

To hide the cost, the bill would raise premiums slowly—too slowly to cover major losses for 10 years.

Raising the FDIC Limit Risks Repeating the S&L Crisis

By Jeb Hensarling And Michael Solon

Government insurance programs are often tied to budget-busting bailouts and economic crises. But political pressures are again driving their expansion—and when these programs fail, taxpayers are left with the bill.

Washington's latest bad idea is the Main Street Depositor Protection Act, offered by Sens. Bill Hagerty (R., Tenn.) and Angela Alsobrooks (D., Md.) and endorsed by Treasury Secretary Scott Bessent. The bill would increase the Federal Deposit Insurance Corp. limit on all non-interest-bearing accounts from \$250,000 to \$10 million. But the change would apply only to midsize and community banks—not to global, systemically important banks. Smaller banks wouldn't have to pay the estimated \$42 billion for the increased insurance; the premium increases are largely shifted to bigger banks. Banks under \$10 billion in assets don't have to pay any additional premiums.

To hide the price shock from big banks inevitably passing the costs on to their customers, the bill would phase in higher deposit-insurance fees and increased required reserves over the course of a decade. Consequently, the FDIC's ratio of guaranteed deposits to reserves—a critical indicator of the fund's ability to protect taxpayers—would be dangerously distorted for 10 years.

We've seen this before. A similar lack of reserves prevented the shutdown of troubled savings-and-loan associations in the 1980s. Regulators lacked the resources in their insurance fund to close bankrupt S&Ls, forcing an era of "forbearance" when thrifts stayed open despite insolvency. It dramatically drove up the resolution cost of the S&L crisis from an estimated \$25 billion had the problem been addressed in 1983 to an actual cost of \$160 billion by the 1990s.

The newly proposed FDIC deposit hike resembles Congress's 1980 increase of the insured deposit limit from \$40,000 to \$100,000. In its review of the S&L crisis, the FDIC said the increase "added substantially to the potential costs of resolving failed financial institutions" and worsened the moral hazard problem. The increase Congress is now considering would be more than 160 times the size of the 1980 hike.

The 2008 financial crisis represents another infamous example of expanding liabilities without necessary capital. After Congress authorized the Department of Housing and Urban Development in 1992 to set affordable-housing goals, Fannie Mae and Freddie Mac repeatedly lowered credit standards. The mortgage assets held or guaranteed by Fannie and Freddie then grew from roughly \$1.1 trillion in 1992 to \$5.2 trillion by 2008. Despite skyrocketing portfolio risk, they never raised guarantee fees. When widespread subprime mortgage defaults began in 2007, Fannie and Freddie only held roughly 1.6% in capital and sustained combined losses of over \$100 billion in 2008 alone. They have remained functionally insolvent and under government conservatorship ever since.

Proponents of raising deposit insurance from \$250,000 maintain that "too big to fail" banks have a competitive advantage over smaller

financial institutions, where government bailouts are unlikely. But smaller banks have their own advantages. Under the Dodd-Frank Act, capital requirements for the largest banks are often 10% or more, compared with roughly 7% for smaller banks. Larger banks also face stress tests and other burdensome regulations that smaller banks don't.

With this legislation, regional and community banks will have deposit guarantees comparable to large banks but without similar capital and regulatory burdens. Does anyone believe Democrats won't eventually push similarly crushing regulations onto these smaller institutions? After the 2023 collapse of Silicon Valley Bank, Sen. Elizabeth Warren (D., Mass.) supported higher deposit-guarantee limits but only in return for more regulation.

The government is full of programs guaranteeing assets without imposing fees or premiums commensurate with risk. Flood insurance rebuilds the same house five times, and taxpayers are stuck with 60% of the premiums for federal crop insurance. When flooding happens or the crop fails, insufficient funds exist to pay claims. Government then passes emergency funding legislation to make up the shortfall. Federal regulatory power inevitably expands.

The same principles apply to federal deposit insurance. Increasing the level of insured deposits without imposing the actuarially sound insurance cost on the banks and businesses that benefit encourages reckless behavior. Federal and state laws would never permit any private insurer to operate as federal insurance programs regularly do.

Public insurance has become one of the most sustained sources of systemic risk in our economy. Congress shouldn't make it worse.

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