12. SVBUK are one of the banks in my syndicate - are they a 'Defaulting Lender' and what happens next?

In short, the LMA provisions allow the Borrower to replace the Defaulting Lender with an existing lender in the syndicate or a third-party lender. Again the provisions of the loan agreement will need to be reviewed on a case-by-case basis to determine the 'trigger' for SVBUK to become a Defaulting Lender. However, if the Bank of England proceeds with plans to place SVBUK into insolvency, this will in the vast majority of cases, trigger the Defaulting Lender provisions.

13. SVBUK are the agent bank under my loan agreement - what happens next?

The LMA provisions relating to 'Impaired Agent' may apply to allow the other lenders to replace SVBUK as Agent. Again the provisions of the loan agreement will need to be reviewed on a case-by-case basis.

14. My loan agreement refers to Silicon Valley Bank (London Branch). Does the Bank of England statement apply to my loan?

In short, yes. The assets and liabilities, including the loans and deposits of Silicon Valley Bank (London Branch), were transferred to SVBUK on 31 July 2022 under Part VII of the Financial Services and Markets Act 2000.

15. We bank with both SVB in the US and the UK. Are the processes the same?

No, SVBUK is ring fenced from the US bank so issues will have to be addressed separately.

Other considerations

Some further points to consider if you are a fund (or an investor in a fund) which banks with SVBUK:

- Is the fund still obliged to pay investor commitments into an SVBUK account?

Most capital call facilities will require investor commitments to be paid into an SVBUK bank account over which SVBUK has security. Given the current situation, is the fund still obliged to do so? If SVBUK are no longer accepting deposits as per the Bank of England statement, it might not be possible to do so regardless of the contractual position. In any case, whether a fund is obliged to do so may depend on whether there are account bank criteria and if so, whether these have been complied with (eg ratings from established rating agencies). Even if the fund is contractually obliged to and able to do so, the fund should consider if it can legally refuse to do so due to the current circumstances and, in particular the impact of any mandatory insolvency set-off which may have arisen by operation of law.

- As an investor, we've been issued a capital call notice from the fund to pay into an SVBUK account? What should we do?

We would strongly suggest you get in touch with the fund to ask them to reassess the situation; this needs to be done on a timely basis given the short duration within which capital calls need to be made. We've heard that some funds have reached out to their LPs after capital calls have been issued to tell them specifically not to pay into the SVBUK account and to wait to hear from the GP.

- We've advanced our LP commitments to an SVBUK account with the fund. Is our contribution an asset of the fund? Can we ask the fund to return this money?

Yes, it is still an asset of the fund, although there is a separate issue around how to get access to the cash. Any request for return of the funds will have to be in accordance with the fund documents/co-investment agreements.

- The limited partner commitments to the fund are secured in favour of SVBUK. What's the status of that security?

There is no change to this. SVBUK will not be able to enforce the security outside of the agreed parameters in the facility agreement (eg event of default).

- What should we do if we have SVBUK as a hedge counterparty for our fund level currency hedges?

Close-out/termination provisions may apply and urgent advice should be sought as to whether these can and/or should be exercised.

- Our fund has a SVBUK issued LC in support of our underlying investments. Do we need to do anything about this?

Some of the SVBUK fund finance facilities may provide for the issuance of letters of credit. If the LC issuer is SVBUK, the fund will need to consider if any resolution/insolvency process would result in a breach of the fund's underlying obligations to an LC beneficiary. If so, the fund will need to cancel the existing LC and consider alternative issuers to issue a replacement LC.

We appreciate that this may be a difficult time. We're here to help. For any questions, please get in touch with your usual Simmons contact or email our dedicated team at SVBenquiries@simmons-simmons.com.

Appendix

macro-market insights



Bottom line

The failure of SVB seems to have been the result of a perfect storm of circumstances, some of which beyond its own control. Key amongst them is an unusually high level of long dated securities, which have proved vulnerable to the background of rising central bank and longer-dated interest rates in the fight against inflation. Much now depends on the responses from regulators and policymakers around the globe if the particular events at SVB are to be contained. Longer term, the consequences may stretch so far as to soften the tone and degree of interest rate and tax policy around the globe. It's likely also to lead to revisiting past relaxation of regulatory scrutiny.

Details

Background - a 'perfect storm'

- an unusually high proportion of long-dated securities held as part of its capital base: according to some reports around \$90bn in eg MBS or Treasuries, representing some 40% of its asset value at the time of its failure;
- falling bond prices (rising yields) as inflation gathered pace and the Fed raised interest rates; a warning from Moody's about possible credit downgrade;
- the earlier failure of Silvergate - and previously FTX - prompting depositors to begin withdrawing funds in other banks;
- a poorly received cash-call from the company to help fund depositor withdrawals;
- the forced sale of bonds (to fund withdrawals) crystallising losses for SVB that they may otherwise have been able to avoid under HTM (Hold To Maturity) accounting rules.

Read across

Implications fall broadly into two timeframes: short-term and longer-term.

Short term

1. Even if the cause of failure is largely unique to SVB it plays into risk scenarios, [including those we have called out for 2023](#), that have been present in global financial markets ever since inflation and then central bank interest rates began to rise from end '21/early '22. An index of global bank shares is in bear-market territory - despite a recent rally it's down 20% from its 2021 peak.
2. But with market valuations still high on some measures there remains little room for error and the markets are in no mood easily to forgive. Hence now the fears for contagion: VIX - the so-called 'fear index' jumped 25% at the end of last week. Risks remain to the downside.

3. Financial markets will be looking for swift action from regulators/policymakers with so-called 'short-sellers' likely holding their toes to the fire with a focus on institutions they believe to share some characteristics with SVB - notably a high percentage of their asset base held in bonds compared to their depositor base.
4. At country-level US Treasury data shows investors in Japan, China and the UK as the top three international owners of US debt (all durations). Institutions in those jurisdictions may be particularly in focus - especially where their holdings are also the subject of any currency hedging.
5. Action from regulators/policymakers will likely need to include not only the fate of SVB and its reported \$155bn of uninsured deposits but also for the solvency/ working capital requirements (eg meeting payroll) of some of its client companies – including those in the crypto and broader tech sectors.

Longer term

The fall-out from SVB has the potential to make material change to the course of economic policy and the regulatory framework

1. **Economic policy.** The next round of central bank meetings may bring a softer tone than the more recently hawkish one. If so, financial markets may lower their expectations for the peak of this interest rate cycle. In the UK the fiscal budget due this week (March 15th) may also soften the tone and possibly the pace of expected tax increases.
2. **Regulatory.** In 2018 President Trump eased the regulatory burden on some banks by raising the threshold Dodd-Frank regulatory oversight from \$50bn of assets to \$250bn. At the time the SVB asset value was well below the new \$250bn threshold; by early 2022 it had risen to \$220bn.

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