# Section 1: Executive Summary

***The Federal Deposit Insurance Corporation was established in 1933 in response to widespread bank runs and bank failures that inflicted severe damage on the U.S. economy.*** Although many banks have failed since then, all insured deposits have been fully protected by the FDIC.

***Trends in uninsured deposits have increased the exposure of the banking system to bank runs.*** At its peak in 2021, the proportion of uninsured deposits in the banking system was 46.6 percent, higher than at any time since 1949. Uninsured deposits are held in a small share of accounts but can be a large proportion of banks' funding, particularly among the largest 10 percent and largest 1 percent of banks by asset size. Large concentrations of uninsured deposits, or other short-term demandable liabilities, increase the potential for bank runs and can threaten financial stability. Uninsured depositor runs triggered the failures of Silicon Valley Bank and Signature Bank in March 2023, respectively the second and third largest bank failures in the FDIC's history at the time.

***Technological changes may increase the risk of bank runs.*** The speed with which information, or misinformation, is disseminated and the speed with which depositors can withdraw funds in response to information may contribute to faster, and more costly, bank runs. The spread of information and the ability of depositors to transfer funds overnight and on weekends may make it more challenging to promptly intervene in a bank run.

***A primary objective of deposit insurance is to promote financial stability.*** By issuing demandable deposits and lending long term, banks are subject to runs. When there is a bank run, a bank may be forced to liquidate assets inefficiently. The bank may need to be sold on short notice, reducing its valuation and increasing resolution costs. A bank run may also lead to contagion, as demandable liability holders at similarly situated banks withdraw their funds, leading to increased stress in the banking system. Depositors who lose access to their funds in bank failures may be unable to meet obligations coming due, resulting in financial stress to firms and households. Deposit insurance reduces these risks.

***Protecting small depositors, who hold most of the deposit accounts, has been an objective of the deposit insurance system since its founding.*** As of December 2022, more than 99 percent of deposit accounts were under the $250,000 deposit insurance limit. Monitoring bank solvency involves fixed costs, making it both impractical and inefficient for small depositors to conduct due diligence. Monitoring banks is also time consuming and requires financial, regulatory, and legal expertise that cannot be expected of small depositors. Deposit insurance protects small depositors' savings, without these undue costs and burdens.

***Deposit insurance can result in moral hazard and can increase bank risk-taking.*** Moral hazard is the incentive to take on greater risk as a result of being protected from the consequences of risk-taking. Since insured depositors face no risk of loss and little incentive to withdraw funds, risks and embedded losses can sometimes build over time at banks funded largely by insured deposits. Therefore, changes to deposit insurance must consider both the financial stability benefits of more coverage and the possible implications for risk-taking in the banking system.

***Regulation and supervision are essential for helping the deposit insurance system meet its objectives and constrain moral hazard.*** Tools such as capital requirements and supervision of bank growth can reduce moral hazard that arises from deposit insurance. Meanwhile, liquidity regulation and interest rate risk regulation and supervision can complement deposit insurance to reduce run risk. Expansion of long-term debt requirements may both increase financial stability by facilitating bank resolution and reduce moral hazard by increasing market discipline from debtholders.

***Bank runs are a costly form of market discipline to mitigate moral hazard.*** Bank runs by uninsured depositors transfer losses to the FDIC and other market participants, increase risk to the system by preventing an orderly resolution of the bank, and can increase risk to stakeholders at other banks through contagion. Still, deposit withdrawals can force the closure of banks with unsafe business practices not otherwise addressed. The threat of bank runs may also deter bank risk-taking if bank management perceives that the risk of a run threatens bank franchise value. Forms of market discipline that similarly constrain bank management, but not through runs, are preferable from a financial stability perspective.

***Even with deposit insurance, non-deposit creditors and shareholders may still constrain bank risk-taking.*** However, deposit insurance may reduce the cost of deposit funding and so reduce bank incentives to raise non-deposit funding. Policies that promote reliance on other market participants to constrain bank risk-taking can dampen moral hazard concerns related to deposit insurance.

***Deposit insurance has broader market effects.*** Banks compete for deposits on several dimensions. As deposit insurance increases, deposits become a relatively more attractive asset. In addition, as deposit insurance coverage increases, demand for deposits may rise, leading to a decline in deposit interest rates and an increase in bank reliance on deposit funding. Understanding the broader market implications of changes to deposit insurance is important for any policy decision.

***Deposit insurance is not free and must be funded through assessments on the banking system.*** Although the challenges posed by concentrations of uninsured depositors in the system are driven primarily by a small subset of depositors at a subset of banks, increases to the deposit insurance limit increase the size of the Deposit Insurance Fund (DIF, or the Fund) necessary for a given target ratio of the Fund to insured deposits. Increasing the size of the Fund must be done through increased assessments on banks.

***Additional policies can support deposit insurance objectives and mitigate undesired consequences.*** Deposit insurance pricing is a tool that promotes fund adequacy, encourages the fair allocation of the cost of deposit insurance across banks and, to some extent, influences bank risk-taking. Requiring collateralization of large uninsured deposits may also be considered an option to limit bank reliance on uninsured deposits, reduce depositor run incentives, and increase depositor discipline. Limiting the convertibility of large uninsured deposits would restrict the capacity of depositors to run and may improve depositor discipline in a manner that does not threaten financial stability.

***This report evaluates three options to reform the deposit insurance system.*** Ordered only for clarity of discussion, **Limited Coverage** maintains the current structure of deposit insurance in which there is a finite deposit insurance limit that applies across depositors and types of accounts. Limited Coverage includes the possibility of an increased, but finite, deposit insurance limit. **Unlimited Coverage** provides unlimited deposit insurance. **Targeted Coverage** allows for different levels of deposit insurance coverage across different types of accounts and focuses on higher coverage for business payment accounts. Targeted Coverage includes the possibility that some account types receive unlimited coverage, while others do not. Although each option has strengths and weaknesses, Targeted Coverage captures many of the financial stability benefits of expanded coverage while mitigating many of the undesirable consequences.

***Each option should be viewed alongside other policy changes.*** Because each of the options has relative strengths and weaknesses, their effectiveness depends upon the extent to which other policies are pursued simultaneously. Regulation and supervision and deposit insurance pricing can be used to support financial stability objectives and mitigate consequences. In addition, limiting the convertibility of large uninsured deposits, requiring collateralization of large uninsured deposits, simplifying deposit insurance, or providing excess deposit insurance may be considered alongside Limited Coverage and Targeted Coverage options.

***Limited Coverage maintains the current system of deposit insurance and does not, by itself, address the run risk associated with high concentrations of uninsured deposits, even with an increase to the deposit insurance limit.*** Increasing the limit by an order of magnitude (for example, to millions of dollars) is insufficient to cover many of the largest uninsured deposit accounts, the sudden withdrawal of which may be sufficient to destabilize segments of the banking system. Therefore, achieving financial stability goals in a system with large quantities of uninsured demandable deposits should be pursued alongside other tools that limit bank reliance on uninsured demandable deposits, reduce the incentive of uninsured depositors to run, or reduce the ability of uninsured depositors to run. Small and medium-size businesses that hold deposits at ranges modestly above the current limit may benefit from an increase to the deposit insurance limit. Absent an increase in the limit by multiple orders of magnitude, the overall effects on other markets and the adequacy of the DIF are likely to be small.

***Unlimited Coverage—fully insuring all deposits—effectively removes run risks but may have large effects on bank risk-taking, the level of deposit insurance assessments on banks, and broader financial markets.*** Insurance backed by the federal government provides the best deterrent to run risk. However, full deposit insurance may also generate large inflows of deposit funding to banks. It also would remove depositor discipline and may induce excessive risk-taking by banks. In addition, full deposit insurance may lead to significant disruptions for asset markets for which deposits are a substitute. Other tools, such as regulation, supervision, and pricing, may be used along with insurance to reduce disruptions to other asset markets and to dampen increased moral hazard. Full deposit insurance would increase the size of the DIF needed to achieve any given ratio of the DIF to insured deposits by about 70 to 80 percent, ignoring possible inflows of deposits, leading to significantly higher assessments on banks.

***Targeted Coverage would provide substantial additional coverage to business payment accounts without extending similar insurance to all deposits, yielding large financial stability benefits relative to its costs. A challenge to Targeted Coverage is the need to delineate between business payment deposits and other deposits.*** Extending deposit insurance to business payment accounts may have relatively large financial stability benefits, with fewer costs to moral hazard relative to increasing the limit for all accounts, as in the other options. It is difficult for businesses to maintain payment accounts across multiple banks to obtain increased deposit insurance coverage. Payment accounts rarely involve weighing a risk-return tradeoff typical of investments that form the basis of desirable market discipline. Further, losses on business payment accounts are most likely to spill over to payroll and other businesses. However, significant challenges in Targeted Coverage are distinguishing accounts that merit higher coverage from those that do not and limiting the ability of depositors and banks to circumvent those distinctions. Extending considerably higher deposit insurance to business payment accounts may require a significant increase in assessments.

***Overview:*** This report highlights the limitations of the current deposit insurance system to achieve financial stability objectives in an environment with large quantities of uninsured deposits and policy options that may be considered to help the deposit insurance system meet those objectives. Table 1.1 provides a summary of the advantages and disadvantages of the options along with complementary tools for consideration. Section 2 discusses the events of March 2023 and broader industry trends that give rise to financial stability concerns. Section 3 provides a brief history of changes to the U.S. deposit insurance system. Section 4 outlines the objectives and consequences of deposit insurance. Section 5 discusses tools that may be used in conjunction with deposit insurance to achieve policy objectives. Section 6 discusses options and considerations for reform to the deposit insurance system. Section 7 concludes.

**TABLE 1.1**

## Summary of Advantages and Disadvantages of the Options for Deposit Insurance Reform

| | Advantages | Disadvantages | Potential Complementary Tools |
|---|---|---|---|
| Limited Coverage | • Best tested model of deposit insurance<br>• Results in a limited effect on moral hazard<br>• Has a limited effect on Deposit Insurance Fund (DIF) adequacy<br>• Creates limited disruption in other markets | • Raises financial stability concerns from uninsured deposits at risk | • Consider liquidity regulations that reduce reliance on uninsured deposits<br>• Incorporate additional liquidity risk measures into pricing<br>• Place limits on convertibility for large deposits<br>• Implement deposit insurance simplification coupled with an increase in coverage to address transparency concerns and complexity<br>• Consider long-term subordinated debt requirement to facilitate resolution |
| Unlimited Coverage | • Largely eliminates bank runs<br>• Enhances transparency—clear understanding of insurance status for depositors<br>• Simplifies resolution process | • Eliminates depositor discipline; burden of market discipline falls to debtholders and stockholders<br>• Potentially broader market disruptions<br>• Generates large effects on DIF and increased assessments | • Consider long-term subordinated debt requirements and capital requirements to mitigate moral hazard<br>• Consider regulation that limits reliance on deposits<br>• Consider interest rate restrictions |
| Targeted Coverage | • Targets coverage to meet ongoing payment and operational needs of businesses<br>• Increases financial stability, depending on the increase in coverage<br>• Results in a limited decrease in depositor discipline depending on types of accounts covered<br>• Previous experience (Transaction Account Guarantee Program) | • Challenging to define type of accounts, risk of regulatory arbitrage<br>• Decrease in transparency due to complexity<br>• Increases complexity of resolutions<br>• Requires additional DIF funding | • Consider interest rate restrictions on accounts for which additional coverage is extended<br>• Consider simplification of ownership categories to decrease complexity<br>• If large accounts remain partially insured, require that large deposits are secured<br>• If large accounts remain partially insured, place limits on convertibility for large deposits |