



DC Deep Dive: Failing Banks

In this month's CivicPoint DC Deep Dive, Jonathan Miller interviews Nathan Berger, Frost Brown Todd's expert on bank regulatory issues about the genesis of recent major bank failures, Capitol Hill's reaction, and the impact on the financial industry.

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Silicon Valley Bank, a bank that is deeply enmeshed in the tech industry, recently went under. There was a run on the bank, and there was a great concern that this could spread to the rest of the industry, leading to a larger collapse. That didn't happen. What was done to prevent that?

The Treasury and the Federal Reserve stepped in and used their emergency powers to prevent a larger collapse. The FDIC formed bridge banks for SVB and Signature bank, meaning that the FDIC assumed the deposits and purchased all of the assets of those organizations so that the depositors wouldn't incur any loss.

The federal reserve's funding program also helped prevent a larger systemic failure. All of this began when the Fed started raising rates. Banks assets are loans and investments. The Federal Reserve's funding program allows banks to borrow against the full par value of their investments. Every bank that may have been in a fragile liquidity position, had the ability to shore up liquidity in the event there was a run on their bank, and a number of banks took advantage of this.

The Federal Reserve has since admitted that they made some mistakes in the run up to the collapse of SVB. What were those mistakes and what changes might they lead to in the banking industry?

The Fed released a report of over 100 pages. The primary mistake was that the warning signs were there, but no action was taken. Silicon Valley Bank was not in a fragile capital position to fail, but the warning signs existed related to the bank's liquidity. The mistake that the federal reserve has admitted to was that they were not strict enough in taking action with the management team at SVB to guide them back to a more stable liquidity position. Moving forward, all banks will likely have their balance sheets and liquidity under a microscope because, in the current environment, liquidity becomes the most important aspect of their balance sheet and their financial statements.

Will anything happen related to changing laws that would attempt to deal with this proactively?

There is a lot of effort from Democrats to change the law, but with a divided congress, there will likely be no action. There will likely be efforts to increase the Federal Deposit insurance limit. There may be efforts to reimplement the strict guidelines and stress testing required of large financial institutions from the Dodd Frank Act. Alternatively, bank regulators will definitely be more strict with all banks.

Silicon Valley Bank was not the end- We most recently saw the failure of First Republic Bank which was then purchased by JP Morgan. How is this different and will we see more failures in the near term?

Most analysts believe that the remainder of the large banks will be spared from failure. Though somewhat different, Silicon Valley, Signature, and First Republic were very similar from a financial perspective. All of the banks had large numbers of uninsured deposits. There are other banks out there that have a lot of unrealized losses in their health and securities portfolios, but they don't have nearly the number of uninsured deposits and usually they have more customers with smaller deposits. Most analysts

believe First Republic was the last remaining bank with such an extreme balance sheet.

What is recommended for clients to avoid the fate of Silicon Valley and First Republic and to deal with this extra scrutiny from regulators?

For small to medium sized banks, focus in on liquidity. The next federal and state bank exams will likely key in on that to ensure that if for some reason there is a run on banks, they have the liquidity to meet customer withdrawal demands without bank failure. There's some spill over here in terms of consumer confidence and compliance that will also be heavily scrutinized. Be prepared to answer hard questions and take aggressive action when it's needed.

For larger banks, there's a possibility that those old Dodd Frank requirements that were applied to banks with 50B Billion or more will come back if Congress comes to an agreement.

It is also expected that, if Congress can come to an agreement, there will be more regulation around digital assets.

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