FEDERAL DEPOSIT INSURANCE CORPORATION

WASHINGTON 25

ADDRESS OF

MR. H. EARL COOK

DIRECTOR, FEDERAL DEPOSIT INSURANCE CORPORATION

Before the

ILLINOIS FRATERNAL CONGRESS

CHICAGO, ILLINOIS FEBRUARY 21, 1948

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Mr. Chairman, Ladies and Gentlemen of the Congress:

It would seem unusual, I suppose, if I came before you as a banker or bank supervisor, the two fields in which I have spent most of my adult life. There is a relation between your activities and those I pursued in those capacities, but the connection is somewhat far removed. It happened, however, that last year President Truman saw fit to appoint me to the board of directors of Federal Deposit Insurance Corporation, and so I feel not at all strange among you, for we are in the insurance business, too.

Let me say, to begin with, that I appreciate the honor President Johnson showed me when he invited me to address this meeting. I appreciate equally the privilege of meeting here with you whose careers have been devoted to providing financial security and its consequent peace of mind to so many millions of American families. I understand that the groups represented here today have more than 1,000,000 policies in force in the State of Illinois alone. The total for the country must be tremendous, and the influence of fraternal insurance organizations far greater than is commonly supposed.

Certainly the social contribution of your various groups has been great. We all know that individual welfare depends upon common welfare. But there are too many individuals still who refuse to practice that principle, even though they admit its truth. It is gratifying, therefore, to see your thousands of members uniting to enhance each his social and financial future by contributing to the welfare and future security of the whole confraternity.

Life insurance companies are by far the largest single reservoir of individual long-term savings in this country. As of December 31, 1946, these companies held 40 percent of the $100 billion of accumulated individual savings in thrift institutions. Insured commercial banks followed closely with 31 percent of the total, while mutual savings banks, savings and loan associations, and postal savings in that order, split the remainder.

The instinct to save is strong within most of the people. Each of us wants to prepare for the lean years and to establish security for himself and his family during the years of age or infirmity when earning power is diminished. The incentive to save, however, has been subject to repeated and discouraging body blows. Consider the plight of the person today who is drawing upon past savings to meet current living expenses. According to reliable estimates he must now pay $1.60 to get goods and services that were available at $1.00 in 1940. Such is the price of inflation, and it certainly encourages speculation rather than thrift. Consider the plight of millions who entrusted their savings to bona fide thrift institutions during the early decades of this century, only to lose all or part of their accumulation when unreasoning panic and falling markets forced wholesale liquidation of assets in the early 1930's.

To combat inflation and its disastrous effect upon purchasing power, there is much that you in the insurance field can do. But neither you, nor the bankers, nor the farmers, nor the laborers can do the whole job alone. How absurd it is for an individual, or a group of individuals, or a particular segment of our financial economy to jockey for position in order to turn a fast dollar, only to learn that today's dollar is tomorrow's fifty-cent piece.

So long as consumer goods are in short supply, it is absolutely essential that financial institutions curtail to the best of their ability the amount of money in the hands of the public that will permit it to bid up the prices of these short-supply goods. The two most immediate avenues towards such curtailment are, of course, close scrutiny of each extension of credit and encouragement of individual savings in every possible means. It is both significant and alarming, I believe, to note that the ratio of gross national savings to gross national income, which stood at 15 percent in 1940, rose to 26 percent in 1944, then plummeted to 12.7 percent in 1946. It is doubtful that this ratio will rise very rapidly for 1947 and 1948, with so many people forced to dip into savings to meet rising costs of living, but it is likely not to fall much farther in view of the widespread consumer resistance that has sprung up in the face of inflationary price rises. It would appear that the levelling-off process has begun, and that with the cooperation of consumers and enlightened businessmen, disastrous inflation can be avoided.

With respect to that other deterrent to thrift, the unsatisfactory safety record of our financial institutions prior to 1933, a workable solution was finally envolved. It is my privilege to appear before you today as representative of an unprecedented and what appears after fourteen years to be an unusually workable adaptation of the insurance principle, Federal Deposit Insurance Corporation.

Certainly nowhere more than in the field of finance is individual welfare dependent upon the welfare of all our people. Without financial security there can be no stability in any phase of our economy. The Russians awoke one morning to find their rubles worth a fraction of what they were worth the day before. That must not happen here. We want our dollars, first of all, to be safe and, secondly, to have a fairly predictable purchasing power. These desires, of course, can be realized only through the agency of Government. Many people are inclined to look upon Government as something apart from them and above them. In this Nation, more than anywhere else, that is not the case. Government here is entirely the servant of the people, dedicated to their protection and to furthering their welfare. It behooves every citizen, therefore, to understand what his government is doing in his interest and to take an active voice in directing his legislators to steady improvement of the common welfare.

It became obvious during the demoralized years of 1930-33 that something would have to be done if we were to continue in this country our system of independent banking. The stresses of that period were tremendous upon all segments of our economy. Banks had to curtail credit and call loans to meet demands of depositors; business had to lay off men because they were unable to get working capital from the banks; the laid-off men had to draw on their savings to live, and that meant further credit contraction. Ultimately the country banks had to call upon their big-city correspondents for cash as withdrawals mounted, and that accelerated the liquidation of assets to meet deposit shrinkage. The cycle was one of the most destructive ever undergone by our economy, and it culminated in the Banking Holiday of 1933. A major part of the waste and the destruction resulted not from individual needs, but from individual panic that built into mass hysteria and forced sound banks into liquidation with the same impunity it used to crush weak institutions.

We in the Federal Deposit Insurance Corporation like to think that a new era of banking was brought in by the Banking Act of 1933. Leading legislative minds and leaders in the banking world evolved a plan that was embodied in that Act designed to prevent a recurrence of mass depositor hysteria and, in conjunction with other banking legislation, to prevent the unnecessary asset shrinkage and the billions of dollars of utter waste that were suffered by the banking system in earlier periods of depression.

The plan of Federal Deposit insurance aimed to instill in depositors a sense of safety and security and trust in their banks based upon demonstrable improvement in these fundamentals of banking.

a. Selection of risk: All national banks and all State banks members of the Federal Reserve System are required to be members of Federal Deposit Insurance Corporation. State banks not members of the Federal Reserve System may apply and are admitted to insurance after examination and approval by the Corporation.

b. Supervision of risk: Examinations of all insured banks are reviewed annually by the Corporation. Weaknesses in management, deficiencies in capital, inadequate earnings, and concentrations of unsatisfactory assets are brought to the attention of the management and the appropriate supervisory authority when they are discovered, and correction generally is forthcoming promptly.

In the event corrections are not made quickly, the Federal Deposit Insurance Corporation is empowered to cite the bank for unsafe and unsound practices and, after hearing, to dismiss it from insurance. In this event, all depositors of the bank are notified of the termination before its effective date.

c. Adequate provision for realization of risk: The Corporation today has capital and surplus of more than one billion dollars, acquired through annual assessments paid by insured banks at the rate of 1/12 of one percent of their average deposits and through income on its investments. In case of need, the United States Treasury is directed to lend the Corporation up to an additional three billion dollars.

Today there are nearly 13,400 commercial banks and trust companies and 200 mutual savings banks whose deposits are insured by the Corporation. These institutions comprise 92 percent of all banks in the nation, and they hold 95 percent of all the deposits which, as of June 30, 1947, amounted to 155 billion dollars.

Selection of Risk

The chartering of new banks is controlled rigidly by the Comptroller of the Currency and by the various State supervisory authorities and, in most instances, any application for a new charter is referred to the Federal Deposit Insurance Corporation for review and approval before the license to open for business is granted. In this way it is possible to reduce risks to the Corporation as a result of overbanking. Results of this cooperative approach to date have been very satisfactory, and it is rare, indeed, that a new bank is permitted to open after the Federal Deposit Insurance Corporation has indicated its disapproval of the application. Standards of management, capitalization, and earnings prospects are kept intentionally high and, as a result, the performance of institutions chartered during recent years has been most satisfactory.

Supervision of Risk

Each insured bank not a member of the Federal Reserve System is examined annually by the Corporation as well as by the appropriate State banking authority. The Corporation also reviews each examination of a national bank or of a State bank member of the Federal Reserve System. From these examinations and reviews we try always to keep abreast of developments within individual institutions and to anticipate trends that seem to be affecting the banking system as a whole.

The Corporation has had for some time a long-range program to improve bank supervisory techniques and to encourage better banking practices. From its establishment the FDIC has worked in close cooperation with the State banking authorities and with the other Federal agencies in the task of strengthening the banking structure.

In 1938, in cooperation with the National Association of Supervisors of State Banks, changes in bank examination procedures were conceived and announced which placed less reliance upon market valuations of securities. This change brought greater emphasis upon the intrinsic quality of the bank's asset and capital position.

The achievement of greater uniformity in the methods and forms used by bank examiners now makes it possible for the FDIC and State examiners to make examinations jointly or concurrently in a number of States; in other

States alternate examinations are made and the reports exchanged. As a result of the adoption of uniform procedures, banks are now able to submit identical reports of condition and of earnings and expenses to Federal and State authorities in practically all States.

All of these changes reduce to a minimum the inconvenience to banks incident to the preparation of these necessary reports. This has been a matter of considerable importance to banks in recent years when they have been undermanned, on account of the substantial loss of personnel to the armed forces.

Our staff of examiners likewise was depleted by the war so that bank examinations had to be made less frequently then usual. The return of younger examiners from military service and the planned recruitment of additional junior examiners should permit resumption of our normal schedule.

A comprehensive program of education and training for new assistant examiners was recently adopted. We also hold periodic conferences of examiners in each of the 12 districts throughout the country, to provide refresher education for the returned servicemen and new examiners. Thus the field force will be kept acquainted with the banking problems in the Nation as a whole. At the same time, these conferences enable our Board of Directors to ascertain first hand from the men who examine the banks what the changing problems of the banks really are and how well the banks are meeting the needs within their own communities.

In the early years of its operation, the Corporation was forced by circumstances to devote the major part of its attention to bank assets. Despite the more than one billion dollars of RFC capital poured into the banks and despite the millions of dollars that were absorbed through stockholders' assessments and deposit waivers in the early thirties, there were still on our banks' books hundreds of millions of dollars of assets that were worthless or substandard when Federal Deposit Insurance Corporation began operations. During the first two years of its existence, after calm appraisal became possible, the Corporation devoted its energies to locating and analyzing concentrations of these unsatisfactory assets throughout the banking system. As soon as authority was granted by the Banking Act of 1935, the Corporation moved immediately, in conjunction with State bank supervisors and the Comptroller of the Currency to clean up those concentrations of deadwood.

Meanwhile, and again in conjunction with supervisory authorities, we set about preventing deterioration in assets that were then acceptable or that subsequently were to be acquired. We began, as you will recall, with requirements that charge-offs or valuation allowances be taken care of out of current earnings before stockholders' dividends were declared.

Then came the war and its upward pressure on prices, which enabled many banks to salvage something from assets that previously had appeared to be worthless.

So, through earnings and through asset appreciation, the banks were able to greatly improve the quality of their assets. They benefitted greatly and so did the whole economy.

Provision for Losses

As I mentioned earlier, the Federal Deposit Insurance Corporation now has capital and reserves in excess of one billion dollars. It has, in addition, a three billion dollar line of credit with the United States Treasury in the remote event that credit ever is needed. Our responsibility under law is to protect depositors in insured banks against loss.

In the more than 14 years of its operation, the Corporation has promptly advanced $87,000,000 in the 245 insured banks that have been placed in receivership. More than 330,000 depositors in those institutions were completely protected.

By authorization of the Banking Act of 1935, the Federal Deposit Insurance Corporation exerts every effort to forestall failures by aiding the merger of weak insured banks with stronger institutions. There have been 159 such mergers, with the Federal Deposit Insurance Corporation disbursing some $176,000,000 to protect an additional 1,000,000 depositors. The advantages of this type of action are that all depositors are fully protected and that there is no interruption to banking service in the community. The successor, or absorbing bank takes over all sound assets of the weak bank. The difference between the amount of these sound assets and the deposit liabilities assumed by the continuing bank is paid promptly in cash by the Federal Deposit Insurance Corporation. The advantages of this latter technique, when it is made more flexible to care for situations where there is only one bank in a town or where existing competitors will not assume liabilities and assets are obvious. It is the logical vehicle for depositor and community protection, in our opinion, and will be used wherever possible.

It was surprising to see last fall a group of fire, marine and casualty insurance agents asking for a Federal reinsurance corporation to absorb catastrophe risks and excess coverage. Last year's weather and the effects of inflation undoubtedly affected those companies, just as they had an influence on your associations and upon the banks. However, it would seem preferable to spread these risks among the various companies in the form of reinsurance pools.

One of the advocates of the government reinsurance corporation likened it to the Federal Deposit Insurance Corporation. But he failed to consider certain vital differences.

Banks pay relatively small sums for the use of money. Their rates of interest and investment procedures are rigidly controlled by law. The FDIC, said the Chicago Journal of Commerce in this connection, ".. was a safe enterprise for government because, with extensive controls over banking, Uncle Sam could virtually eliminate risk from FDIC. The history of the Corporation corroborates that statement."

The Board of Directors of the Corporation last year recommended to the Congress that it be permitted to repay the capital subscriptions of the Treasury and the Federal Reserve banks in order that any vestige of Government subsidy would be removed from the banking system of the Nation. We feel that the idea of deposit insurance requires the prestige of Federal creation and management to make it fully effective as a stabilizing influence. We are convinced, however, that the banking system is now sufficiently of age to carry its own financial load for the protection of its depositors' funds except in case of extreme emergency. The function of the Corporation, as we see it, will be to act as trustee for a fund built up by all insured banks for the protection of all their depositors.

Like any insurance company, we rely upon the right to examine our risks to minimize demands upon the insurance fund. We rely also upon improved bank supervision and enlightened bank management to keep losses at a minimum.

By authority of an Act of the last session of Congress we have repaid to the United States Treasury more than $196,000,000 of the $289,000,000 original capital subscribed to the Corporation by the Treasury and the twelve Federal reserve banks. We anticipate that the remainder will be repaid during 1948 in amounts that will not reduce our net worth below one billion dollars.

As I said earlier, the Corporation has been called upon so far to protect 1,324,000 depositors in 404 closed banks, holding $512,000,000 of deposits.

Of the $307,000,000 advanced by the Corporation in these cases, our ultimate losses are estimated to be not more than $25,000,000. That represents 8% of the advances, and 5% of the deposits that were protected.

Operating expenses of the Corporation for the entire fourteen years of its operation amounted to only $53,000,000.

Yes, we are in the insurance business, too. And we hope, with the help of sound bank management and enlightened bank supervision to make a real and lasting contribution to the stability of the American economy and to the safety and security of each citizen of this Nation who is a bank depositor. If we can do our job as ably as you people have done yours, we shall consider the effort well spent—the goal achieved.

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