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Bank GCs Shoring Up Against Risks In Wake Of Collapses

By **Sue Reisinger**

Law360 (March 14, 2023, 4:43 PM EDT) -- Although general counsel had little to do with the collapse of three U.S. banks in less than a week — most fingers are pointing at the CEOs, chief financial officers and chief risk officers there — the general counsel are dealing with the fallout, and probably will be for some time, according to several experts.

"This is seismic," Boston University law professor and banking lawyer Cornelius Hurley told Law360 Pulse after the collapse of Silvergate Bank in San Diego six days ago, followed by two larger ones — Silicon Valley Bank in Santa Clara, California, on Friday, and Signature Bank in New York on Sunday.

Hurley, former general counsel of Shawmut National Corp., a regional bank holding company, and an ex-assistant general counsel of the Board of Governors of the Federal Reserve System, added, "It changes the rules of the road going forward."

Several finance lawyers told Law360 they have spent the last 96 hours almost nonstop taking calls from tense general counsel and other corporate executives, both in and out of banking, about what to do next. The speed of the banks' failures and the federal government's rapid response on Sunday night took them by surprise.

"In the digital banking era, a run is shocking and unprecedented," said one Wall Street lawyer who formerly spent 10 years as a division general counsel at a major New York bank. Calling depositors' actions a "social media prairie fire," he said an online run can happen so quickly and there is no margin for error nor time to enact a rescue plan.

Immediately affected were Silicon Valley Bank general counsel Michael Zuckert and Signature Bank general counsel Seth William Stern. They did not return messages seeking comment. Regulators have closed down Signature Bank, but Silicon Valley reopened Monday with a new CEO.

The Federal Deposit Insurance Corp. installed Tim Mayopoulos as the new CEO of the "bridge bank" that is replacing Silicon Valley. He comes with a lawyer's eye, as the former general counsel and CEO of Fannie Mae, and former general counsel of Bank of America.

Meanwhile, the issues that other general counsel and their companies are grappling with can depend on the company, the bank involved and other specific facts. The impact of the failures will be both short-term and long-term, financial and regulatory.

But in general, experts said the key issues fall into common categories:

New Funding

To stabilize the bank run, on Sunday the federal government announced that it would protect all depositors in the Silicon Valley and Signature banks, beyond the usual $250,000 FDIC limit.

Both the banks and corporate investors with funds in those two banks will be examining that move. "You are dealing with this new critical funding source," Hurley explained. "The rules are not written for that yet."

He questioned how the FDIC could assure depositors at those banks that served primarily tech and crypto companies but not at other banks.

"If you are inside counsel, you've got to be looking at that very closely as maybe your primary source of liquidity," Hurley added.

Carl Fornaris, partner and co-chair of the financial services practice in Winston & Strawn LLP's Miami office, told Law360 Pulse that the federal government used the "systemic risk exception" to justify covering deposits at those two failed banks.

Fornaris added that the decision was a legal one, but pointed out that "the systemic risk exception has never been used in the manner the FDIC used it on Sunday night." Also notable, he said, "was the swiftness with which the federal financial agencies responded, underscoring their deep concern with the spread of contagion across the financial markets."

Customer Questions

Many companies were customers of the closed banks, and they are left with numerous questions.

Matthew Bisanz, a partner in Mayer Brown LLP's financial services and regulatory and enforcement practice in Washington, D.C., is another lawyer who spent the last several days answering frantic phone calls and "a lot of questions" from general counsel and CFOs.

Bisanz said questions ranged from the everyday ones about FDIC insurance coverage to how they can draw on a lending facility to what the impact is if one of the failed banks is part of a multibank deal.

Other questions tended to be more specific to the bank and its situation, such as when a transaction is determined to be final, what the legal standard is to reverse a transaction, or what the likelihood of recovery is under certain circumstances.

One effect of the failures, Bisanz said, is that corporations now have heightened due diligence on banking relationships, especially when doing a transaction with a counterparty. "You now ask first, 'Who's your bank?'" he added.

And companies are rethinking how they manage their cash and whether they have resiliency. "In case of a bank failure, earthquake or cyberattack, it is not overkill to have a second checking account at another bank that you could switch to," he advised.

Regulator Scrutiny

Kathryn Judge, the Harvey J. Goldschmid professor of law and vice dean at Columbia Law School, is an expert on banking, financial innovation, financial crises and regulatory architecture. Judge told Law360 Pulse on Tuesday that it is likely the Federal Reserve, Congress and others will review what went so wrong that "the government felt the need to come in and assure that the depositors for both banks were protected in full."

One issue from the general counsel perspective, Judge said, is what the changing regulatory regime will look like, and how supervisory relationships might take on a different tone.

Regulators, she said, are "facing really significant questions if they've been doing an adequate job. We will see more scrutiny by regulators and by Congress in the future."

Hurley agreed, saying that "regulators are rightly being beat up mercilessly for having missed it in Silicon Valley when the handwriting was on wall seven months ago. I think you'll see a wave of enforcement actions."

He said general counsel will also see regulators get tough. "So getting up to speed with how you deal with a more aggressive regulator will be a challenge," Hurley said.

Banking Law Reform

Most of the experts agreed that regulatory reform will be the major fallout from this crisis.

"Already in the last day there's a fierce debate around what if anything should be changed in the regulatory framework," Bisanz noted. "I've seen arguments on both sides. But I haven't studied it yet because I've been responding to the emergency."

He said Signature Bank was exempt from most of these regulations because it was not a bank holding company, and reform would not have helped it. "I think there will be a lot of debate," Bisanz added, "and the regulatory effect will keep the banks busy for a while."

The nonpartisan group Americans for Financial Reform released a statement Monday citing the need "for strict oversight of large banks and the entirety of the financial system." The group criticized changes in 2018 that it said weakened the law.

It also called for strengthening of bank capital and liquidity rules and making use of the Financial Stability Oversight Council and the Office of Financial Research to identify emerging risks, designating firms as systemically important, and properly regulating both banks and nonbanks. "They should also implement the Dodd-Frank mandate to limit executive compensation," the group said.

Judge said it is too early to know what regulatory changes will be made, but "when any bank of good size fails, that suggests we need a more religious regulatory structure and better supervision over banking institutions." She suggested rethinking the regulatory regime around short-term liabilities, which she believes contributed to the run on Silicon Valley.

Another area of concern, Judge said, is the impact of raising interest rates quickly. "It can have an unexpected and unforeseen spillover effect on various parts of the economy, as it did here" on Silicon Valley, she explained.

As the Fed continues to raise rates to fight inflation, "it can reveal sources of fragility," she said. "It is time to be on high alert."

--Editing by Marygrace Anderson.
