CONCEPT: HISTORY OF THE US BANKING SYSTEM

● The US Banking system has evolved over time, generally in response to financial crises

- □ *Prior to 1864*: Banks printed their own notes, no uniform currency and virtually no regulation
- □ *1864 – 1913*: Federally regulated national banks, uniform currency, but no central bank
  - > Money supply was not responsive to local fluctuations
  - > Rumors of insufficient currency would lead to panics and bank runs
  - > Bank panics (running out of money) and financial crises occurred once or twice per decade
- □ *Panic of 1907*: Trusts managed deposits from wealthy clients (i.e. inheritances and estates)
  - > Trusts are supposed to maintain the wealth through low-risk investments
  - > Trusts were less regulated, lower reserve requirements, thus lower cash reserves
  - > Economic boom caused trusts to begin speculating in real estate and stocks (i.e. not low-risk investment)
  - > Trusts began to suffer massive losses in their speculative investments, leading to panics in their investors
  - > Bank panics occurred, credit markets froze, stock market crashed
  - > New York's wealthiest man, JP Morgan, stepped in and stopped the panic, loaning reserves to banks
- □ *1913*: Creation of the ______________________
- □ *Great Depression*: plunging commodity prices (i.e. agricultural markets) led to bank runs in 1930, 1931, and 1933
  - > Glass-Steagall Act of 1933 created FDIC, which insured bank deposits
    - - If a bank fails, you're deposits will be reimbursed by the government (up to a certain amount)
  - > Glass-Steagall Act separated banks into two categories:
    - - ***Commercial Banks*** – depository banks that accept deposits and are FDIC-insured
    - - ***Investment Banks*** – create and trade financial assets, such as stocks and bonds, not insured
- □ *Savings and Loan Crisis of 1980s*: S&L banks took riskier investments leading to insolvency
  - > ***Savings and Loan Bank*** – depository bank specialized in issuing home loans
  - > High inflation during the 1970s led depositors to remove funds from S&L banks
    - - Rather invest in higher interest money market accounts
  - > To remain competitive, Congress eased regulation on S&L investments
  - > S&Ls were plagued with riskier real estate lending decisions and corruption from executives
  - > S&Ls failed, FDIC insurance caused government to foot the bill (approximately $124 billion)