SMALL BANKS, SMALLER SAFETY NETS

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Abstract

The Federal Deposit Insurance Corporation (FDIC) plays a critical role in maintaining trust and stability in the banking system, yet its disparate treatment of uninsured depositors at small versus large banks raises significant questions. This essay examines the implications of the FDIC's policies, illustrated by the failures of the First National Bank of Lindsay and Silicon Valley Bank (SVB). While uninsured depositors at SVB were fully protected under the systemic risk exception, uninsured depositors at the smaller Lindsay bank faced losses. This discrepancy could lead to market consolidation, increased moral hazard risk, and public distrust in the traditional banking system. The essay then explores potential reforms, including expanded deposit insurance, changes to assessment fees, and stricter enforcement of moral hazard to ensure a more equitable approach to bank resolution.

* J.D. 2025, Harvard Law School; B.S., Economics, University of Michigan. Thank you to the editors of the *Harvard Business Law Review* for their edits and feedback. All errors are my own. All views are my own and do not reflect the position of any employer or affiliate.

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Introduction

On October 18, 2024, the First National Bank of Lindsay failed.[1] The bank was subsequently placed into Federal Deposit Insurance Corporation ("FDIC") receivership.[2] Shortly thereafter, FDIC entered into a purchase and assumption ("P&A") agreement with First Bank & Trust Co. Duncan, Okla.[3] Thus, three days after the failure, insured depositors of the failed First National Bank of Lindsay could access their funds from First Bank & Trust Co. However, uninsured depositors could only access 50 percent of their assets held by the failed bank at that time.[4]

Compare this with the Silicon Valley Bank ("SVB") failure in March 2023.[5] Three days following the bank's shut down, the FDIC, using its systemic risk exception, fully guaranteed all deposits—insured and uninsured—of the bank.[6] And this was before any bank had agreed to take on some of the SVB balance sheet. Thus, days after the failure, *all* depositors were able to access their money. This is as about 90 percent of the deposits held by the bank were uninsured.[7]

The difference in treatment of uninsured depositors in both instances is stark. And the reasoning is due to the size of the respective banks. First National Bank of Lindsay only had about $100 million of total deposits, with likely less than $10 million uninsured.[8] In contrast, SVB had over $200 billion in deposits—most of which were uninsured—about a year before its failure.[9] Given this size differential, a refusal to fully insure SVBs depositors could have inflicted significantly more harm to the overall financial system. This explains the FDICs usage of the systemic risk exception to extend deposit

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[1] FDIC, *Failed Bank Information for The First National Bank of Lindsay, Lindsay, OK*, https://www.fdic.gov/bank-failures/failed-bank-list/first-national-bank-lindsay [https://perma.cc/3BY9-LYZS] (last visited Jan. 9, 2025).

[2] *Id.*

[3] *Id.*

[4] *Id.*

[5] *Failed Bank Information for Silicon Valley Bank, Santa Clara, CA*, FDIChttps://www.fdic.gov/resources/resolutions/bank-failures/failed-bank-list/silicon-valley.html [https://perma.cc/B5RX-RL2J] (last visited Jan. 9, 2025).

[6] *FDIC Acts to Protect All Depositors of the former Silicon Valley Bank, Santa Clara, California*, FDIC (Mar. 13, 2023), https://www.fdic.gov/news/press-releases/2023/pr23019.html [https://perma.cc/KG2Y-VS3Q].

[7] *See* David Hayes, SVB, *Signature racked up some high rates of uninsured deposits*, S&P Glob. Mkt. Intel. (Mar. 14, 2023), https://www.spglobal.com/market-intelligence/en/news-insights/articles/2023/3/svb-signature-racked-up-some-high-rates-of-uninsured-deposits-74747639 [https://perma.cc/J76N-PBKB].

[8] *First National Bank of Lindsay Closes, FDIC Takes over Deposits*, News9 (Oct. 18, 2024), https://www.news9.com/story/67131d0292f4d252bbe60336/first-national-bank-of-lindsay-closes--fdic-takes-over-deposits [https://perma.cc/M2LG-FWXU].

[9] Board of Governors of the Federal Reserve System, *Material Loss Review of Silicon Valley Bank* 9 (Sep. 25, 2023), https://oig.federalreserve.gov/reports/board-material-loss-review-silicon-valley-bank-sep2023.pdf

insurance coverage beyond its normal limit.[10] But because First National Bank of Lindsay was a small bank with few uninsured depositors, their depositors were barred from reaping the benefits of the exception that only applies in cases where failure would have serious adverse effects on financial stability or economic conditions.[11]

Ever since 2008, much attention has been paid to the issue of protecting and responding to failures of banks that are "too big to fail" due to their grave impacts on the rest of the financial system.[12] But is there a cost of letting the small banks fail and refusing to cover their uninsured depositors? This essay will shed light on this corollary issue. Part I of this essay will provide a brief primer on the various ways the FDIC resolves banks, Part II will identify and assess some of the consequences of differential treatment for small banks, and Part III will identify some potential solutions to address this discrepancy.

I. On Deposit Insurance and FDIC Resolution

Under current law, the FDIC insures up to $250,000 in deposits.[13] Banks usually fail because their assets drop below the level of their liabilities (of which deposits are a primary form).[14] When this happens, the value of the bank's assets may not cover all the insured deposits. The FDIC then steps in. Depositors can be paid—directly or indirectly—from the FDICs deposit insurance fund ("DIF").[15] This fund is not composed of taxpayer dollars. Instead, banks pay regular assessment fees to the FDIC to supply the fund.[16] After the failure of SVB, the DIF took a significant hit. To recover some of the losses, FDIC mandated that all insured banks pay a special assessment fee in accordance with the amount of uninsured deposits they held.[17]

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[10] See Congressional Research Service, *The FDIC's Systemic Risk Exception* (Apr. 23, 2024) https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-occ-2023-43a.pdf [https://perma.cc/5Y9S-34RZ].

[11] *Bank Failures: The FDIC's Systemic Risk Exception*, Congressional Research Service (Apr. 23, 2024), https://crsreports.congress.gov/product/pdf/IF/IF12378 [https://perma.cc/85BQ-J8WL].

[12] *See generally*, Andrew Ross Sorkin, Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System—and Themselves (2010) (describing the 2008 financial crisis and the government's decision to create the Troubled Asset Relief Program).

[13] *Your Insured Deposits*, FDIC, https://www.fdic.gov/resources/deposit-insurance/brochures/insured-deposits, [https://perma.cc/F8E6-RU75] (last visited Jan. 25, 2025).

[14] Julia Kagan, *What is a Bank Failure? Definition, Causes, Results, and Examples,* Investopedia (Dec. 1, 2023) https://www.investopedia.com/terms/b/bank-failure.asp [https://perma.cc/XF6K-CX7C].

[15] *Deposit Insurance Fund*, FDIC, https://www.fdic.gov/resources/deposit-insurance/deposit-insurance-fund/ (last updated Mar. 14, 2024) [https://perma.cc/7UMH-KWBE].

[16] *Id.*

[17] *FDIC Finalizes $16.3 Billion Special Assessment to Recover Loss from SVB and Signature Bank Failures*, Davis Polk (Nov. 28, 2023), https://www.davispolk.com/insights/client-update/fdic-finalizes-163-billion-special-assessment-recover-loss-svb-and-signature [https://perma.cc/3JWT-VL7S].

The two primary ways of resolving a failed bank are insured depositor payoffs and purchase and assumption ("P&A") agreements.[18] In selecting which method to choose, the FDIC is legally bound by a "least-cost" requirement: they must select the solution that imposes the "least cost" on the agency.[19] However, utilizing the systemic risk exception for SVB allowed the agency to avoid this constraint.[20] The true degree to which the constraint is binding in effect is an open question, as the FDIC has overwhelmingly used the P&A method in recent years.[21]

A P&A involves the transfer of a failed bank's assets or liabilities to a solvent buyer. The "whole bank" P&A is when all assets and liabilities are transferred.[22] A "partial" P&A is when only a subset of the assets and liabilities are taken on by the assuming bank.[23] Sometimes the FDIC adds funds or offers to bear some risk in the transaction to incentivize potential buyers to bid.[24] P&As generally impose minimal costs on depositors since their funds will be available as soon as the purchase is made.[25] Both the First National Bank of Lindsay and SVB failures were resolved via P&A.

In the case of First National Bank of Lindsay, the purchaser bought all the insured deposits (considered liabilities) and about $20 million of the bank's assets.[26] Thus, insured depositors experienced little change. They could access their funds at their new bank, First Bank & Trust Co. Duncan, Okla. the weekend following the failure.[27] However, the uninsured depositors were not so lucky. The FDIC guaranteed them only 50% of their deposits

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[18] Michael S. Barr et al., Financial Regulation: Law and Policy 1045–46 (3rd ed. 2021). The insured depositor payoff is the simplest form of resolution. Following a bank's failure, the bank is placed into the FDIC's hands as a "receiver." The FDIC then mails checks to insured depositors of the full amount of their insured deposits. The agency also sells off the bank's assets to get the highest possible recovery for the bank's creditors (including the uninsured depositors). Thus, for the insured depositors the process is relatively painless. They are only unable to access their deposits for a few days. However, the uninsured depositors are forced to wait for the often undesirable assets of the bank to be sold by the FDIC before being compensated. And since these assets often sell at a discount, they often are not made whole.

[19] 12 C.F.R. §360.1

[20] *Bank Failures: The FDIC's Systemic Risk Exception*, Congressional Research Service (Apr. 23, 2024), https://crsreports.congress.gov/product/pdf/IF/IF12378.

[21] Michael Ohlrogge, *Why Have Uninsured Depositors Become De Facto Insured*, 100 N.Y.U. L. Rev. (forthcoming 2025) (manuscript at 1), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4624095.

[22] Barr et al., *supra* note 18 at 1049.

[23] Ohlrogge, *supra* note 21, at 20.

[24] Raj Ashar, *Misinformed Depositors*, 33 U. Mia. Bus. L. Rev. 29, 56 (2024).

[25] *See* Christine E. Blair & Rose M. Kushmeider, FDIC, *A Guide to Processing Deposit Insurance Claims: A Cross-Country Perspective*, 4 FDIC Q. 42, 43 (2010) ("A whole bank P&A transaction greatly reduces the work involved in the claims process, as it is not necessary to make an insurance determination.").

[26] FDIC, *First Bank & Trust Co., Duncan, OK, Acquires Insured Deposits of The First National Bank of Lindsay, Lindsay, OK* (Oct. 18, 2024), https://www.fdic.gov/news/press-releases/2024/first-bank-trust-co-duncan-ok-acquires-insured-deposits-first-national [https://perma.cc/HA6B-A6PL].

[27] *Id.*

up front.[28] For the rest, the FDIC would sell off the Bank of Lindsay's assets and compensate the uninsured with whatever value they received.[29] Despite not fully insuring the uninsured depositors, the DIF still took a loss of about $43 million.[30]

SVB was also resolved through a partial P&A.[31] First Citizens Bank and Trust Company (FCBT) purchased some of SVBs assets from the FDIC acting as receiver.[32] The FDIC also entered into a loss-sharing agreement with FCBT to incentivize their purchase.[33] Under the agreement, the FDIC promised to share some of the potential losses on the loans purchased by FCBT.[34] However, in this case, uninsured depositor coverage did not depend on the sale price of the SVB assets that the FDIC kept and sold off; uninsured depositors were fully covered. As a result, the FDIC incurred a loss of about $16.3 billion.[35]

II. Consequences of Differential Treatment

Continued differential treatment of uninsured depositors at large versus small institutions could have three major consequences: (1) Market Consolidation, (2) Moral Hazard, and (3) Erosion of Public Trust.

A. Market Consolidation

Favoring uninsured depositors at small banks could incentivize a further consolidation of the banking sector. After observing the instances of SVB and First National Bank of Lindsay, depositors are incentivized to bank at a large institution whose failures could significantly impact the broader financial system. Given the importance of large financial institutions to overall financial stability, the FDIC would be more likely to protect uninsured depositors banking with them compared to those banking at a smaller institution. Thus, the uninsured deposits bear less risk of loss when housed at large banks, as there is an implicit guarantee of insurance.

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[28] *Id.*

[29] *Id.*

[30] Anna Pope, *Federal agency closes First National Bank of Lindsay in South Central Oklahoma*, KGOU (Oct. 22, 2024), https://www.kgou.org/business-and-economy/2024-10-22/federal-agency-closes-first-national-bank-of-lindsay-in-south-central-oklahoma [https://perma.cc/D85C-2X6G].

[31] FDIC, *First–Citizens Bank & Trust Company, Raleigh, NC, to Assume All Deposits and Loans of Silicon Valley Bridge Bank, N.A., From the FDIC* (Mar. 26, 2023), https://www.fdic.gov/news/press-releases/2023/pr23023.html [https://perma.cc/5WN9-4FBB].

[32] *Id.*

[33] *Id.*

[34] *Id.*

[35] *FDIC Finalizes $16.3 Billion Special Assessment to Recover Loss from SVB and Signature Bank Failures*, *supra* note 15.

Furthermore, favoring larger institutions may encourage consolidation from the banks' perspective. Small banks are already struggling.[36] The prospect of government protection due to size could be appealing to them. Thus, the status quo of treating large and small banks differently would encourage mergers.[37] And while the Biden Administration was skeptical of bank mergers, the Trump Administration will likely reverse course.[38]

Market consolidation will have consequences though. First, it will alter the risk profile of the overall financial system. Second, the unique benefits offered by smaller banks will be lost. Finally, there will be a loss in competition.

Consolidation of banks in the marketplace would alter the overall risk to the financial system. Those that argue that it would increase risk claim that large banks tend to adopt riskier and more aggressive strategies as they grow, increasing systemic risk.[39] Similarly, a recent empirical study found that on average U.S. banks become *less* resilient after mergers.[40] However, a banking group has argued that mergers between regional banks would not impact systemic risk.[41] Similarly, they argue that mergers involving systemically important banks do not increase financial stability risk.[42] Thus, the actual risk presented varies on a transaction-by-transaction, but it is likely that a flurry of mergers would end up increasing overall risk to the financial system.

A second consideration is the loss of unique benefits offered by community banks, the category of the smallest banks in the United States. If these banks increasingly merge, some community bank branches may

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[36] Marc Chandler & Nancy Seelye, *Small Banks are Teetering. Expect More Failures*, BARRON'S (Feb. 8, 2024), https://www.barrons.com/articles/small-community-banks-are-teetering-expect-more-failures-a3de6f78 [https://perma.cc/G3UU-S8E6].

[37] *See* Aliya Shibli, *Wave of consolidation could save smaller US banks*, THE BANKER (Dec. 4, 2023), https://www.thebanker.com/Wave-of-consolidation-could-save-smaller-US-banks-1701704550 [https://perma.cc/RX99-85QZ].

[38] Caitlin Mullen, *How a second Trump term may change bank M&A*, BANKINGDIVE (Nov. 7, 2024), https://www.bankingdive.com/news/trump-bank-mergers-acquisitions-regulation-occ-fdic-doj/732290/ [https://perma.cc/WWQ4-25LP]. *See* Steve Cocheo, *Changing Conditions May Drive More Community Bank Mergers in 2025*, The Financial Brand (Oct. 30, 2024) https://thefinancialbrand.com/news/banking-trends-strategies/2025-could-see-more-community-bank-ma-says-fitch-182584 [https://perma.cc/EGW2-YPUX].

[39] Art E. Wilmarth Jr., *Ch. 28: Controlling Systemic Risk in an Era of Financial Consolidation* in CURRENT DEVELOPMENTS IN MONETARY AND FINANCIAL LAW at 563 (Vol. 3, International Monetary Fund).

[40] *See* Jeffrey Jou, Teng Wang & Jeffery Zhang, *Are Bank Mergers Bad for Financial Stability?* (2024), available at https://www.fdic.gov/system/files/2024-09/jou-paper-9324.pdf [https://perma.cc/77MB-FV49].

[41] See Francisco Covas et al., *Regional Bank Mergers Would Increase Competition without Increasing Systemic Risk*, BANK POLICY INSTITUTE (Jul. 22, 2024), https://bpi.com/regional-bank-mergers-would-increase-competition-without-increasing-systemic-risk/ [https://perma.cc/S7CC-D4DZ].

[42] See Francisco Covas et al., *Mergers Involving GSIBs Do Not Inherently Increase Financial Stability Risk*, BANK POLICY INSTITUTE, (May 16, 2024), https://bpi.com/mergers-involving-gsibs-do-not-inherently-increase-financial-stability-risk/ [https://perma.cc/3JBH-AHB7].

close.[43] And if they do not, they are potentially placed at risk due to uninsured depositor flight. As a result, communities could lose out on these small relationship lenders that are tailored to the needs of their community.[44] It could also exacerbate the trend of an increasing number of "banking deserts."[45] This leaves consumers vulnerable to predatory non-bank financial companies like payday lenders, which offer small but high interest loans and pop up in place of banks after mergers lead to branch closures.[46] Closures can also lead to the loss of certain specialized banking products.[47]

Finally, consolidation—whether due to closures or mergers—can lead to a loss in competition. Bank consolidation has led to an increase in fees charged to customers and decreasing interest offered to depositors.[48] This disproportionately impacts small businesses and low- and middle-income communities.[49]

B. Moral Hazard

A second risk of differential treatment is moral hazard on the part of both the banks and the depositors. By insuring banks that pose systemic risks, larger banks might be emboldened to take increased risks in search of higher profits.[50] Of course, the counterargument to this is that equity holders are often wiped out and the bank's executives lose their jobs during bank failures.[51]

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[43] *See* Jim Dobbs, *Why banks are closing branches faster as M&A returns*, AMER. BANKER (Dec. 6, 2024) https://www.americanbanker.com/news/why-banks-are-closing-so-many-branches [https://perma.cc/K9SA-PAYQ].

[44] Rohit Chopra, *Statement of CFPB Director Rohit Chopra, Member, FDIC Board of Directors, on Deposit Insurance Reform and the Failure of The First National Bank of Lindsay* (Nov. 18, 2024) https://www.consumerfinance.gov/about-us/newsroom/statement-of-cfpb-director-rohit-chopra-member-fdic-board-of-directors-on-deposit-insurance-reform-and-the-failure-of-the-first-national-bank-of-lindsay/ [https://perma.cc/XU4W-FCWT].

[45] Drew Dahl & Michelle Franke, *Banking Deserts Become a Concern as Branches Dry Up*, FED. RSRV. BANK OF ST. LOUIS (Jul. 15, 2017), https://www.stlouisfed.org/publications/regional-economist/second-quarter-2017/banking-deserts-become-a-concern-as-branches-dry-up [https://perma.cc/X4D4-5NCZ].

[46] Shahid Naeem, *Revitalizing Bank Merger Enforcement to Restore Competition and Fairness in Banking*, AM. ECON. LIB. PROJECT 4 (Jun. 2023), https://www.economicliberties.us/wp-content/uploads/2023/06/062023_AELP_BankMerger_Brief_R2.pdf [https://perma.cc/T6NP-PENY].

[47] *Customer FAQs on Bank Mergers and Acquisitions, Answered*, EVANSTON COMMUNITY BANK AND TRUST https://www.bankevanston.com/small-business/resources/financial-education/2022/04/customer-faqs-on-bank-mergers-and-acquisitions-answered.html#:~:text=Pay%20attention%20to%20what's%20happening,%E2%80%94%20they%20impact%20communities%2C%20too [https://perma.cc/FW92-Y66H], (last visited Jan. 9, 2025).

[48] Jeremy Kress, *Reviving Bank Antitrust*, DUKE L.J. 519, 556 (2022).

[49] *See id.* at 555–61.

[50] *See* Itay Goldstein & Yao Zeng, *SVB: US Regulators have generated "a moral hazard,"* THE BANKER (Mar. 24, 2023) https://www.thebanker.com/SVB-US-regulators-have-generated-a-moral-hazard-1679645486 [https://perma.cc/3C5A-Q4AE].

[51] *Id.*

This alone could serve as an effective deterrent. However, it has not stopped banks from taking risks in the past.[52]

Similarly, depositors could take risks. In the case of SVB, some large depositors left large chunks of their assets in the bank. For example, Roku had one-fourth of its cash in SVB before its failure.[53] Fully insuring them does not incentivize other future companies to separate out their deposits. Instead, they are incentivized to put all their funds in the largest few banks. It also does not incentivize depositors to research the institutions prior to depositing.[54] If their funds were actually in jeopardy, large, sophisticated institutions might review the health of institutions prior to depositing. Thus, the institutions which take less risk would be rewarded. But in the status quo, uninsured depositors face little to no risk.

C. Erosion of Public Trust

In the aftermath of the shutdown and resolution of the First National Bank of Lindsay, Former Consumer Financial Protection Bureau (CFPB) director Rohit Chopra, criticized the difference in treatment between the uninsured depositors at First National Bank of Lindsay and SVB.[55] In his words, "big businesses putting their money in big banks enjoy free deposit insurance, and small businesses putting their money in small banks don't. This is fundamentally unfair."[56] While it is unlikely banking regulators intended to disfavor smaller banks, it could appear that they are in the eyes of the public.

As a result, public trust in the banking system could be jeopardized. This is particularly risky now. Many fintech firms engaging in banking-like behavior, but without the same supervision, are competing for customers' deposits.[57] Reduced trust in the traditional system could result in the growth of these firms which lack adequate supervision to serve large swaths of the public. Thus, in the event of a crisis from the firms, the government could be

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[52] See Alexandra Digby et al., *Recent banking crises are rooted in a system that rewards excessive risk-taking – as First Republic's failure shows*, The Conversation (May 1, 2023) https://theconversation.com/recent-banking-crises-are-rooted-in-a-system-that-rewards-excessive-risk-taking-as-first-republics-failure-shows-204255 [https://perma.cc/5HSQ-P5E7].

[53] Dade Hayes, *Roku Had One-Fourth Of Its Cash In Failed Silicon Valley Bank, Most Of It Uninsured; Streaming Giant Says It Can Still Meet Expenses*, Deadline (Mar. 10, 2023) https://deadline.com/2023/03/roku-cash-failed-silicon-valley-bank-streaming-1235285439/ [https://perma.cc/WN48-MWAL].

[54] *See* Deniz Anger & Ata Can Beray, *Market discipline*, World Bank Blogs (Dec. 4, 2019), https://blogs.worldbank.org/en/allaboutfinance/market-discipline [https://perma.cc/3FR4-Y8KL].

[55] Chopra, *supra* note 44.

[56] *Id.*

[57] *See* George Iddenden, *The battle for merchant deposits: How the fintech sector is challenging banks' core business*, The Payments Ass'n (Nov. 18, 2024) https://thepaymentsassociation.org/article/the-battle-for-merchant-deposits-how-the-fintech-sector-is-challenging-banks-core-business/ [https://perma.cc/6D8A-D843].

forced to step in. However, they currently do not have the power to, nor is there an appetite for them to ex ante regulate the risk-taking of these firms.

The financial system is built on trust.[58] It has suffered some setbacks in recent years, and the disparate treatment could further perpetuate this.

III. Potential Solutions

This Part will briefly outline and analyze some possible solutions to the discrepancy in treatment. Options include expanded deposit insurance, a change in the assessment fees, and stricter enforcement of moral hazard.

A. *Expanded Deposit Insurance*

In the aftermath of SVB, expanded deposit insurance was debated, but nothing changed. Two potential options raised were: (1) expanding insurance beyond the $250,000 cap or (2) expanding insurance for certain types of accounts. In the first case, the benefit is that there would be fewer or possibly no—in the case of unlimited insurance—uninsured depositors at a bank. Thus, the discrepancy would be mitigated or cured. This could also potentially lead to fewer crises. Fewer people will have the incentive to run on a bank if more deposits are covered.[59] But, as the FDIC identifies, expanded insurance would necessitate higher assessment fees, could reduce depositor moral hazard, and induce more risk taking from banks.[60] The magnitude of these effects would increase with increased coverage.

A second option is more targeted expansion of deposit insurance. One example of this is the Payroll Account Guarantee Act, which was introduced by then-Senator J.D. Vance in 2023. The legislation would fully guarantee all non-interest-bearing transaction accounts at banks with less than $225 billion in assets, and at all credit union regardless of assets held.[61] These transaction accounts tend to be business payroll and operating accounts.[62] The FDIC similarly identified targeted coverage for business accounts in their report on deposit insurance reform.[63]

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[58] See Ronald J. Colombo, *The Role of Trust in Financial Regulation*, Villanova L. Rev. 577, 578–79 (2010).

[59] FDIC, *Options for Deposit Insurance Reform – Section 1: Executive Summary*, 3 (2023) https://www.fdic.gov/analysis/options-deposit-insurance-reforms/report/options-deposit-insurance-reform-section-1.pdf [https://perma.cc/M5JZ-8SA4].

[60] *Id.*

[61] *Vance introduced bill to increase deposite insurance protection*, Nat'l Assoc. of Federally-Insured Credit Unions (Jul. 26, 2023), https://www.nafcu.org/newsroom/vance-introduces-bill-increase-deposit-insurance-protection [https://perma.cc/7TVD-J2PL].

[62] Rajashree Chakravarty, *CFPB's Chopra urges deposit insurance reform*, BankingDive (Nov. 19, 2024) https://www.bankingdive.com/news/cfpbs-rohit-chopra-urges-deposit-insurance-reform-oklahoma-first-national-bank-of-lindsay/733370/ [https://perma.cc/8TMZ-XEPC].

[63] FDIC, *supra* note 59 at 2.

This is a popular proposal because the failure to insure large, interconnected businesses is what can lead to shockwaves through an economy. For example, in the case of SVB, Roku's business would be significantly impacted if they lost only half of their uninsured deposits at SVB. And following the failure of SVB, national security officials were concerned about the impact to certain businesses that banked at SVB and were integral to national security interest. Selectively targeting certain business accounts could address the domino effects of bank failures while increasing moral hazard less than full insurance would.

B. Change in Assessment Fees

Another option is to alter the FDICs structure of assessment fees. The assessment fee a bank pays is calculated by multiplying the rate (expressed in cents per $100 of assessment base) times the assessment base.[64] The assessment base is a bank's average consolidated total assets minus its average tangible equity (essentially a bank's liabilities).[65] In determining the rate, the FDIC considers a variety of factors related to the bank's health.[66] Additionally, the FDIC has a statutory mandate to cover any losses to the DIF after use of the systemic risk exception.[67]

One way to alter the assessment fee structure is to allow banks to "purchase" additional deposit insurance from the FDIC through optional higher assessments.[68] In this case, the FDIC would need to calibrate the level and amount of the additional assessments to the loss the DIF would sustain if the institution failed. Congress would also likely need to give the FDIC the authority to selectively raise the deposit insurance cap; promises to use the systemic risk exception probably would not induce banks to purchase additional insurance. This measure would also require action on the depositors. The hope is that large depositors, seeing that an institution is insured beyond the $250,000, would move their deposits to these institutions. If this did not happen, large institutions would refuse to buy in and continue to bank on the FDIC invoking the systemic risk exception.

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[64] Barr et al., *supra* note 18 at 262. Assessment Methodology & Rates, FDIC, https://www.fdic.gov/resources/deposit-insurance/deposit-insurance-fund/dif-assessments.html [https://perma.cc/H99A-UMUD], (last updated Nov. 12, 2024).

[65] *Assessment Methodology & Rates*, *supra* note 64. Prior to Dodd-Frank, the assessment base was the bank's total domestic deposits. Total liabilities are much bigger than demand deposits. Barr et al., *supra* note 20, at 262.

[66] Ashar, *supra* note 22, at 54.

[67] *FDIC Finalizes $16.3 Billion Special Assessment to Recover Loss from SVB and Signature Bank Failures*, *supra* note 15.

[68] Professor Christina Skinner advocates for a similar idea but instead for banks to purchase this extra insurance through third parties or through bank created insurers. Christina Parajon Skinner, *Privatizing Deposit Insurance*, 14 Harv. Bus. L. Rev. 455, 483 (2024).

C. Moral Hazard Enforcement

A final option is a stricter commitment to moral hazard enforcement. The FDIC would thus lean towards refusal to insure the uninsured depositors during failures of large banks beyond the $250,000 limit, or partially insure them (as in the 50% for First National Bank of Lindsay).[69] The benefit of this is that it could encourage depositors to be careful about how much they deposit at each bank. If they know their deposits will not be insured beyond the cap, they will likely spread them out.[70] Additionally, more sophisticated depositors might conduct additional due diligence into the health of the bank.[71] This could in turn deter risk-taking behavior by the depository institutions. Enforcement could be paired with the option to purchase more deposit insurance. Because of a more credible threat that large banks will be allowed to fail, there is further incentive for institutions to purchase additional insurance.

However, strict moral hazard enforcement comes at a cost. In letting uninsured depositors take losses, there might be ripple effects across the financial system. With SVB we saw its run catalyze a run on First Republic. Uninsured depositors across the economy could be spooked if they were to see a large bank fail and many depositors take losses. Thus, strict moral hazard enforcement during a crisis is likely not a favorable solution.

Conclusion

The FDIC's disparate treatment of uninsured depositors at large versus small banks underscores a fundamental tension within the financial regulatory framework. While protecting the broader financial system is critical, the status quo risks fostering market consolidation, moral hazard, and public mistrust. Expanded deposit insurance, adjustments to assessment fees, and targeted moral hazard enforcement are viable paths forward, but each carries tradeoffs that policymakers must carefully weigh. Ultimately, a more consistent and transparent approach is essential to ensuring trust in the banking system and safeguarding its resilience in the face of future crises.

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[69] Partial insurance close to, but not, the full amount of the deposits (e.g., 90%) might be an attractive solution since it still could incentivize behavior change on the part of the depositor without the same systemic risk implications of minimal insurance.

[70] *See* Dylan Ryfe & Alessio Saretto*, Reciprocal deposit networks provide means to exceed FDIC's $250,000 account cap*, Fed Rsrv. Bank of Dallas (Nov. 28, 2023), https://www.dallasfed.org/research/economics/2023/1128 [https://perma.cc/9H2S-H7RF].

[71] *See* Krzystof Jackowicz et al., *Depositor Discipline During Good and Bad Times: The Role of Guarantor of Last Resort*, SSRN (Mar. 2, 2015) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2572001 ("In these circumstances unsophisticated depositors who are unable to evaluate the GLR's risk and may even be unaware of its existence do not change their behavior; however, sophisticated depositors may require higher yields.").