Chapter 4
Insurance Coverage and Financial Operations of the FDIC

The past 50 years have witnessed many changes in the operations of the FDIC. Some have been the result of legislation, while others have been due to the experience gained in providing deposit insurance. In retrospect, the changes have been relatively minor considering the economic climate and the level of experience with deposit insurance prevailing in 1933. This chapter focuses on the changes in the financial and internal operations of the FDIC since 1933.

Financial Operations

Many informed observers in 1933 felt that a system of federal deposit insurance, especially if substantive coverage were provided to virtually all banks, could not remain viable without direct support from the Treasury. The banking crisis of the early 1930s had left the banking system in a weakened condition. There was concern that another banking crisis could result in an accelerating rate of bank failures, and that already low bank earnings would not be sufficient to finance a deposit insurance system. At the same time, the use of tax revenues to finance a deposit insurance scheme was viewed as unacceptable, and in fact formed one of the primary bases for the Roosevelt Administration's opposition to federal deposit insurance.

The concern regarding federal involvement in financing deposit insurance led to an initial organization that closely paralleled a typical casualty insurance company. Because of the weakened condition of the banking system, however, it was recognized that at least some of the initial capitalization would have to be supplied from government sources. It was anticipated, although with some reservations on the part of many, that expenses, losses and future additions to reserves (net worth) would be covered by insurance premiums levied on insured banks and by income from investments.

As discussed in Chapter 3, the 1933 Act provided for two deposit insurance plans: a temporary plan and a permanent plan. Funding to support the temporary plan was provided by an assessment of one-half of one percent of total *insured* deposits, half of which was payable upon admittance to the program and the remainder subject to call by the FDIC. If this proved to be inadequate to cover expenses and losses, the FDIC had the authority to levy one additional assessment not to exceed the amounts already paid by insured banks. The Act also provided for one reassessment based on changes in insured deposits during the existence of the interim plan.

The financing of the permanent plan was somewhat more complex and potentially very burdensome to the banking system. Basically, the system would have involved an initial capital contribution (capital stock purchase) upon joining the program and an assessment (insurance premium) effectively to pass all insurance losses directly to insured institutions.[1] The basis for both the initial contribution and subsequent assessments was to have been shifted from insured deposits to total deposit liabilities.

During the 20 months that the Temporary Federal Deposit Insurance Fund was in operation, the banking situation improved significantly. Attention thus shifted to the specific insurance provisions of the 1933 Act. Most of those who had originally opposed deposit insurance legislation apparently had been convinced that the existence of the FDIC was a major contributing factor to the drastic reduction in bank failures. However, various provisions of the original permanent plan were viewed as not being appropriate in the new environment.

The banking industry did not like the potential for virtually unlimited assessments and generally felt that the assessment rate should be set at a relatively low level. Large banks took exception to shifting the assessment base from insured to total deposits, contending that they would be unduly penalized because of the relatively large portion of uninsured deposits held in larger institutions. State chartered, nonmember banks objected to mandatory membership in the Federal Reserve System as a precondition for retaining deposit insurance coverage.

[1]All capital stock issued by the FDIC was non-voting; shares issued to the Federal Reserve Banks (Class B) paid no dividends, while those that were to be issued to member banks (Class A) and issued to the U.S. Treasury carried a 6 percent, cumulative dividend rate.

For its part, the FDIC was faced with a dilemma. Although the bank failure rate had dropped precipitously and the capital rehabilitation program of the RFC and FDIC had been moderately successful, the banking system was not strong and the prospects for bank earnings were not bright. Additionally, the fears and uncertainties regarding the bank failure rate had not been dispelled by 1934 and indeed would not recede for more than two decades. The FDIC thus was faced with the problems of protecting the earnings of insured banks until capital and reserve positions could be rebuilt while, at the same time, conserving what was by historical standards a modest deposit insurance fund.

During 1934, FDIC staff began drafting what was to become Title I of the Banking Act of 1935. In hearings beginning in February 1935 before the House Committee on Banking and Currency, FDIC Chairman Leo Crowley articulated his plan for the future of federal deposit insurance. In addition to an assessment rate lower than historical experience would suggest, his plan consisted of a combination of stricter entrance standards for new banks and expanded authority over the actions of existing banks, expanded powers regarding the handling of failing banks, a reduction in insurance exposure (*i.e.*, retention of the $5,000 insurance coverage rather than the higher limit envisaged in the original permanent plan) and other provisions that would tend to conserve the deposit insurance fund.[2] From a practical point of view, the program advocated by Mr. Crowley consisted of attempting to strengthen the banking system, while using every legal means available to conserve FDIC financial resources. This philosophy dominated FDIC behavior until the mid-1960s.

The deposit insurance provisions of the Banking Act of 1935, with few exceptions, were identical to the draft legislation prepared by the FDIC. From a financial point of view, one of the most significant revisions to the original permanent plan related to the calculation of assessments levied on insured banks. The 1935 Act provided that assessments were to be based on a flat annual rate of one-twelfth of one percent of *total* deposits; the net effect of this change was to shift the relative burden of the deposit insurance system to the larger banks while protecting the

[2]For a more detailed discussion of the provisions of the Banking Act of 1935, see Chapter 3.

level of assessment income to the FDIC. Additionally, the requirement for initial and subsequent capital subscriptions by insured banks was deleted, and the payment of dividends on capital stock held by the U.S. Treasury was eliminated. To provide for emergency situations, the FDIC was given authority to borrow up to $975 million from the Treasury.[3]

By year-end 1946, the deposit insurance fund (net worth) had increased to over $1 billion. Because of the highly liquid condition of the banking industry, the legislation passed in the 1930s to reduce risks in many sectors of the economy and the recent low bank failure rate, many observers felt that a $1 billion fund was sufficient to cover almost any economic contingency. In fact, three years later, in connection with the Congressional hearings relating to the Federal Deposit Insurance Act of 1950, Jesse Jones, former chairman of the RFC, advocated an effective assessment rate that would maintain the deposit insurance fund at the $1 billion level. Apparently, Congress felt that the fund was adequate at that time and legislatively mandated repayment of the original capital subscriptions. The $289 million initially subscribed by the Treasury and the Federal Reserve Banks was fully repaid by the end of 1948.

Bankers also had voiced concern that the assessment rate was too high. By 1950, the deposit insurance fund had reached a level of over $1.2 billion, despite the repayment of capital completed two years earlier. Assessment income had been growing at a high rate, reflecting the rapid growth in bank deposits during the World War II and post-war years. Moreover, because of low interest rates during this same period, bank earnings lagged increases in prices and deposit insurance expenses.

The FDIC was reluctant to support a permanent reduction in the basic assessment rate. There still was concern that accumulated earnings would be insufficient to handle the increased rate of bank failures that many thought would occur during the 1950s. This fear was reinforced by the decrease in capitalization

[3]The 1933 Act explicitly authorized the FDIC to issue " . . . notes, debentures, bonds, or other similar obligations . . ." necessary to conduct insurance operations. The 1935 Act *directed* the Secretary of the Treasury to purchase, under certain conditions, up to $500 million of these obligations, and *authorized* the Secretary to purchase up to an additional $475 million if deemed necessary. In 1947, the specific authority of the FDIC to issue obligations was deleted, and the FDIC was given authority to borrow up to $3 billion directly from the Treasury. The FDIC has never exercised this authority.

On September 9, 1947, FDIC Chairman Maple Harl (right) presented to Under Secretary of the Treasury A.L.M Wiggins a check for $146 million, repaying more than half of the government's initial funding of the FDIC. The balance was repaid in 1948.

Photo: Harris & Ewing

of the banking industry due to low earnings and rapid asset expansion since 1940.

As a compromise, deposit insurance charges were effectively reduced by the Federal Deposit Insurance Act of 1950. Rather than lowering the basic assessment rate, however, the reduction was accomplished through a rebate system. After deducting operating expenses and insurance losses from gross assessment income, 40 percent was to be retained by the FDIC, with the remainder to be rebated to insured banks. This procedure meant that losses were to be shared by insured banks and the FDIC on a 60 percent - 40 percent basis. This provision has tended to stabilize FDIC earnings during periods of fluctuating loss experience.

The 1950 Act also required the FDIC to reimburse the Treasury for interest foregone on the initial capital contributions. This requirement was the result of an exchange between FDIC Chairman Maple T. Harl and Senator Paul Douglas of Illinois during hearings on the 1950 Act. The exchange went as follows:

> Senator Douglas: . . . Mr. Harl, on page 2 [of your prepared statement] you speak of making final payment to the Treasury on August 30, 1948, when you paid the Treasury out in full for the loans [capital] which were advanced. Do I understand that to be your statement?
>
> Mr. Harl: We paid them for the money advanced.
>
> Senator Douglas: Would that include the interest upon the Goverment loan which was made?
>
> Mr. Harl: It did not. The law provided that there should be no dividend upon the capital stock.
>
> Senator Douglas: In practice, the Government has made an advance to the FDIC which has not been repaid; namely, the interest on the bonds which the Government issued, but for which it was not reimbursed.
>
> . . . .
>
> Mr. Harl: . . . This Corporation stands ready to reimburse the Government, or anyone else, provided it is legally authorized to do so.
>
> Senator Douglas: You are ready to pay the interest, is that right?
>
> Mr. Harl: Yes. If we have an obligation we are ready to pay it.
>
> . . .
>
> Senator Douglas: That is a possible source of revenue that I had not thought of. This brief conversation, which I at first thought was going to be unprofitable, might yield the Government as much as $40,000,000. I first thought it was love's labor lost. It may turn out that there was gold in "them there hills."[4]

[4]U.S., Congress, Senate, Committee on Banking and Currency, *Hearings before a subcommittee of the Senate Committee on Banking and Currency on Bills to Amend the Federal Deposit Insurance Act*, 81st Cong., 2d sess., January 11, 23 and 30, 1950, pp. 27-29.

During 1950 and 1951, the FDIC paid about $81 million to the Treasury for the interest foregone on the initial contribution of both the Treasury and the Federal Reserve Banks.[5]

The 1950 Act also removed the law governing FDIC operations from the Federal Reserve Act, and created a separate body of law known as the Federal Deposit Insurance Act. Although of only symbolic significance, this change over the years has reinforced the FDIC's separate identity.

To compensate certain banks for the effect of a technical change in the computation of the assessment base, net assessments were further reduced in 1960, when the rebate percentage was increased to 66⅔ percent. In 1980, the basic percentage was lowered to 60 percent, with mandatory adjustments to be made if the ratio of the deposit insurance fund to estimated "insured" deposits were to exceed 1.40 percent or were less than 1.10 percent. The FDIC sought this latter provision to help rebuild the fund if abnormally high losses were experienced, and to inhibit excessive growth of the fund in periods of low losses.

Income and Expenses of the FDIC

The major sources of income to the FDIC have been assessments collected from insured banks and interest on its portfolio of U.S. Treasury securities. In recent years, interest on capital notes advanced to facilitate mergers and deposit assumption transactions and to assist open insured banks has become an increasing, although not major, source of income.

Expenses incurred by the FDIC are normally grouped into two categories. Administrative expenses include expenditures not directly attributable to bank closings and the subsequent liquidation of assets. The other major expense category, insurance expenses and losses, includes expenses associated with bank closings, liquidation activities and the FDIC's share of losses on acquired assets.

Table 4-1 presents the major income and expense items for each year since 1933. For over half of this period, assessments accounted for the largest share of income to the FDIC. However, continued favorable loss experience allowed the securities portfolio to grow so that, in 1961, investment income exceeded assessments. This relationship has continued since that time and, absent abnormally large cash demands or drastic reductions

[5]The rate was set by statute at two percent per annum.

Table 4-1. FDIC Income and Expenses, 1934-1982 ($ Millions)

	Deposit Insurance Assessments[1]	Investment Income	Other Income	Administrative Expenses	Insurance Losses & Expenses	Net Income
1982	1,012.7	1,370.0	142.0	129.9	869.9	1,524.8
1981	921.9	1,115.5	37.3	127.2	720.9	1,226.6
1980	430.8	863.1	16.5	118.2	(34.6)	1,226.8
1979	356.4	704.3	29.7	106.8	(13.1)	996.7
1978	367.0	565.8	19.3	103.3	45.6	803.2
1977	319.4	503.2	15.3	89.3	24.3	724.2
1976	296.5	449.7	18.7	180.4[3]	31.9	552.6
1975	278.9	394.3	16.1	67.7	29.8	591.8
1974	302.0	357.8	8.6	59.2	100.0	508.9
1973	246.0	311.1	4.0	54.4	53.8	452.8
1972	188.5	277.0	1.5	49.6	10.1	407.3
1971	175.8	239.1	.400	46.9	13.4	355.0
1970	159.3	222.7	.647	42.2	3.8	336.7
1969	144.0	191.7	.031	33.5	1.0	301.3
1968	132.4	162.6	(.015)	29.0	0.1	265.9
1967	120.7	142.3	.008	24.4	2.9	235.7
1966	111.7	129.3	.002	19.8	0.1	221.1
1965	102.2	112.3	.202	17.7	5.2	191.7
1964	93.0	104.1	.010	15.5	2.9	178.7
1963	84.2	97.5	.064	14.4	0.7	166.8
1962	76.5	84.6	.031	13.7	0.1	147.3
1961	73.4	73.8	.021	13.2	1.6	132.5
1960	79.6	64.9	.132	12.4	0.1	132.1
1959	78.6	57.8	.020	11.9	0.2	124.4
1958	73.8	53.1	.015	11.6	. . .	115.2
1957	69.1	48.2	.008	9.6	0.1	107.6
1956	68.2	43.7	.075	9.1	0.3	102.5
1955	66.1	39.6	.024	8.7	0.3	96.7
1954	62.4	37.3	.035	7.7	0.1	91.9
1953	60.2	33.9	.390	7.2	0.1	86.9
1952	57.3	31.3	.182	7.0	0.8	80.8
1951	54.3	29.4	.219	6.6	. . .	76.9
1950	54.2	28.0	2.619	6.4	1.4	77.0

in interest rates, the relative importance of interest income probably will increase.

In addition to the absolute size of the securities portfolio, investment income also is sensitive to the interest rate environment and the investment strategy followed by the FDIC. This phenomenon first became apparent in the mid-1960s, when market rates started to exhibit some degree of short-term instability.

In the mid-1970s, the FDIC started to pursue an active role in managing its investment portfolio;[6] prior to this time the FDIC

[6]The FDIC, except on rare occasions, has not sold securities to take advantage of market conditions. The term "manage" as used in the text refers to investment of cash flows from current income and maturing securities.

	Deposit Insurance Assessments[1]	Investment Income	Other Income	Administrative Expenses	Insurance Losses & Expenses	Net Income
1949	122.7	25.1	.487	6.1	0.3	144.7
1948	119.3	24.8	2.803	6.3[4]	0.7	138.6
1947	114.4	42.9	.455	9.8	0.1	147.6
1946	107.0	23.6	.281	9.9	0.1	120.7
1945	93.7	27.2	.376	9.3	0.1	111.6
1944	80.9	17.8	.784	9.2	0.1	90.0
1943	70.0	16.3	.319	9.6	0.2	76.8
1942	56.5	12.4	.459	9.6	0.5	59.0
1941	51.4	10.6	.018	9.5	0.6	51.9
1940	46.2	9.7	.049	9.4	3.5	43.0
1939	40.7	10.4	.030	9.2	7.2	34.8
1938	38.3	9.4	.012	8.8	2.5	36.4
1937	38.8	9.3	. . .	8.5	3.7	36.0
1936	35.6	8.2	. . .	8.3	2.6	32.9
1935	11.5	9.2	. . .	8.5	2.8	9.5
1934-33	. . .[2]	7.0	. . .	9.8[5]	0.2	(3.0)

[1] For the period from 1950 to 1982, inclusive, figures are net after deducting the portion of net assessment income credited to insured banks pursuant to provisions of the Federal Deposit Insurance Act of 1950, as amended.

[2] Assessments collected from members of the temporary insurance funds which became insured under the permanent plan were credited to their accounts at the termination of the temporary funds and were applied toward payment of subsequent assessments becoming due under the permanent insurance fund, resulting in no income to the Corporation from assessments during the existence of the temporary insurance funds.

[3] Includes net loss on sales of U.S. government securities of $105.6 million in 1976 and $3.6 million in 1978.

[4] For the period 1933-1948, includes interest accrued on capital stock held by the U.S. Treasury and the Federal Reserve Banks.

[5] Net after deducting the portion of expenses and losses charged to banks withdrawing from the temporary insurance funds on June 30, 1934.

had assumed a passive role and, in essence, allowed the Treasury to invest the funds in whatever issues it felt appropriate. About this same time, the FDIC started to shorten the average maturity of its portfolio and generally to achieve a better maturity balance. As the earnings problems faced by mutual savings banks became more apparent, the FDIC sharply reduced the average maturity of its portfolio in anticipation of large cash needs and as a hedge against rising interest rates. While the need for the amount of liquidity originally envisaged never materialized, a highly liquid position, coupled with historically high short-term interest rates, resulted in extraordinarily high earnings from investments and helped to offset unprecedented insurance expenses during 1981 and 1982.

Assessment income has paralleled the growth of deposits in the banking system. The assessment rebate system adopted in 1950 has resulted in a lower level of assessments being retained by the FDIC. In most years since 1950, the FDIC has retained slightly in excess of 40 percent of gross assessment income. In 1981 and 1982, however, the large insurance losses resulted in retention of about 90 percent of gross assessments. Since a sliding scale of rebates was mandated in 1980, the ratio of the fund to insured deposits has remained within the statutory limits and the rebate has remained at 60 percent of net assessment income.

Administrative expenses of the FDIC have grown roughly in proportion to changes in the price level and staffing requirements.[7] The one exception occurred in 1976, when substantial losses ($105.6 million) on sales of securities were realized in connection with the shift in investment strategy mentioned earlier. Normally, gains and losses on securities transactions are considered to be part of interest income; however, this loss (and a smaller loss realized in 1978) was incurred as a result of a change in operating procedures, and it was decided at the time that the loss was more appropriately an operating expense.

Insurance losses and expenses are related to the number and size of banks requiring financial intervention by the FDIC. Periodically, the expected loss to the FDIC from each active closed bank or assisted merger case is revaluated, and adjustments are applied to the appropriate loss reserve and expense accounts. For accounting purposes, the adjustments are combined with current year losses, and the net is charged to insurance expense. This practice can result in a misleading impression, and can compound the difficulties experienced by readers of FDIC financial statements. Perhaps the best example of the magnitude of the distortion that can occur is the insurance loss of $100 million reported by the FDIC in 1974. Essentially this entire amount was attributable to a revision to the expected loss on the United States National Bank (San Diego) failure that had occurred the previous year. Again in 1982, reported losses included a $158 million reduction in losses associated with assisted mergers of mutual savings banks during 1981. The negative losses reported by the FDIC in 1979 and 1980 also were the result of revisions to original cost estimates.

Table 4-2 presents a summary by year of the number and total assets of failed insured banks, and the losses realized by the

[7]Staffing of the FDIC is discussed later in this chapter.

FDIC in connection with these failures. Because of the periodic revaluation of loss estimates, the losses reported for accounting purposes (Table 4-1) cannot be traced easily in this table.

Table 4-2. Insured Bank Failures, 1934-1982* ($ Thousands)

	Total Failures			Deposit Payoffs		Deposit Assumptions	
Year	Number	Assets	Losses	Number	Assets	Number	Assets
1982	42	$11,632,415	$1,069,130	7	$585,418	35	$11,046,997
1981	10	4,859,060	556,698	2	51,019	8	4,808,041
1980	10	236,164	20,960	3	17,832	7	218,332
1979	10	132,988	7,833	3	13,565	7	119,423
1978	7	994,035	5,885	1	1,660	6	992,375
1977	6	232,612	1,160	0	. . .	6	232,612
1976	16	1,039,292	22,514	3	20,530	13	1,018,762
1975	13	419,950	18,695	3	43,145	10	376,805
1974	4	3,822,596	328	0	. . .	4	3,822,596
1973	6	1,309,675	67,597	3	29,208	3	1,280,467
1972	1	22,054	1,226	1	22,054	0	. . .
1971	6	196,520	193	5	86,781	1	109,739
1970	7	62,147	288	4	37,498	3	24,649
1969	9	43,572	82	4	9,879	5	33,693
1968	3	25,154	12	0	. . .	3	25,154
1967	4	11,993	1,010	4	11,993	0	. . .
1966	7	120,646	479	1	832	6	119,814
1965	5	58,751	3,903	3	57,556	2	1,195
1964	7	25,849	911	7	25,849	0	. . .
1963	2	26,179	286	2	26,179	0	. . .
1962	0	. . .	. . .	0	. . .	0	. . .
1961	5	9,820	1,502	5	9,820	0	. . .
1960	1	7,506	. . .	1	7,506	0	. . .
1959	3	2,859	97	3	2,859	0	. . .
1958	4	8,905	28	3	4,429	1	4,476
1957	1	1,253	. . .	1	1,253	0	. . .
1956	2	12,914	213	1	5,202	1	7,712
1955	5	11,986	230	4	5,950	1	6,036
1954	2	1,138	258	0	. . .	2	1,138
1953	2	18,811	. . .	0	. . .	2	18,811
1952	3	2,388	792	0	. . .	3	2,388
1951	2	3,050	. . .	0	. . .	2	3,050
1950	4	4,005	1,385	0	. . .	4	4,005
1949	4	4,886	369	0	. . .	4	4,886
1948	3	10,360	641	0	. . .	3	10,360
1947	5	6,798	59	0	. . .	5	6,798
1946	1	351	. . .	0	. . .	1	351
1945	1	6,392	. . .	0	. . .	1	6,392
1944	2	2,098	40	1	447	1	1,651
1943	5	14,059	123	4	7,382	1	6,677
1942	20	21,756	688	6	1,603	14	20,153
1941	15	34,805	591	8	17,812	7	16,993
1940	43	161,898	3,796	19	7,960	24	153,938
1939	60	181,522	7,152	32	43,933	28	137,589
1938	74	69,518	2,425	50	13,925	24	55,593
1937	75	40,462	3,672	50	19,376	25	21,086
1936	69	31,955	2,333	42	12,989	27	18,966
1935	25	16,023	2,685	24	11,105	1	4,918
1934	9	2,657	207	9	2,657	0	. . .
Total	620	$25,961,827	$1,808,476	319	$1,217,206	301	$24,744,621

* Includes savings banks merged with financial assistance in order to avert failure: three in 1981 and eight in 1982.

Another source of distortion arises from the FDIC's past policies with respect to explicit interest charges on funds advanced in connection with insurance operations. The policy has been not to adjust cost estimates to reflect foregone interest, and this has significantly understated reported losses. Beginning in 1983, the FDIC changed its policy so that explicit interest will be factored into all future cost estimates.

The FDIC's practice of not allocating administrative costs to insurance expense also has tended to understate reported losses. In 1984, the FDIC will begin allocating overhead expenses to each failed bank receivership.

The understatement of historical costs notwithstanding, the loss experience of the FDIC has been modest. A majority of failures of insured banks (360) occurred before World War II, resulting in reported losses slightly less than nine percent of assessments collected over this same period. It was not until the mid-1970s that losses again approached and surpassed this level.

The Deposit Insurance Fund

The deposit insurance fund is the net worth of the FDIC, and represents accumulated earnings retained since 1933. In every year except 1947, when the FDIC retired a majority of the capital stock originally issued to the Treasury and Federal Reserve Banks, the fund has increased and was approximately $14.3 billion in mid-1983.

The fund is often compared to various definitions of deposit liabilities in insured banks in an attempt to measure its ability to absorb losses in the banking system. The relationship that probably has received the most attention is the ratio of the fund to total insured deposits. As a practical matter, however, the concept of an aggregate level of insured deposits has little meaning.

Since the mid-1960s, the FDIC has handled most failed banks in a way that all depositors, and indeed all general creditors, have been afforded *de facto* 100 percent insurance.[8] It is only in cases where the FDIC pays off the depositors of a failed bank that the basic insurance limit becomes relevant. However, even in the case of a payoff, many uninsured depositors are either collateralized or have an offset against an outstanding credit. Thus, the ratio of the fund to insured deposits probably represents an underestimate of the exposure of the fund.

[8]This topic is addressed more fully in Chapter 5.

Additionally, the measurement of total insured deposits within the system with any precision has become extremely difficult, if not impossible. The complexities in the law pertaining to the definition of deposits, the method of aggregating individual depositors' accounts within a bank for insurance purposes and the increased activity of brokers, who specialize in gathering funds from many individuals and placing them in fully insured deposit accounts, all contribute to measurement problems.

In Table 4-3, the ratios of the fund to both insured and total (domestic) deposits are presented. Although there have been some fluctuations in these ratios, they have remained remarkably stable over time. This is a reflection of the ability of the FDIC to generate sufficient income to cover operating expenses and insurance losses, and to contribute enough to the fund to maintain a stable relationship to deposit liabilities. Even in 1981-1982, years when record losses were absorbed by the FDIC, the fund increased both in absolute terms and in relation to total deposits.

There are several reasons to believe that the historical relationship of the fund to deposits will continue into the future. Market interest rates tend to move with bank deposits. Over the past 25 years, interest rates on three- to five-year Treasury securities have increased at an annual average compound rate of one to one-and-one-half percent less than deposits in the banking system. While this same relationship has not been constant over time, it is probable that the positive correlation will continue into the future. Whatever the shortfall of interest income, retained assessment income is the other source available to stabilize the ratio of the fund to deposits. The magnitude of this income depends importantly on the volume of insurance losses.

In general, losses incurred by the FDIC in connection with failed banks have been modest. From 1934 to 1980, reported losses and insurance expenses accounted for less than five percent of assessment income. The record losses reported in 1981 and 1982, when losses accounted for approximately 74 percent of assessment income, are not expected to continue over any protracted period of time. While future losses may be higher than those experienced through 1980, losses even greater than the more recent levels would have to persist for several years before the ability of the fund to generate substantial income would be compromised. Although 1981 and 1982 cannot be considered to represent a normal period, it must be recognized that the fund grew by about 25 percent during this period despite the enormous losses absorbed by the FDIC.

Table 4-3. The Balance Sheet of the FDIC and Deposits in Insured Banks, 1934-1982 ($ Millions)

	U.S. Govt. Securities	All Other Assets	Total Assets[1]	Deposit Insurance Fund (Net Worth)	Total Deposits in Ins. Banks[2]	"Insured" Deposits[2]	Ratio of Total Deposits	Fund to Insured Deposits
1982	$ 13,559.4	$ 1,674.1	$ 15,233.5	$ 13,770.9	$1,544,697	$1,134,221	.89%	1.21%
1981	12,236.3	1,005.3	13,241.7	12,246.1	1,409,322	988,898	.87	1.24
1980	10,720.9	914.7	11,635.6	11,019.5	1,324,463	948,717	.83	1.16
1979	9,636.1	723.2	10,359.3	9,792.7	1,226,943	808,555	.80	1.21
1978	8,373.1	909.5	9,282.6	8,796.0	1,145,835	760,706	.77	1.16
1977	7,267.0	1,195.5	8,462.5	7,992.8	1,050,435	692,533	.76	1.15
1976	6,760.2	1,795.6	8,555.9	7,268.8	941,923	628,263	.77	1.16
1975	6,472.2	1,877.5	8,349.8	6,716.0	875,985	569,101	.77	1.18
1974	5,966.2	2,211.5	8,177.9	6,124.2	833,277	520,309	.73	1.18
1973	5,639.5	283.8	5,923.3	5,615.3	766,509	465,600	.73	1.21
1972	5,333.0	122.6	5,455.6	5,158.7	697,480	419,756	.74	1.23
1971	4,831.0	162.2	4,993.2	4,739.9	610,685	374,568	.78	1.27
1970	4,575.1	56.2	4,631.3	4,379.6	545,198	349,581	.80	1.25
1969	4,261.1	36.3	4,297.4	4,051.1	495,858	313,085	.82	1.29
1968	3,942.9	27.7	3,970.7	3,749.2	491,513	296,701	.76	1.26
1967	3,661.4	30.2	3,691.7	3,485.5	448,709	261,149	.78	1.33
1966	3,413.9	29.2	3,443.2	3,252.0	401,096	234,150	.81	1.39
1965	3,190.2	21.5	3,211.7	3,036.3	377,400	209,690	.80	1.45
1964	2,981.5	27.3	3,008.8	2,844.7	348,981	191,787	.82	1.48
1963	2,798.1	25.0	2,823.1	2,667.9	313,304[3]	177,381	.85	1.50
1962	2,634.8	10.7	2,644.5	2,502.0	297,548[4]	170,210	.84	1.47
1961	2,470.4	11.0	2,481.5	2,353.8	281,304	160,309	.84	1.47
1960	2,324.7	11.9	2,336.6	2,222.2	260,495	149,684	.85	1.48
1959	2,189.5	7.9	2,197.4	2,089.8	247,589	142,131	.84	1.47
1958	2,060.6	6.8	2,067.5	1,965.4	242,445	137,698	.81	1.43
1957	1,944.9	5.9	1,950.9	1,850.5	225,507	127,055	.82	1.46
1956	1,831.2	8.7	1,840.0	1,742.1	219,393	121,008	.79	1.44
1955	1,725.4	8.6	1,734.0	1,639.6	212,226	116,380	.77	1.41
1954	1,628.8	3.8	1,632.7	1,542.7	203,195	110,973	.76	1.39
1953	1,530.5	6.2	1,536.7	1,450.7	193,466	105,610	.75	1.37
1952	1,441.3	2.6	1,444.0	1,363.5	188,142	101,841	.72	1.34
1951	1,356.2	4.0	1,360.3	1,282.2	178,540	96,713	.72	1.33
1950	1,278.3	3.9	1,282.2	1,243.9	167,818	91,359	.74	1.36
1949	1,207.2	4.4	1,211.7	1,203.9	156,786	76,589	.77	1.57
1948	1,066.0	5.9	1,072.0	1,065.9	153,454	75,320	.69	1.42
1947	1,022.5	8.2	1,030.7	1,006.1	154,096	76,254	.65	1.32
1946	1,047.7	13.0	1,060.7	1,058.5	148,458	73,759	.71	1.44
1945	899.9	31.1	931.0	929.2	157,174	67,021	.59	1.39
1944	762.0	44.1	806.2	804.3	134,662	56,398	.60	1.43
1943	573.3	87.5	660.8	703.1	111,650	48,440	.63	1.45
1942	536.8	81.9	618.7	615.9	89,869	32,837	.69	1.88
1941	419.9	104.6	524.6	553.5	71,209	28,249	.78	1.96
1940	384.5	112.6	497.2	496.0	65,288	26,638	.76	1.86
1939	363.5	92.5	456.1	452.7	57,485	24,650	.79	1.84
1938	372.7	48.8	421.6	420.5	50,791	23,121	.83	1.82
1937	348.5	36.8	385.3	383.1	48,228	22,557	.79	1.70
1936	332.6	20.5	353.2	343.4	50,281	22,330	.68	1.54
1935	298.3	38.9	337.2	306.0	45,125	20,158	.68	1.52
1934	315.1	18.4	333.7	291.7	40,060	18,075	.73	1.61

[1] Due to rounding differences, components may not add to totals.

[2] Deposits in foreign branches are omitted from totals. Insured deposits are estimated by applying to the deposits in the various types of accounts at the regular Call dates, the percentages insured as determined from the Summary of Deposits survey submitted by insured banks. Unless otherwise noted, deposits are as of December 31 of each year.

[3] December 20, 1963.

[4] December 28, 1962.

The nature of the assessment mechanism is another important reason why the fund-to-deposit relationship can be expected to remain relatively stable over the longer-run. The rebate system in essence places 60 percent of losses directly with insured banks; this provides a cushion to the fund in absorbing insurance losses. Further, if operating expenses and losses exceed gross assessment income, the excess is carried forward to subsequent years and is charged against gross income in the same manner as current losses. Moreover, current law ties the proportion of net assessment income returned to insured banks to the relationship of the fund to insured deposits. Thus, there could be situations where the fund actually declines, but the system would automatically accelerate the rate of income retention until historical relationships have been restored.

Insurance Coverage

Several factors determine the effective insurance coverage afforded individual depositors in an insured bank. First is the basic insurance limit in effect at the time a bank fails. The limit is set by law and currently stands at $100,000. Second, protection can be expanded beyond the basic insurance limit by use of multiple accounts held in different forms of ownership. Finally, and perhaps most importantly, effective coverage depends on the way the FDIC chooses to handle a failed bank.

The basic insurance limit represents the minimum insurance coverage available to a bank depositor. The original limit was set at $2,500 in the 1933 Act, but was increased to $5,000, effective June 30, 1934. This limit remained in effect until 1950, when it was increased to $10,000 as part of the Federal Deposit Insurance Act. The limit was next increased to $15,000 in 1966, to $20,000 in 1969 and to $40,000 in 1974. In 1974, the insurance limit for time and savings accounts held by state and political subdivisions was increased to $100,000; this same limit was extended to Individual Retirement (IRA) and Keogh Accounts in 1978.

The most recent increase occurred in 1980, when it was raised to $100,000 for all types of accounts despite the FDIC's reservations (the FDIC also had resisted previous increases in the insurance limit). This represented a departure from previous changes in insurance coverage, which generally had been more modest and more or less reflected changes in the price level. The increase to $100,000 was not designed to keep pace with inflation. Rather, it was in recognition that many banks and

savings and loan associations, facing disintermediation in a high interest rate climate, had sizable amounts of large certificates of deposits (CDs) outstanding. The new limit facilitated retention of some of these deposits or replaced outflows from other deposit accounts with ceiling-free CDs. In 1980, only time accounts with balances of $100,000 or more were exempt from interest rate ceilings.

A depositor may increase insurance coverage by maintaining multiple accounts held in different forms of legal ownership. In determining the insurance coverage afforded a depositor, the statute has always required the FDIC to aggregate all balances held in the same right and capacity before application of the basic insurance limit. Accounts held in different rights and capacities, however, are each insured up to the basic limit.

Until 1967, the FDIC relied on state laws to define what constituted different forms of deposit ownership. Because state laws often differed on this topic, this practice often led to confusion and sometimes hard feelings on the part of depositors in closed banks. In 1967, the FDIC and the Federal Savings and Loan Insurance Corporation (FSLIC) cooperated in an effort to produce regulations that would set forth a consistent set of rules defining how the agencies would treat multiple accounts for insurance purposes. While consistency was achieved, the resulting rules are complex.

One of the unanticipated outgrowths of the way in which insured deposits are defined is the practice of brokers gathering funds in individual amounts up to the basic limit, and purchasing large, fully-insured CDs from banks.[9] Since the funds are held in an agency relationship, each identifiable ownership interest is insured to the basic limit, although balances would be aggregated with other deposits held by owners to determine balances for insurance purposes. This activity accelerated after the payoff of Penn Square Bank in July 1982, as investors (depositors) searched for the highest return without incurring any default risk.

The expansion of insurance coverage through the use of brokers has been of great concern to the federal deposit insurance agencies. Dating from the early debates on deposit insurance legislation, there has been a fear that deposit guarantees would erode the discipline of depositors on the actions of banks.

[9]There are other ways the same result can be achieved. For example, some brokers purchase a large CD, and then offer participations in amounts up to the insurance limit to individual investors.

The increased activity of brokers has heightened these concerns, and was the subject of extensive discussion in Congress, the regulatory agencies and the financial community during 1983.

Depositors in some cases also may increase the effective deposit insurance limit by utilizing the right of offset. A depositor has the right to apply outstanding loan balances to reduce the balances in deposit accounts. Since deposit balances for insurance purposes are determined after applicable offsets, otherwise uninsured deposits can be protected by means of this mechanism. In a closed bank situation, the FDIC does not have the right to offset loan balances against deposit accounts unless the credit is carried in a delinquent status. Unless an explict request is made by the debtor/depositor, loan balances are kept intact and the total deposit balances are insured to the basic limit.

During most of the first 30 years of its existence, the FDIC routinely exercised its statutory right to withhold payment of insured deposits until all indebtedness of the depositor to the closed bank had been satisfied. This practice had its beginnings during the period when there were concerns that the deposit insurance fund would not be adequate to handle insurance losses, although the policy continued long after the need for it had passed. Eventually, vocal protests from irate depositors and prodding by some consumer activists persuaded the FDIC to abandon this policy in 1964.

The level of effective deposit insurance coverage becomes relevant only in cases where depositors in a failed bank are paid off to the basic insurance limit. Sometimes the FDIC will handle a failing or failed bank situation by providing direct assistance to the bank or by assisting an open-bank merger with another bank. More often, a failed bank's non-subordinated liabilities will be assumed by another banking organization. The result in these situations is that all depositors and other creditors with equal or preferred standing are afforded the benefits of 100 percent insurance coverage. Although the philosophy governing the handling of troubled banks has changed over time (see Chapter 5), in the past decade most failures, and virtually all large failures, have been handled by assumption transactions. Payoffs have occurred when no interested or qualified purchaser could be found, or where there was evidence that significant unbooked liabilities or contingent claims existed. The latter circumstance normally occurs where the bank fails as a result of fraud or excessive insider abuse. In many cases depositors have

been placed in a position of having insurance coverage dependent not only on factors outside their control, but on factors that they could not be reasonably expected to know prior to failure.

In closing this section, it perhaps is appropriate to note that the FDIC has spent considerable time and effort trying to inform the public about federal deposit insurance coverage. Most of this effort has centered on what is and what is not an insured deposit, and what deposit insurance means to a depositor if a bank should fail. Admittedly, the rules are complex, although the basic purpose of deposit insurance seems clear to most people. Evidently, this is not always true. Two examples may serve to illustrate the point.

Ed Johnson, who began work as an FDIC claim agent in 1938, recalled an incident in which a depositor of a failed New Jersey bank appeared unsatisfied with his FDIC check for $225. While admitting this was, in fact, his account balance, the customer indicated a nearby FDIC sign: "But, the sign, she say $5,000."

"I guess," said Johnson, "he thought he hit the jackpot!"[10]

In the second incident, an office of Maryland's Register of Wills received a telephone call in the late 1970s from a recently widowed woman. Her husband had an FDIC-insured bank account, she related, and now that he had died she wanted to know how to collect the $40,000 insurance. Hopefully this was not an integral part of their estate planning.

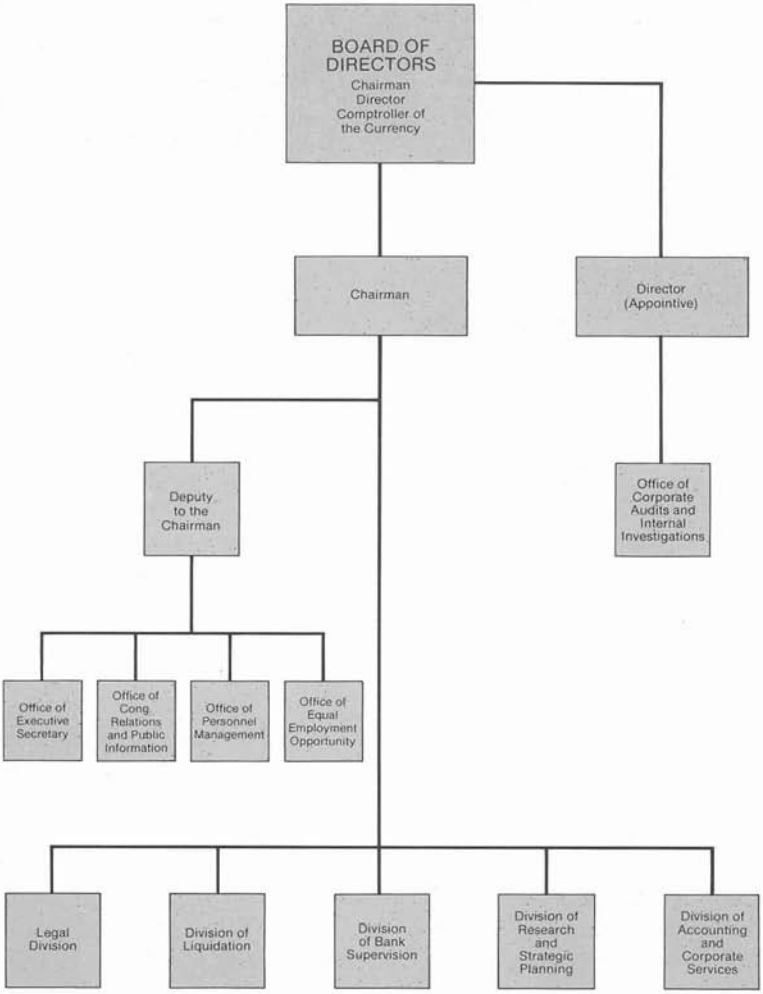
Organization and Staffing

The first task facing the FDIC was to develop an organization and staff to perform the insurance admission examinations required by the 1933 Act. This task consumed almost all available resources during 1933. By the time the temporary fund began operations on January 1, 1934, virtually all of the examinations had been completed. Attention thus shifted to development of an organization to handle the ongoing responsibilities of the insurance agency. This task was one of the first problems faced by Leo Crowley when he became Chairman in early 1934.

Traditionally, the organization chart of the FDIC has reflected a mixture of functional and specialized responsibilities typical of

[10]Interview with Ed Johnson, "Early Claim Agents Had Key Role in Payoff of Insured Deposits," *FDIC News* (August 1983), Vol. 3:9, p. 2.

Chart 4-1. FDIC Organization Chart



many organizations. The two primary responsibilities of controlling risks to the insurance fund and providing for the orderly liquidation of assets acquired from failed and failing banks were placed in the Division of Examinations (renamed the Division of Bank Supervision in 1969) and the New and Closed Bank Division (renamed the Division of Liquidation in 1936). Other activities, although in some cases acting as an integral part of the bank examination or liquidation functions, have had a separate existence within the corporate structure. Chart 4-1 presents the current organizational structure of the FDIC.

Table 4-4. Total Employment by Function, Selected Years (Year-End)

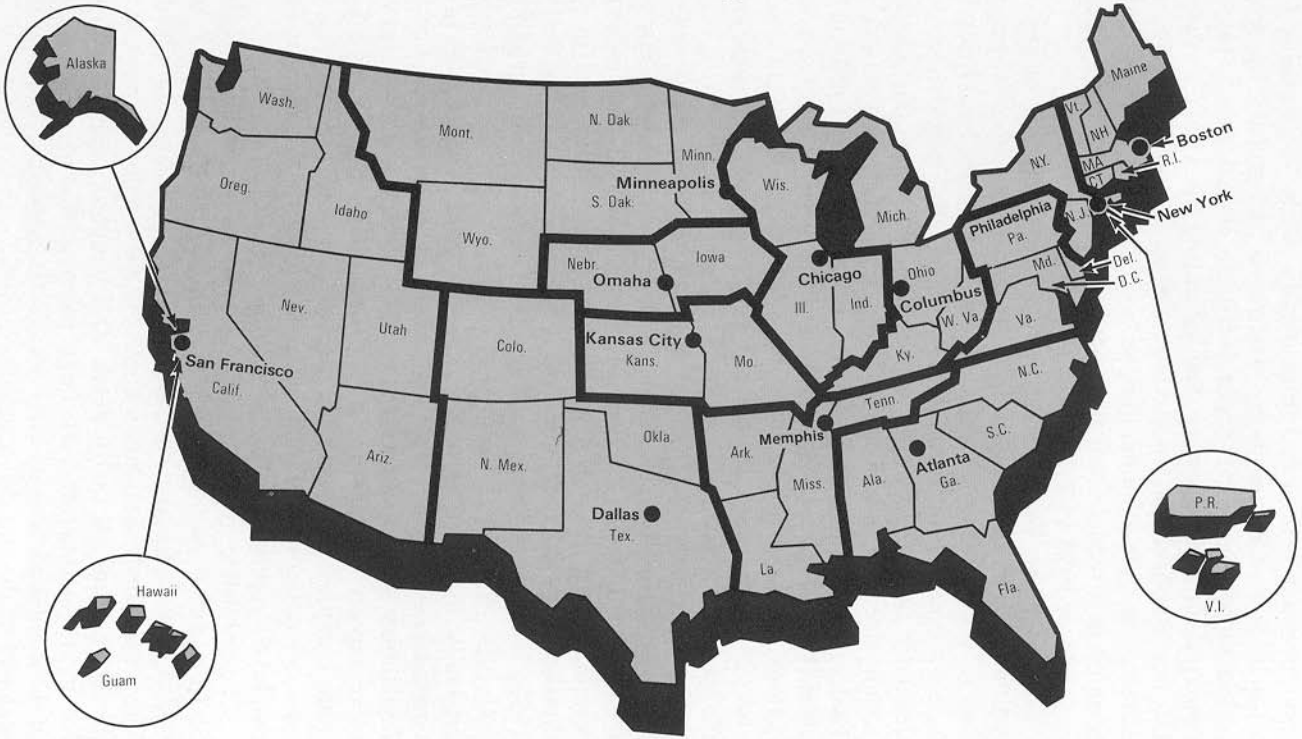
	Bank Supervision	Liquidation	Legal	Other	Total
1934	592	8	15	231	**846**
1940	609	998	37	283	**1,927**
1945	497	342	35	310	**1,184**
1950	727	90	24	234	**1,075**
1955	816	58	22	235	**1,131**
1960	938	38	23	244	**1,243**
1965	1,078	101	36	231	**1,446**
1970	1,890	175	54	389	**2,508**
1975	2,282	423	83	486	**3,274**
1980	2,544	460	107	533	**3,644**
1982	2,129	778	105	492	**3,504**

By federal agency standards, the FDIC has never been a large agency. By the end of 1934, total employment stood at 846, and reached a peak of 3,773 in 1978. Table 4-4 presents total employment for selected years and, where possible, the employment within each functional area. Because of numerous internal reorganizations and shifting responsibilities, it is virtually impossible to reconstruct a consistent employment series for most of the major areas of responsibility.

Except for the period 1939-45, when liquidation activity had intensified because of the large number of bank failures during 1934-40, most of the resources of the FDIC have been devoted to the bank examination process. Historically, employment in the Division of Bank Supervision has averaged about 65 percent of all FDIC personnel. Most of these employees are located in the twelve regional offices situated around the country (see Chart 4-2). The FDIC had originally established fifteen regional offices, but they were cut back to twelve in 1935. In 1966, the number was increased to fourteen, before being reduced to thirteen in 1981 and to the present level in 1983. Within each region there are a number of field offices, located in most of the larger cities, to coordinate on-site examinations.

Employment within the Division of Bank Supervision has depended on the size and complexity of banks directly examined by the FDIC, perceptions of risk within the industry and additional regulatory requirements imposed by Congress. With the exception of the World War II years, and the personnel shortages that accompanied the war effort, the staff of the division slowly and steadily grew through the late 1960s. Beginning at this time, Congress passed a series of laws, primarily in the consumer protection area, that placed additional responsibilities

Chart 4-2. FDIC Regions



on the regulatory agencies. Additionally, banking had become more complex and, at least by the early 1970s, more exposed to adverse economic conditions. Staffing of the division began to reflect those changes in about 1967; the annual growth rate in employment approximately doubled during the 1967-82 period. Greater emphasis on cost control, accompanied by increased reliance on state examinations and off-site monitoring systems, resulted in a reduction of personnel in the division from a peak of 2,648 in 1978 to 2,129 at the end of 1982.

Although the Division of Liquidation performs a variety of activities, including payment of insured depositors in payoff cases, most of its personnel are engaged in the liquidation of assets acquired from failed banks. Historically, employment has depended on the number of active liquidations and the size and complexity of acquired assets. Employment reached a peak of 1,623 in 1941. While there were only about $130 million in assets being liquidated at that time, there were 286 active liquidations. By way of contrast, there were $2.2 billion in assets and 128 active cases at year-end 1982, and only 778 total employees at that time.

The large number of active liquidations in the 1940s was a result of the relatively large number of bank failures occurring from 1934 to 1942. As these liquidations were terminated and few banks failed over the next 30 years, employment in the division was drastically reduced. The low point was reached in 1952, when there were only 32 people engaged in liquidation activities. Since the early 1960s, the number of employees gradually increased through the early 1970s as a result of a conscious effort to build and retain an experienced staff of liquidation specialists. More recently, the division has grown more rapidly in response to the need to liquidate larger and more complex assets and, in the last two years, in response to an accelerating rate of bank failures. By late 1983, the division employed approximately 1,400 people.

The published number of employees operating in the Division of Liquidation includes both permanent FDIC employees and others who are hired at the liquidation site on a temporary basis. These so-called Liquidation Graded (LG) employees provide to the FDIC a means to fill needs of a temporary nature without having to maintain a very large permanent staff. In times of peak liquidation activity, LG employees normally comprise the majority of the division's employment.

In recent years, the Division of Bank Supervision has provided examiners to the Division of Liquidation on a detail or temporary basis. These examiners are used in the initial period after a bank is closed to assist in inventorying and appraising assets and investigating bond claims, civil claims against officers and directors and criminal matters. In some of the larger, more complex failures, large numbers of examiners have been utilized for these purposes and, in some cases, have been assigned to a liquidation for several months.

In 1981, the division reorganized its operations, effectively decentralizing much of its activities. Prior to this time, administrative services were handled in the Washington office, with liquidation activities performed at sites located in close proximity to the location of failed banks. The reorganization created five area offices to act as regional administrative centers and provide a means to consolidate individual liquidation sites on a more timely basis (see Chart 4-3).

The FDIC's bank supervision and liquidation functions normally require a considerable amount of legal services. This activity traditionally has been performed by a permanent staff of attorneys, supplemented by the use of outside counsel. The internal staff of lawyers always has been organized to provide "open-bank" and "closed-bank" service. Until 1940, the closed-bank operations were organizationally located in the Division of Liquidation; since 1940, virtually all staff attorneys have been assigned to the Legal Division.

Staffing of the Legal Division has been determined by the same factors that have affected other operations of the FDIC. Employment in the open-bank section has reflected the needs of the Division of Bank Supervision and the requirements to promulgate rules and regulations relating to banking activities. On the other hand, employment in the closed-bank section has reflected the number and complexity of bank failures.

In 1967, attorneys were assigned to some regional offices of the Division of Bank Supervision on an experimental basis. This program was successful and was extended to the area offices of the Division of Liquidation during 1983. These attorneys still report directly to the General Counsel, although their work is most directly related to the activities of the remote locations to which they are assigned.

The FDIC always has maintained some form of research capability. The Division of Research historically has served in a

Chart 4-3. FDIC Liquidation Areas

support capacity, particularly in the areas of economic and financial analysis of developments in banking, resolution of problem bank situations and legislative matters. The division also has engaged in longer-term research relating to matters of interest to the FDIC. During most of its existence, the research function was performed in conjunction with the statistical responsibilities of the FDIC.[11] In 1977, research activities were segregated from the statistical function and made a separate operating unit reporting directly to the Chairman. The division's name was changed to the Division of Research and Strategic Planning in 1981, reflecting additional responsibilities. Employees devoted to research have averaged about 30 persons in recent years.

The other activities performed by FDIC employees have been variously assigned to the executive offices (Office of the Chairman) and other operating units. In 1981, the internal structure of the FDIC was reorganized. The accounting, data processing and facilities management activities were placed in the Division of Accounting and Corporate Services. This move combined what had been the comptroller's function with the data processing area. The other support areas were placed either under the Appointive Director (internal audits) or the Deputy to the Chairman (secretariat, congressional relations and public information, personnel and equal employment opportunity). The size of the staffs in each of these areas has grown in proportion to the complexity of FDIC internal operations and the increased demands placed on the agency by the supervision and liquidation functions.

[11]Beginning in 1934, the FDIC has collected, edited and published periodic balance sheet and income statement information from FDIC-regulated banks.