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Deposit Insurance and the Failures of Silicon Valley Bank and Signature Bank

Congress created the Federal Deposit Insurance Corporation (FDIC) in the wake of the Great Depression to limit the losses depositors would face if their banks failed. It did so to instill confidence in the banking system and deter economically detrimental events such as bank runs. This In Focus examines the role of deposit insurance in the financial system and addresses policy considerations for the 118th Congress in the wake of recent turmoil in the banking system precipitated by the failures of Silicon Valley Bank (SVB) and Signature Bank.

Deposit Insurance

When a bank fails in the United States, consumer deposits are guaranteed up to a certain amount by the government. This is designed to create trust in the banking system between consumers and institutions, and that trust is intended to promote liquidity in banks by allowing them to keep fewer reserves and make available more credit. Over time, the amount guaranteed by these insurance schemes has increased, and today it is \$250,000 per account (12 U.S.C. §1821).

Which Accounts Are Covered?

A number of accounts are eligible for deposit insurance, while others are explicitly not covered. Deposit insurance is limited to certain bank-offered products and accounts. Examples are shown in **Table 1**.

Table 1. Financial Accounts and FDIC Coverage

Examples of Types of Accounts/Products, by Coverage Eligibility

Covered	Not Covered
Checking accounts, savings accounts, money market accounts, certificates of deposit, and certain prepaid cards	Stock investments, bond investments, mutual funds, crypto assets, life insurance policies, annuities, municipal securities, safe deposit boxes or their contents

Source: FDIC.

Notes: Depositors can own multiple insured accounts in different ownership categories, thereby protecting more than \$250,000.

Who Pays for Deposit Insurance?

The FDIC relies on the Deposit Insurance Fund (DIF) to facilitate deposit insurance payouts and to cover the cost of resolving a failed institution. The DIF is funded in two ways: quarterly assessments on banks and interest earned on funds invested in U.S. government securities.

Assessments are calculated by multiplying a bank’s assessment base by its assessment rate. The base is defined by P.L. 111-203 as average consolidated total assets minus tangible equity. In other words, it is based on total liabilities. Title 12, Section 1817(1)(A) of the *U.S. Code* requires the FDIC to establish a risk-based system to calculate the assessment rate tied to an institution’s probability of causing a loss to the DIF. The way risk-based rates are calculated differs for larger and smaller institutions. Section 1817(3)(B) requires the FDIC to set a reserve ratio (DIF balance/estimated insured deposits) of no less than 1.35%. The FDIC is also authorized to impose any special assessments necessary to maintain the DIF or repay any amounts borrowed from Treasury to manage the cost of a bank failure. Section 1824 allows the FDIC to borrow up to \$100 billion from Treasury if needed to supplement the costs of bank failures. In this sense, the DIF is said to be backed by the full faith and credit of the U.S. government.

What Happens When a Bank Fails?

The FDIC serves to protect depositors when a bank fails. The FDIC typically resolves a bank by seeking an acquirer to purchase as many of the bank’s assets and liabilities as possible, thus minimizing the amount left in the receivership. To do this, the FDIC uses a bidding process designed to end in the purchase and assumption of some or all of the failed bank’s assets, deposits, and certain other liabilities. Occasionally, the FDIC will directly pay the depositors up to the insured limits if it cannot find a reasonable purchase and assumption alternative.

Pursuant to Title 12, Section 1821(d)(11), of the *U.S. Code*, the FDIC must prioritize the payout of certain claims on the assets of the failed institutions. Similar to bankruptcy proceedings, when a payout occurs, there is a hierarchy of claims for the FDIC to follow, as detailed in **Table 2**.

Table 2. Depositor Preference

By Order of Claims Paid by FDIC, First to Last

Hierarchy of Claims
FDIC Administrative Expenses
Insured Deposits
Uninsured Deposits
General Creditors
Stockholders

Source: 12 U.S.C. §1821(d)(11).

How Are Banks Supervised for Deposit Insurance?

Because the FDIC wants to minimize losses to the DIF and prevent failures from disrupting financial stability, the banking agencies supervise banks routinely to try to ensure that they are operating in a safe and sound manner. With respect to deposit insurance, assessment rates are determined in part by how a bank is evaluated in its examinations process. In the 1970s, the banking agencies adopted a “Uniform Financial Institutions Rating System” to evaluate banks. This system has been updated several times over the years and comprises six elements that bank examiners assess: capital adequacy, asset quality, management, earnings, liquidity, and sensitivity to market risk (abbreviated as CAMELS). Bank examiners assess each component and derive an overall rating for the bank (from 1 to 5, with 1 being the best), and that rating is used to determine the total assessment rate.

Policy Issues

The recent failures of SVB and Signature Bank have raised a number of policy questions, which are explored below.

Is the Current Deposit Insurance Limit Sufficient?

The typical bank customer holds much less than \$250,000 in a covered bank account. Thus, runs among banks that mostly provide traditional checking account services is unlikely. However, larger institutions, particularly those with a concentration of corporate and business accounts, may hold a significant portion of deposits that exceed the \$250,000 limit. This was the case with SVB and Signature Bank. Around 90% of both banks’ deposit base was uninsured. Because of the swift nature of the banks’ deterioration, their size, and the fear that a run would spread to other banks, the federal banking agencies decided to protect all of the banks’ depositors, both insured and uninsured, by invoking its systemic risk exception to least cost resolution.

Some have asked: What is the point of a deposit insurance limit? The FDIC’s statutory requirement is to protect the DIF from loss, not to prevent banks from failing. Thus, a key question is which poses a more likely loss to the DIF: protecting uninsured deposits in the short run or the potential for further bank runs. The flip side of this policy tradeoff is at the heart of the economic debate around the virtues of market discipline (whereby depositors incentivize banks to operate in a safe way by removing deposits in response to banks’ reckless behavior) in preventing moral hazard (whereby banks are free to take more risks, because they do not bear the downside of those risks).

Historically, quelling a bank crisis has motivated policymakers to protect both uninsured and insured depositors. During the 2007-2009 financial crisis, the FDIC implemented a temporary unlimited guarantee on certain transaction accounts (called the TAG Program). The FDIC also temporarily guaranteed certain debt products to shore up liquidity at the banks. Additionally, before the deposit limit was permanently raised to \$250,000 (P.L. 111-203), Congress temporarily expanded the limit from \$100,000 to \$250,000 in an attempt to calm depositor fears.

Recently, there have been a number of proposals for raising the deposit insurance limit further. (Pursuant to Title 12, Section 1821(a)(1)(f), of the *U.S. Code*, the FDIC is required every five years beginning in 2010 to assess whether an inflation adjustment to the limit is necessary and to report to Congress if it is. The next revision date is April 2025.) One possible basis for this is that many of the accounts that are uninsured are business accounts, which are used for a number of things, such as payroll.

While P.L. 111-203 restricted the FDIC from reinstating TAG, Congress could establish a similar guarantee on transaction accounts. Because businesses use these accounts to manage cash for purposes such as payroll, it is feasible that guaranteeing all of these types of accounts could protect payroll operations and limit moral hazard, since these accounts do not offer interest rates that incentivize depositors to move funds.

Another option is to raise the entire limit or even make it unlimited. It is reasonable to expect something like this to reduce the risk of bank runs. However, it would erode market discipline from depositors, and it could be costly to banks. The FDIC would need to adjust its assessment base to provide substantially more funds to the DIF to guarantee all deposits. As of December 2022, around 50% of the \$19 trillion deposit base was insured.

The DIF reserve ratio dipped below its statutory minimum in June 2020 due to a spike in insured deposits during the pandemic. The FDIC, subsequently, enacted a plan to restore the ratio to 1.35% by 2028. In October 2022, the FDIC raised assessment rates in part to restore the DIF. While this action was taken to meet a statutory requirement, some banks opposed it on the basis that deposit levels were normalizing, and thus the DIF ratio would return to its minimum without a change in assessments. In addition, special assessments might be needed to replenish the DIF if losses from resolution were sufficiently large.

Regardless, if the FDIC were to provide insurance coverage to all deposits, it would need to increase the DIF sufficiently to cover another \$9 trillion or more in deposits. Moreover, if uninsured depositors were to be made whole in any failure going forward (based on the response to SVB and Signature Bank), at least for large banks, then increasing the size of the DIF before—instead of after—another bank fails would reduce the chance that the DIF would be exhausted. This approach could also be more equitable for healthy banks and small banks, as uninsured depositors may shift to large banks in the belief that the FDIC will rescue only large bank customers in a failure.

Another option is to eliminate or narrow the FDIC’s systemic risk exception, which would reduce moral hazard and increase market discipline but would increase the incentive for bank runs, which pose systemic risk.

CRS Resources

CRS Insight IN12125, *Silicon Valley Bank and Signature Bank Failures*, by Andrew P. Scott and Marc Labonte

CRS In Focus IF10055, *Bank Failures and the FDIC*, by
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