Section 6: Options for Increased Deposit Insurance Coverage

This section presents several options for alternative deposit insurance schemes. The options differ in how much they deviate from the statutory status quo and in their likely effects upon deposit insurance objectives. Of the options considered, the report suggests that Targeted Coverage, which allows for higher or unlimited deposit insurance limits for business payment accounts, has the greatest potential to meet many of the objectives of the deposit insurance system while mitigating many of the undesirable consequences of raising the limit more broadly.

Limited Coverage maintains the existing deposit insurance framework that insures all depositors up to a limit by ownership rights and capacities at the current limit or a higher limit. Given its long history, Limited Coverage is the best tested model of deposit insurance. However, Limited Coverage does little to address the financial stability concerns associated with the events of March 2023 and the broader trends in the banking system.

Unlimited Coverage provides unlimited deposit insurance for all deposits. Although Unlimited Coverage likely provides the greatest financial stability benefits of the options considered, it is also a significant departure from the existing system. In addition to its possible effects on bank risk-taking, Unlimited Coverage may cause significant disruptions to other asset markets and would require a substantial increase in assessments on the industry to support the adequacy of the DIF.

Targeted Coverage considers different coverage across account types, with a focus on providing significantly higher or unlimited coverage to business payment accounts. Because losses on uninsured deposits associated with business payments are most likely to create spillovers, providing higher coverage on these deposits increases financial stability without expanding the safety net more broadly. Relative to investment accounts, business payment accounts are less likely to seek yield and are more difficult to diversify across banks in the current system to obtain full deposit insurance. The major limitations to Targeted Coverage are identifying business payment accounts subject to a higher deposit insurance limit and restricting the ability of depositors to exploit coverage differentials. Although more analysis is warranted, Targeted Coverage provides significantly greater financial stability benefits than Limited Coverage while attenuating many of the drawbacks associated with Unlimited Coverage.

This section also explores additional options that may be considered alongside Limited Coverage and Targeted Coverage in which some depositors remain uninsured. The section reviews voluntary excess deposit insurance, in which individual banks or depositors may choose to insure above the deposit insurance limit. If large concentrations of uninsured deposits remain under Limited Coverage or Targeted Coverage, additional approaches could include requiring collateralization of large, uninsured deposits or limiting their convertibility.

Limited Coverage

An option for deposit insurance reform is to maintain the current deposit insurance framework that provides insurance to depositors up to a specified limit by ownership rights and capacities as discussed in Section 3. Although retaining the status quo deposit insurance coverage limits, increasing

limits but maintaining them at finite levels, or simplifying the deposit insurance system while maintaining limited coverage are technically different deposit insurance structures, many of the fundamental effects of such proposals on the objectives and consequences of deposit insurance are similar. A change to the deposit insurance coverage limit could be of any magnitude—to $500,000, $1 million, $2.5 million, or $10 million, for example.[126] While the benefits and costs of raising the limit vary, the variation is differences in degree not kind. This report does not consider any precise, finite coverage limit and evaluates as one any reform options that maintain the existing deposit insurance framework in which nontrivial amounts of all deposit products are explicitly uninsured.

The existing limited coverage deposit insurance framework is the best tested model of deposit insurance. It has been used in the United States since the founding of the FDIC and is in place in many other countries as well. Maintaining this framework minimizes transition costs and potential broader market disruptions associated with larger departures from the status quo.

The costs associated with a deposit insurance determination associated with Limited Coverage are the same as those in the current system, which can be significant, and relate to financial stability. Consequently, in an option with limited, but an increased, deposit insurance coverage limit, simplification merits consideration. The FDI Act provides depositors with separate deposit insurance coverage at each chartered institution where they hold deposits. The deposit insurance coverage limit is applied to deposit amounts aggregated by different ownership rights and capacities (known as ownership categories) at the same institution.[127] Simplification can also complement the Targeted Coverage option, which is discussed below.

As of May 2023, there are 14 ownership categories that are covered separately by deposit insurance up to the standard maximum deposit insurance amount of $250,000 per institution.[128] Multiple ownership

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[126] Expressed as a percentage of per capita GDP, U.S. deposit insurance coverage is the most comprehensive of any G7 peer and amongst the highest of the G20 countries. Current U.S. deposit insurance coverage also exceeds substantially both the current median IADI member coverage and IADI historical average. Using information from the IADI Annual Deposit Insurance Survey of 2022 on coverage levels and the IMF World Economic Outlook, October 2022, for GDP, the average coverage limit of members of the Financial Stability Board is $75,367 and the average coverage to per capita GDP is 193.5 percent. In the United States, the current coverage level of $250,000 is 328 percent of U.S. per capita GDP. This is the sixth largest number of all of the countries who are part of the Financial Stability Board, and the largest of all of the G7 countries. https://www.iadi.org/en/research/data-warehouse/deposit-insurance-surveys/

[127] See 12 U.S.C. § 1821(a)(1)(C). In determining the net amount due to a depositor, the FDIC is required to aggregate all deposits in the insured depository institution which are maintained by a depositor “in the same capacity and the same right”. In other words, all deposits that an accountholder has in the same ownership category at the same bank are added together and insured up to the standard insurance amount. The United States is one of the few international jurisdictions that provide deposit insurance on a per ownership category, rather than per depositor, basis. Depending on the organization of the depositor’s accounts, this results in a higher deposit insurance coverage level per depositor than the coverage limit would indicate.

[128] The categories are: single accounts, certain retirement accounts, joint accounts, revocable trust accounts, irrevocable trust accounts, employee benefit plan accounts, corporation/partnership/unincorporated association accounts, government accounts, mortgage servicing accounts, public bond accounts, irrevocable trusts accounts with banks as trustee, annuity contract accounts, custodian accounts for Native Americans, and accounts of a bank pursuant to the bank deposit financial assistance program of the Department of Energy. For

categories complicate the resolution process, potentially delay payments to insured depositors, and add uncertainty to the FDIC's ability to provide liquidity to uninsured depositors through an advance dividend. Reducing the number of categories or limiting deposit insurance to a unique depositor identifier (such as a social security number or tax identification number) would reduce some of the challenges of resolution. However, a reduction or elimination in the number of deposit insurance categories reduces the effective deposit insurance limit available to a depositor with accounts in multiple categories.

Simplification may also contribute to depositor protection by reducing barriers to understanding deposit insurance coverage and by reducing asymmetries across depositors based upon their financial, legal, and regulatory knowledge. Clarity on deposit insurance coverage can then help depositors make informed decisions about their deposit choices. Clearer information may further financial stability, as uncertainty about insurance coverage in the event of a bank run is likely to lead depositors to withdraw their funds, even when their accounts may be fully covered.

Financial Stability

As the events of March 2023 revealed, financial stability under the current deposit insurance framework can be improved. Bank runs at Silicon Valley Bank and Signature were reminiscent of runs that occurred before the FDIC's creation. Further, market perceptions of protection of uninsured depositors may have changed following the invocation of the systemic risk exception in March 2023 amid concerns about the potential for bank runs at multiple regional banks. Uncertainty associated with protection of uninsured depositors reduces the transparency and consistency of the deposit insurance system.

Incentives to run are created by the potential loss incurred by depositors. Although increases in the deposit insurance limit reduce run risk from depositors covered by the increase, run risk can be driven primarily by a small fraction of depositors who hold large concentrations of deposits.[129] Even if deposit insurance limits increase, run risk to banks holding the largest deposits persists.

The financial stability benefits of the Limited Coverage option are strongly related to the amount of the increase in the deposit insurance limit. Even with a ten-fold increase in deposit insurance, there are likely to remain large uninsured deposits that can pose financial stability concerns. Thus, additional tools should be considered to further promote financial stability. For example, large, partially covered accounts may need to be subject to other restrictions such as collateralization, limits

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the most common insurance categories, see FDIC, "Your Insured Deposit" https://www.fdic.gov/resources/deposit-insurance/brochures/insured-deposits/. Note that rules for revocable trusts, irrevocable trusts, and mortgage service accounts will change on April 1, 2024. For information on these changes, see "Final Rule on Simplification of Deposit Insurance Rules for Trust and Mortgage Servicing Accounts." https://www.fdic.gov/news/fact-sheets/final-rule-trust-mortgage-accounts-01-21-22.pdf.

[129] In congressional testimony on March 27, 2023, FDIC Chairman Gruenberg noted that the ten largest accounts held $13.3 billion collectively. https://www.fdic.gov/news/speeches/2023/spmar2723.html
In addition to the size of the largest ten accounts, the average account above the insurance limit at Silicon Valley Bank as of December 2022 was over $4 million. Thus, the incentive of depositors to run at Silicon Valley Bank would likely be materially similar whether the deposit insurance limit was $250,000 or even ten times that limit.

to liquidity, or a limited draw schedule that curtails the associated run risk (discussed later in this section).

Because the existing framework of limited deposit insurance coverage is not expected to meaningfully affect financial stability, it is important that this option is considered alongside other available tools to improve upon financial stability.

Such tools include reducing the runnable deposits in the banking system and discouraging uninsured depositors from running even during an impending failure. To discourage the accumulation of uninsured deposits, regulations that specifically target the ratio of uninsured deposits to bank assets would directly affect the bank's willingness or ability to accept run-susceptible uninsured deposits. Extending to other institutions simplified versions of existing liquidity regulations that apply to large institutions may also promote financial stability and limit runs. The supervisory framework can also play an important role in monitoring interest rate risk and subjecting banks to enforcement actions if they fail to remediate risks associated with unstable funds. Moreover, the deposit insurance pricing system could be modified to incorporate additional premiums for concentrations of uninsured deposits, short-term liabilities, or maturity mismatch. More generally, the pricing system could better incorporate risks, such as interest rate risk, that may be associated with financial stability concerns. Explicit collateralization requirements, such as those discussed in Secured Deposits later in this section, could further lower prospective losses for uninsured depositors, decreasing their incentives to run. In addition, limiting the full withdrawal capacity of large, demandable accounts may be considered to promote financial stability when considering limited deposit insurance, discussed in Limited Convertibility later in this section.

Moral Hazard, Market Discipline, and Depositor Discipline

Existing levels of depositor discipline, overall market discipline, and moral hazard are unlikely to be greatly affected by changes to deposit insurance coverage limits that maintain the existing deposit insurance framework. This is especially the case for coverage limit changes that raise the rate by less than several orders of magnitude. For example, an increase in coverage from $250,000 to $2.5 million would directly affect only depositors with accounts in the affected range. Among previously uninsured depositors, those who become fully insured with a limit increase are likely to have been those with the least resources to monitor banks and to affect risk-taking incentives, though uninsured depositors with multimillion dollar balances may be more influential monitors at smaller institutions. Overall, the removal of monitoring incentives for depositors whose accounts become fully insured following a limited coverage change is unlikely to significantly affect other market participants and bank risk-taking behavior.

Broader Market Effects

The competitive effects of increases in coverage limits within the existing deposit insurance structure are tied to the degree of increase. A given coverage increase may affect only a small percentage of consumer accounts, but it may apply to a much larger share of accounts used by businesses. The effects on competing financial products are likely minimal since there are few compelling alternatives to transaction accounts for business purposes.

Consistency and Transparency

The current deposit insurance framework suffers from perceived consistency and transparency issues. Deposit insurance coverage reform options that maintain greater amounts of the existing framework are more likely to perpetuate the existing perceived consistency and transparency issues.

Fund Adequacy

The effects on Fund adequacy would depend upon the extent of changes to the deposit insurance limit. Limited information on the volume of deposits at alternative thresholds makes it difficult to determine the extent to which the DIF would need to increase. By number, the vast majority of deposit accounts are already insured and to the extent that uninsured deposits are heavily concentrated among the largest depositors, the less increases in the limit would affect the DIF. The anticipated effects to the DIF, therefore, are likely modest.[130]

Unlimited Coverage

Extending unlimited deposit insurance coverage to all deposits is a second option for deposit insurance reform.[131] This option would directly and effectively address financial stability concerns. Of the options considered, however, unlimited deposit insurance is likely to have the most dramatic effects on depositor discipline and the most likely to have broader market implications. It would also have the largest effect on the exposure to and adequacy of the DIF. To limit undesirable consequences, unlimited deposit insurance would need to be paired with other tools, and the efficacy of those tools would need to be assessed to ensure that they meet policy objectives.

An additional benefit of Unlimited Coverage is that it eliminates the need for a deposit insurance determination and simplifies the resolution process. Also, as all deposits are insured, there is no need to secure deposits or limit their convertibility and no basis for voluntary excess deposit insurance. Consequently, those options do not apply to Unlimited Coverage.

Financial Stability

While there are various methods to reduce destabilizing bank runs, the most direct way is to remove the incentives for depositors to run. These incentives are inseparably tied to the degree to which depositors are subjected to potential loss in the event of a bank failure. The possibility of bank runs can be almost fully eliminated by expanding deposit insurance to all depositors and deposits. As discussed in the next section, however, increased moral hazard could increase overall risk in the system and affect financial stability.

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[130] For example, FDIC (2000) estimated that a doubling of the deposit insurance limit at the time from $100,000 to $200,000 would be associated with an increase in insured deposits of $270 billion relative to almost $3 trillion in insured deposits at that time.

[131] Proposals for unlimited deposit insurance are not new. Out of the 150 proposals for deposit insurance made in Congress between 1886 and 1933, 80 percent called for insurance of all or nearly all deposits (FDIC 1983, pp. 29-30).

Moral Hazard, Depositor Discipline, and Market Discipline

Although unlimited deposit insurance would promote financial stability through the decreased propensity for bank runs, it also has the potential to exacerbate moral hazard problems, as depositors have no incentive to evaluate bank risk-taking behavior when placing their deposits and minimal incentive to regularly monitor bank risk-taking behavior.[132] Depositor discipline can occur on an ongoing basis to the extent depositors monitor and influence bank risk-taking. For such depositor discipline to be effective, depositors must not only have the incentive to exercise discipline, they also need willingness and expertise to evaluate bank behavior. Depositor discipline can also occur after the fact in the form of bank runs. Depositor discipline in the form of bank runs has significant financial stability costs, but it also puts an end to problems at a bank that may have gone unaddressed. Unlimited deposit insurance coverage would for practical purposes put an end to both types of depositor discipline.

Although unlimited deposit insurance removes depositor discipline, it need not reduce overall market discipline on a bank from non-deposit creditors, such as debt holders and stockholders. It is even possible that non-deposit creditors would perceive themselves to be at increased risk of loss under a system of unlimited deposit insurance coverage and have greater incentives to exercise discipline. This is because the coverage of all depositors, and the operational ease of doing so, may make it unlikely that a systemic risk determination would be warranted.

Another consideration is that unlimited deposit insurance would likely increase banks' incentive to fund themselves largely with deposits and less with uninsured funding sources whose claimants have incentives to monitor risk. On balance, an explicit full deposit insurance guarantee of all deposits would greatly increase banks' ability to access and rely on federally guaranteed funding. With bank runs effectively eliminated, the burden on other parts of the system of controlling large buildups of bank risk would increase. Any underperformance of supervision, regulation, deposit insurance pricing, or other risk control mechanism such as discussed in Section 5 would likely have greater cost to the DIF under a system of unlimited deposit insurance.

Existing tools can support Unlimited Coverage by mitigating the associated moral hazard concerns. For example, increasing capital requirements or expanding long-term unsecured debt requirements may provide meaningful constraints to moral hazard in the absence of depositor discipline with unlimited insurance. In addition, moral hazard concerns under Unlimited Coverage may be addressed

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[132] Unlimited deposit insurance will not eliminate bank failures, and depositors still may suffer inconvenience costs associated with failure. These costs may be a reason why insured depositors sometimes run from a bank approaching failure (Davenport and McDill, 2006). A large component of inconvenience costs is likely the possibility of restricted access to deposited funds in the event of failure. Without the need to complete an insurance determination and with an adequately capitalized deposit insurance fund (or a credible commitment from the Treasury to ensure the FDIC can meet all financial obligations), depositors should not experience restricted access to their funds. Since unlimited deposit insurance does not eliminate bank failures entirely, there will still be some inconvenience costs associated with depositors needing to find a new bank on a timeline that is outside of their control during a failure. (These costs are borne by depositors withdrawing their deposits from a bank, but the timing of when these costs are felt is under the control of the depositor outside of a failure.) Thus, despite being greatly reduced through the provision of unlimited deposit insurance, incentives to run will remain. These incentives are likely minimal.

to some degree with interest rate restrictions on deposits. There is longstanding historical precedent for the use of interest rate controls as a tool to constrain bank risk-taking, dating to the establishment of federal deposit insurance in the United States and the Banking Act of 1933, and implemented through Regulation Q (discussed in Section 3). Although general interest rate restrictions on deposits were gradually removed starting with the Depository Institutions Deregulation and Monetary Control Act of 1980 and ending with the repeal of Regulation Q in 2011, they are still used to limit risk-taking incentives of less than well-capitalized banks under the Financial Institutions, Reform, Recovery, and Enforcement Act of 1989. Under a significant expansion of the deposit insurance safety net, it is worth considering whether interest rate restrictions are warranted to mitigate moral hazard concerns.

Broader Market Effects

The competitive effects from a regime change to unlimited deposit insurance are potentially large. Deposits exist within a broad range of competing financial products. Absent accompanying changes in returns, extending deposit insurance coverage to all deposits will make deposits more attractive relative to other products. This would increase customer demand for deposit products and reduce demand for other competing assets. To the extent a significant shift toward deposits occurs, deposit rates and asset prices would adjust to reach a new equilibrium allocation of aggregate investment across products.

Consistency and Transparency

Explicit insurance coverage of all deposits produces a consistent and transparent deposit insurance framework. All depositors know with certainty that their deposits are safe. Expanding insurance coverage to all deposits and depositors minimizes potential differentials in coverage based on a customer's ability or knowledge about the opportunities for expanded coverage, for example, through pass-through coverage.[133]

Fund Adequacy

Unlimited deposit insurance coverage would have significant implications for the size of the DIF. Before accounting for possible deposit inflows, unlimited deposit insurance would increase the size of the DIF required to achieve a given ratio of the Fund to insured deposits by about 70 to 80 percent.[134] The need to increase the DIF would require that the FDIC raise assessments on banks and maintain them at levels significantly higher than their current levels. In addition, unlimited deposit insurance may warrant an adjustment to the designated reserve ratio. FDIC losses would be higher in a failure, other things equal, because there would be no uninsured depositors to take loss. Failures may be less costly if unlimited deposit insurance prevents costly bank runs or more costly if it allows risks on bank balance sheets to go unaddressed for long periods of time.

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[133]An important caveat is that unlimited insurance would apply to domestic deposits, retaining the currently explicit absence of coverage of foreign deposits.

[134] As of fourth quarter 2022, the DIF was $125.5 billion, the reserve ratio was 1.27 percent, and estimated insured deposits were $10.1 trillion. To meet the minimum reserve ratio of 1.35 percent the DIF would need to be $136.4 billion. If all of the $17.8 trillion of domestic deposits were insured, everything else equal, then the DIF would need to be $240 billion to reach a reserve ratio of 1.35 percent.

Targeted Coverage

A third option for deposit insurance reform is to offer different deposit insurance coverage across account types, or Targeted Coverage. This option may extend unlimited coverage to some account types and provide limited coverage to others, or it may provide limited coverage across all account types but with different limits. This option may help target financial stability objectives associated with higher or unlimited insurance while maintaining depositor discipline and mitigating disruptions across markets that compete with deposits. Targeted Coverage is analogous to the TAG program discussed in Section 3. For this option, the qualifying accounts could be analogous to or different than those in the original TAG program.[135]

The account types that may merit higher coverage are those used for payment purposes, specifically business payment accounts.[136] Conceptually, deposits have two distinct purposes: payments services and investment. Payments services enable depositors to easily transfer monetary value as part of the exchange of goods and services. In contrast, the primary purpose of deposits used for investment is to provide depositors a store of value and a return on investment. While deposits used for investment have many substitute products against which a depositor can assess a risk-return tradeoff, deposits used for payments services have fewer substitutes. Further, deposits used for investments are not essential to support the daily operations of households and businesses: investors regularly incur losses to investments without prompting significant financial or economic spillovers. In contrast, deposits used for payments are essential for businesses and households to manage cash inflows and outflows. Losses to deposits used for payments—or a delay in access to deposit funds—can abruptly debilitate daily operations.

Business payment accounts are not currently defined in the structure of the deposit insurance system but must be identifiable for the viability of Targeted Coverage. Practically, such accounts may be measurable by first distinguishing the identifier associated with the account: for example, using a tax identification number (TIN) or employer identification number (EIN) rather than a social security number (SSN). In addition, business payment accounts may be distinguished from other accounts using account features. For example, business payment accounts may be defined as those that are demandable and do not pay interest (or do not pay interest above some benchmark). In addition to creating a practical definition to identify business payment accounts, delineating between accounts eligible to receive higher coverage is a major challenge and discussed further below.[137]

[135] Although not entirely analogous, the European Bank Recovery and Resolution Directive (B provides differential priority in a resolution between natural persons and small businesses. Article 108(1)(a) of Directive 2014/59/EU (BRRD). https://www.eba.europa.eu/regulation-and-policy/single-rulebook/interactive-single-rulebook/100804

[136] The definitions used may broader than business payment accounts, for example, all transaction accounts, such as those used in the TAG. Broader definitions may be more practical to implement or may serve a broader policy object to also include households that require large account balances for transaction purposes.

[137] As a back-of-the-envelope calculation, median monthly income in the United States in fourth quarter 2022 was $4,878 (Bureau of Labor Statistics, not seasonally adjusted, weekly income multiplied by 4.34). Defining small businesses as those with less than 500 employees, a deposit insurance limit of $2.5 million for accounts with either an EIN or TIN (rather than a SSN), would likely cover payroll for a large proportion of small- and

There is also an argument to differentiate business payment accounts from other accounts from an efficiency perspective. It is likely that deposit accounts used for operational purposes are more difficult to maintain across multiple banks to obtain greater deposit insurance coverage. There are also likely large inefficiencies in managing daily inflows and outflows across multiple banks relative to accounts used for investment purposes. Thus, business payment accounts are least able to take advantage of insurance across banks in the current system.

The main challenges of Targeted Coverage are the practical considerations when defining account types that receive higher insurance coverage to ensure that the criteria for qualifying accounts are strictly defined and cannot be easily circumvented, especially given recent improvements in financial technology. For example, individuals, trusts, or estates may exploit account definitions and adopt EINs or TINs to obtain higher coverage under Targeted Coverage. In addition, banks and depositors may find other ways to circumvent restrictions placed on accounts with higher coverage. For instance, a bank may offer accounts with no interest but where loyalty "points" can be accrued and redeemed for gift cards or even cash. Alternatively, or in conjunction, banks could offer lower loan rates to customers who have noninterest-bearing accounts. Banks will be incentivized to pursue these or other innovations to attract deposits. Given the rapid pace of financial and technological innovation, it may be challenging for regulators to stay ahead of new product offerings.

Alternatively, banks may offer accounts with sweep arrangements in which deposits are regularly transferred from one type of account into another in ways intended to combine the advantages of investment-type accounts with the advantage of increased coverage of the transaction account. Deposit sweep arrangements may complicate failure resolution since failing banks may close either during regular business hours or at other times. Though banks may have to provide formal notice to depositors, depositors may not comprehend the implications of sweep programs. For example, some depositors may not read the relevant disclosure documents, or some may agree to sweep programs when opening an account and later forget. The increased complexity may cause some depositors to believe that they have higher insurance coverage in specific accounts when in fact they do not.

Ultimately, the distinction between accounts with higher coverage and other account types should be based on criteria that are easily accessible and distinguishable between accounts, and that are clearly defined and disclosed in ways that depositors understand. Since large amounts of uninsured deposits may remain in banks under this option, it may be appropriate to consider other tools such as those in Section 5 to mitigate the risk of banks runs.

The separation of accounts by function—payments and investments—is a key concept of Targeted Coverage. Consequently, interest rate restrictions (as discussed in Section 3 and in Unlimited Coverage) on accounts with higher coverage may be an important consideration for implementation of Targeted Coverage. Similarly, large deposit accounts that are not eligible for higher coverage should have clear restrictions on withdrawals to maintain a clear separation of payments and investment functions. In delineating accounts, it is important that large deposit accounts do not simultaneously offer insurance coverage, liquidity, and high yield.

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medium-sized business payment accounts. Such a calculation excludes other business expenses which vary by business type, and ignores variation in monthly earnings.

The costs associated with conducting a deposit insurance determination associated with Targeted Coverage are similar to those for Limited Coverage or potentially higher, depending on the how accounts are identified. For example, accounts receiving higher coverage may be viewed as an additional ownership right and capacity over which accounts must be aggregated before applying the deposit insurance coverage limit, which could complicate deposit insurance determinations. As discussed in Limited Coverage, deposit insurance simplification may provide additional benefits when considered in tandem with Targeted Coverage.

Financial Stability

Providing increased coverage to specific types of accounts has several advantages. First, it allows for a form of targeting, in which additional insurance is provided depending on the needs of customers and financial stability objectives, rather than being constrained to using only one limit to serve all account types. The original TAG program served the needs of businesses, nonprofit organizations, government municipalities, and other entities that needed ongoing use of large deposit amounts (e.g., for payroll).[138] In serving these needs, the original TAG program increased financial stability overall and benefited the broader economy.

The primary source of run risk that generates financial stability concerns is demandable deposits, especially those deposits used for operational purposes. Business payment deposits are less easily diversifiable across banks, and business accounts in this category may become very large. Providing greater or unlimited deposit insurance to business payment accounts provides the benefits of higher insurance without extending the guarantee to large depositors whose deposits are used for investment purposes.

Increasing coverage to large deposit accounts with the most demand for liquidity would reduce or eliminate the need for depositors of such accounts to withdraw their funds out of fear for the safety of their deposits and for the continuity of their operations. This would have benefits for financial stability, as these depositors are not expected to discipline risk-taking by demanding a higher return, but instead have a strong incentive to run in response to solvency concerns. Large investment-type deposits, which would remain uninsured, could still expose banks to risk of runs or periods of funding stress if these uninsured funds do not roll over when they mature.

Like Limited Coverage, the financial stability benefits of Targeted Coverage relate to the amount of the increase in the deposit insurance limit, especially as it pertains to demandable accounts. If there remain large uninsured demandable accounts, additional tools to further promote financial stability should be considered. For example, large, partially covered, demandable accounts may need to be subject to other restrictions (such as collateralization or limits to liquidity or a limited draw schedule, discussed later in this section) that limit the associated run risk.

Moral Hazard, Market Discipline, and Depositor Discipline

The primary drawbacks to providing greater or unlimited coverage to specific account types are the potential loss in depositor discipline and resulting implications for bank risk-taking. With respect to

[138] Depositors excluded from TAG program coverage were primarily those holding higher interest-bearing accounts that appear more similar to investors than those using their accounts for ongoing operating expenses.

depositor discipline, operational business depositors may be poorly situated to evaluate the risks on their bank's balance sheet relative to investors, since the primary focus of the owner of a business payment account is running a business. By providing higher insurance coverage to these types of accounts, the deposit insurance system may reduce inefficiencies created by maintaining many business payment accounts across banks and benefit those for whom financial stability concerns are highest. Interest rate restrictions on accounts with higher coverage can also mitigate moral hazard concerns from increased deposit insurance.

With Targeted Coverage, one may conjecture that the loss in depositor discipline would occur for holders only of previously uninsured accounts that are now insured; however, the resulting loss to depositor discipline may apply more broadly. Beyond the standard tradeoffs involved in deposit insurance reform, there are unique advantages and challenges to implementing Targeted Coverage.

Under Targeted Coverage, instead of running in response to bank solvency concerns, depositors may simply move their deposits to an account with higher coverage within the same bank, to the extent they are able. Consequently, depositor discipline is weakened because the deposits do not flee the bank. Though it weakens depositor discipline, the ability to obtain more insurance by moving deposits across accounts within the same bank may increase financial system stability. First, because deposits remain within the same bank, the bank is under less pressure to liquidate assets. Second, panic-driven runs are less likely if depositors can obtain greater insurance by switching account types or transferring funds to a different account within the same bank. Third, the movement of funds to more highly insured accounts can itself serve as an early-warning signal for bank supervisors, managers, and boards to rectify risky behavior that may drive a flight to safety of deposits within the bank.

Broader Market Effects

Increasing or fully insuring only business payment accounts would limit disruptions to other asset markets that compete with deposits as investment vehicles. For example, absent a full insurance option on a business payment account at a single bank, a small or medium-size firm that needs liquidity to meet its day-to-day operations may allocate its funds across multiple banks and substitute products, weighing a combination of safety, convenience, and yield. Given the choice to keep its business payment accounts fully insured, the firm may willingly sacrifice yield, or may even pay a premium, to do so. In contrast, an investor seeking yield may find restrictions on business payment accounts (such as rate caps) insufficient to justify the benefit of insurance. Thus, to the extent that business payment accounts can be distinguished from investment accounts, Targeted Coverage may support banks in their essential role in the payments system while minimizing the distorting effects that unlimited or increased deposit insurance may have relative to other assets.

Consistency and Transparency

Targeted Coverage may increase complexity compared with other options for deposit insurance reform. Even in its most basic form—for example, with two types of accounts (qualifying vs. non-qualifying) and two different limits—differential insurance would naturally generate questions from depositors about the actual insurance limit on their accounts. Because the criteria for qualifying accounts would need to be detailed, many depositors might find the criteria difficult to understand. It

would be important for banks to be transparent about the insurance limits and relevant account details, and new disclosure requirements may need to be considered. Banks may need to clearly and regularly specify to depositors the insurance limit associated with each account type (e.g., at account opening, on their account webpage, and on account statements).

Increased or unlimited deposit insurance for business payment accounts would reduce the role of perceived protection against uninsured depositor losses, providing greater consistency and transparency.

Fund Adequacy

Offering increased or unlimited insurance on only specific accounts would reduce the exposure of the FDIC in a failure, as compared with full insurance on all account types (holding constant the risk of bank failure), though this option would still entail a significant expansion of the DIF. The extent to which the DIF would need to expand would be a function of both how business payment accounts are defined and the extent to which the demand for business payment accounts results in inflows from other asset markets. Although assessments would likely need to increase, it is difficult to estimate to what extent.

Excess Deposit Insurance Coverage

In addition to changes in deposit insurance coverage, there are options that would address different aspects of the current deposit insurance system. These warrant consideration alongside the options for changes in deposit insurance coverage.

Excess deposit insurance, or voluntary coverage for deposits above the insurance limit, may be an option alongside changes to deposit insurance limits. In theory, optional coverage may be provided at the bank or depositor level, and may be provided by the private sector, by the FDIC, or by a combination.

To be credible, an insurer must have the funds to cover the loss event against which it is insuring. Excess deposit insurance would have to address the concentration of deposits in a single institution that is subject to a loss event, the correlation of loss events across small institutions associated with banking crises, and the combination of the two. Absent the federal government backstop, it seems unlikely that private insurers can address those risks sufficiently to provide enough coverage to significantly enhance financial stability. The existing private excess deposit insurance market is limited in scope and coverage and does not address the challenge of industry concentration of uninsured depositors in large institutions.[139] In an optional excess deposit insurance program, banks or depositors who pose systemic risks for which the program is designed would need to opt in for the

[139] Some organizations that offer excess deposit insurance but it is limited in scope, provides limited coverage, or the issuers retain the right to cancel, or all three. At least one such insurer abandoned offering coverage as the financial crisis took hold in 2008. The Deposit Insurance Fund in Massachusetts is a private, industry-sponsored fund that provides excess insurance for all deposits above the FDIC coverage levels. Most member banks are either savings or cooperative banks. As of year-end 2022, member banks had approximately $77.8 billion in deposits, with insured excess deposits of $28.6 billion. The Massachusetts fund had a $487 million fund balance. https://www.difxs.com/DIF/Home.aspx

program to be effective. If large banks or depositors opt out, historical experience is that they may continue to expect support from future interventions but would not bear the associated costs. Coverage that is optional neither changes perceptions about future support nor does it impose a cost on those benefiting from those perceptions.

Accurate pricing of bank risk-taking for deposit insurance is already a challenge. Pricing excess deposit insurance would be an even larger challenge given the adverse selection problem: banks or depositors who opt into an excess deposit insurance system are likely to have different characteristics than banks or depositors who do not opt in. Fair pricing would require that the FDIC account for the decision to opt in, in addition to the typical challenges associated with pricing.

Financial Stability

The effects of excess coverage on financial stability would depend upon the participation of uninsured depositors. If participation is sufficient and funds are available in a timely manner, excess deposit insurance would have significant stability benefits. If there is insufficient participation or payment on excess deposit insurance claims were delayed, however, excess deposit insurance would have limited impact on financial stability.

If excess deposit insurance were offered at the bank level, it is likely that banks most exposed to bank runs would opt in. Thus, voluntary participation has a beneficial aspect of encouraging participation of banks for whom run risk is highest. Banks would have an incentive, however, to opt in when they are experiencing stress or are near failure. For a viable system, eligibility requirements to opt in would be necessary; if some banks are not eligible, they would still be exposed to runs and thereby affect financial stability.

Deposit insurance for an individual depositor at a bank reduces that depositor's incentive to run and reduces run risk at that bank. Similarly, the decision of an individual bank to obtain excess deposit insurance coverage reduces the contagion risk within the banking system. When choosing a level of excess coverage, individual depositors and banks are likely to consider only the benefits of coverage to themselves and are unlikely to consider the benefits they bring to the system when opting in. Thus, the benefits to the system are likely higher under mandatory coverage relative to voluntary coverage.

Moral Hazard, Market Discipline, and Depositor Discipline

The implications of excess deposit insurance on moral hazard, market discipline, and depositor discipline are ambiguous. Depositors who exhaust significant resources to monitor banks may find it preferable to obtain voluntary excess deposit insurance, if offered. If depositors who previously monitored the bank opt into voluntary coverage, excess deposit insurance would have significant effects on depositor discipline, with associated effects on moral hazard and bank risk-taking. But if the least resourced depositors who currently monitor less have strong preferences for insurance and are most likely to opt in, then the effects of excess deposit insurance coverage on risk-taking incentives would be smaller.

If instead excess deposit insurance was offered at the bank level, it is likely that that those banks most exposed to bank runs would opt in. So long as deposit insurance pricing does not perfectly account for the associated run risk, moral hazard is likely to increase for banks most prone to risk-taking.

Tools such as deposit insurance pricing may be used alongside excess deposit insurance coverage to mitigate moral hazard. However, voluntary insurance programs are subject to adverse selection problems that affect other insurance programs: the agents that opt into the insurance program are those for whom the expected benefits of insurance exceed the costs of participation. Fair risk-based pricing for deposit insurance is already a challenge, and adverse selection makes the challenge of fair pricing of voluntary deposit insurance even greater.

Broader Market Effects

Voluntary excess deposit insurance is unlikely to have notable broader market effects. Especially for small banks, there already exist private excess deposit insurance programs for which deposit concentrations are not as significant of a concern as they are in the broader economy. It is unclear that broader market effects are significantly different in the presence of excess deposit insurance.

Consistency and Transparency

Excess deposit insurance likely would not significantly improve the consistency and transparency of the deposit insurance system. Financial stability concerns would continue to motivate perceptions of future interventions of support.

Fund Adequacy

If excess deposit insurance coverage were to be funded by the DIF, then banks who did not opt into the program would share the risk with those that opted in. Given its structure, an excess deposit insurance system would therefore likely be managed in parallel to the DIF and would not have direct implications for Fund adequacy. However, if a separate insurance fund is created for the program, then it would risk being underfunded.

In addition to adverse selection problems across banks, there is also an adverse selection problem across time that would inhibit the adequacy of an excess deposit insurance system. During periods of financial calm, the incentive to participate in a voluntary program are low when compared with periods of economic stress. An excess deposit insurance fund is likely to struggle to maintain adequacy to cover the difference in demand for deposit insurance over the financial cycle.

Additional Options

Under Limited Coverage and Targeted Coverage, large concentrations of uninsured depositors may remain. This section of the report considers two options that may complement those options to help achieve financial stability objectives in the current environment.

Require Secured Deposits for Large Uninsured Deposits

Requiring that short-term liabilities are funded with short-term assets is a commonly proposed solution for solving the financial stability challenges associated with runnable liabilities. Backing short-term liabilities, such as deposits, with safe, short-term assets effectively separates the payments system and credit intermediation functions of banks.

Some specific segments of the deposit market already segment the payments system and intermediation functions of banks. Depending on state or federal law, otherwise uninsured deposits of state, county, or municipal governments, and their political subdivisions, are secured by collateral or assets of the bank.[140] In the event of failure, the FDIC honors valid and enforceable collateralization agreements applicable under law. The value of the collateral, however, may not be sufficient to cover the uninsured amounts at par.

Although the tradeoff between stability and credit intermediation may not justify a collateralization requirement for large uninsured deposits, the experience of public deposits suggests that there may cases where the public interest in financial stability outweigh the associated costs to credit intermediation. The challenges posed by concentrations of large deposits at large institutions suggest that for such depositors and institutions, mandating that uninsured deposits, or possibly those above some larger dollar threshold, be secured by safe assets merits consideration.

Among the benefits of collateralizing deposits for large depositors is that it decreases the depositor's burden of monitoring. Rather than requiring depositors to understand bank financial statements and assess the riskiness of their portfolio, or make conjectures about the likelihood of a systemic risk determination, depositors need only to understand the evaluation of the specific, well-defined collateral backing their deposits. Such an expectation is the norm for custodians of funds at municipal, county, and state governments and can therefore be seen as a reasonable expectation for decision-makers at large firms. If secured depositors are more attuned to monitoring collateral, they may also impose increased haircuts, which may also serve as an early-warning signal to supervisors.

An additional benefit of secured deposits is that they allow private markets to price the risks associated with concentrated short-term liabilities. Banks that issue uninsured deposits would continue to provide liquidity but would expand their balance sheet, and would likely pass those costs to the large depositors. Doing so would discourage the largest depositors from cash hoarding, especially at a single financial institution, and would discourage large depositors from relying on market perceptions of support to earn yield: uninsured deposits used for investment rather than transaction services would likely benefit from investing directly in the desired collateral rather than through the costly expansion of bank balance sheets.

However, secured deposits likely would not entirely solve the problem of runs if an institution is suddenly revealed to be undercapitalized. As in repo markets in 2007–2008,[141] short-term collateralized loans also may be subject to runs. Upon realizing that its financial institution may be undercapitalized, a secured depositor is likely to prefer withdrawal to recouping collateral in a resolution process and incurring the valuation risk associated with the collateral in a failure.

From a competitive standpoint, the collateralization of deposit services for the largest depositors is likely to affect primarily large institutions that hold most of the uninsured deposits. Aggregate large bank credit supply could be curtailed relative to smaller institutions. Whether overall credit supply is reduced depends on the ability of smaller banks and nonbank financial intermediaries to meet the

[140] FDIC, Deposit Insurance for Accounts Held by Government Depositors. https://www.fdic.gov/deposit/deposits/factsheet.html
[141] Gorton and Metrick (2012).

demand. From the perspective of deposit market competition, secured deposits are likely to make small banks less competitive for the largest uninsured deposits given their balance sheet capacity. However, small banks are already less competitive for uninsured depositors, especially the largest depositors who might be targeted by a collateralization requirement. Requiring collateral for large deposits also would limit the capacity of insured institutions to provide the deposits. Requiring the collateralization of large deposits may therefore lead to both reductions in credit supply and a reduced capacity of the system to meet the demand for large deposits. Although both outcomes are consequential, such outcomes may be the result of a current mispricing of the liquidity risk posed by large quantities of uninsured deposits due to market perceptions of support in crisis.

Mandating the collateralization of large uninsured deposits also could have broader market implications. Banks issuing uninsured deposits would have greater demand for safe, short-term assets, thereby driving up the price. Depositors may also find the newly priced deposits unattractive and migrate out of the banking system. Depending on where the large depositors migrate, the associated run risk may migrate with them without improving financial stability.

Secured deposits could also have implications for fund adequacy. While an increase in the deposit insurance limit increases insured deposits and the necessary size of the DIF, converting uninsured deposits into secured deposits would not directly affect the amount of insured deposits or the reserve ratio. However, secured deposits stand ahead of the FDIC in the priority of receivership claims, and so could increase losses to the DIF and uninsured depositors in resolution.

Requiring collateral for uninsured depositors could apply to the entire class of uninsured deposits or for uninsured deposit accounts above some threshold, and could apply at the depositor or institution level. Requiring collateralization of some uninsured deposits could also be applied only to banks with material concentrations of uninsured deposits or other runnable liabilities. While the experience of public deposits is a natural starting point for operationalizing secured deposits, the costs and benefits of any mandate on collateral for uninsured deposits is complex and beyond the scope of this report.

Limit Convertibility of Deposits Above the Deposit Insurance Limit

One possibility to limit the extent to which a run by large depositors can inflict sudden damage to a bank and the broader economy is to limit the full liquidity of large, uninsured accounts.[142] Placing constraints on the ability of large depositors to withdraw funds would be a variation of the bank suspensions that occurred in large numbers before the creation of the FDIC, but such constraints could be more tailored than those suspensions were. Such limitations could apply to deposits above the deposit insurance limit, or at a considerably higher level. They could apply in the normal course of business, or banks could have the discretion to apply them in the face of financial stress; bank supervisors could also determine how to apply the limitations.

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[142] Existing tools limit convertibility for money market funds. For example, SEC Rule 2a-7 passed in 2014 allows a money market fund board to impose up to a 2 percent liquidity during stress or temporarily suspect redemptions.
https://www.sec.gov/news/press-release/2014-143

For example, deposit accounts above some threshold could be restricted from withdrawing more than some percentage of their account balance within a specified timeframe.[143] Additional withdrawals would be allowed after the specified timeframe. Thus, the largest depositors would be restricted from liquidating their accounts on demand. Withdrawal requests that approach or exceed the threshold may then also serve as an early-warning signal for supervisors. Thus, large depositors would maintain some skin-in-the-game following large withdrawals, suppressing incentives to incite further panic and maintaining an interest in the franchise value of a bank in resolution.

In addition to reducing the ability of large depositors to run, limiting liquidity for the largest depositors may also induce these depositors to diversify funds more broadly across banks, thereby reducing their concentration at a single bank. A more diversified depositor base may then further contribute to financial stability.

Finally, limiting the liquidity of large uninsured deposits may increase the incentives of the largest depositors to exert market discipline in a manner that reduces bank risk-taking. A large depositor with concerns about bank solvency has an incentive to withdraw funds immediately. If the ability to withdraw funds is limited, large depositors are more likely to retain exposure to the bank in a failure. Consequently, incentives of the largest depositors may be more closely aligned with other debtholders and the resolution authority and may induce those depositors to discipline the bank in a way that threatens its value in a failure event.

For mismanaged and undercapitalized banks, limiting the liquidity of the largest accounts is unlikely to prevent a bank failure. Instead, by slowing the run, the FDIC would have time to resolve the bank through an orderly resolution process, rather than through a costly bank run. Similarly, limiting withdrawals will not necessarily prevent the contagious spread of concerns about banks' health. Knowing that large withdrawals are occurring at some banks may cause large depositors at other banks to do the same. But again, the limitations on withdrawals could greatly slow the speed with which liquidity issues can propagate, supporting financial stability and the orderly resolution of problems.

[143] McCabe, Cipriani, Holscher, and Martin (2012) propose that a small fraction of each MMF investor's balance be demarcated to absorb loss, a "minimum balance at risk," if the fund is liquidated.