FEDERAL DEPOSIT INSURANCE CORPORATION
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"CONFIDENCE"

ADDRESS OF HONORABLE H. EARL COOK, CHAIRMAN

FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE ANNUAL CONVENTION

OF THE

INDEPENDENT BANKERS ASSOCIATION

DETROIT, MICHIGAN

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It is pleasant to meet again with my friends of the Independent Bankers Association, particularly in the great State of Michigan. The names of two of that State's most distinguished sons, the late Senator Vandenberg and Congressman Jesse Wolcott, appear often in our history. For long years after the establishment of Federal Deposit Insurance Corporation, Senator Vandenberg was our leading advocate and guardian on Capitol Hill. His team-mate on the other side of the Capitol, our friend Jesse Wolcott, has always been a tower of strength to the banking system. Michigan can well be proud of having given to the Nation and to banking these two able legislators.

My theme today is "Confidence". What I have to say about confidence would be hardly worth listening to if I lacked faith in the ultimate goodness of God, and in the force of human progress. We cannot be confident concerning the outcome of every-day problems if we lack faith in the direction and destiny of mankind himself.

Our Nation would not have reached the position of power and responsibility which it occupies today had it not been founded upon confidence in divine wisdom. From the first settlement at Jamestown and the Pilgrims' landing at Plymouth Rock, America's promise of freedom and opportunity has beckoned to oppressed and despondent and enterprising people everywhere. Broad frontiers challenged the spirit of adventure. Individual freedom to dare great things led to great achievements.

Along the way we have, true enough, had our set-backs. We have known the waste of war and depression, and the distress of unemployment. We have seen our savings dissipated during inflation, and consumed during periods of enforced idleness. We have resented the heavy hand of government, and then have welcomed its help. This Nation survives because confidence in its institutions and faith in its destiny refuse to bow to temporary changes of fortune.

By now you must be wondering what all this has to do with banking. It is just this: that banking illustrates within its own province the crucial part that confidence has played in bringing us to our present station.

Whatever the fears and dangers which surround us today, mass bank failures is not one of them. Where twenty years ago banking was enveloped in a cloud of distrust and doubt, today the horizon is clear. It has been said that worry is the interest paid on debts never incurred. In the same vein, it might be said that confidence pays dividends without requiring any investment.

Without confidence, our system of exchange, our very economic system, would collapse. If all creditors tried at the same time to collect what was owed to them, our economic system would become hopelessly snarled, our political institutions would be under severe pressure, even our way of living would be severely affected.

Fortunately, these things are not likely to happen, for as a nation and as individuals, we do have confidence. We show our confidence every time we write or accept a check. We show it when we buy bonds, deposit money in a bank, or take out an insurance policy. Every industry has an important stake in public confidence, but banking leads the list. Banks deal not in goods but in promises, and confidence is the essential element in every promise.

The confidence with which depositors today regard our banking system is a priceless asset. To maintain confidence in our banking system, we should know the elements which are mainly responsible for its existence.

The generally favorable economic climate of the past several years is, of course, the fundamental source of today's confidence. Within the framework, however, banks themselves have achieved a status which has instilled confidence. The sources of this confidence may be summarized in three sentences: (1) Bank failures and depositor losses have been very low during the past twenty years; (2) Banks are today in generally sound condition; and (3) The protection of depositors by the Federal Deposit Insurance Corporation provides valuable reassurance. Let us explore for the moment the validity and significance of each of these statements.

(1) Since the Federal Deposit Insurance Corporation began operations in 1934, its assistance has been enlisted in the cases of 422 banks. During

an equal period before its organization over 15,000 banks failed, more banks than are now in existence.

In 177 cases in which the Corporation has extended its financial aid all depositors have been fully protected. In those cases the Corporation sought to minimize its losses by arranging a transfer of deposit liabilities to another insured bank. The Corporation has also been called upon to protect depositors in 245 receivership cases. In all of them there was the possibility of loss to depositors whose accounts exceeded the basic protection. Yet even in these cases, 99 percent of all depositors and 98 percent of all deposits were fully protected.

This favorable record of few bank failures and low depositor losses has led bank depositors to have confidence that their deposits are safe. They project this reassuring experience into the future.

(2) Just how sound and how worthy of this confidence are banks today?

The stability of present-day banking is one of its salient characteristics. The decline in the number of bank failures, along with rigorous requirements for the chartering of new banks, has stabilized to a great extent the number of banking offices. This situation tends to promote efficiency in the organization and provision of banking services.

Bank assets and bank earnings have reached unprecedented heights. In part this is the normal result of a growing economy; but it is also evidence that banks are meeting the competitive challenge -- that they are moving forward in keeping with their strategic responsibilities.

As to bank assets today, I want to make it clear that we have every reason for assurance concerning their quality.

Our basic security lies in the fact that bank assets represent an investment in our Nation; they are investments in our factories, our homes and our farms. Federal government obligations account for a substantial proportion of the total. Beyond these facts there are several safeguards which offer further reassurance. Appraisal methods based on the intrinsic value of assets, as today's methods are, minimize the untoward effects of market fluctuations. Wholesale liquidations which depress values and spread consternation and frustration are practically eliminated by today's appraisal methods. Moreover, resources are readily available to tide individual banks over a crisis.

Apart from their obligations to depositors, banks themselves have sizeable resources. Capital accounts have grown steadily for many years; for a time their ratio to total liabilities declined, but this course has been reversed. Capital and surplus accounts of all banks now exceed

$15 billion. The practice of setting up reserves for losses and of absorbing losses currently has become increasingly widespread, with the result that portfolios are relatively clear of dead wood.

Improvements in banking practices and better bank management are of paramount importance. All banking problems come to a focus in management. The quality of management makes or breaks a bank. There is growing recognition among bank directors that theirs is a sober responsibility.

(3) The third ingredient of confidence which I mentioned, the Federal Deposit Insurance Corporation, is one in which I am naturally deeply interested. Yet there is more than bias in my belief that the insurance of bank depositors is one of the prime sources of confidence. It has, I believe, been the predominant factor in the favorable experience of the past two decades; and through its examining activities, Federal deposit insurance has contributed further to the soundness of our banking structure. These are positive influences which we should be careful to preserve.

How this confidence in the Corporation has arisen, and what presently supports it, are matters of considerable importance. I should like to suggest that confidence comes primarily from the Corporation's record in being able to meet its statutory responsibilities, and from its presumed ability to meet whatever demands are made upon it.

The contribution of the Federal Deposit Insurance Fund to the maintenance of confidence in our entire banking system is well worthy of note. What is the essential character of the fund, what is an appropriate target for size, and how fast should the fund grow, if at all? These questions have provoked pronounced differences of opinion.

From time to time proposals have been made to curb the growth of the deposit insurance fund. There has been some desire to reduce the amount of assessments paid by insured banks. Some presume that the insurance fund is large enough to take care of all foreseeable contingencies. In considering each such proposal its effect upon depositor confidence is of primary importance.

When Congress amended the Federal deposit insurance law in 1950, it made provision for crediting insured banks with 60 percent of their assessment, after making allowance for Corporation expenses and losses and adding the remainder to the insurance fund. Under terms of this legislation, effective assessments have been reduced more than half in each year since 1950.

Along with this reduction, however, it should be noted that the Congress recognized two important principles: the principle of bank payments for deposit insurance protection, and the necessity for growth in the fund.

The provision for bank assessment payments to the fund rests upon both need and principle. Growth of the fund depends materially upon financial participation by the insured banks. By such participation the banks provide a tangible expression of their faith in the system of deposit insurance. The deposit insurance assessment is a measure of bankers' confidence; it is evidence of their active support of the principle that deposit insurance is a form of mutual aid and not dependent upon a government subsidy.

Should bankers cease to contribute to the growth of the fund, the question of subsidy could be raised again. Both the Corporation and the banks have been steadfast in their efforts to eliminate public subsidies from the structure of deposit insurance. If the assessments paid by insured bankers were to end, there would be some basis for the contention that they had repudiated their efforts to eliminate subsidy.

To be sure, if the low loss experience of the past few years continues the deposit insurance fund would continue to grow without bank assessment payments, through the income on its investments. These, however, are principally in obligations of the Federal government. If the sole support of deposit insurance came indirectly from the general funds of the Federal government in the form of interest on the investment, critics could charge that banks had become passive beneficiaries of public subsidy. Insured banks would not want to lose the prerogatives and status which derive from their position as active participants in the fund. Think of what it would mean if the fund lost its character as the mutual endeavor of all insured banks. What then would be the basis for distinguishing the insured from the noninsured bank?

Aside from these matters of principle, the size of the deposit insurance fund is a matter of more significance than meets the eye. At the end of 1953 the fund amounted to $1,450 million. This may seem like a large amount; yet relatively to the deposit liabilities of insured banks, it is no larger -- in fact, it is smaller -- than it was 20 years ago.

Expansion, not stagnation, is the outstanding characteristic of our economy. Depositors look with favor upon the growing deposit insurance fund. So long as it grows along with the rest of the economy, it stands as an important symbol of strength.

Yet it is more than a symbol. It is a resource readily available for the protection of insured depositors. So far the total insurance losses incurred by the Corporation have totaled $28 million, a figure sometimes cited as evidence that the fund is sufficiently large to take care of all conceivable losses. Proud as we are of this fine record, it should be made clear that net losses are not an adequate measure of demands which might be placed upon the fund.

The operation of deposit insurance requires outlays much greater than the ultimate net losses sustained in protecting depositors. When an insured bank gets into difficulty, and the Corporation advances funds to pay off depositors, it acquires assets that may require several years to liquidate. The ability to manage and to hold these assets until liquidation opportunities arise accounts in large part for our favorable loss experience. Up to now Corporation disbursements to protect depositors have been more than ten times as much as our realized losses.

Deposit liabilities of insured banks now stand at record totals. Recognizing the possibility that these banks in the future may require relatively more assistance, the fund seems not out of line with possible demands upon it. It is worth noting that there are 14 insured banks, each with deposits larger than the Fund. Certainly, we are not looking for trouble to originate with them; nor would the amount of working capital which we might be called upon to provide be more than a fraction of their total deposits. However, the situation does not justify ignoring our contingent liability.

Sometimes the need for a large fund, or indeed the need for any fund, is discounted because of the borrowing authority of the Corporation. We have authority to borrow up to $3 billion from the U.S. Treasury. However, this borrowing authority has always been looked upon only as a last resort. It must be apparent that at the moment we draw upon this line of credit, the character of deposit insurance would change. We would lose that independence which comes from our ability to operate on our own. Banks would become liable to charges of public subsidy. The act of borrowing to meet its obligations would be regrettable evidence that the Corporation has not realized the hopes and intentions of its founders. In the minds of depositors it could be construed as a sign of weakness. The popular confidence which is the mainstay and support of our banking system would suffer an incalculable shock.

In closing, I should like again to refer to Senator Vandenberg, and his appraisal of the importance of confidence. I do this with some hesitancy, although anyone associated with the Federal Deposit Insurance Corporation feels proud of his comments concerning the Corporation. These are words of his back in 1947, contained in a letter to Senator Bridges:

> "The FDIC is the most important of all contributors to the psychology of public confidence in the public and private fiscal system of this country. It was a banking crisis

which actually precipitated our great depression in the early thirties. The first necessity in meeting that depression was to cure popular distrust of our banking system and to create unlimited confidence in it. This is precisely what the FDIC did and has continued to do with spectacular success ever since. It is the most successful single instrumentality of Government created this century. Just why we should start to tamper with its status at this particular moment is beyond my comprehension. Although we are entirely surrounded these days by economic uncertainty and economic anxiety in all other directions, there is no worry about our banking system. The answer is the FDIC. I confess that I am totally unable to understand why Congress should do anything to upset this priceless psychology."

Let us hope that Senator Vandenberg was right, and that the source of confidence in our banking system will continue to be nurtured in keeping with their importance.

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