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Treasury Management for Fiduciaries in the Wake of Recent Bank Failures

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Recent turmoil in the U.S. banking system has brought the treasury management function of all institutions into sharper focus. Within the corporate bankruptcy space, federal and state fiduciaries, such as receivers and U.S. trustees, often manage substantial cash positions for the benefit of receivership or bankruptcy estates. In order to protect estates for the ultimate benefit of creditors or even defrauded victims, these fiduciaries are typically mandated with minimizing risk. In the wake of recent bank failures, it is more important than ever to carefully consider the cash-management options available for the needs of each particular case and the risk tradeoffs to analyze when operating within the structures of the U.S. banking system.

An Overview of the U.S. Banking System and FDIC Insurance

At banking institutions insured by the Federal Deposit Insurance Corp. (FDIC), deposits up to $250,000 held by an individual or entity at each bank are insured. As of Q4 2022, there were 4,706 FDIC-insured banks in operation. While the recent bank failures in 2023 have heightened concerns about bank stability, the failure of FDIC-insured institutions have been relatively rare since 1933. According to the FDIC's published data, there were no failures in 2022 or 2021, four in 2020, four in 2019, zero in 2019, eight in 2017 and five in 2016.

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When bank failures do occur, insured deposits are typically moved to a successor bank, usually overnight or close to it, and are generally available within days. Uninsured deposits are transformed into receivership certificates, typically with an initial dividend paid right away.

Payouts on the remaining value of the certificates generally occur over the life of the receivership as assets are unwound. In the recent Silicon Valley Bank and Signature Bank cases, the federal government intervened to make sure that uninsured depositors were made whole.

An Overview of Cash-Management Needs for Fiduciaries

While specific cash management needs vary from case to case, there are similarities that are seen across most cases. Receiverships and bankruptcy estates often hold cash for eventual distribution to claimants and creditors. That often requires a claims process, a distribution plan, and an actual distribution to be approved by a court, which can take months or even years.

However, cash is generally needed on a periodic basis to pay for professional fees, as administrative costs are generally borne by the estate. Furthermore, receiverships and bankruptcies that involve the continued operation of an ongoing business or the servicing of ongoing financial obligations may require cash on a regular basis.

Cash Management Options for Fiduciaries

As receivers and trustees navigate their cash management needs in the wake of recent banking failures, they should carefully evaluate all of their options to determine the best fit for each case, assuring their deposits are being held as securely and safely as possible. Without recommending any particular direction, some of the common options to consider include the following:

Single Account: As one very cost-effective and administratively simple option, fiduciaries can hold cash in a single account with the excess over $250,000 being uninsured by FDIC. The associated risks with this approach might be mitigated by holding funds at a systemically important bank (SIB), however, the yield on such accounts may be lower than alternative options.

Insured Cash Sweep: Under an insured cash sweep (ICS) program (such as IntraFI or similar programs), deposits over the insured limited are syndicated to other FDIC-insured institutions, in increments less than$250,000 to take advantage of each destination institution's FDIC protection. Because failures of FDIC-insured institutions are rare, the recovery of any insured deposit (which usually happens very quickly), can be placed in another FDIC-insured destination institution. However, using an ICS product can incur an additional cost, typically a reduction in the interest rate earned, and the wire transfer deadlines are generally earlier in the business day. In addition, there are limits as to the amount of funds that can be placed in an ICS program.

Multiple Accounts: For relatively smaller estates, it might be feasible to open accounts at multiple institutions and hold under $250,000 in each institution. For example, a receivership with $1.2 million in cash would be able to open and maintain five separate accounts at FDIC-insured institutions, keeping the balances at each bank below the $250,000 threshold for FDIC insurance. The administrative burden to this solution may make it impractical for larger estates that would require accounts to be syndicated across a large number of banks.

Surety Bonds: Common in bankruptcy cases based on the requirements of 11 U.S.C. Section 345(b), a fiduciary could purchase a surety bond to cover the excess deposits, either directly, through an insurance broker, or possibly through the financial institution itself. In the latter scenario, the cost of the bond could be a reduction in the interest rate earned on the account. The estate would add exposure to the insurer as well, although that would likely presume two simultaneous failures (the bank and the insurer). Current market conditions have reduced the number of providers offering surety bonds.

Custody or Escrow Account: Under certain circumstances, the fiduciary could place the funds into a custody or escrow arrangement, and to pay a fee for such custody. Unlike in a typical banking relationship where title to the funds is passed to the bank, the funds would be held in escrow and remain in the title of the fiduciary. Although perhaps an uncommon method for securing USD—as the yield is effectively negative—this method can be useful in managing or liquidating cryptocurrency.

Brokerage Account: A fiduciary may also open a brokerage account and invest the funds in certain securities, provided that such securities are suitable for the purpose of the case and consistent with the fiduciary's risk management mandate. Although with any investment there can be both principal and liquidity risk, the Department of Treasury publishes a list of "Acceptable Collateral for 31 CFR Part 225" (//www.treasurydirect.gov/files/laws-and-regulations/collateral-programs/2018-final-

225-list-of-acceptable-collateral.pdf) consisting of instruments "whose principal and interest are unconditionally guaranteed by the U.S. government." Such instruments include various bills, notes and bonds issued by the Department of Treasury, as well as certain securities issued by the Department of Housing and Urban Development, the Department of Veterans Affairs and the Small Business Administration. A fiduciary would also have to ensure that they had sufficient court authorization to make such investments.

Other Considerations for Fiduciaries

There is no right answer in choosing among the various cash-management options available to fiduciaries. The options available are not necessarily mutually exclusive, and it also is possible that the needs could change over time. For example, a substantial recovery might materially increase the cash position, or a substantial distribution might materially decrease the cash position; and in either instance a change in strategy may be warranted. While each fiduciary must use their own judgment depending on each case, there are a number of common factors to consider.

Purpose of the Estate: Is the fiduciary operating the estate for a potential going concern, with payroll and expenses to meet on a regular basis, or winding down an inactive estate? If a receivership is unwinding an alleged fraud that will primarily require distributing receivership funds to defrauded victims, the nature of any alleged fraud may also determine which cash management options are appropriate.

Risk Tolerance: While receiverships and bankruptcy estates are generally conservatively managed, there can be substantial differences in what risk is considered to be acceptably conservative. Some fiduciaries may weigh the likelihood of certain outcomes differently, especially when weighed against the possibility of earning yield on the managed cash.

Portfolio Size: The size of the cash under management, both in absolute terms and when compared to the total assets under management, may significantly impact a fiduciary's preferred strategy. A fiduciary managing $500,000 may be less concerned about yield when the difference between 1% and 4% per year amounts to $15,000 per year, when compared to a fiduciary managing $200 million where the same difference in yield would amount to an annual difference of $6 million.

Timing and Liquidity: A fiduciary who needs to access cash on an ongoing basis may have different liquidity needs than one who plans to hold most of the cash until distribution. Cost Structure: The cost structure of any deposit protection may also be important to consider as there may be substantial differences in a cost that is structured as a reduced interest rate versus a cost that is structured as an actual cash payment. Some fiduciaries might also decide whether and to what extent to take opportunity cost (i.e., yield that could be earned elsewhere) into account.

Despite recent bank failures, there remains a variety of cash-management options for fiduciaries involved in receiverships and bankruptcies. As we have seen, there is more to cash management than simply comparing rates. Receivers and trustees often have various stakeholder needs to balance—the court, regulators, creditors, victims, principals, related individuals, and so forth—all of whom may also have views on cash management or who would react poorly if a fiduciary was involved in a bank failure, even if fully insured. A fiduciary will have to determine whether, how, and to what extent to take such considerations into account when fulfilling their duties in managing estates to maximize value while minimizing risk.

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