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New York City Bankruptcy Conference

Bank Issues

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Banking in 2023 | Today's Panel



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Agenda

- I. Overview of Banking Issues & FDIC
- II. Overview of Receivership Powers
- III. Market Conditions
- IV. Regulatory Environment
- V. Q&A

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I. Overview of Banking Issues & FDIC

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Timeline of Bank Failures

Key drivers of the **GFC**:

- Rising interest rates
- Subprime mortgage crisis
- Excessive risk taking among banks

Key drivers of the **2023 Banking Crisis**:

- Rising interest rates
- Held-To-Maturity losses
- Yield curve inversion

Jul '08

Aug '09

Jul '08: IndyMac collapses. The bank underwrote Alt-A mortgages using bank deposits as funding. IndyMac experienced a **bank run** and was seized by regulators shortly after

Sep '08: Regulators seize WaMu and arrange a sale of assets to JP Morgan Chase. The largest bank failure in US history at the time. Failed due to collapse of MBS market and overexpansion

Aug '09: Colonial Bank was seized by regulators due to mortgage fraud and major exposure to real estate lending. This was the largest bank failure of 2009

Source: FDIC

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Timeline of Bank Failures (cont.)

Feb 24: KPMG signs audit report giving SVB a **clean bill of health** for 2022

Mar 10: SVB shares **halted premarket**. Fed regulators take control of SVB before open

Mar 12: Fed regulators take control of a second bank, **Signature Bank**

Mar 13: President Biden speaks publicly to restore confidence

Mar 15: Credit Suisse shares decline on contagion spreading across the Atlantic. US Regional banks slide as First Republic Bank (FRC) is downgraded to junk

Mar 17: FRC shares plunge again. **SVB's parent company files for Chapter 11**

Feb '23

Mar '23

Mar 8-9: SVB books a **\$1.8 billion loss** after selling investments to cover increasing withdrawals. **SVB stock crashes** when markets open on Mar 9. **Silvergate Bank** announces voluntary winddown

Mar 11-12: Tech startups scramble over the weekend to line up funding for payroll and operations as deposits are locked up

Mar 14: Justice Department and SEC investigate SVB's collapse, separately

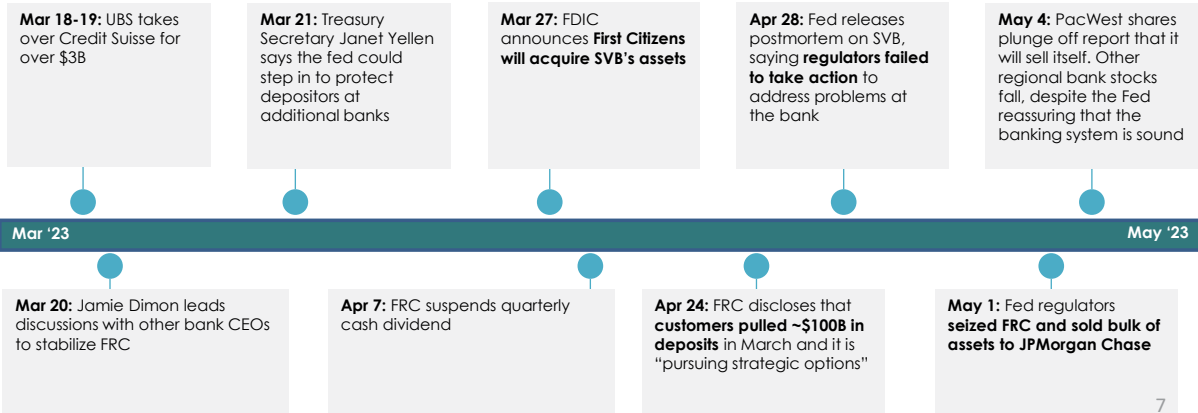
Mar 16: Credit Suisse shares jump after borrowing 50B Swiss Franc to shore up finances. FRC shares jump after news of the large bank's rescue plan

Source: WSJ

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Timeline of Bank Failures (cont.)

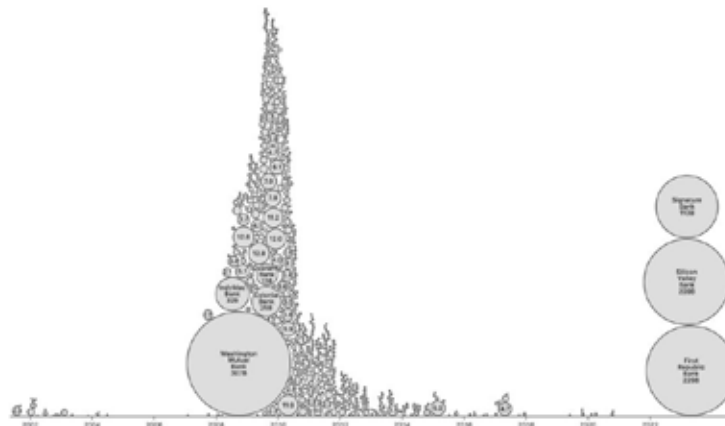


Source: WSJ

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Bank Failures Since 2000

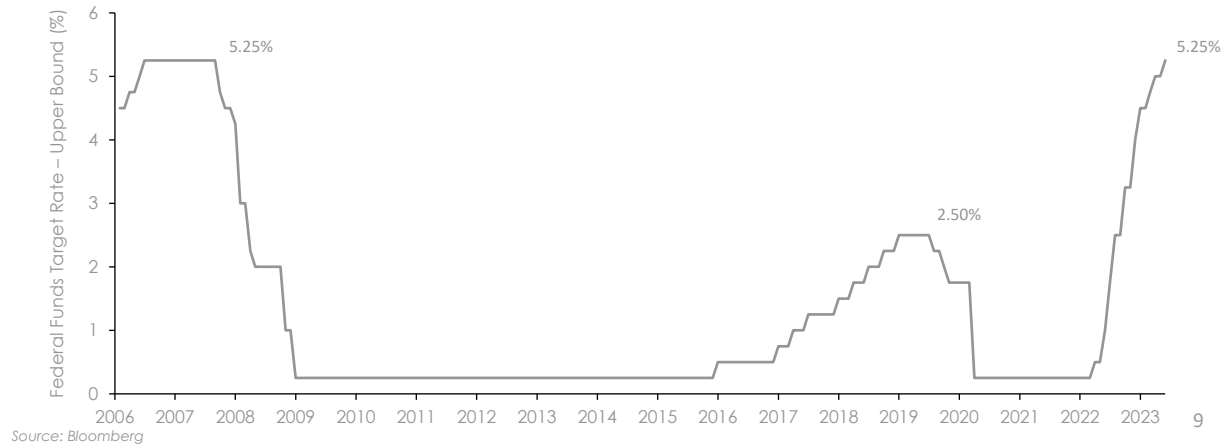


Source: FDIC.gov

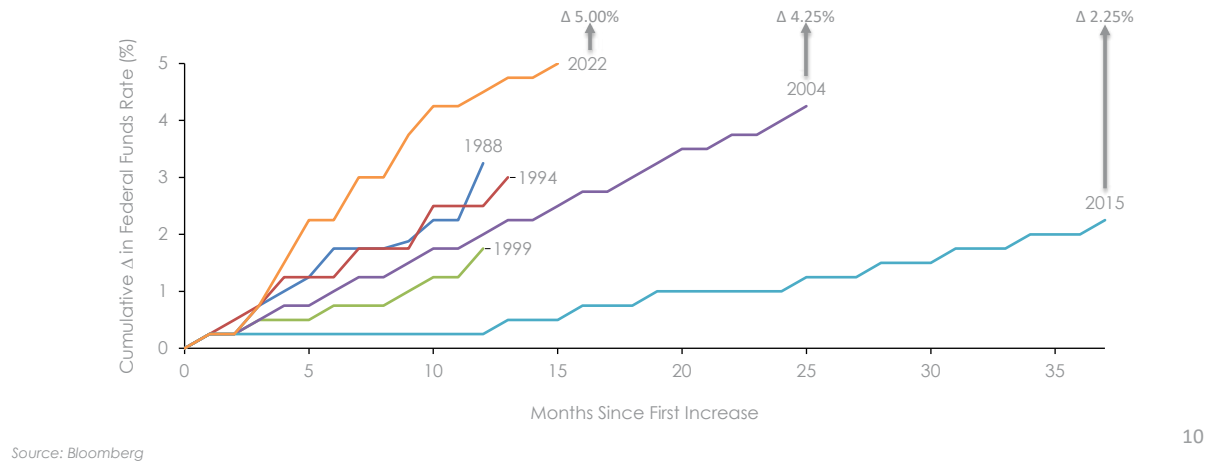
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Interest Rate Hikes Since 2006



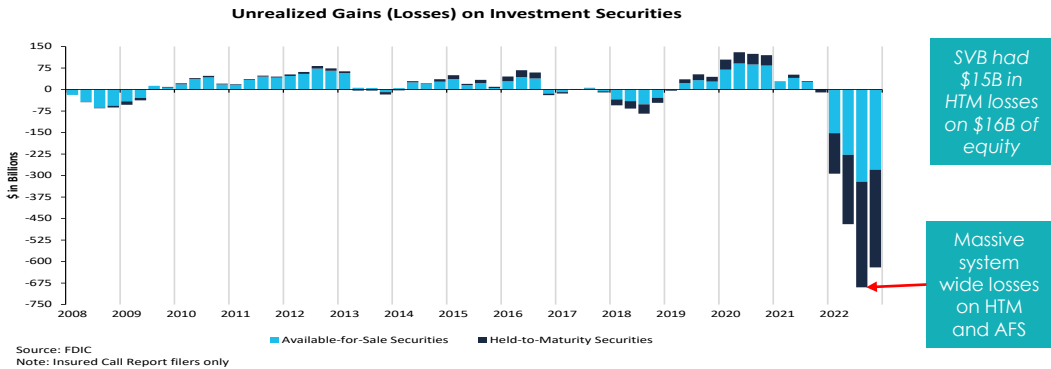
Historical Federal Fund Rate Increases





Unrealized Losses for Banks?

- Held to Maturity Securities ("HTM") recorded at cost – unrealized losses do not impact the income statement
- Available for Sale Securities ("AFS") recorded at fair value but not via the income statement



Unrealized losses on HTM and AFS securities are approaching \$700B across the banking system

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FDIC – Program To Insure Depositors

Maintains stability and public confidence in the US financial system through the Deposit Insurance Fund (DIF)

- Primary objectives
 - Insure deposits and protect the depositors of insured banking institutions
 - Resolve and assist failed banks
- Two sources of funding
 - **Assessments**, or insurance premiums, on FDIC-insured institutions
 - **Interest earned** on funds invested in U.S. government obligations
- Fund management
 - Maintain a level to uphold public confidence
 - Dodd-Frank Act (2010) – set requirements for the Designed Reserve Ratio (DRR) and redefined the assessment base
 - **DRR** = DIF / Total Estimated Insured Deposits. DRR is set to **2.0%**
 - **Assessment Base** = (Average consolidated total assets – Average tangible equity)
 - Bank's pay assessments on **total liabilities**, not on only insured deposits
 - Average tangible equity = (Average common stockholders' equity – Annual average goodwill – Average identifiable intangible assets)

Source: FDIC.gov

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FDIC – Insurance Premium For Banks

DIF is maintained through **quarterly assessments** on insured banks: Assessment rate * Assessment base

- Small banks (Less than \$10 billion in assets)
 - Assigned an individual rate based on a formula using financial data and CAMELS component ratings:
 - Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity
- Large banks (\$10 billion or more in assets)
 - Assigned an individual rate based on a scorecard
 - There are two versions of the scorecard: one for most large institutions and a second for highly complex institutions
 - Combine the following measures:
 - CAMELS component ratings, financial measures used to measure bank's ability to withstand asset and funding related stress, and a measure of loss severity that measures potential losses to FDIC in the event of a failure
- Subject to adjustments
 - Decrease for issuance of long-term unsecured debt
 - Increase for holdings of long-term unsecured/subordinated debt issued by other insured banks
 - For banks that are not well-capitalized or well-rated, increase for significant holdings of brokered deposits

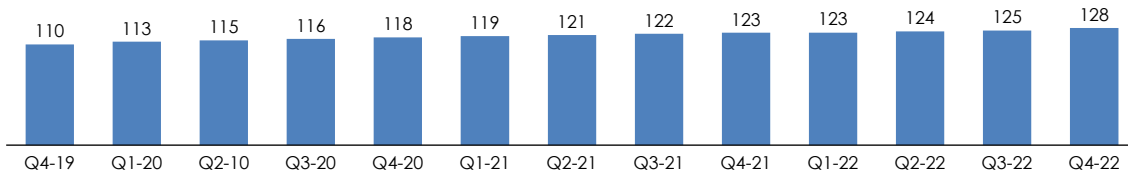
Source: FDIC.gov

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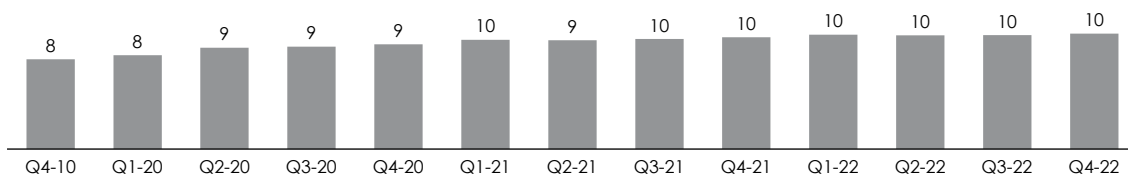


FDIC – Program To Insure Depositors

DIF Balance (\$, Billions)



DIF – Insured Deposits (\$, Trillions)



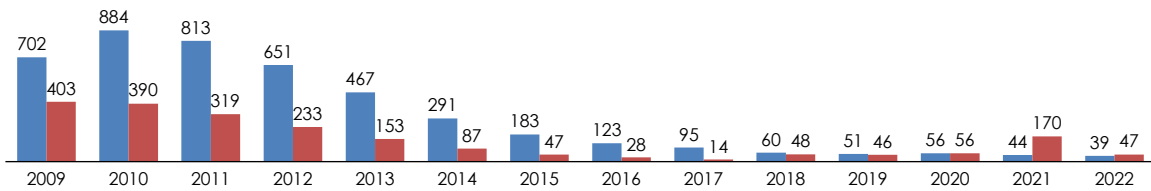
Source: FDIC.gov

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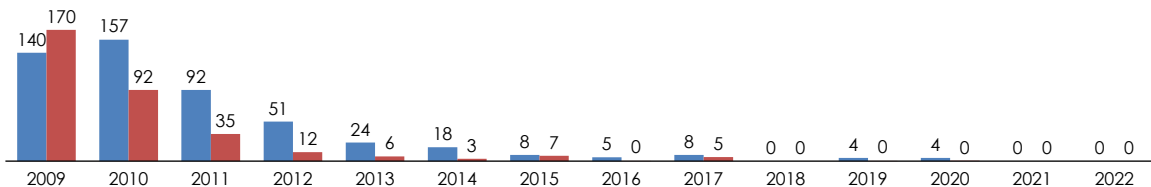


FDIC – Program To Insure Depositors

Problem Institutions



Failed Institutions



Source: FDIC.gov

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II. Receivership Powers & Flexibility



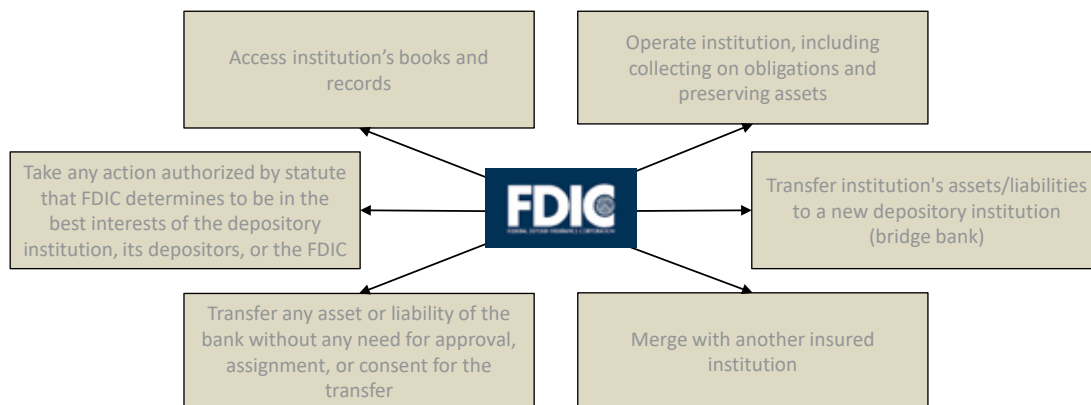
Overview of Receivership Powers/Flexibility

- How does FDIC make decisions to put into receivership
- How do claims work: priority and claims process
- Single point of entry
- Operational issues from Holdco/bank being in separate processes

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FDIC Powers as a Receiver



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Claims Process

- FDIC has broad powers to establish claim filing and review procedures
- Courts lack subject matter jurisdiction to intervene in the process or hear claims before the claimholder goes through the claims process
- Mandatory timeframes / deadlines:
 - Deadline to submit proofs of claim (not less than 90 days after notice)
 - FDIC has 180 days to decide whether to allow or disallow
- Failure to file a claim results in mandatory disallowance

Claims Priority

1. Secured claims / Claims for funds held in trust
2. Administrative costs
3. Deposit liabilities
4. Other general or senior liabilities of the bank
5. Subordinated obligations
6. Equity holder claims

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Single Point of Entry Overview

- Under the Dodd-Frank Act, FDIC can place a financial institution into an FDIC receivership process
 - Fall back to bankruptcy if determined that a bankruptcy would have serious adverse effects on U.S. financial stability
- FDIC developed SPOE strategy as potential tool in such situations
 - Would place bank holding company into receivership
 - Would hold shareholders, debt holder, management of holding company accountable for failure
 - Operating subsidiaries would remain open to avoid systemic contagion

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III. Market Conditions

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Bank Term Loan Program – Mar 2023

- To provide liquidity to U.S. depository institutions, each Federal Reserve Bank would make advances to eligible borrowers, taking as collateral certain types of securities
 - Many of the securities that would be collateral (e.g., long term treasuries) could not be sold for par today given current rate environment
 - Rate is one-year overnight index swap rate plus 10 basis points
 - Eligible collateral is any collateral eligible for purchase by the Federal Reserve banks in open market operations (so long as owned by borrower on 3/12/2023)
 - Collateral valued at par, with margin = 100% of par value
- Department of the Treasury will make available up to \$25 billion from the Exchange Stabilization Fund as a backstop for the BTFP
- Depository institutions may obtain liquidity against a wide range of collateral through the discount window
- Program Duration: Advances can be requested under the Program until March 11th, 2024

Source: [federalreserve.gov](https://www.federalreserve.gov)

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Federal Home Loan Banking

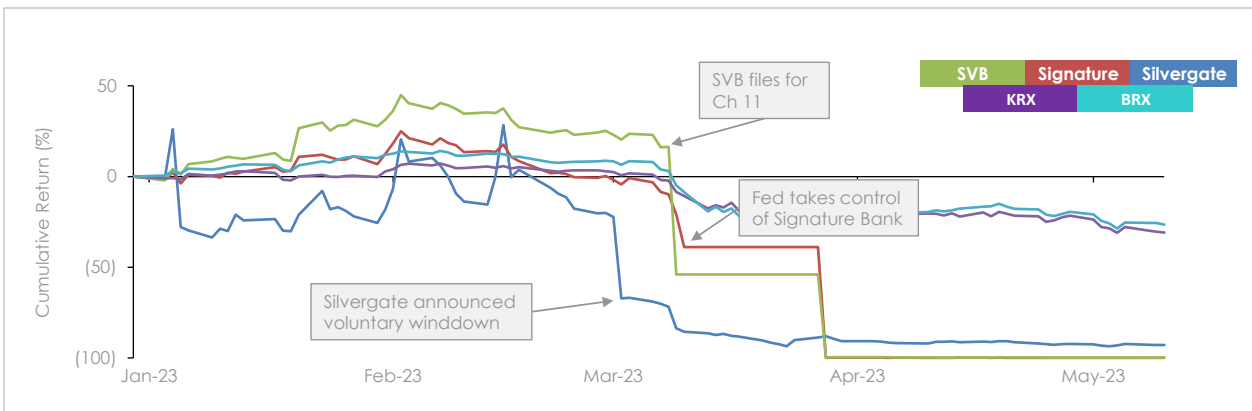
- The FHLB is defined as a funding source for a variety of mortgage products, including those focused on very low- and low- and moderate- income households
 - Advances help members originate mortgages that they want to hold in portfolio or sell later
- Silicon Valley Bank, Signature Bank and Silvergate Bank were among the largest borrowers last year of the FHLB
 - The three failed banks received a combined \$30.6B from the FHLB last year
- Other banks with interest rate-related strains were among the largest borrowers of the FHLB System last year, including First Republic Bank and Charles Schwab
- The \$1.2T FHLB System has pumped nearly \$500B into the banking industry so far this year

Source: Bloomberg

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Regional Bank Stock Performance



Source: Yahoo Finance

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Goldman Sachs US Financial Conditions Index



Falling value indicates loosening, and rising value indicates tightening. The historical index average is 100 points

Source: reuters.com

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IV. Current Regulatory Environment



Deposit Insurance

FDIC's report on deposit insurance system and call for "targeted" coverage reform. Trends in uninsured deposits have increased the exposure of the banking system to bank runs. Technological changes may increase the risk of bank runs

A primary objective of deposit insurance is to promote financial stability

- **Limited Coverage:** maintains the current structure
- **Unlimited Coverage:** provides unlimited deposit insurance
- **Targeted Coverage:** allows for different levels of deposit insurance coverage across different types of accounts; higher coverage for business payment accounts; possibility that some account types receive unlimited coverage, while others do not

Recently, congress has discussed the possibility of private insurance of deposits

Source: fdic.gov

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Dimon 9 Point Plan

1. We want to strengthen regional, midsized & community banks, which are essential to American economic system
2. We need large, complex banks to continue to play a critical role in the U.S. and global financial system
3. We should want a system in which a bank failure does not cause undue panic and financial harm
4. We want proper transparency and strong regulations
5. We should want market makers to have the ability to effectively intermediate
6. We need banks to be there for their clients in tough times
7. Regulation, particularly stress testing, should be more thoughtful and forward looking
8. We should decide *a priori* what should stay in the regulatory system and what shouldn't
9. We need banks to be attractive investments

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Recent Government Intervention



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Regulatory Response

Key Bank Issues:

- Rate increases:** The Fed has engaged in an aggressive tightening campaign, raising rates from near 0% to 5%+ in 16 months (the quickest pace since the 1980s)
- Duration mismatch:** Banks invested in longer term treasuries at ultra-low interest rates. Once rates increased, those securities portfolios declined in value (the now-well known "HTM losses")
- Management missteps:** Large banks (\$50B+ in assets) are required to have a risk committee that reports to the Board. In several instances, these committees appear to have lacked proper experience and have not provided appropriate oversight. In particular—and despite obvious risks—several banks engaged in the unhedged "invest long", "borrow short" strategy that took down SVB. HTM losses as well as other issues (often related, including in bank's commercial real estate lending portfolios), will likely continue to impact the market in the months and quarters to come

Leads to:

- Management claw backs:** The Senate Banking Committee is exploring how it can strengthen its claw back powers. The committee is focusing on bank executives' compensation, specifically during the five years leading up to the failure

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V. Q&A

Faculty

Hon. Lisa G. Beckerman is a U.S. Bankruptcy Judge, sworn in on Feb. 26, 2021. From May 1999 until she was appointed to the bench, she was a partner in the financial restructuring group at Akin Gump Strauss Hauer & Feld LLP. From September 1989 until May 1999, she was an associate and then a partner in the bankruptcy group at Stroock & Stroock & Lavan LLP. Prior to her appointment, Judge Beckerman served as a co-chair of the Executive Committee of UJA-Federation of New York's Bankruptcy and Reorganization Group, as co-chair and as a member of the Advisory Board of ABI's New York City Bankruptcy Conference, and as a member of ABI's Board of Directors of from 2013-19. She is a Fellow and a member of the board of directors of the American College of Bankruptcy and a member of the National Conference of Bankruptcy Judges (NCBJ) and the 2021 NCBJ Education Committee. She also is a member of the Dean's Advisory Board for Boston University School of Law. Judge Beckerman received her A.B. from University of Chicago in 1984, her M.B.A. from the University of Texas in 1986 and her J.D. from Boston University in 1989.

Christian P. Jensen is an associate in the New York office of Sullivan & Cromwell LLP, where he focuses on credit and leveraged finance and restructuring. He began working for the firm as a summer associate. Previously, Mr. Jensen was a paralegal with Loeb & Loeb LLP and a compliance manager with Aura International Manufacturing, Inc. He received his B.A. in 2009 from Haverford College, his M.B.A. in 2015 from Columbia University and his J.D. in 2015 from Columbia Law School.

Ryan Kielty is a partner at Centerview Partners in New York, where he focuses on corporate finance, private equity and capital markets. He previously was an analyst and associate at Miller Buckfire. Mr. Kielty received his undergraduate degree from Villanova University.

Tanya Meerovich, CFA, CFE, CIRA, CTP is a senior managing director with FTI Consulting, Inc. in New York and specializes in providing financial and strategic solutions to companies, their creditors and investors. She has worked with both public and private companies across many sectors. Ms. Meerovich has industry expertise in the financial services, real estate, nonprofit, insurance, health care, education, energy, manufacturing, infrastructure, print, entertainment and retail industries. Her advisory services include assisting senior management teams and various stakeholders in developing and implementing strategic alternatives, revenue enhancement initiatives and cost-reduction initiatives. In addition, she has experience in the review and assessment of business plans and financial models, preparation of financial projections and cash-flow models, financial analysis, cash management, asset management and liquidation, claims analysis, fraud investigations and forensic accounting. Ms. Meerovich's recent engagements include advising management teams and boards of AG Mortgage Investment Trust Inc, the Government Development Bank of Puerto Rico, Impac Mortgage, MFA Financial, Ocwen Financial, Puerto Rico Highways and Transportation Authority, Residential Capital (ResCap), Three Lions Entertainment, Workflow Management and several mortgage REITs. She also has advised senior secured lenders. Prior to joining FTI Consulting, Ms. Meerovich was in the Financial Services Advisory group of RSM Cayman Islands, where she was involved in a number of high-profile and complex cross-border insolvency engagements in the financial services sector. Prior to that, she worked for a securities broker-dealer in the Chicago area. Ms. Meerovich

previously held NASD Series 24, 7 and 63 licenses and served on several boards, including the New York Chapter of the International Women's Insolvency & Restructuring Confederation and Rock & Rawhide, a nonprofit organization. She is a member of ABI, the Association for Financial Professionals, the Association of Certified Fraud Examiners, the Association of Insolvency & Restructuring Advisors, the Chartered Financial Analyst Institute, the New York Society of Security Analysts and the Turnaround Management Association. Ms. Meerovich received her B.S. in finance and business management from Roosevelt University.

Mark A. Renzi is a member of Berkeley Research Group, LLC Corporate Finance in Boston and specializes in performance improvement and restructurings. He has more than 20 years of business experience, with approximately 16 years of financial consulting experience, including liquidity and capital structure assessment, debt and equity restructuring advice, and identification of reorganization alternatives. Mr. Renzi has experience across a broad range of industries, including financial services, retail and consumer products, metals, manufacturing, health care, chemical, oil and gas, and telecommunications. He has provided restructuring services on more than 35 engagements in both out-of-court workout situations and chapter 11 proceedings. Further, he has advised distressed companies with day-to-day management activities, including development of *pro forma* financials, cash-flow management, cost rationalization, and identification of liquidity enhancing activities. He also has provided restructuring advice to portfolio companies of private-equity firms and has served in interim management positions. Mr. Renzi is experienced in analyzing and implementing strategic and operational change, including the refinement of business plans and redeployment of capital to address changing industry conditions, as well as stabilizing and fixing noncore operations through product and customer rationalization initiatives. He has developed options and solutions through detailed financial and operational analyses while collaborating closely with management and other stakeholders. In addition to operational turnarounds, he has assisted in financial restructurings, including refinancings, recapitalizations, debt-for-equity swaps, and strategic mergers and acquisitions. Previously, Mr. Renzi was a senior managing director at a global business advisory firm with a 15-year tenure. He also worked at a boutique money management firm in New York evaluating equity and commodity derivative portfolios, and he held various positions in FP&A, business plan development, treasury and global cash management. Mr. Renzi received his B.A. in economics from Washington College and his M.S. in finance from Boston College.

Benjamin M. Rhode is a partner in Ropes & Gray LLP's business restructuring group in New York, where his practice focuses on all aspects of corporate restructuring, bankruptcy and insolvency proceedings. He advises public and private companies, boards, financial sponsors and distressed investors in complex domestic and international distressed situations, including out-of-court liability management transactions, in-court chapter 11 proceedings and distressed acquisitions. Mr. Rhode's experience spans a broad range of industries, including automotive, retail, oil and gas, health care, communications, gaming, and media and entertainment. He received his B.S. with great distinction in 2007 from Clarkson University and his J.D. *magna cum laude* in 2012 from Cornell Law School, where he was admitted to the Order of the Coif.

Todd R. Snyder is a managing director and global head of Restructuring at Piper Sandler Companies restructuring group, TRS Advisors, in New York. Prior to joining the firm, he was CEO at TRS Advisors and executive vice chairman of Rothschild & Co., as well as co-head of its North American re-

structuring advisory business. Prior to that, Mr. Snyder was a managing director in the restructuring and reorganization group at Peter J. Solomon Co. and a managing director at KPMG Peat Marwick in its corporate recovery group, where he also served as national director of its corporate recovery practice for government enterprises. Before making the move to investment banking, he practiced law in the business reorganization department of Weil, Gotshal & Manges. Mr. Snyder was a commissioner of the New York State Gaming Commission and a member of New York State's financial restructuring board for local governments. He serves as a director of Amplify Energy Corp and previously served as a director of Midstates Petroleum Co., Inc., GenCorp Inc., AMC Financial, Inc. and EcoStim Energy Solutions. Mr. Snyder currently serves as trustee for nonprofit organizations Bowery Residents Committee and Shining Hope for Communities. He received his B.A. in religious studies in 1984 from Wesleyan University and his J.D. in 1988 from the University of Pennsylvania Carey Law School.

Michael H. Torkin is a partner with Simpson Thacher & Bartlett LLP in its Restructuring Practice in New York, and he founded the firm's Private Capital and Special Situations Investment Group. His multidisciplinary practice includes representing companies on liability management, recapitalization and restructuring transactions, both in and out of court, domestically and internationally. He also routinely represents sponsors, acquirers of distressed businesses, and hedge fund and private-equity fund clients in connection with a broad array of special-situation investments and recapitalization transactions. During his career, Mr. Torkin has been involved in restructuring matters across the globe, including Canada, Latin American, Mexico, the U.K., Israel, Africa, The Netherlands and Australia. His practice has included the representation of numerous private-equity and hedge fund clients, including Angelo Gordon, The Blackstone Group, The Carlyle Group, Chambers Energy Partners, Charterhouse, First Reserve, KKR Credit, Platinum Equity, Pointstate Capital, Primavera Capital Group, Riverstone and Silver Lake Partners, as well as corporates on an array of transactions. Mr. Torkin is ranked as a leading lawyer by *Chambers USA* and by *Chambers Global* and *The Legal 500 United States*, and he was recognized by The M&A Advisor as one of the top "40 under 40" M&A, financing and turnaround professionals in 2010 and by *Turnarounds & Workouts* as one of 12 "Outstanding Young Restructuring Lawyers" in 2009 and 2010. He is a member of ABI and the Turnaround Management Association. Mr. Torkin received his B.A. in 1993 from the University of Western Ontario and his J.D. in 1997 from Osgoode Hall Law School.