A Historical Perspective on Deposit Insurance Coverage

by Christine M. Bradley*

Since 1980, deposit accounts held in federally insured depository institutions have been protected by deposit insurance for up to $100,000. Now attention is being directed at deposit insurance reform, and questions have been raised as to whether the current insurance limit is sufficient.

This article traces the deposit-insurance limitation from its original figure of $2,500, adopted in 1933, through each subsequent increase up to the current coverage. The article is intended to serve only as background for discussions of whether an increase is appropriate and does not draw any conclusion on whether such an increase is justified.

The first section of this article recounts the events that made enactment of federal deposit insurance inevitable in 1933, when at least 149 previous proposals had been considered over 57 years and failed.[1] The second section focuses on the enactment of the Banking Act of 1933 and the adoption of a federal insurance program. The third section of the paper concentrates on the limitations Congress imposed on insurance coverage, beginning with the initial limitation and proceeding through six increases (in 1934, 1950, 1966, 1969, 1974 and 1980). The discussion centers on the rationale(s) for each of the limits set. Some concluding remarks are contained in the fourth section.

BACKGROUND: 1920–1933

The high prosperity and steady economic growth that the United States enjoyed for most of the 1920s came to a halt in 1929.[2] Although the mere mention of 1929 brings to mind the dramatic stock market crash, the October crash had been preceded by declines in other economic indicators. From August through October of that year, production had fallen at an annualized rate of 20 percent, and wholesale prices and personal income had fallen at annualized rates of 7.5 percent and 5 percent, respectively.[3] But despite the general downward trend of the economy, it was the stock market crash that resulted in what has been called "an oppression of the spirit."[4]

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[1] Kennedy (1973), 215; FDIC (1950), 80–101.

[2] The country suffered recessions in 1924 and 1927, but both were so mild that ordinary citizens were unaware that they had occurred. *See* Friedman and Schwartz (1993), 296.

[3] Ibid., 306.

[4] Kennedy (1973), 18.

The nation's financial sector had not been impervious to the effects of the worsening economy: bank suspensions were numerous throughout the 1921–1929 period. Nonetheless, the suspensions were easy to dismiss as regional issues because the closings were locally contained. From 1923–1924, for example, the number of bank suspensions rose in the Central United States because of problems in the agricultural sector, and suspensions in 1926 increased in the South Atlantic states largely because of the collapse of real-estate prices in Florida.[5] Although no banking panic immediately followed the stock market crash, in early 1930 the rate of bank failures began to increase over broader geographic areas of the country.

As the number of bank suspensions increased, fear spread among depositors. But the bank failure that did most to undermine confidence in the financial sector was that of the Bank of United States in December 1930. Although the Bank of United States was the largest commercial bank to have failed up to that time in U.S. history,[6] the effect of its failure was magnified by its name, which led many to believe (erroneously) that it was affiliated with the U.S. government. Additionally, when the Federal Reserve Bank of New York was unsuccessful in attempts to rally support to save the institution, the bank's closing contributed to a growing lack of confidence in the Federal Reserve System.[7]

The pressures that led to the failure of the Bank of United States, and that were felt in the financial sector as a whole throughout the closing months of 1930, moderated in the next year. By early 1931, the number of bank failures had sharply declined, and other indicators of economic activity also showed some improvement. Nevertheless, in January 1931 the U.S. Senate began hearings on the banking situation.[8] Deposit insurance was not one of the designated subjects of these hearings but the number of bank failures and the inability of depositors to gain access to their deposits demanded attention. During the hearings some thought was given to setting up a fund to take charge of failed institutions and pay off depositors and stockholders immediately,[9] but given the signs of improvement shown by economic indicators compared with the low figures of late 1930, no sense of urgency developed.[10]

By late March 1931, as if on a seesaw, the number of bank failures began to rise again.[11] This time members of the public reacted almost immediately by converting their deposits into currency.[12] By November 1931, almost one-half billion dollars had gone into hiding.[13] Some depositors who had withdrawn their funds looked for alternatives to keeping their money at home. Postal savings banks (PSBs) had been established in 1910 as a small-scale program for low-income savers, but PSBs were limited in their ability to compete with commercial banks because accounts in PSBs were limited to a maximum of $2,500.[14] However, as depositors became disillusioned with the more traditional depository institutions, PSBs seemed a safe alternative, especially because they were in effect operated by the government and enjoyed a government guarantee. Between March 1929 and year-end 1931, time deposits held by PSBs increased by nearly 400 percent,[15] whereas the deposits held by member and nonmember banks fell by almost 20 percent between January 1929 and year-end 1931.[16] It was apparent that something had to be done with the increasingly precarious condition of the U.S. banking system.

Action was taken on several fronts in an effort to revive the banking industry. In August 1931, the Federal Reserve Bank of New York requested that a

[5] During the 1931 Senate hearings concerning the condition of the banking system (discussed below), bank failures were seen as the result of a change in economic conditions brought about by the use of the automobile. With the advent of the automobile and improved roads, depositors were more readily able to get to larger towns and larger banks and many smaller, rural banks were no longer needed. Since many of the smaller banks operated with limited capital, they were unable to adjust. U.S. Senate Committee on Banking and Currency (1931), 44–45.

[6] As measured by volume of deposits. Friedman and Schwartz (1993), 309–10.

[7] Ibid., 309–11, 357–59.

[8] U.S. Senate Committee on Banking and Currency (1931).

[9] Ibid., 332.

[10] Friedman and Schwartz (1993), 313.

[11] Federal Reserve Board of Governors (1931), 126.

[12] Another factor that added to the increasing withdrawals from commercial banks was fear on the part of foreign depositors that the United States was going to abandon the gold standard much as Great Britain had in September 1931. See, for example, Friedman and Schwartz (1993), 315–18.

[13] Kennedy (1973), 30.

[14] The limit on accounts held by the PSBs was originally set at $500. In 1918, the amount was raised to $2,500. PSBs were solely deposit-taking institutions and were not authorized to lend money to individuals. For details about the history of the PSBs, see the third section of this article.

[15] Federal Reserve Board of Governors (1934), 170.

[16] Ibid., 163.

group of member banks purchase the assets of failed banks so that depositors could immediately be advanced a portion of their funds. President Herbert Hoover urged the formation of the National Credit Corporation (NCC). Although the NCC was created in October 1931 with President Hoover's encouragement, it was a private organization of banks that provided loans to individual banks against sound but not readily marketable assets. It had been envisioned as a form of bankers' self-help: The financial structure of weaker institutions would be strengthened with the aid of stronger ones. Whether the NCC was successful to any degree is open to question. Friedman and Schwartz claim that the group of bankers forming the NCC gave up almost immediately and demanded direct government action.[17] Nonetheless, contemporaries maintained that, even though the funds actually loaned by the NCC were minimal, the formation of the group had a beneficial psychological effect and tended to restore the confidence of both bankers and depositors.[18] In any case, within two weeks of the NCC's creation, bank failures as well as bank withdrawals declined.[19]

The calm that followed the establishment of the NCC did not last. In December 1931 another wave of bank failures began, making direct government intervention unavoidable. In January 1932, the Reconstruction Finance Corporation (RFC) was established as part of President Hoover's 18-point program to combat the economic depression. The RFC was developed partly in response to a general feeling that any possible recovery was being hampered by the huge volume of deposits that remained tied up in unliquidated banks. The RFC began making loans in February 1932. Within four months it had approved $5 billion worth of loans. The recipients of these funds included—in addition to agencies, agricultural credit corporations, and life insurance companies—4,000 banks.[20]

But the RFC opened itself up to criticism almost immediately when several of its first loans went to huge financial institutions rather than to smaller institutions. Further damage was done when the RFC loaned funds to an institution headed by its former president just weeks after he had left the corporation; the ensuing scandal escalated into a run on banks in the Chicago area.[21] With the RFC's practices under attack, Congress elected to provide some oversight, and in the summer of 1932 it required the RFC to provide the Senate with a list of all the recipients of its loans.[22]

In the same month that the RFC began making loans (February 1932), Congress passed the Glass-Steagall Act in a further attempt to reinvigorate the financial sector. The 1932 law broadened the circumstances under which banks could borrow from the Federal Reserve System and increased the amount of collateral the Federal Reserve System could hold against Federal Reserve notes.[23] The creation of the RFC, the enactment of Glass-Steagall, and a concomitant reduction in the number of bank failures somewhat restored the public's confidence in the U.S. banking sector, and an inflow of bank deposits resulted.[24]

Nevertheless, bankers remained uncertain about the timing and level of future withdrawals and continued to keep ever-larger reserve accounts. Between July and December 1932, member banks increased their holdings of U.S. government securities by $912 million.[25] At the end of 1932, member bank balances exceeded the required reserve by $5.75 million.[26] Between March 1929 and year-end 1932, loans made by member and nonmember banks fell by 64 percent.[27] A report on the causes of the economic depression by the National Industrial Conference Board stated that "the course of the present depression has been made deeper by the failure of the banking system at large to extend credit accommodation to industry and trade as a whole."[28]

In January 1933, congressional hearings that had originally been intended to look into stock exchange practices crossed over into an investigation of the banking industry. Before the hearings ended, banking customers had been painted as victims, while bankers

[17] Friedman and Schwartz (1993), 320.

[18] *See* Kennedy (1973), 35; U.S. Committee on Banking and Currency 68 (1932) (statement of George L. Harrison).

[19] Wicker (1996), 95–97.

[20] Kennedy (1973), 39.

[21] Ibid., 39–45.

[22] Ibid., 37–45. Consequences of the publication of the list of loan recipients are discussed below. See text accompanying note 31.

[23] Public Law 72-44, Statutes at Large 47 (1932): 56–57 (codified as amended at 12 U.S.C. §§ 347a, 347b, and 412 (1989)). Note: There are two pieces of Glass-Steagall legislation. The 1932 legislation is distinct from the better known Glass-Steagall Act that was part of the Banking Act of 1933. The 1933 legislation was generally concerned with separating commercial and investment banking activities. Public Law 73-66, Statutes at Large 48 (1933): 162 (codified as amended in scattered sections of 12 U.S.C.). In this article, *Glass-Steagall* refers to the provisions of the 1932 law.

[24] Federal Reserve Board of Governors (1932b), March, 141.

[25] Federal Reserve Board of Governors (1933a), 6.

[26] Ibid., 1.

[27] Federal Reserve Board of Governors (1934), 161.

[28] Kennedy (1973), 130.

had come to be seen as profiteers who were unfavorably compared to Al Capone.[29] At any other time the hearings would probably not have had a significant effect on the banking sector, but coming on the heels of four years of turmoil in the industry, the hearings reinforced the public's distrust of the U.S. banking system and nourished existing hostilities.[30]

Any hope that tensions would ease before the new president (Franklin Roosevelt) took office in March 1933 vanished when the House of Representatives ordered the RFC to release a report of its operations. Included in the report was a list of the banks that had received loans from the RFC. President Hoover had warned against such a release, and much as he predicted, the public panicked when they assumed that any institution requiring a loan from the RFC was in jeopardy of failing—heavy withdrawals followed.[31] But unlike earlier crises, this time even banks that had turned themselves around were hit hard with withdrawals.

By the end of January 1933, the banking crisis had reached such a point that closing the banks appeared to be the only option. In many cities, individual state-chartered banks had already restricted withdrawals. Many states were facing statewide bank holidays, and restrictions on national banks' ability to limit withdrawals were removed in February 1933. A national bank was now able to limit or restrict withdrawals according to the terms allowed for state banks located within the same state.[32]

Having been defeated in the presidential election, President Hoover would not take any action without the support of the president-elect and Congress or the Federal Reserve Board. President Hoover made it clear that he favored some form of federal guarantee of deposits instead of declaring a national banking holiday, but support for action was not forthcoming. As a result, he left office without either declaring a national banking holiday or proposing federal deposit insurance. The failure of the federal government to take action forced the states to act, and by March 4, 1933, all 48 states had declared some form of banking holiday or had otherwise restricted deposits.[33]

March 1933

By March 4, 1933, when Franklin Roosevelt took the oath of office as president, the national income had fallen 53 percent below what it was in 1929, and wholesale prices had fallen almost 37 percent; the national debt had increased 20.7 percent above what it was in 1929, and security prices had fallen to approximately one-fourth the prices of 1929.[34] Since the beginning of 1929, 6,169 banks had suspended operations.[35] Some observers maintained that Roosevelt took office without fully appreciating the extent of the crisis that was overwhelming the financial sector of the country.[36] They believed that he thought the banking system needed only minor adjustments and as a result he had no plan for restoring the system to working order.[37] Nonetheless, President Roosevelt knew that he had to assume national leadership if order was going to be restored to the country. Within days of taking office he declared a national banking holiday, announcing that banks would be closed from March 7, 1933, until March 9, 1933. President Roosevelt knew that a limited closure would not be enough, but he also realized that to suspend banking indefinitely would be unwise.[38] Ultimately the banks remained closed until March 13, 1933.

After taking steps to stall the deterioration of the banking industry, President Roosevelt recognized that it was vital that currency be returned to the banking system when the banks were reopened. For this to happen, he knew that depositors' confidence had to be restored. Accordingly, he pledged that only safe-and-sound banks would be reopened, and immediately announced a schedule for their reopening.[39] The public responded. Between March 13 and March 30, 1933, currency in circulation declined by $600 million as funds were redeposited.[40] Realizing that the banking industry had narrowly escaped total disaster,

[29] See, for example, *Commonweal* (1933), 535.

[30] President Hoover originally requested the hearings in 1932, but congressional recesses and political maneuvering delayed them until 1933. When the hearings began to delve into banking practices, Ferdinand Pecora became counsel of the subcommittee and was primarily responsible for them. As a result, the hearings became known as "the Pecora hearings." They ran until March 1933. For a thorough discussion of the hearings, see Kennedy (1973), 103–28.

[31] See text accompanying note 22.

[32] Nevada had declared a statewide banking holiday on October 31, 1932, when runs on several individual banks threatened to develop into runs throughout the state. But not until February 1933 had conditions nationwide deteriorated to the point that a majority of states were considering banking holidays.

[33] Wicker (1996), 128–29.

[34] Kennedy (1973), 153; Federal Reserve Board of Governors (1933b), 462.

[35] Federal Reserve Board of Governors (1937), September, 867; (1934), 206.

[36] *See* Kennedy (1973), 164, 168.

[37] *See* Phillips (1995), 33.

[38] Roosevelt (1934), 17–18.

[39] On March 7, 1933, 17,032 banks suspended activity. On March 12, 12,817 of them were licensed to reopen. By the end of 1933, 1,105 of the original group had been placed into liquidation. Wicker (1996), 146–47.

[40] Ibid., 147.

President Roosevelt knew that if any licensed bank were again closed after the banking holiday, another and far more serious crisis would develop. The government had no choice but to stand behind every bank that had reopened.

THE BANKING ACT OF 1933

When the banks reopened, the country enjoyed a surge of confidence in its financial system and in its future. But President Roosevelt understood that, although the banking holiday had cut short the crisis, the underlying system that had allowed the panic to develop had not been altered. By the spring of 1933, just two months after the banking holiday, Congress was ready to acknowledge that permanent changes had to be made to the banking system, and by June the Banking Act of 1933 (Banking Act) was law.[41] Although the Banking Act was mainly concerned with ensuring that bank funds were not used for speculative purposes, the legislation also provided for federal deposit insurance.

The federal insurance program was not the first program in the United States to guarantee deposits. Deposit accounts had previously been insured under state systems, but by 1929 all the state systems were either insolvent or inoperative.[42] In 1932 a bill for federal deposit insurance sponsored by Representative Henry Steagall passed in the House of Representatives but went nowhere in the Senate, largely because of the opposition of Senator Carter Glass.[43] Senator Glass instead supported a liquidating corporation that would give depositors of a failed bank their expected recovery almost immediately and thereby quickly return the funds to the community.[44] President Roosevelt was against providing a government guarantee of bank deposits. He was not alone: bankers, including the American Bankers Association, opposed an insurance program, maintaining that such a program rewarded inept banking operations.[45] Despite this broad-based opposition to federal deposit insurance, the combination of public opinion (pressure from constituents) and the circumstances of the time forced Congress to take action. A federal deposit insurance program was adopted less than four months after President Roosevelt took office.

The deposit insurance issue had been thoroughly debated in 1931 and 1932.[46] The earlier debates indicate that the motives for approving a federal insurance program can be generally classified as either to ensure monetary stability or to protect the depositor, but in the eyes of most, ensuring the continued stability of the monetary system was of primary importance.[47] As was stated in 1932:

> To provide the people of the United States with an absolutely safe place and a convenient place to put their savings and their deposits is essential to the stability of banking, bank deposits and loans, the checks which function as money, and business conditions in every line. It is essential to the stability, therefore, of manufacturing and distributing goods in this country through the merchants and jobbers and wholesalers. It is essential to the maintenance of the commodity prices in this country, including . . . those things which are produced by the farmers, miners, foresters. . . . It is essential to the stability of the income of the Nation. . . . It is a far greater matter than the very important end of protecting the individual depositor or the bank from loss.[48]

[41] The Banking Act of 1933, ch. 89, Statutes at Large 48 (1933): 162 (codified as amended in scattered sections of 12 U.S.C.).

[42] *See* Kennedy (1973), 215; FDIC (1950), 65.

[43] Barr (1964), 53.

[44] Kennedy (1973), 52.

[45] *See* Kennedy (1973), 215–20; Preston (1933), 598.

[46] U.S. House Committee on Banking and Currency (1932); U.S. Senate Committee on Banking and Currency (1931). Since the congressional committee in 1933 referred to the previous hearings and reports with approval, much of the discussion in this article relies on these records. Federal deposit insurance had been discussed as early as 1886 and some form of deposit insurance legislation was attempted in almost every Congress between that time and 1933, resulting in at least 149 other bills before the 1933 legislation. FDIC (1950), 80–101.

[47] The justifications used for enacting federal deposit insurance included the following: (1) to provide protection against bank runs—see, for example, 77 *Cong. Rec.* S3728 (daily ed. May 19, 1933); (2) to ensure a steady source of funds as a circulating medium—see, for example, 77 *Cong. Rec.* H3839 (daily ed. May 20, 1933); (3) to return funds to circulation after bank failure through the prompt payment of depositors—see, for example, 77 *Cong. Rec.* H5895 (daily ed. June 13, 1933); (4) to prevent the evaporation of bank credit—see, for example, U.S. House Committee on Banking and Currency (1932), 203–04; (5) to protect the small depositor—see, for example, 77 *Cong. Rec.* H3837 (daily ed. May 20, 1933); (6) to revive small rural banks—see, for example, U.S. House Committee on Banking and Currency (1932), 253; (7) to encourage bank membership in the Federal Reserve System—see, for example, 77 *Cong. Rec.* S3727 (daily ed. May 19, 1933); and (8) to provide protection comparable to that given by postal savings banks—see, for example, 77 *Cong. Rec.* H3924 (daily ed. May 22, 1933). Although each of these was used as a rationale for adopting federal deposit insurance, the first four were concerned with ensuring monetary stability while the last four were most concerned with protecting the depositor and the banking system. Over the years various analysts have emphasized different reasons for the adoption of federal deposit insurance, and no consensus emerges as to the primary factor motivating adoption of the insurance program. See, for example, Marlin (1969), 116: deposit insurance was enacted to prevent a recurrence of bank failures; Boulos (1967), 46: to preserve the unit system of banking; Golembe (1960), 189: to restore the circulating medium to the community after bank failure; and Hotchkiss (1941), 33: to restore the public's confidence in the banking system.

[48] U.S. House Committee on Banking and Commerce (1932), 117 (statement of Senator Robert L. Owen).

The Banking Act established a temporary plan under which deposits were to be insured from January 1 to July 1, 1934, for up to $2,500 (temporary plan). Deposits would have been insured under a permanent plan beginning July 1, 1934. The permanent plan would have fully insured deposits of less than $10,000; deposits between $10,000 and $50,000 would have had 75 percent coverage; and deposits over $50,000 would have had 50 percent coverage. As part of a compromise with Senator Glass, the Banking Act also established the Federal Deposit Insurance Corporation (FDIC). One of the functions of the FDIC was to liquidate the assets of failed banks and quickly return to depositors as much of their funds as the agency expected to realize from the liquidation of the failed bank's assets.[49]

The temporary plan had been proposed as an amendment to the banking bill by Senator Arthur Vandenberg, who stated that the plan was created under a "temporary formula" pending the effective date of the permanent plan. Without the temporary plan, deposits would have remained uninsured for one year following the bill's enactment. According to Senator Vandenberg, "There is no remote possibility of adequate and competent economic recuperation in the United States during the next 12 months . . . until confidence in normal banking is restored; and in the face of the existing circumstances I am perfectly sure that the insurance of bank deposits immediately is the paramount and fundamental necessity of the moment."[50]

DEPOSIT INSURANCE COVERAGE 1934–1980

Deposits have never been insured to the degree contemplated under the original permanent plan, but insurance coverage has been raised from the initial $2,500 limitation on six occasions. The reasons for each increase have been varied and are often influenced by events or circumstances from outside the banking industry. The following section discusses the rationale for each of the adjustments to deposit insurance coverage.

January 1934: Establishment of $2,500 Deposit Insurance Coverage

As stated above, the $2,500 insurance coverage adopted in 1933 was the result of an amendment that was proposed by Senator Vandenberg (Vandenberg amendment). He proposed the amendment to increase the prospect that a federal insurance program would be quickly adopted.[51] But providing deposit insurance, even at the reduced level, required compromise: Although strong proponents of the insurance plan had hoped for an effective date of July 1, 1933, they moved the date to January 1, 1934, in order to win presidential approval.[52]

Limiting the insurance guarantee was essential to getting the program passed. By setting a limitation, Senator Vandenberg was able to fend off those who criticized the federal program as merely replicating the earlier unworkable state programs, none of which had limited their insurance coverage.[53] Additionally, Senator Vandenberg's amendment introduced an aspect of depositor discipline into the system by not covering all deposits with a guarantee. In this way he addressed the concern that deposit insurance would eliminate the need for depositors to be cautious in deciding where to put their money.[54] Although it is clear that limiting coverage was key to the program's enactment, it is less clear if the maximum insured deposit was set arbitrarily at $2,500.

[49] Public Law 73-66, Statutes at Large 48 (1933): 162.

[50] 77 *Cong. Rec.* S3731 (daily ed. May 19, 1933).

[51] 77 *Cong. Rec.* H3906 (daily ed. May 22, 1933).

[52] The House had signed a pledge not to adjourn until after the bill containing the deposit insurance provisions was passed, but until Senator Vandenberg proposed the reduced level of insurance, the bill was in jeopardy. According to the New York *Herald Tribune*, President Roosevelt would have been satisfied to shelve the legislation (reported in *Financial Chronicle* June 17, 1933, p. 4192). Even after the bill was amended to limit the deposit insurance guarantee, President Roosevelt threatened to veto it if the effective date was not postponed. 77 *Cong. Rec.* S5256 (daily ed. June 8, 1933). According to congressional testimony, the fact that insured banks were required to become members of the Federal Reserve System persuaded President Roosevelt to support the deposit insurance bill: He thought that required membership in the Federal Reserve System would result in a unified banking system. U.S. Senate Committee on Banking and Currency (1935), 46.

[53] Providing deposit insurance on a federal basis had other advantages over the unsuccessful state systems: (1) in a federal system, risk was more adequately distributed inasmuch as it covered the entire country (states were not large enough to permit adequate distribution of the risk); (2) in a federal system, the insurance fund would be much larger relative to the risk incurred; (3) presumably only safe-and-sound banks would be participating in the federal system, since only solvent banks were reopened after the banking holiday; and (4) political pressure was less apt to affect a federal system. See, for example, Preston (1933), 600.

[54] 77 *Cong. Rec.* H4052 (daily ed. May 23, 1933). Congress also saw a 100 percent guarantee as encouraging laxity on the part of bankers. According to Representative John L. Cable, bankers "would be inclined to make loans which their good judgment would tell them were unsafe. They would feel that they could do this because the depositors' money they would be lending would be completely insured." U.S. House Committee on Banking and Currency (1932), 114.

The congressional debates and other available writings show that the figure resulted from two considerations. First and foremost, $2,500 was the maximum amount that could be placed in a deposit account held by a PSB. As discussed above, after 1929 the competition presented by the PSBs concerned bankers and Congress alike. Second, there was concern about the burden that deposit insurance assessments would place on banks as they struggled to recover from the financial crisis; setting the insurance coverage at $2,500 appeased bankers, who were naturally apprehensive about taking on any additional financial commitment.[55]

Competition from Postal Savings Banks

The federal deposit insurance program adopted in 1933 was technically not the first protection offered depositors by the federal government. The Postal Savings System was established in the United States in 1910 to be a vehicle that encouraged thrift among small savers. Although the limit on accounts held by PSBs had been set originally at $500, by 1933 the maximum amount that could be held in one PSB account was $2,500.[56] The Postal Savings System was set up to operate through the U.S. postal system. As a result, the government was effectively operating a financial institution. Because of this unorthodox structure, a nearly 40-year debate preceded establishment of the Postal Savings System in the United States.[57] Yet, it was this same structure that led to the system's dramatic growth after 1929.

Before 1930, PSBs operated much as had been envisioned: on a small scale without directly competing with private financial institutions. But in the early 1930s, the fact that the federal government backed accounts that were held in PSBs drew increased interest. The ability of PSBs to offer security to depositors, which bankers were unable to match, became a primary concern during the 1933 congressional debates. PSBs had become legitimate competitors of other financial institutions, and in the year immediately preceding adoption of federal deposit insurance, deposits in PSBs increased by more than 125 percent.[58] Once Congress became aware that almost 97 percent of the depositors in national banks had deposits of less than $2,500, their concern intensified: How many of these depositors would soon choose to flee to PSBs?[59] As Congress was warned, "[Depositors] are going to ask for a guaranty of their deposits and if they do not get it, they are going to go more and more to the Postal Savings System."[60]

PSBs had always offered security to their depositors. Perhaps this would have been enough to attract depositors during this unsettled period, but deposits held in PSBs also began to make economic sense. Congress had set the interest rate that could be paid on deposits held by PSBs at 2 percent—below that being paid by private financial institutions. But by the early 1930s, interest being paid on deposits held by private financial institutions had fallen, and PSBs were able to offer prospective depositors a competitive rate in addition to their government guarantee.[61]

Congress had designed the structure of the Postal Savings System to ensure that funds deposited in PSBs would be kept in the local community. To that end, the Postal Savings Act required PSBs to deposit 95 percent of their deposits in a local bank willing to provide security for the deposits and pay the PSB 2.25 percent interest.[62] When banks located within a community reached the point at which they were unwilling to provide adequate security and pay the required rate of interest, they refused the deposits. As a result, PSBs deposited the funds outside the jurisdiction in which they originated. Consequently, not only did the increase in PSB deposits mean a corresponding decrease in the funds held by private financial institutions, but the increase in PSB deposits further exasperated the financial chaos found in local markets by withdrawing money from the community itself.[63]

[55] Deposit insurance assessments originally were based on insured deposits.

[56] See note 14 above.

[57] A movement to establish a system of postal banks began in 1871. Congress considered ten proposals for such a system, but not until after the banking panic of 1907 did it finally adopt a Postal Savings System. A large part of the resistance to postal savings banks came from the banking sector, which not only protested the government's involvement in what was considered to be a private-sector activity but also predicted that such a system would lead to a government takeover of the entire financial sector. O'Hara and Easley (1979), 742.

[58] 77 *Cong. Rec.* H4058 (daily ed. May 23, 1933); see O'Connor (1938), 86.

[59] In 1933, 96.76 percent of the depositors in national banks had deposits of less than $2,500. 77 *Cong. Rec.* H5893 (daily ed. June 13, 1933).

[60] U.S. House Committee on Banking and Currency (1932), 210 (statement of D.N. Stafford).

[61] When the Postal Savings System was being set up, one of the criticisms was that it would be in competition with private financial institutions while having an unfair advantage because of its government backing. To circumvent this criticism, Congress fixed the rate of interest PSBs could pay on deposits at 2 percent. (In 1910, when PSBs were established, banks were paying 3.5 percent on time deposits.)

[62] U.S. Postal Savings Act, ch. 214, § 9 (1910).

[63] Additional problems occurred when deposits held by PSBs were invested in government securities, as the Postal Savings Act required under certain circumstances. In such cases, money that would normally be held as cash or left on deposit with Federal Reserve Banks was diverted to the U.S. Treasury; this diversion resulted in distortions in the economy. O'Hara and Easley (1979), 744–45, 751–52.

Although the Postal Savings System had proved beneficial to depositors, Congress realized that, if the country was to recover from the Depression, money had to be returned to the traditional banking system. "By insuring bank deposits and thereby placing them on a par with postal savings deposits, postal savings funds will find their way back into the banks."[64] According to a memorandum written by Senator Vandenberg, "The protection of deposits up to $2,500 provides comparable protection to the limits in the Postal Savings System. Thus it meets Postal Savings competition. . . . It protects bank deposits as represented by the great mass of depositors."[65] In the final analysis, adopting a $2,500 limitation for the new deposit insurance system made sense, since it provided the same protection as the Postal Savings System while insuring over 90 percent of the depositors.[66]

Deposit Insurance Assessments

In considering the federal deposit insurance program, Congress was aware that 20 percent of all banks that had been in operation at the end of 1929 had failed between 1930 and 1932.[67] How could a deposit insurance program be set up so that funds would be sufficient to pay depositors in future bank closings, but the cost would be manageable for bankers who were trying to recover from the economic crisis? As was stated at the hearings on the federal insurance program:

> The cost of depositors [sic] insurance to the banks must not be such as to in any event endanger their solvency or be an unfair burden upon sound banks. The requirement of special assessments to pay depositors in times of great losses caused by a deluge of bank failures was the cause of the breakdown of the State guaranty laws. . . . The charge to the banks for this insurance must be so reasonable that the benefits derived from it more than compensate for its cost.[68]

The FDIC was initially capitalized through the sale of nonvoting stock: The Treasury Department subscribed for $150 million, and the Federal Reserve Banks subscribed for approximately $139 million. Under the permanent plan, insured institutions would have been assessed 0.5 percent of total deposits. Additional assessments equal to 0.25 percent of total deposits were possible with no limit on the number of additional assessments that could be imposed.

After studying the cost of insurance, Congress concluded that the cost to banks under the permanent plan would possibly be more than they were earning at that point in their economic recovery.[69] As a result, the Banking Act prohibited banks that were members of the Federal Reserve System from paying interest on demand deposits and authorized the Federal Reserve Board to limit the interest rate that member banks could pay on time deposits.[70] Congress reasoned that the money the banks saved through the interest-rate limitations would be more than enough to pay the deposit insurance assessment.[71]

Nevertheless, during the debates on the bill, bankers vehemently opposed the plan: There was no way they could reasonably expect to turn things around and pay such large assessments.[72] In attempting to secure the quick passage of the deposit insurance program, Senator Vandenberg addressed the bankers' concerns. Under his amendment, banks were assessed 0.5 percent of insured (rather than total) deposits; 0.25 percent of the assessment was to be paid in cash, with the other 0.25 percent subject to call by the FDIC, and only one additional assessment could be imposed.

Senator Vandenberg had analyzed the history of bank failures relative to the $2,500 insurance limitation and compared the insurance fund's liability under such a scenario with its potential size under his proposal. He reasoned that the cost of deposit insurance under his plan would be covered by the savings that insured institutions would realize under the limitations that the Banking Act imposed on interest paid to depositors. As he illustrated, if deposits had been insured for a maximum of $2,500 in 1932, the net loss

[64] U.S. House Committee on Banking and Currency (1932), 241 (statement from John G. Noble letter placed in the record by Representative Steagall).

[65] 77 *Cong. Rec.* S4240 (daily ed. May 26, 1933).

[66] 77 *Cong. Rec.* S5861–62, S5893 (daily ed. June 13, 1933).

[67] Kennedy (1973), 131.

[68] U.S. House Committee on Banking and Currency (1932), 111 (statement of Representative Ashton C. Shallenberger).

[69] Ibid., 227.

[70] Even though the provision of the Banking Act limiting the interest rates paid to depositors applied only to member banks, it was not intended that nonmember banks would receive a competitive advantage, since the Act required all insured banks to become members of the Federal Reserve System by July 1, 1936. (The date was later extended to July 1, 1937. But the Banking Act of 1935 modified the requirement before the effective date and as a result, only state banks having average deposits of $1 million or more were obligated to become members of the Federal Reserve System. This requirement was repealed on June 20, 1939, before taking effect.)

[71] 77 *Cong. Rec.* S4168 (daily ed. May 25, 1933). The limitation on the rate of interest paid on deposits was also an attempt to staunch the flow of money from small towns into money-center banks. Money-center banks had been bidding up the interest paid on deposits, thereby drawing funds away from small towns. 77 *Cong. Rec.* S4170 (daily ed. May 25, 1933).

[72] See, for example, 77 *Cong. Rec.* S4168 (daily ed. May 25, 1933); Preston (1933), 599–600.

to the deposit insurance fund (allowing for a recovery on liquidation of between 55 percent and 60 percent) would have been less than one-half of the total resources that would have been available under his proposal.[73] His goal was to show that the $2,500 limit on deposit insurance coverage protected a majority of depositors while containing the costs to bankers and that, as a result, "[the temporary plan] represent[ed] a *maximum* answer. . . [with] a *minimum* speculation in terms of the fiscal risk." It was a "limited experiment" that "no *valid* objection [could] be sustained against."[74]

June 1934: Deposit Insurance Coverage Raised to $5,000

The temporary plan was originally intended to provide insurance coverage until July 1, 1934, at which time the permanent plan was scheduled to become effective. But in April 1934, Congress held hearings on extending the temporary plan for one year. Congress reasoned that the extension would allow the FDIC time to gain experience in dealing with the deposit insurance program so that it could recommend any changes that should be made to the permanent plan before its effective date. The additional time would also allow those institutions that were not obligated to be covered by deposit insurance a further opportunity to evaluate the benefits of Federal Reserve System membership and federal deposit insurance protection.[75] The FDIC supported the extension. Leo T. Crowley, Chairman of the FDIC, stated that even though the FDIC found that an extension "of the limited insurance provided by the temporary fund [was] necessary," the agency favored neither an indefinite postponement of the implementation of the permanent insurance plan nor any changes to the permanent plan.[76]

As part of the extension of the temporary plan, Congress raised deposit insurance coverage to $5,000.[77] The congressional committee report stated that "it [was] highly important . . . that . . . further provision be made for adding to the insurance in order to secure still further protection. . . . In order to accomplish this further protection, the committee has provided for increasing the amount of the deposits of a depositor eligible for insurance . . . from $2,500 to $5,000."[78] Chairman Crowley testified that the FDIC supported the deposit insurance increase.[79] According to Chairman Crowley, the FDIC thought that deposit insurance should cover "reasonably large deposits."[80]

The congressional committee was also persuaded to raise the limits by the resistance the insurance continued to evoke. The American Bankers Association and the U.S. Chamber of Commerce lobbied for an extension to the temporary plan, hoping that an extension would eventually lead to a repeal of the insurance law. The congressional committee reasoned that an increase in the insurance limit to $5,000 would avoid the possibility of the extensions being misinterpreted as a sign of lukewarm support for the program.[81]

Although the subject of the congressional hearings was extending the temporary plan, testimony was also provided on the deposit insurance provisions contained in the permanent plan. During the hearings it became clear that implementation of the permanent plan would meet resistance. Although many bankers were concerned about the unlimited liability imposed on participating institutions under the permanent plan, the institutions especially concerned were mutual savings banks.[82] The FDIC and the Office of the Comptroller of the Currency testified that they expected a majority of those banks voluntarily participating in the deposit insurance plan to withdraw from the system if and when the permanent plan became operational because of the unlimited liability provisions.[83]

[73] 77 *Cong. Rec.* S4240 (daily ed. May 26, 1933).

[74] Vandenberg (1933), 42 (emphasis in the original).

[75] See note 70 above. Congress understood that the viability of the deposit insurance program depended on broad participation. Fifty-five percent of banks were voluntarily members of the temporary insurance fund. Congress and the FDIC were especially concerned as to whether the Morris Plan banks and mutual savings banks would choose to retain deposit insurance coverage and thus remain members of the Federal Reserve System. At the time of the hearings, Morris Plan banks and mutual savings banks held 28 percent of insured deposits, an amount equal to that held by state nonmember banks. In Congress's view, it was inadvisable to force these institutions to make their choice by July 1, 1934, for fear they would choose to leave the system. U.S. House Committee on Banking and Currency (1934b), 2. (Morris Plan banks were consumer-oriented institutions that extended installment credit to consumers and accepted savings deposits or sold investment certificates.)

[76] U.S. House Committee on Banking and Currency (1934a), 2. The FDIC favored extending the temporary plan for three reasons: (1) to give state legislatures time to make any changes to state law that were necessary to allow state banks to buy stock in the FDIC, which they were required to do under the Banking Act; (2) to give the FDIC more experience with the administration and operation of the insurance plan; and (3) to allow the Reconstruction Finance Corporation additional time to bolster the capital structure of banks. FDIC (1934), 32.

[77] The temporary plan was again extended by congressional resolution until August 31, 1935.

[78] H. Rept. 73-1724 (1934), 2.

[79] U.S. House Committee on Banking and Currency (1934a), 3.

[80] Ibid., 29.

[81] Ibid., 142.

[82] Ibid., 43.

[83] Ibid., 97, 135.

1935: $5,000 Deposit Insurance Coverage Adopted as Permanent

The FDIC had a lead role in persuading Congress to abandon the more extensive liability that would have been imposed on banks and the FDIC under the original permanent plan. In 1935, responding to a request made by President Roosevelt, the FDIC formally recommended that the $5,000 limitation on deposit insurance coverage be permanently retained. The FDIC reasoned that the increased liability that would have accrued to the Corporation under the original permanent plan was not justified because more than 98 percent of depositors were protected in full under the $5,000 limitation. According to congressional testimony, if the permanent plan were implemented as originally proposed, the liability of the FDIC would have increased by $30 billion while additional coverage would have been provided for only 1 out of every 100 depositors.[84]

The FDIC also recommended that insurance premiums be regularly assessed on the total deposits held in an insured institution rather than on only the insured deposits. The FDIC reasoned that assessments based solely on insured deposits placed a heavy burden on small institutions.[85] The Corporation also suggested an annual assessment rate of 1/12 of 1 percent of total average deposits, payable in two installments. After weighing the options available, the FDIC Chairman testified that "[w]e do not believe that one-twelfth of one percent will build large enough reserves for the Deposit Insurance Corporation for the future, but the earning capacity of the banks right now is very low. We are interested first in the banks having sufficient income themselves so that they may take their losses currently and so that they may build reserves."[86] The Banking Act of 1935 initiated annual assessments of 1/12 of 1 percent of total average deposits, which were payable in two installments.[87]

1950: Increase in Deposit Insurance Coverage to $10,000

In 1950, Congress enacted the Federal Deposit Insurance Act, which included a provision that increased deposit insurance coverage from $5,000 to $10,000.[88] Review of the testimony surrounding the increase reveals that the proposal for additional insurance coverage met with practically no opposition. The Federal Reserve Board testified that the additional coverage was justified on the basis of the increase in the wholesale price index, which had more than doubled since 1935, as well as the increase in the number of depositors.[89] The Treasury Department favored increasing deposit insurance coverage, since in its view the FDIC could support the added expense.[90] The FDIC went on record as recommending that the law be passed.[91] As was testified to at the hearings on the increase, "[Deposit insurance coverage] should be regarded as flexible, and under the changing times and changing conditions which characterize the day, change should be made."[92]

Protection Comparable to 1934

One of the justifications for increasing the deposit insurance coverage in 1950 was that a change was needed to keep pace with increases in the monetary and credit levels in the United States that had occurred since 1933. According to the FDIC, by 1950 the $5,000 deposit insurance coverage provided only one-half of the protection that had been provided in 1934.[93] Congressional testimony confirms that the increase restored coverage to where it was in 1934, both as to the value of the dollar and the number of depositors covered.[94] In the opinion of many, the increase was viewed as a "natural sequence to the steadily rising economy since 1935."[95]

[84] 79 *Cong. Rec.* H6922 (daily ed. May 3, 1935).

[85] FDIC (1934), 34. Chairman Crowley testified that "[i]t is recommended that assessments be based upon total deposits in insured banks, regardless of whether or not the insurance is limited to $5,000 per depositor. To base assessments solely on the first $5,000 of each depositor's account places an undue burden upon the small banks. The greatest risk to the Corporation does not necessarily lie in these institutions. . . . It has been demonstrated frequently in recent years that the consequences of the failure of a large bank may be more disastrous than the failure of a number of small institutions." U.S. Senate Committee on Banking and Currency (1935), 29.

[86] U.S. House Committee on Banking and Currency (1935), 48.

[87] Although the FDIC recommended that the deposit insurance limit be retained at $5,000, the limitation was also viewed as a compromise between those who did not want any federal deposit insurance and those who wanted 100 percent insurance coverage with liability resting with the federal government. 79 *Cong. Rec.* S5575 (daily ed. May 3, 1936).

[88] Before 1950, the law relevant to deposit insurance coverage and the Federal Deposit Insurance Corporation was contained within the Federal Reserve Act.

[89] Federal Reserve Board of Governors (1950b), February, 151–60.

[90] U.S. Senate Committee on Banking and Currency (1950a), 55.

[91] Ibid.

[92] U.S. House Committee on Banking and Currency (1950a), 127 (statement of Richard H. Stout, Chairman of the Legislative Committee of the Consumer Bankers Association).

[93] FDIC (1950), 3.

[94] U.S. Senate Committee on Banking and Currency (1950a), 70.

[95] Ibid., 89.

Benefits to Small Depositors

The explanation given for the initial implementation of a federal deposit insurance program expanded in 1950. It had generally been recognized that the insurance system was intended to benefit small savers more than large ones. However, ensuring the continued stability of the monetary system was the motivation usually referred to as influencing passage of legislation enacting the program in 1933.[96] Then, in 1950 the FDIC testified before Congress that the primary purpose of the Corporation was "to protect the small depositor."[97] In addressing the proposed increase of the insurance limit to $10,000, the FDIC testified that the increase was needed "to protect the same percentage of depositors as was covered in 1935 under the $5,000 maximum."[98]

In keeping with the concern for small savers, Congress was also interested in protecting the funds held in mutual savings banks, which were known as "depositaries for small savers."[99] In 1934, accounts held in mutual savings banks could be fully protected by deposit insurance because they were limited under state law to a maximum of $5,000.[100] But by 1950, the limitation on accounts held by mutual savings banks had been raised to $7,500, with an additional sum allowed for any interest that had accrued. As a result of the increase of the deposit insurance limit to $10,000, the number of accounts held by mutual savings banks that were fully protected rose from 93.4 percent to 99.7 percent.[101]

Benefits to Small Banks

Another justification for the increase in deposit insurance coverage in 1950 was the expected benefit to small banks and its importance to local communities. The condition of small banks was outlined by the FDIC in its 1949 *Annual Report*.[102] The FDIC compared the deposits held in small banks in 1949 with those held in 1936. In 1936, approximately 15.5 percent of insured deposits were held in banks with deposits of less than $1 million. By 1949, banks of this size held only 2.1 percent of all insured deposits. In contrast, banks with deposits of more than $25 million held two-fifths of all insured deposits in 1936, but by 1949 they held substantially more than one-half of all insured deposits.

Even though there had been no receivership appointed for an insured institution since 1944,[103] depositors continued to keep their funds in smaller institutions only to the extent that they were covered by insurance. Larger deposits tended to be placed in large money-center banks. In 1949, 97.2 percent of the accounts held by banks with deposits of less than $1 million were fully protected by deposit insurance.[104] Congress recognized that raising the deposit insurance limit would directly benefit these institutions. The congressional report accompanying the bill to increase the deposit insurance limit stated that the increase "should tend to benefit the smaller banks through encouraging the retention in such banks of deposits in excess of $5,000."[105]

While recognizing the benefit to small banks, it was acknowledged that a return of deposits to small community banks would also help meet local credit needs: "[The deposit insurance increase] will bring the money that is going into the larger centers, back into the small communities. . . . It will put that money in use in the small communities, and will reverse the trend . . . which showed that deposits were coming to the large centers and leaving the small communities."[106] The FDIC testified that the increase would benefit small communities on the whole, since it would "remove the incentive to shift deposits from the small community banks and . . . make available more funds for local credit needs."[107]

Strengthened Public Confidence

As was seen in the review of the legislative history for each of the increases in deposit insurance coverage, events affecting the broader economy often influenced the decisions to raise the insurance limit. In 1950, the United States was emerging from a moder-

[96] See notes 47 and 48 above and accompanying text.

[97] U.S. House Committee on Banking and Currency (1950a), 24.

[98] Ibid.

[99] Ibid., 65.

[100] Mutual savings banks were not required to participate in the federal deposit insurance program. See note 75 above.

[101] Ibid. In order to understand the key role that mutual savings banks played during this period, it is important to understand the degree to which these institutions were concentrated in certain areas of the country. Although mutual savings banks held only 36 percent of the total savings and time deposits in the United States, these institutions held 74 percent of the savings and time deposits located in New England and New York. FDIC (1949), 49. As a result of the high density of mutual savings banks in New England, the increase in the deposit insurance limit had great importance for this area of the country.

[102] All data in this paragraph are from FDIC (1949), 64.

[103] FDIC (1950), 277.

[104] FDIC (1949), 66.

[105] H. Rept. 81-2564 (1950), 6.

[106] U.S. House Committee on Banking and Currency (1950a), 46 (statement of Henry M. Arthur).

[107] Ibid., 24.

ate recession that had occurred in the first half of 1949, and although business activity increased by 1950, it had not generally returned to the levels reached before the downturn. By the first quarter of 1950, unemployment had reached the highest levels since 1941; it was 50 percent higher than the first quarter of 1949 and nearly double that of 1948.[108] Tensions were mounting in Korea, and the initiation of a far-reaching program of national defense contributed to the public's uneasiness. Congress became concerned that the public's confidence in the safety of the banking system was wavering. They saw the adjustment to the deposit insurance limitation as a vehicle that would further strengthen and buttress "public confidence . . . without additional cost to the taxpayer, to the government, or to the banks."[109] The FDIC confirmed that public confidence needed a boost when H. Earl Cook, a Director of the FDIC, testified that much of the currency that was in circulation was being kept in safe-deposit boxes. The FDIC believed that the increase might be the incentive needed to draw the money out of the safe-deposit boxes and back into "the channels of trade."[110]

1966: Increase in Deposit Insurance Coverage to $15,000

In late 1965 and early 1966, total spending in the United States was increasing rapidly. Consumers' demand for goods, services, and credit was outpacing supply, while added stress was being felt by the demands of the deepening Vietnam War. The convergent pressures on resources produced soaring prices and a dramatic increase in interest rates, as the demand for funds overtook the supply. Demands for credit spilled over into the securities markets, and as a result, the yields offered in these markets rose. By the time Congress raised the deposit insurance limit in 1966, depository institutions, particularly the savings and loan (S&L) industry, were becoming desperate.[111]

Although interest-rate ceilings hampered commercial banks in their ability to compete directly with the securities markets, the rapid turnover of bank assets and the ability of banks to offer the public tailor-made debt instruments helped them maintain an inflow of funds.[112] Thrifts,[113] in contrast, were left little room to maneuver because they were dependent on short-term liabilities to fund their long-term assets in an interest-rate environment that kept short-term interest rates above the return on their long-term assets. In addition, the thrift charter left the institutions few options regarding the instruments or services they offered. As a result, the normal flow of funds to these institutions evaporated as depositors shifted their accounts into commercial banks and the securities markets.[114]

The statutory provision increasing the deposit insurance limit to $15,000 was added to the Financial Institutions Supervisory Act of 1966 almost as an afterthought. Although discussion of a deposit insurance increase was limited in 1966, extensive debate on the issue had taken place in 1963 when Congress considered raising the insurance limit to $25,000. At that time the President's Committee on Financial Institutions had overwhelmingly recommended that the increase be approved; however, the matter was tabled because S&Ls did not have adequate dividend-rate controls and the Federal Home Loan Bank Board (FHLBB) did not have flexible enforcement powers.[115] But in 1966 those objections were quieted. Earlier in the year Congress had imposed interest-rate

[108] Federal Reserve Board of Governors (1950b), 507, 514.

[109] U.S. House Committee on Banking and Currency (1950a), 127.

[110] Ibid., 24.

[111] S&Ls are depository institutions that were originally established to receive deposits from their members and invest the funds in mortgages on the residences of the members. Although the Federal Savings and Loan Insurance Corporation (FSLIC) provided federal deposit insurance for S&Ls from 1934 through 1989, this article makes no distinction as to the source of the insurance. The level of deposit insurance provided by the FSLIC paralleled that provided by the FDIC.

[112] Interest-rate ceilings had originally been imposed on commercial banks after the banking crisis of the 1930s. The ceilings were intended to protect banks both by holding the institutions' cost of funds below their return on assets and by restraining competition within the industry (by limiting the likelihood that banks would bid up their interest rates to attract depositors). Interest-rate ceilings did not apply to S&Ls. Consequently, savings associations were able to pay rates slightly higher than commercial banks. The added interest payment was intended to offset the extra services that a customer received from a bank but that savings associations were not authorized to offer.
By 1966 banks felt additional pressure to increase earnings, since costs at financial institutions had been increasing dramatically as a result of a change in the institutions' deposit mix: The total of time and savings deposits that paid interest increased 44 percent from December 1961 through June 1964. See speech by K. A. Randall, FDIC Chairman, to the ABA on February 1, 1965. In addition, advances in services made in response to customers' demands, such as automated check clearing, greatly reduced the time lag between a check's deposit and its payment, resulting in a decrease in earnings that had been made through the "float."

[113] For purposes of this article, the terms *savings and loan*, *savings association*, and *thrift* are used interchangeably.

[114] The term *disintermediation* was coined in 1966 to describe the process of transferring funds out of savings associations. *Cross intermediation* was used to describe the process of transferring funds out of the savings associations into other types of depository institutions.

[115] The Chairman of the FDIC and the Comptroller of the Currency were among those on the committee who voted that deposit insurance coverage be increased to $25,000. Both the FDIC and the FHLBB had testified in favor of the increase. President Lyndon Johnson had also recommended in his 1966 Economic Report that the insurance limit be increased.

ceilings on deposits held by S&Ls,[116] and the legislation containing the deposit insurance increase also authorized the FHLBB to take enforcement action. In the end Congress anticipated that the $15,000 limit would be short-lived, since it intended to consider a further increase shortly after the $15,000 ceiling was approved.[117]

Increases Deposits to Savings Institutions

As outlined above, S&Ls had difficulty competing during this period with either commercial banks or the securities industry in attracting depositors. The viability of the thrift industry was of concern, since S&L portfolios consisted of mortgage loans, the bulk of which had been made in earlier years at lower rates. Insured S&Ls experienced $770 million in net withdrawals in April 1966, compared with $99 million in April 1965.[118] The FHLBB stated that the April "withdrawals from associations had been so heavy that the ability of the [Federal Home Loan] Banks to meet withdrawal drains and to supply expansion advances in sufficient volume to replace the usual inflow of savings appeared doubtful."[119] Because thrift institutions were the primary source of mortgage loans as well as of construction financing, more was at stake than the health of the thrift industry. In June 1966, $1.575 billion of mortgage loans were made—a decline of $2.345 billion from June 1965.[120] Congress considered the situation to be so serious so as to challenge the nation's "long-standing public policy [of] encouraging homeownership."[121]

According to congressional testimony, previous increases in the deposit insurance limit had been followed by increases in deposits.[122] As a result, Congress was advised that if the deposit insurance limit was raised to $15,000, an additional "several billion dollars" would be available for mortgage loans. The dramatic increase in funds was expected to come from institutional investors who had been prohibited from maintaining accounts in excess of the deposit insurance limit and from retail savers who chose to keep their deposits below the insured limit.[123]

Economic Considerations: Advances in Income and Savings

In 1963, during the debate on raising the deposit insurance limit to $25,000, the FDIC and the Federal Savings and Loan Insurance Corporation (FSLIC) had testified that the insurance funds could support the increase with no additional cost to either the taxpayer or the banker.[124] As a result of that testimony, there was not much discussion in 1966 about whether the deposit insurance funds could handle increasing the insurance limit to $15,000. Instead, there was a general consensus that the economic changes that had occurred between 1950 and 1966 demanded an increase in the deposit insurance limit. Congress reasoned that the country "increase[s] account insurance roughly every 15 years . . . ," which was appropriate since "15 years is a sufficiently long period of time to witness dramatic economic changes, including substantial growth."[125] Between 1950 and 1966 family income had doubled, the gross national product had more than doubled, and personal savings had increased dramatically.[126] The House reported that "the great advances in the personal income and savings of the American people since the last insurance increase in 1950 require that account insurance be increased to at least $15,000."[127]

Increases Public Confidence in U.S. Financial System

There was some sentiment in Congress that its failure to increase the deposit insurance limit in 1963 was "a terrible error," and as the number of failures of insured institutions increased in 1964, some observers

[116] Although interest rates paid by S&Ls were controlled after 1966, it was made clear at the congressional hearing that S&Ls could continue to pay slightly higher rates on deposits than commercial banks. The need for the difference, as well as its extent and degree, were left to the discretion of the banking agencies. The difference between the rate of interest paid by commercial banks and savings associations became known as the "interest-rate differential." *See* Interest Rate Control Act of 1966, Public Law 89-597, 1966 U.S.C.C.A.N. (Statutes at Large 80 (1966): 823) 3001.

[117] H.R. Conf. Rept. 89-2232 (1966), 4 (statement of the House managers); 112 *Cong. Rec.* H26212 (daily ed. Oct. 12, 1966).

[118] H. Rept. 89-1777 (1966), 5–6. In 1966 the net savings inflow at S&Ls was 57 percent below what it had been the previous year, even though the net savings inflow in 1965 had already fallen by 21 percent. Federal Home Loan Bank Board (1966), 13.

[119] Ibid., 46–47.

[120] H. Rept. 89-1777 (1966), 5.

[121] Ibid., 6.

[122] 112 *Cong. Rec.* H25003 (daily ed. Oct. 4, 1966). The experience of the S&L industry in 1951 after the deposit insurance ceiling was raised in 1950 provides some evidence that deposits increase after the insurance limit has been raised. In 1951, S&Ls added $2.1 billion of new savings—the largest amount that had been added in one year to that point. Federal Home Loan Bank Board (1951), 3. After the 1966 deposit insurance increase, deposits at commercial banks advanced in 1967 by a record $43 billion. FDIC (1967), 9.

[123] U.S. House Committee on Banking and Currency (1966c), 126. In addition, Congress viewed the increase in the insurance ceiling as another way of encouraging growth in small banks. U.S. House Committee on Banking and Currency (1963), 30.

[124] Ibid., 7, 21.

[125] 112 *Cong. Rec.* H25005 (daily ed. Oct. 4, 1966).

[126] Ibid.

[127] H. Rept. 89-2077 (1966), 5.

discerned a corresponding loss of confidence in the U.S. financial system on the part of depositors.[128] Congress saw the 1966 increase in the deposit insurance limit as a way to dispel depositors' fears as well as to express a "vote of confidence in the American financial system."[129]

Encourages Public to Save

As discussed above, 1966 saw a sharp reduction in the flow of funds to depository institutions because of the dramatic increase in interest rates offered through the securities markets. The flow of funds through depository institutions fell from $32.9 billion in 1965 to $20.3 billion in 1966.[130] A large proportion of this decrease resulted from the behavior of private households: Households reduced their savings in depository institutions from $26.4 billion in 1965 to $18.9 billion in 1966. During the same period, household purchases of credit-market instruments increased dramatically. The thrift industry was hit particularly hard, and as a result S&Ls decreased their mortgage lending from $8.9 billion in 1965 to $3.8 billion in 1966. Congress viewed the additional deposit insurance coverage as a way of encouraging members of the public to increase their savings; greater savings would result in an inflow of funds to the insured institutions.[131]

1969: Increase in Deposit Insurance Coverage to $20,000

In 1969, the U.S. economy was experiencing another credit crunch. At the time, both consumer and business spending had increased, causing intensified pressure on both prices and costs. When the Federal Reserve Board adopted a restrictive monetary policy to contain inflation, the strong demand for credit resulted in an extremely tight market. The Federal Reserve Bank discount rate rose to 6 percent, the highest level charged up to that time. Overall interest rates in 1969 reached the highest levels of the century.[132] As money-market rates moved up sharply during 1969 and the interest rate that could be paid on bank deposits remained unchanged, the amount that was being held in large-denomination certificates of deposit (CDs) fell by approximately $12 billion. Although there was a modest gain in consumer CDs, total time deposits decreased by almost $10 billion. As a result of this outflow, banks turned to nondeposit sources for funds and increased their borrowings through federal funds and Eurodollars while also increasing the issuance of commercial paper by bank-related affiliates. Through the increased use of these alternative sources of funding, banks were able to increase their loans by $25 billion.

Savings associations experienced a net outflow of funds in 1969 when the excess of withdrawals over new deposits received amounted to $1 billion.[133] Despite this decrease, savings associations were in a slightly better position than they had been in 1966. In 1969, changes in the regulatory structure of depository institutions made it possible for savings associations to compete with other depository institutions. First, commercial banks were restrained from the intense rate competition that had occurred in 1966 by special rate ceilings that had been placed on their time deposits for amounts under $100,000;[134] second, savings associations were now able to offer a variety of savings instruments at rates above their regular passbook account rate. But as rates offered in the securities market increased and the spread between these rates and those offered by the savings associations widened, S&Ls found themselves once again unable to compete.

The increase in the deposit insurance ceiling from $15,000 to $20,000 in 1969 was intended to aid the S&L industry. As congressional testimony explains, "The added insurance should make [savings] accounts much more attractive. New savings dollars [will] strengthen the savings industry while providing additional liquidity for housing."[135] An increase in the insurance limit gained additional support from the FDIC and the FHLBB when they reiterated their endorsement of raising the insurance ceiling to $25,000.[136] And although congressional testimony

[128] 112 *Cong. Rec.* H24984–85 (daily ed. Oct. 4, 1966). In 1964 more banks failed than in any year since 1942, and although there was a reduction in the number of banks that failed the following year, those that did fail in 1965 held twice the total in deposits as those that failed in 1964. FDIC (1965), 9. In 1966, Congress thought that the increase in the number of bank failures in 1964 and 1965 could have been avoided had the deposit insurance limit been increased in 1963. 112 *Cong. Rec.* H24985 (daily ed. Oct. 4, 1966).

[129] 112 *Cong. Rec.* H25004–05 (daily ed. Oct. 4, 1966). Congress also viewed the increase in the deposit insurance limit as an expression of its confidence in the thrift industry. 112 *Cong. Rec.* H25003 (daily ed. Oct. 4, 1966).

[130] All data in this paragraph are from Federal Home Loan Bank Board (1966), 5, 7.

[131] 112 *Cong. Rec.* H25003 (daily ed. Oct. 4, 1966). See also U.S. House Committee on Banking and Currency (1963), 12, 15.

[132] All data in this paragraph are from FDIC (1969), 3. Interest rates have since risen above the level reached in 1969.

[133] Federal Home Loan Bank Board (1969), 8.

[134] At the beginning of 1966, the same maximum interest rate was imposed on all time deposits. Effective September 26, 1966, time deposits of less than $100,000 were subject to lower ceilings than time deposits of $100,000 or more.

[135] 115 *Cong. Rec.* H39678 (daily ed. Dec. 17, 1969). See, for example, H. Rept. 91-755 (1969), 7 reprinted in 1969 U.S.C.C.A.N. 1467, 1474; 115 *Cong. Rec.* H39683 (daily ed. Dec. 17, 1969).

[136] H. Rept. 91-755 (1969), 8 reprinted in 1969 U.S.C.C.A.N. 1467, 1474.

mentions restoring national confidence and strengthening small business as justifications for the deposit insurance increase, the force of the testimony confirms that the increase was primarily viewed as an aid to the thrift industry.[137]

1974: Increase in Deposit Insurance Coverage to $40,000

In 1974 the United States experienced the most dramatic inflationary period since the years immediately following World War II: The rate of inflation rose from 6.3 percent in 1973 to 11.4 percent.[138] In addition, the country moved into a recession that was on the brink of becoming one of the deepest since World War II. Two developments that contributed extensively to the overall economic situation of the country were the oil embargo, which extended from October 1973 to April 1974, and the termination of wage and price controls in April 1974.[139] Wholesale prices of fuel, power, and related products rose approximately 50 percent from December 1973 to December 1974.[140] At the same time, the increase in wholesale prices of producers' finished goods jumped from an annual rate of approximately 5 percent during the second half of 1973 to 13 percent in the first quarter of 1974, to 27 percent in the second quarter, and up to 32 percent by the third quarter.

The Federal Reserve Board acted to counter inflation by restricting the growth of money and credit. As credit demands increased, particularly in the business sector, interest rates rose above previous historical highs. As rates being paid on open-market instruments increased well above those being paid by S&Ls, funds were again diverted from the thrift industry into higher yielding instruments. In 1974, new funds that were deposited in savings associations declined 55.6 percent from the amount deposited in 1973 and 80.5 percent from the amount deposited in 1972.[141] Although total assets of insured commercial banks increased by 9.6 percent in 1974, this was one-third less than the increase banks had experienced in 1973.[142]

It was during this period that Congress again debated raising the deposit insurance ceiling. The House fought for an increase to $50,000, while the Senate urged that a more limited increase be adopted and endorsed an increase to $25,000. Both the FDIC and the FHLBB supported increasing the insurance limit and testified that the added coverage would produce only a marginal increase in insurance risk.[143] A compromise was reached while the bill was in conference and the deposit insurance limit was raised to $40,000.[144]

Encouragement of Deposits

Even though savings associations were now able to offer alternatives to passbook accounts that had not been available during the 1966 credit crunch, depositors continued to shift funds out of thrifts and into direct capital market investments more quickly than they did from commercial banks. To aggravate matters, thrifts were also hampered by a decline in mortgage loan prepayments. Mortgage prepayments, which are usually the most stable source of S&L funds, declined by 11 percent from the prepayments of a year earlier.[145] As a result of these declines, closed mortgage loans held by S&Ls in 1974 were 21 percent less than loans held in 1973.[146] Since the bulk of the mortgage debt financing of residential property in the United States was held by S&Ls, any decrease in funds available for mortgage financing by these institutions was a cause for concern that transcended the individual institutions.[147]

Congress expected that deposits would increase following an adjustment to deposit insurance coverage, as they had after previous increases to the deposit insurance ceiling.[148] But in 1974, Congress also increased the insurance on public unit deposits from $20,000 to $100,000.[149] The increase in insurance

[137] 115 *Cong. Rec.* H39683 (daily ed. Dec. 17, 1969).

[138] Federal Reserve Board of Governors (1975), January, 1–2.

[139] On August 15, 1971, President Richard Nixon froze wages and prices for 90 days. The freeze was replaced with wage and price restraints, which were aimed at holding price increases to no more than 2.5 percent per year. It is generally acknowledged that the wage and price restraints had only temporary success in moderating inflation, and termination of the program led to an adjustment in prices that contributed to the stepped-up rate of inflation experienced during the period. *See* Federal Reserve Board of Governors (1974), 3–5.

[140] Data in this and the next sentence are from Federal Reserve Board of Governors (1974), 5.

[141] Federal Home Loan Bank Board (1975), 6–7; U. S. League of Savings Associations (1975), 19.

[142] FDIC (1974), xi–xii.

[143] U.S. House Committee on Banking and Currency (1973), 17, 33.

[144] H.R. Conf. Rept. 93-1429 (1974), 33–34.

[145] Federal Home Loan Bank Board (1975), 9.

[146] Ibid., 11.

[147] In 1974, savings associations held approximately 48 percent of all residential mortgage loans and, at the end of 1974, mortgage loans represented 84.3 percent of the total assets held by S&Ls. U.S. League of Savings Associations (1975), 29, 25.

[148] See note 122 above; see also H. Rept. 93-751 (1974), 2; 120 *Cong. Rec.* H10274 (daily ed. Oct. 9, 1974).

[149] Public unit deposits are deposits made on behalf of any state, county, or municipality of the United States. 12 U.S.C. § 1813(m)(1) (1989). Public unit deposits had been insured to the same extent as other deposits before the 1974 deposit insurance increase.

coverage to public units not only benefited depository institutions by encouraging further growth in deposits; it also freed previously pledged assets.[150]

Upon signing the deposit insurance legislation, President Gerald Ford stated that "the [deposit insurance] increase will help . . . financial institutions attract larger deposits. It will . . . encourage savers to build up funds for retirement or other purposes in institutions with which they are familiar and which are insured by federal agencies that have earned their confidence over the years."[151]

Economic Conditions Warrant an Increase

In 1974 the United States experienced the largest increase in the consumer price index (CPI) since 1947, when the CPI rose by 11 percent.[152] Between 1969 and 1974 the wholesale price index increased more than 50 percent.[153] In Congress's view, inflation alone provided sufficient rationale for increasing the deposit insurance coverage in 1974.[154] The FDIC agreed and testified that the "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."[155]

As Representative Fernand St Germain stated:

> In these days when the price of living keeps soaring; when the price of energy has reached unprecedented heights; when the working man and woman gets his [sic] paycheck and finds another increase in social security tax; I think it is . . . about time that Congress . . . say to the American people: We are going to increase the insurance on your deposits from $20,000 to $50,000.[156]

Restoration of Confidence in the Banking System

The year 1974 has been described as one in which the "confidence in the U.S. banking system [was] at its lowest point since the 1930s."[157] As in the Depression years, federal banking regulators publicly identified hoarding as a factor affecting the flow of money in the United States.[158] The threat of a financial crisis developed during the year largely because of the failures of Franklin National Bank (FNB), which was the largest U.S. bank to have failed to that point, and the Bankhaus I.S. Herstatt, a private bank in West Germany. By the middle of June 1974, FNB had announced heavy losses and Herstatt had declared bankruptcy because of heavy foreign-exchange losses.[159] Depositors' apprehension regarding the safety of their funds at FNB quickly enveloped U.S. markets as a whole, and a flight to safety and liquidity developed.[160]

Congress acknowledged that a lack of confidence in the U.S. financial sector had developed. The increase in the deposit insurance limit was viewed as a vote of confidence in the banking industry: Increasing the deposit insurance ceiling was a way "to restore the public's confidence in the viability of our financial institutions during a time when we see an increasing number of banks failing."[161] In addition, Congress acknowledged that the increase in the insurance limit would encourage members of the public to increase their savings and thereby provide a stabilizing influence during a volatile period.[162]

[150] Before this increase, savings associations did not solicit deposits from public units, since it was necessary in most cases for the institutions to pledge government securities in an amount equal to the uninsured portion of the deposit. The FHLBB estimated that in 1974 only approximately 0.2 percent of the deposits held by savings associations were public funds. In 1972, commercial and mutual savings banks held $51 billion in public unit deposits. Approximately $49 billion was in accounts of more than the insured limit. 120 *Cong. Rec.* H473 (daily ed. Feb. 5, 1974).

[151] Ford (1974), 497.

[152] Ford (1975), 47.

[153] U.S. Department of Commerce (1975), 418.

[154] See, for example, H. Rept. 93-751 (1974), 3.

[155] Wille (1974a).

[156] 120 *Cong. Rec.* H473 (daily ed. Feb. 5, 1974).

[157] Sinkey (1975).

[158] Federal Reserve Board of Governors (1975), March, 123.

[159] Although the financial problems of FNB were publicized at the height of the public's lack of confidence in the financial sector, concern about the viability of larger banks began in October 1973 with the failure of the U.S. National Bank of San Diego (USNB). USNB had been the largest failure in U.S. history to that point. For a discussion of the failure of USNB, see, for example, Sinkey (1974).

Throughout the late 1960s and early 1970s, FNB had attempted to transform itself from a regional institution to a power in international banking. To attract business, FNB made a market in providing loans to poor credit risks. FNB relied heavily on purchased money to fund its operations, especially large CDs and federal funds, but it also borrowed heavily in the Eurodollar interbank market. Although FNB's failure affected international markets, its relevance to the present discussion is the repercussions it had on domestic markets. Once FNB announced that it had lost $63.8 million in the first five months of 1974, holders of FNB's liabilities rushed to withdraw their funds. By the end of July, FNB had lost 71 percent of its domestic and foreign money-market resources. For a further discussion of the failure of FNB, see, for example, Wolfson (1994) 49–59; Brimmer (1976).

[160] In addition to the problems developing in depository institutions, news of increasingly serious problems in the financial condition of New York City also made the public uneasy. New York City had been issuing a substantial amount of debt throughout the year. At one point the city accounted for almost 30 percent of the total short-term debt that had been issued in the tax-exempt sector of the market. The city had difficulty marketing a bond issue in October 1974, and by December 1974 it was forced to pay the highest rate of return on a note issue in the city's history. Federal Reserve Board of Governors (1975), March, 128.

[161] 120 *Cong. Rec.* H10276 (daily ed. Oct. 9, 1974).

[162] S. Rept. 93-902 (1974), 2.

Continued Competitiveness of Financial Institutions

The FDIC testified in favor of raising the deposit insurance limit. The Corporation viewed the increase as a way of putting small bankers on a more equal footing with their larger competitors. In addition, the FDIC considered higher insurance coverage as a means of helping all institutions sustain their position in the increasingly competitive market for savings, since business firms might reconsider switching their funds from depository institutions after weighing the increased protection against higher yields.[163] The congressional report on the bill to increase the insurance limit affirms that the increased limit was viewed as a means for insured institutions to compete with nondepository institutions during periods of high interest rates.[164]

1980: Increase in Deposit Insurance Coverage to $100,000

The years leading up to the most recent increase in deposit insurance coverage were described at the time as the period that had the longest economic expansion since World War II and at the same time was plagued with "virulent inflation, . . . record high interest rates and record low savings rates."[165] The personal savings rate in the United States had fallen to the lowest level in almost 30 years.[166] Interest-rate volatility was unparalleled, while the highest interest rate that could be earned on a traditional account at any insured depository institution averaged more than 2 percentage points less than the highest rate available at the time from nonbank intermediaries.[167] The disparity between the amount of interest that could be earned at depository institutions and the amount available on the open market placed not only depository institutions at a competitive disadvantage but was also perceived as shortchanging small depositors.[168]

The bouts of high inflation and higher interest rates in the 1970s increased the unpredictability of the savings flow into and out of depository institutions, particularly S&Ls. The turnover ratio (which measures the stability of funds) averaged nearly 48 percent during the 1970s compared with an average of 33.7 percent from 1965 through 1969. In 1979, the turnover ratio was almost 75 percent.[169] The increased volatility of deposits held by savings associations in the 1970s largely contributed to the "boom or bust" nature of the housing industry during the decade. Mortgage loans closed by S&Ls in 1979 dropped by $8.7 billion from the previous year, but savings associations still accounted for 49.9 percent of all new mortgage loans made that year, illustrating the key role these institutions played in the nation's housing market.[170]

In 1980 Congress elected to phase out over six years the limitations on the maximum rates of interest and dividends that insured depository institutions could pay on deposit accounts, recognizing that while such constraints were in place, the institutions could not compete with the high-yielding instruments available on the open market.[171] Congress's goal in phasing out the interest-rate ceilings was to prevent the outflow of funds from depository institutions during periods of high interest so that an even flow of funds would be available for the housing market. The legislation also increased deposit insurance coverage from $40,000 to $100,000. As Congress reasoned, "An increase from $40,000 to $100,000 will not only meet inflationary needs but lend a hand in stabilizing deposit flows among depository institutions and noninsured intermediaries."[172]

[163] U.S. Senate Committee on Banking, Housing and Urban Affairs (1974b), 33. The FDIC was particularly concerned about new financing instruments that were being used by nondepository institutions but appeared to be "deposit-like." Citicorp had just proposed issuing a low-denomination note that would be issued by the bank holding company whose public identification was synonymous with the bank. The note carried an option to redeem before its potential 15-year maturity. The option was exercisable at the holder's option. The FDIC believed that the early-redemption feature at the holder's option would directly compete with traditional time deposits then being offered by insured institutions. Under the regulatory structure in existence, in order for a depository institution to offer a comparable yield, the holder would not be able to redeem the note for at least seven years. Wille (1974b).

[164] H. Rept. 93-751 (1974), 3.

[165] U.S. League of Savings Associations (1980), 7.

[166] Federal Reserve Board of Governors (1980), 613.

[167] *See* U.S. League of Savings Associations (1980), 15. The rate on savings deposits at insured savings associations was used in this calculation, since savings associations paid higher rates during this period than commercial banks by virtue of the interest-rate differential. See note 116.

[168] Small depositors were frequently unable to meet the minimum deposit required to earn the higher rate available on the open market.

[169] U.S. League of Savings Associations (1980), 62–63.

[170] Ibid., 66.

[171] Depository Institutions Deregulation and Monetary Control Act of 1980, Public Law 96-221, Statutes at Large 94 (1980): 142 (codified at 12 U.S.C. § 3501).

[172] 125 *Cong. Rec.* S3170 (daily ed. Mar. 27, 1980).

Increase in Deposits to Depository Institutions

Although the gradual elimination of interest-rate ceilings was intended to aid depository institutions in their fight against the outflow of deposits, the removal also placed S&Ls in a precarious position. Savings associations continued to be saddled with a portfolio of long-term mortgages paying less than market rates. Yet even before the six-year phase out of interest-rate limitations, savings associations had seen their interest and dividend payments soar: in 1979, savings associations paid $6.4 billion more in interest than in the preceding year; in 1979, the ratio of interest to net savings jumped over 24 percent from what it had been in 1978.[173] Although the S&L industry reluctantly supported the elimination of the interest-rate structure, the industry realized that it did not have the earnings capacity to remain viable without some additional means of attracting new deposits.[174]

The provision increasing the deposit insurance limit was not initially included in the 1980 legislation. Only after concern was expressed about the ability of the S&L industry to survive the repeal of the interest-rate ceilings did deposit insurance become an issue. As was the case with prior deposit insurance increases, Congress believed that an increase in insurance coverage would result in an influx of deposits. As the deposit insurance increase was being added to the 1980 legislation, one of the proponents in the Senate stated that an increase "represents no additional cost to the insurance fund and, in the past, when the FSLIC insurance has been raised, it has brought more savings in. If there is anything we need right now . . . it is for people to put more money in savings institutions."[175]

A Retrospective Look at the 1980 Deposit Insurance Coverage Increase

In 1989 the increase of deposit insurance to $100,000 was described as "almost an afterthought" that occurred "with little debate and no congressional hearings."[176] During 1990 testimony on S&L policies, Donald Regan, former Secretary of the Treasury, characterized the legislative session in which the increase was adopted as being conducted "in the dead of night . . . somewhere on the Hill."[177] Former Chairman of the FDIC William Seidman wrote that "it was a bipartisan effort, done at a late-night conference committee meeting, with none of the normal reviews by the press and the public."[178]

A review of the legislative history confirms that increasing deposit insurance coverage was not the primary purpose of the 1980 legislation. In addition to the deregulation of interest rates, the legislation authorized the payment of interest on negotiable order of withdrawal (NOW) accounts, required all depository institutions to comply with certain Federal Reserve Board reserve requirements for the first time, and involved wide-ranging changes to the nation's monetary system. Despite the lesser degree of interest that may have been directed at the issue of deposit insurance, discussion on increasing the deposit insurance limit had occurred in October 1979: Senator William Proxmire, Chairman of Senate Committee on Banking, Housing, and Urban Affairs, stated that Congress had considered raising the deposit insurance limit to $100,000 in 1974. Senator Jake Garn agreed and said Congress needed to increase the insurance limit "early next year."[179] A bill to raise the deposit insurance limit from $40,000 to $100,000 was introduced on December 20, 1979.[180]

When the final version of the 1980 bill was described on the Senate floor, Senator Proxmire made the following statement:

> One very important component [of the legislation] is that one which increases the federal deposit insurance coverage over deposits at insured depository institutions from $40,000 to $100,000 effective upon the date of enactment of the legislation. Federal insurance protection has been a bulwark of stability for depository institutions since its inception in the 1930's. An increase from $40,000 to $100,000 will not only meet inflationary needs but lend a hand in stabilizing deposit flows among depository institutions and noninsured intermediaries.[181]

In later discussion of the bill, Senator Proxmire stated:

> I predict if there is any piece of legislation that is likely to be very helpful to the banks and savings and loan institutions in keeping their head above water, it is this bill.

[173] U.S. League of Savings Associations (1980), 64–65.
[174] See, for example, U.S. House Committee on Banking, Finance and Urban Affairs (1980a), 212–13.
[175] 125 *Cong. Rec.* S15278 (daily ed. Oct. 29, 1979).
[176] Pizzo, et al. (1989), 11.
[177] Secretary Regan's testimony was based on what he had been told rather than on direct experience. Regan (1990), 17.
[178] Seidman (1993), 179.
[179] 125 *Cong. Rec.* S15278 (daily ed. Oct. 29, 1979).
[180] H.R. Res. 6216, 96th Cong., 1st Sess. (1979).
[181] 125 *Cong. Rec.* S3170 (daily ed. Mar. 27, 1980).

> I will tell you why. We have in this bill the biggest increase in insurance for depositors that they ever had. Right now, today, FDIC insurance of State chartered bank deposits are [sic] insured up to $40,000. This bill brings it to $100,000. That makes a tremendous difference. And it should make a difference in the confidence people have.[182]

Although in recent years the Federal Reserve Board has criticized the 1980 increase in the deposit insurance limit,[183] a member of the Board of Governors of the Federal Reserve System testified at the 1980 congressional hearings and registered the Federal Reserve Board's support for the increase.[184] At the time of the Federal Reserve Board's testimony, the legislative proposal would have increased deposit insurance coverage from $40,000 to $50,000. According to a chart that was given to the congressional committee summarizing the Federal Reserve Board's views on the legislation, the Board agreed that "the proposed increase [to $50,000] would be in the public interest, but [the Federal Reserve Board was] inclined to favor an increase to $100,000 as [was] contained [in] H.R. 6216."[185]

The FDIC also testified on the increase in deposit insurance coverage. Irving H. Sprague, Chairman of the FDIC, initially suggested that the insurance limit should be raised to $60,000 with an accompanying decrease in the assessment refund. Chairman Sprague stated that "insurance was last changed from $20,000 to $40,000 in 1974, and if $40,000 was the right figure then, taking inflation into account, $60,000 would be the appropriate figure today. . . . If you should decide to increase the insurance limit, [it should be] accompanied with a modest decrease in the assessment refund, so that we can keep the ratio of the fund to insured deposits on an even keel."[186] Later in the same hearing Chairman Sprague did not object to increasing deposit insurance coverage to $100,000, again with a corresponding decrease in the assessment refund.

The following is an excerpt from his testimony:

> **Representative James Hanley:** Mr. Sprague, I am pleased with your testimony which suggests that the insurance be raised to $60,000. I have suggested probably $100,000. One of the reasons for my $100,000 figure is by virtue of the cost mechanics of this. As I understand it, every time a change occurs with today's overhead, it imposes a $3 million obligation of overhead; is that right? . . .
>
> **Chairman Sprague:** Yes, printing of the decals and signs, the mailing, the whole package runs approximately from one-half to three-quarters of $1 million in direct costs to the FDIC . . . . The $60,000 figure is derived by assuming that when Congress decreed $40,000 in 1972, they set the proper figure. And the inflation rate since then would give the equivalent of $60,200, something like that.
>
> **Representative St Germain:** . . . $40,000 was not the proper figure. The proper figure would have been $50,000, but we couldn't convince the Senate to go along with the $50,000—it had to be $40,000. The proper figure was actually $50,000.
>
> **Chairman Sprague:** I think that the Senate is beginning to see some light on this subject . . . . My enthusiasm for increasing the figures is in direct proportion to your enthusiasm for doing something about the assessment refund; $50,000 is fine; $60,000 is fine. You get up to $100,000, if that were coupled with real change in the assessment rate, we wouldn't find it objectionable. . . .
>
> I would suggest a minor adjustment on [the assessment] refund, not on the basic rate, just the refund, which would be a very nominal cost to the institution if coupled with the increase in insurance. I think that would be a very attractive package. . . .
>
> **Representative Hanley:** Well, your opinion with respect to the assessment is fair. And it seems to me a formula could be devised that would take care of that part of your problem.
>
> As you know, the Fed subscribes to the $100,000 figure. I gather, from what you say, you people don't have any serious objection to that. Assuming that this matter related to the assessment, it can be adjusted.
>
> **Chairman Sprague:** The coupling is critical.[187]

As a result of the 1980 legislation, the assessment refund was decreased from 66.66 percent to 60 percent of net assessment income.[188]

[182] 125 *Cong. Rec.* S3243 (daily ed. Mar. 28, 1980).
[183] *See* Greenspan (2000); U.S. House Committee on Banking, Finance and Urban Affairs (1990a), 9 (statement by Alan Greenspan, Chairman of the Federal Reserve Board of Governors).
[184] U.S. House Committee on Banking, Finance and Urban Affairs (1980b), 829–42.
[185] Ibid., 836.
[186] Ibid., 782.
[187] Ibid., 864 (1980).
[188] Barth (1991), 147.

Reaction to Other Changes in the Law

An increase in the deposit insurance limit to $100,000 for private deposits brought the insurance protection for these deposits in line with that of other types of deposits. In 1974, when the deposit insurance for private deposits was raised to $40,000, deposit insurance coverage for time and savings accounts held by state and political subdivisions was increased to $100,000.[189] Additionally, deposit insurance coverage for time and savings deposits of Individual Retirement Accounts (IRAs) and KEOGH funds was increased to $100,000 in 1978.[190] After the 1980 increase in insurance coverage for private deposits, all deposits were insured to the same level.

[189] Act of October 28, 1974, Public Law 93-495, §101, Statutes at Large 88 (1974): 1500–01; see notes 149 and 150 above and accompanying text.

[190] Financial Institutions Regulatory and Interest Rate Control Act of 1978 § 1401, Public Law 95-630, Statutes at Large 92 (1978): 3641, 3712 (codified as amended at 12 U.S.C. § 1821(a)(3)(1989)).

CONCLUSION

Federal deposit insurance coverage in the United States has never been extended to the extent envisioned under the original permanent plan enacted in 1933. Whether the level of coverage available at any particular time is adequate is open to interpretation. Although the motives for increasing the deposit insurance coverage have varied over time, after reviewing the legislative history for evidence of Congress's intent in raising the insurance limit, one can make several general observations. Just as the initial reasons for adopting a federal deposit insurance program were numerous, the reasons for each of the subsequent increases in coverage have been many. For the most part, increases in deposit insurance coverage have been uncontroversial, and in each case Congress has been influenced by developments in the broader economy.

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