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IN FOCUS

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Bank Failures and the FDIC

This In Focus provides an introduction to the Federal Deposit Insurance Corporation's (FDIC's) process for resolving failing FDIC-insured banks. It also identifies policy issues Congress may consider related to the recent failures of two large banks in 2023—Silicon Valley Bank (SVB) and Signature Bank (SB).

Overview of Bank Failures

Banks fail for many reasons, although most trace back to the management of bank resources, resulting in a bank's inability to meet liquidity or capital requirements. Liquidity is the ability of a bank to meet cash flow needs, including deposit withdrawals by its customers. Capital (equity) is the difference between assets and liabilities. A bank's capital helps absorb losses on loans, securities purchased by the bank, and other assets while the bank remains solvent. When a bank's capital situation deteriorates such that it fails to meet minimum regulatory standards, the bank's primary federal regulator is required to take prompt corrective action (PCA). Regulators typically issue a PCA letter advising the bank on specific actions it must take to restore itself to financial health. When a critically undercapitalized bank fails to meet PCA requirements, its chartering agency will typically close the bank. By law, the FDIC is appointed receiver.

Bank Failures, 2001-2020. There were 561 bank failures between 2001 and 2020 (see **Table 1**). The failed banks collectively held $721 billion in assets and $522 billion in deposits. In nominal dollars, the largest bank failure in U.S. history was Washington Mutual Bank in 2008 with $307 billion in assets and $188 billion in deposits. Most depository institutions that failed were relatively small banks, with a large majority having less than $1 billion in deposits. Not all banks fail after becoming distressed—the number of problem banks identified by the bank regulators reached a high of 884, representing $390 billion in assets at the end of 2010.

In response to the bank failures between 2007 and 2010 and the related financial crisis, the Dodd-Frank Wall Street and Consumer Protection Act in 2010 (P.L. 111-203) was enacted to reform the financial regulatory system. The act permanently increased the deposit insurance limit from $100,000 to $250,000. Subsequently, in 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (P.L. 115-174) was enacted, providing banks regulatory relief from certain requirements.

Bank Failures, 2021-2023. There were no bank failures in 2021 or 2022. The two bank failures in 2023—SVB and SB—collectively held $319 billion in assets and $264 billion in deposits (see **Table 1**). The second-largest bank failure in U.S. history was SVB, with $209 billion in assets and $175 billion in deposits. SB had $110 billion in assets and $89 billion in deposits when it failed. The number of problem banks as of Q3 2022 was 39, with combined assets of $47.5 billion.

Deposit Insurance Fund (DIF). Deposit insurance guarantees repayments of deposits at a bank up to the statutory insured limit, $250,000. It is intended to protect depositors, prevent bank runs, and reduce the risk of systemic failure of the banking system. Banks pay deposit insurance premiums to the FDIC, which maintains the DIF to meet its obligations of insuring deposits and resolving failed banks. Since the start of federal deposit insurance in 1934, all depositors have been made whole up to their insured limits after bank failures.

Table 1. Bank Failures 2001-2023

	Bank Failures	Assets (in billions)	Deposits (in billions)
2001-2020	561	$721	$522
2021-2023	2	$319	$264

Source: CRS with data from FDIC, *Bank Failures in Brief*.

Notes: As of March 22, 2023.

The FDIC deposit insurance is backed by the full faith and credit of the United States through a line of credit with the U.S. Treasury. While the DIF was funded to its statutory limit before the last financial crisis, bank failures rapidly depleted it during the crisis. The DIF balance was at its lowest at the end of 2009 with a negative balance of $20.9 billion. Through regular bank assessments the FDIC has increased the DIF to $128.2 billion as of December 2022. The fund has remained largely self-financed with some borrowings from the Treasury. As of year-end 2022, the FDIC insured deposits of nearly $10 trillion at 4,715 banks. Total deposits at the end of 2022 were over $19 trillion—with FDIC insuring nearly 50% of all deposits.

Overview of the Resolution Process

As receiver of a failed bank, the FDIC evaluates all possible resolution alternatives and selects the one that is least costly to the DIF, per statute, unless the systemic risk exception (described below) is invoked. Typically, uninsured depositors, creditors, and shareholders are not protected against losses in order to meet the least cost requirement. The FDIC normally uses two main resolution methods: (1) purchase and assumption transactions and (2) deposit payoffs. Another method, bridge banks, is a type of resolution method the FDIC has used on a limited basis to resolve large or complex failing banks.

Purchase and Assumption Agreement (P&A). The most commonly used resolution method is the P&A with an acquirer. The FDIC seeks bids from qualified bidders for the failed bank's assets and the assumption of deposits and accepts the bid that is judged least costly to the DIF.

Bridge Banks. In a bridge bank P&A, the FDIC initially acts as the acquirer and receiver until the bank is marketed to external parties. The FDIC may establish a bridge bank to resolve a large or complex failing bank in which more time is needed to find a buyer. By law, a bridge bank is initially chartered for two years, with optional one-year extensions for three more years. The FDIC used bridge banks on a limited basis during the last financial crisis.

Deposit Payoffs. If no viable P&A acquiring institution (AI) can be found, then the FDIC typically deploys a deposit payoff. In a deposit payoff, the FDIC ensures that the customers of the failed institution receive the full amount of their insured deposits. The FDIC retains the assets of the failed institution in its capacity as receiver. The assets are eventually sold to maximize the recoveries to the DIF, uninsured depositors, creditors, and owners.

Deposit Insurance National Bank (DINB). If there are no viable AIs and the FDIC determines that a deposit payoff would be disruptive to the community and financial markets, then the FDIC might use a DINB to resolve a failed bank. In a DINB, the FDIC establishes a new national bank with a charter from the Office of the Comptroller of the Currency. By law, a DINB charter can be as long as two years, with optional one-year extensions for three more years, but in practice the FDIC typically charters a DINB with limited life and surrenders the charter within a few weeks. A DINB resolution allows failed-bank customers a brief period to move their deposits to other banks. The bank has no capitalization requirements. The FDIC retains all of the assets in its capacity as the receiver to eventually sell them.

Loss Sharing Agreements. While the FDIC can enter into loss sharing agreements whenever it sells the assets of a failed bank to minimize the cost to the DIF, it has often been used with P&A transactions. Based on the P&A, the AI may purchase a majority, if not all, of the assets and assume all or some of the deposits and certain other liabilities of the failed bank or from a bridge bank. With loss sharing agreements, the FDIC agrees to absorb a portion of the losses on the sale or the write-downs on the value of loans.

Recent Failures and Policy Issues

The California Department of Financial Protection and Innovation closed SVB on the morning of Friday, March 10. The New York State Department of Financial Services closed SB on Sunday, March 12. Typically, banks are closed on Friday evenings. During the last financial crisis, most of the failed banks were purchased by an AI; neither SVB nor SB initially had AIs.

Arguably, the banking regulators did not anticipate the speed at which the conditions at these banks would deteriorate or the potential systemic issues. When SVB was closed, the FDIC initially created the Deposit Insurance National Bank of Santa Clara. It would have paid each depositor that qualified up to the insured limit of $250,000. Initially, the uninsured depositors would have been issued receivership certificates for the remaining balance of their deposits. Eventually, the uninsured depositors would have received dividends in different tranches as compensation when the FDIC sold the bank's assets. Subsequently, the FDIC transferred all deposits and substantially all assets of the Deposit Insurance National Bank of Santa Clara to Silicon Valley Bridge Bank, N.A. Likewise, the FDIC created a bridge bank for SB, transferring all deposits and substantially all assets to Signature Bridge Bank, N.A.

On Sunday, March 12—with the failure of SB—the FDIC, Federal Reserve, and Treasury Secretary, after consultation with the President, determined that systemic risk existed that could potentially have adverse economic conditions or affect financial stability and decided to guarantee uninsured deposits under the systemic risk exception to least cost resolution—enacted in the Federal Deposit Insurance Corporation Improvement Act of 1991 (P.L. 102-242).

Deposit Insurance. There has been much discussion surrounding how deposit insurance should be used in the event of additional bank failures. One policy question is whether Congress should give all deposits in the United States insurance coverage or whether it should be limited. Another issue widely discussed surrounds whether failing banks of smaller size, including community banks, will be temporarily provided the systemic risk exception to provide guarantee of all deposits.

Monitoring and Examination of Problem Banks. The total number of problem banks and their collective assets is regularly published in the Quarterly Banking Profile (QBP) by the FDIC. When FDIC published its latest QBP in 2023, based on Q3 2022 information, it reported 39 problem banks with collective assets of $47.5 billion. Based on the amount of assets reported at the end of September 2022, bank regulators did not consider SVB and SB problem banks. This was also the case when Washington Mutual Bank failed in September 2008.

Arguably, the issues surrounding the bank failures in 2023 evolved quickly, but some of the underlying issues existed even five years ago. In a report published by the Financial Stability Oversight Council in 2018, among medium-size banks, SVB had the highest percentage of uninsured deposits at nearly 80%. It had nearly $44 billion in total deposits in March 2018, and the deposits grew to $175 billion by March 2023—nearly a fourfold increase.

As a consequence of these recent failures, questions have arisen surrounding the large bank regulatory regime created in the first two decades of this century and how they should be tailored to address the systemic risks posed by medium-size banks, not just the largest banks.

For more information, see CRS Insight IN12125, *Silicon Valley Bank and Signature Bank Failures*, by Andrew P. Scott and Marc Labonte; and CRS In Focus IF10035, *Introduction to Financial Services: Banking*, by Raj Gnanarajah and Andrew P. Scott.

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