Address by The Honorable H. Earl Cook, Director, Federal Deposit Insurance Corporation, Washington, D. C., before the National Association of Supervisors of State Banks.

Reno, Nevada October 26, 1949

"Our Public Responsibility"

In announcing my subject, perhaps I should have worded it "Our Joint Public Responsibility" because I had no intention of narrowing the subject to the public responsibility of the Federal Deposit Insurance Corporation and its Board of Directors, so you will understand that my subject is intended to embrace all of the state and federal banking agencies that have to do with the protection of depositors' funds and the safeguarding of our banking system.

Of course, I realize that it is somewhat like carrying coals to Newcastle to talk to this gathering on such a subject because there is no organized group in banking that approaches its job with the seriousness that is always in evidence at the annual meetings of this association. There is always the possibility, however, that any one of us might be overcome by complacency or may be bored by the daily burdens of our responsibilities. Speaking of these daily burdens reminds me of the expression of an old lady who, being completely exasperated by the daily round of cooking, dishwashing, sweeping and other routine household duties, remarked to a friend of hers that "Life is just so daily." Perhaps sometimes we subconsciously fall into that feeling and regard our respective responsibilities as burdens rather than opportunities.

There is another reason for choosing this subject, and that is, by reason of our dual system of banking with 48 state banking departments and 3 federal banking agencies, we sometimes find ourselves thinking only in terms of our individual spheres of responsibility. As you well know, there have been recommendations from high places that in order to have a well-coordinated banking system, the entire responsibility for bank supervision should be centered in one agency and, naturally, that would have to be a federal banking agency. We of the Federal Deposit Insurance Corporation do not and will not subscribe to any such doctrine. The greatness of our country has been built upon the right of free men to engage in any legitimate enterprise of their choosing and a most important factor in promoting this ideal has been our free enterprise banking system. This means the right of would-be bankers to operate either under a national bank charter or a state bank charter and, in the case of the latter, either to be members of the Federal Deposit Insurance Corporation or the Federal Reserve System, as their own best interests seem to dictate. So, it seems to me that in the exercise of our joint public responsibility we must accept as a premise the fact that we all have our own individual responsibility to discharge but, at the same time, recognize that our individual responsibility must be discharged in the interest of the larger community. This is to say, that while it would not be in the interest of the public for any of us to subordinate our individual thinking to any one dictum, it is most important for all of us at all times to keep in mind our common major objective, which is sound banking service to the American public, and reconcile our minor differences with that end in view.

When we found ourselves in the banking crisis of 1933, we all came to the realization--and when I say "all," I mean state and federal bank supervisors and bankers alike--that we all had to hang together or we would hang separately. During the past few years of easy times for banking and bank supervision, there has been a tendency for us to pull apart. It has been said that the human body changes completely over a period of 7 years, and perhaps it is only natural that we should by this time have forgotten the poignancy of those dark days for banking which we had to face in 1933. If we are not careful, we can once again drift into an attitude that perhaps is best expressed by a homely old story from my native State of Ohio. This tells of two brothers who had a falling-out concerning a cow. These brothers, realizing that they both needed milk for their families and neither one being financially able to own his own cow, decided to buy one in partnership. The cow was purchased and duly installed on one of the brothers' premises. Then the trouble began. The brother on whose premise the cow was installed insisted on having all the milk, claiming that his half of the cow was the back half. The other brother, in order to get even, decided to kill his half of the cow and, naturally, his brother's half died and neither one had any milk.

Now let us return more directly to the subject, "our joint responsibility to the public," in the light of conditions as they exist today. I believe we shall have no trouble in stipulating that our common objective is sound banking service to the American public. While the primary responsibility of bank supervisors is the protection of the depositors' funds, this, of itself, involves a number of collateral factors. The savings depositor, for example, cannot expect an interest return on his deposit unless the bank with which he is dealing is earning a fair return on the funds at its disposal. The commercial depositor, in return for entrusting his funds to his bank, has the right to expect a legitimate credit extension during his peak business periods. The customer of the bank who would become a home-owner has the right to expect the bank to extend him legitimate credit in achieving his objective.

So, the bank supervisor is placed in the delicate position of policing the safety of depositors' funds without unduly restricting the lending and investing operations of bank management. Now, just where does this place us with respect to our public responsibility? I believe it is well-defined in sub-section (g) of the Federal Deposit Insurance Law. As you know, this section requires our Board of Directors to consider the following factors in connection with any application for insurance on the part of a non-member state bank:

(1) The financial history and condition of the bank;

(2) The adequacy of its capital structure;

(3) Its future earnings prospects;

(4) The general character of its management; and

(5) The convenience and needs of the community to be served.

These same factors are required to be considered by the Comptroller of the Currency in chartering a national bank which, of course, automatically becomes insured. Similar factors are written into the laws of most of the states in connection with the chartering of state banks. While these factors are only general guides, the principles outlined give bank supervisors an adequate framework to support them in the full discharge of their responsibilities to the public.

One of the most controversial of these factors, where controversy has arisen, is that of adequacy of capital. The position of the Corporation with respect to this factor has sometimes been misunderstood. I believe, however, that our thinking in this respect is essentially sound. First of all, we must recognize that the margin of protection furnished by bank capital today is quite thin. Entirely aside from any consideration of the safety of the deposit insurance fund, it is our opinion that it is most important to stockholders themselves to work toward a stronger capital position. From a practical point of view, it is difficult to introduce additional capital funds into existing banks under present conditions by the sale of new stock. Therefore, this objective of strengthening the capital structure of our banking system, for the most part, can only be accomplished in two ways; first, by encouraging banks to retain in their capital structure a substantial amount of their earnings and, second, by preventing the influx of unneeded new banking units into the system on an under-capitalized basis. As a standard, we have adopted the policy of requiring new members of the Federal Deposit Insurance system to provide capital at least equal to the national average for all insured commercial banks. In the case of proposed new banks, we endeavor to estimate the deposit volume to be attained at the end of three years' operations and establish our dollar figure as to adequacy of capital on that basis. We feel that this is a reasonable basis upon which to determine adequacy of capital, even though it often results in a dollar figure greater than the statutory requirements of the law under which the bank is being chartered.

As of December 31, 1948, the national average for insured commercial banks was 6.7% against total assets, and as of June 30, 1949 it was 7.1%. The 7.1% average of all insured commercial banks as of June 30, 1949 reflects the meeting point of the highest state average, which was 11% and the lowest which was 4.4%. Whether we are considering proposals for deposit insurance, preferred capital retirements, or urging insured banks to strengthen capital, we have not generally pressed for more than the national average. As you know, in working a component toward an average, we have to move upward or downward, or from both extremes toward the middle, depending upon the objective. We emphasize that our policy of working lower ratios upward has been tempered by aiming at the current average instead of the top. We realize that success along these lines will gradually raise the average, but is there anyone who would suggest that we work in the opposite direction?

Perhaps I have dwelt too long on this particular aspect--adequacy of bank capital. If I have, I know you will pardon me in the light of some remarks Lee Wiggins, former President of the American Bankers Association and former Under-Secretary of the Treasury, made during an off-the-record talk before a small group of bankers in Washington a couple of years ago. I shall not attempt to quote him verbatim because I cannot remember his exact language. I shall, however, attempt to paraphrase his remarks. As I recall, he said, in effect, that the term "our free enterprise system" was becoming a hackneyed expression because we seemed to be coming to the point where we were placing too much emphasis on the word free and too little on enterprise. He continued by saying--and I am still paraphrasing--that too many of us were drifting into the idea that all we needed was a little enterprise, and everything else would come along "free for nothing." He continued by saying that in his business experience in our enterprise system he had found that it did not come free, but was the result of hard work and the courage to back ideas with dollars. He concluded this phase of his remarks by suggesting that we substitute either the expression "free capitalistic system" or "capitalistic enterprise system" for the more common expression "free enterprise system."

This leads me to a brief discussion of the vital factor of bank management. It is our responsibility to the public to see that our banks are operating under sound management. We in the Federal Deposit Insurance Corporation recognize that in most instances the management factor may be more important than the factor of capital. We have listened to the persuasive arguments that no amount of capital will protect a bank against the ravages of a weak or bad management. With this we are in general agreement. We cannot agree, however, that management is a complete substitute for capital. The best of bank management without elbow room in the way of capital is bound to be restricted in rendering proper service to the banking community.

It seems to me that our public responsibility with respect to bank management has three facets:

(1) Due care in approving management for proposed new banks.

(2) Appraisal of management policies in operating banks and constructive suggestions for improvement where desirable.

(3) Prompt action to remove or replace bank managements which are definitely weak or self-serving.

The latter action is accorded the Federal Deposit Insurance Corporation in sub-section (i) of our law relating to continued unsafe and unsound practices and violations of law.

Although my subject is "Our Public Responsibility," I might go on and mention other responsibilities which it is our duty to recognize. Time does not permit to explore this field fully, but I cannot pass up the opportunity briefly to mention the responsibility of a bank to its stockholders.

Some of the primary considerations with respect to this responsibility are the safeguards which have been introduced by bank management to discourage lack of fidelity on the part of its officers and employees. Following this thought further for a moment, one of the principal safeguards is that of adequate fidelity bond coverage. All of us remember the days when many banks still used personal surety bonds and a number of bank supervisors here know of the grief experienced in attempting to collect such bonds from sureties who had disposed of or otherwise concealed their principal assets. We have come a long way since then, and to my knowledge there is not a single insured bank in the country that has this form of coverage today. The comprehensive study and recommendation of the Insurance and Protective Committee of the American Bankers Association, which was published in 1941 in the "Digest of Bank Insurance," was a long step forward in urging adequate fidelity coverage based upon the size of the bank. Everyone realizes that this is only a "rule of thumb" which, of course, must be varied to provide for any unusually hazardous operations. The bankers of the country have really taken this recommendation to heart as is evidenced by the improved condition which has taken place in the past few years with respect to the amount of blanket bond coverage held by all banks.

During 1948 the Federal Deposit Insurance Corporation made a summary of the banks having less than the "minimum" coverage recommended by the American Bankers Association, those having at least the "minimum" but less than the "fair" coverage, and those with the "fair" coverage and over. This summary covered 9,484 insured commercial banks and was based upon the 1947 examination reports. On the basis of this tabulation we found that 53% of all insured commercial banks had less than the "minimum" coverage and only 20% had the recommended "fair" or better coverage. A similar tabulation based upon the 1948 examination reports of 12,922 insured commercial banks disclosed that only 23% of these institutions had less than the "minimum" coverage and those having the "fair" or better protection had increased to 33%. A cursory review of the examination reports of insured banks made during 1949 indicates that the program for increased fidelity coverage is proceeding at a rapid pace, and it is believed that by the end of 1949 approximately one-half of all insured banks will have at least "fair" coverage.

Since 1945 the Corporation has rendered financial assistance to only 12 banks. All but three of these banks were forced to discontinue business because of defalcations greatly exceeding the fidelity coverage provided. Although it is recognized that the banking profession is fundamentally honest, we cannot relax our efforts to urge all insured banks to provide adequate fidelity protection. There is still much to be done in this respect if the directors of our banks are to be able to say to their stockholders they are satisfied that adequate blanket bond coverage has been provided to protect each shareholder against the hazard of infidelity on the part of the officers and employees. You all know of the great premium reduction which has been brought about by this joint effort, and the fact that much more comprehensive coverage and adequate protection can now be provided at a greatly reduced premium than was the case several years ago.

May I suggest that our responsibilities to the public are both joint and several. They are joint in that we all have the common objective of promoting a sound banking system and maintaining public confidence in our banks. They are several in that each of us has his individual responsibility. The state bank supervisor must not only be concerned about the solvency of his banks and their management policies, but is also charged by statute to see that all the banks under his supervision comply with the requirements of the applicable laws and regulations. The Comptroller of the Currency has a like responsibility with respect to national banks. The Board of Governors of the Federal Reserve System has its own responsibilities as defined by the Federal Reserve Act. The Federal Deposit Insurance Corporation has its particular responsibility to protect bank depositors against loss. I believe we have a definite idea as to what our joint and several responsibilities are to the public. We will discharge those responsibilities in reaching our common objective.

On behalf of the Federal Deposit Insurance Corporation, it is my high privilege to express our appreciation to the National Association of Supervisors of State Banks and to the other supervisory agencies for the cooperative attitude they have given to bringing about better understanding and closer coordination in the activities in which we all have a mutual interest.

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