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PROSPECTS FOR AMERICAN BANKING

By Leo T. Crowley, Chairman of the Board, Federal Deposit Insurance Corporation

Address before Forty-Seventh
Anniversary Convention of
California Bankers Association
Del Monte, California, May 26, 1938

I am very happy to meet with you today. Circumstances have prevented my accepting any of the kind invitations to address you that were extended by your officers in previous years. On this occasion, therefore, there is added to the personal pleasure of my first visit in California the privilege of discussing with you for the first time some problems of mutual interest.

The Federal Deposit Insurance Corporation has tried at all times to keep its operations and its policies matters of public interest. We believe that an informed public, particularly an informed banking public, is essential to the maintenance of a sound banking system. I have long felt that bank supervisors were far too secretive about their problems and their policies and that as a consequence bankers either lost all interest in the aims of supervision or attached to supervisory moves an air of mystery.

The Corporation has tried to eliminate this tendency. We believe that bankers and the public are entitled to complete and current knowledge of our condition and activities. At least twice a year statements of our condition and resumes of our operations are issued. These supplement the detailed historical text of our Annual Reports to Congress.

We believe further that we are responsible for keeping the public informed as to the condition of insured banks and as to the management policies which we advocate be followed. Much of the difficulty our banking system encountered during past years could have been avoided had bankers been forced currently to recognize the condition of their institutions. The records indicate that thousands of the banks which failed during recent years did so principally because supervisors had white-washed undesirable aspects of these banks' pictures and had not had the courage to require current elimination of losses and adherence to sound management principles. In the past losses following upon a bank failure fell first upon the stockholders and then upon the depositors. Today our Corporation is substituted for these disorganized groups. We intend that the unified effort and the courage which are required for the maintenance of a sound banking system, and which our Corporation can supply, shall be directed consistently toward improvement of our banks and toward elimination of the causes of bank failures and losses.

It is only by straight-forward, open discussion of our mutual problems that sound solutions may be found. I believe that from our experience, which is in reality the collective experience of all of the banks, can be demonstrated those basic principles which must underlie a sound banking structure and sound standards of banking management.

Deposit insurance came into existence because more than $3,500,000,000 of depositors' funds were dissipated during the years between 1865 and 1933. When the collapse of the system in 1933 demonstrated that public confidence in financial institutions had been destroyed, there were two alternatives open to Congress as means to its restoration. First, the banking function could have been taken out of the realm of private enterprise, all banks nationalized, and banking made a governmental function. Despite the system's weakness, it was thought inadvisable to subject it to such drastic revision at that time. Instead, the second alternative was chosen. Federal insurance of deposits was adopted as a legislative measure to restore popular confidence in the banks and to maintain that reborn confidence in the banks through progressive correction of the weaknesses in the existing system.

Now I believe that when Government assumes responsibility for the supervision of banks and for the safety of deposits, depositors have a right to expect that their insured claims shall be safe and liquid at all times. As a governmental supervisory agency, the FDIC has this responsibility. As insurer of the safety of more than $20 billion of depositors' funds, its responsibility is unique and unprecedented.

I believe further that Congress chose wisely betwee n the possible alternatives. I believe that the virtues of our system of independent banking by private enterprise outweigh its weaknesses. I believe that deposit insurance, properly administered and properly supported by bankers, can perpetuate that system. And I say that if deposit insurance does fail that failure will be due not to anything fallacious in the idea of deposit insurance, but rather to those of the system's weaknesses we are unable to correct. Confidence has been restored; it will be maintained only so long as depositors can be certain that their banks are well managed and that they are thoroughly examined and adequately supervised by governmental authorities.

The weaknesses leading to the banking system's loss record and to its complete collapse during the early thirties developed most rapidly during the period 1920 to 1929. Analysis of these factors is fairly easy in retrospect, and though such analysis will do nothing to remedy the economic waste that is now part of our history, at least it furnishes a starting point for those of us who are determined that such waste shall not occur again.

The number of operating banks in this country fell from 30,000 in 1921 to less than 15,000 in 1933. Many of the failures were due to economic developments which it was impossible to foresee. Hundreds of other institutions, fundamentally sound and in good condition, were pushed into insolvency by the unreasoning demands of panic-stricken depositors at times when those demands could be met only by liquidation at ruinous prices. Still others were banks that could be classed as unjustified or unnecessary and that had little chance for permanence on the basis of either existing or prospective facts. The moral our corporation has drawn is, of course, that extreme care must be exercised in passing upon the application of every proposed bank for a charter. Although we actually do not have the responsibility for final decision on any such applications, our power to pass upon the qualifications of new institutions for insurance has proved in most instances to be an effective check upon an unwarranted expansion of bank facilities.

Bank weaknesses contributed to the story of destruction. The period of expansion of the banking structure was so rapid that it was impossible to find trained personnel to man more than a fraction of the new institutions. Lack of experience, and lack of judgment among many of those who fancied themselves adequately prepared for the business of banking led to the acquisition of improper assets, to the unwarranted distribution of profits, and to fairly complete neglect of the rights of depositors to protection in the form of capital and reserves.

A large part of the blame for the banking system's record during the past decade must be ascribed to the unprecedented breakdown to which our whole economy was subjected. Banks joined heartily in the general feeling of optimism that led to the excesses of the boom period, and they were not exempt from effects of the deflation which followed explosion of the economic bubble. The country was quite without the machinery necessary to offset the vicious spiral of deflation and to absorb or forestall the flood of forced liquidation which so completely destroyed any semblance of true asset value during that time.

Bank supervisors themselves were not entirely without blame. The Corporation's research into bank supervision prior to the banking holiday shows that inadequate supervisory powers and lack of consistency in the application of such powers as did exist greatly weakened the effectiveness of supervision. The payment of dividends was permitted by supervisors in many instances where the funds should properly have been used to eliminate known losses. Incapable bank managers were permitted by supervisors to continue in their positions to the certain detriment of the institutions involved. Considerations of political and personal expediency frequently gave rise to inequities in the application of supervisory policies. Finally, it seems evident that proper care was not exercised in many jurisdictions with respect to the chartering of new institutions.

Deposit insurance has now been effective for more than four years. There is much talk in banking circles of appraising our accomplishments so far. I am sure that the end-product of any such appraisal will demonstrate that the FDIC has done has done much in this short time to strengthen the banking system. The Corporation and the RFC were instrumental in rehabilitating the banks with more than $1,000,000,000 of new capital. Effective control of the banking structure has become possible for the first time and the record bears witness to the success of our efforts to prune the system of its dead timber. Basic improvement in the asset and capital positions of thousands of banks has come about largely as the result of the supervisors' insistence upon remedial action. A cooperative approach to supervisory problems has been encouraged by the fact that the FDIC is an agency interested in the welfare of banks of every class in every part of the country. The National Association of Supervisors of State Banks and the Federal Deposit Insurance Corporation have worked in close cooperation and all Federal and State authorities have conscientiously attempted to raise banking standards. Examination practices have been improved and progress made in standardizing both State and Federal procedure.

Perhaps the most notable feature of the current economic situation is the excellent condition of the banking system in general as compared with its vulnerable position during previous periods of business inactivity. The past few years have seen a notable improvement in the quality of assets held by our banks. Nearly three and one-half billion dollars of bad assets have been eliminated since 1933. This house-cleaning was made possible by the injection of large amounts of new capital into our banks by the RFC and by local investors, by the revival of values, and by improved bank earnings. For the most part sound and acceptable assets have been taken into our banks to offset the growth in deposits which occurred during the past four years. Cash and due from banks at the end of 1937 constituted 28 percent of the assets of insured commercial banks of the country. United States Government securities made up another 25 percent. Bank loans appear on the whole to be sound. Only a relatively small proportion of the securities held by the banks are of low credit status.

Federal authorities and authorities in most States recognize the need for and are now exercising close control over the chartering of new banks. Some improvement in this regard is still possible, but on the whole, we have been able to attain very satisfactory results.

Supervision of our banking system involves an appreciation of the operating problems of a large number of small and medium-sized banks as well as of the few big banks. These operating problems, furthermore, vary a great deal from region to region. When talking about the banking system we must bear in mind that of the 14,000 insured banks about 13,500 have deposits of less than $10 million each. The 13,500 banks include 5,100 national banks and 8,400 State banks located throughout a large country. Only 244 national banks and 187 state banks have deposits of more than $10 million each. Effective supervision, therefore, involves an appreciation of the problems of all classes of banks and requires coordination of policies of supervisory agencies. I know that you will be pleased to hear that substantial progress has been made along this line.

From the Corporation's standpoint, the distribution of its responsibilities among the large number of small and medium-sized banks results in a spreading of risk. In the big banks we have a concentration of risk so that when one of them gets into difficulties the effects upon the Corporation and the general banking system are intensified. The 400 banks hold approximately two-thirds of the deposits of the insured banks while the 13,500 banks hold about one-third of the deposits. The Corporation's liability in the 13,500 banks amounts to slightly more than $10 billion, or 75 percent of the total deposits in those banks. About two-thirds of the insured commercial banks, more than 9,000 banks, are insured up to 80 percent or more. In the banks which we paid offi in 1937 all but 4 percent of the deposits were fully protected by insurance, security, preferment, or offsetting claims.

Our system of commercial banking, with its 15,000 constituent units, is a good system, consistent with the principles of democracy, free enterprise, and local initiative. The unit bankers' courage and foresight and interest in local development have helped to make this country great. Our system of banking has made possible the tremendous advances that have left our nation without an economic peer.

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~~Unit banking today is confronted with the growth of the multiple office banking.~~ There is a real question whether the concentration of control this type of banking makes possible is in the best interests of our business and financial structures. As insurer of the safety of deposits the Corporation believes that some limits must be placed upon the number of offices and upon the extent of control over banking resources in a given area that are permitted to any corporate entity, be it branch bank or holding company. Diversification of risk is essential to the success of any insurance plan. Too great a concentration of an area's resources in any branch bank or group violates this basic principle. We believe further that if there is to be multiple-office banking its extent should be a matter for determination in each State and the regulations adopted by a State should apply to all insured banks operating within its boundaries.

No corporate device should be permitted to accomplish by indirection what may be specifically prohibited by law. This the holding company does by permitting centralized control of large banking organizations extending over many States. The opportunities inherent in holding company structures for concentration of credit lines to related interests are likewise contrary to the spirit of banking laws which contemplate that bank credit shall be directed into many, rather than few, channels. Adequate examination and supervision of large branch banks within a State is difficult. Proper supervisory control of holding company ~~organizations operating throughout many States is almost impossible.~~

All of our plans for the future of the banking system rest upon the fundamental proposition that neither legislation nor supervision can ever replace good bank management. Under no circumstances do we aspire to run the country's banks. Our function is rather one of counsellor and friendly critic; our aim is the achievement of needed reforms by the voluntary action of enlightened bank managers.

so that exercise of our police power will be necessary only in the few cases where managers either fail to recognize or openly neglect their primary responsibility, the safety of depositor's funds.

It will continue to be essential that supervisors formulate their policies on a long-range basis and that these policies be administered consistently and courageously. If the Corporation is permitted to go ahead with its program, plugging steadily away at its objectives and taking its losses as they arise, improvement of the banking system can be expected to proceed rapidly. The existence of deposit insurance, the recent rehabilitation of bank capital, and the fact that the vast majority of banks are in excellent financial condition make it desirable to keep moving aggressively toward our goal.

Among the principal objectives we have set with respect to "going institutions" are the improvement of both the ability and the conscience of bank management, progressive improvement of bank assets, proper provision for depreciation and losses, and building an adequate capital cushion.

The chief danger to consumption of our program of progressive improvement of bank assets lies in the speculative tendencies of a sizable minority of bankers. It will be recalled that during the early part of 1937 the Corporation warned repeatedly against the dangers of speculation in medium and low-grade securities with a view toward taking profits on a rising market. I believe that subsequent events have proved the timeliness of that warning. We have likewise emphasized on many occasions that trading in and out of the securities market is absolutely inconsistent with the investment function of a bank. I should like here to stress that this rule applies just as much to large institutions as it does to small banks. No matter what the size of an institution its securities should be bought from the investment point of view, to be held to maturity. The basic principle of any investment policy should be that safety of principal and certainty of income are the factors to be sought. We maintain that shifts in bank security holdings should be made for one purpose only; namely: To improve the quality of the bank's portfolio.

Fortunately, most bankers realize the necessity for conservative management at their portfolios. These men, who have been guided by the accepted principles of institutional investment, should find no cause for alarm in temporary market drops. Most of the current concern about the effect upon banks or recent drops in bond prices is unwarranged. The Corporation is not concerned about and does not criticize market depreciation in securities of investment quality. Market depreciation of securities bought for investment, with a credit standing that indicates payment at par at maturity and continuity of interest payments, is of no practical significance in a well-run bank.

It should not be necessary to remind bankers of the necessity for current provision against depreciation and losses. Unfortunately, this basic principle of bank management is either unknown or ignored in some banks. I mentioned earlier the important part played by accumulated losses and depreciation in precipitating bank failures. This fact makes understandable the Corporation's insistence upon regular and reasonable allowances for depreciation of fixed assets, upon the necessity for eliminating known losses as they arise, and, particularly, upon the shortsightedness of considering as earnings available for dividends profits which are realized through the sale of assets. There can be no quarrel with those principles. They are among the very fundamentals of business and banking management and they must be observed.

The Corporation's campaign for an adequate capital cushion in each insured bank has been opposed on a number of varied grounds. This objective from the Corporation's point of view is inseparable from our primary concern, the safety of depositors' funds. If depositors, and in their stead, the Corporation are to be assured payment at par of the banks' contractual obligations, the banks' capital accounts must represent cushions sufficiently large to absorb fluctuations in value which are likely to occur during the normal run of the business cycle. As of a given moment some allowances can be made for the quality of assets of an individual institution in measuring the adequacy of its capital. Quality, however, is subject to change. The Corporation cannot ignore the fact that the make-up of a bank's assets can readily and rapidly be changed. Considerations of safety require that quality be used as a complement of adequate capital rather than as a substitute.

The Corporation has so far been called upon to aid the depositors of 213 insolvent insured banks. More than $110,000,000 or 92 percent, of the $119,000,000 of deposits in these banks was made almost immediately available to depositors, and only 675, or one-sixth of one percent of the 413,000 depositors were not fully protected.

The Corporation has over $289 million of capital stock and its surplus has now passed the $100,000,000 mark. Our annual income is now about $49,000,000 of which about $40,000,000 was carried to surplus in 1937.

As a matter of fact, the financial aspects of the Corporation must be viewed in the light of its functions. Congress has given us a job to do -- preventing losses to depositors of insured banks. Fulfillment of that task will depend upon our success in strengthening the banking system through elimination of hazardous units and through improvement of going banks. Neither the accomplishment of the job nor the means to its accomplishment can properly be measured in dollars and cents. If we can do our work and do it in an orderly fashion, taking our losses currently, deposit insurance will succeed, and at a nominal cost.

It is true that accomplishment of our purpose will require adequate powers of control and supervision over insured institutions as well as capable administration of those powers. There can be no quarrel, however, with granting the requisite powers, since they are indispensable to a permanently sound banking system. Further, the self interest of banks, based upon their sizable financial investment if not upon more social considerations, will lead them to insist upon proper administration of the Corporation's duties and privileges.

There has been no attempt by the Corporation to usurp States' rights in furthering any aspect of its program. What has been achieved by way of strengthening the banking system has come about as the result of thorough cooperation between the Federal agencies and State supervisors and between these agencies and bankers. State supervisors and State bankers realize that we favor continuation of the dual system, and these men have done much to pur State banking systems on a sounder basis. Revision of State laws has been undertaken to raise the operating standards of State banks. Supervisors and bankers have joined in the development of uniform examination and report policies and procedures. The working out of problem cases has been the joint task of the Corporation and the supervisor concerned. The greatly strengthened position of most banks and the progressive elimination of weakened institutions show what can be accomplished by cooperative effort.

The prospects for American banking, then, seem to me to depend entirely upon our faithful adherence to a few fundamental concepts. If preservation of a strong unit system is our goal, let the next step be definition of our responsibilities. These I summarized earlier when I said that the confidence of our people in the soundness of the banks depended upon their certainty that the banks were competently managed and thoroughly and consistently supervised.

The bankers responsibility is only partly met by adequate handling of the problems of his institution. That is, of course, the logical and the indispensable starting point. But the soundness of the system requires an awareness of the interdependence of the thousands of units and the cooperative application of individual abilities to the problems of all banks. "Come, let us counsel together," has been the keynote of many recent bankers' meetings and in that phrase is expressed what I believe to be the proper approach to fulfillment of the bankers' communal responsibility.

My views on what supervisory authorities must do to meet their share of the responsibility for preservation of our banking system have been stated on many occasions. Thoroughness, impartiality, and consistency -- these are and must always be the ingredients of effective supervision. I have stated that nothing revolutionary is embodied in the Corporation's supervisory program. We ask nothing but the observance of basic banking axioms.

There has been developed, as the indispensable fact-finding tool of supervision, the procedure known as bank examination. The Corporation's examining policies have been framed with a view to obtaining a complete and an accurate picture of the condition of each bank, its management and its prospects. The policies give due regard to the rights of all interested parties: depositors, stockholders, and borrowers. They have been designed to apply in all banks, in all parts of the country, at any stage of the business cycle. It is my belief that examination policies and standards should characterize every report of examination, no matter what its date nor to whom it is addressed.

From time to time during my remarks this morning I have drawn certain distinctions between large banks and small banks. May I here point out that all of my distinctions had to do with immediate rather than with ultimate problems. Basically, and from the long-range point of view, what holds for banks of one size is equally true for those of any other size. There have been countless evidences of the inter-dependence of our rural and urban institutions. The well defined path of failures from rural areas to Wall Street during previous periods of crisis will serve as an example. Possibly, as has been claimed upon occasion, the metropolitan banks are not their country cousins' keepers. Experience has demonstrated, however, that the converse is true and that the health of large banks depends in astonishing measure upon the well-being of country banks. We all would benefit from a more general realization of this fact. We must look past the four walls of our own bank and admit that the problems of all banks are our problems and that the combined effort of all concerned will be required for their satisfactory solution.

I know that our operating record and the rate at which the Corporation's resources are growing leads bankers to ask when they can expect adjustments of some of the items now making up our assessment base, and perhaps, a reduction in the rate of assessment. I think it likely that certain of the moot points, such as duplicate payment upon deposits of certain types, can be eliminated in the very near future. As to a reduction in rate, however, an answer in terms of months or years cannot be given as yet. _If_ the Corporation can proceed steadily with the program I have outlined and _if_ bankers will support our efforts and continue to improve the position of their own institutions, I believe that our reserves will, within a few years, have reached a point where a reduced annual assessment will permit us to take care of current requirements.

There can be no retreat -- no compromise with conscience or responsibilities on the part of bankers and no slackening of the supervisory standards which have been so instrumental in building the sound foundation upon which the system now stands. I offer to you my assurance that the Federal Deposit Insurance Corporation will continue to build for the future. I ask in return a continuance of your efforts to make materialize the truly golden prospects for American banking.