



# Options for Deposit Insurance Reform to Stabilize Our Banking System and Protect Depositors

**Emily DiVito**

June 2023

# About the Author

Emily DiVito is senior program manager for the Corporate Power program at the Roosevelt Institute. Her work focuses on inclusive banking and financial inclusion, financial technologies and regulations, and progressive taxation of wealth and the wealthy. DiVito holds a BA from Wellesley College, and an MPA from Columbia University.

# Acknowledgments

Special thanks to Mike Konczal, Lev Menand, and Todd Phillips for their insights and feedback. Roosevelt staff Suzanne Kahn and Sonya Gurwitt, as well as Claire Greilich, contributed to this brief.

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# I. Introduction: Recent Bank Failures Highlight the Importance—and Potential—of Deposit Insurance

Since the banking panics of the early 1930s, the US has offered federal deposit insurance (FDI) on eligible deposit accounts (including checking and savings accounts) up to the statutory limit of \$250,000. FDI has been remarkably successful in preventing bank runs and mitigating financial panic—until recently. The collapses of Silicon Valley Bank (SVB), Signature Bank, and First Republic Bank (FRB) have exposed vulnerabilities in—or at the very least cast doubt on—FDI’s current terms and structure. Is FDI protecting the “right” depositors at the “right” coverage threshold? Is it maximizing the government’s ability to avert a financial crisis and, if one occurs, contain it with minimal contagion to the rest of the US economy? And finally, because FDI applies to individual and institutional depositors alike, who is the banking system *for* and what does that imply about the government policies and practices in place to serve them?

The existence of FDI—and the Federal Deposit Insurance Corporation (FDIC) that administers it—offers eligible bank customers peace of mind so that they are not inclined to withdraw their deposits en masse. It thus acts as a stabilizing force to the banking system as a whole. Most of the time, this intangible government guarantee is sufficient to keep banking stable. But depositors can still panic about the uninsured deposits over \$250,000. And, as the SVB, Signature, and FRB crises have demonstrated, when uninsured depositors panic, it threatens the entire US banking system.

Taking lessons from the recent bank failures, many experts have proposed FDI reforms. These proposals vary widely, but all reckon with similar themes: financial stability, depositor protection, market discipline, and moral hazard. This brief aims to synthesize this bevy of proposals to better understand the policy trade-offs each carries and what these choices say about the larger purpose of our banking system. Though the ultimate aim of each reform is ensuring US financial system stability and depositor protection, each comes to that end through very different sets of arguments. When taken together, three main approaches emerge:

- **Preserve the Current System:** One approach holds that current FDI is mostly functioning well and as intended, and any significant changes could invite moral hazard. To the extent that recent bank crises warrant policy changes, this approach advocates for modest tweaks—such as linking the coverage limit to the price level or

incorporating temporary emergency provisions—in order to inject more resiliency into FDI.

- **Expand Insurance for Certain Accounts that could Bring Market Discipline to Bear:** A second approach, favored by the FDIC, considers the unique position of large business accounts—which are often uninsured and able to trigger destabilizing panic, but not likely to effectively monitor bank risk-taking—and concludes that increased coverage only for certain types of depositors is warranted. The types of accounts eligible for expanded coverage under this approach to reform could include transaction or business payment accounts, all non-interest-bearing, and/or those owned by small- to mid-sized employers.
- **Enact Universal and Unlimited Coverage:** Finally, a third approach to FDI reform maintains that US banking will be vulnerable to acute crises as long as uninsured depositors exist. To that end, this approach supports universal and unlimited deposit insurance. More fundamentally, however, this approach seeks to reckon with questions about the relationship between private financial institutions and the US government, pointing to the need for alternative public banking infrastructure.

Deposit insurance has been a lynchpin to US financial stability and a godsend to otherwise-anxious depositors since the Great Depression. To ensure FDI always serves those functions well and when needed, policymakers must consider what shortcomings and opportunities for reform—if any—the SVB, Signature, and FRB crises have revealed about the current system. Separate from successfully passing and implementing any potential reform legislation, having debates on these long-ignored questions is a valuable exercise that benefits US financial institutions and the depositors who rely on them.

## Table 1. The Range of Federal Deposit Insurance (FDI) Reforms

	<b>Approach 1: Preserve the Current System</b>	<b>Approach 2: Expand Insurance for Certain Accounts</b>	<b>Approach 3: Enact Permanent Universal and Unlimited Coverage</b>
<b>Proposals within each approach</b>	<ul style="list-style-type: none"> <li>• Don't touch the current system at all</li> <li>• Index the coverage cap to inflation</li> <li>• Integrate automatic temporary emergency expansion powers and provisions</li> </ul>	<ul style="list-style-type: none"> <li>• Lift or remove the coverage cap for transaction/business payment accounts, but preserve it for others</li> <li>• Lift or remove the coverage cap for all non-interest-bearing accounts, but preserve it for others</li> <li>• Lift the coverage cap (to \$2 million) for all small businesses and organizations with less than 200 employees; lower the coverage cap (to \$200,000) for all other depositors</li> </ul>	<ul style="list-style-type: none"> <li>• Remove the coverage cap for all accounts, without broader structural changes to the banking/financial sectors</li> <li>• Overhaul the US financial system to replace private money and banking infrastructure with public, thereby making all deposits non-defaultable</li> </ul>
<b>Strengths of each approach</b>	<ul style="list-style-type: none"> <li>• Maintains existing balance of market discipline and moral hazard</li> <li>• Would have little—if any—cost to the Deposit Insurance Fund (DIF)</li> </ul>	<ul style="list-style-type: none"> <li>• Targets coverage to meet operational needs of certain large uninsured depositors</li> <li>• Preserves a degree of depositor discipline</li> </ul>	<ul style="list-style-type: none"> <li>• Virtually eliminates the risk of bank runs</li> <li>• Would eventually result in more accessible public-interest banking and financial infrastructure</li> </ul>
<b>Weaknesses of each approach</b>	<ul style="list-style-type: none"> <li>• Doesn't significantly improve upon existing system</li> <li>• Retains risks related to panicked withdrawals by uninsured depositors</li> </ul>	<ul style="list-style-type: none"> <li>• Makes defining the accounts eligible for expanded coverage difficult</li> <li>• Adds a layer of complexity to FDI</li> <li>• Results in some cost to the DIF</li> </ul>	<ul style="list-style-type: none"> <li>• Eliminates existing depositor discipline and increases moral hazard</li> <li>• Potentially disrupts related markets</li> <li>• Potentially results in large costs to the DIF</li> </ul>

*These lists are non-exhaustive. See also Table 1.1 in [FDIC 2023b](#).*

## II. The History of Deposit Insurance: An Evolution of the Government's Responsibility to Secure Money and Protect Customers

The United States' current system of federal deposit insurance (FDI)—and the Federal Deposit Insurance Corporation (FDIC) through which it is administered—originated with the prolonged banking crises and Great Depression of the early 1930s. Debates at the time revealed ideological and practical considerations to FDI that diverged along the same fault lines we see today in renewed discourse after the failures of Silicon Valley Bank (SVB), Signature Bank, and First Republic Bank (FRB)—namely, concerns over both tangible and intangible costs to reform.

When Congress authorized the FDIC in 1933, deposit insurance was neither a novel idea nor an untested concept. The US has a long history of deposit insurance schemes at the state level that reveals a federal government intermittently negotiating its commitment to secure money and protect bank customers. Between 1829 and 1930, 14 states experimented with deposit insurance for state-chartered banks ([Calomiris 1989](#)). Thus, when President Franklin D. Roosevelt (FDR) was sworn into office in March 1933, almost 40 percent of the nation's banks (nearly 9,000) with \$6.8 billion in total deposits had failed ([Wheelock 1992](#)). But the idea for federal deposit insurance had been percolating for decades—gaining public and political support across parties and regions ([Gates 2017](#)).

Champions of federal deposit insurance, including Henry Steagall, chair of the House Committee on Banking and Currency, argued that the federal government had a right—and even a responsibility—to balance the economic needs of the populace against those of the financial sector elite ([Gates 2017](#)). Proponents also leveraged the legacy of state-level programs to suggest federal deposit insurance as a natural expansion of the government's pledge to secure US credit and currency ([FDIC 1984](#)).

The fiercest opposition came from within the Democratic Party, and initially included FDR and Senator Carter Glass ([FDIC 1998](#)).<sup>1</sup> As governor of New York and then as president, FDR vehemently rejected deposit insurance, claiming it impractical, costly, and likely to inspire laxity in bank management ([Gates 2017](#)). Glass preferred abolishing state banking altogether (which he deemed chronically vulnerable and difficult to regulate) over propping up weak banks with a government guaranty ([Gates 2017](#)).

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<sup>1</sup> Large financial interests were also vocal opponents, but their primary motivation was cost avoidance ([Gates 2017](#)).

Fervent and relentless public support eventually won them over ([Shaw 2015](#); [FDIC 1998](#)). When FDR signed the Banking Act of 1933 (known as Glass-Steagall) into law, it included a system of federal deposit insurance that, unlike other New Deal programs, didn't exclude on the basis of gender and race. Rather, it applied to all deposits at member banks up to the statutory coverage limit—originally set at \$2,500. The banks that joined the FDIC and offered insurance coverage to their customers were assessed a percentage of all insured deposits and paid those premiums into a central fund ([FDIC 1998](#)). The program was originally temporary, but proved so popular and effective that even the banking lobby endorsed it shortly after implementation ([FDIC 1998](#)). By the start of 1934, the FDIC had restored approximately *half* of the deposits lost in the preceding three years, and bank failures had essentially ceased. The Banking Act of 1935 authorized a permanent deposit insurance scheme, superseding the temporary provisions in Glass-Steagall ([FDIC 1998](#)).

### III. The Path to—and Current Terms of—Modern Federal Deposit Insurance

Though the FDIC conducts activities beyond insuring deposits—including examining and supervising financial institutions and managing receivership when banks fail—FDI coverage is account-based. It applies to eligible bank deposit products like checking and savings accounts, money market deposit accounts, and certificates of deposit (CDs).<sup>2</sup>

The coverage limit—also called the standard maximum deposit insurance amount (SMDIA)—is currently \$250,000 per account. The limit largely kept pace with the price level until 1980, when the Depository Institutions Deregulation and Monetary Control Act increased the cap to \$100,000 (or, 2.5 times the previous limit of \$40,000) ([Robinson 2013](#)). This increase wasn't motivated by concerns about depositor overexposure, but by recognition that many banks and savings-and-loan associations were facing disintermediation in a high-interest-rate climate ([FDIC 1998](#)). The higher limit encouraged bank retention of deposits and attracted new ones to help offset outflows.

The next—and as of this writing, most recent—cap increase came during the financial crisis of 2007-2008 when Congress raised it to \$250,000 as a compromise to secure passage of the Troubled Asset Relief Program (TARP).<sup>3</sup> Aaron Klein, chief economist in the Senate Banking Committee at the time, has explained that the rationale for the \$250,000 cap (over another numeric threshold) was simply that the magnitude of the increase (2.5 times the previous

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<sup>2</sup> Deposits at credit unions (up to \$250,000) are insured by the National Credit Union Administration (NCUA).

<sup>3</sup> This increase was made permanent by Dodd-Frank in 2010.

limit of \$100,000) matched the magnitude of the increase before that ([Aronczyk and Fountain 2023](#)).

The FDIC receives no appropriations from Congress, and instead is primarily funded through the premiums banks pay into the Deposit Insurance Fund (DIF).<sup>4</sup> Historically, the FDIC had charged a flat rate for deposit insurance, but by the early 1990s and after years of concerted deregulation, commercial banking was struggling and the fund was insolvent by nearly \$7 billion ([FDIC 1998](#)). To address this, Congress passed the Federal Deposit Insurance Corporation Improvement Act of 1991, which, among other things, adopted a risk-priced assessment structure ([Garnett et al. 2020](#)). In 2011, the FDIC updated its assessment structure for big banks to better account for their particular risk to financial stability, and did the same for small banks in 2016 ([Garnett et al. 2020](#)). These risk-based pricing structures are still in place today.

For much of the FDIC's existence, a bank's assessment base was calculated as its total domestic deposits. In 2011, per the terms of the Wall Street Reform and Consumer Protection Act (known as Dodd-Frank), a bank's assessment base was broadened to equal its average consolidated total assets minus its average tangible equity ([Garnett et al. 2020](#)). In other words, a bank pays assessments on its total liabilities—and not just its total insured deposits. The wider assessment base incentivizes large banks, no longer able to skirt premia by relying on volatile non-deposit funding sources, to favor more stable domestic deposits.

FDIC assessments are determined and paid quarterly. At the end of 2022, the DIF had over \$128 billion, representing 1.27 percent of all insured deposits (but less than the statutory minimum ratio of 1.35 percent) ([FDIC 2023a](#)). The Fed's actions to make SVB's depositors whole and JP Morgan Chase's (JPMC) acquisition of FRB is expected to cost the DIF a combined \$35 billion, and the agency has announced a special assessment fee on large banks to recoup these losses ([Lang 2023](#)).

In the US, though FDI has been remarkably successful, banking system reliance on uninsured deposits has been increasing in recent years—especially as economic inequality worsens ([Vuillemeey 2023](#)). For most Americans, \$250,000 will never come close to what they're able to hold in deposits, but wealthier households can be left exposed. At the end of 2022, 57 percent of all US bank deposits were insured ([Bhutta et al. 2020](#); [FDIC 2023a](#)). Indeed, in 2019, the average amount held in Americans' debit, savings, or money market fund accounts was only \$41,600, and the median was just over \$5,000 ([Board of Governors of the Federal Reserve](#)

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<sup>4</sup> The Deposit Insurance Fund was created through the Federal Deposit Insurance Act of 2005. Prior to that, the Savings Association Insurance Fund (SAIF) and BIF served similar purposes for savings-and-loan and thrift institutions and banks, respectively ([Garnett et al. 2020](#)).



[System 2021](#)). For Black and brown Americans, these figures are significantly lower ([Board of Governors of the Federal Reserve System 2021](#)). But even so, from the end of 2009 to the end of 2022, uninsured deposits increased at a rate of 9.8 percent annualized ([FDIC 2023b](#)). At its peak in 2021, the proportion of uninsured deposits in the banking system was the highest since 1949, at 46.6 percent ([FDIC 2023b](#)). Even so, most depositors are fully guaranteed with the current SMDIA: Though businesses and organizations may be more likely than most individual depositors to be uninsured, one study of small businesses found their median bank balance—\$12,100—was well below the current cap ([Aaron Klein 2023](#)).

## ***A. FDI's Purpose and Pitfalls: Depositor Discipline, Market Discipline, and Moral Hazard***

Bank runs are a self-fulfilling prophecy of sorts. They're also an inherent vulnerability in banking, since deposits, which are a form of borrowing for banks, can be redeemed for cash at virtually any time. Most of the time, deposits are stable and banks are able to reliably use them to finance riskier longer-term activities—like issuing personal and business mortgages, credit, and loans. But if many of a bank's depositors (or simply a handful of large ones) ever want to withdraw at the same time, a bank might not be able to meet all its obligations. This built-in fragility means that if depositors merely *suspect* a problem with a bank, they're incentivized to withdraw funds, which in turn, inspires other depositors to withdraw funds—sparking a bank run.

Deposit insurance serves to prevent this dangerous cycle from commencing by providing depositors guarantee that their money is safe so that they're never motivated to withdraw out of worry. Thus, even more than the individual protection it provides, deposit insurance is a key policy tool in maintaining banking stability. But this effect only extends as far as the reach of deposit insurance coverage. It also introduces moral hazard (i.e., when a bank or financial institution lacks the incentive to guard against risk).

In theory, without FDI, depositors have incentives to monitor their bank's behavior. If a depositor is uncomfortable with their bank's risk, they are motivated to move their money to a different institution. When it works, depositor discipline is a type of market discipline: To attract and retain client deposits and prevent a run, a bank's management may avoid excessive risk before a run could occur. The availability of FDI can reduce a depositor's concern for the safety of their money at a given bank, thereby diminishing the market disciplining effect depositor oversight has on banking activities.

But the extent to which depositor discipline exists at all, and the extent to which it has a measurable effect on a bank's risk-taking, are largely unsettled questions critical to FDI

reform. Not all depositors can—or even should—monitor their banks’ risks. Most individual depositors and many small businesses aren’t positioned, resourced, or knowledgeable enough to do so effectively. And sophisticated depositors can sometimes minimize their particular exposure without moving money out of a bank, thus nullifying the mechanism that would encourage depositor discipline ([FDIC 2023b](#)). Depositor discipline also only works if uninsured depositors can reasonably expect to take a loss in the event of bank failure. Deposit insurance intervenes to protect those depositors that cannot encourage market discipline, but, in theory, any change to the FDI cap also changes the existing balance of these disciplining forces and moral hazard.

## ***B. International Variation: US FDI is Roughly Comparable in System Structure, but Its Statutory Coverage Limit Stands Out***

Deposit insurance is not unique to the US. Demirgüç-Kunt et al. ([2015](#)) analyze deposit insurance internationally, and conclude that the US’s system is relatively comparable to that of other peer countries, though there is much variation. Eighty-four percent of high-income countries offer explicit deposit insurance, while only 32 percent of low-income countries do ([Demirgüç-Kunt et al. 2015](#)). The vast majority of these schemes—88 percent total and about 75 percent in high-income countries—are pre-funded (or *ex ante*), consisting of regular contributions from banks that accumulate in a fund to meet future obligations ([Demirgüç-Kunt et al. 2015](#)). Fifty-seven percent of countries—the US included—have systems that include responsibilities beyond deposit reimbursement, like bank licensing and supervision ([Demirgüç-Kunt et al. 2015](#)).

The US stands out as offering one of the highest statutory coverage limits, but coverage limits vary widely. At the time of Demirgüç-Kunt et al.’s analysis, coverage limits on average amounted to 5.3 times per capita income in high-income countries (and greater in middle- and low-income countries) ([Demirgüç-Kunt et al. 2015](#)). Only two countries (Turkmenistan and Uzbekistan) offered a full statutory guarantee of deposits ([Demirgüç-Kunt et al. 2015](#)). Most deposit insurance schemes—66 percent—are administered by a public institution (like the FDIC), but 56 percent in high-income countries have some form of a private component, either full private administration (like Switzerland) or joint public-private administration (like Germany) ([Demirgüç-Kunt et al. 2015](#)). Some countries also offer deposit insurance beyond the statutory limit. For example, Germany’s two-tiered scheme offers statutory coverage up to €100,000, while a privately offered component offers additional voluntary coverage up to 15 percent of a participating bank’s own funds ([Deutsche Bundesbank n.d.](#); [Demirgüç-Kunt et al. 2015](#)).

Demirgüç-Kunt et al. (2015) also analyze the emergency reforms countries enacted in the wake of the 2007-2008 financial crisis. They find that almost all countries with schemes in place at the time—96 percent—increased their coverage limit, and several countries temporarily offered unlimited coverage (Demirgüç-Kunt et al. 2015). In most cases, these recession-era expansions have been rolled back in the succeeding years (Demirgüç-Kunt et al. 2015).

## IV. The Spectrum of Approaches to FDI Reform

If some of FDI's efficacy rests on large depositors to provide a disciplining effect to banks, the recent bank collapses cast doubt on that foundational assumption. On paper, many of SVB's clients in particular were large businesses and organizations with the staff and resources to be able to keep an eye on their bank's risks. However, their frenzied withdrawals after SVB publicly announced it was struggling suggest they weren't monitoring its activities nearly enough, if at all. The collapse of SVB—when its corporate clients *seemed* capable of monitoring for risk, but didn't—unveiled new questions about FDI's adequacy in ensuring banking stability. To help answer these questions, financial systems and banking experts have offered various reforms to FDI to better achieve the interconnected aims of depositor protection and financial stability.

To better assess the bevy of proposals experts have put forth in recent weeks, we categorize them into three schools of thought on potential FDI expansion, all of which would require acts of Congress:

- 1) Preserve the current system;
- 2) Expand insurance for certain accounts that could bring market discipline to bear; and
- 3) Enact permanent universal and unlimited coverage.

### *Approach 1: Preserve the Current System*

One approach to the deposit insurance reform debate concludes that the current system is working as intended, and therefore doesn't need any reforming. Indeed, FDI has been historically successful in preventing banking panics. And even in the recent cases of SVB, Signature, and FRB, specific non-FDI vulnerabilities—like poor interest rate risk management and supervisory failures—were significant factors in their failure, if not the causal ones (Board of Governors of the Federal Reserve System 2023). This approach also holds that any significant changes to the status quo could actually engender more harm than good. Specifically, because any FDI expansion would disrupt the balance of market discipline and

bank risk-taking that the current system imposes, the costs of additional moral hazard could outweigh any marginal increases to banking stability or depositor protection.

The perspectives of experts within this school of thought range from arguing against any reform whatsoever to recommending FDI fine-tuning to inject more resiliency into the current system.

On one end of the spectrum, experts like Patricia McCoy and Aaron Klein argue against any expanded coverage at all, for reasons both theoretical and practical. Citing the positive correlation between deposit insurance coverage and the likelihood and severity of financial crises in other countries, one of McCoy's primary concerns is the risk of increased moral hazard ([Demirgüç-Kunt and Detragiache 2002](#); [McCoy 2007](#)). McCoy also expresses concern that the FDIC may be unable to collect the higher premia assessments needed for expanded FDI should banks put up formidable resistance or be otherwise unable to pay ([Wessel et al. 2023](#)). Aaron Klein comes to the same conclusion through a slightly different series of public arguments. Klein contends that the current FDI limit already successfully protects vulnerable depositors ([Aaron Klein 2023](#)). Moreover, he suggests that in a competitive and innovative private market for depositors' businesses, bank failures are a necessary occurrence. Banks "can, should, and will" fail, Klein writes, and when they do, losses should be borne by those whose money was at risk ([Aaron Klein 2023](#)).

On the other end of the range of opinions in this school of thought are those who view the recent bank failures as necessitating highly focused improvements to help the current system become more resilient. One such approach would be to index the coverage cap to inflation to help it keep pace with the price level—as it did for the FDIC's first five decades. Economists at the International Association of Deposit Insurers find evidence that rising inflation can erode insurance coverage and lead to a decrease in the real terms of otherwise unchanged nominal coverage levels ([Van Roosebeke and Defina 2022](#)). Given the lengthy time periods without any increase to the SMDIA in the past, indexing it to inflation would allow for coverage to keep pace without needing to individually legislate increases. Similar reforms have been suggested intermittently in the years since the 1980 increase effectively decoupled the cap from the price level: In 2001, former FDIC Chair Donald Powell endorsed indexing the FDI limit to the consumer price index (CPI) ([Singletary 2001](#)). The US came close to a policy like this with the Federal Deposit Insurance Reform Act of 2005, which allowed for a series of inflation-adjusted increases to the SMDIA that were then ultimately superseded by the magnitude of the one-time increase to \$250,000 in 2008 ([FDIC 2023b](#)).<sup>5</sup> After the most recent banking crises, other economists have toyed with similar recommendations ([Ghenis 2023](#)).

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<sup>5</sup> This Act also raised the cap for certain accounts, including retirement accounts, to \$250,000 before Dodd-Frank set the limit at that level for all accounts ([FDIC 2023b](#)).

Another similarly motivated refinement would be to bake in automatic emergency provisions that allow agencies greater authority to quickly intervene in financial crises. Some congressional Republicans have come out in support of this particular reform in recent weeks as concerns about how small banks (compared to big banks) will be relatively less able to weather depositor turmoil and more likely to benefit from expansion in times of crisis ([Mueller 2023](#)). The US has recent historical precedent for such a policy, too. In the fall of 2008, the Transaction Account Guarantee Program (TAGP), part of the larger Temporary Liquidity Guarantee Program (TLGP), temporarily fully guaranteed certain non-interest-bearing transaction accounts ([FDIC 2017](#)). As such, TAGP gave institutions, including smaller ones that might have been ineligible to take advantage of other emergency facilities, the option of purchasing deposit insurance for otherwise uninsured balances. Other countries took similar actions to expand their deposit insurance programs temporarily during the global financial crisis ([Demirgüç-Kunt et al. 2015](#)).

Notably, this general approach toward minimal intervention is the one typically favored by conservative policymakers. In arguing against increasing the SMDIA, these individuals and organizations invoke concerns of moral hazard and espouse a resistance to a stronger government role in private banking ([Lawder 2023](#); [Michel 2023](#)). Oftentimes, they will also cite claims that the costs of expanded coverage to the DIF would be unfairly borne by consumers and not by banks themselves ([Lawder 2023](#)).

On the whole, because this approach is relatively non-interventionist, its weaknesses mirror those of the current FDI system, in which uninsured depositors pose some threat to US financial stability. While some who fall into this school of thought have suggested hyper-targeted refinements to mitigate these stability risks, some of these solutions would only kick in after a crisis had already been triggered or otherwise do little to avert a financial panic. These reforms could help contain a future bank panic like that at SVB, but they wouldn't necessarily prevent it. Accordingly, critics of this approach argue that the recent failures of SVB, Signature, and FRB *do* expose structural vulnerabilities to the status quo that jeopardize US financial stability if not addressed.

## ***Approach 2: Expand Coverage for Certain Accounts That Could Bring Market Discipline to Bear***

A second approach to FDI reform recognizes that the current system fails to strike the right balance between market discipline and moral hazard. This approach holds that the vast majority of depositors simply can't bring market discipline to bear. However, since depositors are a part of a triad of groups (alongside regulators and shareholders) that keep banks in

check, when depositors fail to provide discipline to banks, a key industry-balancing mechanism is out of whack. As such, this approach aims to tease out which depositors can (and can't) bring market discipline to bear in order to target them—and only them—for expanded coverage. This approach ascribes great value in the presence of a coverage cap of some kind, which theoretically allows for FDI protection to small depositors and only leaves exposed those that can fend for themselves. In other words, the threat of loss from bank failure that uninsured depositors face is a necessary motivator, and implicit coverage from large-scale government intervention serves as a dampener on that motivation to monitor banks.

Accordingly, this school of thought seeks to tailor FDI reforms to only the depositors that can't bring market discipline to bear. Since the depositors that fit this bill will tend to be some of the largest of individual depositors and companies (with ready access to things like cash-management expertise and teams of financial advisors and lawyers to monitor bank risk), this school of thought serves to try to delineate the types of accounts that should receive extra coverage from those that shouldn't. Raising or removing the cap for the "wrong" depositors could engender destabilizing moral hazard. Most of the proposals within this approach call for some form of cap—an instrument that these experts see as key to actualizing market discipline—either by eliminating the cap entirely for specific accounts while preserving it as is for smaller depositors, or preserving *some* cap for all depositors but increasing it to a larger (still finite) figure for specific accounts. Such an approach to reform could be made permanent, or fashioned as temporary emergency provisions in times of crisis.

One avenue to achieving differential treatment of accounts is to lift the upper limit on all "transaction accounts," which are those that businesses and organizations use to make payroll and conduct other basic business activities. These accounts, though potentially large, aren't likely to provide any market discipline, as they don't turn a large profit. They are, however, oftentimes the deposits on which other people—namely workers—depend for their own livelihoods, and thus their exposure can trigger consumer panic. For example, when SVB failed, Roku's ability to make payroll was put into jeopardy ([May 2023](#)). Lifting coverage for transaction accounts could prevent the kind of contagious panic that comes with workers' concerns about getting paid on time.



This is the approach favored by the FDIC itself, and has been a feature of FDI in the past.<sup>6</sup> In its May 2023 report on the state of deposit insurance following the SVB and Signature Bank failures, the FDIC suggested that greater coverage on “business payment accounts,” which don’t represent return-seeking opportunities, would yield large financial stability benefits without encouraging a significant increase to moral hazard ([FDIC 2023b](#)).

Todd Phillips ([2023b](#)) proposes accomplishing tiered coverage for certain accounts by removing the current limit entirely for all non-interest-bearing accounts. Phillips’ proposal would keep the current \$250,000 ceiling for yield accounts, as these belong to depositors seeking investment who are more capable of and interested in reviewing the bank reporting documents required to monitor risk ([Phillips 2023b](#)). To help compensate for the increased moral hazard from lifting the cap for certain depositors and to help limit insured institutions to core banking activities to reduce the risk of moral hazard, Phillips also recommends prohibiting insured institutions from holding equity interests or warrants in borrowers (which can encourage risk-taking in search of profit), and disallowing bank directors from working for their bank holding companies (which aligns the director’s profit motives with their bank’s parent company ahead of its customers) ([Phillips 2023b](#)).

Other reforms within this school of thought would change the cap using employment levels as a proxy for ability to bring market discipline to bear, and target any expanded coverage to small- and medium-sized enterprises (SME). SMEs may have large deposit accounts for conducting business, but not the legal and finance staff to oversee bank management decisions. Peter Conti-Brown ([2023](#)) offers a proposal to raise the SMDIA to \$2 million for SMEs with less than 200 employees, but lower it to \$200,000 for individuals. Thomas Phillipon has expressed support for differential treatment of depositors generally, and specifically for Conti-Brown’s proposal ([Wessel et al. 2023](#)). Phillipon has also pitched an idea for reform, inspired by the European experience during the global financial crisis, in which SME deposits would get mandated preference over others in the case of resolution or recovery ([Wessel et al. 2023](#)).

Critiques to this kind of differential treatment of depositors include that it could be difficult to come to political consensus on how to define the types of accounts that deserve additional coverage. This approach could also add a degree of complexity to FDI that could 1) allow depositors to game and so be difficult for the FDIC to enforce, and 2) make bank reporting and resolutions relatively more complicated ([FDIC 2023b](#)). Any increase to the SMDIA would

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<sup>6</sup> Differential treatment of accounts has been a feature of FDI in the past. As early as 1974, statute set the SMDIA at \$40,000, but increased the limit to \$100,000 for public unit time and savings deposits ([FDIC 2023b](#)). More recently, the TAGP provided unlimited deposit insurance coverage to certain eligible transaction accounts but not other depositors ([FDIC 2023b](#)).

also require more funding to the DIF, though how much exactly depends on which changes to the deposit base and cap are made.

### ***Approach 3: Enact Permanent Universal and Unlimited Coverage***

A third approach to FDI reform ultimately weighs the benefits of unlimited, universal deposit insurance over the potential harm of increased moral hazard. This conclusion itself is predicated on the belief that US policymakers will always err on the side of caution in financial crises (e.g., the Fed’s recent actions to invoke the systemic risk exception for SVB) and that unspoken inclination creates a system of implicit deposit insurance. When depositors are confident they have implicit protection, they’re disinclined to monitor bank risk-taking such that any functioning market discipline forces are nullified. But, rather than target reforms to refine the interactions between market discipline and moral hazard, this school of thought seeks to make that system of *implicit* universal deposit insurance *explicit*. With this end goal in mind, there are two distinct policy tracks that differ in scope, though not in spirit: One would remove the cap without necessarily modifying the rest of existing banking infrastructure, and one would lift the cap on deposits as part of a much more expansive slate of reforms to transform private money into public.

On the first, some argue that the current SMDIA can be lifted permanently and for all depositors without requiring broader reform to the rest of banking. Prasad Krishnamurthy recommends lifting the cap and simultaneously refining the DIF assessment fee structure to ensure that the costs of this expanded explicit coverage fall on the largest depositors ([Wessel et al. 2023](#)). Robert Hockett ([2023](#)) offers another proposal to lift the cap entirely. His is predicated on his assertion that the cap is an already-superfluous element of FDI—a vestige of the earlier iteration of deposit insurance in which assessments were levied without risk sensitivity and pro-cyclically (i.e., only when the DIF fell below a certain threshold) ([Hockett 2023](#)). Hockett is also concerned with bank company consolidation. He argues that the presence of an FDI cap pushes depositors to “shadow banking” markets that provide higher returns and/or toward the megabanks that would be most likely to be backstopped in a crisis via the FDIC’s systemic risk exception ([Hockett 2023](#); [Labonte 2023](#)). Both have negative macroeconomic consequences—propping up destabilizing non-bank activities and accelerating banking concentration—so, Hockett argues, doing away with the cap would provide broad net benefits.<sup>7</sup>

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<sup>7</sup> Lev Menand and Morgan Ricks also support lifting the cap independent of broader reforms to the rest of US banking. However, they underscore the importance of doing so with consideration for how broadly deposits are defined (for instance, lifting the cap for all transaction account balances, but not for all CDs)—thus aligning some of their work with approach two ([US House Committee on Financial Services 2023](#); [Menand and Ricks 2023](#)).



On the second, several experts have offered proposals to overhaul US banking law to regulate US banks as public utilities. Part of the inspiration for these reforms comes from a reassessment of the fundamental role, purpose, and efficacy of banks in the economy and society. As Lev Menand and Morgan Ricks ([2023](#)) argue, the pretense of the existence of a market disciplining force through an FDI cap can create the impression that banks are private entities (akin to ordinary businesses), when in reality they perform a critical public function by creating the money supply with extensive government backing. Menand and Ricks propose treating most deposits as public products with explicit government backing. Given that the FDIC tends to take the cautious approach in instances of bank failures to ensure that uninsured depositors are made whole (regardless of the de jure cap), they see this move as better aligning the law with current practice. As part of this proposal, they also recommend increasing FDI assessment fees and strengthening the regulatory oversight of banks ([Menand and Ricks 2023](#)).

In the long term, Menand and Ricks (forthcoming) propose an even more ambitious alternative banking model that would eliminate defaultable money by addressing the problem of uninsured deposit equivalents (like repos and eurodollars) issued by nonbank financial institutions (i.e., shadow banks). The New National Banking System (NNB) they outline would also regulate banks explicitly as investor-owned public utilities. As such, banks would be limited to a fair return on capital. The FDIC would continue to collect risk-based premia, but would do so even if the DIF was fully funded, converting any surplus fees into fiscal revenue. Achieving the NNB would necessitate reform to other aspects of the US financial system—such as bank chartering, share ownership, portfolio constraints, supervision, and capital requirements. The latter would require member banks be subject to common equity capital requirements to mitigate member banks' moral hazard incentives.

Saule Omarova also situates deposit insurance within fundamental questions about the role of the government in administering and maintaining the money supply. Omarova's broader aim is to cleave off the business of money creation and safekeeping from most private lending and investment activities, and in doing so redesign the foundational architecture of modern finance—redefining the Fed's position in the economy as *the* public platform for generating and managing financial resources ([Omarova 2019](#); [Omarova 2023](#)). As part of this larger vision for the US financial system, Omarova advocates for using the US central bank as a commercial bank open to the public<sup>8</sup> through which the Fed offers basic transaction accounts to all US residents and domestically domiciled businesses and institutions

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<sup>8</sup> Morgan Ricks, Lev Menand, and John Crawford have also proposed a public option for bank accounts that would hold non-defaultable balances, FedAccounts (see [Ricks et al. 2018](#)).

([Omarova 2019](#); [Omarova 2023](#)). Under such a system, all money housed in these accounts would be non-defaultable, and thus deposit insurance would be redundant ([Omarova 2023](#)).

By far the most popular critique expressed to this approach is that it would eliminate any potential market disciplining force FDI currently provides and therefore could encourage much greater risk-taking by banks. Critics also highlight the potentially large costs of this reform. If the existing size requirement that the DIF be a percentage of total insured deposits remained in place, mandating coverage for at least an additional \$8 trillion in uninsured deposits would make it the most financially expensive of all the reforms included in this report, and would necessitate much larger assessments on banks.

Moreover, critics assert that the more expansive reforms within this school of thought could provoke widespread disruptions to the business of banking and related financial markets like those for deposit substitutes (though proponents see this as a feature of their approach, citing the threats to financial security that deposit substitutes pose). Matt Klein ([2023](#)) argues that even if all uninsured deposits exited banks to go elsewhere, banks would still be able to conduct their other valuable activities (like loan issuance) since insured deposits correspond almost exactly to banks' outstanding loans to the real economy. Even if accurate, certain of these reforms imagine transformed financial and banking systems, and implementing them would be politically challenging, technically complex, and require a relatively long time horizon.

## V. Other Considerations for FDI Reform

Any deposit insurance scheme is only maximally successful if it coexists with complementary policies to encourage financial stability, oversight, and accountability. Strong institutions generally—and strong bank regulation and supervision specifically—are requisites to a safe and sound banking system. Research shows that countries with strong institutional environments are less likely to suffer from moral hazard concerns from deposit insurance ([Demirgüç-Kunt and Detragiache 2002](#); [Hovakimian et al. 2003](#)). Additionally, thorough and consistent bank regulation and supervision play a major role in promoting financial stability, limiting the moral hazard concerns posed by deposit insurance, and enabling a prompt response to crises that arise. Regulatory rollbacks and a culture change at oversight agencies in recent years have resulted in laxer supervision—specifically, the Economic Growth, Regulatory Relief, and Consumer Protection Act in 2018, which repealed key provisions of Dodd-Frank, as well as a series of “soft” culture changes in recent years. Combined, these changes have loosened regulatory requirements and constrained bank examiners so much that, per the report on SVB's failure issued by Vice Chair for Supervision Michael Barr, they were unable to flag concerns with problem banks *even when* examiners

identified such problems ([Phillips 2023a](#); [Board of Governors of the Federal Reserve System 2023](#)).

Strong liquidity regulations and capital requirements complement FDI to support financial stability objectives. Liquidity requirements, designed to mitigate stability risks associated with banks' funding long-term assets with short-term liabilities, help ensure that banks hold enough liquid assets to compensate for any hypothetical future sudden outflows. For example, as the FDIC notes in its investigation report on the recent failures, SVB and Signature weren't subject to either of the two primary liquidity requirements, Liquidity Coverage Ratio (LCR) or the Net Stable Funding Ratio (NSFR), which exacerbated the crisis when large depositors sought simultaneously withdrawals ([FDIC 2023b](#); [Labonte 2021](#)).

Additionally, strong capital requirements—or the limitations placed on banks' reliance on deposit financing for their other activities—can help make shareholders more sensitive to risk-taking, thereby theoretically reducing moral hazard incentives for banks. Limits on uninsured depositor funding for banks and requirements on liquid assets can both reduce the risk of bank runs *and* provide depositors confidence that banks hold sufficient liquidity to meet withdrawals. If any changes to deposit insurance erode depositor discipline, stronger capital requirements can help mitigate moral hazard ([FDIC 2023b](#)).

## VI. Conclusion

The precipitous failures of SVB, Signature, and FRB shook the US banking industry—as well as the millions of depositors that hold money in the wider financial sector—and unearthed questions about who FDI serves and why. While the FDIC has been extraordinarily successful in preventing bank panics or containing them when symptoms have flared up in the past, the recent crises have revived debate about FDI's continuing ability to protect individual and institutional depositors and stabilize the US financial system. In the weeks after the recent banking crises, experts offered a broad range of reforms to FDI. Though recommendations span from nonintervention to differential account treatment to permanent universal and unlimited coverage, each aims to maximize financial stability and depositor protection. Independent of achieving political passage for any of the proffered proposals, policymakers would do well to wrestle with questions about the current system's purpose and efficacy—and the implications that each potential reform carries. The federal government, banking and depository institutions, and most importantly, depositors, will be better for it.

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