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An Emergency Brake for the Age of Instantaneous Bank Runs

Nicholas L. Georgakopoulos

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AN EMERGENCY BRAKE FOR THE AGE OF INSTANTANEOUS BANK RUNS

NICHOLAS L. GEORGAKOPOULOS*

ABSTRACT

Businesses missing payroll because some bank executives made wrong bets about interest rates is the seed of contagion that financial regulation aims to prevent. Yet, exactly that happened when Silicon Valley Bank failed in March of 2023. Future bank runs will be faster and larger. This Article proposes a regime that would prevent bank runs from hurting the nonfinancial economy. A bank experiencing a run should be allowed to delay withdrawal requests until next Monday (after its run will have been addressed by management or regulators). Exceptions should include payroll, deal closings, and individuals' payments under the insured limit. By letting those transactions proceed, contagion would be averted, while the delay would give management and regulators the time to address bank failures.

* Harold R. Woodard Professor of Law, Indiana University Robert H. McKinney School of Law, Indianapolis. I wish to thank Mark Roe and Joe Montel for their important comments and a special thanks to *William & Mary Business Law Review* Associate Editors Spencer Daus-Haberle and Emma Gaiser, and Editor-in-Chief Andrew Olson for the work behind the appendix. I urge you to send your comments to me at ngeorgak@iu.edu.

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INTRODUCTION

With no financial crisis and no widespread concern about the financial system of the United States, three large banks failed in early 2023. Although two failures were orderly, that of Silicon Valley Bank (SVB) was not—its failure prevented payments that harmed the economic system and eroded confidence in it.[1] Banking regulators should consider SVB's disorderly collapse as a clear signal that bank regulations have failed to keep up with changing transaction technology and practices. Future bank runs will only be faster and larger, and they must be addressed by regulation. A simple regulatory change can tame bank runs. Banks should be able to respond to a bank run by orderly delaying some withdrawal requests until the next Monday, giving managers and regulators (primarily the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC)), time to address the run. But payments that would create the danger of a contagion should continue. Payroll, deal closings, and individuals' payments below the FDIC-insured amount should not be interrupted. The FDIC's proposal for targeted coverage of payroll accounts is a step in the right direction, but far too small a step.[2]

Part I provides a brief overview of the failure of SVB, the accelerating nature of crises and bank runs, and the threat that bank runs pose to the economic system. Part II argues for the necessity of rethinking bank regulation, specifically by allowing banks experiencing a run not to fulfill withdrawal requests until the next Monday, along with the proposed exceptions to this regulation, namely withdrawals for payroll, deal closings, and certain individuals' payments. Part III identifies some wrinkles that the new regime should address.

I. THE ACCELERATING DANGER

The first few months of 2023 showed few signs that would predict bank failures. The only clouds in an otherwise clear sky

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[1] *See generally Explainer: What Caused Silicon Valley Bank's Failure?*, REUTERS (Mar. 10, 2023, 4:39 PM), https://www.reuters.com/business/finance/what-caused-silicon-valley-banks-failure-2023-03-10/ [https://perma.cc/E2LS-XVVZ].

[2] *See* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM 41 (2023) [hereinafter OPTIONS FOR REFORM].

were that interest rates rose and the market for cryptocurrencies imploded.[3] Silicon Valley Bank took wrong positions on interest rates, but what made its failure disorderly was today's transaction speed.[4] Regulators conceded that they could have been tougher on failed banks, but that would not have prevented what happened with SVB; stricter oversight might have merely made the runs happen earlier with perhaps a slightly reduced cost to the FDIC and, eventually, the taxpayer.[5] The major danger, however, is not the FDIC's level of exposure. The danger is having a future banking crisis that spawns a recession or depression. Regulation must prevent the contagion of a financial crisis into the nonfinancial economy and must prevent failures of financial institutions leading to fear, reductions of spending, or failures of real firms.

The other two failures, those of Signature Bank and First Republic Bank, were orderly.[6] The FDIC playbook worked.[7] This meant that the banks worked normally on their last Friday, the FDIC took them over during the weekend, and opened them under their new regime on Monday. The banking of their clients was not interrupted.[8] On Friday, clients transacted through the old bank regime, and on Monday, clients transacted through the new regime. The only harm was to the FDIC, which had to absorb losses. The failure of these banks did not lead to a contagion effect because neither depositors nor beneficiaries of depositors' payments feared that payments from those banks' accounts would not be made.[9]

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[3] *Id.* at 6; Hannah Lang et al., *The Crypto Market Bears the Scars of FTX's Collapse*, REUTERS (Nov. 2, 2023, 12:00 AM), https://www.reuters.com/technology/crypto-market-still-bears-scars-ftxs-collapse-2023-10-03/ [https://perma.cc/5XXY-T2AK].

[4] FED. RSRV., REVIEW OF THE FEDERAL RESERVE'S SUPERVISION AND REGULATION OF SILICON VALLEY BANK 24 (2023).

[5] *See* Ann Saphir et al., *Bank Regulators Promise Better Oversight After Collapses*, REUTERS (Apr. 28, 2023, 6:43 PM), https://www.reuters.com/business/finance/fed-plans-broad-revamp-bank-oversight-after-svb-failure-2023-04-28/ [https://perma.cc/FV5S-8S2R].

[6] OPTIONS FOR REFORM, *supra* note 2, at 6–7; *First Republic Bank*, FDIC (May 16, 2023), https://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/first-republic-faq.pdf [https://perma.cc/9BSP-RRBW].

[7] *See* OPTIONS FOR REFORM, *supra* note 2, at 7.

[8] Press Release, FDIC, FDIC Establishes Signature Bridge Bank, N.A., as Successor to Signature Bank, New York, NY (Mar. 12, 2023), https://www.fdic.gov/news/press-releases/2023/pr23018.html [https://perma.cc/K6CN-6RDB].

[9] OPTIONS FOR REFORM, *supra* note 2, at 50.

The failure of Silicon Valley Bank was different. It produced a threat that a particular financial event, this bank's failure, could cause harmful repercussions in nonfinancial sectors of the economy.[10] That is the risk of contagion that financial regulations seek to avert. But this risk was not averted, and no current proposal will circumvent any future risk.

The problem with Silicon Valley Bank's failure is that the bank did not operate as expected on the last Friday of its life, March 10, 2023.[11] The Friday closure interfered with the payroll operations of many other businesses.[12] Businesses that used accounts at Silicon Valley Bank for their payroll were forced to tell their employees to wait and see what would happen on Monday.[13] The employees who relied on those payments to make their rent and utility payments were left not knowing when or whether they would have access to their funds to make those payments.

Silicon Valley Bank was unable to serve its clients on Friday because customers made over $40 billion of withdrawal requests on its last Thursday and the bank expected over $100 billion of withdrawals for Friday.[14] The bank's deposits at the end of the previous quarter had been $173 billion.[15]

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[10] *Cf.* Michael Barron, *Effects of the Silicon Valley Bank Collapse*, GLOBAL EDGE (Mar. 21, 2023, 10:01 AM), https://globaledge.msu.edu/blog/post/57251/effects-of-the-silicon-valley-bank-colla [https://perma.cc/VQX6-L4YL].

[11] *See* Ari Levy, *Companies Scramble to Meet Payroll, Pay Bills After SVB's Swift Failure*, CNBC (Mar. 10, 2023), https://www.cnbc.com/2023/03/10/silicon-valley-bank-customers-scramble-to-meet-payroll-pay-bills.html [https://perma.cc/J5WM-GHGS].

[12] *Id.*

[13] *See* OPTIONS FOR REFORM, *supra* note 2, at 7 ("Cascading bank runs [from the panic after the failure of SVB] could have caused widespread losses to business payroll accounts and more widespread financial contagion."); Paolo Confino, *Silicon Valley Bank's collapse almost led to payroll disasters. But it offers founders an important finance lesson*, FORTUNE (Mar. 20, 2023), https://fortune.com/2023/03/20/silicon-valley-bank-avoid-payroll-disaster/ [http://perma.cc/4U5P-2EZ9] ("Thousands of startups were left scrambling to meet payroll when [SVB] imploded."); Berber Jin et al., *After Silicon Valley Bank Fails, Tech Startups Race to Meet Payroll*, WALL ST. J. (Mar. 11, 2023, 11:48 PM), https://www.wsj.com/articles/after-silicon-valley-bank-fails-tech-startups-race-to-meet-payroll-4ebd9c5c [http://perma.cc/S9S2-X8B3] (reporting widespread inability to make payroll). *Cf.* Reuter v. City of Methuen, 184 N.E.3d 772, 776, 781 (Mass. 2022) (imposing strict liability, treble damages, and attorneys' fees for any delay in the payment of wages).

[14] FED. RSRV., *supra* note 4, at 24.

[15] *Id.* at 19.

Imagine if the crisis was a little broader and this happened to several financial institutions at the same time. A significant proportion of the population would have their flow of payments disrupted. If utilities and landlords broadly feared not getting paid, they would in turn slow their spending which in turn would slow down the economy and push it toward a recession or a depression. The premise of financial regulation is that financial events remain only financial, that such events do not produce threats to the nonfinancial economy, what finance calls the real economy.[16] Businesses missing payroll because some bank executives made false bets on interest rates is the very nightmare that financial regulation must prevent.

Regulators cannot afford to wait until the next bank failure. Technology accelerates bank runs.[17] During the Great Depression, it took four years, from 1929 to 1933, for well over a third of banks to fail.[18] The next large crisis, in 2008, unfolded over four days—Lehman Brothers filed for bankruptcy on Monday, September 15, 2008. By Thursday, a full run against money market funds, a credit crunch, and aggressive Government intervention ensued.[19] Individual bank runs are similarly accelerating with technology. Before Silicon Valley Bank, the largest domestic bank run occurred

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[16] CONG. BUDGET OFF., FINANCIAL REGULATION AND THE FEDERAL BUDGET 32 (2019); MARC LABONTE, CONG. RSCH. SERV., R47026, FINANCIAL REGULATION: SYSTEMIC RISK 17 (2022).

[17] FED. RSRV., *supra* note 4, at 2.

[18] MILTON FRIEDMAN & ANNA J. SCHWARTZ, A MONETARY HISTORY OF THE UNITED STATES, 1867–1960, 229 (1963) ("[T]he number of commercial banks fell by well over one-third.").

[19] FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 339 (2011) (quoting then-chairman of the Federal Reserve Bernanke that immediately after Lehman's bankruptcy a run on money market funds occurred, starting from the Reserve Primary Fund which held a lot of Lehman commercial paper and "broke the buck"); *id.* at 359 ("The government responded with two new lending programs on Friday, September 19. Treasury would guarantee the $1 net asset value of eligible money market funds, for a fee paid by the funds. And the Fed would provide loans to banks to purchase high-quality-asset-backed commercial paper from money market funds."); *id.* at 362–63 (emergency acceptance as bank holding companies of Morgan Stanley and Goldman); *id.* at 373 (creation of the Fed's Commercial Paper Funding Facility on October 7, 2008, to directly buy commercial paper).

against Washington Mutual (WaMu) in September 2008.[20] Over the course of two weeks, depositors withdrew about $19 billion of Washington Mutual's approximately $188 billion in deposits.[21] The run against Silicon Valley Bank saw withdrawals of over $40 billion on Thursday and an expected $100 billion in withdrawals the next day; its deposits were about $190 billion.[22] Accordingly, regulation should expect runs more than doubling in size and unfolding in a quarter of the last run's duration every few years. Extrapolating from the progression from WaMu to SVB suggests that the next major run could be for about 60% of deposits in a time span of about two hours.[23] Current regulation would not be able to keep open a bank that is subject to such a run.

II. Giving Banks an Out: Delaying Withdrawals

Bank regulators responded to the bank failures of the Great Depression by creating deposit insurance, coupled with solvency and liquidity regulation.[24] The disorderliness of the failure of Silicon Valley Bank shows that these are not enough.

Solvency regulation ensures that banks have an equity cushion that can withstand adverse shocks. Since 1988, solvency regulations have been harmonized internationally for the largest economies through the Basel Committee on Bank Supervision, which requires that equity ("capital" in the language of banking)

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[20] *Self-Fulfilling Prophecies: 5 Big Bank Runs Before Silicon Valley Bank*, ECON. TIMES (Mar. 14, 2023, 8:23 PM), https://economictimes.indiatimes.com/news/international/business/self-fulfilling-prophecies-5-big-bank-runs-before-silicon-valley-bank/articleshow/98638044.cms [https://perma.cc/4EGJ-PEH5].

[21] Press Release, FDIC, JPMorgan Chase Acquires Banking Operations of Washington Mutual (Sept. 25, 2008), https://archive.fdic.gov/view/fdic/3396 [https://perma.cc/3NU8-EZDZ]; FED. RSRV., *supra* note 4, at 4.

[22] FED. RSRV., *supra* note 4, at 24.

[23] *See* Jonathan Rose, *Understanding the Speed and Size of Bank Runs in Historical Comparison*, FED. RSRV. BANK OF ST. LOUIS (May 26, 2023), https://research.stlouisfed.org/publications/economic-synopses/2023/05/26/understanding-the-speed-and-size-of-bank-runs-in-historical-comparison [https://perma.cc/DNY8-W52M].

[24] *The Depression*, SOC. SEC. ADMIN., https://www.ssa.gov/history/bank.html [https://perma.cc/YD9L-WKG6]; *A Brief History of Deposit Insurance in the United States*, FDIC 1 (Sept. 1998) [hereinafter *Brief History*], https://www.fdic.gov/resources/publications/brief-history-of-deposit-insurance/book/brief-history-deposit-insurance.pdf [https://perma.cc/S23G-VK44]; *id.* at 28, 43.

be at least 8% of risk-adjusted assets.[25] Large banks indeed have equity of about 8% of their assets.[26] They can stay solvent in the face of a decline in the value of their assets of up to that fraction. Solvency regulation contributes to the prevention of bank runs by making depositors comfortable that a drop in the value of their bank's assets will not make the bank insolvent and unable to fulfill their withdrawal requests.[27]

Liquidity regulation ensures that banks have sufficient cash and liquid assets to satisfy depositors, even in the face of an unusual amount of withdrawal requests.[28] Again, the relation to reducing the risk of runs is giving depositors the comfort that any withdrawal requests can be met.

Deposit insurance prevents bank runs by reassuring depositors that their deposits will not be lost even if their bank becomes insolvent.[29] The FDIC makes depositors whole up to the insured amount, presently $250,000.[30] In the case of Silicon Valley Bank, the deposit insurance regime was ineffective because many of its accounts were much greater than the insurance limit.[31]

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[25] FELIX I. LESSAMBO, THE U.S. BANKING SYSTEM: LAWS, REGULATIONS, AND RISK MANAGEMENT 185–88 (2020) (discussing the creation of the Basel Committee on Bank Supervision and the requirement of the Basel I agreement that equity be 8% of risk-adjusted assets; banking parlance calls equity "capital"). *Cf.* W. Ronald Gard, *George Bailey in the Twenty-First Century: Are We Moving to the Postmodern Era in International Financial Regulation with Basel II?*, 8 TRANSACTIONS: TENN. J. BUS. L. 161, 162 (2006) (discussing the implementation of the Basel I and Basel II accords).

[26] A search on any finance site, such as Google's or Yahoo's, to access the public balance sheet information, shows that the largest banks' equity is about 8%, ranging from approximately 7.3% to 9.7%. *See, e.g.*, *Balance Sheet*, YAHOO: FIN., https://finance.yahoo.com/quote/BAC/balance-sheet/?guccounter [https://perma.cc/WE2Y-XZHD] (showing that Bank of America Corporation's equity equaled about 7.6% of the bank's total assets).

[27] *See* OPTIONS FOR REFORM, *supra* note 2, at 7 (detailing that depositor concern regarding their bank's solvency may lead to a moving of funds).

[28] *See id.* at 34.

[29] Alan S. Blinder & Robert F. Wescott, *Reform of Deposit Insurance: A Report to the FDIC*, FDIC (Mar. 20, 2001), https://www.fdic.gov/deposit/insurance/initiative/reform.html [https://perma.cc/9MK7-B3YB].

[30] 12 U.S.C. § 1821 ("[T]he term 'standard maximum deposit insurance amount' means $250,000.").

[31] Simon Moore, *Why Deposit Insurance Didn't Help Silicon Valley Bank*, FORBES (Mar. 12, 2023, 1:41 PM), https://www.forbes.com/sites/simonmoore/2023/03/12/why-deposit-insurance-didnt-help-silicon-valley-bank [https://perma.cc/V6UJ-QGJ6].

Depositors did not have any reason to expect that the FDIC would cover deposits beyond the limit and, therefore, had a full incentive to withdraw their funds when they feared that SVB would be unable to meet withdrawal requests.[32] After the bank's failure, regulators decided to provide coverage to all depositors without limit.[33]

The disorderliness of the failure of Silicon Valley Bank demonstrated that current regulation is inadequate. Silicon Valley Bank anticipated large withdrawals for the last Thursday of its life.[34] It sold treasury securities and borrowed funds, producing cash of over $20 billion.[35] This amount was more than the withdrawals of the last big run, the withdrawals that WaMu faced over the span of two weeks fourteen years earlier.[36] But Silicon Valley Bank's efforts were not enough. Their withdrawal requests for Thursday alone were $42 billion and the bank anticipated an additional $100 billion in withdrawals for Friday.[37] Nothing in our regulatory apparatus can address such withdrawal requests. The fundamental choice of the regulatory structure is to prevent runs from arising through the regulation of solvency and deposit

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[32] *Id.*

[33] Press Release, FDIC, Joint Statement by the Department of the Treasury, Federal Reserve, and FDIC (Mar. 12, 2023), https://www.fdic.gov/news/press-releases/2023/pr23017.html [https://perma.cc/3YBH-KFAQ]; Nick Timiraos et al., *SVB, Signature Bank Depositors to Get All Their Money as Fed Moves to Stem Crisis*, WALL ST. J. (Mar. 13, 2023, 5:53 PM), https://www.wsj.com/articles/federal-reserve-rolls-out-emergency-measures-to-prevent-banking-crisis-ba4d7f98 [https://perma.cc/3KM7-CHPT]. *But see* Marshall S. Huebner, *Silicon Valley Bank: A Tragedy in Three or Four Chapters*, DAVIS POLK (Nov. 9, 2023), https://www.davispolk.com/sites/default/files/2023-11/NYSBA%20Keynote%20SVB%20Failure.pdf [https://perma.cc/VYG7-CNU4] (reporting renunciation of full coverage in subsequent proceedings).

[34] Austin Weinstein, *$42 Billion in One Day: SVB Bank Runs Biggest in More Than a Decade*, FORTUNE (Mar. 11, 2023, 10:55 AM), https://fortune.com/2023/03/11/silicon-valley-bank-run-42-billion-attempted-withdrawals-in-one-day/ [https://perma.cc/5XFZ-5T2A].

[35] *SVB Financial Group Announces Proposed Offerings of Common Stock and Mandatory Convertible Preferred Stock*, SILICON VALLEY BANK (Mar. 8, 2023), https://ir.svb.com/news-and-research/news/news-details/2023/SVB-Financial-Group-Announces-Proposed-Offerings-of-Common-Stock-and-Mandatory-Convertible-Preferred-Stock/default.aspx [http://perma.cc/7FQA-BX75].

[36] *See supra* note 21 and accompanying text.

[37] *See supra* note 20 and accompanying text.

insurance rather than to address ongoing runs directly.[38] The message of SVB's collapse is clear: runs will arise and they must be addressed.

During the Great Depression, the government gave beleaguered banks breathing room by declaring a bank holiday.[39] Silicon Valley Bank, unable to face the volume of withdrawal requests and seizure by California regulators, closed Friday morning.[40] Before the advent of the Federal Reserve, banks responded to runs by "suspending convertibility" of the deposits into cash, a euphemism for refusing withdrawals until the run would end.[41] But all these reactions to runs—suspension of convertibility, bank holidays, and SVB's closure—produce contagion risks that good regulation should control for.[42] Friday payments out of SVB could not be made. This probably included many individuals' payments, but it also included businesses that failed to make payroll.[43] Deals awaiting closure on that Friday could not close and deals pending for the week after were in doubt. The financial event of the bank's failure was not contained. It expanded and potentially influenced the spending of all individuals and institutions connected to this chain of failed payments. Bank holidays and indefinite

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[38] *See* OPTIONS FOR REFORM, *supra* note 2, at 1, 25 (noting that preventing bank runs from occurring in the first place is the "primary objective" of deposit insurance).

[39] President Roosevelt declared a four-day "bank holiday" on March 6, 1933. Proclamation 2039—Bank Holiday, March 6–9, 1933, Inclusive, *reprinted in* GERHARD PETERS & JOHN T. WOOLLEY, THE AMERICAN PRESIDENCY PROJECT (Mar. 6, 1933), https://www.presidency.ucsb.edu/documents/proclamation-2039-bank-holiday-march-6-9-1933-inclusive [https://perma.cc/6TBV-MYFS]; Emergency Banking Act of 1933, Pub. L. No. 73-1, 48 Stat. 1 (1933).

[40] Allison Morrow & Matt Egan, *Silicon Valley Bank Collapses After Failing to Raise Capital*, CNN BUS. (Mar. 10, 2023, 11:08 PM), https://www.cnn.com/2023/03/10/investing/svb-bank/index.html [https://perma.cc/LMQ2-7VHF].

[41] Douglas W. Diamond & Philip Dybvig, *Bank Runs, Deposit Insurance, and Liquidity*, 91 J. POL. ECON. 401, 410 (1983) (agreeing with Friedman & Schwartz that by preventing suspension of convertibility, the Fed aggravated the Great Depression). *See also* FRIEDMAN & SCHWARTZ, *supra* note 18, at 157.

[42] Following the closure of SVB, regulators implemented measures in order to prevent financial contagion. Akhilesh Ganti, *What is Financial Contagion During an Economic Crisis?*, INVESTOPEDIA (Mar. 18, 2023), https://www.investopedia.com/terms/c/contagion.asp [https://perma.cc/WPG2-R8LM].

[43] *See supra* note 19 and accompanying text.

suspension of convertibility similarly aggravate the fear about continued payments in the nonfinancial economy.[44]

Imagine if this were not an isolated bank's failure but instead a broad market crisis. Suppose half the major financial institutions were in the position of Silicon Valley Bank. A major panic and a major economic crisis could be expected. In 2008, the economy experienced broad lack of confidence in financial institutions, with the failures of Bear Stearns, Lehman, Wachovia, Washington Mutual, the federal takeovers of Fannie Mae and Freddie Mac, and the virtually unlimited governmental support provided to AIG, all banks, and all money market funds after Lehman's failure.[45] Addressing this regulatory failure is urgent and crucially important.

The solution is to give banks that are subject to a run the time to react without creating risk of contagion. Effectively, the regulation would give banks something akin to an emergency brake. If a bank finds itself subject to a run, it should be allowed to delay withdrawal requests to the coming Monday. The requests likely to produce contagion should be accepted. Individuals' payments (below the threshold of the insured amount), payroll, and deal closings should not be delayed because doing so would lead to the payment recipients curtailing spending, which in turn would create contagion risk. The delay would allow either the bank to overcome the run or give the FDIC time to address the run or to take over the bank.

As technology accelerates finance, regulation needs to produce a countervailing delay that allows managers and regulators to react.[46] Yet, that delay should not be indiscriminate. The delay should only apply to transactions that can be delayed without harming the rest of the economy. Individuals' payments, payroll,

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[44] *Fear of Failure, Bank Panics, and the Great Depression*, NAT'L BUREAU ECON. RSCH. (May 1, 2020), https://www.nber.org/digest/may20/fear-failure-bank-panics-and-great-depression [https://perma.cc/765L-W96J].

[45] *See generally* HENRY M. PAULSON, JR., ON THE BRINK: INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM (2009) (describing, in gripping and detailed fashion, the financial crisis and the responses by the Secretary of the Treasury); DAVID WESSEL, IN FED WE TRUST: BEN BERNANKE'S WAR ON THE GREAT PANIC (2009) (recounting the crisis and responses from the perspective of the Wall Street Journal's lead financial reporter); TIMOTHY F. GEITHNER, STRESS TEST: REFLECTIONS ON FINANCIAL CRISES (2014); *see* FIN. CRISIS INQUIRY COMM'N, *supra* note 19, at 22–23.

[46] *See* FED. RSRV., *supra* note 4, at 2.

and deal closings should not be delayed because their postponement would endanger other transactions further down the economic chain.

Such a delay would have been effective in the case of Silicon Valley Bank. When, on Thursday, the bank's management realized that the bank faced withdrawal requests that it might not be able to honor, it could opt into the delay regime. Because institutional accounts accounted for most withdrawals, many withdrawal requests would be subjected to the delay, but accounts used for payroll or for pending closings of deals would be unaffected. If the bank were unable to raise the cash to meet the withdrawal requests by Friday, then the FDIC would have the time to arrange an orderly takeover of the bank during the weekend. Payroll accounts, the major source of contagion risk in the SVB failure, would not be influenced.[47] By having delayed other withdrawal requests, the bank would be able to honor payroll transfers.

An additional important ramification of this proposal is that, if its deployment is effective in preventing fears of contagion, it will allow regulators the time to decide whether to exceed the insurance limit. In the case of SVB's failure, widespread fear prevented regulators from being able to choose to honor the limit.[48] When payrolls, deals, and ordinary payments are not interrupted, widespread fear may not arise. The FDIC can make the decision about what to cover with less pressure on their deliberation.

The proposed rule would need to define when snowballing withdrawals cross the threshold into being a run. What percentage of the bank's deposits would trigger the bank's ability to switch regimes? This Article need not take a position, but the circumstances argue for a low threshold. The danger that a bank may pull the trigger too early is low. The management of the bank does not want to see an FDIC takeover, a bank closure, and the potential loss of their jobs and those of most bank employees. A low threshold would give management warning that a run may be building and the discretion to address it before it turns into a full-blown run.

An important caveat is that if technology progresses to produce automatic runs, then banks should be able to respond to

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[47] OPTIONS FOR REFORM, *supra* note 2, at 3; Patrick Thibodeau, *How the SVB Collapse Upended Payroll for Thousands*, TECHTARGET (Mar. 13, 2023), https://www.techtarget.com/searchhrsoftware/news/365532574/How-the-SVB-collapse-upended-payroll-for-thousands [https://perma.cc/GF4M-42VH].

[48] *See supra* note 31 and accompanying text.

them automatically as well. Thus, when a significant fraction of deposits are subject to algorithmic control, meaning that an algorithm monitors the bank's safety and is able to electronically respond to perceived risk of the bank by redirecting funds away from the bank, banks need to have an automated, algorithmic response that would stop such moves when the withdrawals exceed some threshold.[49] Perhaps this would be a higher threshold and still set partially at the bank's discretion.

Payroll accounts would need to be identified. Deal closings would need to be pre-announced to the bank. These are simple changes to the system of ordering regular payments of wires.

III. WRINKLES

The switch to the new regime does not seem particularly complex. Nevertheless, in practice, some wrinkles will appear. The current FDIC playbook, utter secrecy until it descends on a bank to be taken over on Friday after hours, is in part motivated by the unknown of what can go wrong in an institution that safeguards large value when its individuals feel that their time and the institution itself are at an end.[50] The possibility that the bank might survive partly mitigates these concerns. However, meticulous record-keeping, omnipresent in banking already, would be necessary.[51]

Moreover, banks already have the right to demand seven-day notice for most withdrawals, a right that Silicon Valley Bank had but did not exercise.[52] Needless to say, banks never invoke this

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[49] OPTIONS FOR REFORM, *supra* note 2, at 22 (stating that automated transactions "exacerbate the potential for panic-driven runs").

[50] Chana Joffe-Walt, *Anatomy of a Bank Takeover*, NPR (Mar. 26, 2009, 1:59 PM), https://www.npr.org/2009/03/26/102384657/anatomy-of-a-bank-takeover [https://perma.cc/P749-H8D7] (recounting the FDIC takeover of the Bank of Clark County); OPTIONS FOR REFORM, *supra* note 2, at 26.

[51] *See* 12 C.F.R. § 1020.410 for the recordkeeping already required of banks.

[52] *See, e.g.*, *id.* § 390.297 (in order to be depository institutions, banks that offer Negotiable Order of Withdrawal [NOW] accounts must offer "accounts . . . on which the [depository institution] reserves the right to require at least seven days' notice prior to withdrawal . . . ."); *see also, e.g.*, SILICON VALLEY BANK, DEPOSIT AGREEMENT AND DISCLOSURE STATEMENT—BUSINESS ACCOUNTS 17, 48, https://www.svb.com/globalassets/library/uploadedfiles/content/products/startup-banking/dads_svb_deposit_agreement_disclosure.pdf [http://perma

right and their systems are not designed to give them the option to demand notice, for example, for outgoing wires.[53] Perhaps, banks do not exercise this right because of a powerful extra-legal norm that has developed and precludes its use.[54] In this case, it may be necessary for the new regime to also have a mandatory threshold that becomes normalized through stress tests. A bank subject to a run facing withdrawal requests greater than some percentage of deposits should be obligated to switch to the delaying regime. A lower threshold would make the switch to the delaying regime optional, as discussed above, but a higher threshold would make switching to the delaying regime mandatory. Then, runs triggering this regime should be included in the various stress tests to which regulators subject banks.[55]

The fact that banks already have the seven-day notice in many of their contracts precludes the concern that this proposal may cause runs. The objection would be that depositors, fearing the activation of the notice regime, would rush to withdraw their

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.cc/N3U5-2HYG] (reserving the right to require seven-day notice of withdrawals); CHASE, DEPOSIT ACCOUNT AGREEMENT AND PRIVACY NOTICE 15, https://www.chase.com/content/dam/chase-ux/documents/personal/checking/deposit-account-agreement.pdf [http://perma.cc/8NCA-XCMB] ("[W]e reserve the right to require seven days' prior written notice of withdrawal."); BANK OF AMERICA, DEPOSIT AGREEMENT AND DISCLOSURES 3, 54, https://www.bankof America.com/salesservices/deposits/resources/deposit-agreements/ [http://perma.cc/6KSK-E29G] ("Federal regulations require us to retain the right to require . . . seven days' written notice before . . . [withdrawals]."). *See infra* Appendix, including notes 69–96 and accompanying text. Following the conclusion, the Appendix expands this search and shows that of the top 25 banks, all retain the right to require seven-day notice for most withdrawals, despite 12 C.F.R. § 390.297 that only requires it for NOW accounts. The proposed regime should require this for all accounts.

[53] FED. RSRV. BD., CONSUMER COMPLIANCE HANDBOOK 3 (2011); *see* BANK OF AMERICA, *supra* note 52, at 3, 54 (indicating how it is not likely for the bank to invoke this right); *The Ins and Outs of Wire Transfers*, WELLS FARGO 1, https://www.wellsfargo.com/financial-education/basic-finances/manage-money/payments/ins-outs-transfers/ [https://perma.cc/MX96-F4MM] (identifying that wire transactions overseen by a bank may take several days to process, thus providing the bank with notice of large transactions).

[54] *Compliance Guide to Small Entities Regulation D: Reserve Requirements of Depository Institutions*, BD. OF GOVERNORS OF THE FED. RSRV. SYS. (Jan. 4, 2018), https://www.federalreserve.gov/supervisionreg/regdcg.htm [https://perma.cc/7ZMU-XXQG] (guidelines for interpreting 12 C.F.R. 204).

[55] OPTIONS FOR REFORM, *supra* note 2, at 23.

funds. But the notice regime already exists, so any incentive toward runs that it produces is already in effect.

Additional issues arise. Consider banks that fail after invoking the right to delay payments and, after the bank failure, the FDIC limits insurance coverage. Those banks will produce an inequity between accounts that serve payroll and deal payments compared to accounts that lose value due to the FDIC's limited insurance.[56] It will appear that accounts that make payroll and deal payments receive favorable treatment. Compare, for example, two accounts of $3 million as of Thursday, when the bank invoked the delay. One of which exhausts its value in making payroll payments on Friday whereas the other is there to face a "haircut"[57] on Monday to the FDIC insurance limit. The unequal treatment of these two types of accounts is inherent in this proposal. It is a consequence of the new regime's design. To the extent that the limit on FDIC insurance is intended to reduce moral hazard, this is not a bug but a feature of the new system—large non-payroll accounts have an incentive to monitor the risk that their bank takes.[58] The fact that the FDIC has already proposed extending full coverage to accounts used for payroll eliminates this concern for payroll accounts.[59] The same should also apply to deal closings.

The new regime should not allow accounts to game the system. Accounts can game the system, for example, by making transfers up to the allowed amount during the delay, and then claiming the full FDIC coverage on Monday after the bank is taken over (and the FDIC decides to limit its coverage).[60] For example, on Friday, Jill Businesswoman may make a $125,000 payment to her law firm and a $125,000 payment to her accounting firm,

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[56] Diamond & Dubvig's model shows that unlimited government insurance is optimal in its stylized setting—it prevents runs while ensuring banks provide liquidity to depositors. *See* Diamond & Dybvig, *supra* note 41, at 411. The current regime limits insurance to $250,000. *See* 12 U.S.C. § 1821. Given any limit, deposits that exceed the limit have an incentive to run. Given imperfect risk attitudes ("moral hazard"), honesty and monitoring, a limit may be justified, although the limit may be very seldom invoked. But this means that runs can occur.

[57] *See* Adam Ashcroft et al., *Two Monetary Tools: Interest Rates and Haircuts*, 25 NAT'L BUREAU ECON. RSCH. 143, 143 (2010).

[58] OPTIONS FOR REFORM, *supra* note 2, at 53.

[59] *Id.* at 41.

[60] *See id.* at 3.

who will eventually return those payments when they determine that they exceeded Jill's bills. But on Monday, Jill argues to the FDIC that $250,000 of her account's remaining balance is under the insured limit (which is currently that amount).[61] In such a situation, the FDIC coverage of those accounts should include a brief reach-back. Rather than applying the limit to Monday's account value, the FDIC limit should include withdrawals initiated a little before the bank invoked the delaying regime.

Another concern for this proposal is the FDIC's capacity, despite that resolving this concern is not a prerequisite for the proposal to succeed. During a major financial crisis, a large fraction of large banks could be subject to runs.[62] After Lehman's failure in 2008, several financial institutions seemed to be on the brink of failure.[63] If several major financial institutions were to exercise this option to delay withdrawals to the next Monday, it would be possible that the FDIC may not have the capacity to address all their failures in a single weekend.[64] A seed of a solution can be extracted from the fact that J.P. Morgan Chase used an 800-person team to inspect First Republic Bank when it failed, to enable J.P. Morgan Chase to make an informed bid for First Republic.[65] In the contingency plans that banks are required to make, an additional contingency plan should be included, for example, the designation of teams that would assist the FDIC with addressing runs in the instance that FDIC capacity is overwhelmed.[66] Each large bank would assign a fraction of its seasoned bankers

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[61] *See* 12 U.S.C. § 1821.

[62] *See Self-Fulfilling Prophecies: 5 Big Bank Runs Before Silicon Valley Bank*, THE ECON. TIMES (Mar. 14, 2023, 8:23 PM), https://economictimes.indiatimes.com/news/international/business/self-fulfilling-prophecies-5-big-bank-runs-before-silicon-valley-bank/articleshow/98638044.cms [https://perma.cc/4XUE-S2L4].

[63] *See supra* note 45 and accompanying text.

[64] *See, e.g.*, *Brief History*, *supra* note 24, at 64–65.

[65] *See, e.g.*, Maureen Farrell et al., *First Republic Bank Is Seized by Regulators and Sold to JPMorgan Chase*, N.Y. TIMES (May 1, 2023), https://www.nytimes.com/2023/05/01/business/first-republic-bank-jpmorgan.html [http://perma.cc/B5SC-UTHW] ("JPMorgan's Mr. Dimon said the bank had 800 employees working on the deal over the past several days.").

[66] FDIC, ADDENDUM TO THE INTERAGENCY POLICY STATEMENT ON FUNDING AND LIQUIDITY RISK MANAGEMENT: IMPORTANCE OF CONTINGENCY FUNDING PLANS (2023), https://www.fdic.gov/news/financial-institution-letters/2023/fil23039a.pdf [https://perma.cc/MB4H-29N9].

to these groups. The selected bankers would receive FDIC training at intervals and be subject to the FDIC calling on them to address a failure. Granted, this is regulatorily aggressive. Banking, however, is essentially about the maintenance of the currency, which is a governmental function that is delegated to private banks.[67] Just as banks provide that governmental function by being subject to numerous restrictions,[68] they can be expected to help with their regulator's capacity at the very rare moment when doing so becomes necessary.

Other wrinkles might arise and will need to be addressed. For example, bank customers should not be allowed to claim deal payments every Friday then proceed to cancel those each Friday that their bank stays healthy, but leave them in place when a Friday comes that the bank enters the emergency regime of delaying payments. However, compared to the gains from the new system, dealing with these issues as they arise is not a major matter.

CONCLUSION: A CONTAGION-PROOF EMERGENCY BRAKE

The disorderly failure of Silicon Valley Bank showed that our current regulatory structure has been overtaken by the speed of finance. This Article proposes a solution. Give banks an emergency brake. In the face of a bank run, invoke a delaying regime to the next Monday for all outgoing funds with exceptions designed to prevent contagion. This answers the new speed of finance with a delay that is necessary for management and regulators to deal with the issues facing the bank. The remedy, however, must avoid the contagion risk that the failure of SVB created. Payrolls, ordinary payments, and deal closings must be allowed to continue. This new regime will produce savings for taxpayers and safety for the economic system.

[67] *See, e.g.,* Eric J. Gouvin, *Banking in North America: The Triumph of Public Choice over Public Policy*, 32 CORNELL INT'L L.J. 1, 15 (1998).

[68] 9 C.J.S. *Banks and Banking* § 549, Westlaw (database updated Mar. 2024).

APPENDIX

Insured U.S. Bank (total assets in millions)[69]	**Accounts the bank reserves the option to require seven-day notice for withdrawals**
JP Morgan Chase ($3,395,126)	• Savings Account[70] • Interest-bearing Checking Accounts • Money Markets
Bank of America ($2,540,116)	• Savings Accounts[71]
Wells Fargo ($1,733,244)	• Savings Accounts[72]
CitiBank ($1,684,710)	• Savings Accounts[73] • Checking Accounts • (Potentially CDs)
U.S. Bank ($650,659)	• Savings Accounts[74]

[69] This data is drawn from Federal Reserve data about the twenty-five largest FDIC-insured U.S. commercial banks. *Federal Reserve Statistical Release: Large Commercial Banks*, FED. RSRV. (Dec. 31, 2023), https://www.federalreserve.gov/releases/lbr/current/default.htm [https://perma.cc/S52W-63G6].

[70] CHASE, *Deposit Agreement and Privacy Notice* 15–16, [https://perma.cc/K2SH-G7QD].

[71] BANK OF AMERICA, *Deposit Agreement and Disclosure* 49 [https://perma.cc/W5HF-U96E].

[72] WELLS FARGO, *Deposit Account Agreement* 31 [https://perma.cc/76SZ-USHS].

[73] CITIBANK, *Consumer Deposit Account Agreement* 38, 45 [https://perma.cc/383X-672P].

[74] U.S. BANK, *Your Deposit Account Agreement* 15 [https://perma.cc/PJZ6-EF95].

Insured U.S. Bank (total assets in millions)	**Accounts the bank reserves the option to require seven-day notice for withdrawals**
PNC Bank ($557,463)	• Interest Bearing Accounts[75] • Checking Accounts via Money Market Subaccount[76]
Truist Bank ($527,530)	• Interest Bearing Transaction Accounts[77] • Savings Accounts • Money Market Accounts
Goldman Sachs ($521,102)	• Savings Accounts[78]
Capital One ($475,629)	• Savings Accounts (reserves 21 days) • Money Market Accounts[79]
TD Bank ($367,175)	• Savings Accounts[80] • Money Market Accounts • Interest Bearing Transaction Subaccounts • All Non-transaction Subaccounts[81]

[75] PNC BANK, *Account Agreement for Personal Checking, Savings, and Money Market Accounts* 6 [https://perma.cc/4U3W-4D9C].

[76] *Id.* at 7.

[77] TRUIST, *Bank Agreement Services* 27 [https://perma.cc/XX9E-EJB6].

[78] MARCUS BY GOLDMAN SACHS, *Deposit Account Agreement* 3 [https://perma.cc/R99U-EHFB].

[79] CAPITAL ONE, *Account Disclosures* 4 [https://perma.cc/JB5J-MHAM].

[80] TD BANK, *Personal Deposit Account Agreement* 6 [https://perma.cc/JNJ5-4E7K].

[81] *Id.* at 29.

Insured U.S. Bank (total assets in millions)	**Accounts the bank reserves the option to require seven-day notice for withdrawals**
BNY Mellon ($332,529)	• Information Unavailable
State Street Bank ($293,238)	• Information Unavailable
BMO ($265,658)	• All Interest-Bearing Accounts[82]
Citizens Bank ($221,750)	• Savings Accounts[83] • Money Markets Accounts • IRA and SEP Accounts
Fifth Third Bank ($213,768)	• Savings Accounts[84]
First Citizens Bank ($213,618)	• Savings Accounts[85] • Interest Bearing Checking Accounts[86]
Silicon Valley Bank ($209,026) [before collapse]	• Checking Accounts • Money Market Accounts • Savings Subaccounts[87]

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[82] BMO, *BMO Personal Account and Disclosure Guide* 64 [https://perma.cc/8NA4-YV2N].

[83] CITIZENS BANK, *Personal Deposit Account Agreement* 11 [https://perma.cc/8SR4-VYK5].

[84] FIFTH THIRD BANK, *Deposit Account Rules & Regulations* 16 [https://perma.cc/M94M-3W4X].

[85] FIRST CITIZENS BANK, *First Citizens Bank Deposit Account Agreement* [https://perma.cc/QX9N-KC2G].

[86] CITIZENS BANK, *Business Deposit Account Agreement* 9 [https://perma.cc/X7BU-6S88].

[87] SILICON VALLEY BANK, *Deposit Agreement and Disclosure Statement—Business Accounts* [http://perma.cc/N3U5-2HYG].

Insured U.S. Bank (total assets in millions)	**Accounts the bank reserves the option to require seven-day notice for withdrawals**
Morgan Stanley ($209,006)	• Information Unavailable
M&T Bank ($207,771)	• Savings Account[88]
Morgan Stanley Private Bank ($203,313)	• Savings Accounts • Money Market Accounts[89]
Huntington Bank ($188,731)	• All accounts other than Estate and Asterisk Free Checking Accounts[90]
Ally Bank ($186,114)	• Money Market Accounts • Savings Accounts[91]
KeyBank ($185,890)	• Checking[92] • Savings
American Express ($180,421)	• Savings Deposit Account[93]

88 M&T BANK, *M&T Bank Commercial Deposit Account Agreement* 4 [https://perma.cc/6YVE-VAH8].

89 MORGAN STANLEY, *Morgan Stanley Private Bank Deposit Account Agreement* [https://perma.cc/8RJ4-X4HP].

90 HUNTINGTON BANK, *Consumer Deposit Account Agreement* 6 [https://perma.cc/CP32-LCJR].

91 ALLY BANK, *Deposit Agreement and Disclosures* 25 [https://perma.cc/29CK-Y7LJ].

92 KEYBANK, *Deposit Account Agreement and Funds Availability Policy* [https://perma.cc/W3K9-NJ38].

93 AMERICAN EXPRESS NATIONAL BANK, *Consumer Savings Deposit Account Agreement* 16 [https://perma.cc/FB7Z-4AG6].

Insured U.S. Bank (total assets in millions)	**Accounts the bank reserves the option to require seven-day notice for withdrawals**
HSBC Bank (US) ($165,172)	• Interest Bearing Checking Account[94] • Savings Account[95]
Regions Bank ($151,314)	• Interest Bearing Accounts[96] • Savings Accounts • Money Market Accounts • Holding Subaccounts

[94] HSBC, *Rules for Consumer Deposit Accounts* 2 [https://perma.cc/HH4A-CUJ6].
[95] *Id.* at 3.
[96] REGIONS, *Deposit Agreement* 15 [https://perma.cc/5HUJ-GRWC].