FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON 25

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FEDERAL DEPOSIT INSURANCE CORPORATION
FORTY-SIXTH ANNUAL CONFERENCE
NATIONAL ASSOCIATION OF STATE BANK SUPERVISORS
WASHINGTON, D. C. - SEPTEMBER 26, 1947

TEAM WORK FOR SAFE BANKING

It is an honor, and pleasant, indeed, to appear before you this morning. Our president, Tom Leggett has been most successful in arranging an outstanding program for this 46th Annual Conference. His painstaking efforts have even extended to suggesting my topic for this morning, "Team Work for Safe Banking." I can think of no better topic than the one he has suggested, for it is only through cooperation that bank supervision can be eminently successful.

Two days ago, Chairman Harl in his address of welcome pointed out the necessity for, and the new spirit of, cooperation between the banking profession and all supervisory agencies. Now, I should like to elaborate upon the comments on cooperation and mutual problems confronting us, as outlined so effectively in Mr. Harl's address.

At no period in our history has "team work" between State and Federal supervisory agencies, and between the supervisory agencies and the banking profession, been more effective than it is today. It has been three years since we have had a failure among insured banks. Bank earnings are at unprecedented levels and holdings of substandard assets have been sharply reduced. Nevertheless, the experience of every one present this morning, will, I am sure, suggest that we must not permit an attitude of over-confidence to bring a relaxation of our efforts toward safe and sound banking. We must continue the cooperation that results in an inter-change of ideas and the selection of the best. Cooperation also means uniform treatment of banks. This is not only just and equitable, but much more is accomplished when all banks are treated alike. There is no chance for playing off one supervisory agency against another, and the banks have no cause for complaining of inequities.

Considerable progress has been made in arranging for joint or concurrent examinations of operating banks by supervisory agencies. These procedures conserve time for both the banker and the supervisory agencies. Where corrective measures are indicated by the examination, cooperation between supervisory agencies in the formulation and prescription of specific measures to be taken produces more effective results. Joint conferences with bank management are more productive than a succession of discussions between the banker and the officials of first one agency and then another.

You will remember that improved methods of classification and appraisal of assets were agreed upon by Federal and State supervisors in 1938. Prior to that time the diversity of standards and procedures complicated, unnecessarily, proper coordination of policy. In addition, abandonment of the so called "slow" classification for loans, and the valuation of bonds on the basis of their long-term prospects rather than the current "market," were constructive steps. Examination reports are now substantially uniform, but more can be done. Appraisal procedures are not perfect; there is no room for mechanical procedures in the appraisal of assets and continued study is necessary.

The Federal Deposit Insurance Corporation instituted on July 1, 1946, new methods for the examination of mutual savings banks. These techniques provide for a more satisfactory classification of assets and more adequate provisions for losses. Provisions for losses are made before the amount of such losses can be definitely determined on the basis of gradations of quality in the classification of assets with emphasis on probable amount of eventual loss, if any, rather than current market values. The new system promotes corrective action on the part of the management by facilitating the disposal of unsound assets and provides the Corporation with a better evaluation of the condition of the institution.

Safe banking requires, besides competent and constant attention to the soundness of assets, adequate cushions against future losses. Some losses on assets are to be expected by every banker, and provision for these losses by commercial banks as well as mutual savings banks may be made much more advantageously in prosperous times than in times of depression.

Adequate provision for losses not only requires the establishment of valuation allowances against bank assets but it also requires adequate provision of bank capital. The wartime expansion in bank assets and deposits has brought the decline in the capital ratio of banks to dangerously low levels. The capital ratio, apparently, will not rise substantially, without coordinated supervisory pressure. The volume of loans and other risk assets has increased rapidly since the end of the war while the volume of Government securities and cash has declined. To the extent that these loans have provided the means toward reconversion to a more productive peace-time economy on a sound and substantial, rather than a speculative, basis, they have been necessary and desirable. A more adequate capital structure for our banks will facilitate meeting the legitimate needs of the community for productive credit. It is imperative, moreover, that the capital structure of banks be increased as risk assets are increased. Abnormally low capital ratios prevalent at the end of the war must not become new norms of the future when different economic and financial conditions may prevail.

Conservation of earnings during periods of prosperity is a most effective method of increasing capital and should be encouraged. Generally prosperous conditions also provide opportunities for strengthening capital by the sale of additional capital stock. Every effort to promote such sales on a sound basis is desirable.

Many banks still retain a legacy from the banking crisis during the last depression in the form of preferred stock or capital notes and debentures held by the Reconstruction Finance Corporation and other sources. Although most of this type of capital has been retired, there remains a small amount which should be eliminated as rapidly as possible whenever an adequate capital cushion can be retained. As a minimum rule, these retirements should not be approved for those banks where the capital ratio will be lowered to a point below the national average at this time.

Another problem of which all of us are well aware is the danger that our current prosperity and the increasing demand for bank credit may lead to loose lending practices. We have experienced a long period of rising prices during which loans that formerly were marginal appear to be sound. We must look to the future when prices may fall below their present levels. Two fields which are particularly vulnerable are real estate loans and consumer loans. The recent increase in real estate loans has been tremendous. Because of the long-term nature of such loans it is especially important that careful consideration be given to conservative lending practices. The volume of consumer credit has already reached the peak attained at the time of our entry into the war. As more durable consumer goods become available and as individuals exhaust their resources accumulated during the war there will be an increase in the demand for this type of credit. Banks may be tempted to liberalize their terms in an attempt to meet the competition of other consumer lending agencies. The possibility of such a development requires constant vigilance.

A similar situation is present with respect to bank investment in securities other than U. S. Government obligations. Such securities are currently selling at astonishingly low yields. Consequently, any rise in the interest rate would bring a decline in prices. The maintenance of a well balanced distribution of bank security portfolios both as to quality and maturity requires constant attention to forestall serious difficulties in the future.

Cooperation among the various banking supervisory agencies is essential for the maintainance of a sound lending and investment program. If banks are subject to different treatment by the different agencies they will become both confused and irritated. We must work together to assist bank management in every way that we can.

The prosperity and expansion of the banking business engendered by the war has been accompanied by a substantial increase in applications for bank charters and for admission to deposit insurance. Wholesome competition by new banks organized on a sound basis where there is need in the community for additional banking facilities is essential under our free enterprise system. The experience during the twenties, however, when excessive expansion in the number of new banks was accompanied by a rising tide of bank suspensions must not be duplicated.

Team work will contribute to chartering new banks on a sound basis. A method that has worked well in actual practice is the joint examination of the proposed organization and management of new banks by the Federal Deposit Insurance Corporation and State banking authorities, prior to admission to insurance and chartering. This method provides economies of time and money to both supervisory agencies and the bank. Both the State supervisors and this Corporation will be provided with ~~with~~ all the facts on which to base the final decision. They will know each other's attitude, and the importance of the various factors in each other's considerations. Under this method it is extremely difficult for a marginal institution to organize and become insured by playing off one agency against another. In view of the gratifying results of joint examinations of proposals for new banks in the few States in which this method is used, we should like to see its use extended to other States.

A sound and flexible guide in chartering and admitting new banks to insurance is provided by the principles set forth in the Banking Act of 1935. This Act provides that before a bank may be admitted to insurance the Board of Directors shall determine upon the basis of a thorough examination that its assets in excess of its capital requirements are adequate to enable it to meet all its liabilities to depositors and other creditors, and shall give consideration to these factors:

1. The adequacy of its capital structure,
2. Its future earnings prospects,
3. The general character of its management,
4. The convenience and needs of the community to be served by the bank,
5. The adequacy of its corporate powers, and where applicable,
6. The financial history and condition of the bank.

These provisions afford a splendid opportunity for team work between State supervisors and this Corporation in the chartering and admission to insurance of new banks.

Team work among supervisory authorities can be more effective and reward'ng in the prevention of, and farsighted provision for, contingencies, than in hasty attempts to cure difficulties when they become serious. Prevailing conditions afford unparalleled opportunities for team work for safe banking. Now is the time to be vigilant in detecting any tendencies which are likely to result in serious banking difficulties. Now is the time to provide for unforeseen contingencies and make our contribution toward safe banking by team work.