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"THE ROLE OF DEPOSIT INSURANCE"

Address of

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"THE ROLE OF DEPOSIT INSURANCE"

The Federal Deposit Insurance Corporation was created by the Congress to protect depositors against the unavailability or loss of their deposits because of bank failures. The performance of this function encompasses many activities, but neither the function nor the activities of the Corporation quite describe its role. As I see it, the role of Federal deposit insurance in our economic system is to provide and maintain banking stability, thus contributing significantly to the maintenance of general economic stability. It is the purpose of today's discussion to describe how the Federal Deposit Insurance Corporation, by fulfilling the function set forth by the Congress, plays its very important role.

Perhaps the best place to start is with a review of the principal duties of the Federal Deposit Insurance Corporation, first as they apply to closed insured banks, and second, to operating insured banks. With respect to the closed category, the Corporation's duty is to pay, or make available, to each depositor the amount of his insured deposit. In those cases in which the Corporation is charged with liquidation of the assets of the bank, it is responsible for carrying out that liquidation in a manner that will secure maximum recovery, without disruption of values in the community concerned.

With respect to operating insured banks, the Corporation's principal duty is to examine insured banks not members of the Federal Reserve System. These, then, are the major duties; let us see how, together, they constitute one of the significant roles in American banking.

At the time of its establishment in 1933, and for a number of years thereafter, most activity by the Corporation centered on closed banks. This is understandable when we recall the events which led to the formation of the Federal Deposit Insurance Corporation.

As is true of most legislation, deposit insurance was devised to meet a particular situation. In the 1920's an average of about 600 banks failed per year, and from 1930 through 1933 bank failures averaged over 2,200 per year. Indeed, the total number of bank failures from 1920 to 1933 exceeded the number of banks in existence today. Losses to depositors during that period reached nearly $2 billion, and losses to bank stockholders were even greater.

During the 1920's, the large number of bank failures gave impetus to proposals for banking reform, the most important of which were those providing for the insurance or guaranty of bank deposits.

These proposals became more urgent with the increasing number and seriousness of bank failures during the early 1930's. The result was the establishment of the Federal Deposit Insurance Corporation in September, 1933.

You will note that, contrary to the impression many people now have, deposit insurance was not a new idea in 1933. As a matter of fact, the bill which became law in that year was at least the 150th bill to be introduced in the Congress calling for the guaranty or insurance of deposits. Such bills had been introduced in every Congress but three, beginning with the 49th Congress during the administration of President Grover Cleveland. I might note that the very first bill to be introduced, on January 11, 1886, was by a Congressman from the State in which we are meeting today.

Not only was deposit insurance an old idea, but it also had been tried separately in fourteen States prior to 1933. In six States deposit insurance systems were in operation prior to the Civil War and most of these were successful in protecting bank depositors. The deposit insurance systems adopted by eight other States, between 1907 and 1917, were generally unsuccessful. This was due to the fact that most of these were farm States, in which there developed serious banking difficulties as a consequence of the agricultural depression of the 1920's.

During 1934, the first full year of nationwide deposit insurance, disbursements by the Corporation to protect depositors were relatively small. The American banking system was given a breathing spell following the events of the several preceding years and the banking holiday of 1933. However, beginning in 1935 there was a marked increase both in the number of bank cases handled by the Corporation and its total disbursements. Disbursements which had been less than $1 million for 1934 rose ten-fold in 1935, to about $9 million. Five years later, in 1940, disbursements to protect depositors of banks failing in that year totaled $74 million and, in addition, there were substantial liquidation expenses and advances.

Since 1940 annual disbursements have been considerably smaller, as the number of insured banks becoming involved in financial difficulties sufficiently serious to require disbursements to protect depositors has averaged only four or five per year. This compares with an average of about 50 banks per year during the first seven years of Federal deposit insurance.

For the entire period, from 1934 through 1955, the Federal Deposit Insurance Corporation has disbursed about a third of a billion dollars to protect depositors in 429 insured banks. These banks had approximately 1.4 million depositors and total deposits of well over one-half billion dollars.

Now let us inquire a little more closely into what these disbursements have meant, and what effect they have had upon the promotion of banking stability. Their immediate effect has been to restore to each of the communities affected that part of its money supply which, in the absence of Federal deposit insurance, would have been entirely lost, or unavailable for a long period of time.

As you all know, deposits in banks constitute by far the largest portion of our money supply, and contraction due to bank failure may lead to corresponding contraction, or even complete paralysis, of business activity. This decline in business may in turn affect other banks; and the result may be an ever-widening banking and economic crisis. This has not occurred during the entire time in which Federal deposit insurance has been in existence.

A second consequence of disbursements to protect depositors has been the protection given individual depositors, many of whom might otherwise have lost their life savings. It is important to observe in this connection that disbursements by the Corporation have resulted in virtually complete protection for depositors, despite the fact that there has always been a maximum insurance limit, presently amounting to $10,000 for each depositor.

The high level of depositor protection has been due to several factors: First, many of the banks which closed were of small size, with few accounts containing deposits larger than the insurance maximum; Second, because of the more orderly liquidation process which deposit insurance has made possible, those depositors whose accounts had balances in excess of the insurance maximum have been able to recover a substantial portion of the excess from the proceeds of receivership; Finally, in many of the cases of banks in serious financial difficulties the Corporation has arranged for the distressed bank to be absorbed by a sound insured bank. This procedure has been used by the Corporation in those cases when it would avert a threatened loss, or would be less costly than a direct payoff of depositors. The incidental result has been to provide full protection for depositors, whatever the amount of their deposits.

Not only have losses to depositors of insured banks been small, but depositors have been paid promptly, averting personal hardship, and, again, helping to sustain the money supply of the community. In each of the 249 receiverships of insured banks, representatives of the Corporation moved immediately into the regular business office of the failed bank. The records of the bank were quickly verified, depositors were notified to present their claims and were then either paid in cash or given demand deposit credits in another insured bank equal to the amount of their insured deposits. The time lapse between the suspension of a bank and start of payoff has been two weeks or less in most of the receivership cases in which the Corporation has been involved.

Payment of insured depositors has been even more expeditious in the 180 cases where the deposits of failing insured banks have been assumed by other insured banks, with the aid of the Corporation. In only two or three of these cases has there been any interruption of regular banking services. Where the assumption method is used depositors of the distressed bank are simply notified that their bank has been absorbed by another insured institution and that their deposits are available at the latter bank.

Before concluding this discussion of the Corporation's activities insofar as they relate to closed or disabled banks, I might observe that the Corporation itself has suffered little financial loss. Indeed, it has recovered about nine-tenths of the disbursements it has made to protect depositors. This favorable rate of recovery has been due principally to the Corporation's ability to await favorable opportunities to liquidate assets.

As I noted earlier, the Corporation's activities relating to closed banks and to banks in serious financial difficulties have become relatively less important since 1940. Emphasis has shifted to those activities which will prevent the development of bank difficulties, insofar as such prevention is within the Corporation's powers.

Today, examination of banks comprises the major part of the Corporation's work; nearly three-fourths of its employees are engaged in such activities. The Corporation regularly examines only insured State banks not members of the Federal Reserve System - some 6,700 banks - and reviews from the standpoint of its insurance risk the examinations of the 4,700 insured banks made by the Comptroller of the Currency and the 1,800 banks examined by the Federal Reserve Banks. The Corporation may also make special examinations of any insured bank, but rarely exercises this authority.

Through its examinations of banks the Corporation has exerted considerable influence upon the structure and character of banking. The quality of bank assets is obviously a matter of importance and receives close attention. Maintenance of adequate capital and regular provision for losses on assets are among the banking practices recommended by the Corporation as consistently as by most bankers themselves. Recognizing the limited scope of any examination, the Corporation has encouraged banks to maintain careful internal controls and to carry adequate fidelity bonds.

The need for qualified bank management, the primary asset of any bank, has been particularly stressed by the Corporation. Conscientious and far-sighted directors, capable officers and competent and loyal employees are beyond mechanical prescription, but success in this area of intangibles is the best assurance of a healthy, prosperous bank.

In addition to its examination procedures the Corporation exercises considerable influence upon the character of American banking through its right to grant or withhold insurance from newly organized banks not members of the Federal Reserve System. In acting upon applications for insurance from such banks the Corporation is required to give consideration to the adequacy of the bank's capital, its future earnings prospects, the quality of management, and its usefulness in serving the convenience and needs of the community. The effect of considering such factors has been to help prevent development of the kind of over-banked condition which plagued the Nation during the 1920's.

Another activity of importance stems from the Corporation's authority to withdraw insurance from banks which engage in unsafe and unsound banking practices, or violations of law. Of course, in most instances such practices or violations are corrected after consultation between bank officials and representatives of the Corporation, and thus never reach the stage where the Corporation must initiate proceedings to terminate insurance. Voluntary correction is the most desirable solution and we have been fortunate over the years in securing a high degree of cooperation from bankers. However, in those instances in which banks persist in engaging in unsafe and unsound banking practices or violations of law the Corporation's authority to withdraw insurance has been used.

Let me now summarize this discussion by reviewing the ways in which the Federal Deposit Insurance Corporation contributes to the maintenance of bank stability. In the case of failing banks, prompt action by the Corporation restores circulating medium to the communities affected, thus preventing economic paralysis. In the case of operating banks, regular examination by the Corporation helps to maintain present high banking standards; at the same time, the exercise of caution in the admission of new banks to insurance and the Corporation's insistence upon corrections in the relatively few cases of unsafe and unsound banking provide additional stablizing factors.

It is at this point that we appear to violate one of the laws of mathematics, for the whole is greater than the sum of its parts. By that I mean that the stablilizing factors I have just described have combined to produce an additional condition for stability which is probably more important than any other: namely, a level of public confidence in American banking that is unmatched in our history.

Confidence is an attitude, an appraisal of the future in the light of the past. Every industry has an important stake in public confidence, but banking heads the list, for banks deal not in goods but in promises, and confidence is the essential element of every promise. The promise which banks make to pay deposits

practically upon demand can be fulfilled only so long as the preponderant volume of deposits is left with the banks - in short, so long as confidence is maintained. In the banking field only confidence lies between order and chaos.

It would be possible to continue this description of the activities of the Federal Deposit Insurance Corporation, but I think such a discussion would add little to an understanding of its role in our economy. It may well be that the future will bring new activities, or change the relative importance of those to which we now give our attention. Of one thing we can be certain: a healthy and dynamic banking system, with stability, is basic to our free enterprise economy; to contribute to the maintenance of such a banking system is the role of deposit insurance.