May 2, 2023

WASHINGTON POLICY STRATEGY

Potomac Perspective

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The Federal Deposit Insurance Corporation (FDIC) released an overview of deposit insurance that included policy options for Congress. In the current environment, chances of changes in deposit insurance are low. As the political winds shift, support for deposit insurance legislation could grow. Historically, it often takes years to build support for financial services legislation, so this could be an issue for 2025 or beyond, rather than 2023 or 2024. If Congress defies expectations, simply raising the current cap stands the best chance of passing, followed by covering transactional accounts. Providing unlimited deposit insurance coverage would face the most significant political opposition and is the least likely option to be adopted.

FDIC Report of Deposit Insurance Starts Long Debate Over Changes – On Monday, the FDIC released "Options for Deposit Insurance Reform" which provides three policy options for Congress to consider. Click here to access the FDIC's deposit insurance report.

The three options for deposit insurance reform included in the report are: Limited Coverage (current system), Unlimited Coverage, and Targeted Coverage. The report describes how each option might be considered alongside other regulatory tools to maximize each option's effectiveness.

Under **the current system (Limited Coverage),** the cap on deposit insurance has been increased intermittently ever since the FDIC and deposit insurance were created in 1933. The current cap is $250,000, and the FDIC report floats the possibility of increasing coverage to $1 million. Since Congress has raised deposit insurance coverage repeatedly, and since this choice would probably involve to fewest changes to the current scheme, it is likely the easiest of the three options to push through Congress. It would also be the option that results in the lowest increase in deposit insurance assessments.

Unlimited Coverage would, as its name suggests, cover all deposits, thus removing the risk of bank runs. This option would, however, result in large increases in deposit insurance assessments and significant regulatory changes to address a substantial increase in moral hazard. It could also disrupt other financial markets if deposits surge into the banking system and out of other markets.

Targeted Coverage would cover business payment accounts, but not all accounts. It would be similar to the Transaction Account Guarantee Program the FDIC created during the Great Financial Crisis (GFC). Congress might struggle to accurately define transaction accounts and other accounts in order to prevent depositors who are not intended for the expanded coverage from accessing the new system. This option would also result in significant increases in deposit insurance assessments and would mitigate, but not eliminate, the risk of bank runs. Although the FDIC does not officially recommend a particular option, the report clearly signals the FDIC's preference for Targeted Coverage.

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The FDIC provided this table which lists the pros and cons of each proposal:

Table 1.1 Summary of Advantages and Disadvantages of the Options for Deposit Insurance Reforms

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

Congressional approval is needed to enact any of these changes. As we have previously opined, the current political environment is not conducive to passing changes in deposit insurance coverage. If the situation in the banking system deteriorated materially, Congress might consider deposit insurance to be a higher priority than it is now. However, in the midst of a debt ceiling debate and the related debate over the fiscal year 2024 spending bills, and with immigration policy and foreign policy issues such as China and the war in Ukraine ranking as higher priorities, there seems to be little appetite or bandwidth for Congress to address deposit insurance this year or next (a presidential election year).

It is worth noting that according to a survey conducted for Punchbowl News, 52% of congressional staffers think the member of Congress they work for is concerned about the recent failures of Silicon Valley Bank and Signature Bank. Only 26% of the surveyed staffers think their boss supports expanding deposit insurance above the current cap -- only 14% of Republicans staffers hold that view, which underscores the difficulty of passing a deposit insurance bill through the GOP-controlled House.

If our view is wrong and Congress passes a deposit insurance bill over the next 18 months, simply increasing the current cap to a higher level ($500,000? $1 million?) seems to stand the best chance. Congress has increased the deposit insurance cap numerous times over the decades, and this approach would require the fewest number of changes to the current system. It is the path of least resistance. **The next most probable option would be Targeted Coverage**, given that the FDIC has previous experience with this option during the GFC. **Unlimited Coverage would face the most political opposition,** especially from community banks – a group that has strong bipartisan support.

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