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Bank Failures Lead to Uncertainty in Cash Management Arrangements

Many segments of the commercial lending and finance markets require cash management structures on their loans. As the immediate questions about existing accounts at failed banks are starting to be addressed, these lenders will face additional questions and concerns over the coming days and weeks regarding disruptions in cash flow and continuity of cash management on their loans as the Silicon Valley Bank and Signature bank failures continue to unfold. These cash management structures generally require borrowers to deposit all revenue from the collateral for the loan into lender-controlled accounts, either upon origination of the loans or opening upon the occurrence of a later event set forth in the governing loan documents (i.e., the account “springing into existence” at such time). This allows the lender to control revenue from the collateral and ensure cash flow is applied to mortgage payments, operating expenses and lender-imposed reserves.

Signature Bank was a significant provider of these cash management services, and the bridge bank the FDIC formed to assume substantially all of Signature Bank’s assets is taking steps to assure that operations are business as usual – including the safety of existing accounts and the ability to open new ones. As lenders evaluate the impact on long-term servicing operations, and the ability for cash management services to resume and continue uninterrupted, lenders are reviewing their loan documents to understand their rights and ability to alter current cash management arrangements if such changes become necessary. Lenders are prioritizing addressing the impact on cash management arrangements for existing loans and loans that are imminently closing, while assessing the implications for future loans. Many market participants are likely evaluating their long-term options as immediate market liquidity concerns have died down, while also keeping a careful eye on what cash management service options may unfold.

The questions raised by the bank failures are complex. The solutions will need to balance competing interests. These interests include the efficiencies for borrowers with springing accounts and the efficiencies and protections for lenders with accounts opened at loan origination. They also include the credit ratings of the banks holding the accounts and the availability of the highest rated banks to perform such services. In the near term, lenders with loans impacted by recent market events that elect to alter current cash management arrangements might consider the following actions:

- Transferring these services to other bank(s) that provide cash management services. The successor bank's capacity and resources available to effectively provide these services should be carefully considered. Many loan documents require a minimum credit rating for the bank holding the accounts. With many affected lenders, there could be limited banks that satisfy the required ratings and have the resources to effectively assume these accounts.
- Evaluating the applicable loan documents to determine what actions can be taken unilaterally by a lender and which will need the borrower's cooperation. Before acting, lenders would be prudent to ensure strict compliance with its obligations under the loan documents, particularly in this context where, more often than not, the borrower and lender have aligned interests in quickly and efficiently determining the long-term solution for the cash management accounts.

Frost Brown Todd will be continually monitoring these financial institution failures and the Treasury Department, FDIC and Federal Reserve Bank's actions. We will provide additional information as it becomes available. To provide guidance and support to clients with exposure to these failed institutions and the evolving situation and concern over other similar financial institution failures, Frost Brown Todd has established a Failed-Bank Response Team.

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