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Testimony
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Hearing on "Promoting the Health of the Banking Sector: Reforming Resolution and Broadening Funding Access for Long-Term Resilience"

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Introduction

Chairman Hill, Ranking Member Waters, and Members of the Committee, thank you for the opportunity to testify at today's hearing. My name is Norbert Michel, and I am Vice President and Director for the Center for Monetary and Financial Alternatives at the Cato Institute. The views I express in this testimony are my own and should not be construed as representing any official position of the Cato Institute.

A healthy banking sector is one that is resilient due to adequate funding and capital, both of which are a natural consequence of the ability to profitably intermediate funds. Policymakers can foster a resilient banking (and financial) sector by creating a less regulated business environment so that people supplying funds can best serve a diverse market of consumers.

Historically, federal officials have taken the opposite approach with financial markets, particularly in banking, where they have created a regulatory framework at odds with limited government and free enterprise. Still, the notion that the government must protect people from freely operating financial markets has guided US bank regulation for most of the country's history. Ironically, as decades of experience show, regulators have taken on a more active role in managing financial firms' risk taking but financial crises have not subsided in tandem. It is now indisputable that *if* this kind of framework can maintain financial stability, it has not done so yet.

Among other problems, the existing bank regulatory framework creates enormous entry costs for new financial firms, and because larger firms and investors are protected in the name of stability, the framework is inherently less competitive than it would be otherwise. The framework therefore prevents incumbent firms from providing the main benefits of a free enterprise system—that is, offering newer, better, or more cost-effective products. Over time, the system has progressively narrowed the scope of what banks can do while also limiting what people can do with their money. An increasingly smaller number of people now control how most Americans can invest, when they can invest, and even who gets to invest. This framework has consistently been expanded in the name of maintaining stability, but it has never worked as promised.

Instead, it has made the banking system more fragile, and it has made it more difficult for most people to invest and build wealth.[1] Dramatic change is needed to increase the kind of diversity that makes a financial system more resilient, in a way that offers more people greater choice and opportunity. Critics claim that the average citizen could not possibly have the knowledge necessary to make good financial decisions under a less regulated financial market, but this condescending view ignores that the existing rules and regulations are too complex and voluminous for the average person to assess how they affect his or her own personal welfare.

Policymakers generally justify extensively regulating banks' activities on two main grounds. First, they fear that without strictly regulating banks' activities, the result would be widespread bank failures and, therefore, system-wide financial and economic instability.[2] (In other words, they justify regulation by citing *systemic-risk* concerns.) Second, they claim extensive regulations are necessary to protect the Deposit Insurance Fund (DIF)of the Federal Deposit Insurance Corporation (FDIC). More broadly, this justification is to protect *taxpayers* because they are ultimately responsible for any FDIC-insured losses beyond the nominal balance in the DIF.

One obvious problem with basing bank regulation on broad stability concerns is that concepts such as "systemic risks," "financial stability," and "economic instability" can easily be used to justify more stringent regulations on all kinds of non-financial firms (not only because they lack a common, objective definition). The number of people who would potentially lose their ability to earn a living if, for example, Walmart, Apple, or Ford closed, is no less an economic concern than if Citibank were to go bankrupt. The failure of any of these companies would temporarily harm the well-being of millions of people who depend on them for a living. A system based on using government regulation and support to ensure widespread economic stability for all industries is not a free enterprise system, and it severely limits economic opportunity and choice for most people.

[1] Norbert Michel and Jennifer Schulp, *Financing Opportunity*, Washington, DC: Cato Institute, 2024; and Charles W. Calomiris and Stephen H. Haber, *Fragile by Design: The Political Origins of Banking Crises and Scarce Credit*, Princeton, NJ: Princeton University Press, 2014.
[2]Mark Flannery, "Supervising Bank Safety and Soundness: Some Open Issues," Federal Reserve Bank of San Francisco, Conference on Safe and Sound Banking: Past, Present, and Future, August 17–18, 2006.

Though most members of Congress would balk at federally insuring the profits and strictly regulating the daily operations of firms such as Home Depot, Walmart, or Apple, most members are at least complicit in setting up such rules in the financial sector. They often base these regulations on the notion that financial firms are different, but the truth is that financial firms are no more special, or dangerous, than non-financial companies. Each group of companies needs the other, and each would suffer in isolation. The evidence suggests that without federal deposit insurance, even *banks* are not particularly special. As Loyola University Chicago economist George Kaufman argued, "There is no evidence to support the widely held belief that, even in the absence of deposit insurance, bank contagion is a holocaust that can bring down solvent banks, the financial system, and even the entire macroeconomy in domino fashion."[3]

Despite a history of failure, many also see extensive regulations as necessary to protect taxpayers from having to cover any shortfalls in the FDIC's DIF.[4] Critically, this argument also assumes that federal deposit insurance is necessary to maintain financial stability. And, in fact, many believe that *both* federal support and extensive regulation for financial markets are necessary to maintain stability. Again, though, the obvious conclusion is that the private sector–even the non-financial portion of the economy–cannot function without extensive government backing and regulation, a very dangerous proposition for mankind.

Unsurprisingly, many advocates of stricter regulation and backing for financial firms openly call for the full government provisioning of money and the federal backing of essentially all short-term credit markets. For example, legal scholars Morgan Ricks and Lev Menand want regulators to "clarify banks' place in U.S. society and their relation to the government," such that all money becomes "a governmental product." They actively hail a "new monetary era" with central bank digital currencies, a digital version of the dollar that ties citizens directly to the government.[5] Saule Omarova, whom President Biden nominated for Comptroller of the Currency in 2021, has called for "the complete migration of demand deposit accounts [at commercial banks] to the Fed's balance sheet."[6] Omarova acknowledges that the "compositional overhaul of the Fed's balance sheet would fundamentally alter the operations

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[3]George Kaufman, "Bank Contagion: A Review of the Theory and Evidence," *Journal of Financial Services Research* 8, no. 2 (1994): 143.
[4]Although it is like a basic spillover argument, others argue that regulation is necessary to protect the *payments system*. That is, it is needed to protect people's ability to use their accounts to conduct transactions. John P. LaWare, member, Board of Governors of the Federal Reserve System, Testimony before the Subcommittee on Economic Stabilization of the House Committee on Banking, Finance, and Urban Affairs, 102nd Cong., 1st sess., May 9, 1991.
[5]Morgan Ricks and Lev Menand, "Scrap the Bank Deposit Insurance Limit," *Washington Post*, March 15, 2023. In his book, Ricks equates all money market instruments to "cash equivalents," thus arguing that this entire financial segment should be regulated as banks, and explicitly backed by the government, because it is engaged in money creation. Ricks, *The Money Problem: Rethinking Financial Regulation* (Chicago: University of Chicago Press, 2016).
[6]Omarova withdrew from the nomination process amid controversy over her interventionist views on the financial industry, which some critics likened to communist economic policies. Pete Schroeder and Andrea Shalal, "Omarova Withdraws Nomination to Lead U.S. Office of the Comptroller of the Currency," Reuters, December 7, 2021.

and systemic footprints of private banks, funds, derivatives dealers, and other financial institutions and markets."[7] Yet she believes that such reforms would "make the financial system more inclusive, efficient, and stable."[8]

Although many aspects of US financial markets consist of a public–private arrangement, this kind of change would all but eliminate the private portion, creating a financial market profoundly different from the one that currently exists in America. Even though the current system is highly flawed, such a new arrangement would give an even smaller number of people untold economic and political power over everyone else. Yet, this sort of approach is the natural extension of the existing regulatory system. Tragically, experience has already demonstrated that people do not have the ability to craft rules and regulations that maintain financial stability while allowing people to take financial risks.

The regulatory system should no longer be based on maintaining financial stability through government regulation or backing. It should no longer be based on the idea that banks and financial firms are special compared with those in the rest of the economy. There is no objective economic justification for this kind of system, and the same arguments for heavily regulating and supporting financial firms could easily be applied to all non-financial firms, severely restricting citizens' economic and political freedom.

The longer the current trajectory is maintained, the further from a free enterprise system the US economy will drift, endangering Americans' widespread prosperity. This testimony discusses a few steps in irradicating the notion that the federal government should plan, protect, and prop up the financial system. It focuses on promoting a healthy banking sector as it relates to resolution, funding, capital regulation, merger and acquisition policy, and ways to minimize the need for FDIC deposit insurance.

Bank Resolution Reforms

Since 1933, all banks, whether federal or state chartered, that join the Federal Reserve System are required to have FDIC deposit insurance, and the FDIC is, at the very least, a secondary regulator of all FDIC-insured banks.[9] Through assessments charged to insured banks,

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[7]Saule Omarova, "The People's Ledger: How to Democratize Money and Finance the Economy," *Vanderbilt Law Review* 74, no. 5 (2021): 1232. Saule Omarova, "Banks Can't Be Trusted: A 'Golden Share' Might Help," *New York Times*, March 23, 2023.

[8]Omarova, "The People's Ledger," p. 1299. Similarly, Ricks, Menand, and another scholar believe that giving Americans accounts at the Federal Reserve would offer an "astonishing range" of benefits, including "greater financial and macroeconomic stability." Morgan Ricks, John Crawford, and Lev Menand, "FedAccounts: Digital Dollars," *George Washington Law Review* 951 (2021): 125.

[9]All federally chartered banks, and all Federal Reserve member banks, are required to have FDIC deposit insurance. All other banks (state-chartered, non-Fed-member banks) are subject to their state's requirements, and most states now require FDIC deposit insurance as a condition of operating a bank.

the FDIC administers the DIF.[10] The DIF is supposed to protect insured depositors and help the FDIC resolve failed banks.

With the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), Congress required the FDIC to resolve failed banks with the least cost to the DIF. However, under the current framework, there is virtually no way for the public to easily verify that these resolutions are carried out at least cost – the public essentially must take the FDIC at its word. It remains unclear, for example, whether nonbank financial firms were frozen out of the bidding process for Silicon Valley Bank (SVB), and whether such bids could have reduced the cost to the DIF.[11] Another problem is that the FDICIA provides an exception to this "least-cost" resolution method. To invoke this exception, two-thirds of the FDIC Board, and two-thirds of the Federal Reserve Board of Governors, must affirmatively vote to provide a written recommendation to the Treasury Secretary, who must then, after consulting with the President, determine that complying with the least-cost resolution requirements would have "serious adverse effects on economic conditions or financial stability and any action or assistance taken under the systemic risk exception would avoid or mitigate such adverse effects."[12] Specifically, the systemic risk exception (SRE) allows the FDIC to ignore the least-cost resolution requirement for the bank it is placing in receivership (i.e., the bank it is closing). It allows the FDIC to take other action or provide assistance to avoid serious adverse effects on economic conditions or financial stability.

The flaws in these provisions were exposed during the bank failures in 2023 and they should be repealed. In practice, these provisions provide political cover to mitigate losses for investors or depositors beyond any insured amounts, much like what was done during the 2008 financial crisis. In the case of SVB and Signature, the SRE allowed the FDIC to cover uninsured depositors at those two banks. For at least one FDIC Board member, the decision to invoke the SRE was driven by the desire to preserve the banks' "operations and franchise value." The Board member believed that, without this move, which allowed the FDIC to cover the banks' uninsured deposits, it would have been impossible to facilitate the sale of failed banks.[13]

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[10]Robert Kaiser, "'Act of Congress': How Barney Frank Foiled the Banking Lobby to Form a New Financial Watchdog," *Washington Post*, May 5, 2013. Section 331 of Dodd-Frank changed the FDIC's assessment base for deposit insurance fees paid by banks. Rather than pay fees based on total deposits, banks now had to pay on the basis of their average consolidated total assets minus their average tangible equity (effectively total liabilities). The change requires banks that pose higher risks to the economy (larger banks) to pay higher rates. Raj Gnanarajah, "FDIC's Deposit Insurance Assessments and Reserve Ratio," Congressional Research Service, August 24, 2018.

[11] Kia Kokalitcheva, "Timeline: Silicon Valley Bank's saga," Axios, March 18, 2023, https://www.axios.com/2023/03/18/silicon-valley-bank-timeline. This statement does not imply, however, that no information on FDIC bank resolutions is publicly available. See, for example, Rosalind L. Bennett and Haluk Unal, "Understanding the Components of Bank Failure Resolution Costs," FDIC Center for Financial Research, WP 2014-04, July 2014, https://www.fdic.gov/analysis/cfr/2014/wp2014/2014-04.pdf.

[12] Section 13(c)(4)(G) of the FDICIA, 12 U.S.C.

[13] Norbert Michel, "McKernan's Statement Underscores Problems With FDIC's Systemic Risk Exception," Forbes, May 16, 2023, https://www.forbes.com/sites/norbertmichel/2023/05/16/mckernan-underscores-problems-with-fdics-systemic-risk-exception/.

This example draws attention to a serious contradiction in U.S. banking law: Maintaining financial stability conflicts with shutting down banks, even when they're insolvent. By design, the SRE gives federal regulators – and Congress – a pass on the least cost resolution requirement. Ironically, the exception makes it more likely the bank will be kept open in the name of keeping "the system" running, which is the exact problem that Congress was ostensibly addressing with the least cost requirement in the first place.

Regardless, the FDIC chose against liquidating SVB even though selling off the bank's securities portfolio would have paid off all the insured depositors in full. In fact, selling the $100 billion (plus) portfolio, even with the losses from recent interest rate increases, would have covered the $18 billion insured deposits nearly five times over. And as the FDIC's own report explains, uninsured depositors historically lose money when banks fail – almost a 25 percent haircut prior to the 2008 financial crisis. So, it is not unusual for uninsured depositors to lose when a bank fails.

Although it is tempting to suggest Congress should provide more structure and accountability to the SRE, it is more sensible for Congress to get rid of the SRE. For starters, the incentives for the systemic risk exception are all wrong, and they will always be all wrong. No government official wants to be the one who didn't do more to stop some kind of economic disaster. Nobody should be put in that position. The good news is that nobody has to be put in that position – it simply isn't the case that resolving a failed bank, no matter how large, means all the money in the bank gets frozen and then disappears. Such failures do nothing to the ability of businesses to profitably operate going forward, even if there is a temporary pause in funding. So, bank failures do not, by themselves, result in major economic disruptions. Moreover, with the Fed providing liquidity to the banking system, it's even harder to make a case that a single bank's failure would cause widespread economic damage.

Nonetheless, the fear that a bank failure could freeze many customer deposits, thus disrupting the economy, has been a main contributing factor to the existing FDIC bank-resolution process *and* the Fed's lender of last resort function. Predictably, that fear seems to have morphed into the fear that freezing *any* deposits would disrupt the economy. And without a clear definition of financial stability, which Congress has already avoided, the SRE will remain easy to invoke.

Additionally, the SVB and Signature failures showed that this basic fear of economic disruption has also morphed into the idea that depositors moving their money around should be defined as a *systemic* risk. While a massive deposit outflow from one bank is obviously a risk to that bank, as SVB demonstrated, they can only threaten the entire financial system if depositors take their money out and put it under their mattresses. If, instead, they move money into other banks, then the outflows cannot possibly threaten the banking system, much less the broader economy. Nonetheless, some officials still claim that business payment accounts could pose even "greater financial stability concerns than other accounts" because they could, when frozen even temporarily, cause businesses to fail to make payrolls.[14]

The events that occurred during these 2023 bank failures also damage the idea that government-backing and intervention can stop financial contagion (i.e., panic).[15] For instance, FDIC Board member Martin Gruenberg's speech in September 2023 essentially repeats the conventional bank failure story. It claims that the *possibility* that uninsured depositors at SVB would experience losses "alarmed uninsured depositors at several other regional banks," thus causing depositors to start withdrawing their funds, at which point Signature experienced heavy withdrawals.[16] On March 12, just two days after SVB's failure, state regulators closed Signature.

Then, because they were faced "with growing contagion in the system," government officials invoked the SRE. The problem for advocates of increased government backing, though, is that the contagion should have been stemmed after the first announcement of covering uninsured depositors. Yet, First Republic failed almost two months later, on May 1, 2023. So, either the effort to stop the contagion didn't work, or the failures were not the result of contagion.

Interestingly, the remnants of First Republic were assumed by JPMorgan Chase. Flagstar Bank and First Citizens, two regional banks, then purchased Signature and SVB, respectively, within two weeks after the failures. Given the timeline, it is difficult to argue that contagion led to the failure of the first three banks despite the government's efforts but was then stemmed (with no new action) and with no effect on other banks' ability to purchase the failed banks.

More broadly, it is true that federal backing helped quell a bank panic during the Great Depression, and there have been fewer bank runs in the FDIC era. But even ignoring the many federal policies that caused the U.S. banking sector to be so fragile prior to the Depression (and beyond), it does not automatically follow that the federal government should insure bank deposits.

Nor does it follow that the FDIC should oversee winding down failed banks – there's no economic reason that a federal bankruptcy court could not administer bankruptcy for all financial institutions. It's even conceivable that FDIC coverage could still be provided to most

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[14] Norbert Michel, "Gruenberg Speech Exposes Flaws In Financial Stability Mandate," Forbes, October 4, 2023, https://www.forbes.com/sites/norbertmichel/2023/10/04/gruenberg-speech-exposes-flaws-in-financial-stability-mandate/.

[15] More broadly, there is good reason to doubt the frequency of financial contagion, where panic destabilizes and brings down otherwise healthy financial firms. Moreover, the events that unfolded during the 2008 financial crisis undercut the idea that government backing can stem such panic. Norbert Michel, *Why Shadow Banking Didn't Cause the Financial Crisis, and Why Regulating Contagion Won't Help*, Cato Institute, Washington, DC, 2022, Pp. 30-36.

[16] Norbert Michel, "Gruenberg Speech Exposes Flaws In Financial Stability Mandate," Forbes, October 4, 2023, https://www.forbes.com/sites/norbertmichel/2023/10/04/gruenberg-speech-exposes-flaws-in-financial-stability-mandate/.

people under such an arrangement, and that large uninsured deposit flights would be pointless because a bankruptcy judge could force those depositors to return anything deemed a preferential transfer. In fact, the steady erosion of normal bankruptcy safe harbors in financial markets, implemented in the name of maintaining stability, contributed to the 2008 financial crisis.[17] Reinstating these safe harbors and extending something like them to the banking sector could be a vast improvement over the current system, particularly with respect to uninsured deposits.

Reforming this feature of the banking system could also help increase capital and funding by breaking down the inherent bias against non-banking firms in the bank resolution process. Even if the overly regulated bank chartering system is not completely reformed, some version of "shelf charters" could be used to bring non-bank investors into the bank resolution process. Shelf charters were first introduced during the 2008 financial crisis, and they appear to have allowed broader participation by nonbank investors in the bank resolution process. In 2023, the Office of the Comptroller of the Currency (OCC) approved at least one shelf charter, but it remains unclear whether nonbank investors were completely frozen out of the bidding process for the banks that failed in 2023.[18] At minimum, the resolution process should be reformed to allow nonbank entities to bid on failed banks.

Finally, it is worth considering whether failed banks could not merely go through bankruptcy like non-financial companies. Bankruptcy itself came out of common law, and it was always designed to prevent the disorderly resolution of a failed company. There are market-based options used around the world that could replace the FDIC bank-resolution process, and even the FDIC has previously used an "open-bank-resolution policy" that freezes a portion of a failed bank's assets but allows the bank to remain open to conduct limited business, thus minimizing economic disruptions.[19]

Improving Access to Funding and Capital

Deposits are a main source of funding for banks. Federal regulators fear customers moving their deposits out of a bank because sudden deposit outflows can cause a bank to become illiquid and insolvent (especially if the deposits are large). Of course, prohibiting someone from transferring their funds from one bank to another bank would not threaten the entire banking system since the total reserves held by banks would remain unchanged.

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[17] Norbert Michel, "Fixing the Regulatory Framework for Derivatives," Heritage Foundation Backgrounder No. 3156, September 14, 2016, https://www.heritage.org/government-regulation/report/fixing-the-regulatory-framework-derivatives.

[18] Skadden Publication, "OCC's Recent 'Shelf' Charter Approval Revives Mechanism for Broader Participation in Failed Bank Auctions," Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates, December 27, 2023, https://www.skadden.com/insights/publications/2023/12/occ-approves-shelf-charter.

[19] Paul Kupiec, "Title II: Is Orderly Liquidation Authority Necessary to Fix 'Too Big to Fail'?," in *The Case Against Dodd-Frank*, edited by Norbert Michel, Heritage Foundation, Washington DC, 2016, pp. 55-85, https://www.heritage.org/sites/default/files/2024-12/CaseAgainstDoddFrank.pdf.

Moreover, prohibitions on moving deposits are equivalent to preventing citizens from accessing their own money. Provided the regulatory framework is geared toward achieving financial stability and protecting the FDIC's DIF, the possibility of large deposits being moved from one bank to another will remain a chief concern of federal regulators because they do not want any banks or depositors to suffer "large" losses.

Moreover, smaller banks have long used FDIC deposit insurance to attract larger deposits. For instance, Robert Harrison, CEO and chairman of First Hawaiian Bank, recently supported a plan to increase FDIC deposit insurance caps, arguing that FDIC insurance helps smaller banks hold on to deposits and compete with much larger banks.[20] Similarly, Ira Robbins, the CEO of Valley National Bank in New Jersey recently argued that "We've seen a barbell environment within our industry, where we have a lot of smaller banks and a lot of larger banks, and there's very little, if any, mid-sized banks left in the entire country. That has to stop…and deposit insurance is the leveling of the playing field that's needed."[21]

The difference between the existing FDIC deposit insurance caps and the typical account balance reflects this reality–FDIC insurance is mainly a tool for banks to attract deposits, not for protecting the typical American. The current FDIC cap is $250,000, far above both the median account balance (approximately $5,000) and the average balance ($42,000). Even most high-income families have balances well below the $250,000 cap—as of 2023, the average balance for the highest 10 percent of income earners, surely biased upward by very high earners, was $229,000.[22]

Regardless of the original intent, FDIC deposit insurance has morphed into a federally backstopped funding mechanism, and it should not be used to further engineer the banking sector. It should not, for example, be used to force the industry to have any specific market segmentation, whether that means eliminating a "barbell environment" or any other type of structure. If it is the case that banks, whether small or large, cannot compete without federal backing, then taxpayers should not be forced to keep inefficient banks afloat. Of course, there is no shortage of regulatory fixes that would lower banks' costs, thus enabling banks of all sizes to better compete. The goal should be to reduce regulatory costs for the sake of allowing banks to best serve their customers, not to protect against the agglomeration of "large" or "medium" or "small" banks based on ill-defined market concentration arguments.

The existing system also treats brokered deposits, reciprocal deposits, and custodial deposits under frameworks developed in a pre-digital era. Brokered deposits are, to a large

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[20] Claire Williams, "Bankers Demand Deposit Fix While Fighting Over Price Tag," American Banker, August 25, 2025, https://www.americanbanker.com/news/bankers-demand-deposit-fix-while-fighting-over-price-tag.
[21] Claire Williams, "Bankers Demand Deposit Fix While Fighting Over Price Tag," American Banker, August 25, 2025, https://www.americanbanker.com/news/bankers-demand-deposit-fix-while-fighting-over-price-tag.
[22] Norbert Michel, "Fewer Than One Percent Of Accounts Are Above The FDIC Limit," Cato at Liberty, April 6, 2023, https://www.cato.org/blog/less-one-percent-accounts-are-above-fdic-limit.

extent, synonymous with unstable "hot money," deposits that are likely to "run" from a bank at the first hint of trouble. Reciprocal deposits emerged later as a stabilizing innovation, but that "cooling" of the hot money was achieved by allowing banks (mostly smaller/community banks) to electronically "spread" balances across insured institutions to ensure deposits above the FDIC insurance cap. Retail sweep accounts, which gave rise to increased use of custodial accounts, were first introduced in the 1990s as a way to minimize banks' reserve requirements.[23] Each of these innovations has changed the ways bank acquire funds, and the changes even spurred Congress to amend the Federal Deposit Insurance Act. However, across the previous two administrations, the FDIC has vacillated on its treatment of brokered deposits.

For instance, section 202 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (S. 2155) amended Section 29 of the Federal Deposit Insurance Act (12 U.S.C. 1831f) to provide a "limited exception for reciprocal deposits." As a result, any insured depository institution using a reciprocal deposit network was ensured its reciprocal deposits would not be considered (for regulatory purposes) *brokered* deposits provided they were the lesser of $5 billion or 20 percent of its total liabilities. Separately, during the first Trump administration, under chairman Jelena McWilliams, the FDIC sought to modernize regulations governing brokered deposits. McWilliams's effort resulted in a new rule, finalized in 2021.[24] This rule clarified the standards for determining whether an entity meets the statutory definition of a "deposit broker," but the regulations still contain more than 10 exceptions and a nine-part test to determine which entities are not deposit brokers.[25] During the Biden administration, under the leadership of FDIC chairman Martin Gruenberg, the FDIC issued a notice of proposed rulemaking that would have essentially reversed the brokered deposit changes finalized by the FDIC in 2021.[26] While the rule was withdrawn in 2025, these events

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[23] David D. VanHoose and David B. Humphrey, "Sweep Accounts, Reserve Management, And Interest Rate Volatility," Journal of Economics and Business, Volume 53, Issue 4, July–August 2001, pp. 387-404; and Kelly Emery, Greg Gonzalez II, Richard Stefanich, "Sweep Activity: Managing Bank Reserves in the Seventh District," Chicago Fed Letter, No. 253, August 2008, https://www.chicagofed.org/publications/chicago-fed-letter/2008/august-253. In recent years, at least one regulatory proposal seems to place undue burdens on banks for problems that arose at nonbank entities. See, for example, BPI Staff, "BPI and Others Comment on FDIC's Notice Of Proposed Rulemaking on Recordkeeping for Custodial Accounts," Bank Policy Institute, January 16, 2025, https://bpi.com/bpi-and-others-comment-on-fdics-notice-of-proposed-rulemaking-on-recordkeeping-for-custodial-accounts/.

[24] Federal Deposit Insurance Corporation, "Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions," Federal Register, Final Rule, Vol. 86, No. 13, January 22, 2021, https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-a-fr.pdf; and Jelena McWilliams, "Brokered Deposits in the Fintech Age," Speech, Brookings Institution, Washington, D.C., December 11, 2019, https://www.fdic.gov/news/speeches/2019/spdec1119.html.

[25] See 12 CFR Part 337, https://www.ecfr.gov/current/title-12/chapter-III/subchapter-B/part-337.

[26] Federal Deposit Insurance Corporation, "FDIC Board Approves Proposed Rule to Revise Brokered Deposit Regulations," Press Release, July 30, 2024, https://www.fdic.gov/news/press-releases/2024/fdic-board-approves-proposed-rule-revise-brokered-deposit-regulations; and, David F. Freeman, Jr., Christopher L. Allen, Nancy L. Perkins, Anthony Raglani, and Trevor Kirby, "FDIC Proposes to Amend Brokered Deposits Restrictions," Arnold &

show just how quickly regulations can be changed, and they represent the uncertain environment that the regulatory framework forces banks to operate under.[27]

The brokered deposit rules, pre- and post-amendment, provide an excellent example of how difficult regulations make it for banks to fund their operations. Markets constantly evolve and regulation must adapt, but the existing framework forces regulators to decide which funding sources are acceptable. This process replaces bankers' judgement with regulators' judgement, disregarding the ability of bankers to choose acceptable levels of risk and assuming regulators can successfully quantify risk. This approach provides a false sense of security because regulators have no special powers of foresight and judgement – both regulators and bankers are imperfect, as the bank failures of 2023 remind us. Perhaps worse, this regulatory approach helps entrench incumbent firms that can best deal with regulatory costs and centralizes power in the federal government. To whatever extent "protecting the DIF" justifies this type of regulation, the proper solution is to reduce reliance on the DIF and expand reliance on private markets, both for basic funding and for deposit insurance.

The regulatory framework should not discourage banks from developing diverse sources of funding and capital, but fixing this problem will require major changes. It will require more than mere tinkering with exceptions and definitions. Aside from no longer regulating to maintain financial stability and to protect the DIF, the harmful regulatory barriers between bank and non-bank financial markets, as well as the harmful separation between banking and commerce, must be excised from the regulatory framework.[28] The rules and regulations must encourage banks to build diverse sources of capital and funding, thus building a more robust and resilient financial sector. The rules should foster competition for funding, enhancing both the supply and demand of financial services—competition drives the processes by which businesses best serve consumers.

Regulatory Improvements for Bank Merger & Acquisition Process

Bank mergers and acquisitions (M&As) are regularly demonized for making the banking industry too concentrated and making bigger banks too powerful, worsening the so called "too big to fail" problem. Yet, M&A activity is necessary for a dynamic, resilient banking sector – combining banks typically allows these institutions to more easily achieve scale, invest, and diversify their risks. Moreover, bailing out banks is entirely up to Congress regardless of the

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Porter, August 6, 2024, https://www.arnoldporter.com/en/perspectives/advisories/2024/08/fdic-proposes-to-amend-brokered-deposits-restrictions.

[27] Federal Deposit Insurance Corporation, "FDIC Withdraws Proposed Rules Related to Brokered Deposits, Corporate Governance, the Change in Bank Control Act, and Incentive-Based Compensation Arrangements", Financial Institution Letters, March 3, 2025, https://www.fdic.gov/news/financial-institution-letters/2025/fdic-withdraws-proposed-rules-related-brokered-deposits.

[28] Alexander Raskovich, "Should Banking Be Kept Separate from Commerce," U.S. Department of Justice, Antitrust Division, Economic Analysis Group Discussion Paper, August 2008, https://www.justice.gov/atr/should-banking-be-kept-separate-commerce.

industry concentration and typical bank size. As the Great Depression era demonstrated, a banking industry full of small banks does not translate into a safe or stable industry.[29] Additionally, as recent bank failures in 2023 demonstrated, Congress has created a formal framework that can be used to bail out even uninsured depositors of banks that were not previously deemed too big to fail.

As with any non-financial industry, banks who want to engage in M&A activity should not be forced to get federal officials' seal of approval. When banks freely engage in M&A activity, it allows them to efficiently use capital to best serve customers. Any M&A regulations that do exist should be simple, objective, and transparent—criteria that the current system does not meet. For instance, the Bank Merger Act authorizes federal banking regulators to regulate bank M&A activity.[30] As discussed in a recent Jones Day report, the Bank Merger Act (BMA) directs the Office of the Comptroller of the Currency (OCC) to:

> consider five factors when conducting these reviews: (i) competition; (ii) the financial and managerial resources and future prospects of the existing and proposed institutions; (iii) the convenience and needs of the community to be served; (iv) the risk to the stability of the U.S. banking or financial system; and (v) the effectiveness of any insured depository institution involved in combatting money-laundering activities, including in overseas branches. When considering the impact a merger will have on competition (the first factor above), the OCC has traditionally relied on the Department of Justice ("DOJ") and its 1995 guidelines.[31]

There is no objective way to measure most of these factors, including competition, banks' future prospects, or the needs of the community. It is not even objectively clear that, for example, it is more or less risky having 95 percent, 85 percent, or 50 percent of total deposits concentrated in 5, 15, 50, or 100 banks. Moreover, regulators can block M&A activity based on any number of other subjectively determined criteria, including the failure to satisfy vague Community Reinvestment Act requirements.[32] Unsurprisingly, banks have rarely been happy with the M&A regulatory environment, not least because rules can change rapidly under

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[29] Stephen M. Miller, Vera Soliman, and Joe Brunk, "On the Historical Rise and (Recent) Decline in the Number of Banks," Mercatus Center Commentary, June 18, 2019, https://www.mercatus.org/economic-insights/expert-commentary/historical-rise-and-recent-decline-number-banks.

[30] The Bank Merger Act is section 18(c) of the Federal Deposit Insurance Act, 12 U.S.C. 1828(c).

[31] Jones Day, "OCC Proposal and Policy Statement on Bank Mergers Could Freeze the Banking Industry in Place," Insights, February 14, 2024, https://www.jonesday.com/en/insights/2024/02/occ-proposal-and-policy-statement-on-bank-mergers#:~:text=Under%20the%20Bank%20Merger%20Act,association%20must%20receive%20OCC%20approval..

[32] The U.S. Department of Justice evaluates mergers on several criteria, including "banks' record of compliance with the Community Reinvestment Act." Sarah Flowers, "The 10 Bank M&A Policy Reforms We Need Now, and Later," Bank Policy Institute, January 22, 2025, https://bpi.com/the-10-bank-ma-policy-reforms-we-need-now-and-later/; and, BPI Staff, "Breaking Down the Bank Merger Review Process," Bank Policy Institute, February 29, 2024, https://bpi.com/breaking-down-the-bank-merger-review-process/.

different political environments. For instance, in 2024, on the same day, the FDIC, the OCC and the U.S. Department of Justice (DOJ) announced changes to their bank M&A policies.[33] In 2025, the FDIC rescinded its changes.[34] This kind of process – issuing new rules that are soon rescinded – can occur under any future administration, under the same basic processes.

The banking industry needs a timelier and more transparent regulatory framework for M&A activity, but not merely to avoid creating a "barbell" structure or any other type of industry concentration. It needs a better system because relying on subjective criteria, as well as things like concentration ratios and geographic metrics, makes it more difficult for banks to serve customers. It also concentrates power in the federal government and creates a more fragile banking and financial sector. Banks face competition from other banks, as well as from fintech firms, online lenders, and other non-bank financial firms. They should be allowed to merge, enter, and exit as they see fit, to best compete and serve their customers.

Right Sizing Bank Regulation

During the first Trump administration, Congress passed the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (S. 2155) and issued new regulations to "tailor" the capital framework for large banks. The S. 2155 bill also included a community bank leverage ratio (CBLR), a measure designed to simplify "small" banks' capital requirements. The CBLR is available to any depository institution or depository institution holding company with total consolidated assets of less than $10 billion. While the provision does leave regulators some discretion, it generally deems any such "small" bank with a leverage ratio of between 8 percent and 10 percent to have met all its capital requirements.[35]

In addition to the discretion to define the ratio itself, S. 2155 authorizes federal banking regulators to disqualify "small" banks from using the CBLR based on the bank's "risk profile." The statute also specifies that the risk profile "shall be based on consideration of— (i) off-balance sheet exposures; (ii) trading assets and liabilities; (iii) total notional derivatives exposures; and (iv) such other factors as the appropriate Federal banking agencies determine

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[33] Davis Polk, "Key Takeaways From Bank Merger Policy Updates," Insights, September 23, 2024, https://www.davispolk.com/insights/client-update/key-takeaways-bank-merger-policy-updates; and, Office of the Comptroller of the Currency, "Business Combinations Under the Bank Merger Act," Federal Register, Final Rule, Vol. 89, No. 186, September 25, 2024, https://www.govinfo.gov/content/pkg/FR-2024-09-25/pdf/2024-21560.pdf; and Federal Deposit Insurance Corporation, "FDIC's Final Statement of Policy on Bank Merger Transactions," Supervisory Guidance, September 17, 2024, https://www.fdic.gov/news/inactive-financial-institution-letters/2024/fdics-final-statement-policy-bank-merger-transactions.

[34] Federal Deposit Insurance Corporation, "Statement of Policy on Bank Merger Transactions: Rescission and Reinstatement," Supervisory Guidance, May 20, 2025, https://www.fdic.gov/news/financial-institution-letters/2025/statement-policy-bank-merger-transactions-rescission-and.

[35] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Interagency Statement on the Community Bank Leverage Ratio Framework," December 21, 2021, https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-66a.pdf.

appropriate." According to the FDIC, as of 2024, approximately 1,700 insured depository institutions were CBLR banks (a bit under 40 percent of insured depository institutions).

Congress should expand the use of the CBLR. It could, for example, eliminate the risk profile provision that allows regulators to disqualify banks from the CBLR. Alternatively, it could eliminate the fourth provision, the one that allows regulators to determine whether other factors should disqualify a bank from using the CBLR. Or, if worried about these additional risk factors, Congress could increase the leverage ratio requirement for banks who have larger exposures to these risk factors. Of course, taking this last approach could ultimately defeat the purpose of simplifying banks' regulatory capital requirements. An alternative is a tiered requirement, providing more regulatory relief for banks who meet higher requirements.[36] Optimally, Congress would expand the use of a CBLR style "off-ramp" to all banks who meet a higher leverage ratio requirement.

More broadly, there is no shortage of ways to improve the capital framework for banks, regardless of their size. The existing system is grossly overcomplicated. It contains volumes of rules with mind-numbingly complex details, many of which are redundant. It includes ill-defined concepts such as reputational risk and operational risk that contribute no marginal benefit to the basic capital and liquidity rules. It has been cobbled together over decades by stacking new rules on top of old rules as new problems pop up, but regulators have rarely cleared the outdated provisions. It is true that banks now have more and higher capital requirements than they did in the past, but that change does not necessarily mean the system is better.

Higher capital requirements are costly and can create perverse incentives. Furthermore, higher capital does not automatically stabilize the financial system or prevent government bailouts. Although it seems to be forgotten, U.S. commercial banks exceeded their minimum capital requirements by 2 to 3 percentage points (on average) for six years leading up to the 2008 financial crisis. More recently, when SVB failed in 2023, its liquidity position was strong enough to meet more stringent liquidity rules required for larger banks. There simply is no guarantee that these provisions will prevent bank failures, so Congress and regulators should not treat them as such.

Regardless, there are many other ways that federal regulators could simplify (and improve) the existing system. For instance, the existing capital framework includes a standardized approach and an advanced approach. There is no need for two approaches. The existing framework includes a common equity tier 1 ratio, a tier 1 capital ratio, and a total

[36] Additional regulatory exemptions, based on higher ratios, could be provided for any number of regulations, including stress tests, the Truth in Lending Act (TILA), the Real Estate Settlement Procedures Act (RESPA), the Home Mortgage Disclosure Act (HMDA), and the Community Reinvestment Act (CRA). Norbert Michel, "Money and Banking Provisions in the Financial CHOICE Act: A Major Step in the Right Direction," Heritage Foundation Backgrounder No. 3152, August 31, 2016, https://www.heritage.org/markets-and-finance/report/money-and-banking-provisions-the-financial-choice-act-major-step-the.

capital ratio – there is no reason to have all three; one will suffice. The existing framework has a risk-weighted leverage ratio, a supplemental leverage ratio, and an enhanced supplemental leverage ratio – we can just pick one. The existing framework includes a stress capital buffer and a capital conservation buffer, figures that are added to the above-mentioned capital ratios. There is no need to have complicated buffers—if the capital ratio is too low, raise it.

Provided they maintain higher ratios for the largest banks (the so-called Global Systemically Important Banks, or GSIBs), then regulatory agencies can make these suggested changes without any new legislation. The framework would be much simpler and there's no objective reason this kind of simplification would weaken or destabilize the financial sector. Congress would do better, though, by starting over. The new requirements should include less regulatory discretion because regulators are in no better position than bank managers to deduce the correct treatment of specific asset classes or financial exposures. This principle applies to banks of all sizes, from the largest to the smallest.

Ultimately, Congress should not regulate banks and financial firms based on different principles. The goal should be to foster a more robust, diverse, dynamic financial sector that does not treat particular types of firms as special. One starting point would be to recognize that banks do not need more than one federal regulator. Because so many agencies are currently involved in regulating banks, it will be difficult to change the existing system. One approach that might work, though, would be as follows:

- Make the Office of the Comptroller of the Currency the federal regulator for all banks with more than $15 billion in assets.
- Make Fed district banks the federal regulator for banks in their districts with less than $15 billion.
- Remove the Consumer Financial Protection Bureau's examination authority.
- Remove the Federal Deposit Insurance Corporation's regulatory responsibilities and convert it to an agency that administers deposit insurance.
- Eliminate the Fed's Vice Chair of Supervision.

Congress could also reform the system by making the following changes:

- Eliminate the ability of federal regulators to use reputational risk in their examinations.
- Create a materiality threshold for all safety and soundness risks.
- Create a materiality threshold for all federal regulatory directives, such as Matters Requiring Attention.

- Transfer all regulatory authority for Bank Secrecy Act rules and regulations from the Fed and the OCC to the Financial Crimes Enforcement Network or the Federal Bureau of Investigations.

- Remove the concept of “abusive practices” from federal consumer protection statutes, reverting to the standard (time-tested) legal standards for “unfair” and “deceptive” practices.

Ultimately, Congress must uproot the notion that the federal government should plan, protect, and prop up the financial system. Fifteen years after the passage of the Dodd-Frank Act, the legislation stands not as a triumph of reform but as a case study in how sweeping legislation can miss the mark. Dodd-Frank was based on a mistaken belief that the 2008 crisis stemmed from unregulated financial markets. It spawned hundreds of separate rulemakings. It expanded the authority of existing federal regulators, created new federal agencies, and altered the regulatory framework for several distinct financial sectors. It imposed unnecessarily high compliance burdens, failed to solve the too-big-to-fail problem, and didn’t end bailouts. It also included many small provisions that had nothing to do with the 2008 financial crisis. Arguably, many of these provisions created a regulatory mess where none previously existed, and the Dodd-Frank Act itself should be uprooted.[37]

Federal Deposit Insurance Coverage Should Be Reduced

Throughout U.S. history, banking regulations have increasingly focused on risk management conducted by regulatory agencies rather than on disclosure and fraud prevention. Yet, the U.S. is one of only three developed countries with at least two banking crises between 1970 and 2010.[38] Although there were many banking problems prior to the 1900s, research suggests that harmful regulations caused at least some of those problems, and it appears that spillovers from banking panics to the rest of the economy were extremely limited.[39]

Nonetheless, Congress created FDIC deposit insurance in the 1930s after a wave of bank failures and sold the idea partly as needed to protect financially unsophisticated depositors from losing their money.[40] Bank failures increased from approximately 600 per year during the

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[37] Norbert Michel, “Fifteen Years of Dodd-Frank: A Legacy of Missed Targets and Regulatory Overreach,” Cato at Liberty, July 23, 2025, https://www.cato.org/blog/dodd-franks-15th-anniversary-not-much-celebrate.

[38] Norbert Michel and David Burton, “Financial Institutions: Necessary for Prosperity,” Heritage Foundation, April 14, 2016, https://www.heritage.org/markets-and-finance/report/financial-institutions-necessary-prosperity.

[39] George Selgin, “The Fable of the Cats,” Alt-M, July 6, 2021, https://www.cato.org/blog/fable-cats; George Selgin, “New York’s Bank: The National Monetary Commission and the Founding of the Fed,” Cato Institute Policy Analysis no. 793, June 21, 2016, https://www.cato.org/publications/policy-analysis/new-yorks-bank-national-monetary-commission-founding-fed; and Jeffrey Rogers Hummel, “The History of U.S. Recessions and Banking Crises,” Alt-M, October 22, 2015, https://www.cato.org/blog/history-us-recessions-banking-crises.

[40] Mark Calabria, “Deposit Insurance, Bank Resolution, and Market Discipline,” in *Prosperity Unleashed: Smarter Financial Regulation*, edited by Norbert Michel, Heritage Foundation, Washington, DC, 2017, https://www.heritage.org/markets-and-finance/report/deposit-insurance-bank-resolution-and-market-discipline.

1920s to more than 1,000 in 1930, and peaked near 4,000 per year by 1933 as depositors pulled gold out of banks in anticipation of President Franklin Roosevelt's eventual devaluation and abandonment of the gold standard.[41] Still, even in the worst year for bank failures, 1933, total losses represented just over 2 percent of total system deposits.[42]

With the Banking Act of 1933, Congress authorized the FDIC to pay a maximum of $2,500 to depositors of failed, insured banks, equal to less than $59,000 in 2023 dollars. Congress lifted coverage limits many times throughout the post World War II period, and the justification underwent subtle changes.[43] Congress increased the limit to $100,000 in 1980, where it remained until 2005, when Congress increased it to $250,000 for retirement accounts. With the 2010 Dodd-Frank Act, Congress extended the $250,000 limit to all transaction deposit accounts.[44] As mentioned above, the $250,000 limit is far above both the median account balance (approximately $5,000) and the average balance ($42,000). In fact, even most high-income families have balances well below the $250,000 cap. As of 2023, the average balance for the highest 10 percent of income earners was $229,000.[45]

Regardless of its original intent, FDIC deposit insurance has morphed into a federally backstopped funding mechanism, one mostly relied upon by smaller—at least, not the largest—banks.[46] The difference between the existing FDIC deposit insurance caps and the typical account balance reflects this reality—FDIC insurance is mainly a tool for banks to attract deposits, not for protecting the typical American.

For decades, the *safety and soundness* regulations imposed on U.S. banks have been justified by citing systemic-risk concerns (financial and macroeconomic stability), as well as the necessity of protecting the FDIC insurance fund.[47] The DIF is funded by an assessment on banks,

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[41] Calabria, "Deposit Insurance, Bank Resolution, and Market Discipline."
[42] Calabria, "Deposit Insurance, Bank Resolution, and Market Discipline."
[43] Federal Deposit Insurance Corporation, The History of the FDIC, FDIC 90 Years, https://www.fdic.gov/90years#:~:text=At%20its%20start%2C%20FDIC%20deposit,to%20%245%2C000%20effective%20July%201.
[44] Transaction accounts include checking, savings, money market, and call accounts. See Federal Reserve Board of Governors, "Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances," Federal Reserve Bulletin Vol. 100, No. 4 (September 2014), p. 16, http://www.federalreserve.gov/pubs/bulletin/2014/pdf/scf14.pdf (accessed March 15, 2016). Also see Christine M. Bradley, "A Historical Perspective on Deposit Insurance Coverage," FDIC Banking Review, December 2000, https://www.fdic.gov/bank/analytical/banking/2000dec/brv13n2_1.pdf (accessed March 15, 2016)
[45] Norbert Michel, "Fewer Than One Percent Of Accounts Are Above The FDIC Limit," Cato at Liberty, April 6, 2023, https://www.cato.org/blog/less-one-percent-accounts-are-above-fdic-limit.
[46] Long before the 1930s, small rural bankers and landowning farmers pushed for federal deposit insurance. Charles Calomiris and Matthew Jaremski, "Deposit Insurance: Savior or Subsidy?," Harvard Law School Forum on Corporate Governance, July 8, 2016, https://corpgov.law.harvard.edu/2016/07/08/deposit-insurance-savior-or-subsidy/.
[47] Prior to the 1990s, research showed that FDIC insurance subsidized risky loans and increased systemic risk. Alessandro Penati and Aris Protopapadakis, "The Effect Of Implicit Deposit Insurance On Banks' Portfolio Choices

and there is no doubt that at least some of that cost is borne by consumers. Moreover, taxpayers are responsible for any losses beyond the amount in the DIF, so there is no doubt that "government provided" does not equate to "free" deposit insurance (and is something of a misnomer because the fees charged to banks). As the SVB failure demonstrated, there is no doubt that the expectation of government backing, as well as the existence of taxpayer-backed deposit insurance, at least partially insulates banks from market discipline. It is Congress's responsibility to fix this problem, but it likely cannot do so if it leaves the SRE in place. There is also no doubt that FDIC deposit insurance crowds out private alternatives, ultimately reducing economic opportunities for people who would otherwise provide market-priced financial products to protect deposits. The banking sector would be more efficient and deliver more benefits to people if Congress would shrink the government footprint in the banking sector.

Unfortunately, some members of Congress and the administration seem inclined to expand FDIC coverage limits. Sens. Bill Hagerty (R-TN) and Angela Alsobrooks (D-MD) introduced an amendment to the National Defense Authorization Act, considered "must pass" legislation, that would increase FDIC deposit insurance limits to $20 million for noninterest-bearing transaction accounts at insured depository institutions with total assets less than $250 billion.[48] While it appears that the amendment has been withdrawn, the Senate Banking Committee will now hold a hearing on the issue (September 10th) and Treasury Secretary Scott Bessent indicated (in April) that he would support raising the coverage limits.[49] Naturally, banks will have to pay additional fees for this expanded coverage, and taxpayers will still (presumably) be responsible for any losses not covered by the DIF, so these costs will surely be passed on to consumers. The Taxpayers Protection Alliance estimates an increase in coverage of this size would require a one-time assessment of $30 billion for the FDIC to maintain its (statutorily required) reserve ratio, and annual premiums could soon rise to approximately $3 billion.[50]

Regardless of that nominal cost, FDIC deposit coverage, with unlimited government backing, comes with other costs. Indeed, the existing coverage scheme has long been used to justify the stringent regulations currently imposed on America's banks, much to the detriment of millions of taxpayers and consumers. Separately, research has overwhelmingly found that

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With An Application To International 'Overexposure'," Journal of Monetary Economics, Volume 21, Issue 1, January 1988, pp. 107-126, https://www.sciencedirect.com/science/article/abs/pii/0304393288900499.

[48] Senate Amendment 3649—119th Congress (2025-2026), https://www.congress.gov/amendment/119th-congress/senate-amendment/3649/text.

[49] Claire Williams, "Bankers Demand Deposit Fix While Fighting Over Price Tag," American Banker, August 25, 2025, https://www.americanbanker.com/news/bankers-demand-deposit-fix-while-fighting-over-price-tag.

[50] Dan Savickas, "Raising Deposit Insurance Limits Would Cost Consumers Over $30 Billion," American Banker, August 5, 2025, https://www.americanbanker.com/opinion/raising-deposit-insurance-limits-would-cost-consumers-over-30-billion.

modern deposit insurance encourages greater risk-taking, reduces market discipline, and reduces growth of the financial system, ultimately increasing instability in the banking sector.[51]

Another cost, though very difficult to quantify, is that the consistent expansion of FDIC coverage and backing gives the impression that a private financial industry cannot function on its own. Ultimately, this myth serves to protect the wealthiest depositors at the expense of everyone else, as evidenced by the ever-increasing push to expand coverage well beyond the typical depositor's balance.

Even if the current FDIC system is not expanded, it maintains perverse incentives in private markets and it crowds out the incentive to provide private deposit insurance. This crowding out weakens the overall economy by lowering people's economic opportunities, a problem that is difficult to measure. Yet, research shows that countries with more government involvement in a deposit insurance system, and with higher levels of deposit insurance coverage, tend to have more bank failures and financial crises.[52]

If Congress will not eliminate FDIC deposit coverage, it should at least reduce coverage to protect only those citizens most vulnerable to economic difficulties. Even if Congress reduced FDIC deposit insurance limits to the pre-1980 figure of $40,000 per account, the coverage limit would still be nearly 10 times the average transaction account balance. Regardless, Congress should shrink the role of the FDIC in both deposit insurance and bank resolutions. Doing so will remove both explicit and implicit government backing, fostering a more resilient financial sector.[53]

Conclusion

The current approach to bank regulation is exceedingly prescriptive and highly flawed. It provides a false sense of security because the government confers an aura of safety on all firms that play by the rules. The arrangement is problematic for three major reasons: (a) people take on more risk than they would in the absence of such rules, (b) people have lower incentives to monitor financial risks than they would otherwise, and (c) compared with other actors in the market, regulators do not have superior knowledge of future risks. Federal backing compounds these problems, so it is no surprise that the existing system has failed to prevent financial turmoil.

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[51] Calomiris and Jaremski, "Deposit Insurance: Savior or Subsidy?"; and Thomas L. Hogan and Kristine Johnson, "Alternatives to FDIC Deposit Insurance," The Independent Review, Vol. 20, No. 3 (Winter 2016), pp. 433-454, https://www.jstor.org/stable/24562166.

[52] Michel and Burton, "Financial Institutions: Necessary for Prosperity."

[53] David R. Burton and Norbert J. Michel, "Proposals to Foster Economic Growth and Capital Formation," Submission to U.S. Senate Banking Committee Ranking Member Pat Toomey, March 18th, 2021, https://www.banking.senate.gov/imo/media/doc/David%20Burton%20and%20Norbert%20Michel%20-%202021-3-18.pdf.

It is true that members of Congress will always be afraid to bail out any large company, but policies should not make doing so easier. Politics will always favor rescuing large companies and investors, but economics does not. At the very least, federal law should force political accountability for elected officials who decide to rescue large companies or investors, whether in the financial sector or otherwise.

As in other sectors of the economy, it would be better to base financial regulation on protecting individuals from fraud and violations of contractual rights, not prescriptive merit-based regulation or micromanagement of firms' activities. As with many previous federal bailouts, it is very difficult to see the SVB uninsured depositor bailout as anything other than a policy mistake that benefited a very small number of wealthy individuals. It would be a mistake to impose even more costs on Americans for Congress's mistake, whether directly with additional FDIC assessment fees or more regulation, one of which begets the other. Thank you for the opportunity to provide this information, and I welcome any questions that you may have.