



## Insight

# Deposit Insurance: A Primer

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### Executive Summary

- Deposit insurance is a government guarantee that protects depositors against losses if their bank fails—and, foundationally, seeks to prevent bank runs at all.
- Calls to expand coverage reflect a concerning drift toward implicit guarantees that erode market discipline and increase systemic risk.
- If reform is deemed necessary, it should be limited, rules-based, and not rely on taxpayer support; principled expansion could include temporary guarantees for operational accounts during periods of systemic stress paired with enhanced risk-based premiums, transparency requirements, and stronger supervisory tools to preserve accountability and prevent moral hazard.

### Introduction

[Deposit insurance](#) is a foundational feature of the modern U.S. banking system. It is also increasingly a flashpoint for broader debates about risk, regulation, and moral hazard. Recent turmoil in the banking sector has led to calls from policymakers and pundits alike to expand the scope or scale of deposit insurance, in some cases dramatically. This primer reviews what deposit insurance is, traces its development in U.S. financial history, assesses recent legislative proposals to amend it, and explains why expansion—particularly toward unlimited coverage—is poor policy.

### What Is Deposit Insurance?

Deposit insurance is a government guarantee that protects depositors against losses if their bank fails – and, foundationally, seeks to prevent bank runs at all. In the U.S., this coverage

is provided by the Federal Deposit Insurance Corporation (FDIC), an independent agency created in 1933 in the aftermath of widespread bank runs during the Great Depression.

Today, the FDIC insures deposits at member banks up to \$250,000 per depositor, per insured bank, per ownership category. This limit in theory is not arbitrary—it is designed to protect the average American while preserving market discipline for large depositors who, in theory, have both the resources and the incentive to monitor bank risk.

To pay for this, the FDIC maintains an [insurance fund](#), paid for by premiums assessed on banks—not taxpayers (directly, at least). In the event of a bank failure, the fund is used to reimburse insured depositors. Uninsured depositors may receive partial recoveries through the resolution process, but they are not guaranteed.

By number of accounts, FDIC deposit insurance covers [99 percent](#) of all accounts in the United States. By dollar value, the 1 percent uninsured represents roughly [60 percent of the total](#).

## **A Brief History of Deposit Insurance in the United States**

Deposit insurance began as a confidence-building measure during a time of systemic crisis. Signed into law as part of the [Banking Act of 1933](#) (Glass-Steagall), it was never intended to eliminate all depositor risk—only to prevent self-reinforcing runs from imperiling fundamentally sound institutions.

In the decades since, Congress has raised the insurance limit multiple times: first, from \$2,500 in 1934 (about [\\$65,000 in today's dollars](#)) to \$100,000 in 1980 (during the [S&L crisis](#)); and eventually to \$250,000 in 2008 (as part of the [Emergency Economic Stabilization Act](#), in response to the global financial crisis).

Each increase has occurred under political pressure to reassure depositors in periods of acute stress, but the long-run effects of these changes have largely gone unexamined.

## **Recent Legislative Proposals to Expand Deposit Insurance**

The March 2023 [failures of Silicon Valley Bank and Signature Bank](#) reignited the debate over deposit insurance. Both institutions had unusually high levels of uninsured deposits—in some cases over 90 percent of their deposit base—concentrated among tech firms, startups, and crypto firms.

In response, the FDIC invoked the systemic risk exception to cover all deposits, including those above the insured limit, in an effort to contain contagion, or the perception of contagion. While legal under existing law, this move essentially backstopped large,

sophisticated depositors with public funds. In doing this, the Biden Administration essentially reversed the governing ethos of deposit insurance, which originally sought to protect only smaller depositors at fundamentally sound banks using funds raised from the banks themselves.

In the aftermath, lawmakers introduced several proposals seeking to codify this change in approach. Most recently, Senator Bill Hagerty (R-TN) [introduced legislation](#) aimed at establishing expanded FDIC insurance for all noninterest-bearing transaction accounts. Under this proposal, the FDIC would raise the guarantee on these accounts from \$250,000 to \$10 million. Hagerty positioned the measure as a market-stabilizing measure to prevent SVB-style bank runs, but critics argue it would further entrench the expectation of government backstops for large depositors. Few proposals have gained traction legislatively, but the political appetite for expanded coverage remains, particularly among constituencies who stand to benefit directly.

### **Why Expanding Deposit Insurance Is a Terrible Idea**

Calls to expand deposit insurance often stem from a desire to avoid financial instability. But such expansions come with significant policy risks, most of which fall into the categories of moral hazard, market distortion, and fiscal exposure.

#### *Moral Hazard*

Unlimited or substantially increased deposit insurance would eliminate one of the few remaining mechanisms of market discipline in banking: the incentive for large depositors to monitor bank risk-taking. Without this check, banks may face even fewer consequences for pursuing aggressive strategies, knowing deposit flight is less likely and public backstops are in place.

This effect is not hypothetical. The S&L crisis, the 2008 financial crisis, and the failures in 2023 all share a common thread: institutions with weak governance taking advantage of implicit or explicit guarantees.

#### *Competitive Distortions*

Expanding deposit insurance could favor certain business models—particularly large institutions with heavy reliance on uninsured funding—over smaller banks or fintechs with more diversified or insured funding bases.

In addition, firms that cluster large deposits in a few institutions (e.g., tech startups, venture capital funds) would gain disproportionate benefits, creating further incentives for

concentrated risk in the financial system.

### *Taxpayer Exposure*

While the FDIC fund is nominally industry-financed, any sharp increase in coverage would eventually lead to higher premiums, greater industry consolidation, or, in the extreme, a draw on taxpayer resources. The post-2008 [Transaction Account Guarantee](#) (TAG) program was temporary and paid for by premiums—but scaling such a program permanently would shift costs either to small banks or to the public.

Furthermore, perception matters: If depositors believe that all funds are insured in practice, even if not in law, the FDIC could face escalating political pressure to cover more in the next crisis, regardless of the fund's solvency.

### **What Principled Reform Could Look Like**

If policymakers conclude that some form of expanded deposit insurance is truly necessary—either to address structural vulnerabilities in transaction accounts or to limit contagion in future crises—then any reform should be targeted, temporary, and paired with strong guardrails to avoid broad-based moral hazard.

A principled approach would begin with clear delineation of purpose: The aim should not be to shield all depositors from all losses, but to prevent fire-sale dynamics that disrupt essential business operations. To that end, temporary, narrowly scoped coverage could be extended to operational accounts tied to payroll or vendor payments, much like the TAG program—but this time, subject to predefined triggers, strict time limits, and mandatory premiums that fully internalize the cost of protection.

Alternatively, Congress could authorize a standing resolution regime in which the FDIC, under limited conditions and with Treasury signoff, can temporarily guarantee specific classes of deposits during systemic events—but only if those guarantees are publicly disclosed, pre-funded, and sunset automatically after the crisis period.

In short, if reform is unavoidable, it should be done with a scalpel, not a sledgehammer—and always in ways that preserve accountability, minimize fiscal exposure, and reinforce the norms of depositor due diligence.

### **Conclusion**

Deposit insurance plays a vital role in financial stability, but its scope must be clearly limited and carefully designed. Calls to expand deposit coverage may be politically expedient during moments of market panic, but they threaten to erode the fundamental

tradeoff between risk and accountability in the banking sector.

Rather than papering over problems with bigger guarantees, policymakers should focus on supervisory rigor, resolution planning, and crisis tools that preserve confidence without socializing risk. Expanding deposit insurance is a seductive but ultimately misguided solution—far beyond a solution looking for a problem, most of these proposals represent the cure being worse than the illness.