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LEGAL UPDATES AND NEWS

Considerations for Credit Unions in the Wake of Second and Third Largest Bank Failures in U.S. History

In the immediate wake of the failures of Silicon Valley Bank, the second largest bank failure in U.S. history, and Signature Bank, the third largest bank failure in U.S. history, below are some steps and considerations when assessing the failures and related fallout. Notably, the failures of Silicon Valley Bank and Signature Bank were not generally related to their credit quality, but to their liquidity and business models. Regardless of how different your institution may be from Silicon Valley Bank or Signature Bank, you should consider how these bank failures may impact your credit union.

In reaction to these two bank failures, the U.S Department of the Treasury, the Federal Reserve and the FDIC recently issued a joint statement announcing two significant responses. First, all depositors of Silicon Valley Bank and Signature Bank will have access to their funds, including their uninsured deposits. Second, the Federal Reserve has established a new liquidity program – the Bank Term Funding Program (BTFP). Under the BTFP, institutions can receive a loan of up to one year in length from the Federal Reserve by pledging certain collateral eligible to be purchased by the Federal Reserve in open market operations, such as U.S Treasuries, U.S. agency securities and U.S. agency mortgage-backed securities. These assets will be valued at par. Credit unions are eligible to participate in the BTFP.

The Term Sheet for accessing the BTFP can be found here: https://www.federalreserve.gov/newsevents/pressreleases/files/monetary20230312a1.pdf

The FAQ related to the BTFP can be found here: www.federalreserve.gov/monetarypolicy/files/bank-term-funding-program-faqs.pdf

The definition of eligible collateral, as used in the BTFP, can be found under 12 CFR 201.108(b) here - CFR-2022-title12-vol2-sec201-108.pdf (govinfo.gov)

What Steps Should a Credit Union Take Right Now?

Internal and External Communications. If you have not already, you should communicate talking points to your customer-facing credit union team and to all employees and directors. As applicable, credit unions should emphasize to their customers their strong liquidity position: *i.e.,* a strong capital position; cash and cash equivalents; borrowings capacity from the Federal Reserve and/or the FHLB, as applicable; and correspondent banking relationships. The communication could also address how you are different from Silicon Valley Bank and Signature Bank, such as most of your credit union's share accounts are insured, your credit union has a diversified membership base, and/or that your credit union does not have deposits, loans or equity investments related to digital assets/cryptocurrency or fintech.

You should also consider an external communication aimed specifically at credit union members that addresses the items discussed above. These communications should also be posted on your website and through social media, as applicable. This type of release should be discussed and reviewed with counsel.

Consider Getting Pre-Approved to Issue Subordinated Debt Immediately. Although the business models of Silicon Valley Bank and Signature Bank were not representative of the credit union industry, the issues that contributed to their failures – underwater securities portfolios, deposit flow and pricing pressures due to adverse current market conditions – are ones that may impact several credit unions. In a rising interest rate environment, liquidity is a significant risk to the financial condition of credit unions, particularly when member shares are their primary funding source. Considering the foregoing, getting pre-approved by the NCUA to issue subordinated debt may be a prudent step so that your credit union can access the capital markets to gain liquidity and strengthen its balance sheet and net worth and risk-based capital ratios.

Subordinated debt is a borrowing or series of borrowings issued by a credit union to certain qualifying investors (such as other credit unions). If the terms of the borrowing satisfy the requirements and restrictions of the NCUA rules, it is treated as regulatory capital. To be eligible to issue subordinated debt, a credit union must (1) either be a low-income designated credit union or, if not low-income designated, have an asset size exceeding $500 million and a risk-based net worth greater than 6%; and (2) not be an "investor" in any credit union subordinated debt. Eligible credit unions must apply and receive pre-approval form the NCUA before issuing subordinated debt. Once pre-approved, an eligible credit union will have a two-year window to issue the subordinated debt without any further approvals from the NCUA.

More information about subordinated debt can be found here: White Paper - NCUA Subordinated Debt Final Rule

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