MUFG

Policy Note

As the US banking crisis has intensified, we believe that pressure is "ramping up" in Washington to expand deposit guarantees, but that major legislative action is neither imminent nor likely near-term

Who?

The Senate Banking Committee is the "center of gravity" for any potential action. The House Financial Services Committee will likely defer to the Senate for leadership if bank sector problems persist.

When?

Pressure to act is "ramping up" given duration of bank stress, but still <u>not</u> imminent or likely near-term. Timing would be post-debt ceiling resolution, and only if bank sector deteriorates substantively from here. Contagion to farming states, agriculture and auto sectors also likely needed.

How?

FDIC may expand insurance on a bank-by-bank basis (especially for closed banks) as they did for SVB and Signature, but ***a broad-based expansion of deposit insurance to all banks requires a joint resolution from Congress*** (60 votes in the Senate, 218 in the House), signed by the President.

What?

If needed, Congress could pass legislation to increase deposit insurance coverage, and expand FDIC/ regulatory powers. Since unlikely near term, ***Treasury use of the Exchange Stabilization Fund (ESF) is the more likely vehicle for bank sector support if needed near term*** as the FDIC's Deposit Insurance Fund (DIF) declines. Treasury use of the ESF does not require Congressional approval.

The FDIC released a report on May 1 analyzing options for a sweeping overhaul of its deposit insurance program after multiple recent bank failures reduced the Deposit Insurance Fund (DIF). FDIC Chair Martin Gruenberg highlighted that digitization and growth in uninsured deposits have increased bank run exposure. Today, roughly 45%, or $7.7 trillion, of US deposits are uninsured.

Potential changes to the FDIC insurance program

	Status Quo	***FDIC Preferred Option***	***Politically Less Viable***
	Limited Coverage	Targeted Coverage	Unlimited Coverage
Description	Current framework ($250k per account)	Vary coverage by account type	Unlimited coverage
Advantages	▪ Well tested ▪ Minimum disruption ▪ Less moral hazard	▪ Better align with business needs ▪ Strengthens financial stability	▪ Minimizes bank runs ▪ Strengthens stability ▪ Simplifies resolutions
Disadvantages	▪ Greater deposit outflows ▪ Higher financial stability risk	▪ More account types ▪ More complexity ▪ Additional DIF funding required	▪ Higher moral hazard risk ▪ Exorbitant increase in DIF funding required

Less Deposit Insurance → More Deposit Insurance

Source: FDIC "Options for Deposit Insurance Reform" (May 1, 2023).

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