The Rationale and Creation of the Federal Deposit Insurance Corporation

An Honors Thesis (ID 499)

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INTRODUCTION

"Deposits up to $40,000 guaranteed by the FDIC" is a very common sign to most people. This emblem is found in every bank teller's window. Yet there are probably only a few people who know of the long history of deposit insurance. This paper tells of the origins of guaranty of deposits, why it was needed, how it evolved from a state issue to a national issue, and finally how the Federal Deposit Insurance Corporation was created.
A BRIEF RATIONALIZATION OF DEPOSIT INSURANCE

"The shadow of a great rock in a weary land"¹ was used by Representative Lister Hill of Alabama to describe the section in the Banking Act of 1933. This was the section that provided for the insurance of bank deposits. This is a good description of the legislation which created the Federal Deposit Insurance Corporation. During 1929 and the early 1930's there was a Great Depression. These were extremely rough years economically for everyone world-wide. Many people throughout the United States lost hundreds of thousands of dollars through bank failures during the Depression. As a result many people advised the national government to guarantee bank deposits.

Deposit insurance was a major issue on Capitol Hill, and throughout the United States from 1890-1933. There was a great amount of interest displayed in the guaranty of deposits. This concern stemmed from those who felt that deposit insurance was essential for the re-establishment of confidence in the banking structure of the United States.² During the Great Depression, and the Panics of 1893 and 1907, there was little confidence in the banking system. This lack of trust resulted from the large number of bank failures during these panics.
Looking back to that era it can be seen that this lack of confidence usually resulted from one bank failure. It seems that the collapse of one bank tended to undermine the confidence of the community. Runs then started at other banks. Usually this "domino" effect started with one bank which failed because of inexperienced managers, poor investment or speculation of funds, improper regulation, or failure of crop prices. The crippled bank would close, or depositors would discover this and quickly withdraw their funds. Usually large volumes of money were lost or tied up in this closed bank. Other people in the community would then lose confidence in their banks, and immediately withdraw their deposits. This in turn caused other banks to close. This led Marcus Nadler to remark that bank failures were contagious.

Confidence in banks and the safety of deposits is necessary for the economic well-being of the country. This is true because bank failures hurt business in a number of ways. Businessmen customarily depend on banks for loans to carry on transactions. Banks on the other hand issue credits based upon deposits. Therefore if there are runs on banks, there is a reduction in the amount of money to be loaned to business. This is true because during such periods banks have to retain a larger amount of cash on hand, or the bank may have to close its doors. Also failures make it necessary for business firms to repay loans immediately, and these failures tie up the deposi-
itor's money so that he cannot make purchases. Therefore, solvent, safe banks are needed for financial and economic stability.

Moreover, there is a final defect in the relationship among businesses, banks, and deposits. The defect which demanded immediate and effective remedy, was that our complex and collossal business fabric rested upon the banks of the country. In turn, the banks depended for their solvency and continued usefulness upon a theoretical, yet practical, mutual confidence between themselves and their depositors. This confidence, in reality, only existed during prosperous times, and disappeared when needed in times of stress. Moreover, during those stressful periods assurance was replaced with a keen mutual distrust. This then led to a destructive, competitive scramble for currency. This was the moving cause of all our severe financial panics.
THE EARLIEST GUARANTY OF DEPOSITS

The belief has persisted that the 1933 legislation was a novel measure prompted by banking crises. Originally there was an opinion that Roosevelt’s administration devised deposit insurance to protect depositors of modest means against losses due to bank failure.\(^\text{11}\) Actually the first deposit insurance scheme was used in New York State in 1829. New Yorkers were dissatisfied with their existing banking system. Governor Martin Van Buren, worried that expiring bank charters would not be renewed, made a proposal that all banks be responsible for losses the public sustained through bank failures.\(^\text{12}\)

Van Buren’s proposal, for which there was no American precedent, was concocted by Joshua Foreman, a Syracuse businessman. He stated that the scheme was suggested by merchants in Canton, who were liable for the debts of each other in case of failure. He compared the Chinese business system to the banking system of the United States. He thought it was similar because banks had the exclusive right of making a paper currency for the people of the state. By the same rule he felt the banks should be answerable for that currency.\(^\text{13}\)

The plan, known as The Safety Fund, was passed by the New York State legislature and became law on April 2,
1829. It created a fund to which all participating banks, when renewing their charters, were assessed. The banks were charged one half of one percent of paid-in capital stock, until the total paid equaled three percent of its capital stock.\textsuperscript{14} The law also contained a provision that set up a board of commissioners. These officials were to examine the banks on a regular basis. This fund protected the entire account of all depositors. A creditor's money was reimbursed upon completion of the liquidation of the assets of a failed bank. Then if it was found that full recovery had not been secured, payments were to be made out of the insurance fund.\textsuperscript{15}
FURTHER ADOPTION OF DEPOSIT GUARANTY

Soon after the adoption of The Safety Fund Act in New York two other states, Vermont in 1831 and Michigan in 1836, implemented similar plans. In 1834 Indiana established a banking system. It was made up of one state bank which fictitiously acted as a bank with "branches". These "branches" were actually independent banks. The Indiana legislature allowed only state banks. This system was used because bankers could get around legislation and have their own banks. With this system they introduced their own form of deposit insurance. With the failure of one bank, the remaining branch banks were liable for all the debts unpaid within one year after failure. No insurance fund was provided. The necessary amounts were to be raised by special assessments on the branch banks.16

During the panic of 1837 these four deposit guaranty systems were tested. The Michigan system failed immediately. In fact, during its six years of operation it never made any payments to creditors of failed banks.17 The first insurance plan in New York was successful through the panic of 1837. Then in 1841 the Bank of Buffalo failed and was soon followed by seven other failures. These failures, immediately following the panic of 1837, caused the fund to be insufficient. The system was then suspended.
The Indiana and Vermont systems were the most successful. Indiana had only one bank failure and Vermont had an amazing none.

In 1845 Ohio adopted a system of deposit guaranty similar to Indiana's. The only difference was that it provided for an insurance fund. Iowa, in 1858, also started a banking and insurance system resembling that of Ohio. These two systems, along with the four states who originally started deposit guaranty, were successful up to and through the panic of 1857. The only exception was Vermont; which in 1857 was unable to refund claimants of one bank. Vermont's system failed because of unauthorized refunds to withdrawing banks. These refunds then depleted the fund. 18

Even though the state systems functioned well, all ceased operations by 1866 because of two new banking trends. The first was the "free-banking" idea which started in the 1830's. This was an alternative to insurance of deposits. "Free-banking" provided for the state officials to post bonds and mortgages in an amount equal to its total issues of the bank's notes. The second new concept was that the establishment of the national system in 1863. With this Congress placed a prohibitive tax on state bank notes, and guaranteed the notes of national banks. The tax destroyed state bank notes. Because deposit banking grew so rapidly after the Civil War, deposits grew to twice the amount of circulating notes. This caused new apprehension. Once again attempts were made to use insurance to guard against the consequences of bank failures. 19
ARGUMENTS FOR AND AGAINST DEPOSIT INSURANCE

From 1886 to the turn of the century eighteen deposit guaranty bills were introduced in Congress, but none were enacted. Meanwhile state insurance was being widely debated. The advocates of such a system argued there was need for such a system: (1) To protect depositors from loss; (2) to insure business stability; (3) to prevent runs on banks; (4) to prevent panics; (5) to bring money out of hoarding; and (6) to protect bankers themselves from disaster.20 Also the people who wanted deposit insurance believed it would work. They thought this because it was practicable and sound in principle. Also it was based on the same principles as those of other kinds of insurance.21

Supporters of insurance funds felt that if deposits were guaranteed people's faith would be restored in the banking system. They would then take their money out of hiding, and this money would be put back into the system. This would then promote business stability as discussed earlier. Also people would know that their deposits were guaranteed. There would then be no need to rush to the bank and withdraw their money if financial and economic stability seemed to be declining. The combination of these effects would then supposedly prevent panic. In retrospect, the prevention of panics was the only unsound argument.
On the other hand, critics thought deposit insurance: (1) would encourage speculative and wildcat banking; (2) it would make deposits so easy to get that bankers would be induced to loan them recklessly; (3) that it would reduce all banks to the same low level, thus taking away the incentive for a bank to limit its operations to sound methods; (4) that it would destroy discrimination on the part of depositors; and (5) that no adequate guaranty fund could be collected to meet the losses of failed banks without inviting graft and corruption in politics. 22

The opposition of deposit insurance worried about bankers of questionable behavior. Opposers were afraid that the bankers who used funds for risky speculation and personal gains, would be able to advertise guaranteed deposits. Thus they would obtain more deposits because people would deposit their money with anyone as long as it was guaranteed. Also risky banks could offer a higher rate of interest, as compared to sound banks, to obtain more deposits. And finally, because the deposits would be guaranteed, bankers might be less risk averse when loaning. Together these arguments became the first and most familiar objection. "That the conservatively managed institution would be compelled to contribute toward the guaranty of the banks which were incompetently or recklessly conducted." 23

Critics of deposit insurance also attacked the argument that it would prevent panics. They were correct in their assumptions because deposit insurance could not stop failures due to crop conditions, depressions, or "over-
banking" in small districts. "Over-banking happened because it was possible with a small amount of capital to open a bank. Because of this there were too many banks in some communities. It also could not automatically foster good banking practices.\textsuperscript{24} Therefore, those in opposition felt that since the guaranty of deposits would not prevent the materials for a crisis gathering; since it would not advance sound banking methods; since it would be unjust to legitimate bankers; and since all the benefits to be gained by it could be secured by a proper note issue, or by better methods of banking, there was no great reason for going into such a scheme.\textsuperscript{25} They also felt the only thing that it could do, at the best, was to save the depositor from waiting for his funds during the time of liquidation.\textsuperscript{26}
OKLAHOMA AND ITS DEPOSIT INSURANCE

As stated earlier deposit insurance was discussed by Congress as early as 1886, and often debated by state legislatures. Many states felt that such a system would work. One reason the states thought this was that they knew the chartered banks of Mexico had long maintained a voluntary league among themselves. Under the practical working of this system all came to the aid of each in time of peril, with the result that no banks failed.\textsuperscript{27} In fact after the crisis of 1893 it was a subject of great agitation, especially in Nebraska and Kansas. In these two states it was an item on the Populist program of reform legislation, persistently urged as a remedy for the evils of bank failures. In 1898,\textsuperscript{28} and again in 1899, a measure was almost passed by the legislature of Kansas,\textsuperscript{29} which contained guaranty of deposits.

Even though state guaranty of deposits was heavily discussed it fell to the wayside until the panic of 1907. This panic hurt the country, especially the western states, because of the weak banking system. Many felt after this panic that the time had "come to bring state banking laws of the country up to a higher standard of efficiency."\textsuperscript{30} It was strongly thought that some systematic and effective protection should be established for bank deposits. This
was not for the benefit and safety of depositors only, but of the banks themselves, and indirectly of the entire community as well. 31 "It was easy, therefore, to resurrect the idea [of deposit insurance] from the past and raise a clamor for its immediate adoption." 32

Late in 1907 a week-long banking holiday was declared to circumvent a stampede by depositors. The Executive Committee of the Oklahoma Bankers' Association met at Guthrie, then the state capital. The group suggested that the state guarantee the bank deposits so depositors would know their deposits were safe and sound. 33 The Guaranty Banking Bill was passed by the first legislative session of the state and approved by Governor Haskell on December 17, 1907. The law actually went into effect on February 14, 1908.

Under this first state deposit insurance plan a guaranty fund was created and placed under the general management of the State Banking Board. Each bank was required to contribute one percent of its daily average deposits for the preceding year. Annually thereafter each bank had to report its average daily deposits and contribute one percent on the amount that exceeded the previous averages. Also new banks were required to pay three percent of its capital stock into the fund. From the fund depositors of an insolvent bank, complying with the provision of the law, were to be paid immediately. The state then had the first lien upon the insolvent bank's assets. 34
After a tremendous amount of criticism that the fund was too small to cover the banks Oklahoma amended the Guaranty Banking Bill. The major change included assessments which continued annually until the fund equalled five percent of the total deposits. Another change concerned the guaranty fund if it proved insufficient to pay the depositors of failed banks. It provided that the State Banking Board was empowered to raise additional funds by the issue of a six percent interest bearing certificate. Critics also claimed the fund was illiquid and therefore defeated its purpose. The new amendment required that at least twenty-five percent of the fund had to be held in the form of cash while the other seventy-five percent could be invested. Also banks had advertised that the state government pledged to pay all bank losses. Therefore the amendment provided that banks had to change their advertisements so that depositors would no longer be misled.
OTHER STATES ADOPT DEPOSIT INSURANCE

Soon after the adoption of Oklahoma's successful Guaranty Banking Bill other western states passed deposit insurance plans. The other states which adopted deposit guaranty were Kansas, Texas, and Nebraska in 1909, Mississippi in 1914, South Dakota and Washington in 1915, North Dakota in 1917, and finally Wisconsin in 1932. Although the systems were similar they differed in such areas as participation, compulsory or voluntary; size of assessments; the deposits which were insured; how the fund was kept, cash or investments; and when deposits of failed banks were paid.

After the states started guaranteeing deposits many questions were raised about this relatively new phenomenon. In fact there was one dispute that probably "ranks as the leading decision in connection with the guaranty of bank deposits." It seems that after Oklahoma passed its law, Noble State Bank took the governor of Oklahoma and members of the State Banking Board to court. Noble State Bank felt that they should not be assessed because they were solvent, and they did not want the help of the guaranty fund. Hence the bank could not be called upon to contribute towards securing the depositors in other banks in view of article i, section x, and the Fourteenth Amendment of the Constitution of the United States.
Originally the petition of Noble State Bank was dismissed by the Oklahoma Supreme Court. On January 14, 1911, the United States Supreme Court, by unanimous decision, found that the law was not contrary to the United States Constitution. The Supreme Court found that such taxation was not the taking of private property for private use, but was the taking of private property for a public purpose. Therefore the Court concluded that it was a valid exercise of the public powers of the states. The Court stated that "when the Oklahoma legislature declared by implication that free banking was a public danger, and that incorporation, inspection, and co-operation were necessary safeguards, this court certainly cannot say that it was wrong." Therefore the Court made it clear that it did not approve or disapprove of the efficacy or economical advantage of bank deposit guaranty laws.

Then during the late 1920's and early 1930's all of the state guaranty laws were repealed. At first the systems worked well, but because of the large number of failures and weak administrations, the laws had to be repealed. The laws were annulled because the funds assumed such tremendous amounts of claims or went into debt. According to critics the guaranty systems did a good job. H. T. Dobbins, in an article in The Independent, felt that if there had been no guaranty law many more banks would have failed.
Even though the state deposit insurance plans were considered failures, the experiences taught several things: (1) the administration of the guaranty law must be kept out of politics; (2) there must be a sound general banking law accompanying the guaranty law; and (3) the administration of this general banking law must be honest and efficient.44 Also the later experiences, especially that of Nebraska, confirmed "that a guaranty system would compel the experienced and legitimate bankers to protect themselves against the operations of rascals and incompetents within the system, and thus protect the public."45 Finally it can be concluded that states could not pay deposits in full as soon as a bank closed.46 It was discovered that liquidating the assets and then paying off depositors was a better plan.
WHY DEPOSIT INSURANCE WAS DEBATED BY CONGRESS

As early as 1886 a bill was introduced in the national Congress to provide an insurance fund for the protection of depositors. Bills similar in purpose were introduced in nearly every Congress before final enactment was secured in 1933. In the Sixieth Congress alone, which met during the years immediately following the panic of 1907, thirty-three bills for deposit insurance or guaranty were submitted. Even the Federal Reserve Act as first passed by the Senate in 1913 contained a provision—eliminated in conference with the House of Representatives—for establishing a depositors' guaranty fund. Among the one hundred and fifty bills introduced on the subject between 1886 and 1933 may be found several of the features which were incorporated in the Banking Act of 1933.47

There are several reasons why deposit insurance was both presented and dropped by Congress before it was finally enacted. One of the first and major reasons was that a great proportion of the depositors in this country wanted it. Also the federal government felt a responsibility to provide it. This responsibility was felt to be more of a moral obligation. It came about because depositors assumed that if the federal government regulated banks, they were
morally bound to insure depositors and the safety of their deposits in the banks.\textsuperscript{48}

Next, a lot of individuals wanted deposit insurance passed because they felt that the system would work under federal control. The reasons the backers of the guaranty scheme felt it would be successful was that first, all banks would be included. This resulted from the thought that with federal control of all banking, banks could not exist outside of the system, or membership could even be made compulsive. Secondly membership would be so diverse that local causes of failure would not weaken the entire system. Third, this system would insure more careful supervision of member banks. This resulted mainly because bankers could not afford to let confidence in the system decline. In addition the federal government could force banks to meet the obligations of the guaranty system. A fourth argument was that funds for the insurance scheme would come from levies on the banks themselves. This would then cause bankers to insist on sounder banks in order to reduce losses.\textsuperscript{49}

One reason the legislation was dropped so often was due to a tremendous amount of people who felt that deposit insurance would not work. Many people believed that the system would fail because of the unsuccessfulness of the states' systems. These people felt that the state systems failed because they did not instill the confidence they were supposed to in system. If the state systems had caused
public confidence to grow they would have worked, instead they were looked upon as failures.

A second reason why the proposal was continuously dropped was that it lacked the support of the Federal Reserve Board. In 1918 the Federal Reserve Board felt that unification of the state and federal bank systems was needed, but felt that it would be threatened by guaranty of deposits. The Board thought that guaranty would tend to stimulate a spirit of competition and antagonism between state bank systems and the national banking system. Also it was believed that it would be difficult and embarrassing for the banks that were not as solvent as required, thus making it impossible to be guaranteed. 50
FAILURES CONTINUE

During the 1920's bank failures were common and definitely a sign that our banking system needed revamping. The stock market crash in October of 1929 and the depression afterwards put additional pressures on the banking industry. As a result, the banking system was scrutinized and investigated by Congress. Also as bank failures continued to increase, public confidence continued to decline. Thus the faulty financial structure of our nation was strained to the utmost.\textsuperscript{51}

The government, after a period of inaction, took cognizance of the adverse banking situation and adopted remedies for buttressing the collapsing banking system.\textsuperscript{52} Even though the problem was serious our leaders felt it was a short-term matter. They thought bank failures were caused by bad business conditions. They felt they could solve the problem by inventing a scheme to restore confidence in the banks, and then they would operate as before. One of the first steps taken by the Administration to help the collapsing system was to create, on October 31, 1931, the National Credit Corporation.\textsuperscript{53}
The National Credit Corporation was primarily a psychological trick to alleviate the fears of depositors. Basically the system was organized to obtain funds with which to make loans to banks needing aid. This program definitely did not do what it set out to do. During its first month in operation there were five hundred twenty-two bank failures.\textsuperscript{54} Apparently it did not blind the eyes of depositors as was expected.

A second scheme of the government was to create the Reconstruction Finance Corporation on January 22, 1932. The Administration finally realized that in order to prevent banks from failing, substantial and fully secured loans would have to be granted to them. Any commercial bank confronted with a run could pledge collateral with the Reconstruction Finance Corporation and then receive assistance from it. The effect of the Reconstruction Finance Corporation was direct and immediate. The number of bank failures decreased sharply. It was believed that the Reconstruction Finance Corporation, with huge resources at its disposal, could prevent bank failures. This changed the attitude of depositors toward their banks, and it was this new attitude that immediately restored the confidence of the public in banks.\textsuperscript{55}

Although the merits of the Reconstruction Finance Corporation cannot be denied, it was obvious that it acted only as a sedative. It was considered as a temporary emer-
gency measure. Its success depended upon further legislation looking toward the reorganization and strengthening of the entire banking system. Instead of taking adequate measures to reorganize the banks during the period in which the Reconstruction Finance Corporation instilled confidence in the people throughout the country, the Administration rested on its laurels.56

The system continued to run smoothly until June, 1932. During June and July there was a large number of bank failures which started in Chicago and spread across the country. Immediately following this the Clerk of the House of Representatives misinterpreted a law. He then mistakenly published a list of the banks that had borrowed funds from the Reconstruction Finance Corporation. When the names of these banks appeared in papers throughout the country depositors began to withdraw their funds from these banks. Runs started on these institutions, but as long as they had collateral they were able to get loans from the Reconstruction Finance Corporation. Soon their collateral gave out. No longer having anything to pledge and thus no way to receive additional loans, banks began to fail. During October, 1932, one hundred and three banks failed. This once again destroyed the confidence of the public.57

Unable to cope with the situation of such a large number of runs and failures, a number of mayors of several western states declared banking holidays. The first holi-
occurred on October 31, 1932, when the Lieutenant Governor of Nevada declared a banking holiday for twelve days. Then suddenly on February 4, 1933, Louisiana declared a public holiday so that banks could have a respite from their depositors. Quickly following this most other states had banking moratoriums or limited withdrawals of deposits to five percent. On March 5, President Roosevelt decreed a four day bank holiday, and Congress was called in for special session. On March 9, 1933, Congress passed emergency legislation that gave the President complete control over banks. Then on March 11 banks began to slowly reopen.
DEPOSIT INSURANCE DISCUSSED IN 1932

Finally, after many years of debate over the passage of deposit insurance, guaranty of deposits was given the nod after the Great Depression. It took the crash of 1929 to really wake up many parties to the fact that ours was a "quickly deteriorating banking system." One party that showed a little more interest was the Federal Reserve System. Although they did not offer a complete program for legislative action, the Federal Reserve System did pursue a policy of indirect pressure on banks in an effort to stabilize economic conditions.

Legislators were another faction who opened their eyes to the problem after the depression. When so many banks closed and bank depositors were so severely hurt, concern for their plight became important to legislators. This was reflected in the fact that there was a flood of legislation concerned with guaranty of deposits during the first session of the Seventy-Second Congress. Also it was of special significance that the support of these bills was so diversified. Support for these measures was not characterized by regional or special interest groups. Support came from all areas and groups.
Of the bills introduced, attention centered primarily on a measure presented by Congressman Steagall on April 14, 1932. This bill provided for a guaranty fund for deposits in banks. It covered national banks, Federal Reserve member banks, and non-member state banks. The Steagall bill was rigorously debated on the floor of Congress, in banking journals, and in the general press. Bankers in particular were opposed to its enactment. The general public; however, looked with favor on the act. The bill was sent to the House Banking and Currency Committee, reported out, and was discussed at length on the floor of the House. On May 27, it passed the House with amendments. On May 29, it was sent to the Senate where it was referred to the Senate Banking and Currency Committee. There it remained until the close of the final session of the Seventy-Second Congress.64

Even though the public was pressuring Congress for deposit insurance, the legislators did not take the subject half-heartedly. Instead of passing the legislation quickly to keep the public happy, they took the matter seriously. They discussed the topic until they confidently felt that the legislation would be a good, sound measure. Indeed they were successful because the Steagall bill that they passed became part of the final deposit insurance legislation.
THE FEDERAL DEPOSIT INSURANCE CORPORATION IS CREATED

In the early part of Roosevelt's Administration, Vice President Garner, Congressman Steagall, and other Senators pressed Roosevelt and Senator Glass for a guaranty system. Despite this urging, Roosevelt remained amiable, but adamant. During his first presidential press conference on March 8, 1933 he publicly opposed deposit insurance.65

Senator Glass did not want deposit insurance, but he had to yield to the country's demand. It became perfectly apparent that the voters wanted the guaranty. In fact a bill which did not contain such a provision would not be satisfactory either to Congress or to the public. Washington does not remember any issue on which the sentiment of the country was so undivided or so emphatically expressed.66

Then in the Spring of 1933 the Glass Bill was introduced. Its three areas of reform included: (1) banking structure, including change in the organization of the Federal Reserve System, possible Reserve control of all banks, and some solution to the branch, chain, or group banking debate; (2) commercial and investment banks, their proper relationship and control of credit; and finally after a long
waiting period (3) guaranty of deposits by the federal government or by a liquidating corporation. The third provision of course was the most controversial issue.

On May 10, Senator Glass introduced a revised version of his banking bill. It was immediately referred to the Senate Banking and Currency Committee. This plan included a provision for insurance under a sinking fund similar to his original bill. One week later, on May 17, Representative Steagall introduced a similar bill in the House of Representatives. Steagall wrote in a guaranty fund to which all banks could have free access. In these two versions of the bill lay the alignment of large and small banks. Glass's program, the more conservative, would win whatever support was available from the big banks. Steagall's bill represented the broader guaranty position of the small-bank men. These bankers hoped that such a fund would provide sufficient reinforcement to prop up their banks against threats of compulsory membership in a national system. From the combination of these measures was the basis of what came to be known during debate as the Federal Deposit Insurance Corporation.

The Senate Banking and Currency Committee reported the Glass bill to the Senate on May 15. Debate concentrated on the deposit insurance proposal. It seemed that under the proposal the proposed Federal Deposit Insurance Corporation would not begin operations until July 1, 1934.
Many legislators felt strongly that an immediate guaranty of deposits was necessary.\textsuperscript{73} Four days later Republican Senator Arthur Vandenberg introduced an amendment to the Glass bill providing for insurance of bank deposits up to $2,500 at once.\textsuperscript{74} This temporary plan was to be financed by the federal government and was to begin immediately, continuing until the establishment of the permanent Federal Deposit Insurance Corporation.\textsuperscript{75} The Vandenberg amendment appeared made to order for those like Vice President Garner who had long favored a guaranty. It passed with the support of the Midwestern senators, and went to Conference Committee. Meanwhile, thousands of telegrams, letters, and many depositors in closed banks, inundated the politicians with pleas for guaranty.\textsuperscript{76} On May 20, the House of Representatives took up the Steagall bill; after debate it was passed\textsuperscript{77} by a vote of two hundred and sixty-two to nineteen on May 23, 1933.\textsuperscript{78} Meanwhile, in the Senate, debate continued on the Glass bill. On May 26, it too was approved, with the Vandenberg amendment included.\textsuperscript{79}

While the debate on deposit insurance raged in the legislative branch of the government, the president continued to study the problem. It was said that Roosevelt was completely opposed to the Vandenberg amendment which provided for the immediate guarantee of bank deposits. In fact it was rumored that Roosevelt would veto the bill if the Vandenberg amendment was attached. Roosevelt, how-
ever, astute politician that he was, did not underestimate the power of the people. He agreed to accept the amendment if the effective date was postponed until January 1, 1934. He also consented to approve a provision that would empower him to fix by proclamation an earlier date for the beginning of deposit insurance, should he deem it necessary. This compromise was accepted by the House and Senate members of the Conference Committee when they met to iron out the differences between banking bills passed by their respective chambers. 80

A second compromise was reached by the conferees. In the final analysis the Senate version of the Banking Act of 1933 differed from that of the House in its approach to eligible membership in the Federal Deposit Insurance Corporation. Congressman Steagall had insisted that state member banks be allowed to join the Corporation, regardless of their membership in the Federal Reserve System. The House bill reflected his position. Carter Glass saw the Corporation as a means whereby state banks could be forced to become members of the Federal Reserve System. He felt there should be only a federal system of banking. He had insisted upon the inclusion of this provision in the Senate bill. 81 The Conference Report recommended that State banks which were not members of the Federal Reserve System should be permitted to join the Federal Deposit Insurance Corporation, with the proviso that they would become members of
During the Corporation's first decade of existence its immediate goal was to rebuild the public's faith in banks. During this time its perspectives and objectives broadened in line with the need of modern society to view the economy as a whole—rather than focus on only one segment of an essentially interrelated whole. The Federal Deposit Insurance Corporation's concern as insurer of deposits and supervisor of insured non-member banks of the Federal level is to insure the vigor and viability of the banking system. Also it is concerned about the ability to meet the current and potential financial requirements of the economy. 95

There have been many changes in banking, and there are changes yet to come. Automation and computerization present new challenges, while new ways of doing business open up new fields for banking. There exists sizable unfulfilled needs of society. These might include the urgent need to undertake urban renewal projects, to make education more broadly available, to upgrade housing, to provide financing for small businesses. Therefore these projects pose other problems which must be solved. 96

The Federal Deposit Insurance Corporation considers it an important part of its current responsibilities to assist banks in meeting these needs and challenges. This appears at first glance to constitute a major shift away from the role delegated to the Federal Deposit
CONCLUSION AND SUMMARY

Ironically, the controversial issue of insurance succeeded for exactly the reasons that its most bitter critics condemned it to failure. It made strong banks responsible for the losses of the weak. As a result, the more stable members of the banking system compelled their less sound colleagues to reform before disaster forced them to seek refuge in the fund. Bad banks were seldom permitted to go under. Instead they were reorganized under new management or merged with a good bank. Thus the Federal Deposit Insurance Corporation had only to assume responsibility for losses on depreciated assets, not the collapse of an entire institution. Moreover, small depositors felt sure that they would get their money even if one bank experienced financial difficulties. Therefore, a single failure no longer led to runs which might force sound banks to suspend.93

The Federal Deposit Insurance Corporation has concentrated its efforts on the task of restoring public confidence in banks following the banking crisis of the early 1930's. Subsequently the Federal Deposit Insurance Corporation tries to maintain this confidence by policies designed to strengthen the banking system.94
the system by July 1, 1936.\textsuperscript{82} On June 13, 1933, the report of the Conference Committee was submitted in both houses of Congress. In both houses debate was brief, the Conference Report was accepted, and a banking bill was finally approved by Congress. Three days later, on June 16, 1933, the president signed the new banking act into law\textsuperscript{83} lauding it as the "second most important banking legislation enacted in the history of the country."\textsuperscript{84} This law was the first serious, and partially successful piece of legislation. It was directed at the fundamental causes rather than the symptoms of the problems in the American banking system.\textsuperscript{85}
THE BANKING ACT OF 1933

The Banking Act of 1933 created a fund of a half billion dollars to guarantee deposits in Federal Reserve member banks. It also established a board of directors of the Corporation composed of the Secretary of the Treasury, the Comptroller of the Currency, and three members appointed by the President. The fund was created by transferring $167,000,000 from the United States Treasury. This amount had been paid by Federal Reserve Banks as a franchise tax. Added to this was $130,000,000 from the Federal Reserve System surplus of $275,000,000. Also member banks were assessed $130,000,000 in ratio to their deposits, with the provision that an additional $70,000,000 would be obtained after the board started to function.86 When the permanent plan took effect each bank would be required to pay one half of one percent of amounts of its deposits.87

The institutions whose deposits were to be covered by the insurance were the national banks, the State bank members of the Federal Reserve System, and until July 1, 1936, other state banks found on examination to be solvent.88 Under the law it was necessary for non-member State banks to be examined to determine their eligibility
for deposit insurance in the Temporary Fund. All member banks of the Federal Reserve System automatically became members of the Fund. The examination process of the Federal Deposit Insurance Corporation provided that when a bank was declared insolvent, it would be taken over by the board, and all depositors would be paid off in installments. The final payment made twenty months after the bank closed.

The Federal Deposit Insurance Corporation is organized to insure the deposits of all banks that are qualified under the law to receive the benefits of deposit insurance. The entire resources of the Corporation are placed behind every insured bank to guarantee to each depositor the safety of his deposit. As a first step in this program the Corporation set up a Temporary Insurance Fund, January 1, 1934. This was to insure all deposits in eligible banks up to a maximum amount of $2,500 each until July 1, 1934. About ninety-seven percent of the depositors in the banks had less than $2,500 in their accounts. This meant that the vast majority of depositors had one hundred percent protection, even under the Temporary Plan.

On July 1, 1934, the Permanent Fund was to go into effect and deposits up to $10,000 were to be insured one hundred percent; amounts up to $50,000 insured seventy-five percent, and amounts in excess of $50,000 for fifty
percent. The period of operation of the temporary plan
was extended to July 1, 1935, by an amendment in 1934, and
to August 31, 1935, by a Congressional resolution signed
by the President. On August 23, 1935, a permanent system
in roughly its present form became effective under the
provisions of Title I of the Banking Act of 1935.92
Insurance Corporation by Section 8 of the Banking Act of 1933. On closer examination it is found that the Corporation's place in the Federal bank supervisory structure today is a logical extension of its original responsibilities. \(^97\)

Federal deposit insurance came upon the national scene in 1934 as a fairly modest effort to lesson the number of bank failures and to soften their impact. This was to help restore confidence in the banking system and to protect the money supply. Even though the Federal Deposit Insurance Corporation was given only limited financial resources at the beginning, it was early invested with supervisory responsibilities. These were intended to help assure soundness in banks so that only minimum calls would have to be made on those resources. This basic rationale of deposit insurance has been modified only in minor respects since. Federal deposit insurance has successfully all but erased bank failures as a major threat to our banking system. \(^98\)

Participation in Federal deposit insurance has always been high, increasing steadily from an initial eighty-six percent to the current ninety-seven percent. Coverage has risen from an initial maximum on $2,500 for each depositor to the present maximum of $40,000. Losses of depositors of failed insured banks have been only a fraction of one percent of their deposits. At the same time, the deposit insurance fund has grown steadily from
the initial $289,000,000 capital subscribed by the United States Treasury and the Federal Reserve Banks. The Corporation has an additional three billion dollars in borrowing authority from the Treasury which has never been used.99

The Corporation's record of protecting depositors is good. After the first few years, upwards of ninety-five percent of all deposit accounts have come within whatever insurance maximum was currently applicable, thus minimizing the chance of loss. In the cases in which banks have been closed for liquidation, depositors with excess deposits (above the insurance limit) have been able to recover it through liquidation of the bank's assets. The bank's assets are liquidated by the Corporation who acts as receiver and liquidator. And, in the cases in which distressed banks have been absorbed by other banks, with the Corporation's financial assistance, all depositors have been fully protected. Altogether, the Corporation had actively protected over 1,630,000 depositors of four hundred and seventy failing banks by the end of 1967. Fewer than two thousand depositors in all terminated cases had not received full recovery.100

In recent years there has been added to the historic depositor orientation of the Corporation a new job. It now has responsibility for adequate disclosure of information to certain bank shareholders. The Corporation
has also acquired some additional regulatory tools. These include the authority to establish interest rate ceilings on a more flexible basis and as yet unused cease-and-desist authority as a means of supervision. Cease-and-desist is a less drastic measure than the termination of insurance provisions for banks persisting in unsafe and unsound banking practices. Some of these changes reflect recognition of the emergence of a different pattern of bank failures than in the 1930's. Previously economic conditions or individual bank weakness accounted for most failures in the early years of deposit insurance. Now fraud has been the main cause for failures in recent years. Thus deposit insurance has moved with the times. It undertakes new responsibilities and programs both to keep abreast of current developments and to help set the pace of a dynamic banking system. 101
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6 Hodgson, Federal Regulation of Banking, p. 17.

7 Nadler, Banking Crisis, p. 21.

8 Hodgson, Federal Regulation of Banking, p. 17.

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13 Ibid., p. 183.

14 Ibid.

15 Ibid.

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17 Ibid., p. 185.

18 Ibid., p. 186.

19 Ibid., pp. 186-7.

21 Ibid., p. 219.
22 Ibid., pp. 217-8.
26 Ibid., pp. 103-4.
27 Nettleton, "Deposits Be Guaranteed?" p. 340.
29 Nettleton, "Deposits Be Guaranteed?" p. 340.
31 Nettleton, "Deposits Be Guaranteed?" p. 340.
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38 Ibid., pp. 131-2.
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52 Nadler, Banking Crisis, pp. 101-102.

53 Ibid.

54 Ibid., p. 102.

55 Ibid., p. 106.

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57 Ibid., p. 131.

58 Ibid., p. 134.

59 Ibid.

60 Burns, American Banking Community, p. 12.

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Ibid., p. 203.

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87 "Deposit Insurance Draws Near," Review of Reviews, December 1933, p. 50.


90 "Uncle Sam Guarantee," p. 12.

91 Federal Reserve Bulletin, October 1933, p. 597.


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