Testimony of Nicholas J. Podsiadly
Partner, Jones Day
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hearing on
"Evaluating Perspectives on Deposit Insurance Reform"

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Chairman Scott, Ranking Member Warren, and Members of the Committee, thank you for the opportunity to discuss deposit insurance reform. My testimony today is my own. I am speaking today solely in my personal capacity and not on behalf of any client or my firm.

As the former General Counsel of the FDIC, I speak to bring perspective on policies that have been brought forward to expand the current coverage of deposit insurance following multiple bank failures in 2023. I welcome the opportunity to discuss proposals to expand deposit insurance and look forward to answering any questions from the Committee.

Background: FDIC Inception

Congress created federal deposit insurance in the Banking Act of 1933 (also known as the Glass-Steagall Act) to halt the depositor panics that had followed the 1929 market crash.[1] In the same Act, Congress established the Federal Deposit Insurance Corporation ("FDIC") as a temporary program insuring up to $2,500 per depositor. Congress subsequently made the FDIC permanent in the Banking Act of 1935 and later recodified its authority in the Federal Deposit Insurance Act of 1950.

Coverage limits have been raised repeatedly to keep pace with economic growth and inflation, as well as systemic risk: from $2,500 in 1934, to $5,000 later that year, then $10,000 in 1950, $20,000 in 1969, $40,000 in 1974, $100,000 in 1980, and ultimately to the current $250,000, starting in 2008, per depositor, per insured capacity.[2]

Post-Financial Crisis Period

The most significant recent expansion of the FDIC occurred during the 2008 financial crisis. The Emergency Economic Stabilization Act temporarily increased deposit insurance coverage to $250,000 per depositor.

Congress then enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), which brought the following additional changes:

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[1] See Section 8 of the Banking Act of 1933, amending Section 12B of the Federal Reserve Act to create the Federal Deposit Insurance Corporation. A Brief History of Deposit Insurance in the United States, FDIC.gov

[2] FDIC 90 Years

The Dodd-Frank Act:

- Made permanent the temporary $250,000 deposit insurance limit, which was first enacted during the crisis, and retroactively applied the expanded limit back to January 1, 2008.
- Provided temporary unlimited insurance coverage for noninterest-bearing transaction accounts at all FDIC-insured depository institutions from December 31, 2010 through December 31, 2012.
- Changed the method of calculating assessments from one based on domestic deposits to assessing premiums based on an institution's average consolidated total assets minus average tangible equity.
    - This shift placed a greater share of the assessment burden on larger banks that rely more heavily on non-deposit funding sources, effectively raising the costs more for more risk-taking institutions.
- Eliminated risk categories and debt ratings from the assessment calculations and instead used scorecards including financial measures that are predictive of long-term performance.
- Raised the minimum designated reserve ratio for the Deposit Insurance Fund ("DIF") from 1.15% to 1.35% of insured deposits, with the FDIC required to reach this target by September 30, 2020. The Act directed the FDIC to "offset the effect" of increased assessments on smaller banks (those with less than $10 billion in assets), ensuring that larger institutions bore most of the cost of rebuilding the fund after the crisis.
    - The FDIC currently projects sees its reserve ration as on track to reach the current statutory minimum of 1.35 percent ahead of the current deadline of September 30, 2028.[3]
- Eliminated the requirement that the FDIC pay dividends to insured institutions when the reserve ratio exceeded specified thresholds, allowing the fund to grow more robustly in anticipation of future crises.

Recent Changes Since 2023 Bank Failures

In March and May 2023, the failures of Silicon Valley Bank ("SVB"), Signature Bank, and First Republic Bank marked the largest U.S. bank collapses since the 2008 financial crisis.

In response, the FDIC, Federal Reserve, and Treasury Department took extraordinary steps to protect depositors and maintain financial stability:

- Systemic Risk Exception: For SVB and Signature Bank, the FDIC invoked the "systemic risk exception," allowing it to guarantee all deposits—including those above the standard $250,000 insurance limit. This was done to prevent broader panic in the banking system. For First Republic, all deposits were assumed by JPMorgan Chase, so a systemic risk exception was not required.
- Bridge Banks: The FDIC established bridge banks for SVB and Signature to ensure continued access to deposits and banking services while seeking buyers for the failed institutions.

[3] FDIC: Semiannual Update on Deposit Insurance Fund Restoration Plan

Despite these extraordinary measures, Congress did not raise the standard $250,000 per depositor, per insured bank limit. The expanded coverage in 2023 was temporary and applied only to the specific failed banks under the systemic risk exception.

At the time of the 2023 bank failures, many commentators noted the high rate of uninsured deposits held by SVB, Signature Bank, and First Republic Bank and argued that such high percentage contributed to the failure. At the year-end of 2022, SVB reported that 94 percent of its deposits were uninsured, while Signature's percentage of uninsured deposits was nearly 90 percent.[4] While not as high, approximately 68% of First Republic's deposits were uninsured.[5]

The 2023 failures prompted regulatory agencies to review and assess the deposit insurance framework and supervisory practices:

- The FDIC estimated significant losses to the DIF from covering uninsured deposits at SVB and Signature. To replenish the fund, the FDIC announced a special assessment on large insured banks.
    - The total estimated losses for the three large regional bank failures in 2023 was about $35.2 billion as of September 30, 2023.[6] The special assessment on the banking industry to cover the portion of the estimated losses attributable to uninsured deposits totaled $16.3 billion.[7] were recovered from the banking industry through a special assessment.
- The FDIC and other regulators began evaluating whether changes to deposit insurance coverage or structure were warranted, especially for business payment accounts and large, concentrated depositors.

The FDIC published a report in May 2023 outlining three options for deposit insurance reform:[8]

1. <u>Limited Coverage</u>: Maintaining the current deposit insurance framework, which provides insurance to depositors up to a specified limit (possibly higher than the current $250,000 limit) by ownership rights and capacities.
2. <u>Unlimited Coverage</u>: Extending unlimited deposit insurance coverage to all depositors.
3. <u>Targeted Coverage</u>: Offering different deposit insurance limits across account types, where business payment accounts receive significantly higher coverage than other accounts.

Congress has not yet adopted any one of these three reforms proposed by the FDIC.

[4] FDIC: Memorandum and Resolution on Request for Authority to Sue Six Former Officers and Eleven Former Directors of Silicon Valley Bank; Bank Policy Institute: What to do About Uninsured Deposits?

[5] Investopedia: How Much Of Regional Bank Deposits Are Not FDIC Insured?

[6] FDIC: Selected Financial Data

[7] Federal Register: Special Assessment Pursuant to Systemic Risk Determination

[8] FDIC Releases Comprehensive Overview of Deposit Insurance System; Options for Deposit Insurance Reform

Since the 2023 bank failures, the FDIC has maintained an emphasis on readiness and coordination to prepare for future stress on banks.[9]

- There is a new focus on regular internal reviews, after-action assessments, and tracking of corrective actions to improve the agency's ability to respond to crises.
- The FDIC is updating its internal frameworks and guidance to ensure that all divisions understand their roles in a large bank resolution and that resources (human and technological) are sufficient and well-coordinated.
- The FDIC is working to ensure that future resolutions can be handled efficiently and at the least possible cost to the DIF, with systemic risk exceptions reserved for truly extraordinary situations.

As part of its emphasis on readiness for future stress on banks, the FDIC issued a final rule[10] amending its resolution plan requirements for insured depository institutions (IDIs), particularly those with $50 billion or more in assets. The new rule creates two groups:

- **Group A:** IDIs with assets of $100 billion or more must submit full resolution plans every three years.
- **Group B:** IDIs with assets between $50 billion and $100 billion must submit limited informational filings every three years.

Both groups must submit plans every two years if they are affiliates of a Global Systemically Important Bank (G-SIB). The rule enhances requirements for demonstrating the ability to market the bank and its assets, provide timely key reports, and quickly establish a virtual data room for potential bidders in a resolution scenario. The definition of "key personnel" is expanded to include both staff and contractors.

The proposed legislation offered as an amendment to the Defense authorization bill earlier this year, would increase deposit insurance for operational accounts of up to $20 million held at institutions with consolidated assets below $250B. While this proposal has significant merits to prevent withdrawals at depository institutions, there are many questions that should be addressed before Congress authorizes the expansion of deposit insurance. Specifically, questions remain regarding the cost to the financial sector as a whole, potentially impacting the ability of financial institutions to offer credit given risk-based capital requirements. Further, there are significant questions as to whether asset thresholds included in the proposed legislation are sufficient given growth of the financial sector indexed to inflation. I welcome the opportunity to address these questions and thank the Committee for the opportunity to testify.

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[9] OIG Report: FDIC Readiness to Resolve Large Regional Banks

[10] FDIC Board of Directors Approves Final Revised Rule to Strengthen Resolution Planning for Large Banks