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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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The Cost of the Savings and Loan Crisis: Truth and Consequences

by Timothy Curry and Lynn Shibut*

It has been more than a decade since enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which began the taxpayers' involvement in the cleanup of the savings and loan industry.[1] Over time, misinformation about the cost of the crisis has been widespread; some published reports have placed the cost at less than $100 billion, and others as high as $500 billion.[2] Now that the cleanup is nearly complete, we can answer the following questions about a debacle that has consumed the nation for years:

- What was the total cost of the crisis?
- How much of the total was borne by the U.S. taxpayer?
- How much was borne by the thrift industry?
- How do the actual costs compare with those predicted before and during the cleanup years?

The thrift cleanup was Congress's response to the greatest collapse of U.S. financial institutions since the 1930s. From 1986 to 1989, the Federal Savings and Loan Insurance Corporation (FSLIC), the insurer of the thrift industry, closed or otherwise resolved 296 institutions with total assets of $125 billion (table 1).[3] An even more traumatic period followed, with the creation of the Resolution Trust Corporation (RTC) in 1989 and that agency's resolution by mid-1995 of an additional 747 thrifts with total assets of $394 billion.[4] The combined closings by both agencies of 1,043 institutions holding $519 billion in assets contributed to a massive restructuring of the number of firms in the industry. From January 1, 1986, through year-end 1995, the number of federally insured thrift institutions in the United States declined from 3,234 to 1,645, or by approximately 50 percent.[5]

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[1] Although the roots of the savings and loan crisis lay in the late 1970s, the passage of FIRREA in 1989 marked the first time taxpayer funds were used to resolve the crisis. That use of taxpayer funds to meet the guarantee to insured depositors is the reason the term *cleanup* is used rather than *bailout*.

[2] For example, see White (1991), 197. Also, Thomas (2000), 13.

[3] The word *thrifts* refers to savings associations insured by the FSLIC until August 8, 1989, and after that date by the Savings Association Insurance Fund (SAIF), administered by the FDIC.

[4] The $394 billion figure measures total assets as reported in the Thrift Financial Report that was most recent at the time of each thrift's failure. This figure is net of valuation allowances on the books of the institution at the time of failure. Other published numbers have reported the total assets for the 747 thrifts at takeover to be $402.4 billion. This reported number is gross of valuation allowances. Unless otherwise noted, the source for all data is the FDIC.

[5] The total number of thrift institutions represents those that were FSLIC-insured at year-end 1986 and SAIF-insured at year-end 1995. It should be noted that not all of the thrift industry consolidation occurred because of the thrift crisis. Even without such a crisis, some consolidation of the industry would probably have occurred.

Table 1
Thrift Failures, 1986–1995
($Millions)

Year	FSLIC Number	FSLIC Assets	RTC Number	RTC Assets
1986	54	$ 16,264		
1987	48	11,270		
1988	185	96,760		
1989	9	725	318	$134,520
1990			213	129,662
1991			144	78,899
1992			59	44,197
1993			9	6,148
1994			2	137
1995			2	435
Total	**296**	**$125,019**	**747**	**$393,998**

Source: FDIC.
Note: Data are for the period January 1, 1986, to December 31, 1995.

Although the roots of the thrift crisis stretch back to the late 1970s, the financial losses experienced by taxpayers and the industry are tabulated as beginning on January 1, 1986, and ending at year-end 1995. The year 1986 was selected as the starting point because this was the first year when the FSLIC was reported insolvent. Before then, the thrift insurance fund had been able to cover losses from thrift failures. Recognition of the FSLIC's insolvency as of year-end 1986 marked a watershed: at that time many observers realized that taxpayer involvement in the resolution of the crisis was a strong possibility.

The next section of this article provides background material on the crisis. It is followed first by a retrospective on the changing estimates of the size of the thrift problem over time and then by a three-part section identifying and analyzing the cost of meeting the deposit insurance obligations that remained in the wake of the debacle. The costs are broken into the FSLIC and RTC segments, as well as the taxpayer and the thrift industry shares of each, and the total is then analyzed. A brief summary concludes. An appendix discusses the "goodwill" litigation associated with FIRREA.

Background

The causes and severity of the thrift crisis have been documented by scholars for more than a decade.[6] Several reasons cited for the collapse include:

- high and volatile interest rates during the late 1970s and early 1980s, which exposed thrifts to interest-rate risk (caused by a mismatch in duration and by interest-rate sensitivity of assets and liabilities);
- the phase-out and eventual elimination in the early 1980s of the Federal Reserve's Regulation Q, which caused increasing costs of thrift liabilities relative to many fixed-rate assets and adversely affected industry profitability and capital;
- adverse regional economic conditions;
- state and federal deregulation of depository institutions, which allowed thrifts to enter new but riskier loan markets;
- the deregulation of the thrift industry without an accompanying increase in examination resources (for some years examiner resources actually declined);
- reduced regulatory capital requirements, which allowed thrifts to use alternative accounting procedures to increase reported capital levels;
- excessive chartering of new thrifts during the 1980s;
- the withdrawal in 1986 of federal tax laws (enacted in 1981) that benefited commercial real-estate investments;
- the development during the 1980s of the brokered deposit market; and
- delays in funding the thrift insurance fund during the 1980s and the RTC during the 1990s, which led to regulators' failure to close many insolvent institutions in a timely manner.

As a consequence of all these factors, during the 1980s the thrift industry realized unprecedented losses on loans and investments. The result, as noted, was the failure of hundreds of thrift institutions and the insolvency by year-end 1986 of the FSLIC, the federal insurer for the thrift industry. As of year-end 1986, 441 thrifts with $113 billion in assets were book insolvent, and another 533 thrifts, with $453 billion in assets, had tangible capital of no more than 2 percent of total assets. These 974 thrifts held 47 percent of industry assets. In response, Congress created the Financing Corporation (FICO) in 1987 to provide funding to the FSLIC by issuing long-term bonds. By the time FIRREA was passed two years later, FICO had contributed $8.2 billion in financing to the

[6] *See* Barth *et al.* (1985); Kane (1989); Barth (1991); White (1991); Barth and Brumbaugh (1992); Bennett and Loucks (1996); and FDIC (1997).

Table 2

Chronology of Thrift Crisis Events

December 31, 1986	FSLIC insolvent
August 10, 1987	FICO created to fund FSLIC
August 9, 1989	Enactment of FIRREA
	– FSLIC abolished
	– FRF created (succeeds to FSLIC's assets, liabilities, and operations)
	– SAIF created to handle thrift failures starting August 9, 1992
	– RTC created to resolve thrifts placed into conservatorships or receiverships between January 1, 1989 and August 8, 1992[a] (RTC to cease operations December 31, 1996)[b]
	– REFCORP created to fund RTC

Note: FSLIC = Federal Savings and Loan Insurance Corporation
FICO = Financing Corporation
FRF = FSLIC Resolution Fund
SAIF = Savings Association Insurance Fund
RTC = Resolution Trust Corporation
REFCORP = Resolution Funding Corporation

[a]Cutoff date for takeovers later extended to June 30, 1995.

[b]Date to cease operations later changed to December 31, 1995.

FSLIC, an amount insufficient to deal with the industry's massive problems.[7]

In response to the deepening crisis, Congress enacted FIRREA on August 9, 1989, beginning the taxpayers' involvement in the resolution of the problem. (See table 2 for a listing of thrift crisis events.) FIRREA abolished the FSLIC and transferred its assets, liabilities, and operations to the newly created FSLIC Resolution Fund (FRF), to be administered by the FDIC. In addition, FIRREA created—to be administered by the FDIC—a new thrift insurance fund named the Savings Association Insurance Fund (SAIF), which would handle thrift failures starting three years from the date of FIRREA. FIRREA also created the RTC to resolve virtually all troubled thrifts placed into conservatorships or receiverships between January 1, 1989, and August 8, 1992. Because of the continuing thrift crisis, however, the RTC's authorization to take over insolvent institutions was twice extended, the second time to June 30, 1995.[8] The RTC was required to cease its operations on December 31, 1995, and transfer any remaining assets and liabilities to the FSLIC Resolution Fund.[9]

FIRREA provided the RTC with $50 billion to resolve failed institutions. Approximately $30 billion of this amount originated through the establishment of the Resolution Funding Corporation (REFCORP), which was a private-public partnership created to issue long-term bonds to the public.[10] The remaining $20 billion came from the U.S. Treasury ($18.8 billion) and the Federal Home Loan Banks ($1.2 billion). Because the $50 billion in initial funding was insufficient to deal with the scope of the problem, Congress enacted subsequent legislation three times, raising total authorized RTC funding for losses to $105 billion between 1989 and 1995. Some of this amount was never used. (See table 3.)

[7] FICO was created by the Competitive Equality Banking Act of 1987 (CEBA) as the vehicle for recapitalizing the insolvent FSLIC. The law authorized FICO to raise funds for the FSLIC by selling bonds to the public; as noted, FICO had $8.2 billion of outstanding debt as of the passage of FIRREA in August 1989. Initially the thrift industry was to be responsible for payment of interest and principal on the outstanding debt. Later FIRREA permitted the FICO bonds to be paid for by annual assessments from the newly created SAIF insurance fund. Because of concern over the low reserves of the SAIF, the Deposit Insurance Funds Act of 1996 (PL 104-208) provided for the SAIF's capitalization. As part of the capitalization effort, future interest payments on the FICO bonds were to be paid for by all FDIC-insured institutions.

[8] FIRREA's original period for the takeover of insolvent institutions was three years, which ended August 8, 1992. The RTC Refinancing, Restructuring and Improvement Act of 1991 extended the period to October 1, 1993. The RTC Completion Act of 1993 extended it through June 30, 1995.

[9] The original RTC termination date, established by FIRREA in August 1989, was December 31, 1996. The RTC Completion Act of 1993 changed the closure date to December 31, 1995.

[10] The 1989 legislation created a quasi-private corporation to provide funds for the RTC. The organization and structure of REFCORP were patterned after FICO, established in 1987 to raise funds for the insolvent FSLIC. REFCORP was authorized to issue debt obligations in an aggregate amount of $30 billion starting in fiscal years 1990 and 1991. The $30 billion in principal on the REFCORP bonds was paid from the sale of non-interest-bearing U.S. Treasury obligations, which REFCORP purchased in amounts approximately equal to the principal of the REFCORP obligations. These zero-coupon securities were funded from the reserves and special assessments of the FHLBs and the SAIF. Funds for the payment of interest on REFCORP obligations came from several sources, including $300 million per year from FHLB contributions and from the U.S. Treasury. REFCORP raised the $30 billion in offerings by January 1991.

Table 3
RTC Funding Legislation
($Billions)

Legislation	Loss Funds	Date of Enactment
FIRREA, 1989	$ 50.1	August 9, 1989
RTC Funding Act of 1991	30.0	March 23, 1991
RTC Refinancing, Restructuring and Improvement Act of 1991	6.7	December 12, 1991
RTC Completion Act of 1993	18.3	December 17, 1993
Total Funds Appropriated	**$105.1**	
Total Funds Provided to RTC	**$ 91.3**	

History of Cost Estimates

Before, during, and even after the RTC's lifetime, estimates of the costs of the crisis created widespread confusion. Federal agencies, politicians, thrift industry experts, and others put forth myriad estimates on what was called the size of the problem. These forecasts often diverged widely and changed frequently in response to surging industry losses. For example, most loss projections for RTC resolutions during the year leading up to passage of FIRREA in 1989 were in the range of $30 billion to $50 billion, but some reached as high as $100 billion at that time.[11] Over the next few years, as a greater-than-expected number of thrifts failed and the resolution costs per failure soared, loss projections escalated. Reflecting the increased number of failures and costs per failure, the official Treasury and RTC projections of the cost of the RTC resolutions rose from $50 billion in August 1989 to a range of $100 billion to $160 billion at the height of the crisis peak in June 1991, a range two to three times as high as the original $50 billion.[12] The fact that the estimates were moving targets increased the public's confusion and compounded Congress's difficulty in reaching a consensus on funding levels for the cleanup.

What accounted for the disparity and volatility among these projections? First, timely information on the condition of the failed institutions was lacking, especially during the early years. Analysts were forced to base their loss predictions on Thrift Financial Report data that were often outdated and unreliable (because thrift examinations had been infrequent and relaxed accounting standards were used at the time). In reality, the industry was in much worse shape than most observers had anticipated, and once the cleanup got under way and the industry came under intense scrutiny, this became apparent. During the asset reviews of insolvent and undercapitalized institutions, it became obvious that the embedded losses were much greater than thrift financial statements had reported.

Another factor was uncertainty about the expected number of future failures. This number was hard to predict because the economy was changing, as were interest rates and commercial real-estate markets. The Bush administration, for example, originally estimated that more than 400 thrifts with over $200 billion in assets would be turned over to the RTC at a cost of approximately $50 billion, but in less than a year the administration's estimate had grown to 700 or 800 thrifts with assets of over $400 billion. The dramatic misreading of the number of failures and subsequent costs of the crisis, especially during the early years, was acknowledged by L. William Seidman, Chairman of both the FDIC and RTC during this era, in his memoir. "Only three months after the cleanup started," he said, "it was already evident that the problem was far worse than anyone in government had envisioned, including me, and it was getting worse every day. The economy was beginning to slide into recession. Real estate was in real depression in some parts of the country, particularly in Texas, where the savings and loan problem was the largest . . . we would also need billions more to pay off depositors and carry weak assets of the institutions until they were sold and we could

[11] The $30 billion to $50 billion estimates formed the basis for the Bush administration plan in February 1989 to provide $50 billion in funding for the cleanup. Experts outside the federal government at that time claimed that the costs could be substantially higher—possibly reaching $100 billion.

[12] During the final year of the cleanup, the Treasury lowered its official estimates to $120 billion.

recover the funds we had invested . . . we were faced with taking the most politically unacceptable action of all, having to admit that we made a big mistake."[13]

A third factor contributing to the disparate and volatile nature of the projections was that some public reports on the size of the problem looked at "apples" and others at "oranges," and the two groups were not comparable. For example, some estimates included only the expected losses from RTC failures but did not incorporate past FSLIC costs. Other estimates included both the FSLIC and RTC losses but focused only on the taxpayers' losses, while excluding losses incurred by the thrift industry over the same period.

One of the most important factors in explaining the variance among the loss estimates was methodological: the total estimated cost sometimes did and sometimes did not include, in addition to the estimated losses, the borrowing costs for the billions of dollars of debt issues floated to fund the cleanup. During the FSLIC and RTC eras, the industry contributed $38.3 billion (sometimes in partnership with the Treasury) in funding for the cleanup. Special government-established financing entities (FICO and REFCORP) raised these funds by selling long-term bonds in the capital markets. The Treasury contributed another $99 billion,[14] some or all of which was also borrowed because the federal government was experiencing large budget deficits during the period. When some analysts tabulated the costs of the cleanup, they included not only the principal borrowed but also interest costs for periods of up to 30 to 40 years on some or all of the borrowings. Including the financing costs in addition to principal could easily double or triple the estimates of the final cost of the cleanup.

However, in our view, including financing costs when tallying the costs of the thrift crisis is methodologically incorrect. It is invalid because, in present-value terms, the amount borrowed is equal to the sum of the interest charges plus debt repayment. Adding the sum of interest payments to the amount borrowed would overstate the true economic cost of resolving the crisis. An example will illustrate the point. Assume an individual pays $100,000 for the purchase of a residential property and finances the whole amount with a 30-year loan at 10 percent interest. Over the 30 years of the loan the individual pays more than $300,000 in total costs, comprising interest and principal. Yet, the cost of the home is still $100,000, because the present value of the total costs of $300,000 for 30 years of payments discounted by the interest rate of 10 percent is approximately $100,000.[15] Another example: the federal government does not include interest charges when costing specific programs, such as weapons systems or school lunches.

Accounting for the Thrift Cleanup Costs

The costs of the thrift crisis are analyzed below in three sections. The first section looks at costs borne by the FSLIC for thrifts that failed from year-end 1985 through August 8, 1989.[16] Funds were provided to the FSLIC, and when the FSLIC was abolished in 1989, the FRF became responsible for paying off notes and other obligations the FSLIC had left behind.[17]

The second section analyzes costs associated with the RTC resolutions of institutions that failed after January 1, 1989 (excluding failures resolved by the FSLIC). These institutions consist of two groups of failed thrifts: (1) those that were nationalized and placed into FDIC-supervised conservatorships from January 1, 1989, through the passage of FIRREA on August 9, 1989,[18] and (2) those that failed after August 8, 1989. In the first group—institutions taken over before August 9, 1989—there were 262 failed thrifts from 33 states, with $104 billion in total assets. In the second group—institutions that failed after August 8, 1989, and before June 30, 1995—there were 485 thrifts with total assets of $290 billion. The third section analyzes total estimated resolution costs.

Table 4 breaks out the thrift crisis losses for both FSLIC- and RTC-related resolutions by source—either the private or the public sector—as of year-end 1999.

[13] Seidman (1993), 208.

[14] Includes $43.5 billion to the FRF and $55.9 billion to the RTC. See table 4. An additional $4.2 billion was provided to the RTC and later returned to the Treasury.

[15] Actually, the total amount paid out over 30 years would be $315,925.

[16] As mentioned above, the tabulation of costs begins in 1986 because that was the year when the FSLIC became insolvent. Its equity was depleted from a positive balance of $4.6 billion on January 1, 1986, to a negative balance of $6.3 billion on December 31, 1986.

[17] FIRREA transferred all of the FSLIC's assets, liabilities, and operations to the newly created FRF to be administered by the FDIC. The funds needed to settle the FSLIC's remaining liabilities were provided by appropriations from the Treasury, industry assessments, and recoveries from asset sales.

[18] Although the failed thrifts were placed into FSLIC conservatorships, an agreement among the FDIC, the FHLBB, and the FSLIC gave the FDIC authority to supervise these conservatorships. In August 1989 at the RTC's inception, the conservatorships were turned over to the RTC for management and ultimate resolution.

Table 4

Estimated Savings and Loan Resolution Cost, 1986–1995

($Billions)

	Private Sector	Public Sector	Total
Direct Cost			
FSLIC/FSLIC Resolution Fund, 1986–95			
FSLIC year-end equity and reserves, 1985	$6.1		$6.1
FSLIC insurance premiums, 1986–89	5.8		5.8
SAIF assessments diverted to FRF, 1989–92	2.0		2.0
FICO bond proceeds, 1987–89	8.2		8.2
FRF appropriations, 1989–95		$43.5	43.5
Less: FRF equity at 12/31/99[a]		(2.5)	(2.5)
Estimated Direct FSLIC/FRF Cost	**$22.0**	**$41.0**	**$63.0**
RTC, 1989–95			
Raised through REFCORP bond proceeds:[b]			
FHLB payments to defease REFCORP debt, 1989–91	1.3		1.3
SAIF assessments paid to defease REFCORP debt, 1990	1.1		1.1
Net present value of FHLB-paid interest on REFCORP bonds[c]	3.5		3.5
Net present value of REFCORP interest paid by U.S. Treasury[d]		24.2	24.2
Total REFCORP bond proceeds	5.9	24.2	30.1
Appropriations from U.S. Treasury[e]		55.9	55.9
Initial contribution from FHLB system	1.2		1.2
Less: RTC equity at 12/31/99[a]		(4.5)	(4.5)
Estimated Direct RTC Cost	**7.1**	**75.6**	**82.7**
Estimated Total Direct Cost	**$29.1**	**$116.5**	**$145.7**
Indirect Cost			
Estimated cost of tax benefits to acquirers from FSLIC assistance		6.3	6.3
Increased interest expense from higher interest rates on REFCORP bonds compared with U.S. Treasury borrowings[f]		1.0	1.0
Estimated Indirect Cost		**7.3**	**7.3**
Estimated Total Cost	**$29.1**	**$123.8**	**$152.9**
Memo: goodwill litigation cost through 12/31/99[g]		0.4	0.4

Note: For these costs to be comparable to those of other government programs, they exclude interest on the national debt incurred to fund the cleanup, and, in the case of FICO and REFCORP, interest that would have accrued to the national debt had such funding come from the general fund of the U.S. Treasury instead of from FICO and REFCORP. Resolution costs start with 1986 because the FSLIC became insolvent that year.

[a]Adjusted for expenses associated with goodwill litigation. See note g below.

[b]REFCORP bonds were funded via a public-private partnership. Total funds raised by REFCORP were $30.1 billion. Because of the mix of private and public funding, discounting is used to allocate the $30.1 billion on the basis of the contributions made by various parties at different times.

[c]Net present value of the FHLBs' $300 million annual contribution to cover part of REFCORP interest expense.

[d]Calculated as the total REFCORP contribution ($30.1 billion) minus the net present value of the private-sector contributions.

[e]Total appropriations were $60 billion, but $4.2 billion was returned to the Treasury in 1999.

[f]Present value of higher interest expense of REFCORP borrowing compared with comparable-term U.S. Treasury securities. This is treated as a public-sector expense because the U.S. Treasury is responsible for all interest expenses above those paid by the FHLBs.

[g]The FDIC cost of litigation stemming from changes in accounting treatment of supervisory goodwill and other items in FIRREA through 12/31/99. The cost borne by the Department of Justice and estimated future costs are unavailable. Awards that have not been paid are excluded. In this presentation, goodwill expenses and recoveries are excluded from the cost of the Savings and Loan resolutions. Goodwill expenses and recoveries relate to legislative changes in FIRREA, not to the resolution of failed thrifts. Thus, this is reported only as a memo item.

FSLIC Estimated Resolution Costs

For FSLIC failures, the loss from the beginning of 1986 forward was $63.0 billion, of which the public sector accounted for $41.0 billion, or 65 percent, while the thrift industry paid $22.0 billion, or 35 percent of the total. All the FRF-related public-sector losses were accounted for by the Treasury's $43.5 billion contribution. As of year-end 1999, however, the FRF still retained $2.5 billion in equity that was expected to be returned to the taxpayers, so the net loss was $41.0 billion.[19] (As mentioned above, the FRF was responsible for settling accounts on all outstanding FSLIC assistance agreements and receiverships.) The $22.0 billion in thrift industry funding for FSLIC losses included: $8.2 billion that came from the thrift industry through the sale of long-term FICO bonds; FSLIC insurance premiums from 1986 forward and SAIF assessments diverted to the FRF, accounting for an additional $7.8 billion in spending; and $6.1 billion from the original FSLIC insurance fund equity and reserves as of year-end 1985.[20]

RTC Estimated Resolution Costs

As of December 31, 1999, the RTC losses for resolving the 747 failed thrifts taken over between January 1, 1989, and June 30, 1995, amounted to an estimated $82.7 billion, of which the public sector accounted for $75.6 billion, or 91 percent, and the private sector accounted for $7.1 billion, or 9 percent (table 4).

The largest component of the public-sector loss was direct Treasury appropriations of $55.9 billion;[21] the Treasury also absorbed $24.2 billion of the $30.1 billion in REFCORP contributions received from 1989 to 1991. However, the public-sector losses were reduced by $4.5 billion in equity held by the RTC as of year-end 1999.[22]

This accumulation of equity over the years was attributable to a number of factors. When an insured depository institution was closed and put into a receivership, the RTC placed a loss adjustment factor against the book value of the assets (this value was based on appraisals or other market information available at the time). These loss reserves reduced the value of the assets to the expected market or recovery value. In its reserving procedures, the RTC (with the approval of the GAO) took a conservative approach so as not to overstate the value of the assets acquired from failed institutions. In applying reserving procedures, the RTC considered a variety of factors including the fair market value of assets when residential and commercial markets were collapsing and the costs associated with particular sales methods developed by the RTC. For example, claims from both representation and warranty guarantees on asset sales and securitizations of nonstandard assets had to be anticipated and loss reserves established. During the 1990s, as the economy improved and real-estate markets recovered, the losses on asset sales and claims from representation and warranty and asset-securitization guarantees were less than anticipated. Thus, a portion of previously set-aside reserves were recaptured into the RTC equity account and offset the overall costs of the cleanup.

The thrift industry losses included the initial $1.2 billion contributed by the Federal Home Loan Banks (FHLBs) to capitalize the REFCORP. The FHLBs also paid $1.3 billion, and the SAIF paid $1.1 billion, to purchase zero-coupon securities worth $30 billion at maturity—to be used to pay the principal of REFCORP debt. The FHLBs incurred an additional $3.5 billion loss that represented the present value of the FHLBs' portion of the interest payments on REFCORP bonds.

Total Estimated Resolution Costs

As of December 31, 1999, total direct costs attributable to the closing of insolvent thrift institutions over the 1986–1995 period amounted to $145.7 billion. Indirect costs due to the loss of Treasury revenue because of the tax benefits that accrued to acquirers of failed institutions under past FSLIC resolutions amounted to $6.3 billion.[23] An additional $1.0 billion of indirect costs was incurred because interest expens-

[19] The FRF equity will be returned to the Treasury as the remaining workload is completed. This figure is adjusted for goodwill litigation costs.

[20] These reserves were premiums paid before 1986 that were spent during the crisis.

[21] Appropriations were $60 billion, but approximately $4.2 billion was returned to the Treasury in 1999.

[22] These funds will be returned to the Treasury, or will be used to reduce the Treasury's interest payments on the REFCORP bonds, as the remaining workload is completed. This figure is adjusted for goodwill litigation costs.

[23] During most of the 1980s, special tax benefits accrued to those acquiring insolvent thrift institutions. For example, assistance paid to acquiring institutions was nontaxable. In addition, in some cases acquiring organizations could carry over certain losses and tax attributes of the troubled institutions to reduce their overall tax liability. These provisions reduced the amount that the FSLIC was required to pay acquiring organizations to take over insolvent institutions. As a consequence of these tax benefits, revenue was lost to the Treasury. Thus, these tax benefits are referred to as "indirect costs." No such benefits were granted after 1988.

es were higher with the use of REFCORP bonds than with Treasury financing.[24] Thus, the combined total for all direct and indirect losses of FSLIC and RTC resolutions was an estimated $152.9 billion. Of this amount, U.S. taxpayer losses amounted to $123.8 billion, or 81 percent of the total costs. The thrift industry losses amounted to $29.1 billion, or 19 percent of the total.

The accumulated losses of $152.9 billion were higher than the official and private forecasts of the late 1980s but lower than those made by the government and others during the early to mid-1990s. As mentioned above, during the late 1980s the full extent of the problem was unknown until the cleanup began; thus, many early forecasts underestimated the size of the problem. In the early to mid-1990s, lower interest rates and an improving economy reduced the number of thrift failures and improved prices for thrift franchises and assets held by thrifts; thus, the final losses were less than those predicted at the height of the crisis. In addition, because perceptions of thrift assets during the crisis years had been unfavorable, the RTC adopted conservative accounting procedures, and the combination of these policies and a strong economy caused the costs of the cleanup to decline every year after 1991.

As of year-end 1999, the savings and loan cleanup was largely complete. The FSLIC Resolution Fund, which controls all remaining assets and liabilities of both the FSLIC and the RTC, either held or had a direct claim on approximately $7 billion in assets, most of which were cash and low-risk securities.[25] Thus, losses from future asset sales will not materially change the loss figures. However, the costs of the goodwill litigation associated with FIRREA (see the Appendix) are still largely unknown, and it could be several more years before these cases are concluded.

Summary

The savings and loan crisis of the 1980s and early 1990s produced the greatest collapse of U.S. financial institutions since the Great Depression. Over the 1986–1995 period, 1,043 thrifts with total assets of over $500 billion failed. The large number of failures overwhelmed the resources of the FSLIC, so U.S. taxpayers were required to back up the commitment extended to insured depositors of the failed institutions. As of December 31, 1999, the thrift crisis had cost taxpayers approximately $124 billion and the thrift industry another $29 billion, for an estimated total loss of approximately $153 billion. The losses were higher than those predicted in the late 1980s, when the RTC was established, but below those forecasted during the early to mid-1990s, at the height of the crisis.

[24] The REFCORP funding mechanism essentially required that the U.S. Treasury pay interest at slightly higher rates than it did for Treasury bonds of similar maturity. Although some might argue that this requirement relates to funding more than to resolution costs, this funding mechanism was considered necessary for Congress to enact the enabling legislation. Further delays in funding would have increased total resolution costs.

[25] Included are $2.9 billion in cash held directly by the FRF, as well as the FRF's claim on $1.5 billion in cash and low-risk securities held by receiverships for which the FRF is the primary creditor.

APPENDIX: GOODWILL LITIGATION

On July 1, 1996, the U.S. Supreme Court ruled that, with the 1989 passage of FIRREA, the federal government had violated contractual obligations.[26] FIRREA mandated new regulatory capital accounting for depository institutions and provided for the elimination or rapid phase-out of the use of "supervisory goodwill" in calculating the regulatory capital of financial institutions. As a result of the Court's ruling, numerous thrifts that had been involved in mergers and acquisitions during the 1980s and had "supervisory goodwill" on their books became undercapitalized. Many of these thrifts were closed by supervisors, while others altered their business strategies (for example, by shrinking their asset base) to meet the new capital standards.

In response, as of July 31, 2000, 141 thrift acquirers had filed suit in District Court or the U.S. Court of Federal Claims, seeking compensation from the federal government for losses (table A.1). As of July 31, 2000, two judgments totaling $40 million had been paid for cases filed in District Court. All other cases were consolidated to the U.S. Court of Federal Claims, where 103 cases were still pending trial. At the U.S. Court of Federal Claims, judgments have been rendered in six cases, awarding the plaintiffs $983 million from the federal government.[27] Four of these cases were on appeal to the U.S. Federal Circuit Court of Appeals; the other two were recent decisions, and appeals are likely. In another five cases, settlements have been reached with plaintiffs receiving approximately $135 million. Another 3 cases had been tried and were awaiting decision; 7 cases had been dismissed; 12 cases had been consolidated with others; and miscellaneous actions have been taken in 3 others.

In cases involving approximately 40 failed thrifts, the FDIC as successor to the closed institutions had become a co-plaintiff in goodwill suits against the United States. Only two of those cases had been decided as of July 31, 2000, and the trial court awarded the FDIC-managed receiverships $19.8 million. All parties appealed one of the decisions, and an appeal of the second decision is expected.

[26] The case was *Winstar Corporation v. United States*, 90-8C; United Savings Bank, Windom, MN.

[27] Most of the $983 million in judgments against the government came from one case: Glendale Federal Bank, FSB, of Glendale, California, was awarded a judgment of $908.9 million.

Table A.1

Status of Goodwill Cases as of July 31, 2000

Case Status	Number	Settlements/ Judgments ($Millions)
Cases with judgments paid[a]	2	$ 40
Cases pending trial	103	
Cases with unpaid judgments	6	983
Cases settled[b]	5	135
Cases tried and awaiting decisions	3	
Cases dismissed	7	
Cases consolidated into others	12	
Other	3	
Total	**141**	**$1,158**

Source: FDIC.

[a]These cases were decided at District Courts. All remaining cases were consolidated to the U.S. Court of Federal Claims.

[b]In one case (Winstar), the Department of Justice settled with the shareholder plaintiff but not with the FDIC. The settlement amount is included here even though the case was pending trial as of July 31, 2000.

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Recent Developments Affecting Depository Institutions

by Lynne Montgomery*

REGULATORY AGENCY ACTIONS

Interagency Actions

Consumer Privacy Rules

On May 10, 2000, the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) issued final regulations implementing the provisions of the Gramm-Leach-Bliley Act (GLBA) governing the privacy of consumer financial information. The regulations limit disclosure by financial institutions of "nonpublic personal information" about individuals who obtain financial products or services for personal purposes. The regulations impose three main requirements established by GLBA: (1) financial institutions must provide initial notices to customers about their privacy policies, describing the conditions under which the institutions may disclose nonpublic personal information to affiliates and nonaffiliated third parties; (2) financial institutions must provide annual notices of their privacy policies to their current customers; and (3) financial institutions must give consumers a reasonable opportunity to "opt out" of allowing the financial institutions to share information about them with nonaffiliated third parties. The privacy rules are effective as of November 13, 2000, but compliance is voluntary until July 1, 2001. *PR-32-2000, FDIC, 5/10/00.*

Federal Deposit Insurance Corporation

Report on Underwriting Practices

The April 2000 issue of the *Report on Underwriting Practices* reported a slight decrease in the overall potential risk associated with current underwriting practices at FDIC-supervised banks during the six months ending March 31, 2000, compared to the previous six-month period ending September 30, 1999. However, examiners reported that risky underwriting practices for agricultural, construction and commercial real-estate lending remain causes for concern. Examiners also noted continued problems with the level of "carryover debt" at FDIC-supervised banks actively making agricultural loans. Carryover debt refers to loans that are not paid off at the end of the growing season and are subsequently carried over into the next growing season. The survey of loan underwriting practices is aimed at providing early warnings of potential problems in underwriting practices at FDIC-supervised, state-chartered nonmember banks. The focus of the survey is threefold: material changes in underwriting standards for new loans, degree of risk in current practices, and specific aspects of the underwriting standards for new loans.

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Reference sources: *American Banker* (AB) and *BNA's Banking Report* (BBR).

The April report includes surveys from 1,158 FDIC-supervised banks that were examined during the six months ending March 31, 2000. *Report on Underwriting Practices, FDIC, April 2000.*

Financial Results for Fourth-Quarter 1999

The FDIC reported that the Savings Association Insurance Fund (SAIF) earned income of approximately $441 million for the calendar year 1999; however, the Bank Insurance Fund (BIF) experienced a comprehensive loss (net loss plus unrealized loss on available-for-sale securities) of $198 million for the year. At December 31, 1999, the BIF balance was approximately $29.4 billion, down from $29.6 billion at year-end 1998. The decrease in the fund balance was primarily attributable to unanticipated and high-cost bank failures. Seven BIF-insured banks failed in 1999, with total assets at failure of $1.4 billion. BIF revenues totaled $1.8 billion in 1999, including $1.7 billion in interest on investments in U.S. Treasury obligations and $33 million in deposit insurance assessments. The SAIF closed the year with a fund balance of $10.3 billion, an increase from $9.8 billion at year-end 1998. The SAIF earned $601 million in revenue during 1999, consisting of $586 million in interest on investments in U.S. Treasury obligations and $15 million in deposit insurance assessments.

The FSLIC Resolution Fund (FRF) returned $4.2 billion in appropriated funds to the U.S. Treasury during 1999, pursuant to the RTC Completion Act. The Act required the FDIC to return any funds that were transferred to the Resolution Trust Corporation (RTC) but were not needed to satisfy obligations of the RTC. FRF assets in liquidation were reduced to $509 million on December 31, 1999. The FRF was established in 1989 to assume the remaining assets and obligations of the former Federal Savings and Loan Insurance Corporation (FSLIC). On January 1, 1996, the former Resolution Trust Corporation's financial operations were merged into the FRF. *BBR, 5/15/00, p. 865.*

Assessment Rates Maintained

The FDIC Board of Directors voted on May 10, 2000, to maintain the existing insurance assessment rate schedules for both the BIF and the SAIF through December 2000. Since the FDIC applies a risk-based assessment system for insurance coverage, the healthiest institutions currently pay nothing for insurance and the weakest institutions pay up to 27 cents per $100 of insured deposits. Federal law requires the FDIC to maintain a minimum reserve ratio of 1.25 percent, or $1.25 for every $100 of insured deposits, in the BIF and the SAIF to cover the costs of bank and thrift failures. As of December 31, 1999, the BIF reserve ratio was 1.36 percent and the SAIF ratio was 1.45 percent. *BBR, 5/15/00, p. 865; AB, 5/11/00.*

Bank Failures

On March 10, 2000, the OTS closed Mutual Federal Savings Bank of Atlanta, Atlanta, Georgia, and named the FDIC as receiver. Mutual Federal had total assets of approximately $33.8 million as of November 30, 1999. Citizens Trust Bank, Atlanta, Georgia, assumed approximately $30 million of the failed institution's deposits in approximately 6,023 deposit accounts, while five additional accounts were pledged as capital. Citizens Trust paid a premium of $2.4 million for the right to assume the deposits and to purchase approximately $29.8 million of the assets. The FDIC will retain the remaining assets for later disposition. As part of the transaction, Citizens Trust will participate in a three-year loss-sharing arrangement on approximately $9.4 million of the assets that were purchased from the receivership. The FDIC estimates this transaction will cost the SAIF approximately $1.5 million. Mutual Federal was the first SAIF-insured institution failure in 2000. *PR-17-2000, FDIC, 3/10/00.*

Monument National Bank, Ridgecrest, California, was closed by the OCC on June 2, 2000, and the FDIC was named receiver. The OCC declared that the failed bank was critically undercapitalized—the bank's tangible equity capital was less than 2 percent of its total assets—which resulted from poor credit administration practices and a high volume of classified assets. The failed bank had total assets of approximately $10 million and total deposits of $9.8 million. Israel Discount Bank of New York assumed all of Monument National's deposits, and paid a premium of $400,000 to purchase $3.7 million of the assets. The FDIC will retain the remaining assets for later disposition. The FDIC estimates that this transaction will cost the BIF less than $100,000. This is the second failure of a BIF-insured bank in 2000. *PR-39-2000, FDIC, 6/2/00.*

On July 14, 2000, Minnesota's Commissioner of Commerce closed Town and Country Bank of Almelund, Almelund, Minnesota, and the FDIC was appointed receiver. The failed institution had total deposits of $27.7 million in approximately 4,900 accounts and total assets of $30.1 million. S&C Bank, Minnesota, a newly chartered subsidiary of S&C Banco, Inc., New Richmond, Wisconsin, paid a premium of $2.9 million for the right to assume the failed institution's insured deposits and to purchase approximately $11.1 of the failed bank's assets. In a separate transaction, Queen City Federal Savings Bank, Virginia, Minnesota, paid a premium of $399,000 to the FDIC to purchase $9.0 million of Town and Country's assets. The FDIC will retain the remaining assets for later disposition. The FDIC estimates that this transaction will cost the BIF approximately $2.8 million. This is the third failure of a BIF-insured institution in 2000. *PR-49-2000, FDIC, 7/14/00.*

Federal Reserve Board

Interest Rates

On March 21, 2000, the Federal Open Market Committee (FOMC) voted to raise the targeted federal funds rate by 25 basis points, increasing the rate from 5.75 percent to 6.0 percent. In a related action, the Board of Governors approved a 25-basis-point increase in the discount rate, raising the rate from 5.25 percent to 5.50 percent. The FOMC raised the federal funds rate an additional 50 basis points on May 16, 2000, increasing the rate to 6.50 percent. The Board of Governors also approved a 50-basis-point increase in the discount rate, raising the discount rate to 6.0 percent. The federal funds rate is the fee that banks charge each other for overnight loans, and the discount rate is the fee charged to financial institutions for borrowing from their district Federal Reserve Banks. *PR-FRB, 3/21/00; PR-FRB, 5/16/00.*

Survey on Bank Lending Practices

In its May 2000 *Senior Loan Officer Opinion Survey on Bank Lending Practices*, the Federal Reserve Board reported that both domestic and foreign banks were tightening lending practices. The percentage of domestic banks becoming more cautious in their lending was the highest since the results of the November 1998 survey. Most banks reported an uncertain or less favorable economic outlook as the motivation for tightening their practices. The Federal Reserve reported that a significant number of banks raised their lending standards for commercial real-estate loans, and the lending standards for residential mortgages remained unchanged. The Federal Reserve also reported that the demand for bank loans slackened for both the residential and commercial real-estate markets. For the report, the Federal Reserve surveyed loan officers from 57 large domestic banks and 21 U.S. branches and agencies of foreign banks. The survey focused on changes during the preceding three months in the supply and demand for bank loans to households and businesses. *BBR, 5/29/00, p. 957.*

Reporting Requirements under Bank Secrecy Act

Beginning July 1, 2000, financial institutions will be excused from reporting certain cash transactions involving more than $10,000. Under the Bank Secrecy Act, financial institutions generally are required to report currency transactions of over $10,000. However, in September 1997, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued a final rule listing "Phase I" exemptions, which exempt banks from the $10,000 reporting requirement for transactions involving other banks operating in the United States, departments and agencies of the U.S. government, companies listed on certain national stock exchanges, and certain subsidiaries of those listed companies. In September 1998, FinCEN adopted "Phase II" exemptions which cover certain non-listed companies as well as payroll customers of a financial institution. The Phase I and Phase II final rules apply to currency transactions after July 1, 2000. *BBR, 7/17/00, p. 96.*

Office of the Comptroller of the Currency

New Rule on Financial Subsidiaries

The OCC's final rule implementing the financial subsidiary provisions of the Gramm-Leach-Bliley Act (GLBA) was published in the Federal Register on March 10, 2000. Under the GLBA, national banks are permitted to own a financial subsidiary that may engage in a variety of expanded financial activities that are not permissible for the parent bank. The final rule establishes an expedited filing process for national banks that seek to acquire or engage in expanded activities through a financial subsidiary. The rule would give the national banks two options. Under the first option, a national bank could certify in advance that both it and its depository institution affiliates are well-capitalized and well-managed. Thereafter, the bank would file a notice with the OCC when it acquires a financial subsidiary, or begins a type of expanded financial activity permitted in a financial subsidiary. The second option would permit national banks to file a combined certification and notice for a financial subsidiary at least five days before acquiring a financial subsidiary or beginning expanded financial activities in a financial subsidiary. National banks continue to have the option of using operating subsidiaries to conduct bank-permissible activities. The new rule also streamlines processes for national banks to establish operating subsidiaries by significantly expanding the list of activities eligible to be conducted pursuant to a simple notice filing. This new streamlined process is available for well-capitalized, well-managed national banks. *NR 2000-16, OCC, 3/9/00.*

Training for Foreign Examiners

In response to requests from foreign bank supervisors for American-style exam training, the OCC is conducting a training course for foreign examiners. The first training class will be given in October 2000, and eventually the course will be offered several times a year. The course is an attempt to show foreign examiners how the OCC examines a bank and supervises using a risk-based approach. *AB, 4/27/00.*

Procedures for Stock Splits

On May 9, 2000, the OCC issued an advisory letter detailing its review procedures covering national banks' use of reverse stock splits. A reverse stock split is a method of reducing the number of outstanding shares or shareholders in a bank, and restructuring ownership interest. Under a reverse stock split, a bank exchanges one share of stock for several outstanding shares and pays cash to shareholders that would have held fractional shares after the exchange. When reviewing an application for a reverse stock split, the OCC will consider several details, including whether the bank: will perform each step of the reverse stock split process in compliance with legal requirements governing its capital structure; has adopted corporate governance provisions that authorize reverse stock splits; has a legitimate corporate purpose for undertaking the reverse stock split; and provides adequate dissenters' rights to its shareholders. The OCC will approve a reverse stock split application on an expedited basis if the bank includes certain certifications with its application. The bank must also demonstrate compliance with the minimum capital requirements for a national bank on the basis of the population of the bank's main office location. *BBR, 5/15/00, p. 872–873.*

Office of Thrift Supervision

Information-Sharing Agreements

On May 24, 2000, the OTS announced that an additional 13 states and the District of Columbia signed information-sharing agreements with the OTS, bringing the total number of states with agreements to 16. The agreements provide for sharing nonpublic information on the financial solvency of insurance companies and any depository institutions owned by the insurance companies that fall within the jurisdiction of the respective state insurance commissioner and the OTS. The agreements also cover insurance and thrift activities, as well as consumer complaints of these entities. In addition to the District of Columbia, the new states signing agreements are Arizona, Arkansas, Connecticut, Delaware, Indiana, Kansas, Louisiana, Michigan, Mississippi, Nebraska, North Dakota, Oklahoma, and Utah. Kentucky and Iowa signed agreements in the spring of 2000. *OTS 00-48, 5/24/00.*

Federal Housing Finance Board

Chairman Resigns

Bruce A. Morrison resigned from his position as chairman of the Federal Housing Finance Board on July 4, 2000. Mr. Morrison had served as chairman of the Federal Housing Finance Board since June 1, 1995. He plans to join GPC/O'Neill, which is the U.S. division of GPC International, a worldwide strategic government relations, public affairs, and communications consulting firm. *FHFB 00-18, 6/6/00.*

Leichter Appointed to Board

On August 4, 2000, President Clinton made a recess appointment of Franz S. Leichter to the Federal Housing Finance Board. Mr. Leichter's nomination had been pending since June 1999. Before this appointment, Mr. Leichter was a practicing attorney with the law firm of Walter, Conston, Alexander, and Green, P.C. He also served in the New York State Senate from 1975 to 1988. *FHFB 00-26, 8/4/00.*

Final Regulation on Membership and Advances Requirements

On June 23, 2000, the Federal Housing Finance Board approved a final regulation that eases requirements for Federal Home Loan Bank membership and removes restrictions on borrowing by banks. Under the new rule, community financial institutions

(CFIs) no longer need at least 10 percent of total assets in residential mortgages to join the FHLBank System. CFIs are FDIC-insured institutions with assets of less than $500 million. The final rule also allows non-qualified thrift lenders equal access to the FHLBank System advances. A qualified thrift lender is one that has at least 60 percent of its assets in residential mortgages. The final rule repeals the following former rules concerning non-qualified thrift lenders (non-QTL): non-QTL members were limited in how much they could borrow in advances; total advances outstanding to non-QTL members could not exceed 30 percent of the FHLBank System total; and non-QTL members had a higher advances-based stock purchase requirement. *BBR, 7/3/00, p. 25.*

Expanded Collateral for FHLBank Advances

The Federal Housing Finance Board approved a final rule on June 29, 2000, implementing provisions of the Gramm-Leach-Bliley Act (GBLA) that enable community financial institutions (CFIs) to pledge additional classes of collateral for Federal Home Loan Bank advances. The new types of collateral that can be pledged by CFIs include: small-business loans, agricultural loans, or securities representing a whole interest in such loans. However, before accepting the new collateral, a FHLBank must demonstrate that it has the proper procedures in place to value and discount the collateral and manage the risks associated with the collateral. The final rule also implements a provision in GLBA that removes the limit on the amount of other real-estate-related collateral that FHLBank System members can pledge for Federal Home Loan Bank advances. The amount had previously been capped at 30 percent of a member's capital. *FHFB 00-21, 6/29/00.*

Final Rule on Mission for FHLBanks

On June 29, 2000, the Federal Housing Finance Board approved a final rule that implements provisions of the Gramm-Leach-Bliley Act by setting guidelines for the core mission activities of the Federal Home Loan Banks. Under the final rule, core mission activities of the FHLBanks will include: making loans or advances to member financial institutions; issuing standby letters of credit; and making targeted investments that support affordable housing, economic development activities, and small-business investment corporations. A proposed rule was issued for comment on April 17, 2000. On the basis of the comments received, the final rule eliminates language in the proposed rule that would have grandfathered the FHLBanks' existing holdings of mortgage-backed securities (MBSs) until maturity. The final rule allows certain MBS investments if they benefit targeted households, offer liquidity for other loans not available in the primary market, or are not sold in the secondary market. Further, the final rule allows acquired member assets, such as Federal Housing Administration-insured loans, to count as core mission activities. *BBR, 7/10/00, p. 67–68.*

National Credit Union Administration

Consumer Privacy

The NCUA issued a final privacy rule applicable to all federally insured credit unions, as required by the Gramm-Leach-Bliley Act. The final rule requires credit unions to have a privacy policy and provide certain disclosures and notices to individuals about whom credit unions collect nonpublic personal information. The rule also restricts a credit union's ability to disclose nonpublic personal information, including giving individuals an opportunity to opt out of the disclosure. The NCUA's final rule takes into account the unique circumstances of federally insured credit unions and their members but is comparable and consistent with the privacy regulations issued by the federal banking agencies. The rule is effective November 13, 2000; however, compliance is not required until July 1, 2001. *12 CFR Part 716, NCUA, 5/8/00.*

Final Rule on Electronic Disclosure

The NCUA issued a final rule amending its regulations that implement the Truth in Savings Act to permit periodic disclosures required by NCUA's regulations to be delivered in electronic form, if a credit union member agrees. The rule gives credit unions flexibility in how they deliver the electronic disclosures. In addition, the rule gives credit unions the option of not using electronic delivery methods at all, but the NCUA expects that those credit unions that use electronic delivery will realize a reduction in their costs of delivery as a result. The final rule, which is effective beginning May 20, 2000, amends an interim rule that was approved on November 18, 1999. *BBR, 5/1/00, p. 795.*

Prompt Corrective Action for Undercapitalized Credit Unions

In February 2000, the NCUA approved a final rule that implements a system of prompt corrective action (PCA) to restore the net worth of federally insured credit unions that are undercapitalized. The PCA rule permits the NCUA to take discretionary action against critically undercapitalized credit unions. An undercapitalized credit union is one with a net worth ratio of less than 2 percent that is not a new credit union. On April 20, 2000, the NCUA published a final rule on secondary capital accounts for low-income credit unions, which conforms to the PCA rule. The secondary capital rule clarifies that the NCUA has discretionary authority to prohibit a credit union from paying principal, dividends, or interest on the credit union's secondary capital accounts set up after August 7, 2000, which is the effective date of the PCA rule. *BBR, 5/1/00, p. 795.*

Final Rule on Share Insurance and Joint Accounts

On May 24, 2000, the NCUA approved a final rule that expands insurance coverage on some revocable trust accounts and clarifies the insurance coverage on joint accounts. Revocable trust accounts allow owners of those accounts to pass funds to one or more beneficiaries when the owner dies. The list of beneficiaries included a spouse, child, or grandchild; however, the new coverage rule adds parents and siblings to the list of eligible beneficiaries. The final rule also expands the maximum coverage on any joint account owned by more than one person from $100,000 for each joint account to $100,000 for each individual owner. The NCUA issued interim rules amending share insurance coverage in April 1999. The final rule adopted the interim rules without major changes. *BBR, 5/29/00, p. 976.*

Loan Rate Ceiling Maintained

The NCUA approved a final rule to maintain the current 18 percent interest-rate ceiling on loans by federal credit unions, instead of allowing the ceiling to revert to 15 percent. The rate ceiling was scheduled to revert to 15 percent on September 9, 2000; however, with the new ruling, the ceiling will remain at 18 percent for the period from September 9, 2000, through March 8, 2002. The NCUA reported that a 15 percent ceiling would restrict certain categories of credit and adversely affect the financial condition of a number of federal credit unions. At the same time, prevailing market rates and economic conditions do not justify a rate higher than the current 18 percent ceiling. The NCUA Board is prepared to reconsider the 18 percent ceiling at any time should changes in economic conditions warrant. *12 CFR Part 701, NCUA, 7/13/00.*

STATE LEGISLATION AND REGULATION

New York

On June 7, 2000, the New York State Senate confirmed Elizabeth McCaul as the superintendent of the state Banking Department. As superintendent, Ms. McCaul will also chair the state's Banking Board, which issues banking regulations. Ms. McCaul had been the acting superintendent since 1997. *BBR, 6/12/00, p. 1045.*

BANK AND THRIFT PERFORMANCE

Fourth-Quarter 1999 Results for Commercial Banks and Savings Institutions

FDIC-insured commercial banks earned $17.8 billion during the three months from October through December 1999, which represents a 20 percent improvement over the $14.8 billion earned in the fourth quarter of 1998. The improvement in earnings resulted from strong growth in noninterest income and lower noninterest expenses. Banks' annualized return on assets (ROA) was 1.27 percent in the fourth quarter, up from 1.10 percent one year earlier. The number of commercial banks on the FDIC's "Problem List" declined from 69 in the third quarter of 1999 to 66 in the fourth quarter; however, assets of problem commercial banks increased from $4.2 billion to $4.5 billion. There were seven bank failures in 1999, and two of those failures occurred during the fourth quarter.

FDIC BIF-insured mutual savings institutions reported earnings of $2.7 billion in the fourth quarter of 1999, which is down by $132 million from the third quarter but up by $678 million from one year earlier. The earnings decline was caused by higher interest costs and lower yields from sales of securities during the quarter. The industry's ROA for the fourth quarter was 0.96 percent, down from 1.00 percent in the third quarter but up from 0.76 percent in the fourth quarter of 1998. The number of problem thrifts increased to 13 thrifts with assets of $5.5 billion, up from 11 thrifts in the third quarter with assets of $3.9 billion. There were no thrift failures during the fourth quarter of 1999, although there was one failure earlier in the year. *FDIC Quarterly Banking Profile, Fourth Quarter 1999.*

First-Quarter 2000 Results for Commercial Banks and Savings Institutions

FDIC-insured commercial banks earned a record-setting $19.5 billion during the first quarter of 2000, which is $125 million greater than the previous record set in the third quarter of 1999 and $1.6 billion higher than earnings in the first quarter of 1999. The increased earnings resulted from gains on equity investments and from the current favorable economic conditions. Commercial banks' average ROA was 1.35 percent in the first quarter of 2000, up from 1.32 percent in the first quarter of 1999. The number of commercial banks on the FDIC's "Problem List" increased to 72, from 66 in the fourth quarter of 1999. There was one bank failure during the first quarter.

FDIC BIF-insured mutual savings institutions reported earnings of $2.9 billion in the three months from January through March 2000, which is $259 million higher than one year earlier. Higher noninterest income and lower income tax expenses accounted for the earnings increase. The industry's ROA for the first quarter was 1.03 percent, up from 0.98 percent in the first quarter of 1999. The number of problem thrifts increased to 15, from 13 in the fourth quarter 1999; however, problem assets decreased from $5.5 billion to $5.3 billion. There was one thrift failure during the first quarter of 2000. *FDIC Quarterly Banking Profile, First Quarter 2000.*

RECENT ARTICLES AND STUDIES

A study released by the Treasury Department on April 19, 2000, reports that mortgage lending to low- and moderate-income borrowers in communities covered by the Community Reinvestment Act (CRA) increased at over twice the rate of loan growth to other borrowers between 1993 and 1998. The CRA is a 1977 law that requires financial institutions to make financial services available to all segments of the communities where they do business. The study, entitled *The Community Reinvestment Act After Financial Modernization: A Baseline Report*, reviewed lending trends in 304 cities across the nation between 1993 and 1998, and found that mortgage loans made during that period by CRA-covered institutions and their affiliates to low- and moderate-income borrowers increased by 39 percent. The Gramm-Leach-Bliley Act mandated that the Treasury Department conduct the study to determine the extent to which sufficient services are being provided under CRA. *BBR, 4/24/00, p. 729.*

According to a report released on May 16, 2000, by the FDIC's Division of Insurance, community banks and thrifts could be more susceptible to rising interest rates than in recent years. The structure of commercial financial institutions' balance sheets has begun to reflect increased interest-rate risk exposure, which primarily results from mismatches in the term structure of the balance sheet. The report says that more institutions' balance sheets are showing increased long-term mortgage holdings and longer asset maturities, and the industry is relying more on potentially volatile funding sources. Additionally, the report notes that the percentage of institutions downgraded by examiners from the "satisfactory" rating for interest-rate risk in the second and third quarters of 1999 exceeded the percentage of institutions that were upgraded. Overall, however, roughly 94 percent of financial institutions examined in 1999 received a "satisfactory" rating. The report is entitled *Increasing Interest Rate Risk at Community Banks and Thrifts*. *BBR, 5/22/00, p. 918–919.*

INTERNATIONAL DEVELOPMENTS

Basel Committee

The Basel Committee on Bank Supervision issued a revised series of voluntary guidelines on February 29, 2000, concerning the effective management of liquidity by banking organizations. The guidelines update earlier recommendations on liquidity management issued by the committee in 1992. The committee's recommendations include 14 core principles covering sound practices for ongoing liquidity management, foreign-currency liquidity management, internal risk controls, public disclosure, and banking supervision. The committee's revised recommendations emphasize the need for contingency planning in order to account for the increasing sophistication of today's global financial markets. The committee also urges banking supervisors to take an active role by carrying out independent reviews of bank liquidity management practices. The Basel Committee is made up of senior central bank and banking supervisory officials from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States. *BBR, 3/6/00, p. 455–456.*

France

The United Kingdom-based Hong Kong and Shanghai Banking Corporation announced on April 1, 2000, plans to carry out a friendly takeover of Credit Commercial de France. The merger, which was approved by France's finance minister on April 4, 2000, represents the first time that a French bank has been sold to foreign investors. *BBR, 4/10/00, p. 674.*

Japan

On July 1, 2000, the Japanese government established a new regulatory body, the Financial Services Agency (FSA), which is responsible for supervising securities, banking, insurance, and other financial activities. The FSA is also responsible for drafting policies and plans related to these sectors. The new agency was formed by merging the Financial Supervisory Agency and the Ministry of Finance's Financial Planning Bureau. The Financial Supervisory Agency was created two years ago to take over the Ministry of Finance's financial supervisory and inspection functions. In January 2001, the Financial Revitalization Agency—which is responsible for the reconstruction of the Japanese financial industry through the mobilization of taxpayer money, mergers, and other means—will also be merged into the new agency. Masaharu Hino, who served as director-general of the Financial Supervisory Agency, was appointed commissioner of the new agency. *BBR, 7/17/00, p. 120–121.*