



**Many Banks and Thrifts Overly
Reliant on “Hot Money” Deposits:
Why an FDIC Coverage Increase to \$250,000 May Not Stop
Bank Runs and Could Cause Other Collateral Damage**

Submitted by
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to
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Many Banks and Thrifts Overly Reliant on “Hot Money” Deposits: Why An FDIC Coverage Increase to \$250,000 May Not Stop Bank Runs and Could Cause Other Collateral Damage

Many banks and thrifts in the United States may be overly reliant on “hot money” deposits — those prone to rapid shifts in response to concerns about bank safety or changing market conditions.

New legislation passed this week by the Senate to raise the limit on FDIC coverage to \$250,000 could help stabilize a portion of these deposits. However, many institutions dependent on hot money could continue to be vulnerable to panicky withdrawals, particularly by individuals and institutions with accounts larger than \$250,000.

We are pleased to see that Congress recognizes the urgency and importance of fortifying safety nets like the FDIC, as discussed in our white paper submitted to Congress last week, [*Proposed \\$700 Billion Bailout Is Too Little, Too Late to End the Debt Crisis; Too Much, Too Soon for the U.S. Bond Market*](#). However, we feel that the legislation to raise FDIC coverage carries serious risks and that other, less risky, measures can be taken to help reduce the possibility of bank runs.

Our analysis, based on second quarter Call Reports recently released by the FDIC, shows that:

- Among 7,689 reporting banks, total deposits are \$6.09 trillion. Of these, \$1.06 trillion, or 17.43%, are deposits in accounts exceeding \$100,000, considered “hot money.”
- In addition, these banks also have \$264 billion, or 4.33% of the total, in insured brokered deposits.¹ These can also be volatile, because, unlike deposits gathered in each bank’s local community, they are acquired through intermediaries from depositors around the country that have historically tended to be less loyal and more likely to shift institutions.
- In sum, banks are dependent on \$1.32 trillion in hot money deposits, representing 21.76% of their total deposits; and many individual institutions are significantly more reliant on hot money than the overall industry.

We also analyzed the second quarter data from the Thrift Financial Reports recently released by the Office of Thrift Supervision and found that the reliance on hot money in the S&L industry is even greater than among banks:

¹ In order to avoid double counting, the brokered deposits cited here exclude those with starting amounts exceeding \$100,000.

- Among 829 reporting thrifts, total deposits in non-retirement accounts are \$928 billion. Of these, \$331.3 billion, or 35.7%, is in accounts exceeding \$100,000.²
- Another \$129.5 billion, or 13.96% is in fully insured brokered deposits.³
- In total, the thrifts are dependent on \$460.9 billion in hot money deposits, representing 49.66% of the total, with many individual institutions more reliant on hot money than the industry as a whole.

Data is not available regarding the proportion of hot money deposits that are in accounts affected by any new legislation — those exceeding \$100,000 but less than \$250,000. Moreover, it is quite possible that institutional deposits over \$250,000 are primarily responsible for recent bank runs, such as experienced by Washington Mutual and Wachovia Bank in September.⁴ Therefore, it is uncertain whether raising the FDIC coverage limit to \$250,000 will make a significant difference in stemming major bank runs that can destabilize the banking system.

At the same time, the risks of raising FDIC coverage limits are well recognized. The higher limits could cause:

1. A potentially destabilizing impact on competing savings vehicles and institutions that do not enjoy similar federal insurance or federal government guarantees, such as
 - Commercial paper issuers, many already suffering an acute liquidity squeeze;
 - Money market funds invested in commercial paper and other non-government instruments, some of which were the source of panic in the credit markets when their asset value fell below \$1 last month;
 - Insurers offering cash-value annuities and life policies that often enjoy lesser guarantees from poorly funded state guarantee associations; as well as
 - Stock brokerage accounts, for which SIPC cash coverage limits are still \$100,000.
2. Far greater liabilities for the FDIC and the U.S. Treasury at a time when government resources are scarce, the ability of many banks to pay higher premiums is greatly reduced, and the risks of high loss ratios are extremely high.

² These figures exclude retirement accounts.

³ As with the banks, to avoid duplication, this figure includes strictly fully insured brokered deposits.

⁴ The outflow of institutional money has also been the primary factor that has historically triggered most failures of large financial companies in recent decades, including the failure of the Bank of New England in and the freeze at large life and health insurers in the early 1990s such as Executive Life of California and Mutual Benefit Life of New Jersey.

3. An incentive to depositors and depository institutions to take more risks and engage in greater speculation despite the fact that past speculative excesses are known to be one of the root causes of the current financial crisis.

Therefore, we believe Congress should:

1. Carefully review the potential collateral damage to competing industries that may be caused by jumping the FDIC's coverage limit from \$100,000 to \$250,000.
2. Seriously consider either (a) postponing the change until relevant data can be collected and/or (b) raising the coverage more modestly.
3. Establish formal procedures for guiding consumers to reputable sources of bank ratings or other independent research to help them make more informed, prudent decisions. Few consumers know where or how to find that information. Consequently, rather than making the rational decision of shifting to stronger institutions deserving of their trust, many could make the irrational choice of pulling their funds out of the banking system entirely.
4. Greatly expand FDIC staff to ensure prompt reimbursement of insured depositors. Currently, the FDIC is hiring a relatively small number of additional examiners and others. However, if the staffing needed for the savings and loan crisis of the 1980s is any guide, the FDIC's current human resources may be vastly inadequate.
5. Fortify other safety nets, including the Securities Investor Protection Corporation (SIPC) and the state guarantee associations that cover insurance policyholders.⁵

Conclusions

Former Treasury Secretary Lawrence Summers, speaking in opposition to a proposal to double FDIC insurance limits in 2000, stated that "such an increase would be ill-advised and would represent a serious policy error that could increase systemic risk by eroding market discipline." Former Federal Reserve Chairman Alan Greenspan agreed, saying that most economists considered prior coverage increases to be "a bad mistake," and that any new proposal to do so would also be "a major policy mistake."

Similarly, we believe the current proposal to increase the FDIC coverage limit is yet another rush to judgment by policymakers lacking the critical data needed to support prudent decisions for the benefit of the economy as a whole.

⁵ For more details, see [*Proposed \\$700 Billion Bailout Is Too Little, Too Late to End the Debt Crisis; Too Much, Too Soon for the U.S. Bond Market*](#)