



The CARES Act (P.L. 116-136) Section 4008: FDIC Bank Debt Guarantee Authority

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Section 4008 of the [Coronavirus Aid, Relief, and Economic Security Act](#) (CARES; P.L. 116-136) authorizes the Federal Deposit Insurance Corporation (FDIC) to guarantee certain deposits that are not eligible for regular FDIC deposit insurance due to the existing \$250,000 per account insurance limit. This broadens FDIC authority from Section 1105 of P.L. 111-203 (Dodd-Frank Act) to establish a [program that would guarantee bank debt](#) in the event of a financial liquidity crisis. Section 4008 also preemptively grants the requisite congressional approval for any such program needed to respond to the COVID-19 outbreak, provided the FDIC guarantee terminates no later than December 31, 2020. This Insight provides an overview of FDIC guarantees and Section 4008.

General Background

To [banks](#), deposits and debt are liabilities that place inflexible repayment obligations upon them. If an event occurs that causes depositors or creditors to doubt the banking industry's health—such as a financial crisis or the prospect of widespread loan defaults due to a pandemic—they may have an incentive to withdraw their funding. Because banks face a [liquidity mismatch](#) wherein their assets' value depends on long-term repayment and their liabilities are relatively short term, this incentive may cause otherwise healthy banks to fail to meet their obligations. Put simply, depositors and creditors would not be able to get their money back. This prospect can cause panic and bank runs.

Traditional bank runs saw depositors withdraw money from their bank accounts en masse. In a self-fulfilling prophecy, fear of bank failures caused banks to fail. A number of laws, regulations, and government programs have been implemented to address this problem. Notably, in response to the widespread bank failures during the [Great Depression](#), in the Banking Act of 1933 (P.L. 73-66), Congress created the government-backed FDIC to insure deposits up to a limit of \$2,500. The statutory limit has been raised over the years, mostly recently by Dodd-Frank. Currently, it is [\\$250,000](#) per depositor, per bank. With this government guarantee, there has been little incentive for depositors to run.

While government guarantees for banks protect individuals and businesses from losses, they present potential challenges. One is that they potentially expose the government, and thus ultimately taxpayers, to losses. In addition, guaranteeing bank liabilities may create [moral hazard](#), wherein banks take on more

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risk than they otherwise would, because their depositors and creditors have less incentive to monitor bank riskiness. To limit potential losses and moral hazard, the deposit insurance limit is capped. Raising this cap could increase the probability that moral hazard occurs.

The 2008 Financial Crisis and Dodd-Frank

The 2008 financial crisis revealed issues that caused some to raise concerns about aspects of existing government guarantees. For example, the deposit insurance limit, while sufficient to protect most individuals' accounts, did not cover deposit amounts in business checking accounts, local government accounts, and other non-interest bearing transaction accounts that exceeded the insurance limit. Moreover, financial panic during this crisis caused a [different kind of run](#), wherein creditors withdrew funding from certain debt markets.

At the onset of the crisis, FDIC was required to abide by a [least-cost resolution](#) standard and did not have authority to guarantee bank debt or deposit amounts over the limit. However, Section 141 of the Federal Deposit Insurance Improvement Act of 1991 (P.L. 102-242) granted an [exception](#) to the least cost resolution requirement to address failures that could pose "[systemic risk](#)" (i.e., risk to the entire financial system). The FDIC used this exception to create the [Temporary Liquidity Guarantee Program](#) (TLGP) in October 2008. The program expired on December 31, 2012. TLGP had two parts: the Transaction Account Guarantee (TAG) program and the Debt Guarantee Program (DGP). TAG provided no-limit deposit insurance for non-interest bearing transaction accounts to banks that chose to join the program for an additional assessment fee. DGP fully guaranteed newly issued bank debt.

Dodd-Frank included provisions related to those programs. Section 343 expanded the coverage of TAG to all depository institutions, not just those that voluntarily joined, and set a mandatory expiration date for the program of December 31, 2012.

The precrisis authority the FDIC relied on did not explicitly envision a debt guarantee. Section 1105 explicitly authorized the FDIC to guarantee bank debt during a liquidity crisis, but established procedures that the FDIC, the Federal Reserve, and the Treasury must follow before such guarantees could be issued. Among those procedures was a requirement that Congress pass a joint resolution of approval of the guarantee program, including the maximum allowable amount of debt guaranteed. In addition, the law as enacted did not allow a debt guarantee program to cover deposits.

Thus, at the onset of the COVID-19 outbreak, the FDIC did not have specific authority to guarantee deposits beyond the insurance limit, such as those in large, non-interest bearing transaction accounts.

COVID-19 and the CARES Act

In response to the COVID-19 outbreak, individuals and businesses have significantly reduced economic activity, potentially inflicting unanticipated losses on banks and conceivably causing a liquidity event. The [Fed has responded](#) by using [its legal authorities](#) to implement a number of programs ready to provide liquidity to financial markets. In addition, the Fed, FDIC, and other depository regulators [have taken a number of actions](#) to provide guidance to and temporarily reduce regulatory burden on the banking industry.

As part of Congress's response to COVID-19, Section 4008 of the CARES Act expands the FDIC authority to guarantee bank liabilities through two measures. One, it allows a FDIC debt guarantee program authorized under Section 1105 of the Dodd-Frank Act to back non-interest bearing transaction accounts. Two, it preemptively grants the necessary congressional approval for such a program up to any limit, provided the FDIC's guarantee terminates no later than December 31, 2020. In addition, it grants the National Credit Union Administration—the agency that insures credit unions—the authority to

increase their insurance limit on non-interest bearing transaction accounts to any amount, provided the increase terminates no later than December 31, 2020.

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