FEDERAL DEPOSIT INSURANCE CORPORATION

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Statement by

Frank Wille, Chairman
Federal Deposit Insurance Corporation

On Bills to Increase the Deposit Insurance Limit
and to Provide Full Insurance for Public Funds
(H.R. 11221, S. 2375, S. 2640)

before the

Subcommittee on Financial Institutions

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FEDERAL DEPOSIT INSURANCE CORPORATION, 550 Seventeenth St. N.W., Washington, D.C. 20429 • 202-389-4221

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. 11221, 93d Congress, a bill "To provide full deposit insurance for public units and to increase deposit insurance from $20,000 to $50,000"; Title I of S. 2735, 93d Congress, a bill "To increase the availability of urgently needed mortgage credit for the financing of housing and other purposes"; and S. 2640, 93d Congress, a bill "To provide for full deposit insurance for public funds, and for other purposes."

S. 2640 would provide full deposit insurance for public funds deposited in insured banks and insured savings and loan associations. In addition to such full deposit insurance for public funds, Title I of S. 2735 would increase the insurance limit for other deposits in insured banks and insured savings and loan associations from $20,000 to $50,000. H.R. 11221, which passed the House of Representatives on February 5, 1974, is similar to S. 2735 but covers insured credit unions as well as insured savings and loan associations. As requested, I will focus my remarks primarily on H.R. 11221.

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

H.R. 11221 and S. 2735 would both increase from $20,000 to $50,000 the deposit insurance coverage on accounts in commercial banks and mutual savings banks insured by the FDIC and would provide for a similar increase with respect to the deposit accounts of savings and loan associations insured by the FSLIC. H.R. 11221 would apply a similar increase to deposits in federally insured credit unions. The Corporation's position, in short, is one of support for a substantial increase in the present $20,000 deposit insurance limit.

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 Consumer Price Indices of 112.9 for December 1969 and 138.5 for December 1973, deposit insurance coverage would have to be raised almost $5,000 just to keep pace with inflation alone.

There is, of course, precedent for periodic increases in the deposit insurance limit. At the time of the FDIC's creation by the Banking Act of 1933, the deposit insurance limit was set at $2,500. Except for the first statutory increase which raised this initial figure to $5,000 in October 1934, all increases in the insurance limit have been in $5,000 increments.

The Corporation, however, has recently received letters from Members of Congress, from insured banks 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 Investor Protection Corporation (SIPC), noting that SIPC insures to $50,000 an investor's securities (with a $20,000 limit on claims for credit balances) 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 weigh carefully 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 the competition between depositary and nondeposit institutions for the public's money in high interest periods, increased coverage would nevertheless appear to be one relevant factor in such competition.

The Corporation's Research Division has estimated that increases in deposit insurance coverage 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 Number of Accounts Covered	Percent of Deposits Covered	Ratio of Insurance Fund to Insured Deposits
$20,000 (all deposits)	98.67%	60.9%	1.28%
$30,000 (all deposits)	99.32	64.8	1.20
$40,000 (all deposits)	99.55	67.5	1.16
$50,000 (all deposits)	99.67	69.3	1.13

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$20,000 (except for public funds with 100% coverage)	98.75	68.0	1.16
$30,000 (except for public funds with 100% coverage)	99.39	71.6	1.09
$40,000 (except for public funds with 100% coverage)	99.61	74.0	1.05
$50,000 (except for public funds with 100% coverage)	99.72	75.5	1.03

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.

I should note in addition that even if the deposit insurance limit had been at $50,000 since 1960, it would have had very little net effect on the losses incurred by FDIC on account of failed banks and, therefore, little or no effect on the net assessments paid by the nation's banks for Federal deposit insurance.

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

Full Deposit Insurance for Public Funds

H.R. 11221 would amend the Federal Deposit Insurance Act, the National Housing Act, and the Federal Credit Union Act to require the FDIC, the Federal Savings and Loan Insurance Corporation, and the National Credit Union Administration to insure 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.

As amended on the House floor, however, H. R. 11221 would limit full deposit insurance for public funds in insured banks to "time deposits" and would retain the otherwise applicable dollar insurance limit for public funds placed in "demand deposits" and "savings deposits" of insured banks. At the same time, the bill would cover all public funds placed in insured savings and loan associations and insured credit unions without reference to the type of account utilized.

In the case of public units other than those of the United States, the full insurance provided by H. R. 11221 would be limited to the funds of public units within the State or territory in which the financial institution is located. H. R. 11221 would, in addition, permit the FDIC to limit the aggregate amount of public funds that could be placed in unsecured time deposits on the basis of the asset size of the bank receiving the funds and grant the FSLIC and the NCUA comparable authority with respect to public funds deposited in whatever form in institutions subject to their jurisdiction. Finally, by not addressing the subject at all, H. R. 11221 would permit and apparently approve a situation in which higher rates would be paid on public funds deposited in savings and loan associations, credit unions and mutual savings banks than on public funds deposited in commercial banks.

While the Corporation, strictly from its limited point of view as the nation's deposit insurance agency for banks and as a supervisory agency for nonmember banks, has no objection to the principle of full deposit insurance for public funds, it is opposed to the provisions on this subject contained in H. R. 11221 as passed by the House of Representatives because of their discriminatory effect in the competition among depositary institutions for the receipt of public funds.

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As to the principle of full deposit insurance for public funds, the following information may be helpful to the subcommittee in its review of the various bills before it. Proposals for full insurance protection for public deposits or accounts have in the past been based partly on the assumption that some public units have suffered substantial losses in bank failures throughout the country and may have had to increase taxes to recoup those losses. This assumption, however, 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 have 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 amount, estimated to be $666,217.80 has been or will be recovered through liquidating dividends paid by the Corporation, as receiver, thereby resulting in a total recovery of 99.0 percent of the funds on deposit at the time of failure and a net loss of only $591,887.53 to all public depositors in the 57 banks. We believe this evidence clearly shows that over this 13-year period public units did not suffer substantial losses on the uninsured portion of their deposits in insured banks, although the recovery of some such uninsured deposits may have been delayed. We do not know of any instances where taxes had to be increased to recoup any losses resulting from bank failures.

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 all 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 all deposits of public units were enacted.

Moreover, 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. Furthermore, differentiating between public depositors and other depositors in determining the amount of insurance coverage that should be applicable to their deposits can be justified as a valid exercise of the legislative function, since public deposits represent deposits by the taxpaying public which has no direct voice in the selection of the depository for tax monies and no right to withhold tax payments if they are dissatisfied with the selection.

The Corporation recognizes, however, that other issues deserve careful consideration before Congress moves on this proposal, such as the potential effect the enactment of full insurance coverage might have on pledging requirements and thus on the marketability of debt obligations issued by governmental bodies.

A majority of States require the pledging of securities by banks against the deposits of States and political subdivisions. 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 the same State and local governments. To the extent that full insurance protection for public deposits might obviate the need for pledging such securities or might influence some States to repeal their pledging requirements, and to the extent that repealing those requirements might induce the nation's 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 and other thrift institutions a competitive advantage over commercial banks, since such institutions have generally been permitted to pay higher rates of interest or dividends than commercial 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, this would be true only in the case of public funds which are not in checking accounts or in 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 were partially lifted in June 1970 and have been completely suspended since May 1973. However, substantial funds are still involved. As of June 30, 1972, for example, State and local governments had on deposit in the nation's commercial banks approximately $8.3 billion in accounts of $100,000 or less.

After weighing all of these considerations, the Corporation -- strictly from its limited point of view as the deposit insurance agency for the nation's banks and as a supervisory agency with jurisdiction over insured nonmember commercial and mutual savings banks -- would interpose no objection to the enactment of legislation that would provide full insurance for all public deposits in insured financial institutions.

We are, however, opposed to the applicable provisions on the subject contained in H.R. 11221 as passed by the House of Representatives on February 5, for the following reasons:

1. Contrary to our strong recommendation to the House, H.R. 11221 contains no provision which would 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 that the Corporation took with respect to a similar proposal in the 92d Congress and it is also consistent with the position stated by the Corporation last 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.

2. Contrary to our strong recommendation to the House, H. R. 11221 contains no provision which would require the Corporation, the Federal Savings and Loan Insurance Corporation and the National Credit Union Administration to prescribe uniform restrictions with respect to the aggregate amount of public funds that could be deposited in a bank or invested in a savings and loan association or credit union. We had further suggested that the agencies be allowed to consider, in addition to the asset size of a financial institution, such criteria as liquidity, total deposits and capital.

3. The amendment to H. R. 11221 adopted on the floor of the House of Representatives would have further discriminatory effects among depositary institutions which might be competing for public funds. Thus, insofar as both insured commercial banks and insured mutual savings banks are concerned, H. R. 11221 in its present form would limit full deposit insurance for public funds to "time deposits" -- maintaining the

otherwise applicable dollar limitation for any public deposit not within the scope of that term as defined in Federal Reserve and FDIC regulations. Under present regulations, "time deposits" would not include either deposits maturing in less than 30 days (demand deposits) or passbook accounts (savings deposits). No such limitation is imposed by H.R. 11221 with respect to insured savings and loan associations and insured credit unions.

Although savings and loan associations and credit unions are not generally permitted under present law to offer checking accounts, the advent of NOW accounts, daily interest accounts, electronic funds transfer possibilities and similar innovations has tended to reduce the difference between consumer checking, savings and time accounts and may in the near future render such a distinction less and less meaningful. In any event, there would seem to be little justification for legislation which would provide full deposit insurance for public funds in the passbook accounts of nonbank thrift institutions but not for similar funds in commercial bank passbook accounts or in mutual savings bank passbook accounts.

It may also be useful for us to state for the record our interpretation of the provisions in the proposed legislation which authorize the imposition of amount limitations on public funds deposits in insured financial institutions. As we read these provisions, they would authorize the regulatory agencies to limit the amount of time deposits which any one governmental entity may make in a particular financial institution, as well as the aggregate amount of time deposits which an insured bank may accept from all governmental entities that deposit funds with it. Under the proviso added by the House of Representatives at lines 17-20 of page 3 of H. R. 11221, these amount limitations would apply in the case of insured commercial banks and insured mutual savings banks only to unsecured time deposits of public bodies. However, we construe the amendment as not affecting the grant of full insurance protection to time deposits of public bodies in such banks, whether secured or unsecured, even if the prescribed FDIC limitation as to the amount they may receive on deposit is breached. If the intent behind these provisions does not accord with the foregoing constructions, we would recommend that the necessary clarifying amendments be made.

For the reasons stated, the FDIC opposes the public fund provisions of H. R. 11221 which now appear before this subcommittee.