

STATEMENT CONCERNING H. R. 5130

BY VICE CHAIRMAN C. CANBY BALDERSTON

OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BEFORE THE HOUSE BANKING AND CURRENCY COMMITTEE

APRIL 25, 1963

Mr. Chairman and Members of the Committee:

The question is whether it is desirable to raise the amount of insurance provided by the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation to \$25,000 per account. Judgments concerning the bill should reflect the general purposes of insuring deposits and shares. They also should reflect the impact of such insurance upon the supervision of banks and savings and loan associations. Moreover, they should take into account the benefits and costs both to insured institutions and to the public.

Purposes of Insurance

Federal insurance of deposits and shares has several purposes. It protects individuals from loss of savings in case financial institutions fail. Families of moderate means--those most in need of this protection--do not usually have the requisite knowledge to distinguish institutions that are sound from those that are not. But this purpose of insurance is amply served under the present limit of \$10,000. It would be difficult to demonstrate that protection of small depositors and savers requires an increase in insurance coverage to \$25,000.

A second major purpose of Federal insurance for deposits and shares is to maintain public confidence. The latter is essential to the successful functioning of banks, savings and loan associations, and other financial intermediaries. This is so because their liabilities are usually more liquid than their assets. As financial

intermediaries, they acquire and hold longer-term and less-liquid obligations than savers would be willing to hold as individuals. At the same time, they supply to savers financial assets of greater liquidity than individual borrowers could furnish them directly. Such a system depends importantly on public confidence that these liabilities will be met.

Confidence in the soundness of financial institutions is safeguarded not only by insurance but also by the entire system of governmental regulation. This includes limitations on new charters and branches, examination of portfolios, restrictions as to assets held and regulation of capital adequacy. In addition there is the Federal Reserve as lender of last resort. How vital a role insurance plays in protecting financial soundness is suggested by the fact that, in periods of crisis before Federal insurance was established, even those institutions with prudent management and sound assets were not immune to "runs" by depositors and shareholders. Nevertheless, there is no reason to believe that this purpose of insurance--to preserve confidence--is not adequately served under the present coverage of \$10,000.

Benefits and Costs

Insurance provides a direct benefit to depositors and shareholders by eliminating risk of loss on the insured portion of deposits and shares. One of the results of any insurable limit is that some depositors and shareholders are led thereby to restrict the size of their individual accounts in less well-known institutions. For business firms especially, this is said to involve the inconvenience of splitting deposits, and to require the frequent transfer of funds in order to keep

deposits and shares below the insurance limit. It is argued that if this limit were raised, the volume of such transfers would be lessened, thereby increasing efficiency. We are not aware, however, of substantial evidence that business firms are seriously inconvenienced by the present ceiling.

I turn now to the impact of the proposal upon banks and savings and loan associations. It would affect competitive relationships among institutions of different types and sizes. Those that are less able to attract funds because they are located at a distance or are lesser known would benefit most from the increase in coverage. Furthermore, a higher insurance limit would tend to blur distinctions between institutions with effective management and those with inept management. The greater the insurance coverage, the smaller is the motivation for depositors and shareholders to investigate institutional soundness. This in turn weakens the incentive to manage banks and savings and loan associations prudently, and thus places an additional burden on examining and other supervisory authorities.

These observations suggest that, if increases in insurance coverage become appropriate, there is much to be said for keeping such increases small and infrequent. They also underscore the importance, as a prerequisite to insurance protection, of effective supervision over the institutions that are covered. This point is stressed in the recent report of the President's Committee on Financial Institutions.

Conclusion

In view of these considerations, the Board believes that an increase at this time in the maximum coverage of deposit and share insurance to \$25,000 would not be in the public interest.