

Challenges in the Formation of a U.S. De Novo Bank in the Wake of the 2023 Regional Banking Crisis

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The 2023 banking crisis in the United States was precipitated by a duration mismatch between customer deposits and bank investments, resulting in the failure of several banking institutions, including two prominent banks in Northern California: Silicon Valley Bank and First Republic Bank. In response to these failures, the already stringent regulatory framework governing the U.S. banking sector tightened even further to mitigate the risk of future collapses. The aim of this paper is to discuss the challenges that a group of bank organizers faced in the ambitious task of planning, establishing, and launching Altos Bank, the first de novo bank in Silicon Valley in nearly 20 years, in the middle of this regional banking crisis. The methodology incorporated interviews with bank board directors and executives, and analysis of the written interactions of the bank with state and federal regulators. The net findings of our analysis revealed that over the course of two years and despite numerous challenges, the Altos Bank organizers successfully brought the bank to fruition. While this assessment is limited to the challenges with respect to the formation of a single bank within a regional banking crisis, the findings may prove beneficial for other de novo banks navigating the regulatory process in a period when many new bank applications across the United States were either abandoned or withdrawn. This paper will examine the critical investment, legal, regulatory, and diversity-related challenges encountered during the formation of Altos Bank.

Keywords: *banking crisis, de novo bank, FDIC, First Republic Bank, Silicon Valley Bank*

Introduction

At the start of 2022, the banking sector in the United States appeared poised for a favorable year. Interest rates remained low due to ongoing economic stimulus measures implemented in response to the global Covid-19 pandemic. The U.S. GDP grew at a robust rate of 5.7%, marking the highest annual growth rate since 1984 (BEA 2022). Banks experienced significant liquidity, with total deposits increasing by 35% in the two years between the end of 2019 and the end of 2021 (Castro 2022). Furthermore, low interest loans and lines of credit allowed businesses to borrow money from banks at very little cost, with many of these low interest lending programs supported by the U.S. Federal Reserve (Minoiu et al. 2021).

However, 2021 also witnessed a surge in inflation which reached 4.1% -- the highest annual rate since 1991 (Ball et al. 2022) (Jahromi et al. 2023). This inflation was largely driven by monetary stimulus from the Federal Reserve and fiscal

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stimulus from the U.S. Government, both attempting to intervene in response to the sharp but brief economic slowdown caused by the worldwide Covid-19 pandemic. Guided in part by the monetary policy framework previously established by economist John Taylor, the Federal Reserve initiated a series of interest rate hikes to combat inflation (Taylor 1993) (Wang 2024). The first Federal Reserve rate increase, a modest 0.25%, occurred on March 17, 2022. This was followed by ten additional rate hikes totaling 5% by the summer of 2023, resulting in a Federal Funds target rate of 5.25-5.5% (Shi 2024). These rate increases dramatically changed the environment in banking. The opportunity cost of holding cash in non-interest bearing checking accounts rose sharply, while borrowing costs for business lines of credit increased substantially, creating a challenging environment. It was against this backdrop in March of 2023 that a regional banking crisis evolved in California which would eventually take down the 15th and 16th largest banks in the United States. However, during this period questions arose about the possibility for the formation of a new bank in the center of the region associated with the crisis. The research question sought to be addressed in this paper was to analyze the challenges that a new *de novo* bank would face when seeking approval during the crisis.

Literature Review

Banking crises have been common over the last 40 years, with 151 systemic banking crises occurring between 1970 and 2017 (Laeven 2020). A number of financial studies have evaluated the causes of these systemic banking crises and found a common set of circumstances (Demirgüç-Kunt and Detragiache 1998) (Kaminsky and Reinhart 1999). The genesis for these crises is a deregulatory environment that allows for expansionary credit policies. These credit policies are followed by an increase in asset prices, which, if extreme, can lead to financial bubbles. The bursting of these bubbles leads to a rapid decline in asset prices, which lead banks to adopt a tight credit policy. Increases in non-performing loans and worsening liquidity problems cause banks to falter, and in many cases require governments to step in to support the banking system (Englund 1999) (Kaminsky & Reinhart 1999).

In contrast, the regional banking crises of 2023 was not related to national liquidity issues or significant devaluation in assets. This banking crisis was centered largely in the San Francisco region of California, where several banks had large average customer deposits. A significant number of these deposits exceeded the Federal Deposit Insurance Corporation (FDIC) mandated \$250,000 insurance coverage and were thus “uninsured,” which was not a concern for depositors when these banks were noting significant growth in deposits and assets. However, a fundamental shift in these high deposit clients moving deposits out of several regional banks from the fourth quarter of 2022 through the first quarter of 2023 rapidly contributed to the 2023 regional banking crisis (Chang et al. 2024). Most of these deposits were transferred to the largest banks in the United States, those with assets greater than \$250 Billion, which were believed to be large enough to weather any liquidity issues and provide a greater sense of safety for deposits (Caglio et al. 2024). In the first few months after the start of the 2023 regional banking crisis, deposits at large banks grew 2 to 3% higher than smaller banks, confirming a flight to safety (Chang et al. 2024).

In Northern California, Silicon Valley Bank (SVB) and First Republic Bank (FRB) were the focus of attention during this regional banking crisis. During the years preceding 2022, both banks noted significantly increased deposits. In the low-interest rate environment of 2020-2022, both SVB and FRB chose to place these excess deposits in long term bonds in order to obtain higher returns as the Federal Funds rate through much of that period was close to zero (target range 0 to 0.25%) (Vo and Huong 2023). Following an initial Federal Reserve rate hike in March 2022, and through the series of subsequent rate hikes, consumers and firms now had ample alternatives to place funds in order to maximize interest returns. It became less rational to leave large amounts of cash in non-interest-bearing checking accounts when CD rates and money market rates approached and then in some cases exceeded 4%. Simultaneously, there was a significant pullback in venture capital funding, requiring firms that had previously raised cash to draw on their bank deposits to meet expenses; a reduction in the amount of new funding resulted in firms utilizing savings. These two factors, higher rates elsewhere and cash demands on deposits of companies in the region, both precipitated a demand for increasing cash withdrawals of SVB and FRB.

SVB had customer demographics that would potentially precipitate the demand for large cash withdrawals. SVB catered to a large number of start-up firms, and as increasing cash demands were placed on SVB, a growing concern circulated among the venture capital industry that it may not be prudent to leave large amounts of cash at SVB because of questions regarding the insurability of deposits larger than \$250,000 per customer and whether the bank could realistically meet increasing withdrawal requests. These issues came to a head on March 8, 2023, which is considered to be the start of the 2023 regional financial crisis (Federal Reserve Board 2023). On this date, SVB disclosed that it sold \$21 Billion from its long-term bond portfolio for a \$1.8 Billion loss along with a hastily prepared plan to raise \$2.25 Billion through an equity offering (Silicon Valley Bank 2023). Additionally, on this date, a smaller bank in Southern California, Silvergate Bank, was forced to close its doors in large part due to cryptocurrency losses related to the collapse of FTX, a large cryptocurrency exchange (Silvergate Bank 2023). These events created a significant bank run on Thursday March 9, 2023, in which \$42 Billion dollars in deposits were withdrawn on a single day. The \$2.25 Billion equity raise by SVB was scuttled on the evening of March 9, 2023, when the massive withdrawal amounts from earlier in the day were announced (Metrick 2024). By the early hours of the following morning, March 10, 2023, there were questions of whether SVB could survive to the end of the day as withdrawals continued. As a result, the Federal Deposit Insurance Corporation (FDIC) subsequently took over SVB prior to the bank opening on Friday, March 10, 2023 (Metrick 2024). Over the next several days, in order to stabilize the financial markets and allay the concerns of bank depositors, the FDIC announced that it would guarantee all deposits, including those above the \$250,000 level, and that cash would be available to any bank customers who wished to make a withdrawal. With depositors guaranteed, only the equity and bondholders in SVB ultimately suffered losses. On Sunday March 26, 2023, after several weeks of negotiations with the FDIC, North Carolina based First Citizens Bank acquired the

deposits and loans of the FDIC run intermediary named Silicon Valley Bridge Bank, ending the immediate SVB crisis (Hirsch 2023).

During the massive deposit withdrawals from SVB on Thursday March 9, 2023, FRB actually showed significant increases in deposits that same day, in part due to money moving from SVB to FRB. However, over the subsequent weekend, several articles appeared in the press noting that FRB had a significantly similar portfolio of long-term debt that was underwater as a result of rising interest rates (Branch 1997). By Monday March 13, 2023, FRB was seeing large amounts of net deposit outflows which continued for the next several weeks. On March 16, the ten largest banks in the US deposited \$30 Billion in FRB to ensure that this bank did not fail (Benoit et al. 2023). These large banks believed that continual failures of regional banks would risk the regional banking crisis becoming a national banking crisis (Hachem 2024). However, failures to come up with a longer-term stability plan, a rapidly deteriorating FRB stock price, and credit rating downgrades by Standard and Poors ultimately resulted in the FDIC taking over FRB on May 1, 2023. Unlike the case with SVB where the FDIC ran the bank for several weeks prior to its sale, in the case of FRB the FDIC acquired and simultaneously sold FRB to JP Morgan Chase Bank through a competitive bidding process (Omar et al. 2023).

Methodology

The aim of this paper is to examine to what extent a regional banking crisis can impact the ability to form a *de novo* bank during the crisis period. While studies have shown that financial crises usually follow cyclical patterns, it can be difficult to predict both the timing and mechanism of the crisis (Jin et al. 2016). The loss of two large banks in Silicon Valley (and the 15th and 16th largest banks in the United States at the time) over a two-month period in the spring of 2023 created significant stresses in the financial markets. The Federal Reserve, President Joe Biden, and Treasury Secretary Janet Yellen all sought to allay fears among the public, highlighting that the US banking system was sound and that these few bank failures were isolated incidents. However, the fact that both banks that failed were based out of Northern California and, more specifically, the San Francisco Bay area, cast a pall on the financial sector throughout Northern California and created a heightened sense of uncertainty about banks among investors.

The loss of SVB, in particular, reduced the number of banks headquartered in Santa Clara County, the center of Silicon Valley, from four to three. Considering that in 1992, there were 17 banks headquartered in Santa Clara County, the three remaining banks in 2023 represented the remnants of an 82% reduction in banks founded in the county. Furthermore, the last *de novo* bank founded in Santa Clara County was 2008, and the last *de novo* bank founded in the adjacent San Mateo County was 2003 (Department of Financial Protection & Innovation n.d.). The regional bank crisis heightened scrutiny by bank regulators who tightened requirements for new and existing banks, and increased the legal guidance needed to navigate the evolving requirements. It is against this backdrop of financial uncertainty that a focused group of organizers sought to launch Altos Bank, the first *de novo* bank in Silicon Valley

in nearly 20 years. Multiple obstacles were encountered through the formation of this bank, with this paper focusing on the investing, legal, regulatory, and diversity challenges faced by the bank organizers through this process. Interviews with the Altos Bank Board of Directors and Executive team, and reviews of the correspondence with state and federal regulators were used as the basis for collecting data for this study.

Results

Investment Fundraising

Banks require capital and it is the capital that provides the basis for banks to take in deposits, which in turn allows the bank to make loans. The net interest margin, the difference between which banks charge for their loans and pay for their deposits, is the primary method through which banks generate revenue. In the State of California, The Department of Financial Protection and Innovation (DFPI) serves as the state banking regulator supervising the organization and operations of all banks in the state. California chartered banks are allowed to take in ten times the capital amount in deposits, and therefore a new bank with \$25 Million in initial capital can take in up to \$250 Million in deposits. Banks typically loan 85-90% of their deposits out as loans; \$250 Million in deposits amounts to approximately \$200-225 Million in loans. Thus, a sufficient supply of capital is necessary to launch a bank that will succeed, because until the *de novo* bank becomes profitable, it will need to survive on its capital. At present, it is believed that at a minimum of \$20-25 million of capital is necessary to organize and start a bank. Altos Bank was capitalized in November 2024 with \$27.8 Million after an intensive 30-day capital raise following conditional approval by both the FDIC and the DFPI.

However, raising this capital for Altos Bank was not without significant challenges. A major difficulty encountered by the organizers was the misperceptions that many investors had regarding banks as a result of recency biases based on the still fresh news of the failures of SVB and FRB. Compounding this observation, Altos Bank is situated in Santa Clara County, the same County as SVB. Many potential local investors had also been prior stockholders in SVB and FRB and saw their investments in these two banks completely lost. Additionally, many of the same investors sought out by Altos Bank for capital were impacted as customers of SVB or FRB and saw the confusion, disarray, and frustration that came from the challenges at these two banks. These events gave the perception that investing in banks is a risky endeavor, and that if two \$50 Billion in capital banks could not survive, then how would a new startup bank with \$27.8 Million in capital fare? What was often overlooked by many investors is that from the beginning of 2021 through 2024, only seven of the 4577 federal and state-chartered banks in the US failed (American Banker Editorial Staff 2024). This represents less than a 0.15% failure rate over a nearly full four-year period of time. Despite this reassurance, several investors either chose to make their final investment at a substantially decreased level compared to their initial pledged amount, or in other cases chose to cancel their

investment in Altos Bank altogether. This necessitated having to fundraise from a larger base of potential investors than needed if there was not a regional banking crisis. Some of the most optimistic investors in Altos Bank reside outside of California, where the impact of the California regional banking crisis was likely negligible.

The location of Altos Bank within Silicon Valley invariably created comparisons of Altos Bank's potential with other startups in the region. This group of bank investors hesitated not because they were concerned about bank safety, but because they considered banks a slow and unattractive investment compared to the thousands of other startups present in the region, most of which have projected growth plans far exceeding growth rates seen in banking, a highly regulated industry. Even though SVB bank stock itself returned over 900 times an original investment from 1987 through 2022, generating approximately 22% annualized returns during this 35-year period, these returns were not appreciated by those enamored by the technology sector. Having the headquarters of Google, Apple, Nvidia, Broadcom, and Netflix in the same county (Santa Clara County), and Meta's headquarters in the adjacent county of San Mateo overshadowed any impressive returns of financial institutions located in the shadows of these giants. Ultimately, it was the identification and highlighting of banks in California that had annualized returns that compared to these technology giants that allowed investors the insight that, in the appropriate environment, banks could potentially provide above average returns even in a region dominated by technology companies.

Historically, new banks in California have been able to hire their executive team, submit their application, pass the regulatory processes, and complete their fundraising in 12-15 months. The guidance for the amount of seed capital needed for the formation of a *de novo* bank is based on this estimated timeline. The challenges with the failures of SVB and FRB, as well as the lack of any *de novo* bank formation in Silicon Valley over the last 15-20 years resulted in an extended timeline, as bank regulators in the region had not had any recent experience with approval of new banks over the last several decades; several of the younger regulators had never before participated in the approval of a new bank. The failures of SVB and FRB in the region also created a very meticulous, conservative timeline for regulatory approval. As a result, the timeline from the organization of the precursor of Altos Bank to the actual opening of Altos Bank was nearly two and a half years. As a result of this extended timeline, a significantly larger amount of seed capital was needed than would be required for a previously typical 12-15 month approval window. Furthermore, to the dismay of the Altos Bank organizers, the longer time window allowed some investors who had verbally committed capital to the bank during 2023 to alter or even cancel their actual investment once funds were due in October 2024.

A final challenge encountered during the fundraising aspect of Altos Bank was that certain investors, perhaps misrepresenting either their interest in the bank or financial ability to invest, did not initially follow up on their pledge to invest in the bank during the period of time in which the capital round was open. Repeated contact with these potential investors consumed a disproportionate amount of time and resources, diverting bandwidth away from those investors who had a sincere intent and capacity to invest. As a result of this experience, the organizers of Altos Bank learned a great deal regarding the disproportionate effort that it would take to

raise funds from specific investors, and more importantly, how to identify and focus on those investors with a genuine intent to support and invest in the bank.

It also became clear to the bank organizers that even in Silicon Valley, a small number of investors misrepresented their financial acumen, wealth, and capacity to follow through on their commitments. Some of these investors appeared to seek to invest only if they were offered something of value other than stock, such as bank employment or referral fees for bringing other investors. Others seemed to be outright charlatans, claiming to have financial resources that never materialized. While the majority of investors followed through with their pledges to invest, the minority of investors who expressed interest in participating in the funding round but then did not invest, led to frustration on the part of the board and executive team.

Legal Aspects

As expected with the complex regulatory environment that exists with the formation of a *de novo* bank in California, comprehensive legal guidance is necessary to adhere to all the DFPI and FDIC regulations. Understanding the legal aspects of the regulatory environment around new banks are significantly different from the requirements of any other type of startups.

All documents related to the investment in a *de novo* bank are required to undergo review by DFPI and FDIC regulators. These include slide decks, offering circular and subscription agreements related to the bank investment. Even social media posts on platforms such as LinkedIn, Facebook, and Instagram during the organizational period require regulatory review before being allowed for use. This oversight creates an environment in which organizers of the bank had to fundraise all while having significant restrictions on what could be communicated to investors during the process of raising capital. Information that is commonly presented for startups in most other industries, such as growth projections and pro forma financials, are prohibited by state and federal regulators to be included in the standard pitch decks circulated as part of the fundraising effort. The Altos Bank website also required formal regulatory review for each and every page on the website to ensure that it was acceptable to the DFPI and FDIC, and any violations required immediate correction.

The actual collection of funds from investors for a *de novo* bank is unique compared to other start-ups. In most new companies, the investors choosing to invest in the company make investments payable directly to the startup company. For a new bank, all investments are made to a third party escrow company, typically a banker's bank. This third party escrow company holds all funds related to the funding round, and can only release the funds to the new bank upon two criteria; 1) achieving a minimum amount of investment raise (\$25 Million in the case of Altos Bank) and 2) approval for release of funds by the DFPI and the FDIC. Failure to achieve both of these goals results in funds being returned to investors, with the bank not realizing any receipts of the funding. As a result of these requirements, during the fundraising process of the capital round, Altos Bank was not able to use any of the funding until the entire amount of funds had been raised, and the funding round closed and audited by the escrow company. During this period, even though nearly

\$25 Million in new capital was raised, Altos bank had to operate on the initial seed capital alone.

In addition to the largely rational legal aspects of a *de novo* bank formation, several nuances do exist in the formation of new banks in California. Of greatest significance, California is the only state of the fifty in the US that does not allow those investors who have made a seed capital investment in the precursor bank organization to “roll” their investment into the actual bank once it is formed. This requires the seed investor who has already made an investment in the precursor organization to make a second comparable investment in the actual capital funding round of the subsequent bank. This is then followed by a subsequent return of their seed capital once the bank opens. Particular regulation requires an investor to have liquid assets of twice their amount of his intended final investment in the bank, since the second comparable investment in the main capital round must be made before return of their initial seed capital. During the raise of capital for Altos Bank, a few investors had difficulty understanding this regulation despite its description in the investment documents. This created several instances where the Altos Bank organizers needed additional time and effort for multiple follow up discussions with these investors to clarify the situation and ensure that they had adequate liquidity.

Regulatory Challenges

Altos Bank submitted its bank application for creation of the *de novo* bank on May 12 of 2023. The bank regulatory environment in California at that time was one of significant tension, since three of the four banks that failed in 2023 were in California. State (DFPI) and federal (FDIC) regulators had a mixed response to the initial Altos Bank application. On one hand, they were encouraged by the fact that Altos Bank proposed to be the first new bank in Silicon Valley in almost 20 years, and regulators clearly understood that more competition in the banking industry was always welcome. However, the initial meeting with state and federal regulators and the proposed Altos Bank directors and management team occurred in the San Francisco FDIC building a little more than one month after the failure of SVB, and three days before the FDIC assumed control of FRB. As a result, tension and anxiety among regulators was high and amid this crisis, it seemed that the request by organizers of a new small bank would appear inconsequential. The regulators also stressed that they would place greatest emphasis on the experience of the proposed management team submitted in the application, the director’s ability to raise capital, and the thoroughness of the business plan for the proposed Altos Bank. While the application was encouraged, the regulators indicated that they would be placing a high bar on these requirements.

The fact that no new bank had been approved in Silicon Valley for nearly two decades presented a challenge as a result of limited regulator experience. Many of the regulators had either not been involved with the *de novo* formation of a new bank, especially if they had been employed with the DFPI or FDIC less than 15 years. The loss of several senior regulators following the collapse of SVB and FRB further hindered the approval process for Altos Bank. As previously discussed, this new regulatory environment resulted in a longer than anticipated timeline from

submission to conditional approval by the DFPI and the FDIC. This variance in the time to approval required a larger amount of seed capital than initially expected, and a second seed round raise was completed to ensure adequate liquidity up to bank opening. The fact that this second round was required created some consternation among the investors in the initial seed round who remained concerned about the longer than expected timeline to approval.

A final regulatory aspect that applies to *de novo* banks in California that does not apply to standard startups are restrictions that the DFPI and FDIC place on maximum ownership by an entity or individual. Regulatory restrictions allowed Altos Bank to secure no more than 10% of its investment from foreign investors in aggregate. While this was intended to avoid any situation in which foreign investors or entities could acquire a controlling stake in a US based financial institution, it also hampered the Altos Bank organizers from utilizing the entirety of their fundraising universe, as many of the organizers' contacts were overseas. A number of Altos Bank Organizers had significant connections overseas in Asia, Africa, and the Middle East, and because the aggregate of all foreign investment could not exceed 10%, some foreign investors had to either reduce their investment amount in Altos Bank or be outright turned away. Additionally, DFPI regulatory requirements restricted no individual investor to acquire more than 9.99% of the bank stock and no individual entity (corporation, LLC, trust, etc) to acquire more than 4.99% of the bank stock, even if domestic. Substantial checks were performed by the regulators to identify any familial or business affiliate relationships among investors to prevent groups of individuals or entities from circumventing these limits. As a result, entities that would have been happy to invest larger amounts in Altos Bank were restricted to lesser amounts, requiring us to secure the difference from other investors and increasing the time needed to complete fundraising.

Diversity Challenges

One of the main challenges facing Altos Bank was how to maintain adequate gender and diversity among bank directors and employees, and to serve the diverse minority groups in the local region. Santa Clara, the county that Altos Bank is headquartered, is composed of over 70% minorities, and one of the missions of Altos Bank was to be a financial institution that would welcome these minorities, some of whom have been distrustful of financial institutions in the US due to language or other cultural issues. Latinos, Chinese, and Vietnamese, represent significant percentages of the local population. A primary goal of Altos Bank is to employ staff that understand the culture and can speak the language of these minority groups in order for them to feel welcome and comfortable in doing business with the bank. In larger organizations it is more likely that there are employees on staff that speak a variety of foreign languages, but with a small staff of 17 full time employees at the date of the Altos Bank opening, a concerted effort was needed to hire outstanding employees that were also multilingual. This necessitated interviewing larger number of potential employee candidates than would have otherwise been necessary.

In addition to the bank employees, diversity remained a challenge on the executive team in large part due to the bank's attempt to satisfy regulatory requirements. In

California, the most important aspect that determines whether a *de novo* bank application is approved by regulators is the experience of the executive team. This experience translates to the intellectual capital of the bank, and studies have shown that this is critical in the success of the bank (Onumah and Duho 2019). However, requiring a CEO of a prospective *de novo* bank to have prior CEO experience as well as to have over 30 years of total bank experience reduces the pool of candidates to those who had started in the banking industry in the 1980s. At that time, banking was largely an occupation of white males. Finding C-level executives that were non-white was a significant challenge when restricting candidates to those with decades of experience. Fortunately, despite this challenge, Altos Bank was able to successfully hire one of the top three executives as a minority (Latino).

Like ethnicity, achieving gender balance can be a challenge in any startup, and this was no different with Altos Bank. Compared to established banks which, through their size, provide a potentially more stable job environment, startup financial institutions may be interpreted as a riskier career choice. While startup banks offer the potential for a more rapid promotion and career advancement than a large bank with tens of thousands of employees, the riskier perception of a start-up environment made conservative applicants more likely to decline offers of employment. While the experience was limited to the Silicon Valley region, a focused recruiting effort yielded only 5 women of the 17 employees of Altos Bank at the time of the opening of the bank. A concerted effort will need to remain in place to continue to balance gender, and as Altos Bank grows, it is expected that gender balance will be achieved.

Finally, diversity in race and gender also applies to the board of directors. Bank regulators expect at least one or two bank directors to be retired bank executives with decades of experience, and as with executives, it can be challenging to find non-white males that fit this role. Altos Bank has had much more success in maintaining racial diversity with board members who are not career bank executives. Four of the five directors who are not career bankers are minorities, including two Asian, one Indian, and one African American. Gender diversity on the board was a greater challenge than ethnic diversity. The Altos Bank board had undergone several changes during the two-year process to achieve bank approval. At one point half of the proposed Altos Bank board directors were women, but because of board adjustments made at the request of regulators, no women were represented on the board at the time of final bank approval. As with the employees, significant focus will be applied to add gender diversity back to the bank board moving forward.

Discussion

The 2023 bank crisis was a regional crisis which failed to expand into a larger systemic banking crisis. Many of the common events of a systemic banking crisis, such as asset inflation followed by a crash in asset prices, liquidity problems, and a contraction in lending did not occur (Demirgüç-Kunt and Detragiache 1998) (Kaminsky and Reinhart 1999). However, subsequent analysis showed that reduced regulatory oversight, typically seen in systemic crises, was a factor in this regional crisis (Federal Reserve Board 2023). Analysis by others appears to place most of

the genesis of the 2023 crisis on two factors, the first being a rising percentage of uninsured deposits in a few select banks with a focus on high net worth and commercial clients (Chang et al. 2024). Clients of the banks that failed demonstrated fungibility of their funds during this crisis, easily moving funds out of specific banks to larger banks or brokerage firms with greater perceived safety. The second factor behind the 2023 regional banking crisis was the duration mismatch created between banks deposits and investments (Tsang 2024). During the several years leading up to the crisis, both short term and long-term rates were low, and several banks made the unfortunate decision to chase investment yield by purchasing longer term treasury bonds. These same institutions were then ill-prepared for the subsequent rising interest rate environment which lowered the market rates of their bonds to below face value resulting in large potential losses on their books if they chose to sell the bonds before maturity, a realistic possibility if their clients chose to withdraw deposits.

Even though the regional crisis of 2023 did not expand to become a systemic banking crisis, the fact that Altos Bank chose to incorporate and seek regulatory approval in Silicon Valley, the same region as the failed SVB and FRB, created significant challenges. *De novo* bank formation can be challenging, as evidenced by the lack of new banks originating in Silicon Valley during the 15 years preceding Altos Bank. However, adding the uncertainty of the regional banking crisis only compounded the difficulty. Investors, many of which were either investors or customers in SVB or FRB, were often reluctant to entertain an investment in a new small bank when two multibillion-dollar banks had failed within the last year. Many senior regulators assigned to the Northern California region were blamed for lack of proper oversight of SVB and FRB and were subsequently offered early retirement or transfer to other regions. This reduced the average age of regulators involved in the approval process of Altos Bank, and since many of these new regulators had not been employed as regulators prior to the formation of the last *de novo* bank in the region, the approval process likely took longer than planned.

A number of the requirements placed on the formation of Altos Bank, while appearing to have valid reasoning from the regulatory standpoint, had several potential consequences on Altos Bank. Restricting domestic investors to investing no more than a certain percentage of the capital stock required the organizers of Altos Bank to have to solicit investments from a larger number of people than otherwise, resulting in a longer timeline for the funding round and consumption of a larger amount of the seed capital. Requiring Altos Bank executives to have many decades of experience to be approvable as an executive of Altos Bank had the unintended consequence of reducing diversity and gender among bank executives, discrepancies that may take years to rebalance. In the end, Altos Bank successfully navigated the regulatory approval process, becoming the only new bank approved in California in 2024.

Conclusion

The formation and opening of Altos Bank were a long and arduous process that encountered many challenges from the initial formation of the bank board in the summer of 2022 to the actual opening of the bank in November of 2024. While a few of these challenges were expected, most of those encountered were not anticipated, were often discouraging, and required significant effort on the part of the board and the executive team to overcome. By addressing these challenges, Altos Bank emerged during the challenging post 2023 regional banking crisis at a time when most other *de novo* bank formations were either aborted or withdrawn by the bank organizers or declined by regulators. As a result, Altos Bank became the first new bank in Silicon Valley to open in nearly 20 years, and, as of December 31, 2024, Altos Bank was one of only two new banks approved in the entire United States during 2024 by banking regulators. These accomplishments by Altos Bank organizers, along with the excitement of success in creating a *de novo* startup within the established banking environment, foretells an amazing future in Silicon Valley.

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