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# Locke Lord QuickStudy: Potential Impact of the Silicon Valley ?Bank Insolvency on the Insurance Industry

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Financial institutions, including Insurers, are considering the potential impact of the Silicon Valley Bank's ("SVB's") insolvency. SVB and its parent holding company have provided funding and debt financing to InsurTech Insurers and other venture investment firms. Some of those Insurers have already publicly announced the extent to which the SVB Insolvency has had an impact. The full impact likely will continue to unfold in the coming weeks and months.

**How and why was SVB seized by State Bank Regulators?**

On Friday, March 10, 2023, pursuant to California Financial Code section 603, SVB, located in Santa Clara, California, was placed into Liquidation by its state regulator, Clothilde V. Hewlett, the California Commissioner of Financial Protection and Innovation ("California Bank Regulator"). The Liquidation Order stated that the Bank cannot be reasonably rehabilitated and that it "would be contrary to safe and sound banking for the Bank to resume business." The California Bank Regulator also entered an Order Taking Possession of Property and Business finding that the Bank is insolvent (the "Taking Order"). As a result, the California Bank Regulator appointed the Federal Deposit Insurance Corporation ("FDIC") as the receiver of SVB.

The Taking Order stated that:

On March 8, 2023, the Bank announced a loss of approximately $1.8 billion from a sale of investments (U.S. treasuries and mortgage-backed securities). On March 8, 2023, the Bank's holding company announced it was conducting a capital raise. Despite the bank being in sound financial condition prior to March 9, 2023, investors and depositors reacted by initiating withdrawals of $42 billion in deposits from the Bank on March 9, 2023, causing a run on the Bank. As of the close of business on March 9, the bank had a negative cash balance of approximately $958 million. Despite attempts from the Bank, with the assistance of regulators, to transfer collateral from various sources, the Bank did not meet its cash letter with the Federal Reserve. The precipitous deposit withdrawal has caused the Bank to be incapable of paying its obligations as they come due, and the bank is now insolvent.

On Monday, March 13, 2023, the FDIC issued a press release stating:

The Federal Deposit Insurance Corporation (FDIC) today transferred all deposits—both insured and uninsured—and substantially all assets of the former Silicon Valley Bank of Santa Clara, California, to a newly created, full-service FDIC-operated 'bridge bank' in an action designed to protect all depositors of Silicon Valley Bank.

Depositors will have full access to their money beginning this morning, when Silicon Valley Bridge Bank, N.A., the bridge bank, opens and resumes normal banking hours and activities, including online banking. Depositors and borrowers will automatically become customers of Silicon Valley Bridge Bank, N.A. and will have customer service and access to their funds by ATM, debit cards, and writing checks in the same manner as before. Silicon Valley Bank's official checks will continue to clear. Loan customers should continue making loan payments as usual.

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The transfer of all the deposits was completed under the systemic risk exception approved yesterday. All depositors of the institution will be made whole. No losses associated with the resolution of Silicon Valley Bank will be borne by taxpayers. ***Shareholders and certain unsecured debt holders will not be protected.*** Senior management has also been removed. Any losses to the Deposit Insurance Fund to support uninsured depositors will be recovered by a special assessment on banks, as required by law.

The receiver for Silicon Valley Bank has also transferred all Qualified Financial Contracts (as defined in 12 USC 1821(e)) of the failed bank to the bridge bank.

These actions will protect depositors and preserve the value of the assets and operations of Silicon Valley Bank, which may improve recoveries for creditors and the DIF.

A bridge bank is a chartered national bank that operates under a board appointed by the FDIC. It assumes the deposits and certain other liabilities and purchases certain assets of a failed bank. The bridge bank structure is designed to "bridge" the gap between the failure of a bank and the time when the FDIC can stabilize the institution and implement an orderly resolution.

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**How could Insurers be impacted by SVB's Insolvency?**

It is possible that some Insurers, especially those involved in the InsurTech space, will be adversely affected by SVB's Insolvency. For example, some Insurers could have made deposits at SVB and that cash would be an admitted asset under applicable state insurance laws notwithstanding such cash may exceed the FDIC insured limit of $250,000. Additionally, Insurers may own stocks or bonds issued by SVB's holding company, SVB Financial Group ("SIVB"), which would be admitted assets. Any common stock investments of SIVB owned by Insurers would have always been carried at market value, but it is now likely that any SIVB bonds held by Insurers will be considered other than temporarily impaired, requiring the bonds to be marked to market and the recording of realized losses. Similarly, Cryptocurrency is considered a non-admitted asset under the NAIC accounting practices. INT 21-01. Insurers may have been able to invest in cryptocurrencies under provisions of the investment basket clause in their state insurance investment statutes, but would only be able to admit the value of the cryptocurrency if the Insurer received a permitted accounting practice from its domiciliary regulator. We are unaware of any such permitted practices having been granted.

While the FDIC has indicated that all depositors will be protected, it remains to be seen how SVB's Insolvency may impact Insurers' statutory financials. Insurers issuing Qualified Financial Contracts also may be adversely impacted to the extent that they are unsecured debt holders of SIVB or SVB.

**How are the Rating Agencies viewing SVB's Insolvency?**

A. M. Best has these observations.

SVB Collapse Highlights Critical Lessons for the Insurance Industry," states that just eight U.S. insurers have bond exposures greater than 2% of their capital and surplus, with the maximum being less than 5%. Whether these bonds will become impaired remains to be seen. The ramifications for equity portfolios could be more significant, according to the commentary, as some major bank stocks already have lost significant value. Five U.S. insurers have equity exposures concentrated in the broader bank and trust sector greater than their capital, and 17 have exposures totaling at least half their capital.

Many insurers depend on banks for operational aspects, but generally are not as vulnerable to bank run-on scenarios, although they can occur as we've seen in the past and emphasize the importance of a robust risk management structure, especially for annuity writers in a rising interest rate environment," said Jason Hopper, associate director, industry research and analytics, AM Best. "Insurers that conduct detailed analysis on the impact of rising interest rates on their asset-liability portfolios and manage their impacts through capital and other risk management tools will fare better in those events than those that are less well-managed.

Best's Commentary: "SVB Collapse Highlights Critical Lessons for Insurance Industry," March 14, 2023.

The ripple effect of SVB's Insolvency may include other banks, thus possibly expanding the insurance industry's exposure. Rating agencies are reviewing other banks for possible similar issues.

Please contact Paige D. Waters or Norris Clark if you have any questions or if we can be of any assistance.

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