

# NEWS RELEASE



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## THE ROLE OF THE FDIC IN THE BANKING SYSTEM

Address of

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Washington, D. C.

at the

ANNUAL CONVENTION

of the

NATIONAL ASSOCIATION OF BANK AUDITORS AND CONTROLLERS

at

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## THE ROLE OF THE FDIC IN THE BANKING SYSTEM

Banking is a tremendous industry in the United States. All who participate in banking may be justifiably proud of the tangible evidence of progress over the past decade. Few other industries can make a like showing of growth in size, improvement in services to the public, and progress in adopting new and more efficient methods of doing business.

As members of the National Association of Bank Auditors and Controllars, I know that you are as impressed as I am with the totals showing the amount of resources in our banking system. By the end of this year, assets of all banks may well exceed \$340 billion. Almost 98 percent of bank assets are in banks insured by the Federal Deposit Insurance Corporation.

Growth trends in banking over the past decade are fully as impressive a dimension of the industry as are present aggregates. Looking back to 1952, the total resources of the entire banking system have increased at an average rate of a little over 4 percent a year.

The volume of checks handled by the banking system is almost beyond comprehension. Last year check clearings totaled over \$3 trillion, approximately twice the volume in 1952. As bank auditors and controllers, I know you are particularly interested in this measure of the services your individual institutions furnish to the general business community.

Banks employ more people now than they ever have before. The total is rapidly approaching 700,000, a half more than ten years ago. This, as you well know, has occurred during a period when banks have turned increasingly to the use of electronic and other equipment that increases efficiency and sometimes completely supplants human effort. That employment has increased substantially during this time is a further measure of banks' ability to turn burdens into opportunities for service.

The banking industry now stands on the threshold of very great developments. With only a little imagination, we can look forward to a banking industry with total resources of \$500 to \$550 billion in another ten years, a total well within the round of reasonable achievement.

Now you may very well ask why I feel so confident of continued growth in banking. My own experience in this industry has convinced me that the dual system of free enterprise banking is one of great vitality. In this system, the individual banker is accorded a maximum opportunity to exercise his initiative to serve the needs of his customers. Ability to choose between State laws and federal laws affords the banker the opportunity to obtain a charter to do business under conditions most suitable to his circumstances and objectives. Stockholders may elect to go either State or national, choosing the arrangements most suitable to their particular situation. Legislation enacted in the years following the Great Depression of the early 1930's, including the federal deposit

insurance law, corrected many of the shortcomings that troubled the banking system during its earlier years. This banking legislation together with the Employment Act of 1946 provides a sound basis for continuing progress.

Since the Federal Deposit Insurance Corporation was established in 1933 a new generation has grown up regarding it as a timeless fixture of our economic system. Yet, in the annals of history, the idea that it embodies is a comparative novelty, and its manifestation in the Federal Deposit Insurance Corporation marks it as a unique institution. During my recent attendance at the International Banking Summer School meeting in Moscow, I was again struck by the fact that until very recently no other nation had an institution comparable to the Federal Deposit Insurance Corporation.

At the beginning of this year India established a system of deposit insurance patterned after our own Federal Deposit Insurance Corporation. It is a nation-wide system covering some 2,000 banking organizations, and insures deposits up to 1,500 rupees, or at present exchange rates, about \$315 for each account. Nearly 90 percent of the accounts of the insured banks are fully covered under this limitation. The Deputy Governor of the Bank of India has told me that the reaction to the deposit insurance system among the Indian people has been most favorable.

The uniqueness of deposit insurance poses some interesting questions. Why was it necessary to inaugurate deposit insurance in the

United States? It seemed to me that an institution that functioned like our Corporation would have emerged in the older and more mature banking systems of Western Europe. Why is there no counterpart of the FDIC in those countries?

As I pondered these questions, the answers seemed to lie in the Corporation's specific and apt reconciliation of two conflicting goals entrenched in our economic and political system. On the one hand, we earnestly want freedom to follow our heart's desire; and on the other, we want security against the excesses which freedom brings. The American banking system reflects these twin goals in a remarkable number of ways, and the Corporation has become an indispensable instrument for cushioning the blows that imprudent or excessive freedom could deal to an individual's security.

If one common denominator can be found for the differences which exist between our banking system and the banking systems in other countries, it is the degree of concentration of organization and responsibility. This concentration may be expressed in a few large banks with hundreds of branches, as in Canada; in nationalization of the largest banks, as in France; or in the government's operation of a variety of "so-called" banks, as in the Soviet Union. Other countries, such as Japan and Italy, show less pyramiding of their banking structures. But no country approaches the United States in the diffusion of its banking system into a large number of independent units, separate not only from each other but also subject to various laws and regulations.

It is no mere coincidence that the development of free banking in this country has been paralleled by the development of institutions designed to protect banking creditors from the errors and abuses of freedom. The protection, it is true, has been intermittent and not always as complete as might be desired. But starting with a State guaranty system in New York State in 1829, several States adopted similar programs during the next 100 years aimed at protecting note-holders and depositors from the ravages of bank failures. The Federal Deposit Insurance Corporation is the culmination of this concern for the safety of bank creditors and, in its larger dimension, the preservation of our money system, whose protection should indeed be on a nation-wide basis.

These considerations suggest to me that there is a significant relationship between our nation's multiplicity of independent banking units and the existence of the Corporation. Where banking is centralized and freedom circumscribed, there is less need for any agency such as the Federal Deposit Insurance Corporation. But where the banking system consists of thousands of relatively small banks devoted to serving a variety of needs, observing diverse standards of operation, and subject to different jurisdictions and regulations, the risks are different and perhaps greater. Indeed, a minimum number of failures may be expected, as the banks respond to demands for loans which may turn out to have been imprudent, or where weak management is manifest, or defalcations occur. However, such occasions are the price of progress, as our economy moves ahead. It is here that insurance plays its vital role, permitting the

innovators and imaginative management--yes, along with the embezzlers--to function within a framework that shields the innocent from the mistakes of others.

The Federal Deposit Insurance Corporation is now in its 29th year of operation. During that time nearly a million-and-a-half depositors in 445 insured banks have required its financial help. Their numbers would undoubtedly have been greater had there been no FDIC, and will no doubt increase in the years to come, a prospect that we in the Corporation must be ever ready to meet, even though failures have been relatively few in the last several years. For it is only as federal deposit insurance plays its ordained role that our banking system can retain its individual and splendid character.

We cannot afford, however, to be content with our accomplishments. For the banking industry, being a dynamic one, reflects a convergence of many developments seeking new adaptations of its varied and sometimes conflicting currents of interest. Recognizing these developments, several months ago the President of the United States formed a Committee on Financial Institutions to review the legislation and administrative practices pertaining to commercial banks and other financial intermediaries. As Chairman of the Federal Deposit Insurance Corporation, I was designated to participate in the deliberations of this Committee, and you may be assured that I have taken this responsibility most seriously. The scope of the Committee's work concerns aspects of banking that have been of lifetime concern to me. Within the next two or three months, it is quite likely that the final results of this Committee's efforts will be made available to the public.

Irrespective of whether our frame of reference is the art of banking or the practice of bank supervision, obsolete legislation and outmoded methods should be identified and corrected. From time to time in the past thirty years, questions have been voiced concerning the diffusion of bank supervisory authority between State and federal agencies, as well as among the federal bank supervisors. Once again these questions are a leading subject of discussion. The complexities of the interstate and the State-federal relationship cannot, of course, be resolved by unilateral action at the federal level. However, the diffusion of authority among the federal agencies, now the subject of varied proposals, will no doubt soon enlist the attention of the United States Congress.

As we appraise the relative merits of the various legislative proposals in the field of banking and bank supervision that will appear in the years ahead, definite guiding principles will be needed. Based upon my own studies of the problems, I have formulated an approach which, I believe, has broad applicability. Let me share these guide lines with you: (1) The right to examine a bank is a corollary of the right to charter, and the examining power of a chartering agency should be restricted to banks which it charters; (2) An insurer has an obligation to examine its risks and to select or reject them for sound reasons; (3) The chartering and the insuring functions should be vested in separate and distinct instrumentalities; (4) The bank chartering authority is properly located in the executive departments of the respective State and federal governments; (5) The insurer is an agent of the Congress, and should be administered by a Board or Commission in accordance with

such agency relationships; (6) The cost of deposit insurance, including related examinations, is properly borne by the insured.

Most, but not all, of these principles are embodied in the present supervisory structure. The first two principles, which concern correspondence between the chartering and examining functions, are the ones which are conspicuously short of fulfilment. It was to this area that I directed some suggestions a month or so ago. To recapitulate briefly, I suggested at that time that the FDIC examine once a year all banks whose deposits it insures; that the Comptroller of the Currency reduce his examinations of national banks to one a year, and exchange alternate examination reports with the FDIC; and that the Federal Reserve System be relieved of responsibility for the regular examination of State-chartered member banks, but have access to reports made by the other examining authorities.

These suggestions do not go as far as some advocates of change in present arrangements would like. They are conservative in the sense that they contemplate no changes just for the sake of change, but seek instead only to erase a few rather obvious defects. Certainly we should not be hasty in up-setting arrangements under which our banking system has made the kind of progress I mentioned at the beginning of my remarks. In the States, experience with banking dates back to colonial times. Beginning with the Bank of the United States, the federal government has had 170 years of experience in chartering banks. Next year we shall celebrate the centennial of our national banking system. By then experience with

the Federal Reserve System will have attained 50 years, and federal deposit insurance will reach its 30th birthday.

Taking the long view of this history, it is hard to become convinced that progress would have been possible if banking and bank supervision were afflicted with all the infirmities ascribed to them by the critics. As bankers, you are accustomed to test propositions with the question, "Does it work?" The only reasonable answer to that question, if the progress and prognosis of banking is the criterion, is a resounding affirmative.

Beyond the question, "Does it work?" lies the more difficult question, "Why does it work?" There are so many answers to that question that one could never be certain he had listed them all. To mention only a few does not preclude the existence of others.

Fundamental to the operation of the present supervisory structure is its embodiment of arrangements for maintaining a separation between incompatible functions--as dictated by principles of organization and management. Separation of bank chartering and the insurance of deposits is a good example. Procedural agreements covering relationships among the several agencies, both State and federal, which have a mutual interest in particular problems have been developed to cover most areas of potential conflict. Motivated by a spirit of cooperation, these agencies have succeeded in making the present structure function reasonably well.

These cooperative efforts have cemented together separate provisions of State and federal law into a truly unified structure. The cooperation and coordination of efforts has been achieved without legal

fiat; it has been the result of efforts by bankers and bank supervisors to make the legal arrangements work in actual practice. To illustrate, the Federal Deposit Insurance Corporation has assisted the States in drafting regulations and legislation; also it has furnished leadership in the development of uniform operating procedures. Within this area of voluntary cooperation considerable further progress is possible.

The working relationship of the FDIC with the several State bank supervisory authorities is a happy illustration of what can be accomplished in areas of potential overlap and conflict. Here we have an instance of the chartering agency and the insuring agency carrying out their separate responsibilities in an atmosphere of cooperation. My suggestion that the Corporation and the Comptroller of the Currency alternate in their examination of national banks entails no more than extending our experience with the States to the federal level.

You may wonder about my reason for insisting upon continued structural separation of the chartering and insuring functions. It is my belief that amalgamation of these functions within an agency would tend to force diverse approaches to supervision and examination into a single mold. Owing to the complexities of banking, there is need for the combined wisdom that stems from different viewpoints.

Finally, let me sound a note of warning that the suggestions which combine in a federal chartering authority the power to examine not only the banks so chartered but also banks chartered by State

authorities are proceeding on doubtful grounds. It is only natural to expect that a chartering authority will seek to foster the type of banking enterprise it has the power to create. By limiting bank examination powers of State and federal chartering authorities to their respective orbits, many problems could be averted. Furthermore, the varied economic and geographic needs of the nation are best served by a flexible banking system. One of the great virtues of the dual banking system is its recognition that chartering arrangements well adapted to one part of the country would be quite inappropriate in other sections.

The question of supervisory relationships is only one of many questions now confronting the financial community. Other matters, not touched on here, deserve our earnest attention. Developments in business financing and growth of other financial institutions have begun to challenge the preeminent position of banks in certain fields. Equitable taxation of financial institutions continues to be a problem. Appropriate regulation of holding companies and bank mergers is a matter that needs some consensus of understanding. In these and other problem areas we must maintain an open mind as we seek to find and consolidate areas of agreement.

The most immediate opportunity seems to lie in the area of correcting some recognized defects in the structure of bank supervision. With a determined effort on the part of all of us, I am confident that real improvement will come out of the many suggestions now under study. We have before us the prospect of welding the existing structure into a modern and powerful tool better able to serve the forces of growth inherent in our banking system.