Federal Deposit Insurance Corporation:

The First Fifty Years

A History of the FDIC 1933-1983

Federal Deposit Insurance Corporation
Washington, D.C.
1984

A commemorative stamp marking the 50th anniversary of the FDIC was unveiled as part of a reception program on June 15, 1983. Vice President George Bush, Postmaster General William Bolger, FDIC Chairman William Isaac and Mrs. Bush joined in the ceremony officially opening the anniversary observance.

Photo: Official White House Photograph

Prologue

> On March 3 banking operations in the United States ceased. To review at this time the causes of this failure of our banking system is unnecessary. Suffice it to say that the government has been compelled to step in for the protection of depositors and the business of the nation.

As President Franklin D. Roosevelt spoke these words to Congress on March 9, 1933, the nation's troubled banking system lay dormant. More than 9,000 banks had ceased operations between the stock market crash in October 1929 and the banking holiday in March 1933. The economy was in the midst of the worst economic depression in modern history.

Out of the ruins, birth was given to the FDIC three months later when the President signed the Banking Act of 1933. Opposition to the measure had earlier been voiced by the President, the Chairman of the Senate Banking Committee and the American Bankers Association. They believed a system of deposit insurance would be unduly expensive and would unfairly subsidize poorly managed banks. Public opinion, however, was squarely behind a federal depositor protection plan.

By any standard, deposit insurance was an immediate success in restoring stability to the system. The bank failure rate dropped precipitously, with only nine insured banks failing during 1934. During the 30-year period beginning with World War II, the workings of the economy and the conservative behavior of bank regulators and the banking industry created a situation that posed few risks to the financial system, and the importance of deposit insurance in maintaining stability declined. Indeed, Wright Patman, the then-Chairman of the House banking committee, argued in a speech in 1963 that there were too few bank failures — that we had moved too far in the direction of bank safety.

While it is doubtful that a cause-and-effect relationship exists, Chairman Patman's wish has been realized. Banking has become a considerably more competitive business — more responsive to credit needs and more willing to assume greater risks in meeting those needs. While this development is very positive from the viewpoint of American consumers, farmers and businesses, banks have become concomitantly more vulnerable to changes in economic conditions.

Bank failures have increased in size and number in the past decade, culminating in a post-World War II record number of failures in the 1981-83 period. From the beginning of 1981 to date in 1983, the FDIC has handled 100 bank failures, including 18 of the 25 largest in FDIC history (the FDIC handled 6 failures on a single day in 1983, which was more than the number of failures in a typical year during the 1950s and 1960s). These 100 banks held assets of $24 billion compared to only $9 billion held by the 568 insured banks that failed prior to 1981. The FDIC's estimated losses during this three-year period amounted to $2.2 billion compared to less than $200 million on the previous 568 failures. The FDIC is currently involved in 170 active receiverships, is managing 65,000 receivership assets with an aggregate book value of $4.3 billion, and is a plaintiff or defendant in over 6,000 lawsuits related to receivership activities.

The insurance system has weathered the challenges presented by this staggering volume of activity. Public confidence in the banking system has been maintained without the expenditure of one penny of taxpayer money. The FDIC's insurance fund — whose revenues are derived from bank assessments and interest earned on investments in U.S. Treasury obligations — has grown rapidly from $11 billion at the beginning of 1981 to over $15 billion today.

The events of the past few years and the evolving process of deregulation have prompted the FDIC to reexamine the role of deposit insurance and to revise its attitudes and methods of operation. Our basic concern is that the existence of deposit insurance and, more importantly, the way in which the FDIC has handled most failed banks have provided too much comfort to larger depositors and other bank creditors. With a perception of minimal risk, there is little incentive for larger depositors to exert the degree of market discipline present in other industries. This situation has placed the deposit insurance agencies in a position where they must act in place of the market.

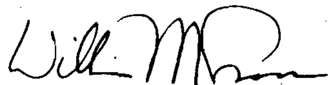
The trend away from market participation in the regulation of bank behavior probably dates from the founding of the FDIC. Over most of this period, when banks operated in a protected and stable environment, the substitution of regulatory for market discipline caused little concern. With the more recent move toward increasingly competitive banking markets, controlling bank risks through a formal regulatory mechanism is more complex and imposes substantial economic costs on both the industry and society as a whole. A better solution is to shift the regulatory balance toward a greater role for the market.

This was the primary conclusion reached in a comprehensive study of the federal deposit insurance system completed and submitted to Congress by the FDIC in the spring of 1983. The means recommended to achieve this goal was to modify the way the FDIC handles bank failures to place uninsured depositors and other creditors at greater risk. As a supplement to this effort, it also was recommended that the FDIC vary deposit insurance premiums according to the risk a bank poses to the insurance fund and to charge for special supervisory activities. In November of 1983, the FDIC submitted to Congress proposed legislation to implement these changes.

The proposed legislation represents a vital first step in rationalizing the regulatory and insurance systems. The entire spectrum of other questions relating to the further deregulation of banking and the appropriate regulatory structure is currently under close study by Congress and various government agencies. For our part, we believe that providing adequate insurance coverage in an evenhanded manner should be the FDIC's principal role. We do not believe the FDIC should divert its resources to the examination of banks that pose little risk to the deposit insurance fund, or to other activities not directly related to our insurance function. This is the direction in which the FDIC is moving.

While this history was prepared by FDIC staff, a genuine attempt has been made to treat objectively the role of the FDIC during the first 50 years of its existence. This is important not only from the standpoint of intellectual honesty, but because this piece is intended to improve understanding of the FDIC and the issues to be considered by those responsible for reforming the system.

We hope the need for deposit insurance will never again be so great as it was in the 1930s. Nevertheless, as the FDIC embarks on its second half-century, the challenges at hand are greater than at any time in the past four decades.



William M. Isaac
Chairman
Federal Deposit Insurance Corporation
December 21, 1983

Acknowledgments

This history was prepared by the Division of Research and Strategic Planning, with main contributions from Detta Voesar and James McFadyen. Other contributors were Stanley C. Silverberg, Director of the division, who also directed the project, and William R. Watson, Associate Director. Jean Roane, Alane Lehfeld and the Library staff provided valuable research assistance. Cathy Curtis supplied greatly appreciated secretarial services throughout the numerous drafts.

Steven A. Seelig of the Division of Liquidation was particularly helpful in the early stages of the project. Useful comments, suggestions and information were provided by many people in various FDIC offices, among whom were William M. Dudley, Division of Liquidation; Donald L. Pfeiffer, Jr. and Ken A. Quincy, Division of Bank Supervision; Douglas Birdzell, Joseph A. DiNuzzo, Roger A. Hood and Carroll R. Shifflett, Legal Division; and Ronald E. Doherty, Division of Accounting and Corporate Services. Carter Golembe of Golembe Associates, Inc., also reviewed the manuscript.

Former employees Neil Greensides and John Early, both of whom are past directors of the Division of Bank Supervision, granted interviews which provided valuable personal insights into past events and personalities.

Gratitude is also due Geoffrey Wade, Geri Pavey and others in the Graphics and Printing Unit.

Table of Contents

PROLOGUE iii

ACKNOWLEDGMENTS vi

Chapter 1: INTRODUCTION 3
- Background 3
- The Early Years 4
- The Period 1942-1972 6
- The Period 1973 - Present 8

Chapter 2: ANTECEDENTS OF THE FEDERAL DEPOSIT INSURANCE CORPORATION 13
- Insurance of Bank Obligations, 1829-1866 13
- Guaranty of Circulating Bank Notes by the Federal Government 22
- State Insurance of Bank Deposits, 1908-1930 24
- Congressional Proposals for Deposit Guaranty or Insurance, 1886-1933 29
- Summary 30

Chapter 3: ESTABLISHMENT OF THE FEDERAL DEPOSIT INSURANCE CORPORATION 33
- Banking Developments, 1930-1932 33
- The Banking Crisis of 1933 37
- Federal Deposit Insurance Legislation 40
- Deposit Insurance Provisions of the Banking Act of 1933 43
- Formation of the Federal Deposit Insurance Corporation 46
- The Temporary Federal Deposit Insurance Fund 46
- Deposit Insurance and Banking Developments in 1934 49
- Proposals to Amend the Permanent Insurance Law 50
- Inauguration of Permanent Plan of Insurance of Bank Deposits 51

Chapter 4: INSURANCE COVERAGE AND FINANCIAL OPERATIONS OF THE FDIC 55
Financial Operations 55
Income and Expenses of the FDIC 61
The Deposit Insurance Fund 66
Insurance Coverage 69
Organization and Staffing 72

Chapter 5: HANDLING BANK FAILURES 81
Procedures Used in Handling Failures — Early Years 81
FDIC as Receiver 83
Cost Test 86
Closed-Bank Purchase and Assumption Transactions 87
Bank Failures Since 1970 89
Large Bank P&As 90
Open-Bank Assistance 94
Penn Square Bank 97
Recent Open-Bank Assumption Transactions 98
Assisted Mergers of Mutual Savings Banks 99
FDIC Liquidation Activity 102
Present Liquidation Procedures 105
Summary 107

Chapter 6: BANK EXAMINATION AND SUPERVISION 111
Historical Overview 111
Admission Examinations 113
Capital Rehabilitation 115
Safety and Soundness Examination Policy 116
Compliance, EDP and Trust Examinations and Other Supervisory Functions 123
Enforcement Powers 124
Problem Banks 127
Federal and State Cooperation 130
Summary 132

EPILOGUE 135

APPENDIX: The Boards of Directors of the FDIC 139

BIBLIOGRAPHY 145