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THE INDEPENDENT STATUS OF THE FEDERAL DEPOSIT INSURANCE CORPORATION

Address Of

Jesse P. Wolcott, Chairman

Federal Deposit Insurance Corporation

Before The Annual Convention

Of The

Ohio Bankers Association

Toledo, Ohio

May 8, 1958

THE INDEPENDENT STATUS OF THE FEDERAL DEPOSIT INSURANCE CORPORATION

I am very pleased to have been invited to address the members and guests of this association. Having for many years been a resident of the State of Michigan, I feel very much at home in this region and I always enjoy my visits here. Only a few months ago I succeeded a well-known resident of Ohio, H. Earl Cook, as Chairman of the Federal Deposit Insurance Corporation. I am sure all of you know and share my respect for Earl Cook. I am particularly grateful to him for his courtesy in helping me over many of the rough spots which attended my initiation as his successor. I shall ever be thankful to him also for his helpful cooperation while I was on the Banking and Currency Committee of the House of Representatives. I was privileged to look to him for guidance on many of the problems which confronted us.

I note that just twenty years ago he was the president of this association. From 1943 to 1947 he was the Superintendent of Banks for the State of Ohio. He left that post to become a director of the Federal Deposit Insurance Corporation and succeeded to the chairmanship in 1953. Earl has indeed rendered distinguished service to banking.

I also am glad to find here my good friend and former colleague, Senator John Bricker. John Bricker has been most cooperative throughout the many years we have been thrown into such close contact, especially in the solution of those vexatious problems which constantly beset us as conferees in reconciling differences between the Senate and the House. Whether he knows it or not, I have always considered John Bricker as my mentor on banking and economic problems. He has been a kind, a thoughtful and a considerate friend; considerate in that on so many occasions he has tolerated my shortcomings and perhaps even my idiosyncrasies.

For several months we have been aware that our economic system has been operating at something less than its full capacity. Much has been said regarding the causes and possible remedies for the reduced level of economic activity. In view of the wide differences of opinion expressed, we may well feel uncertain as to how best to proceed and as to when the upward swing will come. However, we may be confident that recovery will not be hindered by the fear that a portion of the circulating medium will be destroyed or made temporarily unavailable because of bank failures. That fear vanished--let us hope forever--shortly after the establishment of the Federal Deposit Insurance Corporation almost twenty-five years ago.

Those of you who were engaged in banking in 1933 will remember how different were the circumstances which preceded the meeting of this association in that year. In the years 1930-1932 more than 5,000 banks had suspended. Only a few weeks previously a banking holiday had closed the banks throughout the country, and at its termination thousands of banks remained unlicensed. Many depositors had withdrawn cash from their accounts and held it in places which they regarded as safer than banks. Others found their deposits unavailable because of the bank suspensions.

The creation of the Federal Deposit Insurance Corporation was part of a program designed to strengthen the tottering banking system, restore the circulating medium, and promote recovery of the economy. Public confidence in the banks was reestablished, hoarded money flowed back to the banks, and bank credit could once more be extended freely to agriculture and industry. Federal deposit insurance quickly became a strong pillar of support for the Nation's banking and economic system.

Today, Federal deposit insurance is firmly established in the banking structure of our country. Almost 95 percent of all the banks are now insured. Approximately 98 percent of the accounts in these banks have balances of less than $10,000 and are therefore fully protected. The stabilizing influence which deposit insurance exerts upon the financial structure is of incalculable value.

At this point let me remind you what Federal deposit insurance is--and what it is not. It is a mutual insurance system which is supported by the insured banks themselves, and administered through a Government controlled Corporation.

The Corporation is directed by a bipartisan Board, two of the Directors are appointed by the President, and are subject to Senate confirmation. The Comptroller of the Currency, who is also appointed by the President with the approval of the Senate, is the third member of the Board.

The Corporation originally had a capital of $289 million, $150 million of which was subscribed by the Treasury Department, and $139 million by the twelve Federal Reserve Banks. The Corporation has repaid all this capital with interest and operates entirely without the use of appropriated funds. Federal deposit insurance is not, and was never intended to be, a guarantee of bank deposits by the Government. The Treasury of the United States is directed to lend to the Corporation not in excess of $3 billion outstanding at any one time, if requested by the

Corporation. This provision was placed in the law to provide additional funds to the Corporation in case of a serious emergency in the economy of the country. The Government is not otherwise obligated to come to the aid of the Corporation.

My own connection with the Corporation began only a few months ago, so I cannot be accused of boasting when I say that the Corporation has established an outstanding record in its administration of the deposit insurance program. We owe a debt of gratitude to those members of the Congress who have insisted that Federal deposit insurance must be free of political influence and the operations of the Corporation unencumbered by unnecessary restrictions which would limit its ability to perform its functions adequately and promptly. The directors and officials of the Corporation who guided it over its formative period were men of foresight and wisdom. The public has learned that the Corporation will meet all calls upon it without delay, impartially, and unaffected by changes in the operations of Government bureaus.

When Federal deposit insurance was established, Congress wisely provided for its administration through a corporate instrumentality for the express purpose of providing independence and flexibility in operation. The Federal Deposit Insurance Corporation must maintain its independent status in order to perform properly its functions as a monetary agency. By a monetary agency is meant an agency performing a function or functions having a direct effect on the amount of circulating medium. More than nine-tenths of the business in this country is conducted through the use of checks. Bank deposits, therefore, constitute the major part of the circulating medium. The Corporation is responsible for restoring a portion of the circulating medium which has been destroyed or has become temporarily unavailable because of a bank failure. It is also responsible for helping to maintain a sound banking system, thus preventing contraction of the circulating medium because of bank failures or fear-fed hoarding.

The Federal Deposit Insurance Act requires that "Whenever an insured bank shall have been closed on account of inability to meet the demands of its depositors, payment of the insured deposits in such bank shall be made by the Corporation as soon as possible..." Immediate payment is required even if it is clearly apparent on the date of the failure that depositors, in the absence of insurance, would receive full recovery at some future date upon final liquidation of the bank's assets.

It is the duty of the Corporation to make available at once the full amount of each insured deposit, rather than reimbursing depositors the difference, if any, between the amount of their insured deposits and their dividends from the receiver. If deposit insurance were purely for the protection of insured depositors against loss, payments from insurance authorities might be delayed months or years after the failure of the bank while its assets were liquidated. There can be, of course, only one reason for the procedure adopted: deposits are restored to their holders in full, up to the insurance maximum, so as to immediately replace circulating medium lost through a bank failure.

There are two agencies of the Federal Government which have direct responsibility in regard to the volume of the Nation's money supply. These are the Federal Reserve System, with its power over bank reserves and therefore over the creation of the largest portion of the circulating medium, and the Federal Deposit Insurance Corporation, with responsibility for maintaining a sound banking system and of restoring circulating medium which has been destroyed as a result of bank failures.

The principle of independence within Government for those agencies which deal with the Nation's money supply has been well established by history. It has long been recognized that Government faces an almost insurmountable problem when it attempts to establish an agency which will deal directly with the Nation's money supply. Such an agency must be within the Government--in order that it not be responsive to private pressures --and within the Government it must be sufficiently independent so that it will be equally free from political pressures. The financial history of this country is marked with the great debates and controversies which have raged over this very problem--from the chartering of the Bank of the United States in 1791 to the present day.

It is doubtful if there is today any serious disagreement with the proposition that a monetary agency should be free from political influence. There is no question that it is within the authority of the Congress to establish principles for the conduct of such agencies and to alter them whenever it so desires. However, within the framework of these principles, monetary agencies must be permitted to operate with a maximum degree of independence. The need for such independence was apparent to Congress both in 1913, when it established the Federal Reserve System, and in 1933 when it created the Federal Deposit Insurance Corporation.

I am sure you will all agree that, as far as bank failures are concerned "an ounce of prevention is worth a pound of cure". This was recognized by Congress, and the Corporation has been given certain powers which are useful in preventing the closing of insured banks. When an insured bank is in danger of closing, the Board of Directors of the Corporation may determine that continued operation of the bank is essential to provide adequate banking service in the community. In such circumstances, the Corporation is authorized to make loans to or purchase the assets of, or make deposits in the bank. It should be noted that such action is to be taken in order to maintain banking services which are essential to the well-being of the community, thus preventing a reduction in the circulating medium.

The supervision of insured banks is another method by which the Corporation seeks to prevent the closing of banks. It is true that one of the reasons for which the Corporation is given supervisory powers is the very natural one of providing an insurer the right to examine the risk it undertakes to insure. However, a more important purpose, with which there has never been disagreement, is that through the exercise of such supervisory powers the Corporation can contribute substantially to strengthening the Nation's banking system and to the maintenance of a high level of public confidence in insured banks.

Preventive action has not eliminated all bank failures, although only a small number have occurred in recent years. When the Federal Deposit Insurance Corporation acts to avert impairment of circulating medium as a result of a bank failure it may take one of a number of courses. If the bank is placed in receivership by the appropriate chartering authority, the Corporation may pay the depositors of that bank the amount of their insured deposits, or it may determine that its interests, as well as the interests of the depositors, are best served by reopening the bank or by facilitating an assumption of the liabilities of the closed bank by another insured bank. If the bank has not yet been placed in receivership and the Corporation finds that it can reduce its own loss and at the same time facilitate a merger it may provide funds for that purpose. If it finds that continued operation of the bank is essential to the community the Corporation may, as I mentioned a moment ago, make a loan to, purchase assets from, or place a subordinated deposit in the distressed bank.

It is essential that the Corporation be free to choose a procedure based upon an appraisal of the effects which the closing of the individual bank may have upon other banks in the community or the Nation as well as upon its decision as to the need for banking service in the community affected. There is a provision in the law requiring the Corporation, when acting as receiver of a failed bank, to liquidate the assets with "...due regard to the condition of credit in the locality..." Thus, the Corporation endeavors to avert financial distress in affected communities through the orderly liquidation of the assets acquired from closed banks.

In a period of economic crisis, when great numbers of banks both large and small may be in difficulty, decisions by the Corporation may have important and far-reaching consequences. At such times the pressures to which the Corporation will be subject from individuals, from banks, from Government authorities, and many other sources will undoubtedly be intense. It is during such times that it is of crucial importance that the Federal Deposit Insurance Corporation be in a position in which its decisions can be made solely with a view to carrying out its monetary function.

It is essential that the Corporation be able to carry out its supervisory duties in an impartial and objective manner. These duties include, besides the examination of banks, passing upon applications for admission to insurance and certain mergers, as well as upon recommendations that insurance be withdrawn from banks operated in an unsafe or unsound manner. In making decisions and in carrying out its functions the Corporation must be able to resist the pressures of those seeking only their selfish ends as well as those who seek action which appears to be popular but which in the long run would prove destructive. I should like to call to your attention a statement by the Honorable Leo T. Crowley, who was Chairman of the Federal Deposit Insurance Corporation from 1934 until the fall of 1945. Mr. Crowley said, "Based upon my experience in banking and bank supervision, I believe that one of the greatest deterrents to sound bank supervision in this country in the past has been the political control to which it has been subjected."

Of the 13,400 banks now insured by the Federal Deposit Insurance Corporation, 7,000 are State banks which are not members of the Federal Reserve System. Proper operation of Federal deposit insurance necessitates (and the law requires) that there be no discrimination against these banks by the Corporation. How well could this be accomplished in practice if the Corporation were made subordinate, as has sometimes been proposed, either to the Treasury, which department is responsible for the chartering and supervision of national banks, or to the Federal Reserve System? Decisions relating to withdrawal of insurance from a bank because of its unsafe or unsound operation must be taken solely with regard to the merits of the case in terms of the Corporation's duty to help maintain a sound banking system. How well could this be accomplished if the Corporation were placed in a relationship to another government agency which may be inclined to give weight to the pressures which inevitably arise in such instances?

In 1933 the Congress rejected proposals to subordinate the Corporation to the Federal Reserve System or to the Treasury. Since that date the Congress has repeatedly reaffirmed its original decision and has rejected every attempt or proposal to subordinate the Corporation to any other agency.

There is, however, a different threat to the independence of the Corporation. On several prior occasions and again in the present session of the Congress proposals have been made which would subject the Corporation to annual budget review, limitation and control by the Bureau of the Budget and by the Congress. I sincerely believe that it would be most unwise to restrict the operations of the Corporation in this way. Advocates of this proposal attempt to justify it because, as I mentioned earlier, the Corporation is authorized, should the need arise, to borrow Government funds. The weakness of this argument is at once apparent since it is not proposed that the same controls be extended to all corporations which have access to public funds or for whose obligations the Treasury has a liability.

No need for budget control of the Corporation has been or can be shown. Those who support this proposal bring no charge of extravagant or improper use of funds by the Corporation. The continued efficient operation of the Corporation is adequately assured by the interest of insured banks in their assessment costs and assessment credits resulting from such operations, as well as by the fact that the Corporation is regularly audited by the General Accounting Office. Insured banks are furnished the Corporation's annual report to Congress, which includes the audit report, and also a midyear report on operations.

Proponents of Budget control pointed to one or more departments or agencies of Government that have some remote resemblance to the Corporation and conclude that, because such department or agency is subject to Budget control, therefore the same treatment should be given to the Corporation. The fallacy of this argument is that such departments and agencies have only secondary, if any, resemblances to the Corporation. Only the Federal Reserve System, which is not subject to Budget control, has any major responsibility in the maintenance of the monetary system of the Nation. Thus, the comparisons are not appropriate.

There are a number of reasons for believing that irreparable damage would result if the Corporation were placed under Budget control. It is impossible to predict a year in advance how many banks will fail and how great the disbursements of the Corporation must be. Yet, if insufficient allowance for this had been approved in the budget, the Corporation might be unable to promptly make payments to insured depositors. On the other hand, if unusually large amounts were included in the budget in any year, the resulting publicity would undermine confidence in banks.

Because of these difficulties it has been proposed that only the administrative expenses of the Corporation be placed under Budget control. However, that is also unworkable since the Corporation's administrative expenses are inseparably tied to its insurance expenses. If banks begin to experience financial difficulties the administrative expenses of the Corporation must rise. Furthermore, the Corporation's budget, like other budgets, would be subject to curtailment as determined by the current policy of the Government. Bank supervision cannot operate soundly if it is not allowed to operate evenly and without the year-to-year changes which would inevitably result from placing the Corporation under those controls to which Government operations in general are subject.

It appears to me therefore, after reviewing all the potentialities of Budget control, that the independence of the Corporation is of crucial importance. Otherwise there can be no assurance that the Corporation can function to effectuate the purposes for which it was created.

The Federal deposit insurance program can succeed only so long as it has the confidence of the depositing public. Time and again the Corporation has demonstrated its ability to act quickly and effectively to protect the interests of the depositors. This flexibility and ability to meet demands promptly is due to the fact that the Corporation was created and has remained an independent agency, largely free from typical Government controls. It would indeed be a tragedy if the independence of the Corporation were reduced and its priceless asset, the confidence of the depositing public, were impaired.

Agencies excluded (under H.R. 8332) from budget control, but which are authorized to borrow from the U. S. Treasury:

Federal Home Loan Banks

Federal Land Banks

Agencies which (together with the FDIC) it is proposed to include under budget control. Unlike the FDIC, each of the others is a direct lending agency:

Central Bank for Cooperatives

Twelve regional banks for cooperatives

Twelve Federal intermediate credit banks

Preamble to the Banking Act of 1933, setting forth its purposes:

> An Act to provide for the safe and more effective use of the assets of banks, to regulate interbank control, to prevent undue diversion of funds into speculative operations, and for other purposes.