NEWS RELEASE

FEDERAL DEPOSIT INSURANCE CORPORATION
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FOR RELEASE AT 10:00 P.M. OR THEREAFTER
Saturday, May 25, 1963

Remarks of

ERLE COCKE, SR., CHAIRMAN

FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D. C.

before the

RIO GRANDE VALLEY BANKERS ASSOCIATION

at

Mercedes, Texas

Saturday evening, May 25, 1963

REMARKS OF ERLE COCKE, SR., CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, BEFORE THE RIO GRANDE VALLEY BANKERS ASSOCIATION AT MERCEDES, TEXAS, SATURDAY, MAY 25, 1963.

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Next month, on June 16, the Federal Deposit Insurance Corporation will observe two important milestones. We will celebrate the 30th anniversary of the signing of the Act which established the Corporation, and we will dedicate the new building which will house the Corporation.

We are proud of that building. It symbolizes the strength and durability of the Corporation and its great benefit to the banking industry since President Franklin Roosevelt signed such legislation 30 years ago, on June 16, 1933.

But the building symbolizes more than the growth of the Corporation. It stands for the Corporation's aid in building the strengths of the banking industry. We would like for the public, government officials, and particularly bankers, to think of the building as their own, and come to see us when they are in Washington. We greatly appreciate banker visits to us in Washington on particular business or when in town on other matters.

The Corporation was designed to serve the public through service to and with bankers. Throughout the Corporation's almost 30 years of operation, it has devoted every effort to give the best possible service to the banking industry, and through banking, to the public.

One of those efforts to give the best possible service has led to continued study and analysis of the Corporation's insurance contract with insured banks. We believe that we are obligated to give the best possible protection at the lowest possible cost, consistent with safety, as any other insurer would.

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For that reason we have continuously examined the insurance program, aiming at providing either reduced costs or greater coverage, commensurate with our duty to maintain the adequacy of the insurance fund.

As you all know, the adequacy of the fund must be our first consideration. That fund is not owned by the Government, and it is not owned by the bankers which pay assessments to the Corporation. It is, instead, a fiduciary trust for depositors of insured banks, and as such, we believe that those depositors should be given the greatest possible coverage consistent with sound operation of the banking system and of the Corporation itself.

During the history of the Corporation, the ceiling on deposit insurance protection has moved from $2,500 to $10,000, with an increase to $5,000 on July 1, 1934, and to the present level in 1950. During the same period the basic assessment rate for insured banks has remained unchanged at 1/12 of 1%. However, upon recommendation of the Corporation, the effective assessment was reduced in 1950 by statutory provision of the Congress for credit of 60% of assessment income after deduction of insurance losses and expenses, and in 1960 this credit was increased to 66 2/3%. With these credits, the rate of assessment on insured banks has been reduced to an effective rate of 1/27 of 1% in 1950, and, in 1962, to 1/32 of 1%, after a refund to banks of 62.4% of total assessments for the year, or $126.9 million.

Given the experience of the Corporation, and the general trend of the economy, we recommended to the present Congress that the insurance level be increased to $25,000. Hearings were held before the House Banking and Currency Committee late in April, and that committee is now considering several identical bills to increase the limit.

The Corporation's recommendation came after long study and a complete

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analysis of the insurance fund. We considered the loss experience of the Corporation--which, parenthetically, I might say we feel is quite good--and the cost of any increase to the Corporation, with the paramount thought in mind that there would not be any increase in cost whatever to the banks insured by the Corporation.

Since its establishment the Corporation has made disbursements of $359.7 million in connection with 445 insured banks in financial difficulty. Estimated recoveries as of December 31, 1962, were at $329.2 million, resulting in an indicated loss of $30.5 million. Additionally, the Corporation has collected $9.0 million of interest and allowable return on the funds advanced in 159 of the 445 cases cited, reducing the potential loss to approximately $21.5 million.

In projecting the cost of an increase, we used the experience of the past decade. We felt the 1930's could not be used because that period reflected the excesses indulged in prior to the banking holiday, and the 1940's showed a history dominated by World War II and price controls. Throughout those years bank loan portfolios were declining while security portfolios were enlarging, and the loss experience due to bank failures was subnormal.

The past decade, on the other hand, seemed to us to be much more likely to be akin to the period through 1971 than any other period of the Corporation's existence.

We worked out figures, based on projected deposit increase to $436,910 million as of December 31, 1971, and projected loss experience, expenses, and income from assessments and operations, for that period.

For example, the lessening of the accrual to the insurance fund through

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December 31, 1971, would be $244,000 with a $15,000 ceiling; $360,000 with a $20,000 ceiling; and $445,000 with a $25,000 ceiling. This is an average annual decrease in accrual ranging from $24,400 at $15,000 coverage to only $44,500 at $25,000 coverage.

Expressed as a ratio of the insurance fund to total deposits, the figures show even more dramatically. On December 31, 1961, the fund was $2,353,794,000, for a ratio to total deposits of .84%. Assuming no change in insurance coverage ($10,000), the projection to the end of 1971 gives a percentage of .96196%, and a dollar amount of $4,202,902,000.

Even with an increase in insurance coverage to $25,000, the ratio would be increased to .96185%, or only 11/1000ths of 1% less than would accrue at the $10,000 level. Expressed in dollar amounts, at the higher insurance level the fund would be at $4,202,457,000 by the end of 1971, or again, $44,500 less per annum than at the present level.

We wanted to be doubly sure, however, that our figures allowed for any contingency. So we went back and refigured the accruals to the fund through 1971, based on the $25,000 ceiling, if the Corporation's loss experience was four times as great as the 1952-1961 period, and we found that even that loss ratio would affect the fund only minutely. We found it would be reduced to .95782%, a reduction of a mere 47/1000ths of 1%.

Some bankers have asked why we cannot reduce assessments if we are able to increase the coverage without any added cost to the banks -- and I want to stress that the proposed increase would not cost insured banks one penny.

Our major consideration, of course, must be to the adequacy of our fund. Efforts have been made to determine actuarially what size the fund should

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be. Discussions with out-of-government actuaries as well as the General Accounting Office of the Federal Government have been most helpful.

Our experience and studies at the Corporation, however, plus the data that the Corporation has been able to collect and analyze, lead to the conclusion that a deposit insurance fund of 1% of deposits of insured banks is the smallest that should be considered adequate. That ratio now stands at .84%, and, based on current assessment ratios and our projections of income and losses, should reach .96185% by the end of 1971, even with $25,000 coverage.

We do not believe that a further reduction in assessments is actuarially sound at the present time, though we continue to consider this possibility, and I would hope that in the future, when the fund is near or at 1%, reductions will be possible.

Let me add I never would be in favor of eliminating assessments entirely. No matter how large the fund gets, the banks should always contribute something, if only to maintain their interest in the Corporation and their present ties to the Corporation. Even a $1 assessment would still keep the banks partners in the fund.

I might point out also that our major concern in recommending an increase in coverage is to fulfill our duties to the general public, as custodians of a fiduciary trust. We should provide them the best possible coverage which is sound and feasible.

Our proposed increase would help do this. For example, under present coverage it is estimated that 98.2% of the accounts of all depositors are fully insured. At $25,000, this would be increased to 99.4% of the accounts of all depositors. This may seem a small percentage increase, but when it is broken

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down into numbers of accounts, it is not. It represents an estimated 1,921,000 additional accounts which would be covered completely, while increasing from 58.93% to 66.82% the amount of covered deposits in dollars.

Some bankers feel that an increase to $25,000 protection may benefit savings and loan associations more than banks because of the rate competition from savings and loan associations. There are two reasons why we at the Corporation would disagree with this feeling.

In the first place, the rate differentials have been shrinking over the past year or two. In 1962, when banks were authorized to pay up to 4% in interest, banks reported a time and savings gain of 18% while savings and loan share accounts went up only 14%, the first time in many years that commercial banks gained at a greater rate than the savings and loans, as well as mutual savings banks. It is notable that during the last 10 to 15 years, the spread ranged from ½% to as much as 1½%, but since January 1, 1962, it has been reduced to not more than .85%, and considerably less in certain large areas, in the case of 12-month time certificates, with other rates in proportion. The extreme top rates on the West Coast are more confusing than informative when the whole country is being evaluated.

In the second place, official announcements of the Federal Home Loan Bank Board in recent days have urged immediate consideration to further reductions in dividends, and numerous associations all over the nation have responded with announcements of lower dividend rates. This clearly suggest a continuing trend to a lesser spread in the rate structures of commercial banks and savings and loan associations.

Another suggestion advanced by some bankers is that an increase in

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deposit insurance levels will lead somehow to bad banking practices and laxity. This repeats a prophesy made in 1933, when opposing any insurance whatsoever, and repeated in 1950 when the insurance level went from $5,000 to $10,000. As you all know, it didn't happen either time. Nor do we think it will this time.

Actually, bank managements have materially improved over the 30 years during which the Corporation has been in existence. It is acknowledged that the Corporation restored and helps maintain the confidence of the public in the nation's banking system.

We can, I think, go further, and say that the Federal Deposit Insurance Corporation has made bankers confident in themselves. Bankers no longer need hoard cash in emergency conditions which prevailed before deposit insurance came into being. They no longer need to tighten up on new loans in order to maintain liquidity to meet possible runs. The public knows that the Federal Deposit Insurance Corporation stands behind the insured bank, and the public does not fear for its funds. As a result, bankers can continue with confidence to support their communities and allow loans to remain on the books. Further, they can continue, when the clouds darken in the economic skies, to make loans to worthy applicants and serve the credit needs of their areas. As a result, the old tendency to dry up funds in a period of crisis and thus accelerate the crisis has disappeared. This is one reason why levelling-off periods since 1951 have not deepened into deep recession or depression.

Another reason why we do not feel that an increase in coverage will lead to lax bank management is that insurance will not cover all deposits. There will remain in the insured bank system a large amount of uninsured funds, and prudent bank management must consider all funds in their operation.

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Presently, of the approximately $300 billion in deposits in insured banks, some $125 billion is uninsured. With an increase in coverage to $25,000 and an estimated deposit total by the end of 1971 of $450 billion, some $150 billion, or one-third of all deposits, would be uninsured.

Without question this tremendous volume of uninsured deposits would act as one factor in requiring sound and prudent bank management.

Other factors also can be cited. The prudent bank manager must remember that he has stockholders, to whom he must account, and for whom he must earn an adequate income while preserving the safety and soundness of their investments. The prudent manager, if he is to attract the public's funds, must run an institution which maintains the public's respect and trust. The prudent manager, if he wishes to preserve for himself the benefits of his position in his industry and community, will want to maintain a sound institution. And finally, the prudent, sound manager must satisfy the supervisory authorities, including the Federal Deposit Insurance Corporation, other Federal agencies, and, when applicable, state authorities.

None of these factors can be ignored, and all of them require that a bank manager run a prudent, sound, community-oriented, profit-minded, and stable institution.

In outlining a few of the things that we feel an increase in insurance coverage will not do--such as give savings and loan associations an "edge" or the possibility that bank management might tend to become lax--I have in a sense outlined some of the reasons why we are for the increase and why we feel it can be justified.

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More positively, we at the Corporation feel that the increase is justified because it will bring an added element of strength to the national economy by strengthening the monetary structure and encouraging the placement of more funds in insured institutions, creating greater pools of lendable capital.

This would be particularly effective in the manner in which it would help any community where a bank closed, by making a greater amount of funds available promptly through payment of insured funds up to $25,000. The additional liquidity of the monetary structure in such a town would cushion the shock and enable the town to recover from the blow of a closed bank all the more quickly. This would be especially true of the small and medium sized businessman, to whom the loss of even a portion of his working capital for any period of time can spell the difference between continued operation and failure.

I might add that it will be helpful to banking institutions as well, in that those institutions would be able to retain more local funds in most instances.

Too many people forget that there are, as of June 30, 1962, 7,745 one-bank-office towns in the United States, where the local institution must provide all the financial services that the community is to get. If these one-bank-office towns are to retain funds within the community, they must be placed with the bank in the community. With a $10,000 ceiling, many businessmen and depositors may place funds elsewhere when they have reached the ceiling, thus sending out of the community and its economic bloodstream much needed funds. The proposal to increase coverage to $25,000 would be of inestimable assistance to such institutions, and to the communities they serve, by allowing the retention of two-and-a-half times as much in a single account on an insured basis.

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In such communities as this it is not a question of consolidating accounts which may be partially located across the street, thus leading to inter-bank shifts with no positive advantage to the community. In such one-bank-office communities it is a matter of concentrating in the community as much of the funds as possible which are generated within the community, and which represent the community's financial well-being.

In arguing for the extension of insurance coverage, I might point to one final factor, the strengths that the Federal Deposit Insurance Corporation adds to the dual banking system.

It is no coincidence that the development of free banking in this country has been paralleled by the development of institutions designed to protect bank creditors from the errors and abuses of freedom. The Federal Deposit Insurance Corporation is the culmination of this concern for depositors, and, as I outlined earlier, the capstone in assuring public confidence in our banking system.

So long as this confidence continues, and the Federal Deposit Insurance Corporation is there to assure it, the public will continue to hold its trust in the multiplicity of individual banking units and systems of banking control, including state-chartered systems and the national banking systems. It is no accident that such systems have continued to flourish.

We at the Corporation feel an increase in insurance coverage to $25,000 is both justified, and feasible. We feel that now is the time to strengthen, and extend, the "shield" which is the Federal Deposit Insurance Corporation.

In short, we have four recommendations:

First, we support the results of our nearly thirty years' study on

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the feasibility of an increase in deposit insurance coverage.

Second, we support the ten bills introduced to increase to $25,000 insurance coverage, bills introduced by Chairman of the House Banking and Currency Committee and others, plus identical bills before the Senate.

Third, we approve fully the conclusions of the Committee on Financial Institutions supporting a deposit insurance increase.

And fourth, we support the Administration program, as outlined to us by the Bureau of the Budget. That program, as you may know, urges that legislation to increase coverage on deposits and savings share accounts should also include provisions for additional safeguards for the insuring institutions, including adequate requirements on reserves and liquidity, standby authority over maximum interest and dividend rates, and strengthened conflict of interest provisions.

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