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ADDRESS OF

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Before the

ANNUAL CONVENTION OF THE INDEPENDENT BANKERS ASSOCIATION

Minneapolis, Minnesota

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ADDRESS OF H. EARL COOK, DIRECTOR, FEDERAL DEPOSIT INSURANCE CORPORATION, BEFORE THE ANNUAL CONVENTION OF THE INDEPENDENT BANKERS ASSOCIATION

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"FEDERAL DEPOSIT INSURANCE CORPORATION AND THE INSURED BANK"

I am honored, indeed, by this invitation to address the Independent Bankers Association. We of Federal Deposit Insurance Corporation were privileged in January to have a representative group of your membership visit with us in Washington. Mr. Sturgeon, Mr. Bell, Mr. Peters, Mr. Gregory and, of course, the genial Ben DuBois spent a busy day telling us of your problems and listening to ours. We of the Corporation profited greatly from this discussion.

What we told your representatives on that occasion is substantially what I am going to tell the entire group today. It is, essentially, a story of what we find in insured banks, what we recommend as courses of action for insured banks, and what we are doing to protect depositors.

The scope of deposit insurance was recently defined in the Corporation's response to one of the questions asked by the Patman Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report. There we state that "the principal purposes of Federal Deposit Insurance are to protect depositors, to maintain the confidence of depositors in banks, to raise standards of bank management, increase the soundness of the banking system, and to aid in protecting the circulating medium."

One of the most vexing problems of deposit insurance has concerned the proper extent of depositor protection. At first only deposits up to $2,500 were fully protected; for most of the period under which the plan has operated maximum protection was $5,000 for each depositor; since September 21, 1950 the upper limit of complete protection has been $10,000. Beyond this, there have been suggestions that all deposits in insured banks should be fully protected.

Several considerations have prompted the restriction of complete protection to small depositors. Since $10,000 today is roughly the equivalent of $5,000 in 1934, this principle of protection directed primarily to small depositors has been a consistent objective. We believe it is the small depositor who most needs protection. According to a survey we made last September, 110 million accounts in insured banks are fully protected. This amounts to 98.5 percent of all deposit accounts in insured banks. We believe that there would be few advantages in providing complete coverage.

There are also some positive benefits to be derived from limited protection. The Corporation is mindful that the presence of uninsured deposits is a disciplinary influence upon bank management, injecting an element of caution that promotes the soundness of the banks and the safety of deposits. Limited protection also takes account of one of the facts of life, namely, that institutions like individuals, have limited capacities. Though the Corporation has a fund of over $1 billion, an amount which is adequate for any probable need based on experience, it nevertheless is aware that a wave of adverse conditions could quickly exhaust its resources. It is only elementary prudence that the Corporation's liability should be limited to a level within its proximate capacity.

One of the major risks which has enlisted the protection of deposit insurance was foreseen dimly if at all by the architects of the Federal Deposit Insurance Corporation. Almost nothing was said in those early days of the infidelity of employees as a cause of bank failure. Instead, attention was focused on the perverse operation of the economic system, the defective capital and asset structure of banks, and the behavior of depositors under pressure of panic conditions.

The magnitude of this error in expectation may be shown by a simple statistic. From the beginning of Federal deposit insurance to the end of 1951, 106 insured banks closed their doors because of defalcations. These closings due to employee infidelity comprise over a fourth of all collapses of insured banks since 1934. Even more disquieting is the accelerating importance of this source of bank difficulty. During the nine years ending with 1951, 21 of the 27 banks which required the financial assistance of the Corporation were forced into difficulties directly because of defalcations, and subsequent examination revealed defalcations in some of the others. It is obvious, that like any other business group, banks have not escaped the moral laxity which has afflicted our national life and is even now the subject of widespread concern.

The rise of defalcations as the greatest single cause of bank failure has grave implications for deposit insurance. It had required the diversion of resources which were intended for other purposes. More than that, it has revealed the inadequacy of resources which banks themselves had provided against such loss. The 106 cases mentioned above involved defalcations of almost $15 million; fidelity bonds held by the banks and designed to protect them from this loss were less than $3 million. Capital funds of the banks, though sizable, were exhausted and the Federal Deposit Insurance Corporation had to put up the difference, some of which it has recovered, or will. However, none of this outlay would have been required had the original purposes of deposit insurance been operative.

It is fortunate that deposit insurance has this flexibility to meet unexpected conditions. In the case of defalcations it doubly protects banks by insuring them, as it were, against themselves. Protection against defalcations is not, however, a function of deposit insurance that merits cultivation. Banks have the responsibility to protect themselves against loss from infidelity; this they can do by purchasing fidelity bonds, tightening internal controls, providing regular audits, and similar measures. The essence of preventive measures against defalcations goes even beyond these disciplinary operations to bank-sponsored measures to promote the self-respect and well-being of their employees. In the final analysis, contented employees are the best safeguard against wrongdoing.

In the period since the Federal Deposit Insurance Corporation started operations over 1,350,000 depositors have faced possible loss due to difficulties in insured banks. However, because of deposit insurance, fewer than 50,000 sustained any loss, their total loss amounting to less than $2 million. In contrast, during the 70 years before deposit insurance, losses to depositors totaled about $3,500 million. In terms of average annual rates, losses to insured depositors since the Federal Deposit Insurance Corporation entered the picture in 1934 have been less than 1 percent of what depositors lost in the 70 previous years. These depositors have been paid off promptly, or have been credited with deposits in another bank, depending upon the method of protection used in the given situation. This prompt handling of depositors' claims has gained for the

Federal Deposit Insurance Corporation a position of such respect and confidence that virtually no one worries today about the safety of his bank deposit.

Since our whole banking structure is built upon depositor confidence, the significance of this revolution in attitude since the dark days of 1933 can hardly be exaggerated. Indeed, we have done almost too well, for the popular attitude now is that all bank deposits are insured. Perhaps you have heard reports, as we have, of depositors who have been rudely awakened to the fact that not all deposits are insured. We have now a new kind of danger — over-confidence. Depositors may become too complacent about the safety of their deposits, and neglect to inform or concern themselves about the measures necessary to continue deposit insurance along the paths which have proved so effective. In addition to this, the risk of loss is an immediate reality facing depositors in the 1,000 or so banks which still remain outside the fold. Depositors' losses, from whatever source or reason, cast suspicion upon the institution which is supposed in the popular mind to have banished such losses from our economic system.

The revival of depositor confidence has its corollary in the rejuvenation of the banking system. Early fears that insurance would encourage reckless and irresponsible banking practices soon proved unwarranted. Instead, the quality of bank assets steadily improved under the joint stimulus of rigorous examination standards and the upward trend of economic conditions. In like manner there has been a steady growth in the amount of deposits, except for the leveling-off of the postwar years, as deposits were freed from the erratic fluctuations of depositors' confidence. The attitude of depositors is not, of course, the only factor in determining the money supply; the hard realities of reserves, interest rates, and other forces also have their effect. But the climate of confidence provides a framework without which all of the other factors working together would have been powerless.

Bankers themselves would probably say, however, that they have felt the influence of the Federal Deposit Insurance Corporation in much less subtle fashion. They have been much more conscious of bank examinations and other supervisory actions. In the course of examining its risk, the Corporation has taken advantage of the opportunity to impress upon bankers the precepts of sound banking, as it understands them, and to demonstrate in practical ways some of the proven techniques which make for greater efficiency in bank operations. The Corporation has also contributed to sounder banking, albeit reluctantly, by losing many of its best examiners to banks; our regrets on this score are moderated, however, by the belief that our loss is still to our advantage, paradoxical as that may sound.

The number of banks has changed very little since the beginning of Federal deposit insurance, the main reason being the sharp decline in bank failures. Since the Corporation began operations in 1934, 418 insured banks have required its assistance. During an equal period before its organization over 15,000 banks failed, more banks than are now in existence.

Along with the decline in the number of bank failures, the decrease in the number of new banks has contributed to stability in their number. Through its power to grant or withhold deposit insurance, the Corporation exerts a strong influence on the chartering of new banks, for the chartering authorities give considerable weight to a prospective bank's ability to qualify for deposit insurance. The requirements which a newly insured bank must meet are specified by statute, and are designed primarily to assure that the bank fulfills a local need and that it has good prospects of standing on its own feet in the competitive situation that it confronts.

The Corporation is sometimes criticized for its adherence to high standards in the granting of deposit insurance, and its alleged promotion of local monopolies. Let me reiterate, therefore, that we believe wholesome competition by new banks organized on a sound basis to be an essential part of our free enterprise system. We believe, however, that our job is less to provide profit opportunities than to assure such facilities in communities that need and can support them. We must not repeat the experiences of the twenties, when excessive expansion in the number of new banks was accompanied by a rising tide of bank suspensions.

The Federal Deposit Insurance Corporation has always championed the system of private enterprise. The advantages of free enterprise, both politically and economically, are too well appreciated to need repetition here. Pursuit of these advantages has, however, sometimes required the Corporation to take positions unpleasing to some segments of the banking community. The most notable case is with regard to capital standards and the deteriorating capital position of banks.

We believe that bank capital should be adequate to justify and motivate the present basis of control of our banking system. Serious questions are bound to be raised when the legal owners of banks permit their equity to shrink to the point where they have little at stake in sound banking. No other industry risks as little as 7 percent on its enterprise.

The Corporation seeks to prevent further deterioration by requiring the newly insured banks to have capital at least equal to the national average for all insured banks. The retention of current bank earnings has been barely sufficient to enable capital accounts to keep pace with the growth of assets and deposits. The only other source of additional capital, the sale of new stock to investors, has for several years been almost barren. We recognize that there are serious barriers to the building of bank capital. However, continued neglect of the capital problem plays into the hands of critics of private enterprise, and pushes us closer to public management of our banking system.

Today there are nearly 15,000 banks in the United States, for the most part small, locally-owned and operated institutions. Some operate under National charter and some under the charter of States whose requirements vary in accordance with local traditions and circumstances. This large number of banks with differing personalities and the ability to adapt their policies and practices to local needs accounts for much of the vitality of our banking system. As an expression of our political system, whose duality maximizes the opportunity for testing new ideas and minimizes the risks of so doing, it embodies the essential genius of the American system of government.

We need to remember that our banking structure contrasts sharply with that of most other countries, where banking has become concentrated in a small number of large institutions operated through branches. Their system may be best for them; that we do not and need not question. We should be careful, however, to conserve our own dual banking structure. Cumbersome as it sometimes appears to be, it has helped to give us the strongest and most dynamic economy in the world, a true citadel of freedom in this trying age.

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