FedFin Client Report

Wednesday, March 15, 2023

FedFin Assessment: Post-SVB Deposit Insurance Reform

Client Report: DEPOSITINSURANCE118

Executive Summary

As promised in our first post-SVB impact assessment (see *Client Report* **RESOLVE49**), this report begins a series of analyses of specific policy issues. We start here with possible changes to FDIC insurance based on comments from Reps. Maxine Waters (D-CA), Blaine Luetkemeyer (R-MO), and other arguing either that the $250,000 limit for FDIC coverage needs to be eliminated or sharply increased. We also analyze the prospects for shifting the burden of higher DIF premiums to large banks as recommended by the ICBA, ending the FHLB's super-lien due to the resulting, significant increase in FDIC resolution costs in recent failures, changes to the treatment of brokered deposits, and revisions to the FDIC's overall risk-based assessment system (see FSM Report **DEPOSITINSURANCE96**). Other resolution issues – e.g., the future of proposed regional-bank standards (see FSM Report **RESOLVE48**) and bank merger policy will be covered in future reports along with the prospects for significant changes in bank capital, liquidity, and other prudential standards.

Analysis

- **Deposit Insurance Coverage Threshold:** Action here depends on whether all deposits should be considered insured in the current emergency for some period of time and/or permanently altered to increase FDIC coverage to some or all bank deposits. The FDIC in the 2008 crisis not only guaranteed all transaction accounts, but then also all bank deposits and debt, leading some to call now for similar programs. However, the Dodd-Frank Act (see FSM Report **DEPOSITINSURANCE87**) significantly constrained the FDIC's ability to do so, essentially leaving it only the systemic designation used to cover SVB and Signature Bank deposits on Sunday. A similar designation could presumably be reached for all deposits, but press reports suggest that the President would be reluctant to grant the consent that, while not required, is nonetheless essential to Treasury, Fed, and FDIC action except in the event of a new crisis. Any other change to FDIC insurance thresholds and/or the types of insured deposits requires a change in law. This might prove less controversial than many other ideas pending in the wake of recent events, but deposit flows from community banks to large institutions might persuade Congress to intervene given the still higher hurdles to the alternatives detailed below.

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- **Large-Bank Assessments:** It is likely that requiring only banks above a certain size to pay for recent failure costs will require statutory change facing considerable political obstacles to enactment. The only way otherwise to do so in practice would be to alter the current risk-based premium system by rule and, as discussed below, this is a complex undertaking.

- **FHLB Super-Liens:** As noted in recent memos by Karen Petrou and elsewhere, Home Loan Banks are made whole by the FDIC even before it covers its own resolution expenses from the proceeds of a failed bank's resolution. The super-lien was paid off in Silvergate's voluntary liquidation, with the banking organization able to honor deposit claims from its assets. In contrast, the receiverships for SVB and Signature Bank must pay approximately $35 billion in outstanding advances back to Home Loan Banks unless an acquisition is arranged in which the new parent agrees to honor these along with all the other failed-bank obligations subject to the purchase-and-assumption (P&A). There will thus be much talk of changing the super lien but doing so requires a change in law that now seems unlikely. More likely is express and explicit action by FHFA to require Home Loan Banks to restrict advances in situations in which a bank seeks funding due to liquidity shortages unrelated to its housing mission.

- **Brokered Deposits:** In 2020, the FDIC finalized rules liberalizing coverage for brokered deposits strongly opposed by then board member Gruenberg (see FSM Report **DEPOSITINSURANCE111**). With Mr. Gruenberg's appointment as chair, we have long expected this rule to get a makeover, but it has been a lower-priority item than matters such as finalizing the Basel end-game proposal and bank-merger policy. Now, it will move far higher up the agenda, but any change will require a new rulemaking that may prove controversial with the board's two new Republican members. Action via 3-2 votes is of course possible, but Mr. Gruenberg will seek to avoid this is possible and perhaps look for less controversial, targeted changes (e.g., re sweep deposits).

- **Risk-Based Premiums:** Although many now assert that large banks should not only pay for recent failures, but also always pay higher DIF premiums, big banks in fact have paid disproportionate DIF premiums since the FDIC switched in 2011 to its risk- and asset-based assessment system. In the final rule, the FDIC reserved the right to alter individual bank assessment scorecards and, perhaps, the overall scorecard without a new rulemaking. Any decision to alter the rule's methodology would at the least need to be publicly announced, but this provision may give the FDIC scope to alter assessments to capture risks such as unrealized losses.

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