Federal Deposit Insurance Corporation

Eliminate the Need for the Federal Deposit Insurance Corporation

RECOMMENDATION

The private market, not a government-backed insurance system, should control deposit insurance. If customers truly value deposit insurance, private financial companies will provide it.

The Trump Administration should work with Congress to develop the best transition plan to a private system. Important intermediate steps include: (1) reducing the Federal Deposit Insurance Corporation (FDIC) coverage limit; (2) applying FDIC coverage on a per account holder basis; and (3) applying FDIC coverage only to retail accounts.

At the very least, the FDIC limit should be reduced to the pre-Dodd–Frank limit of $100,000. Even reverting to the pre-1980 limit of $40,000 would more than adequately cover the vast majority of U.S. households. Other important reforms include eliminating the FDIC's systemic-risk exception, and prohibiting the FDIC from providing any type of loan guarantees. Finally, once FDIC coverage is significantly reduced, the role of the FDIC in bank resolution can also be reduced. Again, at a minimum, the FDIC's role in the resolution of non-bank financial institutions should return to the role it had prior to the Dodd–Frank Act.

RATIONALE

The FDIC provides federally backed deposit insurance for bank accounts of up to $250,000. The FDIC also serves as banking regulator for all non-Federal Reserve member state-chartered banks, and is responsible for resolving insolvent commercial banks. In addition to its main deposit insurance program, the FDIC has emergency authority to guarantee other types of bank accounts and even loans. The FDIC provided hundreds of billions in loan guarantees in the wake of the 2008 crisis—mainly by invoking its systemic-risk exception in Section 13(G) of the Federal Deposit Insurance Act.

Government provision of financial guarantees harms competitiveness and stability in financial markets. It reduces people's incentive to monitor both personal and institutional financial risks. Shifting to a private system would bring much-needed market discipline to the financial sector. If customers truly value deposit insurance, private financial companies will provide it.

The fear that a bank failure could freeze a large amount of customer deposits, resulting in economic disruption, has been a main contributing factor to the existing FDIC bank-resolution process. Many options from around the world could replace the FDIC process and bring much-needed market discipline to the banking industry. Banks, just as other failed companies, should be allowed to go through the bankruptcy process. Imposing more market discipline in the banking sector requires major changes to the FDIC bank-resolution process, the FDIC deposit-insurance scheme, and the FDIC's authority to grant emergency guarantees.

ADDITIONAL READING

- David R. Burton and Norbert J. Michel, "Financial Institutions: Necessary for Prosperity," Heritage Foundation *Backgrounder* No. 3108, April 14, 2016.
- Mark Calabria, "Deposit Insurance, Bank Resolution, and Market Discipline," in Norbert J. Michel, ed., *Prosperity Unleashed: Smarter Financial Regulation* (Washington, DC: The Heritage Foundation, 2017).