"The Federal Deposit Insurance Act"
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The first banking act of a Congress of the United States was passed just one hundred sixty years ago with the chartering of the first Bank of the United States, which was approved by George Washington in February, 1791. The purpose of this bank was to aid public and private credit, there being only three other banks in existence in the nation when it was chartered. The bank operated until its charter expired in 1811.

The War of 1812 took place between the dissolution of the first Bank of the United States and the chartering of the second Bank of the United States in 1816. During this period about one hundred twenty state banks were chartered, and the government was forced to rely upon these state banks for financial aid during the war. The suspension of specie payments by most of the banks, in 1814, almost paralyzed the operations of the Treasury.

The Congress chartered the second Bank of the United States in 1816 in an effort to restore an orderly currency. This bank met various difficulties, largely attributable to management, and the conduct of branch operations in various cities throughout what then constituted the nation. As the expiration for its charter neared, President Andrew Jackson waged bitter opposition to the institution, and its charter was not renewed when it expired in 1836. When the second Bank of the United States went into liquidation there were seven hundred thirteen other banks in the country, and thereafter this number continued to expand.

The colonists, generally, regarded a bank as primarily a source of some type of currency. The inclination to think of banking in the terms of a medium of furnishing notes for circulation persisted long after evolution of our modern banking was well under way. During the early stages of bank development, the bank deposits of the nation were mainly confined to the larger cities and the use of checks against bank deposits as a circulating medium did not ordinarily extend outside the city of deposit. Consequently, when a business man operating in one city had dealings with one in another city, the funds which passed between them were usually transferred by their banks in the form of drafts. These drafts eventually had to be settled for in money, creating an expense that resulted in the imposition of exchange charges. Actually, rates of exchange existed between various major money centers in this country in its early days in virtually the same manner that such rates still exist between nations today. As a result of this interbank or intercity business, the larger banks found less occasion to issue circulation than did the country institutions, and a considerably smaller proportion of their liabilities was in circulating notes than was the case in the outlying banks.

Up to 1863 there had been many and various plans for securing or protecting the outstanding notes of banks. Some of the devices resorted to placed a limitation upon the liabilities of the bank measured by its capital funds. This was the case in connection with each of the first two banks chartered by Congress.

The Free Banking system established in New York in 1838 produced the first circulating notes secured by state bonds. To use the words of Professor Dunbar, in one of his essays, "The free banking system with provision for a bond secured note issue was followed in other states in such rapid succession in the latter fifties as to suggest the probability that had not the normal course of development been interrupted, the system might have become general." However, prior to the Civil War, it was only in the strong banks of the east that such notes were more than what might be termed mere local credit. One writer in 1863 described the nation as separated by diverse systems of currency which were bounded by state lines, and as widely variant as those of the principalities of Europe.

The notes of banks in some states were in such disrepute that they became known as shinplasters, wildcats, red dogs, and stumptails. These notes were mixed indiscriminately with those of New York and Boston banks which were maintained on a par basis. The inevitable result was confusion. This chaotic state of financial affairs, while causing tremendous loss throughout the country, also became a serious impediment to the development of the nation in its efforts to spread out to the west and to the south from the comparatively well populated and financially established northeast.

The problem of regulating circulation and protecting the holders of bank notes occupied the attentions of law makers and those connected with bank supervision and bank operation, more than did the welfare of depositors, until well into the twentieth century. Depositors were not entirely ignored, but it was generally felt that they had the option of selecting the banks in which they deposited their funds, whereas circulating notes in many instances had to be accepted by persons located far from the issuing bank, most of whom knew nothing about the affairs or the stability of the issuing banks.

In 1863, Congress passed the National Bank Act, for the stated purpose of providing a national currency, secured by a pledge of United States securities, and providing for the circulation and redemption thereof. This authorized the chartering of national banks which would serve as a vehicle for creating and servicing the national currency. The National Bank Act perfected the various previous efforts to protect the holders of bank notes and provided a safe and uniform currency for the entire nation. It was followed within a short time by a federal tax on the circulation of state banks which gradually drove the notes of those banks out of existence. None of the latter were issued after 1894.

Inasmuch as the issuance of national bank notes was dependent upon the holding of United States securities, this medium for creating currency did not prove to be sufficiently flexible, and in the panic of 1907 clearing house certificates were brought into use for a time as currency. Accordingly, one of the purposes of the Federal Reserve Act in 1913 was to provide an elastic currency. The issuance of the national bank notes was not discontinued until 1935. Very few of them are still outstanding and Federal Reserve notes now constitute practically all of the paper currency of the nation. This medium of providing and regulating the national currency has proved to be both safe and adequate.

The first legislative plan which embodied protection to depositors was the Safety-Fund Banking System inaugurated in New York in 1829. This provided for a special fund to guarantee all the debts of the banks. The inclusion of deposits may have been inadvertent and unintended, however, for when the system broke under the strain of the 1837 panic, the legislature amended the law to cover only losses arising from note issues. It was about this time that deposits had begun to give some inkling of their ultimate importance as a currency of the country.

Vermont, Indiana, and Michigan set up guaranty plans from 1831 to 1836. These plans included all bank liabilities. They were for the most part successful, but passed out of existence when the member banks went into the national system to escape the prohibitive tax on circulation.

Toward the end of the nineteenth century bank deposits had gained considerable preponderance over circulating notes, and the need for some form of deposit protection was becoming evident. Four bills for that purpose were introduced in the House of Representatives in 1886, and fourteen more were introduced in Congress before the turn of the century. In the 60th Congress, following the 1907 panic, about thirty proposals for deposit insurance were made. For the most part these bills were intended for national banks, and all failed of passage.

In the ten years beginning with 1907 deposit guaranty funds were set up in eight states, but these failed because of the large number of bank closings that led up to the 1933 banking holiday.

When the Federal Reserve System was created in 1913, a deposit guaranty was given consideration, but was eliminated from the final legislation. It took the banking crisis of 1933 to produce federal deposit insurance.

Temporary federal deposit insurance was provided by the Banking Act of 1933, in an amendment to the Federal Reserve Act, approved by the President on June 16, 1933. On June 16, 1934, legislation was passed extending the temporary insurance fund to July 1, 1935, and increasing individual deposit coverage from $2,500 to $5,000. On June 28, 1935, the temporary fund was again extended, this time for two months, to permit the completion of legislation providing for a permanent plan, finally approved August 23, 1935, as a part of the Banking Act of 1935. Legislation enacted August 5, 1947, called for repayment by the Federal Deposit Insurance Corporation of its original capital, held by the Treasury and the Federal Reserve banks, and authorized the Corporation to borrow up to three billion dollars from the Treasury. On September 21, 1950, a separate Federal Deposit Insurance Act, incorporating a number of changes in the previous law, was enacted.

In 1800 there were only twenty-eight banks in the country. When the National Bank Act was passed in 1863 there were about fifteen hundred state banks. By 1900 the nation had over ten thousand banks with two hundred sixty-five million dollars of circulation outstanding, and more than eight billion five hundred million dollars in deposits. The number of banks rose to more than thirty thousand in 1921. June 30, 1933, found only fourteen thousand six hundred twenty-four banks open. These banks had forty-one billion, five hundred million dollars of deposits, and seven hundred thirty million dollars circulation outstanding. The year 1950 closed with thirteen thousand, six hundred forty insured commercial banks having deposits of one hundred sixty-seven billion, eight hundred million dollars, and no circulation.

The failures of banks in the years leading up to 1863 were many. No complete or accurate tabulation of the losses to noteholders and depositors seems to have been made, but they must have been staggering.

During the years from 1865 through 1920, losses to depositors in closed banks amounted to two hundred sixty-nine million dollars. From 1921 through 1933 they shot up to one billion, nine hundred million dollars. From January 1, 1934, through May 12, 1944, the losses suffered by depositors in closed insured banks were estimated at one million, eight hundred sixty-five thousand dollars. Since May 12, 1944, not a single dollar has been lost by any depositor in a closed insured bank.

From January 1, 1934, to January 1, 1951, the Federal Deposit Insurance Corporation gave financial assistance to four hundred fifteen banks. These banks had one million, three hundred fifty-four thousand accounts, and five hundred thirty-three million, four hundred thousand dollars in deposits. By merger process, the Corporation arranged for full payment of the deposits in one hundred seventy of the banks with nine hundred seventy-one thousand depositors, and four hundred twenty-three million, eight hundred thousand dollars total deposits. In the remaining two hundred and forty-five banks, all of which were placed in receivership, three hundred eighty-two thousand, eight hundred accounts, totaling one hundred nine million, six hundred thousand dollars were covered by the Corporation up to their respective insurance limits of $2,500 or $5,000. To accomplish this, the Corporation disbursed over three hundred nineteen million dollars.

On the twelfth day of this month we began the eighth year in which no depositor in an insured bank has suffered any loss. This new era has resulted from the policy of the Corporation to follow the procedure outlined in our law for aiding distressed banks by purchasing or making loans on their assets, thereby permitting transfer of their deposit liabilities to other insured banks. By this means depositors have been fully protected against loss or even slight delay in obtaining their funds, and the banking system has been spared dangerous or embarrassing disruption. In this manner from May 12, 1944 to the first of this year, the benefits of federal deposit insurance have been extended to fifty-nine thousand, three hundred depositors with deposits of thirty-five million, six hundred thirty-four thousand dollars, in nineteen banks. To do this the Corporation was called upon to disburse only thirteen million, eight hundred twenty-seven thousand dollars. Copies of the annual reports of the Corporation to Congress, sent you every year, will keep you abreast of the extent to which we may be called upon from time to time in the future to extend financial aid to other insured banks.

It should be crystal clear that with bank deposits now representing about 85% of the circulating medium, or currency, of the nation, it is imperative that no breakdown in the banking system be allowed to occur. Bank failures that began as a stream in the twenties became the flood of 1933 that inundated us all. It is more important than ever that we remain on the alert for weak spots and act immediately to plug up any hole that might show in the dikes.

Thus far I have tried to sketch the background of our banking system from the creditor viewpoint, to trace the development of legislation designed to protect depositors, and to give you some picture of federal deposit insurance in action. Now I want to get into the heart of my subject, giving you the objectives and major provisions of our law, and explaining how they are carried out in the administration of the Corporation.

It is apparent that most of the federal banking laws were timed to fit their effect upon banking into particular needs of the government or nation as a whole, or as the aftermath of bad times and as a remedy therefor. And so it seems to have been with the creation of the Federal Deposit Insurance Corporation for which Congress gave this stated objective: "To assure the American people of the continued safety of their deposits, thus preventing another epidemic of bank failures, to restore public confidence in banking, to bring back to business money that might still be in hoarding, to thaw out frozen assets, stimulate industry, free credit, and relieve unemployment." The aims of the Federal Deposit Insurance Corporation toward carrying out the objectives of federal deposit insurance were stated in the annual report of the Corporation to Congress in 1938, as follows: "To improve bank supervision with a view to preventing, in so far as possible, an accumulation of weak or hazardous banking situations, to see that bank capital is maintained in an amount sufficient to provide reasonable protection against deterioration of assets; to see that banks charge off losses and thus carry assets at their reasonable worth; to apply corrective measures to those banks which get into difficulties, to see that banks observe the laws and regulations in the conduct of their business."

As a first step in carrying out the objective of Congress, on

January 1, 1934, the Corporation took into membership all banks then licensed to operate as members of the Federal Reserve System, of which national banks formed the major part, and any incorporated state chartered banks which applied for membership and which were found to be solvent. Obviously, this imposed a strain upon the new insurance system far out of proportion to the margin of safety that would be indicated by ordinary insurance principles. But this was a calculated risk, looking to the stimulus that would be given to the banking business and the economy of the country as a whole by reason of the restoration of public confidence. We need not point out that the judgment of Congress was fully vindicated by what is now banking history.

The foremost objective of Congress was fulfilled when, on January 1, 1934, most of the nation's banks were blanketed into federal deposit insurance. However, having accomplished the restoration of public confidence by establishing temporary federal deposit insurance, Congress charged the Corporation with the responsibility of maintaining a sound banking system, and vested it with authority to do so, when it passed the first permanent legislation in 1935. That legislation contained four clear directives. The first has to do with the admission of newly organized banks, or operating noninsured banks, applying for federal deposit insurance. In addition to determining solvency in the case of operating banks, which was all that was necessary for admission in 1934, the Corporation is required to consider the financial history and condition, adequacy of capital structure, future earnings prospects, general character of management, and convenience and needs of the community to be served, in connection with each bank or proposed bank applying for insurance. It is obvious that affirmative findings on these factors were intended as qualifications for admittance to insurance, and it readily follows that the standards established should be generally consistent with those fostered by the Corporation for the main body of banks already in the system.

The three other directives are, the right to determine the true condition of banks by examination, the privilege and duty of endeavoring to correct defective situations, and as a last resort the authority to eliminate dangerous and unresponsive institutions from the circle of insured banks.

Between the directive to examine into the affairs of insured banks, and the power to eliminate unsound units that will not lend themselves to correction, lies the most delicate task of all, the problem of obtaining correction and strengthening of weak and otherwise unsatisfactory situations. For this the law has laid down no pattern and the course obviously is left to the discretion of the management of the Corporation, its Board of Directors.

As a means of determining the condition of insured banks, Congress placed the facilities of the Comptroller of the Currency and the Federal Reserve System at the disposal of the Corporation by making available the examination reports of member banks prepared by those agencies. It provided for the examination of insured nonmember banks by examiners to be appointed by the Corporation. Today our own staff regularly examines almost fifty percent in number of all insured banks.

It is the desire of the Board of Directors that significant problems, found by our examiners to exist or to be developing, be reviewed with directors and managing officers of the respective banks at the time of examination, and that a corrective program be worked out then. This we believe to be the most desirable means of correcting unsatisfactory situations at the source. Our examiners are our eyes and ears. It is their responsibility to be acquainted with the policies of the Corporation, and, being on the scene, they are in a most advantageous position to cooperate with banks in working out any problems which may have arisen.

When unsatisfactory situations develop which do not readily lend themselves to the corrective efforts of our examiners or other field representatives, it is the policy of the Corporation to attempt to enlist the cooperation of the state banking authorities in order to bring about the desired adjustments. We are fortunate in that we enjoy the full cooperation of the state banking authorities throughout most of the nation. We believe that the insignificant number of cases wherein proceedings to terminate insurance have had to be undertaken is a tribute to the effectiveness of our examiners and to the splendid and cooperative work of the various state banking authorities.

The Federal Deposit Insurance Act, passed last year, provides little in the way of new legislation. In the main, it has taken and preserved the original legislation relating to federal deposit insurance and dating back to 1933. It has, however, given this legislation an identity of its own. In the new act, the original legislation has been broadened and improved. There are few basic changes. Of interest and benefit to depositors and bankers alike is the provision which increases the coverage of individual deposits in each insured bank ~~of~~ to $10,000. The Act has opened the way to reduce the future cost of federal deposit insurance to bankers. I might point out here that this provision for reducing assessments has something in common with the principle whereby banks benefit from a favorable loss experience in the payment of premiums on fidelity bonds. The new Act has also simplified the accounting required in connection with assessments, and has modernized the provisions with respect to advertising. There also have been changes designed to facilitate administration by the Corporation. I shall attempt to discuss some of these provisions in more detail.

When the permanent plan to succeed temporary federal deposit insurance was being considered in 1935, there was some discussion of full coverage of individual deposits up to $10,000, 75% coverage of deposits over $10,000 but under $50,000, and 50% coverage of all deposits in excess of $50,000. The $5,000 coverage for each depositor in each insured bank was substituted for this. One of the outstanding changes incorporated in the Federal Deposit Insurance Act passed last year was the increase in the coverage to the amount of $10,000 for each depositor. This increase was believed advisable to a large extent as a measure to protect the same purchasing power that $5,000 represented back in the thirties. It was also felt that the increase would lessen the splitting of deposits between banks. On the basis of a special call report made of insured banks by the Corporation as at September 30, 1949, increasing coverage from $5,000 to $10,000 would give full coverage to approximately three million additional accounts, bringing approximately one hundred two and a half million accounts under full coverage and leaving only about one million four hundred fifty thousand accounts not fully insured. The increase of insurance to $10,000 as applied to the September 1949 figures would reflect seventy-one billion, eight hundred forty-five million dollars of fully insured accounts, and eighty billion, eight hundred million dollars in other accounts of which fourteen billion, four hundred million dollars would be insured.

The right of the Federal Deposit Insurance Corporation to examine member banks has been revised slightly by the latest legislation, which removed the necessity of obtaining the written consent of the Comptroller of the Currency or the Board of Governors of the Federal Reserve System before making such an examination. This appears to have caused some misapprehension about duplication of examinations. You need have no fear in this respect, for I can assure you that we do not intend to abuse this privilege.

Probably the change in the law which is of the most immediate interest to you bankers is that one relating to assessments. Undoubtedly you are all familiar with the provisions relating to assessments, and further discussion of the mechanics at this time is scarcely necessary. However, I do want to emphasize the fact that the main thing that might stand in the way of banks obtaining the maximum rebate credit would be heavy demands upon the Corporation to assist banks in trouble.

The management of the Federal Deposit Insurance Corporation is not beguiled into thinking that the experience of the Corporation or the economy through which it has functioned are any criteria of the future. We fully realize that the Federal Deposit Insurance Corporation was born in an economy that could scarcely go anywhere but upward, and that the economy has since been given the strong stimulus of a world war followed in succession by a great industrial activity to satisfy consumer demands and a widespread defense program. We know that commercial, industrial, and bank failures are bred in such times as we are now passing through. Accordingly, we feel it our duty to preach the gospel that our bankers should get and keep their houses in order and be constantly on the alert for the pitfalls of apparent prosperity. Obviously, our ability to perpetuate the protection of the depositors of the nation in full as we have been able to do in the recent past, or even if we were to resort to the $10,000 limit, depends to a large measure upon the fundamental soundness of the banking system, which in turn must rely upon the competence of you bankers individually.

It has been suggested that I include some comment about management in my remarks. This is a subject about which volumes have been and still will be written, and time and space will permit me only to point up a few major aspects. Management is the most important single factor in the determining of the success or failure of our banks, singly or collectively, today and for the future. Management should be a combination of the activities and supervision of active officers and employees and directors. The proximity of directors to active management will of course be determined by the size of each bank, but all boards should be kept informed of and in contact with current operations by means of adequate and live organization. Our examination reports indicate that in many instances bank directorates contain too much deadwood, too many uninformed, uninterested members. It is the policy of our examination division to keep informed as to the background and activity of each director in the nonmember insured banks we examine, and to encourage intelligent and active participation in the affairs of those institutions.

Among bankers, just as in any other field, we find individuals who range in competence from outstanding down to a point that indicates unfitness for the job. Unfortunately, in the latter case, it quite often follows that active management weakness is not recognized by directors and it is this type of case that is usually found in the problem banks listed by the Federal Deposit Insurance Corporation and the various other supervising authorities. Fortunately, however, the vast majority of bank managements generally falls into a class that can be described as average, or acceptable, or better.

The reduction of bank personnel by the demands of the armed services, by industry and business related to war and defense efforts, and by the attraction of other businesses which have offered higher compensation to many clerical employees, in many cases has "bogged down" routine work, which when taken up by managing officials has interfered with their executive or administrative performance. This is something that has been observed in a great many instances in the reports of examination coming in to us from our own examiners as well as from the other federal examining agencies.

There is no substitute for the judgment of a competent banker when based on careful consideration of all pertinent factors. However, such judgment can be seriously impaired if there is lack of time or inadequate information. If executive officers turn their attention to routine duties, such as window work and record keeping, they are bound to find that the day does not have enough hours to permit them to give proper attention to their primary duties and responsibilities. More than a few bank officers have broken down in health from the overwork of trying to run two jobs at the same time.

The banker who is harrassed by a shortage of trained and competent personnel may quickly respond to my statements by pleading that he has been forced into such a situation by loss of help, and asking for a solution. It seems to me that there are two courses that should be followed in combination. Every effort should be made to recruit promising new material for replacement and training at the lower levels, with advancement of the more experienced personnel to higher responsibilities. This should be supplemented and implemented by adoption and use of the most modern techniques and equipment, all of which are designed to reduce and speed up routine work. This is the first and more obvious course, and one which most of you are no doubt following. The second, and actually the more difficult course, is to determine the more important duties and responsibilities of the executive division of management and to concentrate attention on those, allowing the lesser phases of operations to suffer, if anything must suffer. A good executive knows how and is willing to delegate responsibility.

The examiners of the Federal Deposit Insurance Corporation are not primarily interested in methods of banking operations but, rather, in the results as long as nothing irregular is involved. However, our examiners make it a point to observe how the business of each bank is conducted, from the activity of the directorate down to the work of the bookkeepers. They make an appraisement of these things which they report to us. We expect our examiners to discuss with the officers and directors of the banks all matters that have a significant bearing upon the welfare of the institution.

It is the intention and desire of our Board that the relation of insured nonmember banks with our examiners be a two-way street. We expect our examiners to be realistic and forthright in presenting their findings and conclusions to bankers and we want the bankers in turn to be articulate about their policies and practices and to freely solicit information and assistance from us through our examiners.

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