



FEDERAL DEPOSIT INSURANCE CORPORATION
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"DEPOSIT INSURANCE -- AN AMERICAN INSTITUTION"

Address of

H. EARL COOK, CHAIRMAN

FEDERAL DEPOSIT INSURANCE CORPORATION

Before The

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DEPOSIT INSURANCE, AN AMERICAN INSTITUTION

I am delighted to have this opportunity to talk to you about Federal deposit insurance. The occasion is particularly appropriate because less than two weeks from today, on September 11, the Federal Deposit Insurance Corporation will complete its twentieth year of operation.

With an anniversary date so near, it is fitting that I begin with a brief review of the Corporation's record. The Banking Act of 1933 provided the Federal Deposit Insurance Corporation with a capital of \$289 million of Treasury and Federal Reserve funds. Today all of that capital has been repaid, with interest, and in its place the insured banks have built up a deposit insurance fund of \$1.4 billion. At the same time, coverage for individual depositors has been increased from \$5,000 to \$10,000 and, in accordance with the Federal Deposit Insurance Act of 1950, the cost of deposit insurance has been substantially reduced through credits provided insured banks on their assessments.

We are naturally quite pleased with this growth in our corporate financial strength, but there is another record of which we at the FDIC are even more proud. Since deposit insurance became effective, 99.8 percent of the depositors of 422 insured banks in financial difficulties have had complete protection for their deposits. These banks had deposits totaling \$559 million but less than $\frac{1}{2}$ of 1 percent was lost to depositors, regardless of the size of their accounts. This is the record of which we are most proud, simply because it demonstrates that Federal deposit insurance has fulfilled and is fulfilling, its primary function. Had we failed in this regard, our financial strength would be of little moment.

There are a few sceptics who maintain that Federal deposit insurance has been successful thus far only because of the favorable climate in which it has been operating. That is, there have been relatively few bank failures since 1933 and, because of the general increase in values since that date, receivers have been able to return to those depositors whose balances exceeded the insurance maximum a larger proportion of their deposits than would have been possible under more unfavorable conditions.

Naturally, there is much truth in this. However, I would remind these sceptics that the fact that there have been fewer bank failures cannot be disassociated from the existence of the Federal Deposit Insurance Corporation. We will never know how many bank runs have been avoided because depositors had confidence in the safety of their deposits through knowing that the Corporation stood ready to come immediately to their assistance in the event of a bank failure. Also, improved methods of supervision and modernization of managerial techniques since 1933 are in part a reflection of efforts by the Corporation to cooperate whenever possible with individual bankers and with other supervisory authorities to secure the strongest possible banking system.

That the small number of bank failures cannot be attributed solely to the times is suggested by the fact that between 1925 and 1929, a five year period of prosperity, no fewer than 3,420 banks, with one billion dollars of deposits, suspended. That is, more than eight times as many banks, holding twice the amount of deposits, failed during this prosperous five year period than has been the case for our twenty years of operation. And remember that our twenty years includes years of depression, several minor

downturns and the very sharp depression of 1937-38.

So far as losses to depositors of the 422 banks are concerned: in 177 cases all depositors received complete protection because the failing bank was merged with a sound insured bank with the financial assistance of the Corporation. In the remaining 245 cases, 98.6 percent of the depositors would have received full protection even if not a cent had been paid by the receivers on common claims. In terms of the total of \$559 million in deposits, \$536 million, or 96 percent, has been made available through Federal deposit insurance.

I suspect that at this point you are becoming weary of statistics. Although there are many more I could give you which would help tell the story of Federal deposit insurance, I think a better understanding can be achieved by examining more closely its origins and development.

A few moments ago I noted that 1953 was the Corporation's twentieth anniversary year. However, the origins of Federal deposit insurance are not to be found in the early 1930's but instead go back more than 100 years, when a small group of forward-looking States were seeking a way to meet the problems attendant upon the development of their banking systems. Let me briefly sketch the scene at that time.

Banking began in America in 1781, but more than a half century was to pass before State banking was finally accepted and permitted to develop without excessive restriction. The story of that early period is interesting but exceedingly complex and need not detain us here. Suffice it to say that advocates of locally oriented, independent State banks had to contend with proponents of a single mammoth bank chartered by the

Federal government, as well as with a substantial proportion of our population which bitterly opposed banking of every description.

By 1834 the battle had been largely won and the States turned their attention to correcting the major defect, at that time, of a free enterprise banking system -- recurrent waves of bank failures. Their motives were no different than those which have ever since prevailed: the failure of a bank not only worked tremendous hardship on individual depositors, particularly those of modest means, but it also meant, so far as the community was concerned, that a portion of the money supply was literally wiped out.

I might add that this latter consequence of bank failures, so destructive to the workings of our entire economic system, was probably even more apparent at that time than is the case today. That is because a large part of the obligations of our early banks was in the form of circulating banknotes, rather than deposits. As means of payment, there is really no essential difference between banknotes redeemable on demand and today's checks written against demand deposits, but there are still some who fail to recognize that the obligations of banks are as much a part of the money supply as the currency carried in our wallets.

A variety of plans were adopted to meet the problem of bank failures, but the most interesting from our point of view were those which made use of the insurance principle. Appropriately enough, it was in this section of the country that they were most enthusiastically adopted. Credit for the first plan must go to New York, but of the six States establishing insurance systems prior to the Civil War, four were the north-central

States of Indiana, Michigan, Ohio and Iowa.

As you might expect, there were differences among the various systems. In New York, Michigan, Indiana, and Vermont insurance protection was extended both to circulating banknotes and deposits, while in Ohio and Iowa only banknotes were insured. Insurance funds were established in all of the States except Indiana, where reliance was placed instead upon guarantee of the obligations of a failed bank by the sound participating banks. Assessment rates varied, ranging from no regular assessment in Indiana to a single assessment of $12\frac{1}{2}$ percent of insured obligations in Iowa.

More important than the differences, however, was the common effort of bankers in each of these States to seek, through the insurance principle of mutual responsibility, a means of counteracting the disastrous effects of bank failures without sacrificing the independence of their respective banking systems. Recently our research staff at Washington discovered some of the records of Ohio's pre-Civil War insurance system. Among them was a letter from the head of the supervisory agency to a participating bank, written at the height of the famous "Panic of 1857", in which he expressed this principle:

We are one family, and our /banks/ are about as much interested in sustaining each other as each is in sustaining itself. In fact, to sustain a sick /bank/ is to sustain yourself.

In this panic, which set off a wave of bank failures which swept the Nation, not a single insured bank in Ohio failed or even suspended specie payments. In fact, only ten participating banks became involved in financial difficulties during the twenty years insurance was in force in Ohio, and in no case did the holders of insured obligations suffer a loss.

Not a single insured bank failed in Indiana or Iowa during the time that their insurance plans were in operation. And remember that this occurred during a period which many of us are prone to think of as the "dark age" of American banking.

In New York and in Vermont a limited measure of success was achieved by the insurance plan and only in Michigan was there complete failure. In this instance the cause was undoubtedly premature adoption of an insurance system. It was started even before Michigan was admitted to the Union as a State, and collapsed two years later in the great depression following the panic of 1837.

More study will have to be given these early insurance plans before we can know definitely the reasons why so many were successful. However, it appears now that much of the credit was due to improved methods of supervision and examination which were introduced along with, and as a part of, the insurance system; to the feeling of mutual responsibility which developed among the participating banks and, finally, to the confidence which these plans fostered among depositors and holders of circulating notes.

Why, you might wonder, were such plans not continued, and adopted by other States, after the Civil War? The answer is simple: when the National banking system was established in 1863, and the circulating notes of State banks were taxed out of existence in 1865, it was felt that the unquestioned safety of the National bank-notes made it unnecessary to continue these insurance plans. As you may recall, National bank-notes were directly guaranteed by the U.S. Treasury and were backed by government bonds.

Prior to 1860 deposits had been about equal in amount to circulating banknotes. Consequently, it was expected that after passage of the National banking act about 50 percent of the money supply would be covered by Federal government guaranty. However, in only twenty years, by the middle 1880's, deposits had come to constitute over four-fifths of the money supply. The Nation was once again faced with the problems attendant upon bank failures.

It is probably no coincidence that the first bill to call for Federal deposit insurance was introduced in the U.S. Congress at this time, by, I might add, a Republican representative from Wisconsin. More followed and, indeed, a total of 150 bills were introduced between 1886 and 1933, by 79 different members of Congress, before Federal deposit insurance became a reality.

Those persons who persist in believing that the 1933 legislation was a hastily conceived and novel idea arising out of the banking emergency of 1932-33 might well ponder this fact; or consult our 1950 Annual Report which contains a detailed study of these congressional proposals for Federal deposit insurance. They will find that many of the basic principles of the present law are to be found in these early bills. And they will also find that the sponsors, representing thirty States in all parts of the Union, were about equally divided between the two major political parties.

Individual States were also beginning to show renewed interest in deposit insurance. In 1907 Oklahoma established a deposit insurance system and within ten years seven other States had followed her lead. All

but one of these States were located west of the Mississippi River and were undoubtedly facing problems similar to those encountered more than a half-century earlier by the first States to try insurance of bank obligations.

Some of you may remember these State systems, since several lasted until 1930. Although most of them provided depositors with protection in their early years of operation, none was able to survive the large number of bank failures of the 1920's and early 1930's. We have not adequate knowledge at this time of all the weaknesses of these State plans, but one factor was that by the 1920's the Nation had become so well integrated economically that deposit insurance on a State basis was impractical.

Although they eventually proved inadequate, these plans provided a testing ground for deposit insurance. Many of the features which had merit are to be found in the present law. Others which were impractical were never to plague us, since their shortcomings had already been demonstrated. Perhaps the most important lesson they taught was that effective examination policies are essential to successful deposit insurance.

Let us consider now what this historical survey has illustrated.

First: it shows that deposit insurance, from the beginning, has been used to protect the individual depositor against loss and to protect the community, now the Nation, from the destruction of its money supply. Nowhere has this been better stated than by Justice Holmes in upholding the constitutionality of one of the State systems:

"the primary object. . .is not a private benefit. . .but. . . is to make the currency of checks secure, and by the same stroke to make safe the almost compulsory resort of depositors to banks as the only available means for keeping money on hand."

Second: the principles of deposit insurance have been tried and tested for more than a century. Certainly, improvements can and will be made as experience dictates, but we are building on a solid and well-constructed foundation.

Third: the future of Federal deposit insurance and the future of our independent banking system are closely joined as their past has been. This relationship is best illustrated by the fact that the two fundamental principles of deposit insurance, today and in the past, are that deposits must be protected and that insurance is the financial responsibility of the insured banks. I have no hesitation whatsoever in stating that to weaken, or drastically alter the character, of Federal deposit insurance would be to strike a blow at the independence of our banking system.

They say that one mark of a good talk is to end at the same place you started. If that is true, let me return to my title, where I referred -- perhaps presumptuously some of you may have thought -- to deposit insurance as "An American Institution". But Webster tells us that "institution" can mean "a practice. . .which is a natural and persistent element in the life. . .of an organized social group". I am sure that you will agree with me when I say that once we lay bare its origins and examine its development, deposit insurance cannot be more appropriately described than as an American institution.
