Lessons Learned from the Regional Banking Crisis[1]

By Mitchell Heyland and Javier Martinez

The panel opened by sharing perspectives of what it was like being at banks directly impacted in March (and the law firms working for those banks) and followed with lessons learned, chief of which was the resiliency of the industry. The panelists more specifically explored the following:

- **What were the key concerns for funds during those first few days of the crisis?** It wasn't just subscription line facilities that were impacted, these banks were involved in every aspect of the fund finance ecosystem and were the primary and sometimes sole banking relationship for many VC and other private capital funds. One of the biggest initial concerns was payroll funding and whether they would be able to access the necessary cash from accounts and lines of credit. There was also general confusion about the status of existing loan facilities with impacted banks, and a reluctance to fund anything into accounts held at these institutions or fund advances to these banks when serving as agent and in receivership. Many funds exercised borrowing requests under impacted facilities to test whether the banks in receivership would fund and they did.

- **What were the key concerns for other lenders and agents during this time?** From the banks' perspective, the primary concern was ensuring clients had access to liquidity via their credit facilities. This entailed detailed risk analysis on the exposure to any bank in receivership as a syndicate lender, as agent, and as deposit bank for collateral accounts. There was also a continual monitoring of other lenders and an updating of this exposure as additional institutions were impacted. While always important, open lines of communication among borrowers, lenders, and lawyers was essential to ensure liquidity needs were able to be met.

- **What about for the lawyers?** The first task was understanding the scope of the problem. The broad powers of the FDIC was quickly identified as a major issue. The next issue was keeping up with the ever-changing flow of information and landscape. Finally, law firms were making sure consistent and correct information was being shared and answering specific client questions. Many of us lived and worked on deals and advised clients during the 2008 financial crisis, but that was very different from what happened last March. One major difference is simply the speed at which things moved this time around. More experienced practitioners at firms that dealt with FDIC-specific issues in the late 1980s Savings and Loan crisis were also able to lend their expertise. The information was coming from multiple sources and was often piecemeal and incomplete or ambiguous. Many of the questions from clients were not of a legal nature, but they were looking for comfort and market intelligence on what law firms were seeing. We were also reminded of the value of relationships in the industry, not just between borrowers and

[1] The panelists were Thomas Byrne, Managing Group Director at Signature Bank, Michael Franks, Head of Alternative Asset Banking Group at Citizens Private Bank, Catherine Gylfe, Director at Sumitomo Mitsui Banking Corporation, Aditi Iyer, Partner at Kirkland, and Javier Martinez, Partner at Haynes and Boone, LLP.

agent and lenders but among all parties. Law firms were talking to other law firms and everyone was sharing information and working towards the same goal of stability.

- **What has changed in the industry since last March?**

  1. From sponsors there has been an intensified focus on more diversified lender bases and lender/banking relationships, especially looking for lenders with flexibility in deposit requirements.

  2. There has also been a subtle shift towards GSIB banks. However, there are still several existing and new regional lenders offering flexible and creative products, with a focus on customer service. The shift towards GSIB banks is in part driven by the underlying LPs, especially foreign LPs, and their nervousness surrounding regional banks.

  3. In the loan documents there has been a lot of attention on flexibility particularly with respect to collateral accounts, requirements for account banks, and processes for creating new accounts and designating new account banks.

  4. Given supply/demand imbalance, lenders are being more selective on which sponsors to onboard, which is typically driven by the broader bank/sponsor relationship and the ancillary opportunities available.

  5. Co-invest programs, management fee lines, and other non-subline fund finance products have been even more disrupted, as several of the impacted banks were the most prominent lenders for those facilities. The market is working to fill this void, but it will take some time for new lenders to build up the infrastructure and internal support to administer these programs in a cost-efficient manner for all parties.

Perhaps what is most interesting is what has not changed. The regional banking crisis last year did not lead to a fundamental change in how these deals are structured or material impairment of the industry. The impacted banks were not impacted because of any inherent weakness in these products, as evidenced by the near par sale price of the Signature Bank fund finance portfolio last summer. The industry pulled together, took a measured approach, and stabilized quickly.