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Reforming FDIC Coverage Limits: The Deposit Insurance Cap

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Reforming FDIC Coverage Limits: The Deposit Insurance Cap

I. Introduction

A college student, a multibillion-dollar company, and your grandmother all have something in common: the maximum amount federal insurance guarantees on their bank deposits.[1] The Federal Deposit Insurance Corporation ("FDIC") has insured all banking deposits, up to a deposit limit, for nearly a century.[2] Considering the collapse of Silicon Valley Bank and Signature Bank, and how those failures unraveled, the FDIC should modify its current coverage regime. The FDIC's adjustment should not be another incremental increase of the coverage cap, nor a blanket abandonment of insurance maximums, but a more tailored approach that will prove sustainably advantageous for the entire market.

This approach should be in the form of targeted coverage, as the FDIC itself recommended in May of 2023.[3] Targeted coverage, whereby business payment accounts are insured up to a higher amount than individual accounts, will increase confidence in the banking system and address deposit insurance's largest structural weakness: a reliance on the systemic risk exception ("SRE" or "the exception").[4] The current levels of coverage force the FDIC to rely on the SRE in the face of potential bank failures exacerbated by large, often uninsured business depositors.[5]

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1. 12 U.S.C. § 1821(a)(1)(E).
2. Fed. Deposit Ins. Corp., A Brief History of Deposit Insurance in the United States 1 (1998), https://www.fdic.gov/bank/historical/brief/brhist.pdf [perma.cc/G88V-T9CC] [hereinafter FDIC, A Brief History of Deposit Insurance].
3. Fed. Deposit Ins. Corp., Options for Deposit Insurance Reform 55–56 (2023), https://www.fdic.gov/analysis/options-deposit-insurance-reforms/report/options-deposit-insurance-reform-full.pdf [perma.cc/C6FH-SYCN][hereinafter FDIC, Options for Deposit Insurance Reform].
4. 12 U.S.C. § 1823(c)(4)(G).
5. *See* FDIC, Options for Deposit Insurance Reform, *supra* note 3, at 1 (explaining that it is not the insured depositors that have an incentive to run a bank).

Given the state of modern banking, delineation of accounts is critical.[6] The FDIC's proposal serves as a starting point, but careful attention must be paid to how accounts are defined, and the amount of coverage extended.

Deposit insurance for business payment accounts could follow the model set forth in the Transaction Account Guarantee ("TAG") program.[7] The program, developed during the 2008 Global Financial Crisis ("GFC"), established a clear line of delineation, providing unlimited deposit insurance coverage to all noninterest-bearing transaction accounts ("NIBTAs").[8] This line allowed the FDIC to isolate accounts with particularly high transactional needs, such as payroll accounts.[9]

This Note proceeds in six parts. Part II will discuss the purpose, history, and structure of federal deposit insurance.[10] Part III will examine the current weaknesses in deposit insurance, including the FDIC's use of the systemic risk exception to the least cost resolution mandate, underscored by the collapse of Silicon Valley Bank and Signature Bank in March of 2023.[11] Part IV will explore potential alterations to the FDIC's deposit insurance coverage cap.[12] Part V will highlight targeted deposit insurance coverage and explain why it may be the best option for reform.[13] Part VI will conclude.[14]

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6. *See* Ann Graham, *Bringing to Heel the Elephants in the Economy: The Case for Ending "Too Big to Fail"*, 8 PIERCE L. REV. 117, 147 (2010) (highlighting the deposit system was not envisioned for the "highly concentrated banking industry" the United States that has developed).

7. *See* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 47 ("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).").

8. SEAN M. HOSKINS, CONG. RSCH. SERV., R42787, AN OVERVIEW OF THE TRANSACTION ACCOUNT GUARANTEE (TAG) PROGRAM AND THE POTENTIAL IMPACT OF ITS EXPIRATION OR EXTENSION 1 (2012).

9. *See id.* ("NIBTAs are accounts that do not pay interest and allow the depositor to make withdrawals without giving advanced notice to the bank. NIBTAs are frequently used by businesses and local governments as a cash management tool, often for payroll transactions, but any depositor whose account meets the eligibility criteria receives unlimited deposit insurance coverage.").

10. *See infra* Part II.

11. *See infra* Part III.

12. *See infra* Part IV.

13. *See infra* Part V.

14. *See infra* Part VI.

II. DEPOSIT INSURANCE

A. *Purpose of Deposit Insurance*

The FDIC's chief mission is to "maintain stability and public confidence in the nation's financial system."[15] Deposit insurance mitigates risk, not only to the insured deposit holders, but the economy at large, by providing a federal safety net for all insured bank deposits if a bank fails.[16]

A loss in confidence in a particular bank may create a bank run.[17] In a bank run, depositors rush to the bank to withdraw their money out of fear the bank may be failing. This can create a self-fulfilling prophecy where the bank does in fact lose the capacity to fulfill withdrawals after it has exhausted its liquid assets.[18] Banks do not hold all deposit funds in a vault, but profit largely by loaning out funds for longer-term, less liquid assets like loans to the community.[19] After a run, depositors at other banks may subsequently question their bank's ability to meet withdrawal requests. Through a contagion effect, a single bank run may create a panic that impacts the entire economy.[20]

The FDIC provides guaranteed deposit insurance coverage, in the event of a bank failure, to all deposits "maintained by the depositor in the same capacity and the same right"[21] up to $250,000 in each institution.[22] This serves to bolster public confidence in banks and

15. *What We Do*, FDIC, https://www.fdic.gov/about/what-we-do/ [perma.cc/94WS-VLUH] (May 15, 2020).
16. Stephen G. Cecchetti, et al., *Revisiting the Design of Deposit Insurance, in 4* RAPID RESPONSE ECONOMICS 148, 148 (Viral Acharya et. al. eds., 2023).
17. John C. Dugan, *Addressing the Fundamental Banking Policy Problem of Runs: Effectively Subordinating Large Amounts of Long-Term Debt to Short-Term Debt to End "Too-Big-To-Fail",* 22 NC BANKING INST. 11, 13 (2018).
18. *See id.* ("Moreover, the very act of increased withdrawals of funds can precipitate a sudden failure of a bank, creating even more of an incentive for a depositor to be 'first in line' to withdraw funds rather than be stuck at the back of the line when the bank fails.").
19. *See* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM*, supra* note 3, at 25 (describing the traditional bank business model whereby demandable deposits are used to fund less liquid investments).
20. *See* Cecchetti, et al., *supra* note 16, at 148 ("The history of banking is punctuated by episodes of runs that disrupt banking services. In the presence of imperfectly informed depositors, a run on a single bank can quickly become a widespread panic that undermines both financial activity and the economy that depends on it.").
21. 12 U.S.C. § 1821(a)(1)(C) (aggregation of deposits).
22. § 1821(a)(1)(E).

reduce the likelihood of bank runs.[23] FDIC insurance coverage is set by statute[24] and the agency does not have the authority to unilaterally alter its coverage regime without an act of Congress.[25] At the end of 2022, less than 1% of all deposit accounts exceeded this $250,000 limit, but more than 40% of total bank deposits were uninsured.[26]

B. History of Deposit Insurance

Deposit insurance was implemented following the banking collapse of the Great Depression.[27] The banking system in the United States was utterly crippled in the early 1930s, after panic forced a bank holiday—officially closing the doors on banks around the nation.[28] Public confidence in banks had eroded and public sentiment favored adoption of deposit insurance.[29] President Franklin Roosevelt, the Secretary of the Treasury, and the Chairman of the Senate Banking Committee expressed reservations, believing the potential expense to the government to be too great.[30] Further, these leaders cautioned that the regime would unjustly subsidize banks with ineffective management.[31] Nevertheless, Congress adopted deposit insurance in 1933.[32] Despite these worries and doubts, the Banking Act of 1933 established more forward-looking protections by creating the Federal Deposit Insurance Corporation.[33]

The Banking Act dramatically decreased the number of bank failures. In the four years before 1934, nearly 9,000 banks were forced

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23. FED. DEPOSIT INS. CORP., KEEPING THE PROMISE: RECOMMENDATIONS FOR DEPOSIT INSURANCE REFORM 1 (2001) ("The public relies on the Federal Deposit Insurance Corporation (FDIC) to protect insured depositors, resolve banking problems quickly, and help maintain public confidence in insured depository institutions.").
24. § 1821(a)(1)(E).
25. Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") § 1105, 12 U.S.C. § 5612 (2012).
26. Martin Gruenberg, Chairman, the Fed. Deposit Ins. Corp., Remarks on the Resolution of Large Regional Banks — Lessons Learned (Aug. 14, 2023) [hereinafter, Gruenberg, Remarks on the Resolution], https://www.fdic.gov/news/speeches/2023/spaug1423.html [perma.cc/DCQ8-2KDX].
27. FDIC, A BRIEF HISTORY OF DEPOSIT INSURANCE, *supra* note 2, at 1.
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.*

to close.[34] Only nine banks failed in 1934, the year deposit insurance became effective.[35]

Congress has repeatedly raised the deposit insurance limit over the years. By July of 1934, the original amount insured was increased from $2,500 per account to $5,000.[36] The cap was raised to $10,000 in 1950, $15,000 in 1966, and $20,000 in 1969.[37] In 1974, the limit doubled once again to $40,000.[38] Then, in 1980, the FDIC raised coverage to $100,000 per account.[39] This number remained unchanged until 2008, when it was temporarily increased to $250,000, in response to the GFC.[40] This increase became permanent in 2010.[41]

C. *The Evolution of Systemic Risk*

With the Federal Deposit Insurance Corporation Improvement Act of 1991,[42] following concerns with the FDIC's assistance to keep Penn Square Bank open, Congress adopted the requirement that the FDIC handle bank failures in the least costly manner.[43] Almost as an afterthought, the systemic risk exception was added to the least cost resolution requirement to provide a mechanism to protect and support

34. *Id.*

35. *Id.*

36. *Id.* at 30.

37. *Id.* at 45.

38. Act of Oct. 28, 1974, Pub. L. No. 93-495, §§ 101–104, 88 Stat. 1500, 1500–03 (codified as amended at 12 U.S.C. § 1831).

39. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132, 147–48 (codified as amended at 12 U.S.C. § 1821(a)(1)).

40. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, § 136, 122 Stat. 3765, 3799 (codified as amended at 12 U.S.C. § 1821(a)(1)(E)).

41. Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") § 335, 12 U.S.C. 1821(a)(1)(E) (2012)*; see also* Lorie Konish, *FDIC Coverage Limits May be Raised Above $250,000 Again. How Experts Say You Can Have More of Your Deposits Insured*, CNBC (Mar. 27, 2023, 4:48 PM), https://www.cnbc.com/2023/03/27/how-experts-say-you-can-have-bank-deposits-above-250000-insured.html [perma.cc/K298-SNZM]. Some institutions guarantee a higher deposit level beyond what the FDIC may cover. *Id.* An account holder may also add a beneficiary, with each beneficiary providing an additional $250,000 worth of coverage on the same account. *Id.*

42. FED. DEPOSIT INS. CORP., CRISIS AND RESPONSE: AN FDIC HISTORY, 2008-2013, at xvii (2017), https://www.fdic.gov/resources/publications/crisis-response/book/crisis-response.pdf [perma.cc/YU8A-AMEF] [hereinafter FDIC, CRISIS AND RESPONSE].

43. *See id.* at 36 ("The roots of the SRE can be found in concerns that FDIC resolutions during the banking crisis of the 1980s and early 1990s had frequently protected uninsured depositors and creditors in addition to insured depositors.").

the banking system in the event that the failure of a large institution created a systemic risk to the financial system.[44]

The systemic risk exception allowed for a suspension of the least cost resolution requirement for a failed bank if the FDIC Board, the Federal Reserve Board ("FRB"), the Secretary of the Treasury, and the President determined additional funds were critical for economic stability.[45] The exception would be extended if the least cost resolution method would have "serious adverse effects on economic conditions and financial stability."[46]

The SRE was formally employed during the financial crisis when the FDIC created the Temporary Liquidity Guarantee Program ("TLGP").[47] The TLGP had two elements: a Debt Guarantee Program, guaranteeing bank unsecured debt issued and repayable during a specified time period, and the TAG program which provided unlimited deposit insurance coverage for NIBTAs.[48] Although these were voluntary programs for banks, both guarantees were issued unless the institution opted out.[49] This broad interpretation of the SRE to authorize large-scale programs even to banks not in danger of failing was questioned by some.[50]

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") addressed the SRE's applicability to larger scale programs and constrained its use in the future.[51]

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44. 12 U.S.C. § 1823(c)(4)(G).

45. FDIC, CRISIS AND RESPONSE, *supra* note 42, at xvii.

46. Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, § 141, 105 Stat. 2236, 2275 (codified as amended at 12 U.S.C. § 1823(G)(i)).

47. Temporary Liquidity Guaranty Program, 73 Fed. Reg. 64179, 64181 (2008) (to be codified at 12 C.F.R. 370); *see also* MARC LABONTE, CONG. RSCH. SERV., IF12378, BANK FAILURES: THE FDIC'S SYSTEMIC RISK EXCEPTION (2023) (describing the five planned uses of the SRE since 1991).

48. LABONTE, *supra* note 47. The SRE was not invoked until 2008, when the FDIC prepared to use it to aid Citigroup to purchase the failing Wachovia bank. *Id.* In the end, the SRE was not used in the Wachovia failure, as Wells Fargo acquired Wachovia shortly thereafter in a bid that did not include any FDIC assistance. *Id.* Just a few months later, in January 2009, the SRE was almost used to assist Bank of America, but conditions stabilized before the Secretary of the Treasury formally approved the action. *Id.* The announcements of the potential use of the SRE, even though not implemented, nevertheless demonstrated an alternative method to stabilize individual institutions and the financial system. *Id.*

49. Temporary Liquidity Guaranty Program, 73 Fed. Reg. at 64181.

50. *See* LABONTE, *supra* note 47 (highlighting the cost, unpredictability, and highly discretionary nature of the exception).

51. Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") § 1106(b), 12 U.S.C. § 1823(c)(4)(G) (2012).

After 2010, broad-based programs required approval not only from the FDIC, FRB, and Treasury, in consultation with the President, but also a joint resolution of Congress.[52] Additionally, broad-based programs could only be implemented "during times of severe economic stress."[53] Congress provided a joint resolution in the CARES Act of 2020, but ultimately the FDIC did not use the authority.[54]

For individual institutions, the original SRE provision was left intact.[55] SRE employment for an individual institution only requires approval from the FDIC, the FRB, and the Treasury (in consultation with the President).[56] Dodd-Frank also amended the exception to require that an institution is in a receivership before authorization.[57] The exception was not invoked again until March 2023 during the SVB and Signature Bank failures.[58]

D. Moral Hazard Considerations

Increasing deposit insurance can be problematic because it increases the risk of moral hazard.[59] As the safety net widens, or deposit insurance policies are modified, banks may be drawn to riskier investments.[60] If the government has promised to step in after failure, the bank may take chances it otherwise would not.[61] Risk and reward incentives become distorted, at the expense of the FDIC.[62] Instead of

52. Dodd-Frank § 1105(c)(1), 12 U.S.C. § 5612(c)(1).

53. Dodd-Frank § 1105(a), 12 U.S.C. § 5612(a)*; see* LABONTE, *supra* note 47 ("Although the exception was clearly intended to be a bank resolution tool, policymakers used the authority at the time to justify two crisis programs that were open to all banks, including healthy ones.").

54. Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") § 4008(a), 12 U.S.C. § 5612 (2020) (amending Dodd-Frank § 1105, 12 U.S.C. § 5612 (2012).

55. 12 U.S.C. § 1823(c)(4)(G).

56. *Id.*

57. FDIC, CRISIS AND RESPONSE, *supra* note 42, at 92.

58. LABONTE, *supra* note 47.

59. *See* George Hanc, *Deposit Insurance Reform: State of the Debate*, 12 FDIC BANKING REV. 1, 5 (1999) ("Concern about bank risk taking and what is now called the moral hazard problem is by no means new.").

60. Rebecca N. Duffy, The Moral Hazard of Increased Deposit Insurance: What the 1980s Savings and Loan Crisis Can Teach Us About Responding to the Current Financial Crisis, 59 DRAKE L. REV. 559, 566 (2011).

61. *See* Nancy J. Coppola, *Increased Federal Deposit Insurance Coverage: At What Cost*, 6 N.C. BANKING INST. 429, 438 (2002) (discussing the savings and loan crisis of the 1980s as a consequence of bank behavior incentivized by increased deposit insurance.).

62. *Id.* at 450.

protecting customers, moral hazard might increase risky behavior and hurt customers and the economy in the long run. Moral hazard concerns are especially acute for banks approaching insolvency.[63]

The theory of moral hazard is not solely concerned with the behavior of the bank.[64] Fully insured depositors may not monitor their bank's behavior since they have no risk even if the bank fails.[65] Deposit insurance may therefore serve more as a vehicle to promote irresponsible bank behavior than as a protective safety net.[66] Moral hazard is important because relying on supervision, regulation, and enforcement mechanisms can be costly and may not always be effective.[67]

III. CALLS FOR CHANGE FOLLOWING THE SILICON VALLEY BANK AND SIGNATURE BANK FAILURES

A. A Brief Explanation of the Failures

In March of 2023, Silicon Valley Bank and Signature Bank failed.[68] Depositors lost confidence in these institutions that, relying heavily on low yield portfolios and uninsured deposits, faced sudden liquidity crises.[69] These were the two biggest bank failures since Washington Mutual was closed in 2008.[70] Silicon Valley Bank, relying largely on longer term government securities, faced sizable depreciation of assets as interest rates increased.[71] This exposure raised concerns

63. Hanc, *supra* note 59, at 4.

64. *See* Coppola, *supra* note 61, at 438 (highlighting altered incentives for depositors if deposit insurance shifts bank insolvency risk outside of the bank).

65. *Id.*

66. *See* Duffy, *supra* note 60, at 566 ("With insurance as a safety net, the insured party has less incentive to act in a cautious manner and more incentive to incur risks that might cause the particular harm the insurance is meant to protect against in the first place.").

67. *See id.* (emphasizing the economic costs and efficiency dilemmas that accompany bank supervision and examination once deposit insurance is in place).

68. Lora Shinn, *What Happened to Signature Bank?*, INVESTOPEDIA, https://www.investopedia.com/what-happened-to-signature-bank-7370710 [perma.cc/AG9Z-A4JA] (May 1, 2023).

69. Gruenberg, Remarks on the Resolution, *supra* note 26 ("These characteristics proved to be a toxic combination when each bank faced stress.").

70. Shinn, *supra* note 68.

71. *The Federal Regulators' Response to Recent Bank Failures: Hearing before the H. Comm. on Fin. Servs.*, 118th Cong. 107–12 (2023), https://www.congress.gov/118/chrg/CHRG-118hhrg52390/CHRG-118hhrg52390.pdf [perma.cc/32XK-RN4J] (statement of Martin Gruenberg, Chairman, Fed. Deposit Ins. Corp) (discussing SVB's banking

with the bank's borrowers, who feared their deposits may not be safe.[72] As SVB reactively tried to demonstrate liquidity by attempting to raise nearly $2.25 billion, depositors' concerns grew.[73] By the end of the day on Thursday, March 9, depositors had withdrawn $42 billion.[74] The FDIC was involved by evening.[75]

The bank was placed in receivership on March 10th.[76] Insured deposits were covered, yet uninsured depositors were informed they would receive only an undetermined amount of funds through an advance dividend.[77] The promise of the advance dividend was intended to quell disruption for those uninsured depositors.[78] Yet, the panic spread.

As fears mounted, Signature Bank began to experience the contagion effects.[79] On the day of SVB's failure, Signature lost 20% of deposits within hours.[80] Signature would ultimately fail and be placed in receivership on March 12th.[81] That same day, a joint statement issued by the Department of the Treasury, the FRB, and the FDIC announced that both institutions would be protected under the systemic risk exception.[82] This meant that uninsured deposits exceeding the $250,000 coverage amount would be fully backed by the FDIC.[83] Depositors were assured of access to those funds by Monday.[84]

This action was neither swift nor inexpensive, with over $15.8 billion spent to protect uninsured accounts.[85] Over the weekend of

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strategies along with market conditions that served as catalysts for the failure) [hereinafter Gruenberg, *Financial Services Hearing*].

72. *Id.* at 109.

73. *Id.*

74. *Id.*

75. *Id.* at 110.

76. Vivian Giang & Mike Dang, *10 Days That Have Roiled Markets: A Timeline of the Banking Chaos*, N.Y. TIMES (Mar. 20, 2023), https://www.nytimes.com/article/svb-silicon-valley-bank-collapse-timeline.html [perma.cc/W3W3-ANXP].

77. Gruenberg, *Financial Services* Hearing, supra note 71, at 110.

78. *Id.*

79. *Id.* at 113.

80. *Id.* at 113–14.

81. Vivian Giang & Mike Dang, *supra* note 76.

82. Press Release, FDIC, Joint Statement by the Department of the Treasury, Federal Reserve, and FDIC (Mar. 12, 2023), https://www.fdic.gov/news/press-releases/2023/pr23017.html [perma.cc/J5PM-STYQ].

83. *Id.*

84. *Id.*

85. *Fact Sheet: Notice of Proposed Rulemaking on Special Assessment Pursuant to Systemic Risk Determination,* FED. DEPOSIT INS. CORP., https://www.fdic.gov/news/fact-sheets/systemic-risk-determination-5-11-23.html [perma.cc/3C3V-VVK9] (May 11, 2023).

chaos, before the exception was invoked, the FDIC received only two bids to purchase SVB.[86] The Chairman attributed this to a "limited timeframe for bidders."[87] When Signature Bank's bank run demonstrated contagion effects shortly thereafter, the FRB, FDIC, and Secretary of the Treasury unanimously decided to invoke the exception for both banks.[88] The least cost provision, they insisted, would result in "serious adverse effects on economic conditions or financial stability."[89] This decision came nearly two days after the chaos began.[90] For nearly two days, depositors at these institutions did not know if they could reach their assets, including businesses needing to make payroll and pay suppliers.[91] This uncertainty sent tangible shockwaves, as companies like Roku and Oncorus were faced with potential calamity, triggering filings with the SEC to disclose exposure.[92]

Signature Bank, smaller than SVB, was the 29th largest bank in the nation.[93] While the bank was large, it was by no means the size of other banking giants the SRE was likely intended for.[94] Regulators did not hold Signature or SVB to the most stringent prudential regulation standards designed for systemically significant players in the industry.[95] Signature Bank was not structured as a bank holding company, and was not subject to enhanced prudential regulatory requirements ("EPR") before its failure.[96] EPR imposes additional safety and soundness requirements on systemically important banks and bank holding companies with assets above $250 billion.[97] SVB, which was owned by a bank holding company, was in the tier of institutions with assets

86. Gruenberg, *Financial Services* Hearing, supra note 71, at 110–11.
87. *Id.* at 110.
88. *Id.* at 115.
89. *Id.* at 116.
90. *Id.* at 115.
91. *Id.*
92. Roku, Inc., Current Report (Form 8-K) (Mar. 10, 2023); Oncorus, Inc., Current Report (Form 8-K) (Mar. 10, 2023).
93. Press Release, FDIC, FDIC's Supervision of Signature Bank, 6 (Apr. 28, 2023), https://www.fdic.gov/news/press-releases/2023/pr23033a.pdf [perma.cc/9Q3P-PFWE] [hereinafter FDIC, Supervision of Signature Bank].
94. *See* ANDREW P. SCOTT & MARC LABONTE, CONG. RSCH. SERV., IN12125, SILICON VALLEY BANK AND SIGNATURE BANK FAILURES 1–2 (Mar. 21, 2023) (explaining the size of Signature's assets did not warrant enhances prudential regulations).
95. *Id.*
96. *Id.*
97. *Id.*

ranging from $100 billion and $250 billion.[98] This designation meant that SVB was also not automatically subject to the most enhanced regulatory requirements.[99] Instead, the FRB retained discretion to apply tailored supervision, if an enhanced regulation regime seemed appropriate.[100] These two banks were not seen as big enough to warrant heightened diligence on the front end, yet they needed the saving power of the big bank exception once the threat of failure loomed.[101]

The tech startup industry connected with SVB illustrated just how quickly an entire industry can scramble.[102] On the Friday of SVB's collapse, a startup accelerator president reported that nearly 400 clients held deposits in excess of the deposit insurance limits at SVB and that over 100 of them were worried they would not be able to make payroll over the next 30 days if there was not a quick resolution of the bank.[103] If a business is caught in a liquidity crunch and misses timely payroll, both the business and its employees can suffer economic distress.[104] National and state laws can create both statutory penalties and civil liabilities that can follow a company even after declaring bankruptcy.[105] These serious penalties accompany serious consequences. If employees are unable to make mortgage payments or rent, entire communities suffer through an economic ripple.[106]

The FDIC's internal review of the failure of Signature Bank largely attributed the failure to management practices, specifically

98. *Id.*
99. *Id.*
100. *Id.*
101. *See id.* at 2 (underscoring the employment of the systemic risk exception for two institutions deemed too small to qualify for EPR).
102. *See* Berber Jin, et al., *After Silicon Valley Bank Fails, Tech Startups Race to Meet Payroll,* WALL ST J., https://www.wsj.com/articles/after-silicon-valley-bank-fails-tech-startups-race-to-meet-payroll-4ebd9c5c [perma.cc/3925-TR4E] (Mar. 11, 2023, 3:48 PM) (surveying the startup sector just days after the SVB collapse).
103. *Id.*
104. *See* CROWELL, CLIENT ALERT: PAYROLL OBLIGATIONS DURING LIQUIDITY CRUNCH CRISIS—IMPLICATIONS AND RESPONSES (Mar. 13, 2023), https://www.crowell.com/en/insights/client-alerts/payroll-obligations-during-liquidity-crunch-crisis-implications-and-responses [perma.cc/Y7QE-V3M5] ("Failure to timely make payroll will result in significant liability to employers due to the robust statutory protection provided by federal and state law.").
105. *Id.*
106. *See* Temporary Liquidity Guaranty Program, 73 Fed. Reg. 64179, 64180 (to be codified at 12 C.F.R. 370) (Oct. 29, 2008) (forecasting economic shockwaves in the event of a bank run precipitated by substantial outflows of uninsured deposits).

highlighting an overreliance on uninsured deposits.[107] The bank's management, according to the FDIC, did not always responsively address regulatory concerns.[108] The attempted profiting through extreme leveraging of several companies' uninsured deposits must not be cast aside.[109]

B. *Wake-Up Call: Should There Be a Change in Deposit Insurance?*

The March 2023 panic, and near disaster, created a national dialogue around deposit insurance and whether and how to protect uninsured depositors.[110] The Mid-Size Bank Coalition of America sent a letter to ask the FDIC to insure all bank deposits for the next two years in order to restore confidence in the banking system.[111] Senator Elizabeth Warren argued that raising the deposit insurance cap would provide greater stability.[112] According to her rationale, rather than the government making exceptions to protect uninsured depositors through the SRE, a statutory change on the front end would stabilize the banking sector and prevent future runs on banks.[113] She is not alone.[114] Legislators from both sides of the aisle have proposed a reexamination of the current FDIC deposit insurance coverage.[115] Martin Gruenberg,

107. FDIC, Supervision of Signature Bank, *supra* note 93, at 7 ("[Signature Bank's] board and management pursued rapid, unrestrained growth without adequate risk management practices; funded growth through an overreliance on uninsured deposits without implementing fundamental liquidity risk management practices; and failed to understand the risk of its association with the crypto industry.").

108. *Id.*

109. *See* Gruenberg, *Financial Services Hearing*, *supra* note 71, at 115 ("A significant number of the uninsured depositors at SVB and Signature Bank were small and medium-sized businesses."); *see also* FDIC, Supervision of Signature Bank, *supra* note 93, at 2 ("SBNY funded its rapid growth through an overreliance on uninsured deposits without implementing fundamental liquidity risk management practices and controls.").

110. Ramishah Maruf, *Why Some Lawmakers Want to Raise the FDIC Insurance Limit for Your Savings*, CNN BUS. https://www.cnn.com/2023/03/22/business/fdic-insurance-expansion-explainer/index.html [perma.cc/66YL-ZNBF] (Mar. 22, 2023, 1:42 PM).

111. *Id.*

112. *Id.*

113. *Id.*

114. *See* David Lawder, *U.S. Lawmakers to Examine Merits of Higher Bank Deposit Insurance Cap*, REUTERS (Mar. 19, 2023), https://www.reuters.com/markets/us/us-lawmakers-examine-hike-fdic-bank-deposit-insurance-cap-2023-03-19/ [perma.cc/4BKE-8CMP] (highlighting Senator Mike Rounds' reservations regarding the current cap).

115. *See id.* (explaining Republican Senator Mike Rounds and Democratic Senator Chris Van Hollen both urged a reconsideration of the deposit insurance cap).

Chairman of the FDIC, expressed a clear interest in discussing alternatives during a US House of Representatives Committee Hearing just days after the collapses.[116] He stated that he would consider a risk-based assessment for all FDIC-insured banks and assured Congress that the FDIC would conduct a comprehensive review of the deposit insurance system.[117] In another statement, Gruenberg described the current risk-based deposit insurance premium system where a bank's premiums to the deposit insurance fund may be increased if the FDIC deems the institution's funding to be unstable.[118]

Others, outside of members of Congress, have also advocated for change.[119] The former FDIC Chief, Sheila Bair, suggested a temporary blanket guarantee on all deposits.[120] She reasoned that a lack of trust in the banking system could hurt healthy, smaller banks if depositors withdraw their funds and flock to the biggest banks perceived as "too big to fail".[121] She did not view Silicon Valley Bank or Signature as systemically important institutions and argued that the FDIC's normal takeover process would have resolved the crisis.[122] In an interview with Reuters, she explained it was not realistic "for similar one-off determinations to be made for other banks."[123] In her view, it would be best to streamline the authority of the FDIC, and create a way for expanded guarantees that was not reliant on a dire liquidity event and cooperation with Congress.[124]

116. Gruenberg, *Financial Services Hearing*, *supra* note 71, at 7.
117. *Id.*
118. Gruenberg, Remarks on the Resolution, *supra* note 26.
119. Lawder, *supra* note 114.
120. *Id.*
121. David Lawder, *US FDIC May Need Temporary Guarantee for All Bank Deposits - Ex Chief Bair*, REUTERS (Mar. 15, 2023, 12:11 AM), https://www.reuters.com/markets/us/us-fdic-may-need-temporary-guarantee-all-bank-deposits-ex-chief-bair-2023-03-16/ [perma.cc/FC65-3JVV].
122. *See id.* ("Bair said she did not view Silicon Valley Bank or Signature Bank as systemically important institutions, adding that they could have been resolved through FDIC's normal takeover process, with a 'haircut' for uninsured deposits.").
123. *Id.*
124. *See id.* ("If that continues, the FDIC and the U.S. Treasury should seek 'streamlined' authority from Congress to guarantee all uninsured deposits and transaction accounts, which handle client company payroll and operations, she said.").

C. Answering the Call

The Signature Bank and SVB failures may have provided a glimpse into a deeper problem of modern bank regulation.[125] The systemic risk exception, an ad-hoc post-crisis band-aid that can be used only in a failing bank situation, should not be the structure the FDIC depends upon to protect bank accounts.[126] Businesses needing to cover payroll should not be relying on a post-failure judgment consensus of federal regulators to assure they will have access to any sums above $250,000.[127] If there are paychecks to fill, and suppliers to pay, access to accounts should not be in question.[128]

The delay and uncertainty caused by ad-hoc decision-making causes unnecessary harm to businesses.[129] Roku, which held $487 million at SVB, explained that roughly 26% of the firm's cash reserves were trusted to the institution.[130] In its filing with the SEC, the company described the deposits to be "largely uninsured" without knowledge of the extent to which their deposits would be recoverable.[131] The S&P 500 dropped by 4.5% during March 2023, driven by reduced confidence after SVB's implosion.[132]

During a crisis, businesses fear that banks will become less willing to lend to both businesses and individuals in the face of

125. *See* Graham, *supra* note 6, at 147 (emphasizing the wide discrepancy between the deposit insurance system and the modern banking system of the twenty-first century).

126. *See* Gruenberg, *Financial Services Hearing*, *supra* note 71, at 123 ("One clear takeaway from recent events is that heavy reliance on uninsured deposits creates liquidity risks that are extremely difficult to manage, particularly in today's environment where money can flow out of institutions with incredible speed in response to news amplified through social media channels.").

127. *See* Joseph Cioffi, et al., *No Guarantee Systemic Risk Exception Will Save the Next Bank,* REUTERS (Apr. 6, 2023, 12:33 PM), https://www.reuters.com/legal/transactional/no-guarantee-systemic-risk-exception-will-save-next-bank-2023-04-06/ [perma.cc/KU4X-9FQC] ("The systemic risk exception is a powerful tool, but its recent use for SVB and Signature Bank may have given depositors at other banks a false sense of assurance.").

128. *See* Gruenberg, *Financial Services Hearing*, *supra* note 71, at 114–15 (detailing the effects of the uncertainty surrounding Signature and SVB prior to the receivership).

129. *See* Peter Santilli, *Companies Whose Deposits in Silicon Valley Bank Were Just Freed,* WALL ST. J., https://www.wsj.com/articles/companies-with-deposits-trapped-in-silicon-valley-bank-9034f33b [perma.cc/TT6E-YKMZ] (Mar. 13, 2023, 11:15 AM) (discussing corporate clients scramble for money following SVB's collapse).

130. Jon Markman, *Tech Titans Beware: SVB Bank's Collapse Threatens Roku*, FORBES (Sep. 19, 2023, 7:08 PM), https://www.forbes.com/sites/jonmarkman/2023/09/19/tech-titans-beware-svb-banks-collapse-threatens-roku/ [perma.cc/85RD-G8PQ].

131. Roku, Inc., Current Report (Form 8-K) (Mar. 10, 2023).

132. Markman, *supra* note 130.

evaporating liquidity.[133] The banks of similar size to SVB were hurt first, but negative effects were observed across the banking system.[134] Further, as businesses flee to banks deemed "too big to fail" and thus systemically significant, those banks grow even bigger.[135] Smaller and mid-sized banks are also harmed because the exodus of businesses destabilizes their deposit bases.[136]

The banking sector as a whole declined by 20% in the wake of the SVB collapse, a larger drop than the rest of the market.[137] The banking industry has become increasingly concentrated, and the FDIC continues to bear the burden of saving massive institutions it deems to be "too big to fail."[138] Furthermore, which banks are big enough to provoke the SRE is up for interpretation given the relative size of Signature and SVB compared to giants like J.P. Morgan Chase or Bank of America.[139] This uncertainty could delay government actors in coming in to save medium-sized institutions, which creates unnecessary harm to the institution if the government decides to save the institution after all.[140] The FRB has recently taken temporary actions to provide further security, but the FDIC has not implemented any significant

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133. *See* Gruenberg, *Financial Services Hearing*, *supra* note 71, at 115 ("Moreover, with the liquidity of banking organizations further reduced and their funding costs increased, banking organizations could become even less willing to lend to businesses and households.").

134. Dong Beom Choi et al., *Contagion Effects of the Silicon Valley Bank Run,* 2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 31772, 2023), https://www.nber.org/system/files/working_papers/w31772/w31772.pdf_[perma.cc/8SYC-S3BL] (explaining the path of negative effects across the banking system, starting with similar-sized institutions).

135. *See* Lawder, *supra* note 121("'My biggest fear now is that that lack of trust in the banking system takes hold and uninsured deposits start fleeing banks of all sizes to the biggest banks, just making them bigger again,' Bair said.").

136. *See id.* (quoting Sheila Bair's concern for panic around institutional health to destabilize deposit bases at banks of all sizes).

137. Dong Beom Choi et al., *supra* note 134, at 9 ("While the S&P index did not show distinct signs of stress following the SVB failure, the banking sector as a whole declined by 20%.").

138. *See* Graham, *supra* note 6, at 146–147 (discussing the role of deposit insurance, changing nature of the banking industry, and historic focus of large institutions),

139. *See* Fed. Rsrv. Bd., Insured U.S.-Chartered Commercial Banks that Have Consolidated Assets of $300 Million or More, Ranked by Consolidated Assets, (June 30, 2023), https://www.federalreserve.gov/releases/lbr/current/lrg_bnk_lst.pdf [perma.cc/E679-FBKD] (reporting banks with assets exceeding $1 trillion).

140. *See* Gruenberg, *Financial Services Hearing, supra* note 71, at 115 ("With uninsured depositors at the two banks likely to face an undetermined amount of losses, depositors at other banks began to move some or all of their deposits to other banks to diversify their exposures and increase their deposit insurance coverage.").

change.[141] It may be time not only for change, but for a different kind of change.

IV. Potential Alterations to Deposit Insurance

There are several proposals for changing the deposit insurance limit that warrant consideration. They will be discussed in this section.

A. Incremental Increase

The coverage cap for FDIC deposit insurance has been raised seven times since its inception in 1933.[142] Calls for an increase in the amount following a financial crisis is by no means new.[143] The FDIC could cover accounts up to $300,000 or even $500,000. Expanding the safety net following a panic or loss of confidence makes intuitive sense.[144] It is a known and tested market adjustment.[145] The FDIC itself has suggested that raising the coverage limit may be a politically feasible option.[146] This adaptation would not require an overhaul of the current structure of deposit insurance.[147]

Supposedly, increased coverage brings with it increased security and peace of mind for the insured. If customers have confidence in their banks and the banking sector generally, the probability of a bank run declines.[148] This is, after all, the mission of deposit insurance to begin with.[149]

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141. *See* Lida R. Weinstock & Marc Labonte, Cong. Rsch. Serv., IN12134, Bank Term Funding Program (BTFP) and Other Federal Reserve Support to Banking System in Turmoil 1 (2023) (discussing the FRB's creation of the Bank Term Funding Program, intended to safeguard deposits and protect the money supply).

142. Bill Chappell, *The FDIC Was Created Exactly for This Kind of Crisis. Here's the History*, NAT'L PUB. RADIO https://www.npr.org/2023/03/13/1163138002/the-fdic-insurance-limit-was-last-raised-in-2008-heres-how-it-works [perma.cc/9UMC-872L] (Mar. 14, 2023, 8:05 AM).

143. *See id.* (discussing the incremental increases in deposit insurance limits over time).

144. *See* Duffy, *supra* note 60, at 571–572 (noting the Congressional decision to expand coverage from $40,000 to $100,000 involved very little discussion and debate).

145. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 4.

146. See *id.* at 42 ("Maintaining this framework minimizes transition costs and potential broader market disruptions associated with larger departures from the status quo.").

147. *See id.* ("The existing limited coverage deposit insurance framework is the best tested model of deposit insurance.").

148. *Id.* at 44.

149. *Id.* at 1.

The moral hazard issue remains, and theoretically, expands as risk is further incentivized.[150] As deposit insurance increases, deposit holders will be forced to rely more heavily on regulators to curtail excessive risk-taking by banks.[151] Most critically, even with an increase, many large business accounts would remain uninsured.[152] For example, Signature Bank reported having around sixty clients with deposits over 1,000 times higher than the $250,000 limit.[153]

B. Universal Coverage

If the FDIC wanted to maximize the public's security and confidence in their deposits, it could cover all accounts regardless of amount. The risk of a bank run would be all but eliminated.[154] This stability comes with a cost of 70%–80% increase in funding according to the FDIC.[155] Since FDIC premiums are paid by banks, this increased deposit insurance expense would negatively impact banks' bottom lines, unless passed on to customers. Not all customers want these costs, nor need them.[156] Further, moral hazard concerns are greatly exacerbated as there is no limit to the risk a bank may take.[157] The government will

150. *See* Duffy, *supra* note 60, at 565 ("While an increase in the rate of deposit insurance may reinforce consumer confidence in the United States' financial sector, someone will still be left to foot the bill accrued by risk-seeking, profit-motivated financial officers."). *But see* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 44 ("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.").

151. *See* Stephen Neukam, *Warren says Congress Should Raise FDIC Insurance Cap*, HILL (Mar. 19, 2023, 8:37 AM), https://thehill.com/homenews/sunday-talk-shows/3907290-warren-says-congress-should-raise-fdic-insurance-cap/ [perma.cc/GZP2-7SRA] (explaining Senator Warren's position that lifting the cap would mean the American people would be "relying even more heavily on the regulators to do their jobs").

152. *See* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 43 ("Even if deposit insurance limits increase, run risk to banks holding the largest deposits persists.").

153. FDIC, Supervision of Signature Bank, *supra* note 93, at 11.

154. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 45.

155. *Id.*

156. *See* Peter Conti-Brown, *This Bank Proposal Will Damage Our Economy and Make Voters Even More Resentf*ul, N.Y. TIMES (April 5, 2023), https://www.nytimes.com/2023/04/05/opinion/banking-reforms-deposit-insurance-guarantee.html [perma.cc/86UG-DB7D] ("The current deposit limit is so much higher that we cannot say it is intended to protect anyone like the average saver.").

157. *See id.* ("An unlimited guarantee to banks that their debts to depositors will always be 100 percent backed by the government is an invitation for the banks to print money with Uncle Sam's credibility but for their private profit.").

have promised to step in, which leaves depositors with little incentive to monitor a bank's behavior.[158]

Implementing the plan may not increase moral hazard as much as one would think. The "too big to fail" mentality has already forced bailouts beyond the caps.[159] Corporate and banks' beliefs that bailouts may be forthcoming already generates significant moral hazard concerns.[160] Concerns about moral hazard when implementing unlimited coverage should be moderated by the knowledge that the current system already creates such moral hazard concerns.[161] However, there may be ways to implement unlimited coverage that limits moral hazard to manageable levels, perhaps by focusing on a subset of accounts.

C. Targeted Coverage

Targeted coverage is a route that takes a more tailored approach to deposit insurance.[162] As proposed by the FDIC, targeted coverage would offer different amounts of coverage for different types of accounts.[163] Some accounts could receive unlimited coverage, while other accounts receive a finite limit for coverage.[164] One promising differentiation is between business and non-business accounts.[165] The FDIC discusses this form of targeted coverage extensively in its

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158. *See* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 44 ("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.").

159. *See* Shinn, *supra* note 68 (discussing the government's decision to ultimately cover all deposits of Signature Bank, even beyond the FDIC cap).

160. *See* Duffy, supra note 60, at 570 (describing the exacerbation of moral hazard with too big to fail).

161. *Cf.* Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237, 239 (1996) ("[M]oral hazard has never been a straightforward, purely logical or scientific concept.").

162. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 46 (describing preliminary differentiation of accounts determining extent of coverage under a targeted coverage approach).

163. *Id.*

164. *Id.*

165. *See id.* at 49 ("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.").

"Options for Deposit Insurance Reform" report.[166] The FDIC report does not definitively set a delineating factor, nor suggest a quantitative coverage amount.[167]

The optimal solution is a form of targeted coverage based on the TAG program.[168] TAG provided a model for identifying business accounts which should be fully insured.[169] Business payments accounts should be treated differently to further the ultimate goals of deposit insurance: stability and depositor confidence.[170]

The Signature and SVB failures exposed the critical problem of underinsured business accounts.[171] Uninsured deposits of mid-sized companies distinctly propelled Signature Bank's growth.[172] This exposure of business accounts is widespread across the banking sector. In December 2022, the FDIC estimated that across all insured institutions, over $7.7 trillion deposits were uninsured, totaling 43% of all domestic deposits,[173] while 88% of the deposits of SVB and 90% of the deposits of Signature Bank were uninsured.[174] During the weekend of the SVB downfall, First Republic Bank also disclosed an insurance deficiency in corporate accounts.[175] While insisting its average account

166. *Id.* at 46–49.

167. *See id.* at 46 ("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.").

168. *See id.* at 48 ("Beyond the standard tradeoffs involved in deposit insurance reform, there are unique advantages and challenges to implementing Targeted Coverage.").

169. *See* Ezekiel Vergara, *United States: Transaction Account Guarantee Program,* 4 J. FIN. CRISES 673, 676 (2022), https://elischolar.library.yale.edu/journal-of-financial-crises/vol4/iss2/31 [perma.cc/W7GW-4SAQ] (describing the implementation of TAG, and the version approved by the Dodd-Frank Act of 2010).

170. *See* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 48 (highlighting the advantages to differentiating coverage based on account types, namely financial stability and service tailored to needs).

171. *See* Gruenberg, *Financial Services Hearing, supra* note 71, at 115 ("A significant number of the uninsured depositors at SVB and Signature Bank were small and medium-sized businesses."); *see also* Nicholar Georgakopoulos, An Emergency Brake for the Age of Instantaneous Bank Runs 6–7 (May 16, 2023) (unpublished manuscript), https://ssrn.com/abstract=4446937 [perma.cc/54P7-WU7T] (describing payroll accounts as the primary source of contagion risk in the SVB failure).

172. FDIC, Supervision of Signature Bank, *supra* note 93, at 10 ("[Signature Bank]'s primary source of growth was through uninsured deposits gathered from mid-sized companies.").

173. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 21.

174. Gruenberg, *Financial Services Hearing*, *supra* note 71, at 112.

175. *See* First Republic Bank, Current Report, (Form 8-K) (Mar. 10, 2023) ("Consumer deposits have an average account size of less than $200,000 and business deposits have an average account size of less than $500,000.").

size was less than $200,000, it explained the business account average was nearing $500,000.[176] Under the current system, many business accounts remain uninsured, endangering businesses, employees, and the economy as a whole.

If deposit accounts are given greater insurance coverage, the banking sector benefits from stability and a lower likelihood of a bank run.[177] As opposed to expanding coverage to all bank accounts no matter the purpose or size, targeted coverage presents a more elegant solution. It tailors the solution to a need: greater systemic confidence through the protection of business funds.[178]

Many American families with personal accounts may not, and likely do not, care if a personal account is insured up to $3 million, $5 million, or an unlimited amount. However, American families are typically not responsible for making payroll for hundreds of employees or for fulfilling a succession of vendor contracts.[179] Consumers with funds in excess of $250,000 may divide up their deposits among different banking institutions. In contrast, a business depositor may need its funds in one place to distribute each month's payroll and other daily business expenses most easily. Signature Bank reported around sixty clients that held deposit account balances above $250 million.[180]

Without greater confidence, contagion effects may spread through a domino effect throughout the economy. If a company is unable to make payroll, its employees may not be able to make a mortgage or rent payment. For a depositor's business operations to continue consistently and dependably through a crisis, deposit insurance needs to cover more than a fraction of assets. This is far from protecting the corporate giants while neglecting the average American. Rather, this adjustment anchors stability before weaknesses can be exposed. This change reduces reliance on emergency aid that may or may not be forthcoming in a timely manner.

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176. *Id.*

177. *See* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 47 ("The primary source of run risk that generates financial stability concerns is demandable deposits, especially those deposits used for operational purposes.").

178. *See* Markman, *supra* note 130 (highlighting the deposit amounts, in the millions, trusted to SVB by Roku and predicting danger for more SVB customers).

179. *See* Conti-Brown, *supra* note 156 ("The critics of the current regime have one important point: It has never made sense to treat wealthy individuals and small businesses identically.").

180. FDIC, Supervision of Signature Bank, *supra* note 93, at 11.

V. RECOMMENDATION: TARGETED COVERAGE SYSTEM

A. An Appropriate Change for the Modern Day

The FDIC should implement targeted coverage to insure deposit accounts at a higher level if the accountholder is a business rather than an individual. Targeted coverage provides two major benefits: responsiveness and stability. Additionally, it levels the playing field for competition in the banking industry; banks besides those deemed "too big to fail" can accept large deposits.[181]

Targeted coverage is "responsive" because businesses would not be forced to anticipate the outcome after learning that their bank has failed and may not be able to fulfill its obligations.[182] As it now stands, the SRE safety net is only deployed after a contagion has already begun, and explicitly limits intervention to individual depository institutions placed under a receivership by the FDIC.[183] The FDIC board itself has made clear that the systemic risk exception is exactly that, an exception, and not a norm to be relied upon.[184]

The first step is likely for Congress to amend 12 U.S.C. § 5612. After Dodd-Frank, the FDIC lacks the authority to implement broad-based programs without first gaining approval from several political actors.[185] As the law currently stands, the FDIC may not exercise its authority to guarantee deposits beyond $250,000 without agreement from the Treasury Secretary, the President, the FRB, and the passing of a joint resolution of Congress.[186] While theoretically possible in a crisis,

181. *See* HOSKINS, *supra* note 8, at 6 (highlighting that the lack on insurance on NIBTA accounts may motivate depositors to choose banks based on perceived size and interconnectedness).

182. *See When a Bank Fails - Facts for Depositors, Creditors, and Borrowers,* FED. DEPOSIT INS. CORP., https://www.fdic.gov/consumers/banking/facts/priority.html (last visited Nov. 10, 2023) [perma.cc/ERE3-RBWW] (underscoring the uncertainty of reimbursed deposits for those without full coverage).

183. 12 U.S.C. § 5613(c)(1).

184. *See* Jonathan McKernan, Member, FDIC Board of Directors, Statement on the Proposed Special Assessment (May 11, 2023), https://www.fdic.gov/news/speeches/2023/spmay1123c.html [perma.cc/TMZ7-ZQK5] ("My March 12 vote was not to backstop the uninsured deposits of all banks or otherwise commit myself to future votes to use the FDIC's emergency powers.").

185. Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") § 1105, 12 U.S.C. § 5612.

186. *Id.*

the current partisan climate does not naturally lend itself to this type of action without a severe threat of national destabilization.[187]

As it now stands, the government is under pressure to wait until it gets serious before acting. This creates a delay. The threat of disaster affects businesses, shareholders, and economic actors around the globe.[188] However, once targeted coverage is legislatively permitted, companies using business payment accounts can rest assured that they will have access to their funds no matter the health of the bank. When the FDIC has been appointed receiver, the deposits remain safe.[189] This is in stark contrast to uninsured deposits at a failed bank.[190] Disbursement of funds to uninsured depositors lacks certainty and stability. Advance dividends could take several years, if they come through at all, based on the timing of liquidation.[191]

Targeted coverage also provides stability because it preemptively protects a broader number of economically critical institutions compared to the combination of the current insurance cap and the SRE. With targeted coverage, the threat of a run on any institution is greatly reduced, because businesses may trust in a robust safety net.[192]

Finally, by insuring business accounts formally, regardless of the size of the bank that depositors have chosen, community banks may have a better chance to compete with larger banks for business depositors' funds even when the account balances often exceed the current $250,000 coverage cap.[193] This leveling of the playing field may

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187. *See* Coronavirus Aid, Relief, and Economic Security ("CARES Act") § 4008(a), 12 U.S.C. § 5612 (2020) (amending Dodd-Frank § 1105, 12 U.S.C. § 5612 (2012) to authorize the FDIC to provide unlimited coverage to NIBTA accounts, during the COVID-19 pandemic).

188. *See* Miklesh Prasad Yadav, et al., *The Domino Effect: Analyzing the Impact of Silicon Valley Bank's Fall on Top Equity Indices Around the World*, 55 FIN. RSCH. LETTERS, 3–4 (2023), https://doi.org/10.1016/j.frl.2023.103952 [perma.cc/2BTZ-2M8X] (underscoring the global economic impact of SVB's collapse, as seen across global equity indices).

189. FED. DEPOSIT INS. CORP., *supra* note 182.

190. *Id*.

191. *Id.*

192. *See* FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 48 (explaining the corresponding reduction of run risk associated with targeted coverage).

193. *See* Deniz Anginer & Asli Demirgüç-Kunt, *Bank Runs and Moral Hazard: A Review of Deposit Insurance*: A Review of Deposit Insurance (World Bank Pol'y Rsch., Working Paper No. 8589, 2018), https://ssrn.com/abstract=3252233 [perma.cc/X8FW-G78Y] ("Deposit insurance can level the playing field and allow smaller banks to attract deposits and thus foster greater competition in the system.").

instill greater competition within the market and provide consumers with more choices beyond the "safe bets" of bigger banks.[194]

B. Critiques of the Targeted Coverage Approach

Some may argue that adopting targeted coverage is a drastic policy change.[195] However, distinctive treatment of business accounts following financial distress is a tested model.[196] The TAG program and CARES Act demonstrate feasibility, both practically and politically.[197] The TAG program, implemented during the GFC, provided unlimited deposit insurance for certain noninterest-bearing transaction accounts.[198] It was an optional program that ultimately ceased in 2012, after 87% of institutions opted to remain in it beyond the initial 30 days.[199] The TAG program helps to provide a roadmap for a permanent program.[200] The mechanics, both delineation of accounts and funding, are practically feasible.[201]

The CARES Act of 2020, on the other hand, shows political feasibility.[202] Enacted shortly after the COVID-19 lockdown, the act gave the FDIC the authority to establish a program that would once again back up NIBTA deposits beyond the traditional cap.[203] Congress, using § 1105 authority, cleared the way for the FDIC to create a broad-based program. Dodd-Frank restricted the possibility without a joint-

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194. *See* HOSKINS, *supra* note 8, at 6 ("If a depositor thinks policymakers would not allow a particular bank to fail, then the depositor may view their uninsured deposits as safer than if the deposits were in a bank that would be allowed to fail.").

195. *See* Casey Quinlan, *Democrats Call for Raising FDIC Insurance Limits at Senate Hearing*, N.J. MONITOR (July 21, 2023, 6:40 AM), https://newjerseymonitor.com/2023/07/21/democrats-call-for-raising-fdic-insurance-limits-at-senate-hearing/ [perma.cc/PD57-L523] (examining several lawmakers proposing and opposing a change to deposit insurance).

196. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 16.

197. *See* David Perkins, Cong. Rsch. Serv., IN11307, The CARES Act (P.L. 116-136) Section 4008: FDIC Bank Debt Guarantee Authority 1–2 (2020) (describing the implementation of TAG and CARES in 2008 and 2020).

198. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 16.

199. *Id.* at 17.

200. *See* HOSKINS, *supra* note 8, at 4 (providing some effects of TAG as well as the alterations imposed on definitions in Dodd-Frank).

201. *See* Vergara, *supra* note 169, at 676 (explaining that the program's architects reflected on TAG as "clearly denoted and equitably priced").

202. *See* PERKINS, *supra* note 197, at 2–3 (discussing congressional response to the 2020 pandemic, mirroring actions in 2008).

203. Coronavirus Aid, Relief, and Economic Security ("CARES Act") § 4008(a), 12 U.S.C. § 5612 (2020) (amending Dodd-Frank § 1105, 12 U.S.C. § 5612 (2012).

resolution of Congress in critical economic circumstances.[204] The FDIC did not need to put the guarantee in place[205] since money was flowing into banks from the various government programs and not out.[206] Now, considering the failures of SVB and Signature years after the CARES Act, Congress should amend § 1105. The FDIC should not be forced to tie its hands in anticipation of a perfect storm. A broad-based, TAG-like scheme should be created now.

With a targeted coverage system, a bank run of sorts may still occur (with much more manageable repercussions) within the same bank.[207] Depositors with one type of account may lose confidence and attempt to move deposits into the account with higher deposit insurance coverage.[208] The FDIC admits this could lead to instability and weaker depositor discipline; however, these movements could potentially serve as critical warning signals as opposed to catastrophic bank runs.[209] Alternatively, perhaps depositors could only be insured up to the amount they had on deposit as of a date several months in advance of the bank's closure.

While there remains general risk and a threat of instability with structural change, this path forward necessarily deviates from past band-aids of incremental increases of limited coverage.[210] Targeted coverage will prove far more sustainable than a reliance on the cumbersome and discretionary ad-hoc post-crisis band-aid that is the SRE or the politically uncertain option of waiting for a liquidity event to provide broad-based guarantees following a joint resolution of Congress.[211]

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204. PERKINS, *supra* note 197, at 2.

205. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 19.

206. *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO- 23-106647, COVID-19 RELIEF: FUNDING AND SPENDING AS OF JAN. 31, 2023 (2023) ("Six COVID-19 relief laws enacted in 2020 and 2021 provided about $4.6 trillion of funding for pandemic response and recovery.").

207. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 48.

208. *Id.*

209. *See id.* ("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.").

210. *See id.* at 45 (outlining a pattern of incremental increases in deposit insurance maximums since DI's inception).

211. Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") § 1105, 12 U.S.C. § 5612.

C. The TAG Model

As noted above, one major question with targeted coverage is how to distinguish between business and nonbusiness accounts. The FDIC has suggested that business accounts may be distinguished because they have either a tax identification number ("TIN") or an employer identification number ("EIN"), rather than a social security number ("SSN") associated with individuals.[212] This would provide a systematic and clear method of differentiation, but this line could easily be circumvented or exploited as trusts and estates may easily adopt these types of identifiers.[213] If individuals begin taking advantage of corporate benefits, there will not only be higher costs but greater chances the coverage will be used to protect investments over transactions – once again raising moral hazard concerns.

With TAG, the FDIC initially provided unlimited coverage only for all NIBTAs, defined as, "a transaction account with respect to which interest is neither accrued nor paid and on which the insured depository institution does not reserve the right to require advance notice of an intended withdrawal."[214] The intent was to explicitly include payment-processing accounts, to stabilize uncertainty for payrolls.[215] Based on the lessons learned through the 2008 TAG program, accounts should be defined similarly and only noninterest-bearing accounts should be eligible for the unlimited deposit insurance coverage.[216] One reason for this requirement is that banks will be paying premiums to the FDIC for this insurance and likely will not also be able to afford paying interest

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212. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 46.

213. *See id.* at 46–47 (explaining that trusts and estates may adopt these identifiers to obtain higher coverage despite being owned by an individual).

214. Temporary Liquidity Guarantee Program, 73 Fed. Reg. 64179, 64182 (Oct. 29, 2008) (to be codified at 12 C.F.R. pt. 370), *rescinded by* Temporary Liquidity Guarantee Program; Unlimited Deposit Insurance Coverage for Noninterest-Bearing Transaction Accounts, 80 Fed. Reg. 65919 (Oct. 28, 2015) (to be codified at 12 CFR pt. 330, 370).

215. *See* Temporary Liquidity Guarantee Program, 73 Fed. Reg. at 64182 ("The FDIC anticipates that these accounts will include payment-processing accounts, such as payroll accounts, frequently used by an insured depository institution's business customers, and further anticipates that the Transaction Account Guarantee Program will stabilize these and other similar accounts.").

216. *See* FDIC, CRISIS AND RESPONSE, *supra* note 42, at 51 (discussing the general structure of TAG).

on these accounts as well. Indeed, to recover their cost for the insurance, banks will likely charge account maintenance fees or other charges.[217]

The TAG program was extended twice through 2010, and the definition eventually evolved to include other types of deposit accounts used by sole proprietorships and charitable organizations.[218] Examples of other accounts ultimately within the program included Interest on Lawyers Trust Accounts ("IOLTAs") and negotiable order of withdrawal ("NOW") accounts.[219]

The TAG program also evolved in terms of payment structure.[220] Participating institutions were first charged a flat rate, before the program transitioned to a risk-based assessment rate.[221] The increased cost of coverage was paid by banks themselves, but TAG was not mandatory.[222] While institutions were automatically enrolled, without cost, the FDIC imposed fees after 30 days.[223] The risk-based assessments aligned with factors including size, asset quality, management, and liquidity.[224]

The expansion was perhaps overinclusive, as individuals were able to secure unlimited insurance primarily intended for business transaction accounts by electing for a NIBTA.[225] The type of accountholder and intent in opening the account were not considered by

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217. *See* Alex Graf & Umer Khan, *Banks Increasingly Look to Noninterest Income to Bolster Revenue*, S&P GLOB.: MKT. INTEL. (June 8, 2022), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/banks-increasingly-look-to-income-to-bolster-revenue-70292875 [perma.cc/D8W3-K92L] (analyzing market trends where banks are relying less on profit from marginal interest differences between deposits and loans and more on fee-based sources).

218. FDIC, CRISIS AND RESPONSE, *supra* note 42, at 51–52 & n.41.

219. *Id.; see also* Temporary Liquidity Guarantee Program, 73 Fed. Reg. 64179, 64187 (Oct. 29, 2008) (defining NIBTA at the onset of the TLGP).

220. FDIC, CRISIS AND RESPONSE, *supra* note 42, at 52.

221. *Id.*

222. Peter G. Weinstock et al., Hunton Andrews Kurth, Client Alert: Recent Bank Runs and the Need for a Permanent Transaction Account Guarantee Program (Mar. 22, 2023), https://www.huntonak.com/en/insights/recent-bank-runs-and-the-need-for-a-permanent-transaction-account-guarantee-program.html [perma.cc/PBP5-73WF].

223. *Id.*

224. *Id.*

225. *See* Temporary Liquidity Guarantee Program, 73 Fed. Reg. 64179, 64183 (Oct. 29, 2008) (to be codified at 12 C.F.R. pt. 370) ("Although the unlimited coverage for noninterest-bearing transaction accounts under the TLG[P] . . . is intended primarily to apply to transaction accounts held by businesses, it applies to all such accounts held by any depositor.").

the FDIC.[226] Nevertheless, the administrable delineation proved efficient in the face of uncertainty: both before a bank faced trouble, and in the event of resolution.[227] The FDIC knew which accounts were insured and which were not, well before a decision on institutional resolution had to be made.[228]

The initial termination deadline was extended, based on the FDIC's concern of market disruption.[229] The unlimited deposit insurance for NIBTAs expired in December of 2012.[230] NIBTAs had grown by approximately $1 trillion when the program ended.[231]

D. *Further Decisions Ahead*

Account definitions and coverage amounts are up for debate, according to the FDIC's report.[232] However, as seen through the TAG program, unlimited coverage is the optimal amount for business accounts.[233] The funding structure, and opt-out format, of the FDIC's new regime could also follow TAG.[234] Allowing institutions to opt-out provides flexibility, as opposed to mandating higher fees.[235] Participating banks will be able to conceivably pass on costs to customers, if the premiums apply only to non-interest bearing

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226. *See id.* (acknowledging the ability of individuals to secure unlimited insurance if using a NIBTA instead of an interest generating account).

227. *See* Vergara, *supra* note 169, at 676 ("The TAGP also helped reduce the FDIC's administrative costs in resolving banks, as the broad insurance coverage meant it did not have to identify which deposits were insured and which were not.").

228. *Id.*

229. *See* Amendment of the Temporary Liquidity Guarantee Program To Extend the Debt Guarantee Program and To Impose Surcharges on Assessments for Certain Debt Issued on or After April 1, 2009, 74 Fed. Reg. 26521, 26521 (June 3, 2009) (to be codified at 12 C.F.R. pt. 370) (discussing a phase-out program as a way to facilitate a smoother return to funding markets beyond the scope of FDIC guarantees).

230. Vergara, *supra* note 169, at 675.

231. *See* HOSKINS, *supra* note 8, at 5 ("NIBTAs have grown by approximately $1 trillion from $1.3 trillion in the third quarter of 2008 (before TAG was implemented) to $2.3 trillion in the second quarter of 2012.").

232. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 46.

233. *See* HOSKINS, *supra* note 8, at 11 (recommending an extension of TAG before its expiration, while considering the market benefits and drawbacks).

234. *See* FDIC, CRISIS AND RESPONSE, *supra* note 42, at 151–68 (framing the FDIC's approach to funding TAG).

235. *See id.* at xviii (underscoring the ability of banks to opt out of TAG).

accounts.[236] Notably, banks may need to consider other forms of fee-based services to fully meet premium obligations.[237] Or, the banks may instead choose to charge depositors directly for increased coverage. Regardless, the FDIC's scheme will not mandate one specific payment structure, nor force the charge onto taxpayers.[238] Banks will have flexibility in decisions of program enrollment and methods of meeting premium assessments. The risk-based assessments directly address moral hazard concerns, incentivizing less risky investments, because banks' payment to the deposit fund would increase as they expanded reliance on riskier activities.[239]

In July of 2023, Republican Senator Vance of Ohio introduced the Payroll Account Guarantee Act, modeled largely after TAG.[240] On the same day his bill was introduced, the Senate Committee on Banking, Housing, and Urban Affairs convened to discuss deposit insurance reform.[241] Democratic Senator Menendez underscored the necessity of a careful and thoughtful definition of accounts that may need increased coverage.[242] The competitive landscape of the banking industry was also discussed.[243] Additional deposit insurance coverage was justified, some said, to allow smaller banks the opportunity to compete for large business deposits.[244]

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236. *See id.* at xix (discussing the tradeoff between the significant funding reliance banks had on transaction accounts, and the decision to remain in TAG in order to lessen the risk of withdrawal).

237. *See* Graf & Khan, *supra* note 217 ("Some banks have acquired fee-based businesses or other banks with fee revenue streams in order to strengthen the non-interest-income side of their portfolios, while some nonbank companies, specifically in fintech, have purchased banks in order to obtain a bank charter and combine it with their fee-based business.").

238. *See* FDIC, CRISIS AND RESPONSE, *supra* note 42, at xviii–xix (describing the intent of TAG to be funded by the banking industry, and the fact that fees levied on banks covered all program costs).

239. *See* Gruenberg, Remarks on the Resolution, *supra* note 26 ("In addition, risk-based deposit insurance pricing can deter banks from relying too heavily on less stable forms of funding such as uninsured deposits and can maintain fairness by charging banks with unstable funding sources for the risk they pose to the Deposit Insurance Fund" (footnote omitted)).

240. S. 2403, 118th Cong. (2023).

241. *Perspectives on Deposit Insurance Reform After Recent Bank Failures: Before the Senate Comm. On Banking, Housing, and Urban Affairs*, 118th Cong., at 00:54:50 (2023), (recording available at https://www.banking.senate.gov/hearings/perspectives-on-deposit-insurance-reform-after-recent-bank-failures [perma.cc/D6WR-3YH5]).

242. *Id.* at 00:58:00 (This idea was posed by Senator of Bob Menendez of New Jersey).

243. *Id.* at 1:00:50 (This statement was made by Emily DiVito, Senior Program Manager for Corporate Power, of the Roosevelt Institute).

244. *Id.*

The FDIC also suggested additional reform that could augment targeted coverage adjustments.[245] The main two ideas were (1) to require secured deposits for large uninsured deposits and (2) to limit convertibility of deposits above the insurance limit.[246] Both seek to minimize run risk and enhance overall financial stability.[247] Collateralization decreases the responsibility of depositors to monitor bank behavior and financial positioning.[248] At the same time, an undercapitalized institution would remain exposed to run risk, and secured deposits could increase losses to the deposit insurance fund if a failure did occur.[249] Limited convertibility may motivate depositors to monitor bank risk and slow bank runs at the outset.[250] These are avenues worth exploring.

VI. CONCLUSION

The FDIC's insurance limit should be changed. This change should not be in the same form as the previous seven changes over the last century. As the banking industry evolves, so should deposit insurance.[251] A reliance on ad-hoc emergency measures will not instill the confidence deposit insurance set out to provide. For this reason, a regime of targeted coverage should be applied to business payment accounts at an unlimited amount. Personal accounts will retain the current deposit limit.

When finalizing this policy, moral hazard should not be forgotten. As insurance increases, incentives for banks to behave irresponsibly also increase. Thus, the policy must narrowly tailor its changes to minimize risks for account holders and the market in general.

The codified definition of business payment accounts, as well as general premium structure, should follow TAG. Setting forth a clear definition of a business payment account will lend itself to fairer administrability and more straight-forward application. These accounts,

245. FDIC, OPTIONS FOR DEPOSIT INSURANCE REFORM, *supra* note 3, at 49.
246. *Id.* at 51–53.
247. *Id.*
248. *Id.* at 51.
249. *Id.* at 52.
250. *Id.* at 53.
251. *See* Gruenberg, Remarks on the Resolution, *supra* note 26 (discussing the increasing reliance on uninsured deposit funding and the need to address underlying vulnerabilities that made the March 2023 failures possible).

once identified, should receive unlimited deposit insurance at participating banks. Congress should clear the path for this authority immediately.

This conversation is nothing new, but today a new path should be taken.

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