FEDERAL DEPOSIT INSURANCE CORPORATION
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"TWO DECADES OF FEDERAL DEPOSIT INSURANCE -- 1933-1953"

ADDRESS OF HONORABLE H. EARL COOK, CHAIRMAN

FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE ANNUAL CONVENTION

OF THE

MISSISSIPPI BANKERS ASSOCIATION

BILOXI, MISSISSIPPI

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Mr. Chairman, members of the association and distinguished guests:

I would imagine that by now Pat McMullan, Leigh Watkins, Joe Latham and the rest of your able officials of the Mississippi Bankers Association would be tired of hearing me talk. When they were kind enough to invite me to appear before this convention, however, I cast aside all compunctions and decided to come along to meet the rest of this fine group. If Pat and Leigh and Joe don't want to listen, they are herewith excused.

It is particularly exciting to me to gather with you here on the Gulf Coast. I have spent most of my life alongside rivers and the Great Lakes, including a sojourn along the Potomac. There is no body of water, however, that can compare in beauty with the Gulf. It is pleasant being here and a true pleasure to meet all of you who represent the banks of this great State of Mississippi.

Just 20 years ago next June 16, the Federal Deposit Insurance Corporation was created by the Congress. It has been my privilege to serve as a member of its board of directors since April 1947, and it is now my responsibility -- and one which I approach humbly -- to act as Chairman of that board in the interest of the thousands of banks and millions of depositors for whom the Corporation serves as a bulwark.

Before I proceed, I should like to convey to you here gathered the warm greetings of my associates in the Corporation. Many of them you all know well. We hope that the others soon will become close friends of all of you.

It was pleasant in January to meet with the officials of your association for a discussion of problems in which we are commonly interested. The agenda on that occasion called for views on the question of bank audits and internal controls, for a review of bank defalcations and the protection of depositors, and for a summary of the Corporation's operations during the past several years.

We of the Corporation were proud to report that: a) All $289,000,000 of Government capital had been repaid to the Treasury, together with about $80 million of interest; b) That coverage for individual depositors had been increased from $5,000 to $10,000; and that c) The cost of insurance to the banks has been reduced greatly.

In keeping with the American philosophy of free enterprise banking, insured banks, in addition to paying the costs and insurance losses of Federal Deposit Insurance Corporation, have been able to build up an insurance fund of about $1,360 million. This growth in our corporate financial strength has been accomplished at diminishing cost to the banks which, in accordance with the Federal Deposit Insurance Act of 1950, continue to receive substantial credits on their assessments. To date, these credits have aggregated more than $212 million.

I should like to quote to you briefly from our report to insured banks as of December 31, 1952. It says, in part:

"Reduction in the cost of deposit insurance has been made possible by the unprecedented stability in banking and the favorable operating experience of the Corporation. The method of effecting these reductions preserves the fundamental principle that deposit insurance is the financial responsibility of the insured banks. To abdicate this responsibility would create a vacuum into which the Government inevitably would be drawn. Reliance on the Government to finance deposit insurance is incompatible with the dual banking system and ultimately could lead to the destruction of free enterprise in banking."

There can be no doubt in your minds that we of Federal Deposit Insurance Corporation stand among the most staunch advocates of the dual banking system. From rostrum to rostrum we have preached the gospel of free-enterprise banking under the dual system for all of these 20 years, and we shall continue to combat any and every effort to alter the character of that system.

It is significant, I believe, that ours is practically the last independent banking system left in this huge world. Dynasties may rise and dynasties may fall, but the confidence of the people in the safety of their savings and their working capital must to us remain the over-riding consideration. Where in other nations banks have been nationalized, we in the United States have been able under our inherent and uninhibited right to speak our minds to maintain a truly independent system of banking, ready and willing to serve the needs of each community and able to mobilize the Nation's resources in time of emergency.

In the early years of the Corporation's existence we were called upon to aid depositors in banks that had extremely weak asset conditions. Large banks for the most part, and located mainly in the Mid-Atlantic region, these institutions had been admitted to insurance under the "solvency certification" of the Banking Act of 1933. Had they been adequately capitalized, or had today's economic conditions then prevailed, many of these banks could have survived. But they were not, and they did not, so we did our duty.

During the past several years, the calls for help have come for a different reason. From 1944 until this year, the banks which have required help have gotten into difficulty because of defalcations.

Nowlet me state for the record that we of Federal Deposit Insurance

Corporation do not believe that the rate and the amounts of defalcations have increased. It is much more likely that improved methods of supervision and modernized managerial techniques have turned up many that have lain dormant for years. It must be recognized, however, that of the 22 cases in which the Corporation has been called upon for financial aid since January 1, 1946, 19 have been the direct result of defalcations.

After a study of the cases which have occurred during the intervening years and after a review of those which occurred earlier, I have come to the conclusion that the primary fault lies not with those who do the misfeasance, but rather with those who permit it to happen.

It is time for those who claim the title of bank director to start directing. It is time for them to start "knowing their Marys and Joes". It is time for them to realize that attending a casual meeting irregularly is not enough to justify their title and that such indifference may be enough to jeopardize not only their standing in the community but their pocketbooks. Those are the two factors that got them the jobs in the first place and they are the two places where it could hurt most if they fail to fulfill their responsibilities.

Defalcations in banks, just as in most other businesses, don't just happen. There has to be an underlying cause. Let me say again that the banking profession, statistically, is a profession of the highest integrity in this respect.

What can be done about eliminating these occasional occurrences? Well, in the first place, we in the supervisory and insuring fields have been introducing new techniques and improving our examining procedures, with the idea of doing the best possible job on our side. We have long been aware of the hazards that are involved and we are working constantly to close what gaps exist, within the limitations of our functions and our capabilities.

On the other side of the picture, the bankers are doing a fine job. There has been general acceptance of our suggestions for improved internal controls. Furthermore, our examiners are instructed to be constantly on the alert for techniques which they find employed in one insured bank that may be beneficial in other institutions.

You men gathered here today are thoroughly familiar with the many simple steps that can be taken to minimize the danger of defalcations. It would be presumptuous to preach to you about them. But I shall take the liberty of reviewing a few of the fundamental safety factors in the hope that you will spread the gospel.

It is significant that of the 19 banks requiring financial aid from Federal Deposit Insurance Corporation as the result of fidelity losses from January 1, 1946 through the end of 1952, all but one held deposits of less than $3.5 million.

That is not to say that irregularities do not occur in larger institutions, but the banks that were grievously damaged through breaches of trust -- those in which fidelity bonds and capital accounts could not equal the depredations of trusted officers and employees -- fell among the small size groupings.

What we hope is that you who have the knowledge, you who have the welfare of the whole American banking system so close to your hearts, will spread the gospel among the other banks of your acquaintance. Not all of the techhical aspects of protection against fraud -- just the fundamentals.

Our purpose in making this request is selfish only to the extent that we, too, share pride in the record of integrity of the American banking system. Financial losses that the Corporation has been required to assume because of infidelity have been relatively small. Remember that the surety coverage and the capital funds all must be dissipated before the Corporation is called upon to put up a single dime.

The two major selling points you should use in your campaign among the neighboring banks would seem to me to be these:

First: The directors and the stockholders should protect themselves against personal loss and disgrace.

Second: What happens by way of dishonesty in the smallest bank reflects upon the integrity of the largest bank and so breeds distrust of our whole banking structure.

Now, with your permission, I shall mention just a few of the fundamental safeguards which we hope you will use and urge upon your friends in other banks. The first, of course, is compulsory vacations for all employees. In some of the shortages mentioned above the offender had not taken a vacation for years and in many cases he was complimented because of his devotion to duty. We had one case within the last few years where directors inaugurated a policy of compulsory vacations. One of the officers, who thought his manipulations were pretty well covered up, decided to take ten days in Canada. When a long-absent depositor called to make a withdrawal and the ledger sheet was found missing, subsequent study found the vacationer to be short about $80,000.

Another safeguard is rotation of employees. In small banks, this is rarely possible, but its use should be encouraged wherever it is possible. The rotation, of course, should not be on any fixed schedule. Its value lies in the element of surprise.

No matter how small the bank, there should be a complete separation of the teller and the bookkeeping functions. Even in banks as large as $5 and $6 million we have found appalling laxity in observing this basic rule. Allowing one officer or employee to perform both functions is like sending a rabbit to the store for a head of lettuce. The temptation is just too great and the opportunities for wrong-doing too many.

Every time a defalcation is uncovered the hue and cry is heard: "Where were the examiners while this was going on?" Now you know and I know that bank examinations are not and cannot be audits in the true sense of the word. The function of examiners is to verify and appraise assets shown on the books of the banks, to assay the quality and efficiency of bank management and to make recommendations for improvements where they seem necessary.

The audit function is definitely and entirely the responsibility of the board of directors in each bank. In only very rare instances are the directors themselves competent enough as accountants to make by themselves the examinations and audits required by statute. For this reason, we urge that they make provision either through their correspondent banks or through private certified public accountants to have adequate audits made. If the directors can be made to understand that the step is primarily for their own protection, then they could have no valid excuse for neglecting their responsibilities in this supremely important phase of bank operations.

In many cases, smaller banks have grouped together on a county-wide basis to employ auditors to inspect all their institutions periodically. This not only has fulfilled the intent of the statutes, but it has reduced costs to an absolute minimum for participating institutions.

Let it be noted, however, that the directors' responsibility does not end when he has established adequate internal controls and provided for periodic audits by qualified accountants. The human factor must always be uppermost in their considerations and deliberations.

As a general rule, the directors are considered to have discharged this part of their responsibility when they select skilled and competent management to operate the bank. Yet they would be wise to review from time to time the personnel policies being followed by the officers they select. Believe me, these are just as important as the lending policies and the new machines, and the shiny fixtures.

I am convinced that the greatest safeguard against losses is management's continuing personal interest in employees of the bank. A bank has no greater liability than a discontented or neglected employee. It could have no more valuable asset than an employee who is given the feeling of "belonging" and the knowledge that he has someone to turn to in time of trouble or stress.

The management of every bank -- and that includes directors as well as officers -- should know more about their employees, what they think and what they are doing.

We at the Corporation, as I have said, are not convinced that there is an increasing incidence of defalcations. We are in the insurance business, and so study these developments thoroughly. Being in the insurance business and being trustees of the funds paid in by the banks such as you represent, we are equally alert to developments on the asset side of the picture.

It is not time yet to sound the alarm, and we hope that such a time will never come again. But it is time for a word of caution. Loans are expanding at a rapid rate and many of them on marginal security; holdings of municipals are growing gradually, as they should, but any sudden spurt could cause you worry.

We cleaned out the asset debris once. We don't want to have to do it again. As an insurance corporation supported by the banks and making every effort to improve the banks' condition throughout the Nation, our primary concern -- after insuring the safety of depositors' funds -- is the welfare and the prosperity of the banks we insure.

We want the banks to earn money, but not at the sacrifice of safety.

We want the directors of banks to realize and recognize their responsibilities, primarily for their own protection.

We want the management of banks to provide both for the continuing education of their employees and for their welfare.

In summary, what we want -- and I am sure that you do, too -- is to insure a long and praiseworthy life for the American system of free enterprise banking. May we count upon your help?

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