How Banking Regulation Failed to Stop the Collapse of Silicon Valley Bank

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I. INTRODUCTION

On March 10th, 2023, Silicon Valley Bank (SVB) announced that the bank had insufficient funds due to investors rushing to pull their money out of the bank.[1] A week later, SVB announced that the bank had filed for Chapter 11 bankruptcy.[2] The collapse of SVB was the second biggest bank collapse in U.S. history, and sent shockwaves throughout the U.S. financial world as investors in other banks began to worry they might suffer the same fate as those who invested in SVB.[3]

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1. Jeffrey Cohen et al., *SVB Financial Group Files for Chapter 11 Bankruptcy*, LOWENSTEIN SANDLER (Mar. 20, 2023), https://www.lowenstein.com/news-insights/publications/client-alerts/svb-financial-group-files-for-chapter-11-bankruptcy-bankruptcy [https://perma.cc/AEV5-JXUD].

2. *Id.*

3. Anita Ramasastry, *The Silicon Valley Bank Collapse Explained*, UNIV. OF WASH. SCH. OF L. (Mar. 24, 2023), https://www.law.uw.edu/news-events/news/2023/svb-collapse [https://perma.cc/DJP4-7EC5].

While large bank collapses are not a new occurrence in the United States, they are rare occurrences that typically result in new banking legislation aimed at ensuring stability in the banking industry.[4] However, the collapse of SVB showed us that the current banking legislation in the United States is not enough to stop banks from collapsing. The Federal Reserve and many others have been quick to point fingers at the Trump administration's rollback of banking regulations rollback for the collapse of SVB.[5] While President Trump's rollbacks may have contributed to the collapse of SVB, the demise of SVB was ultimately caused by poor financial decisions by SVB and a loss of confidence in the banking industry.[6]

The banking industry plays a significant role in the financial stability and growth of the United States. The United States and its citizens rely heavily on credit to make purchases and investments.[7] Without the easily accessible lines of credit that banks provide, the U.S. financial market would collapse.[8] Additionally, banks act as a safe haven for those looking to store their money in a secure location.[9] While banks play the role of creditor and protector of money, the banking industry is still highly competitive.[10] To maximize profits and attract investors, banks seek out high-risk investment opportunities, and these financial decisions do not always result in a positive return.[11] Through multiple poor financial decisions, SVB not only lost money in its investments but lost the confidence of its investors and paid the ultimate price for it.[12]

The goal of this Note is to examine the shortfalls of the current legislation in the banking industry and produce a solution that will allow the banking industry to remain competitive while also putting a stop to any potential bank collapses in the future. Part II of this Note will look at the history of bank collapses and the legislation that followed the collapses. Part III will analyze why the current banking legislation failed to stop the collapse of SVB. Lastly, Part IV will provide a recommendation that will further aid the United States in preventing bank collapses while still allowing the banking industry to remain the competitive cornerstone of the U.S. financial system that it is today.

4. Hannah Lang, Chris Prentice & Pete Schroeder, *US Bank Collapse Sparks Fresh Oversight Fight in Divided Congress*, REUTERS (Mar. 13, 2023), https://www.reuters.com/markets/us/bank-rule-fight-looms-washington-aftermath-svb-collapse-2023-03-13/ (on file with the *Journal of Corporation Law*).

5. Douglas Gillison, *Fed Points Fingers at Trump-era Rollback for SVB Demise*, REUTERS (Apr. 28, 2023), https://www.reuters.com/business/finance/us-fed-points-finger-trump-era-rollback-svb-demise-2023-04-29/ (on file with the *Journal of Corporation Law*).

6. *Id.*

7. Mary Hall, *How the Banking Sector Impacts Our Economy*, INVESTOPEDIA (June 1, 2023), https://www.investopedia.com/ask/answers/032315/what-banking-sector.asp [https://perma.cc/X4F6-DZNS].

8. *Id.*

9. Mark Hendricks, *Is My Money Safe In the Bank?*, FORBES: ADVISOR (Mar. 13, 2023), https://www.forbes.com/advisor/banking/is-my-money-safe-in-the-bank/ [https://perma.cc/5PKW-BQ36].

10. *Id.*

11. Hall, *supra* note 7.

12. Cohen et. al, *supra* note 1.

II. BACKGROUND

Bank collapses and economic depressions are littered throughout U.S. history.[13] It is important to understand why banking legislation exists, how banking legislation fails, and how the U.S. government has responded to these failures in the past because, by analyzing past failures and the responses to those failures, we can gain an understanding of how to properly fix problems in banking legislation in the present and the future. This Note will focus on the creation of the first and second national bank, The Banking Act of 1864, The 1913 Federal Reserve Act, The Great Depression beginning in 1929, and the 2008 financial crisis, as these five events produced the bulk of legislation in U.S. banking.

A. Attempts to Nationalize U.S. Banking Before 1864

Before the National Banking Act of 1864, the United States made two unsuccessful attempts to create a national banking system.[14] These two attempts are recognized as The First Bank of the United States (The First Bank), which was championed by Alexander Hamilton in 1791, and The Second Bank of The United States (The Second Bank), which was created in 1816.[15] When creating these national banks, the U.S. government sought to gain more power and authority in handling the U.S. economy as the government could use fiscal policy to ease the damage of an economic downturn.[16] The idea for The First Bank was brought to Congress by Hamilton in 1790 with the idea that a national bank would help fight inflation, help settle economic disruption, and restore the value of the U.S. currency.[17] The U.S. economy was struggling since the end of the revolutionary war, and Hamilton believed that a national bank that acted as a fiscal agent for the U.S. government, would distribute paper money, and provided a safe place for people to keep their money was the solution to these economic woes.[18] The First Bank did not act like national banks do today.[19] The First Bank was not a lender of last resort, nor did the bank set any type of monetary policy.[20] Although The First Bank performed its intended functions properly, many politicians, including Thomas Jefferson, were afraid that The First Bank would monopolize banking, undermine state banks, and give an advantage to lenders over debtors.[21] Because of these fears, the vote to extend the bank's charter in 1811 failed, and The First Bank was terminated.[22]

13. Matthew Goldberg, *The 7 Largest Bank Collapses in US History*, BANKRATE (May 1, 2023), https://www.bankrate.com/banking/largest-bank-failures/ [https://perma.cc/Q5ZW-ZX66].

14. *Before The Fed*, FED. RSRV. HIST., https://www.federalreservehistory.org/time-period/before-the-fed [https://perma.cc/Y3N5-2UX4].

15. *Id.*

16. *First Bank of the United States*, NAT'L PARK SERV. (Feb. 7, 2024), https://www.nps.gov/inde/learn/historyculture/places-firstbank.htm [https://perma.cc/873F-G8Z5].

17. Andrew T. Hill, *The First Bank of the United States*, FED. RSRV. HIST. (Dec. 4, 2015), https://www.federalreservehistory.org/essays/first-bank-of-the-us [https://perma.cc/FD83-BBHD].

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

22. *First Bank of the United States*, *supra* note 16.

The United States once again found itself in debt and economic turmoil following the War of 1812 which led the U.S. to creating a new iteration of a national bank.[23] The Second Bank played the same role as The First Bank, but this time had a much larger capitalization of $35 million, compared to $10 million for The First Bank.[24] This larger capitalization pool allowed The Second Bank to have a much larger outreach than The First Bank and had a much bigger impact on growing and stabilizing the U.S. economy.[25] However, The Second Bank had one major problem: the newly elected President Andrew Jackson hated banks.[26] Jackson had a bad personal history with banks, believing that the Second Bank was being used to help his political opponents, and that a national bank would undermine state's rights.[27] After Jackson's reelection in 1832, he removed The Second Bank's federal deposit power, which led to the bank's charter renewal being denied in 1834, marking the end of The Second National Bank of the United States.[28]

B. Banking Act of 1864

The history of modern banking legislation begins with the National Banking Act of 1864 (The 1864 Act).[29] In response to the growing need for federal spending caused by the Civil War, Congress sought to nationalize banking laws across all states and encourage spending.[30] Thus the 1864 Act was passed which marked the first time in U.S. history that commercial banks would be actively supervised by the U.S. government.[31] The 1864 Act introduced regulations such as minimum capital levels and reserve requirements meant to increase purchases of U.S. bonds for civil war efforts and create a stable currency and banking system citizens could rely on.[32]

C. The Creation of the Federal Reserve

The 1864 banking system continued throughout the United States until 1913 when the Federal Reserve was created.[33] The 1913 Federal Reserve Act was created in response to unstable markets and depressions that often plagued the U.S. financial market from 1893 to 1907.[34] Before the 1913 Federal Reserve Act, American citizens had little trust in the national banks created by The 1864 Act, as these national banks often had to take out loans from private lenders to meet the demands of people who feared the bank did not have the

23. Andrew T. Hill, *The Second Bank of The United States*, FED. RSRV. HIST. (Dec. 5, 2015), https://www.federalreservehistory.org/essays/second-bank-of-the-us [https://perma.cc/25DB-RAEL].

24. *Id.*

25. *Id.*

26. *Id.*

27. *Id.*

28. Hill, *supra* note 23.

29. National Bank Act of 1864, 12 U.S.C. § 38.

30. Jason Dunn & David C. Wheelock, *National Banking Acts of 1863 and 1864*, FED. RSRV. HIST. (July 31, 2022), https://www.federalreservehistory.org/essays/national-banking-acts# [https://perma.cc/S7JH-BLVE].

31. *Id.*

32. *Id.*

33. *Federal Reserve Act*, BD. OF GOVERNORS OF FED. RSRV. SYS. (Mar. 10, 2017), https://www.federalreserve.gov/aboutthefed/fract.htm [https://perma.cc/QY6P-2KH4].

34. James Chen, *1913 Federal Reserve Act: Definition and Why It's Important*, INVESTOPEDIA (Aug. 5, 2024), https://www.investopedia.com/terms/f/1913-federal-reserve-act.asp [https://perma.cc/9GC9-7S4P].

funds to pay them.[35] These bank runs often created a domino effect because if people heard one bank might be failing, they would rush to withdraw their funds from their bank even if that bank was not in any position to fail.[36] The Federal Reserve sought to end these bank runs by creating a legal and financial safety net for banks and depositors to rely on even in a financial crisis.[37]

To create a stable banking system in the United States, President Woodrow Wilson and the U.S. Congress created the Federal Reserve.[38] The Federal Reserve created a new philosophy towards U.S. banking and gave the U.S. government more power to control the U.S. economy and money supply.[39] The Federal Reserve was created to perform five key functions: (1) Conduct the nation's monetary policy, (2) Promote the stability of the financial system, (3) Promote the safety and soundness of individual financial institutions, (4) Foster payment and settlement system safety and efficiency, and (5) Promote consumer protection and community development.[40]

To carry out these functions, the 1913 Federal Reserve Act created a new U.S. central banking system that no longer had to rely on private lenders in a financial crisis.[41] The Federal Reserve performs its five key functions by setting interest rates, changing reserve requirements, and conducting open market operations to control the money supply.[42] For the Federal Reserve system to work, the Federal Reserve needed to have more power than the central banks that existed before it. The Federal Reserve was granted the ability to control interest rates across the United States and control the money supply.[43] This is why the Federal Reserve is often referred to as a "banker's bank" because the Federal Reserve provides currency to other commercial banks and provides banks with a range of interest rates that they can charge borrowers.[44] The Federal Reserve essentially became the lender of last resort that the U.S. financial system did not have before the Federal Reserve was created.[45]

Additionally, the Federal Reserve was made up of three key entities: (1) The Federal Reserve Board of Governors, (2) twelve Federal Reserve Banks, and (3) The Federal Open Market Committee.[46] These three entities allow the Federal Reserve to make uniform and well-informed decisions about each region of the United States.[47] When the Federal Reserve was first created, the idea was to have twelve decentralized banks that made decisions based on their region and then have the Board of Governors oversee the entirety

35. *Id.*

36. *History and Purpose of the Federal Reserve*, FED. RSRV. BANK OF ST. LOUIS, https://www.stlouisfed.org/in-plain-english/history-and-purpose-of-the-fed [https://perma.cc/C4M7-FFJU].

37. Chen, *supra* note 34.

38. *Id.*

39. *Id.*

40. *Structure and Function of the Federal Reserve System*, BD. OF GOVERNORS OF FED. RSRV. SYS., https://www.federalreserveeducation.org/about-the-fed/archive-structure-and-functions [https://perma.cc/8WCF-YC35].

41. *Id.*

42. *Id.*

43. *Id.*

44. Chen, *supra* note 34.

45. *Id.*

46. *Id.*

47. *Id.*

of the Federal Reserve system.[48] While this system is still in place to this day, as the U.S. financial system became more integrated and complex, the Federal Reserve system became much more of a single system rather than a decentralized, region-based system, meaning that the 12 regional Federal Reserve banks implement mostly the same policies throughout each region.[49]

D. The Great Depression

With the Federal Reserve now in place as the last resort lender in the United States, the U.S. banking system had adequate protection from economic turmoil.[50] At least that is what the U.S. government thought at the time.[51] The Great Depression put the Federal Reserve system to the ultimate test and proved that the Federal Reserve in its current decentralized form did not provide adequate protection for banks to avoid collapses in economic turmoil.[52] The Great Depression proved that the U.S. government needed more protections in place for depositors to ensure depositors that the U.S. banking system was safe to use.[53] This is evidenced by the fact that nearly 40% of all banks in the United States were suspended and eventually closed between 1929 and 1933.[54]

After a short-lived economic downturn in 1920 and 1921, the U.S. economy and stock market began a period of massive growth and expansion.[55] Many industries such as the automobile industry began to rapidly expand during the 1920s, leading to an influx of jobs for the average American worker.[56] With the expansion of the U.S. economy came an increase in investment in the U.S. stock market.[57] Under normal circumstances, people buy and sell stocks based on published data, historical trends, and rumors in the news.[58] However, the stock market in the 20s did not follow this ideology.[59] Instead, the stock market in the 20s became a frenzy of speculation, and traders no longer invested their money based on data, but with the sole purpose and ideology being that the stock market would keep going up and that investors would continually make more money.[60] The

48. *Id.*

49. Chen, *supra* note 34.

50. Kris James Mitchener, *Bank Supervision, Regulation, and Instability During the Great Depression*, 65 J. ECON. HIST. 152, 155 (2005).

51. *Id.*

52. *See id.* at 152.

53. *Id.*

54. *Id.* at 155.

55. Troy Segal, *The Great Depression: Overview, Causes, and Effects*, INVESTOPEDIA (July 13, 2024), https://www.investopedia.com/terms/g/great_depression.asp [https://perma.cc/G752-XCTW].

56. James Grant, *The Forgotten Depression 1921: The Crash that Cured Itself*, MANHATTAN INST. (June 2015), https://manhattan.institute/event/the-forgotten-depression-1921-the-crash-that-cured-itself [https://perma.cc/S7TX-BUV5].

57. Segal, *supra* note 55.

58. Adam Hayes, *Investment Philosophy: Definition, Types, and Examples*, INVESTOPEDIA (Jan. 5, 2024), https://www.investopedia.com/terms/i/investment-philosophy.asp [https://perma.cc/6QQB-Y64K].

59. Leslie Kramer, *The Stock Market Crash of 1929 and the Great Depression*, INVESTOPEDIA (Feb. 27, 2024), https://www.investopedia.com/ask/answers/042115/what-caused-stock-market-crash-1929-preceded-great-depression.asp [https://perma.cc/QAK5-DJAB].

60. Dave Roos, *Here Are Warning Signs Investors Missed Before the 1929 Crash*, HISTORY (Sept. 27, 2024), https://www.history.com/news/1929-stock-market-crash-warning-signs [https://perma.cc/84NK-LX5A]

unprecedented rise in stock market prices was further exacerbated by the immense amount of credit supplied by banks which allowed investors to continue to purchase more stock with borrowed money.[61] Not only were people buying stocks with credit, but the banks were as well.[62] With much of the stock market being boosted by loaned money, a decrease in stock market prices would harm the ability of investors to pay back the credit they took out to invest in the first place. This means that when Black Thursday came on October 24, banks were holding long lines of credit that would never be paid back.

As the stock market frenzy continued to soar during the late 1920s, the banking industry became flooded with competition.[63] Many states had very low minimum capital requirements for banks or had no minimum capital requirement at all, as capital requirements were seen as suggestions.[64] These low minimum capital requirements lowered the barrier to enter the banking industry, which allowed small and underfunded banks to start popping up across the United States[65] These small banks began to take on much riskier investments to compete with larger banks, and when these investments failed, these banks had no capital left to pay depositors.[66]

Additionally, the supervision of banks was quite poor in the 1920s, as each state allowed state officials different levels of authority when monitoring banks.[67] In many cases, state banking commissioners were either influenced politically to continue to allow banks to invest in the economy or didn't have the authority to properly manage banks in the first place.[68]

With the combination of mismanaged banks, poor banking regulation, and the increased use of credit to buy stocks, the U.S. stock market bubble burst leading to the massive collapse of the U.S. banking industry and economy.[69] Depositors rushed to get their money out of banks, but banks were out of cash to pay depositors, leaving many Americans with little to no savings.[70] Because the bank collapses resulted in many Americans losing their savings, the Great Depression caused many Americans to lose faith in U.S. banking. In response, the U.S. government passed three laws to restore faith in U.S. banking and protect investors from potentially poor investments.[71]

The first law passed was the Banking Act of 1933, also known as the Glass-Steagall Act.[72] The Banking Act of 1933 included many provisions, but the most notable were the implementation of deposit insurance, restrictions on the use of bank credit for speculation,

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(describing how a Yale economist argued, in the days leading up to the stock market crash of 1929, that the stock market was not inflated and would not decline).

61. Segal, *supra* note 55.
62. Mitchener, *supra* note 50, at 166.
63. *Id.* at 163.
64. *Id.* at 162–63.
65. *Id.* at 163.
66. *Id.*
67. Mitchener, *supra* note 50, at 164.
68. *Id.* at 164–65.
69. *Id.* at 157–58. (Lobbying efforts and different states having different interests commonly led to banking regulation not being strict enough and vastly different banking laws in each state).
70. Kramer, *supra* note 59.
71. Howard H. Preston, *The Banking Act of 1933*, 23 AM. ECON. REV. 585, 607 (1933).
72. *Id.* at 585.

and increased power for supervising officers.[73] Due to intuitional distrust, it was estimated that over a billion dollars were kept in safety deposit boxes or kept in hiding rather than in banks.[74] The Banking Act of 1933 was meant to assure depositors that the money they kept in banks was safe whether or not the bank failed, as their money was insured.[75]

The next two laws passed in response to the Great Depression were the 1933 and 1934 Securities Acts.[76] While the 1933 and 1934 Securities Acts are an important piece of American history and help explain why the Great Depression occurred, these two acts do not play a large role in banking law. Mentioning these acts is important when talking about the Great Depression; however, these two securities acts will not be an area of focus for this note.

E. The 2008 Housing Market Collapse

Following the Great Depression and its resulting legislation, the U.S. banking system and economy, for the most part, avoided major financial crashes and bank collapses.[77] As with any capitalist market, the U.S. economy experienced waves of turmoil, such as Black Monday in 1987 and the crash of the dot-com bubble in 2000.[78] However, none of these events resulted in catastrophic bank collapses like the Great Depression until the burst of the housing bubble in 2008.[79] The 2008 housing market collapse highlighted the fact that the Banking Act of 1933 did not provide Americans with enough protection from banks, particularly predatory banks looking to take advantage of ordinary people.[80]

The 2008 financial crisis was the product of two poor financial decisions: (1) historically low federal reserve interest rates and (2) the mass distribution of subprime mortgages.[81] In response to the 9/11 terrorist attacks and the burst of the dot-com bubble, the Federal Reserve lowered the federal funds rate from a high of 6.5% in 2000 to 1% in June 2003.[82] Interest rates act as a fee for borrowing money; this means that when interest rates are low, more people borrow money. The 1% interest rate created a large spike in loans taken out to buy houses prompting a large increase in home prices.[83]

Additionally, lenders began distributing subprime mortgages.[84] Subprime mortgages are mortgages given to borrowers with poor or no credit history and often have an

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73. *Id.*

74. *Id.* at 600.

75. *Id.* at 590.

76. *The Laws That Govern the Securities Industry*, SEC:INVESTOR.GOV, https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry [https://perma.cc/755K-R53X].

77. Goldberg, *supra* note 13.

78. Cory Mitchell, *Historical Average Stock Market Returns for S&P 500 (5-Year to 150-Year Averages)* TRADETHATSWING (Sept. 12, 2024), https://tradethatswing.com/average-historical-stock-market-returns-for-sp-500-5-year-up-to-150-year-averages/ [https://perma.cc/UZ6P-EJ9G].

79. Goldberg, *supra* note 13.

80. Manoj Singh, *The 2008 Financial Crisis Explained*, INVESTOPEDIA (Aug. 25, 2024), https://www.investopedia.com/articles/economics/09/financial-crisis-review.asp [https://perma.cc/N8FZ-MNAZ].

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

adjustable interest rate rather than the fixed interest rate that comes with a traditional mortgage.[85] Borrowers who received a subprime mortgage were seen as 'risky,' which meant that these loans needed higher interest rates and adjustable interest rates to make up for the risk the borrower presented.[86] However, the banks distributing the subprime mortgages did not carry any of the risk.[87] The banks that distributed subprime mortgages sold the subprime mortgages to investment companies that turned the loans into collateralized debt obligations (CDOs).[88] The CDOs were then sold as asset-backed securities by investment companies, also known as shadow banks.[89] Shadow banks are exempt from SEC regulations under 3a-7 of the Investment Company Act of 1940, meaning that not only were CDOs a failing investment, but they were also not regulated by the SEC.[90] Shadow banking exasperated the 2008 housing crisis by incentivizing banks to continue offering sub-prime mortgages and then advertising the CDOs made up of these mortgages to shadow banks as a high-yield low-risk investment.[91]

Subprime mortgages work well when interest rates are extremely low because the borrower's mortgage payments are manageable. However, mortgage rates can't stay low forever as the Federal Reserve must eventually raise interest rates to control inflation.[92] When interest rates began to rise in 2006, those who purchased homes with a subprime mortgage began to default on their loans.[93] This caused a massive halt in the distribution of subprime mortgages, meaning that all the banks that were distributing the subprime mortgages to home buyers no longer had an influx of cash coming from shadow banks.[94] Shadow banks were then left with billions of dollars of unrealized debt from the CDOs that were never going to be paid back.[95] Banks and shadow banks started to realize heavy losses which then led to multiple bank collapses.[96] For example, Lehman Brothers, which had a large percentage of its assets tied up in failing CDOs and had multiple quarterly financial reports with billions of dollars in losses, filed for chapter 11 bankruptcy in September 2008, marking the largest bank failure in U.S. history.[97] Lehman Brothers was not the only major bank to collapse in 2008 as over a dozen banks collapsed in 2008 alone with trillions of dollars in assets being liquidated by bankruptcy filings.[98]

With the world economy in shambles and millions of Americans angry that their tax dollars went to billions of dollars' worth of bank bailouts, newly elected President Barack

85. Carol M. Kopp, *What is a Subprime Mortgage? Credit Scores, Interest Rates*, INVESTOPEDIA (Nov. 2, 2024), https://www.investopedia.com/terms/s/subprime_mortgage.asp [https://perma.cc/2A6Q-3TEK].

86. *Id.*

87. Singh, *supra* note 80.

88. *Id.*

89. Patrick M. Corrigan, *Shining Light on Shadow Banks*, 49 J. CORP. L. 1, 18 (2023).

90. *Id.* at 17.

91. *Id.* at 13–14.

92. *See* Singh, *supra* note 80 (describing how the Federal Reserve raised rates in 2004).

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Singh*, supra note 80.

98. *Bank Failures in Brief – Summary*, FDIC (2024), https://www.fdic.gov/resources/resolutions/bank-failures/in-brief/index [https://perma.cc/A32U-4ZA2].

Obama passed the Dodd-Frank Act.[99] The Dodd-Frank Act included three major financial regulations, with the purpose being to restrict financial institutions from making poor or predatory investments.[100] First, the Financial Stability Oversight Committee (FSOC) was created to identify new and emerging threats to financial stability.[101] The FSOC also has the power to delegate non-bank financial institutions as systemically significant which allows the FSOC to monitor and regulate non-banks.[102]

Second, the Dodd-Frank Act created the Consumer Financial Protection Bureau (CFPB) which was created to prevent predatory mortgage lending.[103] With predatory subprime mortgages being the biggest contributor to the 2008 financial crisis, the goal of the CFPB was to ensure that potential borrowers are not taken advantage of by mortgage companies and to make sure borrowers are aware of all of the terms included in their mortgages.[104]

Lastly, the Dodd-Frank Act introduced the Volcker Rule.[105] The Volcker Rule puts restrictions on how banks can invest in the market by evaluating the inherent risk of investments to ensure that banks are not engaging in speculatory trading.[106] Additionally, the Volcker Rule ended proprietary trading which is when a bank uses its capital rather than funds from clients to make financial transactions.[107]

The Dodd-Frank Act has been highly criticized as critics argue that the regulatory powers given to the FSOC are too strong and will hinder the competitive aspect of the banking industry.[108] In response to the criticism, in 2018, President Donald Trump passed the Economic Growth, Regulatory Relief, and Consumer Protection Act which rolled back some of the regulations of the Dodd-Frank Act for small to medium-sized financial institutions.[109] The goal of this act was to allow smaller financial institutions to compete in the banking industry without being burdened by strict regulation from the FSOC.[110] The Act increased the dollar amount of assets a bank needed to qualify for FSOC regulation from $50 billion to $250 billion.[111] According to SVB's website, SVB has $212 billion in assets, meaning that the Economic Growth Act no longer allowed the FSOC to regulate SVB.[112]

99. Adam Hayes, *Dodd-Frank Act: What it Does, Major Components, and Criticisms*, INVESTOPEDIA (July 11, 2024), https://www.investopedia.com/terms/d/dodd-frank-financial-regulatory-reform-bill.asp [https://perma.cc/KG4T-V55R]; Daniel Schwarcz & David Zaring, *Regulation by Threat: Dodd-Frank and the Nonbank Problem*, 84 U. CHI. L. REV. 1813, 1824 (2017).

100. Hayes, *supra* note 99.

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. Hayes, *supra* note 99.

106. *Id.*

107. *Id.*

108. *Id.*

109. Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018, Pub. L. No. 115–174, 132 Stat. 1296.

110. *Id.*

111. *Id.*

112. Silicon Valley Bank, Annual Report (Form 10-K) (Feb. 24, 2023).

III. ANALYSIS

Before discussing how SVB collapsed, it is important to understand why the banking industry is so important to the U.S. economy and why bank failures pose such a threat to global financial stability. SVB was classified as a commercial bank, meaning that it performed two main functions.[113] First, SVB receives money from customers who want to hold their money in a bank account with the promise that the depositor can take out their money at any time and that their money will not be lost or stolen.[114] Often depositors will receive an interest rate on the money they deposited meaning that depositors earn money while holding their money in a bank account.[115] Second, commercial banks then loan out the money that they receive from depositors to people or businesses so that these borrowers can pay expenses or make purchases.[116] SVB makes money by charging higher interest rates on the money they loan out compared to the interest rate they pay on the money that was deposited in bank accounts.[117] Because banks have minimum capital requirements mandated by federal law, to increase the amount of money they loan out and therefore increase profits, banks must increase the amount of money they receive from depositors.[118]

While the main functions of a commercial bank seem quite simple, it cannot be overstated how vital banks are to the economy. Bank loans are the main source of money for most major purchases by your ordinary American and are the lifeline to most businesses.[119] As of 2024, American households held $17.8 trillion in debt and the average household held $104k in debt.[120] This $17.8 trillion debt is what allows people to buy houses, cars, and pay for their daily lives.[121] If Americans were unable to take out loans to buy expensive items, the U.S. economy would come to a halt.[122] Consumer debt increases GDP in the short run by giving consumers the liquidity to purchase items that they cannot afford to pay in cash.[123] Economists argue that having much debt compared to liquid assets decreases GPD in the long term as consumers are stuck paying large monthly payments on loans and, therefore, cannot afford to purchase items in the future.[124] While loans might hurt long-term GDP growth if debt is improperly managed, the positive effect consumer

113. *What is 'Commercial Bank'*, ECON. TIMES, https://economictimes.indiatimes.com/definition/commercial-bank [https://perma.cc/9949-LAN3].

114. Mary Hall, *How the Banking Sector Impacts Our Economy*, INVESTOPEDIA (June 1, 2023), https://www.investopedia.com/ask/answers/032315/what-banking-sector.asp [https://perma.cc/A4ZP-99VR].

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

119. Jack Caporal, *Average American Household Debt in 2024: Facts and Figures*, MOTLEY FOOL MONEY (Nov. 14, 2024), https://www.fool.com/the-ascent/research/average-household-debt/ [https://perma.cc/D6P7-ZNJ2].

120. *Id.*

121. *See id.* (explaining the total American household debt in Q2 2024 is $17.8 trillion).

122. Julia Kagan, *Consumer Debt: Understanding the Pros and Cons*, INVESTOPEDIA (July 18, 2024), https://www.investopedia.com/terms/c/consumer-debt.asp [https://perma.cc/N9WD-C39K].

123. *Id.*

124. Marco Lombardi, Madhusudan Mohanty & Ilhyock Shim, *The Real Effects of Household Debt in the Short and Long Run* 4 (Bank for Int'l Settlements, BIS Working Paper No. 607, 2017), https://www.bis.org/publ/work607.pdf [https://perma.cc/Y2GQ-NVKC].

loans have on the economy is still extremely significant.[125] This is evidenced by the fact that 78% of home purchasers from July 2021 to June 2022 purchased a home with a loan.[126]

While the $17.1 trillion in consumer debt is a significant amount of money issued by lenders, it only makes up about half of the debt in the United States.[127] In 2020, businesses held a combined $17.7 trillion in debt in the United States.[128] A majority of this debt is held by the largest companies in the United States such as Apple, Amazon, Google, and Microsoft as these companies take out large amounts of debt to acquire smaller companies.[129] However, much of the $17.7 trillion is also held by small businesses that use loans to pay their employees, purchase equipment, or fund new projects.[130] Like consumers, businesses would not be able to grow or function without taking out loans.[131]

Because the U.S. economy is so reliant on debt to grow, avoiding bank collapses is extremely important. Bank collapses result in: (1) any depositor who had over $250k in the collapsed bank losing any money that was over 250k, or (2) every depositor having their deposits fully insured and paid for by taxpayers' money.[132] When people lose their money to a bank collapse, they are less inclined to put any more money into the banking industry due to a loss of confidence in banks.[133] This leads to banks having fewer deposits meaning that banks can no longer lend as much money as they could before.[134] If bank loans are restricted, then consumer spending is limited leading to a shrinkage of GDP of the economy.[135]

If the U.S. government decides to fully insure every depositor, which is what the U.S. government did with SVB depositors, then the hard-earned tax dollars of Americans will be used to bail out businesses rather than going to other goals.[136] Bailouts are unfair to the average American who pays their taxes. Taxes are meant to fund government programs that improve quality of life, not bailout wealthy depositors at a failing bank. This principle is yet another reason why U.S. banking laws need to be stronger to prevent bank collapses.

125. Alex Horowitz & Tara Roche, *Small Mortgages are Too Hard to Get*, PEW (July 3, 2023), https://www.pewtrusts.org/en/research-and-analysis/issue-briefs/2023/06/small-mortgages-are-too-hard-to-get [https://perma.cc/X6W3-9853].

126. *Id.*

127. *Borrowing by Businesses and Households*, BD. OF GOVERNORS OF FED. RSRV. SYS. (May 2021), https://www.federalreserve.gov/publications/may-2021-borrowing-by-businesses-and-households.htm [https://perma.cc/4Q7C-QSUZ].

128. *Id.*

129. *Id.*

130. *See id.*

131. *See id.*

132. *See* Preston, *supra* note 71, at 590.

133. *Id.*

134. *See* Gillison, *supra* note 5.

135. *Id.*

136. *See* Press Release, FDIC, FDIC Creates a Deposit Insurance National Bank of Santa Clara to Protect Insured Depositors of Silicon Valley Bank, Santa Clara, California (Mar. 10, 2023), https://www.fdic.gov/news/press-releases/2023/pr23016.html [https://perma.cc/6MSA-ZX42].

A. How Bank Regulation Affects the Economy and the Importance of Banking Competition

While businesses take out loans to compete in the free market, banks themselves are competing in the free market. Competition drives prices down so that consumers pay a lower price for a good.[137] Commercial banks lower interest rates on loans while simultaneously increasing the interest rates they pay to depositors to be more competitive.[138] In theory, banks would be very similar in terms of price and profit margin because every bank would charge and pay the interest at the market rate.[139] However, in practice, commercial banks use strategies other than price to compete.[140] Commercial banks often take on investments with higher risks to increase their assets.[141] These riskier investments are typically long-term loans given to businesses less likely to pay back the loan, investments in long-term debt such as fixed-rate bonds, and having a high debt-to-liquid asset ratio.[142] Banks can increase the amount of money they loan out by lending to riskier businesses and can increase the value of their current assets by earning an interest rate on bonds.[143]

Allowing commercial banks to invest in risky opportunities accomplishes two outcomes: (1) Banks can increase profits and growth by competing with other banks, and (2) the barrier to loans for consumers and businesses is lower.[144] Overregulation of commercial banks would put a stop to banks investing in risky opportunities, therefore shrinking GDP and the economy as consumers and businesses who were able to obtain a loan before the regulation can no longer obtain a loan.[145] Risk-taking for commercial banks is not only important for the growth of commercial banks but has become necessary for economic growth.[146] Negative and slowing economic growth rates lead to lower levels of production, investment, real income, and increases in unemployment.[147] Because

137. *Why is Competition Important in Banking?*, BANK OF ENG. (Jan. 10, 2019), https://www.bankofengland.co.uk/explainers/why-is-competition-important-for-banks [https://perma.cc/P638-826S].

138. *Id.*

139. Christopher J. Neely & Michelle Clark Neely, *Interest Rate Risk, Bank Runs, and Silicon Valley Bank*, FED. RSRV. BANK OF ST. LOUIS (May 11, 2023), https://www.stlouisfed.org/publications/regional-economist/2023/may/interest-rate-risk-bank-runs [https://perma.cc/9U9C-ZJP5].

140. *Id.*

141. Silicon Valley Bank invested in long term bonds to increase yield when interest rates were low. *Id.* However, a large increase in interest rates over the coming year caused the value of these long-term bonds to drop dramatically. *Id.*

142. *Id.* U.S. government bonds are not inherently risky as the U.S. government has never defaulted on U.S. bonds. Neely & Neely, *supra* note 139. However, the risk of buying fixed rate bonds is that the market value of the bond will fall if the interest rate of the bond is significantly lower than the current interest rate for U.S. bonds. *Id.*

143. *Id.*

144. Paolo Coccorese, *Banking Competition and Economic Growth*, *in* HANDBOOK OF COMPETITION IN BANKING AND FINANCE 230, 234 (2017).

145. ORG. FOR ECON. COOP. & DEV., BANK COMPETITION AND FINANCIAL STABILITY 9 (2011), https://www.oecd.org/daf/fin/financial-markets/48501035.pdf [https://web.archive.org/web/20230327163623/https://www.oecd.org/daf/fin/financial-markets/48501035.pdf].

146. *Id.* at 20.

147. Adam Hayes, *Negative Growth: Definition and Economic Impact*, INVESTOPEDIA (Nov. 13, 2020), https://www.investopedia.com/terms/n/negative-growth.asp [https://perma.cc/TT95-9M3E].

consumers and businesses have become so reliant on bank loans for purchases, overregulation of the banking industry not only kills banking competition but kills the economy as well.[148]

However, banking regulation is necessary as the under-regulation of banks has been the cause of many financial crises over the past 150 years.[149] Competition in banking has led to many innovations in the financial industry which led to higher profits for banks and easier access to loans for consumers and businesses.[150] The problem that exists with banking innovation is that these innovations create risk which sometimes develops into financial crises.[151] Examples of this can be seen in the 1929 Great Depression and the 2008 financial crisis. During the great depression, banks continued to allow borrowers to pour more money into the stock market, and the banks invested in the stock market themselves.[152] Banks profited in the short term as their high-risk, high-reward investments paid off, but eventually, these investments into the highly overvalued stock market led to the collapse of almost half of all U.S. banks.[153]

Similarly, banks thought they struck gold in the mid-2000s with sub-prime mortgages and CDOs as the number of depositors and borrowers was skyrocketing , leading to massive growth and increased profits.[154] Sub-prime mortgages and CDOs once again led to massive, short-term growth but ended up creating one of the biggest financial depressions in world history.[155] Financial depressions show that banking regulation is necessary for an economy to grow and avoid major crises.[156] Without proper banking regulation, commercial banks would seek more opportunities to increase profit, leading to an increase in risk for the entirety of the banking industry which would ultimately cause more bank collapses.[157] There should be no question that banking regulation should always be a major concern for lawmakers. Rather, the question for lawmakers is how much regulation is necessary to avoid major financial crises while simultaneously allowing banks to compete, innovate, and grow.

148. Vasco Curdia, *Economic Effects of Tighter Lending by Banks*, FED. RSRV. BANK S.F. (May 6, 2024), https://www.frbsf.org/research-and-insights/publications/economic-letter/2024/05/economic-effects-of-tighter-lending-by-banks/#toc_Conclusion [https://perma.cc/FB2Z-GMLK]. A short-term tightening on lending leads to increased unemployment, likely to persist for multiple years. *Id.* A tightening of a greater proportion of lending standards for an extended period would have a much greater effect. *Id.*

149. Mark A. Calabria, *Did Deregulation Cause the Financial Crisis?*, CATO INST. (July/Aug. 2009), https://www.cato.org/policy-report/july/august-2009/did-deregulation-cause-financial-crisis [https://perma.cc/9XF4-KZWK].

150. *Id.* Banks discovered they could greatly increase the amount of loans they gave out if they gave out sub-prime mortgages to unsophisticated investors. *Id.* While this strategy did increase profits in the short run, sub-prime mortgages were extremely predatory and were a major contributor to the 2008 financial crisis. *Id.*

151. Kramer, *supra* note 59.

152. Mitchener, *supra* note 50, at 166.

153. *Id.*

154. Singh, *supra* note 80.

155. *Id.*

156. Calabria, *supra* note 149. Poor banking regulation leads to financial crashes and bank failures. *Id.* Proper banking regulation would allow the economy to not undergo a financial crisis and speed up economic growth. *Id.*

157. *Id.*

B. SVB's Failure to Monitor Potential Risk and Their Ultimate Collapse

SVB was one of the fastest-growing banks in the world before its collapse, as SVB went from $71 billion in total assets in 2019 to $211 billion in total assets in 2021.[158] SVB achieved this growth by investing heavily in the technology sector and providing funds to startup technology companies that saw massive growth until 2023.[159] Two factors ultimately caused SVB's collapse: (1) slowing activity in the technology sector and (2) rising interest rates.[160]

SVB was known for being the bank that startups should go to if they are deemed too risky by other banks; they profited off tech startups by investing heavily before the technology sector boom.[161] This strategy worked extremely well for SVB until the market changed. The technology sector, which had for so long been able to grow at a rapid pace due to low interest rates and large investments from venture capital firms, was no longer growing at such a rapid rate in 2022 and 2023.[162] Many firms in the tech industry started to cut costs rather than focus on growth, meaning SVB no longer had deposits from clients nor did SVB have many tech startups to loan to.[163] This meant that the inflow of deposits to SVB was quite low while the outflow of deposits was quite high, leaving SVB with very few liquid assets.[164] When a bank poorly manages its liquidity, it becomes susceptible to bank runs.[165] SVB's liquidity issues quickly became apparent to SVB depositors through social media, which led to depositors rushing to get what liquid cash SVB had left.[166]

SVB's liquidity issues were further exacerbated by the large amount of long-term bonds the bank was holding.[167] U.S. bonds are considered the safest form of interest-yielding investments in the world as the United States has never defaulted on its bond interest payments.[168] Long-term bonds are typically paid out over 20 or 30 years and offer a higher interest rate than short-term bonds.[169] The problem SVB faced is that long-term bonds have a fixed interest rate.[170] SVB purchased long-term bonds before the interest rate spikes following COVID-19, meaning that the bonds SVB was holding were less valuable than bonds that could have been purchased from the U.S. government.[171] SVB tried to sell these long-term bonds to get more cash but had to sell the bonds at a massive loss due to the increased interest rates.[172] With SVB already low on liquid assets, taking a massive loss on bonds they thought were equivalent to cash at the time of purchasing them, meant

158. Memorandum from Michael S. Barr, Vice Chair for Supervision, Bd. of Governors of the Fed. Rsrv. Sys., Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank 7 (Apr. 28, 2023), https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf [https://perma.cc/ZJR9-QLGC].
159. *Id.* at 2.
160. *Id.* at 7.
161. *Id.*
162. *Id.* at 17.
163. Memorandum from Michael S. Barr, *supra* note 158, at 18.
164. *Id.*
165. *Id.*
166. *Id.* at 2.
167. *Id.*
168. Curdia, *supra* note 148.
169. *Id.*
170. *Id.*
171. Memorandum from Michael S. Barr, *supra* note 158, at 4.
172. *Id.*

SVB had significantly less cash than expected.[173] The combination of low-interest bonds, fewer deposits, and worsening consumer sentiment led to a bank run on SVB in March 2023, which quickly resulted in SVB being insolvent.[174]

C. Banking Regulations' Failure to Stop the Collapse of SVB

When determining what banking regulations could have prevented the collapse of SVB, two major regulations need to be examined: (1) Liquidity stress testing and (2) Liquid coverage ratio.[175] Liquidity stress testing allows a bank to analyze its portfolio and determine if the bank has enough liquid assets to withstand a market disruption.[176] A liquidity stress test would have likely been able to detect that SVB was in danger of running out of liquid assets in a financial crisis. However, the Trump rollbacks, which increased the amount of assets needed for a bank to undergo enhanced supervision, took SVB out of enhanced supervision and SVB was not subject to enhanced liquidity testing.[177]

However, there is an argument to be made that liquidity tests would not have been enough to save SVB. This is because SVB purchased many of its long-term bonds during 2020 and 2021.[178] The Federal Reserve maintained an interest rate of nearly 0% from early 2020 to early 2022.[179] Then, starting in March 2022, the Federal Reserve increased interest rates to 5.5% in just six months, marking the fastest increase in interest rates in U.S. history.[180] Liquidity testing would have been able to detect SVB's liquidity issue, but there is no telling if these tests would have granted regulators enough time to stop SVB from collapsing.[181] These facts present a question for regulators, as they must answer how banking regulation will address unprecedented market changes, such as the interest rate rises after the COVID-19 pandemic.

Part of the answer to the questions that will be presented to bank regulators is the Liquid Coverage Ratio (LCR). LCR measures the amount of assets a bank has that can be easily and immediately liquidated into cash at little or no loss.[182] Banks that are subject to enhanced regulation must maintain an LCR of 100%.[183] However, SVB did not meet the

173. *Id.*

174. *Id.*

175. Dan Fitzpatrick, David Hollerith & Jennifer Schonberger, *How Silicon Valley Bank Skirted Washington's Toughest Banking Rules*, YAHOO FIN. (Mar. 13, 2023), https://finance.yahoo.com/news/how-silicon-valley-bank-skirted-washingtons-toughest-banking-rules-215501909.html [https://perma.cc/RWF7-T4J9].

176. Antoine Bouveret, *Liquidity Stress Tests for Investment Funds: A Practical Guide* 1 (Int'l Monetary Fund, Working Paper No. 17/226, 2017), https://www.imf.org/en/Publications/WP/Issues/2017/10/31/Liquidity-Stress-Tests-for-Investment-Funds-A-Practical-Guide-45332#.

177. Silicon Valley Bank, *supra* note 112.

178. Memorandum from Michael S. Barr, *supra* note 158, at 30. (showing that SVB purchased a large number of held to maturity securities in January 2021 when interest rates were very low).

179. *United States Fed Fund Interest Rates*, TRADING ECON., https://tradingeconomics.com/united-states/interest-rate [https://perma.cc/9CLL-AJMA].

180. *Id.*

181. Cohen et al., *supra* note 1.

182. Miguel Rodríguez Canfranc, *LCR and NSFR, Banks' Liquidity Shield*, BBVA (Apr. 9, 2024), https://www.bbva.com/en/lcr-and-nsfr-what-do-these-liquidity-ratios-stand-for [https://perma.cc/238B-YXLJ].

183. *Id.*

$250 billion threshold, meaning that it was not subject to the 100% LCR floor.[184] Studies show that SVB had an LCR of about 75% at the end of 2022, three months before it went bankrupt.[185]

Knowing this, it would be easy to simply blame the Trump rollbacks for the failure of SVB. You could argue that if SVB was required to maintain an LCR of 100% then it would have had the liquid cash necessary to pay out depositors and no run would have occurred.

However, SVB presents a unique scenario because its LCR was significantly affected by the clientele it possessed. Most of SVB's depositors were startup tech companies which tend to move cash very quickly.[186] What this meant for SVB is that its LCR would be very hard to calculate because depositors were pulling cash out of SVB extremely quickly.[187] Even if SVB was required to maintain an LCR of 100%, this number would simply be an estimate, and this estimate would have likely been too low given the amount of cash that was being pulled out of SVB. Under normal circumstances, a bank would be able to accurately predict its LCR because the bank would have a diverse client base with some clients pulling a lot of money out during an economic downturn and some clients not pulling any money out since their business is well established and not low on cash.[188] SVB, on the other hand, only had clients pulling out money and few clients with a cash flow able to weather the economic downturn.[189]

For regulators, in certain circumstances, enhanced regulation is not necessarily enough to stop a bank from collapsing. Enhanced regulation of SVB would have helped the situation and potentially allowed SVB to avoid a full collapse. However, the combination of unprecedented interest rate rises and SVB's unique client base suggests that enhanced regulation is not enough. There needs to be banking regulations and testable factors that consider a bank's client base. SVB proved that typical banking standards and estimates cannot be trusted when a bank does not have typical clients or investment strategies.[190] Additionally, the current enhanced regulations are not enough to fend off unprecedented economic conditions. Banking regulations either need to enforce stronger restrictions on banks so that they are better prepared for an economic crisis, or the Federal Reserve needs restrictions when interest rates rise. By strengthening banking regulations, banks will no longer be able to make such risky investments. If the Federal Reserve is restricted on how fast it can raise interest rates, banks will have more time to react to interest rates, and banks like SVB will not have to sell their long-term bonds at such a large loss to meet liquidity requirements.

IV. RECOMMENDATION

Making the argument that the Trump rollbacks in the Economic Growth, Regulatory Relief, and Consumer Protection Act caused the collapse of SVB is not necessarily wrong.

184. Greg Feldberg, *Lessons from Applying the Liquid Coverage Ratio to Silicon Valley Bank*, YALE SCH. OF MGMT. (Mar. 27, 2023), https://som.yale.edu/story/2023/lessons-applying-liquidity-coverage-ratio-silicon-valley-bank [https://perma.cc/L3WP-E7JZ].

185. *Id*.

186. Memorandum from Michael S. Barr, *supra* note 158, at 16.

187. *Id.*

188. *Id.*

189. *Id.*

190. *Id.*

If SVB were under enhanced supervision and were given proper liquidity tests, the collapse of SVB could have been easier to see or prepare for. However, simply reversing the Trump rollbacks does not ensure that bank collapses won't happen and will not ensure that Americans will once again fully trust U.S. banks. For this reason, I recommend the United States make two changes to banking regulatory law. First, the Trump rollback that increased the amount of assets a bank needs to undergo enhanced liquidity testing needs to be reversed, not just to banks with $50 billion or more in assets, but to every bank. Every person with money in a U.S. bank should have access to information about the current state of their bank's liquidity so that depositors can ensure their money is safe in the bank. Second, banks with $50 billion or more in assets should be subject to either client diversification requirements, or a higher liquidity standard to ensure banks have cash on hand during an economic crisis.

A. Liquidity Testing and Reporting Requirements

The Trump rollback in 2018 was not just a rollback of liquidity testing for banks, it was a rollback on overall enhanced supervision.[191] This meant that the rollback included capital stress tests, liquidity stress tests, resolution plans, asset thresholds, and risk management requirements.[192] SVB was still subject to strict banking regulations but was no longer subject to enhanced prudential standards, which included risk control, capital and liquidity tests, and resolution plans.[193] Enhanced supervision was not needed to detect the potential collapse of SVB. The SVB crisis could have been potentially avoided or aided by simply performing liquidity stress tests, which is why I recommend that the capital requirement for enhanced supervision liquidity stress tests be completely abolished.

Before the Trump rollbacks, any bank with $50 billion or more in assets was subject to enhanced supervision.[194] My recommendation is that the capital requirement for enhanced supervision stays at $250 billion but liquidity testing and reporting no longer be considered enhanced supervision. Rather, every bank in the United States should be required to perform and report quarterly liquidity testing. By requiring every U.S. bank to report their liquidity tests, no depositor of a U.S. bank will ever have to guess or speculate about the safety of their deposits. This will eliminate speculative bank runs like the run on SVB as depositors can either be assured their bank has enough money to cover withdrawals or understand that their bank will inevitably fail. In cases where a bank fails, every depositor will have equal access to information about the bank's failure and will give every depositor an equal opportunity to withdraw their funds. When SVB failed, we saw a domino effect of other banks experiencing bank runs as depositors became worried their bank was in a similar financial situation.

Eliminating speculation is important for the overall growth of the U.S. economy because, as we saw with the collapse of SVB, people begin to lose trust in banks and decline

191. Mayra Rodriguez Valladares, *How Trump's Deregulation Sowed the Seeds for Silicon Valley Bank's Demise*, FORBES (Mar. 16, 2023), https://www.forbes.com/sites/mayrarodriguezvalladares/2023/03/12/how-trumps-deregulation-sowed-the-seeds-for-silicon-valley-banks-demise/?sh=713da8193432 (on file with the *Journal of Corporation Law*).

192. *Id.*

193. *Id.*

194. Schwarcz & Zaring, *supra* note 99, at 1822.

to use them when they feel they cannot trust banks. If the U.S. government wants the economy to continue to grow, it must ensure that people trust banks enough to deposit their money in banks. In turn, this allows banks to make more loans and for people and companies to make more purchases and continue economic expansion.

However, this recommendation could potentially cause problems for unsophisticated investors. A sophisticated investor, such as a bank, financial institution, business, or educated investor, will be able to properly read a liquidity test from a bank and determine if the bank has a healthy amount of cash on hand and stable investments.

An unsophisticated investor who does not know how to properly read a liquidity statement might be inclined to misread bank statements and falsely accuse a bank of being in danger of collapsing. These false accusations from unsophisticated investors would lead to even more bank running on banks that are not in financial trouble. It is unrealistic to assume that every investor can properly read a bank's financial statements and act rationally when making financial decisions. Educating people on how to read a bank's financial statements on such short notice is also unrealistic. A potential fix to the unsophisticated investor problem is to have The Federal Reserve or the FDIC label each bank's liquidity statements with a rating such as very healthy, healthy, or somewhat healthy. These statements would allow an unsophisticated investor to understand how healthy a bank's liquidity tests are without having to read the bank's financial statements themselves. These labels are also optimistic and do not include an unhealthy label, as any bank that was labeled unhealthy would surely experience a bank run.

B. Every Industry Operates Differently and Therefore Should be Treated Differently

Each type of industry in the United States carries different types of risks.[195] This can be seen by the differences in beta (measure of volatility or systemic risk) in each sector.[196] For example, the oil and gas distribution industry presents a beta of 0.79, a very low beta which represents a low risk in the industry.[197] On the other hand, other industries present much a higher beta, meaning that an investment in these industries is much more risky.[198] Technology industries such as semiconductor equipment with a beta of 1.53, internet software with a beta of 1.53, and consumer electronics with a beta of 1.62, represent a much higher risk to investors and companies within the industry.[199] When governing banks, governing banks differently based on the volatility of the bank's clients could help

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195. *See* Aswath Damodaran, *Betas by Sector (US)*, N.Y.U. STERN (Jan. 2024), https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/Betas.html [https://perma.cc/VF4P-4V96]. (displaying various industry risks).

196. *Id.*

197. *Id.*

198. S*ee* Will Kenton, *What Beta Means for Investors*, INVESTOPEDIA (July 11, 2024), https://www.investopedia.com/terms/b/beta.asp [https:/perma.cc/9328-STZL] (explaining how a security's beta is calculated); Daniel Liberto, *What Beta Means When Considering a Stock's Risk*, INVESTOPEDIA (June 6, 2024), https://www.investopedia.com/investing/beta-know-risk/ [https://perma.cc/ENY7-58W3] (explaining that beta is the measure of volatility of a stock or group of stocks in a certain industry). If an industry has a beta greater than 1, that industry is expected to be more volatile than the stock market, meaning that when the stock market goes down, investments in an industry with a beta higher than 1 can lead to large losses. *Id.*

199. *See* Damodaran, *supra* note 195.

the United States avoid unique situations such as the SVB collapse. My second recommendation opens banks to regulation based on the bank's portfolio of clients. This allows banks with many volatile clients to be properly regulated, while banks with a more diverse client portfolio will be able to operate without these stricter regulations.

SVB presented a situation where the bank should have been regulated more harshly as SVB was heavily exposed to the fast-moving and constantly changing tech industry.[200] Most of SVB's depositors were up-and-coming tech companies who were seen as risky clients.[201] Part of the risk associated with these startup tech companies was that they move their money very fast.[202] In 2021, SVB saw a $100 billion increase in deposits as these tech startup companies were flourishing and flooded with cash.[203] When interest rates rose, tech startups moved quickly and required a lot of cash, causing SVB's cash flow to decrease more than expected.[204] If SVB had a diversified portfolio of clients, this sudden and unexpected decrease in deposits would not have been so large. Companies that are more established or in steadier industries such as oil, mining, and retail would not have been so cash-demanding when interest rates rose and therefore would not have withdrawn as much money from the bank as tech startups did. This is why my second recommendation forces banks to adhere to one of two requirements: (1) banks prove to regulators that they have a diversified portfolio of clients that will not be overly cash-demanding in an economic crisis or (2) banks adhere to an enhanced liquidity coverage ratio.

Currently, under the Basel III Agreements, the LCR is 100%.[205] This means that the amount of liquid cash a bank can generate must meet the expected total cash outflows for the next 30 days.[206] While the Basel III Agreement is a great law for banking regulation, the problem that it presents is that it says "expected total cash outflows".[207] If you are SVB and most of your clients are startup tech companies that make sudden and unexpected withdrawals constantly, it is very easy to underestimate the amount of cash you need to have a 100% LCR. Requiring banks to have a diverse portfolio of clients will make it so calculating LCR is no longer a guessing game. Clients who are either well-established companies or in a safer sector will not be pulling money out of the bank as fast as startup tech companies so banks can be assured their calculated LCR is very close to reality rather than a somewhat educated guess. If SVB had a more accurate prediction of the money they were going to lose to withdrawals in 2022 and 2023, they could have made more informed decisions when purchasing long-term bonds and therefore would have had more liquid cash to cover withdrawals.

If banks prefer not to have a diversified portfolio of clients and would rather have a client base made up of mostly tech startups like SVB, then they need to adhere to an enhanced LCR requirement. The enhanced LCR requirement would likely have to be 125–50%, rather than 100%. This requirement allows LCR calculations to continue to be a

200. Memorandum from Michael S. Barr, *supra* note 158, at 18.
201. *Id.*
202. Wall Street Journal, *How Silicon Valley Bank Collapsed in 36 Hours | WSJ What Went Wrong*, YOUTUBE (Mar. 15, 2023), https://www.youtube.com/watch?v=QACGoKb48_0.
203. *Id.*
204. *Id.*
205. *Id.*
206. *Id.*
207. Wall Street Journal, *supra* note 202.

guessing game. It is okay to be less accurate with a higher LCR requirement because even if withdrawals are higher than expected, banks will have more liquid cash to cover withdrawals.[208] Each of these requirements will allow banks to make more informed decisions about what to do with excess cash. Instead of putting too much cash into long-term bonds like SVB, banks will have a better understanding of their liquidity requirements and will not put cash into assets that are not liquid or risk taking a big loss.

V. CONCLUSION

In conclusion, banking regulation affects more than just banks. Banking regulation can greatly affect the U.S. economy because when banking regulation fails, economic crises are often soon to follow. When SVB collapsed in 2023, a wave of people losing faith in U.S. banks followed with other banks being wiped out by bank runs in the process. If the U.S. government wishes to ensure people fully trust banks, it must create banking regulations that will stop any bank collapse. SVB was a clear signal that banking regulation does not have liquidity requirements strict enough to stop bank collapses because SVB was able to amass such poor liquidity that a bank run occurred.

However, banking regulation does not need a complete overhaul to fix its issues. By requiring every bank in the United States, to undergo liquidity stress tests and reporting, the U.S. government can ensure every bank depositor has accurate information on the health of their bank. Furthermore, by requiring banks to either have a diverse portfolio of clients or adhere to enhanced LCR requirements, banks will no longer create liquidity problems for themselves because of poor information. These changes to banking regulation will put a stop to banks having too few liquid assets and will allow the banking industry to remain competitive, innovative, and the center of the U.S. economy.

208. Chris B. Murphy, *Liquidity Coverage Ratio (LCR): Definition and How to Calculate*, INVESTOPEDIA (June 27, 2024), https://www.investopedia.com/terms/l/liquidity-coverage-ratio.asp# [https://perma.cc/VBJ2-NPW3] (explaining that LCR is calculated by dividing high-quality liquid asset amount by total net cash outflow amount). An increase in high-quality liquid asset amount would increase LCR, therefore increasing the cash a bank has available to cover withdrawals. *Id.*