FDIC
FEDERAL DEPOSIT INSURANCE CORPORATION

NEWS RELEASE

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Statement by

Frank Wille, Chairman
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before the

Subcommittee on Bank Supervision and Insurance

House of Representatives

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Opening Remarks

Mr. Chairman, I welcome the opportunity to appear before your subcommittee today to present the views of the Federal Deposit Insurance Corporation regarding H.R. 10993, 93d Congress, a bill "To provide full deposit insurance for public units and to increase deposit insurance from $20,000 to $50,000."

Full Deposit Insurance for Public Units

Section 1 of H.R. 10993 would amend the Federal Deposit Insurance Act, the National Housing Act, and the Federal Credit Union Act to require the Corporation, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Administration to insure the deposits and accounts of public units for the full aggregate amount of such deposits or accounts, rather than to the maximum amount of $20,000 currently provided for other depositors or share account holders. In the case of public units other than those of the United States, such insurance would be limited to the funds of public units within the State or territory in which the financial institution is located. The section would also permit the three agencies to limit the aggregate amount of public funds that could be deposited in insured banks or invested in institutions insured by either the Federal Savings and Loan Insurance Corporation or the National Credit Union

Administration on the basis of the size of such banks or institutions in terms of their assets.

In the past proposals for full insurance protection for public deposits or accounts have been based on the assumption that a number of public units had suffered substantial losses in bank failures throughout the country, with the result that Federal, State and local governments had to increase taxes to recoup those losses. We must point out that this assumption is not supported by the evidence.

The Corporation recently completed a study of public deposits, recoveries, and losses in the 57 banks which closed during the period from January 1, 1960 to December 31, 1972. These 57 banks had 350 public depositors with a total of $56,952,916.76 on deposit. As of year-end 1972, the public units involved had recovered 97.8 percent, or $55,694,811.43 of such deposits in one way or another. An additional $666,217.80 has been or will be recovered through liquidating dividends paid by the Corporation, thereby resulting in a total recovery of 99.0 percent of the funds on deposit at the time of failure and an estimated net loss of only $591,887.53 to all public depositors in the 57 banks. We believe this evidence clearly shows that over the past 12 years public units have not suffered substantial losses on the uninsured portion of their deposits in insured banks, although the recovery of such uninsured deposits may have been delayed. We do not know of any Federal, State, or local taxes that had to be increased to recoup any losses resulting from bank failures.

The Corporation believes that some of the arguments historically advanced in opposition to proposals for full insurance protection for public deposits are no longer convincing. There is little evidence, for example, to support the argument that a system of limited insurance causes most public depositors to consider management characteristics and capital adequacy in the selection of depositories, or to support the argument that such a system imposes disciplinary restraint upon bankers who might otherwise succumb to presumed competitive or economic pressures if public deposits were fully insured. Moreover, differentiating between public depositors and other depositors in determining the amount of insurance coverage that should be applicable to their deposits can be justified, since public deposits represent deposits by the taxpaying public, which has no direct voice in the selection of the depository.

In an effort to determine the impact that full insurance protection for deposits of public units might have upon the FDIC's deposit insurance fund, the Corporation, as a supplement to the above study, estimated the additional disbursements, recoveries, and losses which would have resulted if 100 percent insurance for public deposits had been applicable during that same period. In arriving at our estimates, we assumed that full payments would have been made to all public depositors in the 57 closed banks during the period studied and that the Corporation would have been subrogated to their rights against assets being liquidated. We found that the Corporation would have been required to disburse additional sums totaling $28,756,187.18 and that total recoveries to the

Corporation on account of such disbursements would have amounted to $20,367,527.53. These figures produce an additional net estimated loss to the Corporation of $8,388,659.65 for the 13-year period. This would tend to indicate that the deposit insurance fund would not be unduly burdened if legislation providing full insurance protection for deposits of public units were enacted.

The Corporation recognizes, however, that other issues, such as the potential effect the enactment of such legislation might have on pledging requirements, deserve careful consideration.

A majority of States require the pledging of securities by banks against the deposits of States and political subdivisons. Similarly, Federal statutes require that United States Government deposits in banks be secured by the pledge of Government obligations or certain other securities. In large part, the securities pledged against deposits of State and local governments in those States which require such pledging are obligations of State and local governments. To the extent that full insurance protection for public deposits might influence some States to repeal their pledging requirements, and to the extent that repealing those requirements might induce some banks -- which are by far the largest holders of municipal securities -- to dispose of a portion of the municipal securities in their portfolios, the enactment of legislation providing full insurance coverage for public deposits could have a disruptive impact on the market for obligations of State and local governments, many of which already are experiencing substantial difficulties in obtaining adequate financing for essential services. While the removal of pledging requirements could provide new and desirable flexibility to banks in their asset management, it is also conceivable that the alternative investments that might be made could run counter to the monetary policy being pursued at the time by the Board of Governors of the Federal Reserve System.

Your subcommittee and the Congress are also likely to hear arguments that the enactment of legislation providing full insurance protection for deposits of public units would give savings and loan associations a competitive advantage over banks, since savings and loan associations have generally been permitted to pay higher rates of interest or dividends than banks have been permitted to pay and therefore would be able to attract more public deposits because of the differential. Under current interest rate regulations, however, this would be true only in the case of public funds which are not in checking accounts or time deposits of $100,000 or more, since the payment of any interest on demand deposits is prohibited and since rate ceilings for time deposits of $100,000 or more have been completely suspended since May 1973.

After weighing all of these considerations, the Corporation -- strictly from its limited point of view as the nation's deposit insurance agency and as a supervisory agency with jurisdiction over nonmember commercial banks and mutual savings banks -- interposes no objection to the enactment of legislation along the lines proposed by section 1 of H.R. 10993. We strongly recommend, however, that the section be amended so as (1) to require that the aggregate amount of public funds that could be deposited in banks or invested in savings and loan associations be limited in relation to such criteria as liquidity, total deposits, and capital -- rather than merely in relation to the asset size of a financial instititition -- and that the Corporation and the Federal Savings and Loan Insurance Corporation prescribe uniform restrictions with respect to such limitations, and (2) to require that the maximum rates of interest or dividends payable on comparable public deposits under $100,000 be the same for all insured banks and savings and loan associations. This is the same position the Corporation took with respect to a similar proposal, H.R. 15656, 92d Congress, and it is also consistent with the position stated by the Corporation earlier this year with respect to the desirability of a uniform rate of interest on all NOW-type accounts that might be offered -- irrespective of the type of institution offering the account.

Increase Deposit Insurance from $20,000 to $50,000

Section 2 of H.R. 10993 would increase from $20,000 to $50,000 the deposit insurance coverage on accounts in commercial banks and mutual savings banks insured by the FDIC. Section 3 of the bill would provide for a similar increase with respect to the deposit accounts of savings and loan associations insured by the FSLIC.

Changes in economic conditions since the last increase of insurance coverage in December 1969 would seem to make a further increase appropriate at this time. Based on seasonally adjusted Consumer Price Indices of 112.7 for December 1969 and an estimated 136.0 for October 1973, deposit insurance coverage would have to be raised almost $5,000 just to keep pace with inflation alone.

Since the creation of the FDIC by the Banking Act of 1933, the original deposit insurance limit of $2,500 has been increased periodically. Except for the first increase in October 1934 which raised this initial figure to $5,000, all increases in the insurance limit have been in $5,000 increments. The Corporation, however, has recently received letters from members of Congress and from bank depositors in favor of increasing deposit insurance coverage from $20,000 to $50,000. These letters compare such insurance to protection afforded securities investors by the Securities Investors Protection Corporation (SIPC), noting that SIPC insures to $50,000 an investor's securities (with a $20,000 limit on claims for cash) held by a brokerage firm which is placed in liquidation, while the FDIC insures bank deposits only to $20,000. Although there are distinctions between bank deposits and securities held by brokerage firms and although the statutory functions of the FDIC and SIPC differ in many respects, an increase of deposit insurance would make more consistent the protection available to depositors and investors.

Other valid reasons may also exist for a substantial increase in deposit insurance coverage. First, the proposed increase in insurance coverage would put small depositary institutions on a more equal competitive footing with larger institutions. Since depositors seem to believe that their money is safest in the largest institutions, a depositor is more likely to put funds exceeding the insured limit in a large commercial bank than in a small one. A substantial increase of deposit insurance would therefore enable federally-insured depositary institutions of all sizes to compete more effectively for deposits ranging up to the higher insured limit.

Second, increased insurance coverage could help banks and savings and loan associations of all sizes sustain their competitive position in the market for savings during periods of high interest rates, by encouraging business firms and others to carefully weigh the increased protection of funds left on deposit against possibly higher yields obtainable elsewhere from nondeposit institutions. Although the significance of substantially higher deposit insurance coverage should not be overemphasized as a determinative factor in competition between depositary and nondeposit institutions for depositors' funds in high interest periods, increased coverage would nevertheless appear to be one relevant factor in such competition.

Without taking into account the effect of that part of the bill providing for full deposit insurance for public funds, our Research Division has estimated that increases in deposit insurance coverage for all deposits up to such limits as $30,000, $40,000 or $50,000 would be likely to have the results shown in the following table:

Alternative Insurance Coverage

(As of June 30, 1972)

Insurance Coverage	Percent of Deposits Covered	Ratio of Insurance Fund to Insured Deposits
$20,000	60.9	1.28
30,000	64.8	1.20
40,000	67.5	1.16
50,000	69.3	1.13

By way of comparison, it may be noted that the ratio of the Federal deposit insurance fund to insured deposits as of June 1972 was 1.28 percent. Although historically this figure has tended to decline, the 1.28 figure is representative of what the ratio has been during the past five years. Moreover, even if a $50,000 ceiling had been in effect since 1960, it would have had little effect on the losses incurred by FDIC and, therefore, little effect on the net assessments paid by banks for federal deposit insurance.

Based on the foregoing, the Corporation can readily support a substantial increase in the present $20,000 deposit insurance ceiling set by the Congress.