THE DEPOSIT INSURANCE LEGISLATION OF 1933

AN EXAMINATION OF ITS ANTECEDENTS AND ITS PURPOSES*

> Not a part of the President's program, bitterly fought by some of the most powerful interests in the land, beset by enemies in high places where it should have had only friends, the bill has been passed because of the fine patience, the splendid courage, and the masterful resource of the chairman of the conferees.
>
> The country has had nothing comparable to it since the passage of the Federal Reserve Act. It is one of the great pieces of legislation in the history of the government. It is indeed "the shadow of a great rock in a weary land." [1]

THESE words by Representative Lister Hill of Alabama in the closing days of the first session of the 73rd Congress marked the conclusion of a long, and often bitter, struggle to establish a nation-wide system of deposit insurance. During the quarter century which has since passed, the motives and forces which came to focus in 1933 to produce nation-wide insurance of bank deposits seem to have been largely misunderstood. The belief has persisted that the 1933 legislation was a novel measure prompted by the banking crisis and devised by the new administration to protect depositors of modest means against losses due to bank failure.

It is to the major elements of this belief that the present paper is directed. Deposit insurance was not a novel idea; it was not untried; protection of the small depositor, while important, was not its primary purpose; and, finally, it was the only important piece of legislation during the New Deal's

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[1] *Congressional Record*, vol. 77, 73rd Cong., p. 5899. The bill referred to is the Banking Act of 1933, which became law June 16, 1933, and the remarks were directed to that portion of the Act which provided for insurance of bank deposits.

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famous "one hundred days" which was neither requested nor supported by the new administration.

Deposit insurance was purely a creature of Congress. For almost fifty years members had been attempting to secure legislation to this end, without success; while in individual states the record of experimentation with bank-obligation insurance systems dated back more than a century. The adoption of nation-wide deposit insurance in 1933 was made possible by the times, by the perseverance of the Chairman of the House Committee on Banking and Currency, and by the fact that the legislation attracted support from two groups which formerly had divergent aims and interests—those who were determined to end destruction of circulating medium due to bank failures and those who sought to preserve the existing banking structure.

I

In 1829 New York had a new governor and an impending banking problem. The governor was Martin Van Buren and the problem arose from the fact that many bank charters were due to expire within the next several years. The approaching charter expirations, combined with considerable public dissatisfaction with the existing banking structure, had given rise to a wide variety of proposals, ranging from the abolition of all banks to the creation of a state-wide branch banking system owned and operated by the state. Governor Van Buren, in his first message to the state legislature, took note of the situation and indicated that he would propose a novel plan: "My own reflections . . . have derived much assistance from a sensible and apparently well considered plan that has been submitted to me, and which will, in due season, be laid before you. . . . It proposes to make all the banks responsible for any loss the public may sustain." [2]

The plan to which the Governor referred, and which he submitted to the legislature three weeks later, had been devised by Joshua Forman, a Syracuse business man. It provided for the

[2] Charles Z. Lincoln (ed.), *Messages from the Governors* (Albany, 1909), III, 243. For a detailed discussion of state insurance systems, and of proposed federal legislation for deposit insurance or guaranty, prior to 1933, see the following annual reports of the Federal Deposit Insurance Corporation: 1950, pp. 63-101; 1952, pp. 59-72; 1953, pp. 45-67; and 1956, pp. 47-73.

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establishment of an insurance fund to which all banks would be required to contribute as a condition of charter renewals, the appointment of a board of commissioners with full authority to examine the banks regularly, and the investment of bank capital in state bonds or well-secured mortgages.

There seems to have been no American precedent for the proposed insurance plan. Forman claimed that the plan

> . . . was suggested by the regulations of the Hong merchants in Canton, where a number of men, each acting separately, have, by the grant of the government, the exclusive right of trading with foreigners, and are all made liable for the debts of each in case of failure. The case of our banks is very similar; they enjoy in common the exclusive right of making a paper currency for the people of the state, and by the same rule should in common be answerable for that paper.[3]

The examination proposal was hardly less novel, since it contemplated regular examination by salaried officials empowered to investigate the condition of the banks fully—in short a degree of supervision almost unthinkable at that time.

Despite the novelty of the plan—or perhaps because of it—the Forman-Van Buren proposals with respect to insurance and bank examination were adopted by the legislature and became law on April 2, 1829; but the proposed investment of bank capital in securities was not included in the Act. This Act was to apply to all banks "hereafter to be created in this state, or whose charter shall be renewed or extended."[4] The insurance plan itself was based on a fund (known as the Safety Fund) to be raised by requiring each participating bank to pay an annual assessment to the State Treasurer equal to ½ of 1 per cent of paid-in capital stock, until the total paid equaled 3 per cent of its capital stock. Special assessments were authorized whenever the fund fell below the required size. All creditors of failed participating banks, that is, primarily depositors and holders of circulating bank notes, were covered to the full extent of their holdings. Payments were to be made out of the insurance fund whenever, upon completion of the liquidation of the assets of a failed bank, it was found that full recovery had not been secured by the bank's creditors.

[3] *New York Assembly Journal*, 1829, p. 179.

[4] *An Act to create a fund for the benefit of the creditors of certain monied corporations, and for other purposes*, April 2, 1829, section 1.

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At the end of 1829 about half of the banks were subject to the provisions of the new law. As expired charters were renewed, participation increased and by the end of 1837 it exceeded 90 per cent of the state's banks.

Within a relatively short time adaptations of the New York bank legislation appeared in two other states. Vermont in 1831 adopted the insurance and examination proposals for its banks, and Michigan followed in 1836. In each case, there were only minor differences from the New York plan. The adoption of the New York plan in Michigan was probably due to the fact that the latter state was at that time being rapidly settled by former residents of New York.

Between the dates of passage of the insurance legislation in Vermont and Michigan, a different kind of bank-obligation insurance appeared in the Middle West. In 1834 Indiana was faced with the problem of establishing a banking system, a task complicated by the fact that the state constitution appeared to prohibit any banking except that which might be done by a state bank and its branches. The rather ingenious solution was to establish a state bank—which did no banking—and to provide for independent banks—but to label them "branches". Taken together, the "branches" constituted the state bank, but each "branch" had its own stockholders, officers and directors, and paid dividends out of its own earnings. The state bank itself was essentially a supervisory body, with the president occupying a position somewhat similar to that of a present-day bank commissioner.

The insurance plan was simple. Upon the failure of a branch bank, the remaining branch banks were made "mutually . . . responsible for all the debts, notes, and engagements of each other" unpaid within one year after failure.[5] No insurance fund was provided. The necessary amounts were to be raised by special assessments on the branch banks, such assessments to be levied by the directors of the state bank.

The four insurance systems established by 1836 were almost immediately put to a severe test. The panic of 1837 was followed by one of the longest and deepest depressions in the nation's history. The insurance system last established soon collapsed, as numerous bank failures in Michigan threw on the insurance fund obligations which could not possibly be met.

[5] *An Act establishing a State Bank,* January 28, 1834, section 9.

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By 1841 almost all of the insured banks had suspended and the insurance system came to an end a year later. During its six years of operation it made no payments to creditors of failed banks.

The New York insurance system successfully met the test in 1837—owing in part to an amendment to the law which will be described later—and was able to handle the first few failures in 1840-41. However, when the Bank of Buffalo failed in November of 1841 the insurance fund had already been so far drawn down that the State Comptroller hesitated to make provision for the payment of the bank's insured creditors. When seven additional failures followed very soon, it was clear that the insurance fund would be insufficient. In 1842 insurance protection was limited to circulating bank notes, and in 1845 the legislature remedied a defect in the insurance plan—the lack of borrowing power—by authorizing a bond issue to meet obligations due as a result of failures during the depression. Vermont also ran into difficulty at about this time, although the insurance system managed to pay all claims presented.

The Indiana system was the most successful of the four. Only one branch bank suspended (in 1843) and it was swiftly reorganized and reopened, with no loss to depositors or noteholders. By the end of the depression the Indiana banking system was recognized as the strongest in the West.

In 1845 Ohio was faced with essentially the same situation with which New York had to deal in 1829. The charters of many banks had expired in 1843-44, and the difficulties encountered during the depression had led to demands for a reorganization of the banking system. Had this situation developed ten years earlier, it is quite possible that Ohio would have followed the New York precedent, but by 1845 the reputation of Indiana banks was particularly high in Ohio. Consequently, Ohio organized a banking system similar to that of her western neighbor, that is, a state bank which did no banking and "branches" which did the banking and were, for all practical purposes, independent banks.

The Ohio insurance system, while similar to Indiana's, provided for the establishment of an insurance fund. The fund, however, was merely a segregation of a portion of the assets of each bank, to be used to reimburse the banks for any special assessments levied to pay the creditors of failed banks. Ohio

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also borrowed from the revised New York plan in limiting insurance protection to circulating notes.

Iowa was the last of the six states to adopt an insurance program prior to the Civil War. It did so in 1858, basing both its banking and insurance systems on the Ohio model.

The experience of the state insurance systems after 1845 was generally good. Noteholders of failed insured banks in Ohio were paid swiftly and in full. During the panic of 1857 no insured bank in Ohio suspended, although a number required and received aid from the insurance system. Iowa managed to handle successfully what few troubles it encountered. The Indiana system continued its remarkable record, with not a single bank suspension during the remainder of its period of operation. Bank-obligation insurance in New York was hampered by the need to redeem bonds issued during the depression, deferring the payment of claims. Eventually all insured claims were paid, including new claims arising out of suspensions in 1854 and 1857, although with considerable delay in the last cases and probably some loss. Only in Vermont did the insured claimants of a failed bank fail to receive full payment from the insurance fund, and this was owing in large part to unauthorized refunds to withdrawing banks of a portion of the insurance fund by the State Treasurer, so depleting the fund that it was unable to pay all claims in the case which later developed.

Despite the generally successful record of the various insurance systems after 1845, all ceased operations by 1866. Two developments accounted for this. First, the "free-banking" movement which started in the 1830's provided an alternative to insurance of circulating bank notes, that is, the posting with state officials, by each bank, of bonds and mortgages in an amount equal to its total issues of such notes. Many states adopted this "free-banking" idea—including those which also made use of the insurance principle—and "free banks" did not participate in insurance except in Michigan. Consequently, the insurance systems did not become universal in coverage, as had been anticipated, and in the two states where bank-obligation insurance had been first introduced—New York and Vermont—the number of banks participating decreased as charters expired and as new banks were organized under the "free-banking" laws.

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The second factor was the establishment of the national bank system in 1863. When, in 1865, Congress placed a prohibitive tax on the notes of state banks, those of national banks remained the only circulating bank notes. At about that time most insured banks in Ohio, Indiana and Iowa converted to national banks.

After 1866 there was a halt in state plans to insure bank obligations, owing in large part to the guaranty of circulating notes under the national bank system. The notes of national banks were secured by United States bonds but in addition, and more important, they were directly guaranteed by the United States Treasury. As the Comptroller of the Currency pointed out in his first report to Congress, even if the pledged securities were insufficient to redeem the notes of failed national banks, "the notes . . . must still be redeemed in full at the treasury of the United States." [6]

Direct federal guaranty of the notes of national banks meant, if the pre-1860 ratio of bank notes to deposits was maintained, that approximately 40 per cent of the circulating medium would be fully protected. However, deposit banking grew rapidly after the Civil War; by 1870 deposits were twice the circulating notes, and by the end of the century seven times. It was against this setting that attempts were once again made to utilize the insurance principle to guard against the consequences of bank failure.

The first attempts were made in Congress. In 1886 a Wisconsin representative introduced a deposit insurance bill in the House, the first of eighteen such bills to be introduced in the various Congresses between 1886 and the turn of the century. None was enacted into law.

Meanwhile, deposit insurance on a state-wide basis was being debated, and in 1907 a deposit insurance system was adopted in Oklahoma. Within ten years seven other states—Kansas, Nebraska, Texas, Mississippi, South Dakota, North Dakota and Washington—adopted similar legislation.

The various systems differed in detail but were alike in main outline. All provided for assessments on deposits to provide a fund for the payment of deposits of failed banks. The majority of the plans were compulsory for state chartered banks

[6] *First Annual Report of the Comptroller of the Currency*, November 28, 1863.

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and provided insurance protection without maximum insurance limitations for each depositor.

Most of the state systems operated successfully for a number of years, but eventually all were seriously affected by the agricultural difficulties during the 1920's and the consequent large numbers of bank failures. In one fashion or another each state system had become insolvent or inoperative by 1933.

Neither the adoption of deposit insurance systems in the various states nor their subsequent difficulties during the 1920's stopped attempts in Congress to inaugurate nation-wide deposit insurance or guaranty. During the first decade of the new century forty-five additional bills were introduced in Congress, most of them in the 60th Congress in 1907-9. Deposit insurance was included in the original Federal Reserve Act as passed by the Senate, but was omitted from the bill passed by the House and eliminated in the Conference report. From two to eight proposals for deposit insurance or guaranty were submitted in each Congress from the 61st in 1909-11 to the 71st in 1929-31. In the 72nd Congress twenty-one separate bills were introduced, reflecting the impact of the depression, and one of these was passed by the House of Representatives in 1932. In the first ten weeks of the 73rd Congress in 1933, fifteen more such bills were submitted.

In all, 150 separate proposals for deposit insurance or guaranty were made in Congress between 1886 and the establishment of the Federal Deposit Insurance Corporation in 1933. Sponsors of the bills came from thirty states in all parts of the nation, and were divided almost equally between the two major political parties.

In 1934, after establishment of the Federal Deposit Insurance Corporation, about 47 per cent of the circulating medium was protected by insurance or government guaranty. Insured deposits were protected by the Corporation, while all circulating notes, including national bank notes and Federal Reserve notes, were guaranteed by, or direct obligations of, the United States Treasury. Thus, some seven decades after establishment of the national banking system, the proportion of the circulating medium protected was at approximately the level which it had been hoped to achieve when the notes of national banks were guaranteed by the government and made the only circulating bank notes.

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II

Under a banking system chronically afflicted with bank suspensions, the hardship suffered by individual depositors or noteholders long occupied a prominent place in the minds of those attempting to improve the banking system. The rôle of bank-obligation insurance as that of the protector of the bank creditor, particularly the creditor of modest means, has been cited from the beginning. As the committee of the New York Assembly pointed out in 1829 in its report on the bill embodying this first bank-obligation insurance system:

> The loss by the insolvency of banks generally falls upon the farmer, the mechanic and the laborer, who are least acquainted with the condition of banks, and who, of all others, are most illy able either to guard against or to sustain a loss by their failure. The protection and security of this valuable portion of our population demands from us, in their favor, our most untiring exertions; and our time and talents cannot be more beneficially employed, than when we are legislating for their indemnity.[7]

Similar statements can be located with respect to every proposal for bank-obligation insurance. This is not surprising because, first, the objective is important and, second, the argument is appealing—one which would naturally be stressed in public debate.

However, it is clear from both the statements and actions of many proponents and administrators of bank-obligation insurance systems that the primary object has not been to guard the individual depositor or noteholder against loss but, instead, to restore to the community, as quickly as possible, circulating medium destroyed or made unavailable as a consequence of bank failures. In this view, bank-obligation insurance has a monetary function, and the protection of the small creditor against loss is incidental to the achievement of the primary objective.

Confusion over the objectives of bank-obligation insurance prevailed from the beginning in New York. That state's law extended insurance protection to "such portion of the debts, exclusive of the capital stock, of any of the said corporations which shall become insolvent, as shall remain unpaid."[8] Some

[7] *New York Assembly Journal,* 1829, p. 439.

[8] *An Act to create . . .,* section 4.

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understood "debts" to mean only circulating notes. Since these notes were usually widely distributed and held, for the most part, in small amounts, restriction of insurance to circulating notes suggests a limited objective while, contrariwise, the inclusion of deposits suggests the broad objective. When, in 1842, New York did in fact restrict insurance protection to circulating notes, the State Bank Commissioners declared that the legislature in 1829 intended only "to secure bank note holders, and not depositors or other creditors." [9]

Despite the commissioners' claim, there is considerable evidence that many of the leading proponents of the 1829 law had, from the beginning, viewed the legislation as a means of protecting the circulating medium and intended to cover both deposits and circulating notes. For example, James A. Hamilton, a Van Buren supporter and son of Alexander Hamilton, described the primary goals of the 1829 legislation as "the stability of the currency of the country; and, second, the security of the depositors and holders of the notes of the banks." [10] To opponents of the law in 1829, one serious drawback was the fact that it supposedly discriminated against bank stockholders in favor of "the bill holder and depositor." [11] Thus so far as the statement of the commissioners is concerned, the conclusion reached by Redlich seems correct: "The commissioners were uninformed on the history of the act." [12]

Another indication of the intended scope of the New York plan is found in the action of the New York legislature in 1837, amending the law to permit the State Comptroller to make immediate payment out of the fund to holders of the notes of failed banks so that they no longer had to wait until liquidation of assets was completed. Such an amendment was not needed, of course, if the only purpose of the Act was to reimburse creditors for losses. By following this procedure the Comptroller was able to restore the credit and facilitate the reopening of four of five distressed banks in 1837.

[9] "Annual Report of the Bank Commissioners", January 25, 1841, *New York Assembly Documents,* No. 64, pp. 16-17.

[10] James A. Hamilton, *Reminiscences* (New York, 1869), p. 82.

[11] *An Examination of some of the Provisions of the Act . . . passed April 1829,* Anonymous (New York, 1829), p. 6.

[12] Fritz Redlich, *The Molding of American Banking* (New York, 1951), I, 264.

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The experience of the Ohio insurance system throws additional light on the question of the function of insurance. Ten insured banks became *involved in serious financial difficulties during the period 1845-64. Two of these banks were found to be virtually insolvent at the time they entered the insurance* system and reorganization plans were immediately started. The first real cases to come before the insurance authorities were in 1852-54, when four banks failed and were placed in receivership. In each of these cases insured creditors (noteholders in Ohio) were paid through the insurance system. However, in 1857 the Ohio banking system suffered a severe shock, not only from the general effect of the panic of that year but in particular because one of the key bank failures in the country was that of the Ohio Life Insurance and Trust Company, the New York agency of which held the correspondent bank balances of many of the insured Ohio banks. In this situation Ohio insurance authorities rapidly devised a procedure for extending aid to the distressed banks in the form of loans. The purpose of the loans, of course, was to prevent the suspension of the banks and in this respect was completely successful, since not a single insured bank in Ohio failed during the panic or subsequent depression. It is interesting that the long-time secretary of the state bank system chose, years later, to appraise the system in the following terms: "It did what it was designed to do, furnish a safe circulating medium for the people of the State." [13]

Procedures similar to those of Ohio were also followed in Indiana and Iowa with respect to banks in financial difficulties. It seems safe to conclude that if there had been, in all four states—New York, Ohio, Indiana and Iowa—an original intention to restrict the function of insurance to reimbursing the small bank creditor against loss, that intention was substantially modified as the insurance systems gained in experience.

Controversy over the function of bank-obligation insurance was resumed with the formulation of new state plans after 1900. The United States Supreme Court, when called upon in 1911 to consider the constitutionality of the deposit insurance laws of Oklahoma, Kansas and Nebraska, distinguished clearly between the monetary function of protecting the circulating medium and the more limited objective of protecting depositors.

[13] John J. Janney, "State Bank of Ohio", *Magazine of Western History*, II (1885), 174.

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In a unanimous decision the Court held the laws constitutional precisely because they sought to achieve protection of the circulating medium. As Justice Holmes put it:

> . . . probably few would doubt that both usage and preponderant opinion give their sanction to enforcing the primary conditions of successful commerce. One of these conditions at the present time is the possibility of payment by checks drawn against bank deposits, to such an extent do checks replace currency in daily business . . . the primary object of the required assessment is not a private benefit . . . but . . . is to make the currency of checks secure, and by the same stroke to make safe the almost compulsory resort of depositors to banks as the only available means of keeping money on hand.[14]

During the Congressional debates in the early 1930's the monetary function of deposit insurance was frequently stressed. Although there were the usual statements drawing attention to the plight of individual depositors unable to protect themselves when banks failed, the deepening depression was responsible for focusing attention on the relationship between deposit insurance and protection of the circulating medium. This was perhaps best described by former Senator Robert L. Owen, who as Chairman of the Senate Banking and Currency Committee in 1913 had sought to make deposit insurance a part of the Federal Reserve Act. As a witness at House hearings on proposed deposit insurance legislation in 1932, Senator Owen stated:

> The first observation I wish to make is that 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 a far greater matter than the very important end of protecting the individual depositor or the bank from loss.[15]

The report of the House Committee on Banking and Currency accompanying the legislation creating the Federal Deposit Insurance Corporation put it this way:

[14] Noble State Bank v. Haskell (1911), 219 U. S. 111.

[15] *Hearings Before the Subcommittee of the Committee on Banking and Currency, on H. R. 11362,* U.S. House of Representatives, 72nd Cong., 1st Sess., p. 117.

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> . . . Experts advise us that more than 90 percent of the business of the Nation is conducted with bank credit or check currency. The use of bank credit has declined to the vanishing point. The public is afraid to deposit their money in the banks, and the banks are afraid to employ their deposits in the extension of bank credit for the support of trade and commerce. Businessmen and investors are victimized by the same fear. The result is curtailment of business, decline in values, idleness, unemployment, breadlines, national depression and distress. We must resume the use of bank credit if we are to find our way out of our present difficulties.[16]

It might be supposed that if protection of the circulating medium were the overriding concern of the legislators, the deposit insurance legislation would have insured all deposits, regardless of amount, and required immediate payment of depositors, whereas if protection of the small depositor against loss were of primary importance, insurance protection would have been limited to certain types of accounts (say savings accounts and personal checking accounts), with a low maximum insurance limit and payment to be made when loss was determined. Neither course was in fact followed, but action taken by Congress in 1933 strongly suggests the primacy of the monetary function.

Under the original insurance plan, slated to go into operation on June 30, 1934, insurance coverage was to apply to all types of deposit accounts, with maximum limits for each depositor which were fairly generous. Coverage was complete for the first $10,000 and applied to 75 per cent of the next $40,000 and 50 per cent of anything over $50,000. Only in the temporary plan, designed to operate for six months, was coverage restricted to $2,500 for each depositor. However, the original plan never did go into effect. After several extensions of the temporary plan, during the course of which coverage was raised to $5,000 for each depositor and it was found that this provided full coverage for more than 98 per cent of the depositors, a new permanent plan was adopted in 1935 which continued limitation of the maximum coverage to $5,000 for each depositor. At the same time, however, the Corporation received authority, of which it has since made extensive use, to protect depositors of a distressed insured bank under procedures which have the effect of protecting all deposits, regardless of amount.

[16] *Banking Act of 1933, Report to Accompany H. R. 5661,* House Report No. 150, 73rd Cong., p. 6.

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Thus the Corporation may make a loan to, or purchase assets from, a distressed bank when such loan or purchase will reduce the risk or avert a threatened loss to the Corporation and, in addition, will facilitate the merger of the distressed bank with a sound insured bank.[17]

With respect to payment to depositors, Congress required prompt payment by the Corporation under both the temporary plan and the subsequent permanent plan. This action is of importance in determining the function of deposit insurance, for, although immediate payment is helpful to depositors, it is much more important as a means of restoring to the community circulating medium destroyed or unavailable because of bank failure. If it were only a matter of protecting the depositor against loss, this could be accomplished by arranging for the Corporation to pay each depositor the difference, plus interest, between the amount of his deposit and the total amount returned to him in the form of receiver's dividends. In practice, however, insured deposits (or all deposits if the deposit assumption technique is used) are made immediately available to depositors, whether or not it appears that there will be an ultimate loss from liquidation of the bank's assets; it is the Corporation rather than the depositor which awaits the receipt of dividends from the receiver, a process which may extend over a considerable period of time.

The record supports the conclusion that the primary function of deposit insurance is, and always has been, protection of the circulating medium from the consequences of bank failures. That insurance also serves the purpose of guarding the small depositor against loss from bank failures cannot be denied, but this function is of secondary importance. Historically, erratic fluctuation in the money supply of the United States has been attributable to, or primarily attributable to, changes in the volume or effectiveness of bank reserves and to bank failures. Control over the first of these is now exercised by the central bank, while the Federal Deposit Insurance Corporation protects

[17] In 1950 the Corporation received additional authority—which it has not used as yet—authorizing it to make loans or purchases, or to place a deposit in a distressed bank, when in the opinion of the Board of Directors of the Corporation "the continued operation of such bank is essential to provide adequate banking service in the community." Federal Deposit Insurance Act, September 21, 1950, Section 13 (c).

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against destruction of the circulating medium. In each case over a century of debate and experiment was required before these instruments were devised and accepted, and it is no coincidence that a serious attempt was made to establish both a central bank and a deposit insurance system in the same Act in 1913. It is therefore of interest to note a relatively recent appraisal of the 1933 legislation in a staff report to the Board of Governors of the Federal Reserve System:

> Deposit insurance is potentially one of the more important reforms directed to greater monetary stability by the banking legislation of the 1930's. In essence, these banking reforms aimed at preventing a repetition of the wholesale destruction of the money supply that occurred during 1929-33. . . . From the individuals' standpoint, deposit insurance provides protection, within limits, against the banking hazards of deposit ownershp. But the major virtue of deposit insurance is for the Nation as a whole. By assuring the public, individuals and businesses alike, that cash in the form of bank deposits is insured up to a prescribed maximum, a major cause of instability in the Nation's money supply is removed.[18]

III

The development of bank-obligation insurance has been closely related to the banking system which has evolved in the United States. Scattered experiments with insurance prior to 1933 do not, by themselves, account for the fact that American banking has long been characterized by large numbers of small, unit banks, rather than, as in other countries, a relatively small number of banks with extensive branch systems. Yet it is not reading too much into history to say that bank-obligation insurance systems and proposals between 1829 and 1933 reflected and influenced—as did other proposals or experiments to safeguard the circulating medium—attempts to maintain a banking system composed of thousands of independent banks by alleviating one serious shortcoming of such a system: its proneness to bank suspensions, in good times and bad.

A discussion of the relative merits of unit banking and branch banking is beyond the scope of this paper. It need only be mentioned here that one of the oldest and deepest of banking controversies has been between the proponents of banks operating only one office, who hold that such a system is essen-

[18] *Federal Reserve Bulletin,* February 1950, pp. 153-54.

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tial to the maintenance of banking competition and the preservation of small banks, and the proponents of branch banking, who hold that banking stability and efficiency require multi-office institutions. The difference between these two philosophies is reflected in the bewildering variety of state laws respecting branch banking, ranging from outright prohibition of branches in some states to unrestricted state-wide branch banking in others. That the issue is still live is evidenced by the controversies over branch bank legislation which so frequently arise in the various state legislatures.

The relationship between insurance and unit banking was demonstrated in the first insurance plans. It will be recalled from discussion earlier in this paper that insurance was advocated in New York as an alternative to a plan for a state-wide branch bank system. Joshua Forman had this alternative expressly in view in 1829 when, in advocating his new plan, he stated:

> . . . the whole body of banks would constitute a kind of community something after the model of our federal union, in which each in its proper sphere would have the same freedom of action . . . they now possess . . . and a common fund for the common security, which, under the operation of the principle of inspection to prevent mismanagement . . . is on the whole a more ample security to the public than that of a general bank with branches.[19]

In Indiana it will be remembered the state constitution clearly contemplated state-wide branch banking. Instead, the insurance principle was used to provide a unit banking system, perhaps thereby shaping the future development not only of the Indiana banking structure but those of other states, notably Ohio and Iowa.

Experiments with deposit insurance after the turn of the century were, for the most part, in states which were then and still remain strong centers of unit banking. Of the 150 bills introduced in Congress, the largest number was submitted by senators or representatives from southern, southwestern, and plains states, areas generally congenial to unit banking. Over a third of the bills were submitted from four states: Oklahoma, Nebraska, Texas and Kansas, all of which are predominately unit banking states.

[19] *New York Assembly Journal,* 1829, p. 178.

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The importance of deposit insurance as a bulwark of the unit banking system was reflected in the debates early in the 1930's over federal legislation. Most striking in this regard was the testimony of the Comptroller of the Currency in 1932 in opposition to H. R. 11362, a bill to provide a guaranty fund for bank deposits.[20] The Comptroller was "unequivocally and unalterably opposed" to such legislation, primarily because it would block, in his opinion, the development of a nation-wide (or regional) system of branch banking.

> There is only one sound remedy for the country bank situation and that is a system of branch banking built up around strong city banks operating under close Government supervision. For the past three years I have in season and out of season urgently recommended such legislation. . . . Recent developments have served only to confirm me in [this] conviction. . . . Since my first report and recommendations to Congress on the small unit bank situation . . . there have been more than 4,000 additional small bank failures in the United States. . . . While, therefore, I am in agreement with the ultimate purpose of this bill, namely, greater safety to the depositor, the method proposed by the bill and the principles which I advocate stand at opposite poles. A general guaranty of bank deposits is the very antithesis of branch banking.[21]

Debate in 1933 continued to reflect the concern of champions of small unit banking. Senator Vandenberg of Michigan, a leading advocate of deposit insurance in the Senate and author of the temporary deposit insurance plan, quoted with approval editorial support of his plan, which as a part of the Senate bill was then in House-Senate conference: "Foreshadowed was an America without small banks, an America whose credit would be controlled by a few men pulling the strings from New York. . . . The Senate and House, by passing bank deposit guaranty bills, have taken the first Government action of this depression to reverse the vicious trend and save small banks." [22] In the House, Representative Steagall of Alabama, Chairman of the Banking and Currency Committee who, more than any other person in or outside of Congress, was responsible for the eventual passage of deposit insurance, was frequently called upon to deal with criticism from some members who feared the

[20] This is the bill introduced by Representative Steagall of Alabama, which was passed by the House on May 27, 1932 but died in the Senate.

[21] *Hearings Before the Subcommittee . . . on H. R. 11362,* p. 7.

[22] *Congressional Record,* vol. 77, Pt. 5, 73rd Cong., 1st Sess., p. 4429.

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new agency might discriminate against small banks.[23] At one point in the debate such charges led him to declare:

> No man is more concerned about preserving the independent community banks in the United States than I am. The same statement is true of the members of this committee, who have stood together in this House and defeated for years all efforts to undermine independent community banks. . . . This bill will preserve independent, dual banking in the United States. . . . This is what this bill is intended to do.[24]

When the 1933 legislation came out of House-Senate conference there was included a provision authorizing branch banking by national banks in states permitting branch banking. Although this provision was distasteful to the House, Representative Goldsborough of Maryland, one of the House conferees, justified it on the grounds that failure to agree by the House conference members would have endangered the deposit insurance provisions of the Act. Furthermore, he said:

> We decided that if we had a bank-deposit insurance bill it would not only tend to restore the confidence of the American people in the banks and in the business integrity of the country, but if bank deposits were insured and all the people knew that a reservoir of the assets of every bank in the United States was supporting the deposits in their bank, it would tend to restrain the tendency to branch banking. Therefore, we felt we should yield to the Senate provision.[25]

It is quite possible that the importance of the connection between the principle of deposit insurance and preservation of

[23] Such criticism came, for the most part, from those who supported deposit insurance in principle. Opposition to deposit insurance, such as it was in 1933, often reflected the attitudes of important segments of the banking industry which, through the American Bankers Association, declared themselves to be "unalterably opposed", and of some members of the new administration, including the President, who apparently were concerned over possible large losses to the government under a guaranty system. See, for example, *Congressional Record,* vol. 77, 73rd Cong., pp. 3492, 3687, 3728, 3932, 4041, 4044, 5256, 5861, 5899; *The Public Papers and Addresses of Franklin D. Roosevelt* (New York, 1938), II, 37-38; Harold L. Ickes, *The First Thousand Days, 1933-1936* (New York, 1953), p. 41. For a recent description of attitudes toward the deposit insurance legislation see Arthur M. Schlesinger, Jr., *The Coming of the New Deal* (Boston, 1959), pp. 443, 554-555.

[24] *Congressional Record,* vol. 77, 73rd Cong., p. 4033.

[25] *Ibid.,* p. 5897.

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the existing banking structure, particularly with respect to the impetus this relationship gave to the passage of deposit insurance legislation, has been overlooked. In the United States in 1933—as in New York State in 1829—public disillusionment with the independent banking system had reached a point at which fundamental change in the banking structure could easily have been obtained. Whether this would have taken the form of nation-wide branch systems, nationalization, or something different will never be known; for deposit insurance, and possibly only deposit insurance was capable of doing so, made continuation of the existing structure possible. And despite the extensive changes since 1933—particularly the rapid growth in number of branches—at the end of 1959 there were still 14,000 banks in the United States, more than 80 per cent of which were unit banks, the vast majority of small size.

IV

The many and diverse motives responsible for the passage of a particular piece of legislation are always difficult to disentangle. This is particularly so in the case of the deposit insurance legislation of 1933. Under the emergency conditions of early 1933, prolonged study of the legislation was not possible, leading some people to oppose deposit insurance for reasons which should have led them to support it, and some to support the legislation on equally unrealistic grounds. Another important factor was the character of the Banking Act itself, which contained important legislation other than the deposit insurance provisions, thus making it difficult to determine to what portion of the bill some of the comments were directed. Finally, there was the fact that deposit insurance, while immensely popular, was faced with opposition from some leading members of Congress and the Administration, with the result that the legislation which finally emerged contained provisions distasteful to some supporters of insurance.[26]

The foregoing remarks should serve as a reminder that it has not been the intention of the present paper to describe all the functions and purposes which were claimed for the deposit insurance legislation of 1933. Rather, as mentioned in the intro-

[26] One such provision was the requirement (repealed in 1939) that insured nonmember banks eventually enter the Federal Reserve System.

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ductory remarks, attention has been focused on two important purposes of the legislation which have been insufficiently emphasized: protection of circulating medium and preservation of the existing banking structure. Perhaps the recovery after 1933—and particularly the relatively small number of bank failures after that year—accounts for the fact that the legislation's major function, that of guarding communities—and the nation—against the economic shock of bank failures, has been so much neglected. The same reason may account for the fact that the difficulties in which the American banking system found itself in 1933 are seldom thought of today.

Certainly it cannot be said that deposit insurance fixed for all time the type of banking system which the nation will have. Far-reaching changes have occurred since 1933 and are still under way. Nevertheless, it is suggested here that, at one of those rare moments in history when almost anything is possible, deposit insurance was advanced and accepted as a method of controlling the economic consequences of bank failures without altering the basic structure of the banking system; it thus provided a rallying point for men formerly in disagreement and confounded in equal measure those who did not admit a need for government action and those who sought fundamental reorganization of the banking structure.

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