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ADVANCE - FOR RELEASE 10:00 A.M. EST, THURSDAY, OCT. 14, 1954

"THE CORPORATION'S STATUTORY RESPONSIBILITIES"

ADDRESS OF

H. EARL COOK
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE

NATIONAL ASSOCIATION
SUPERVISORS OF STATE BANKS

RALEIGH, NORTH CAROLINA

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"THE CORPORATION'S STATUTORY RESPONSIBILITIES"

Each of you at some time has had occasion to point out to bank directors the legal responsibilities which accompany their charter or license to engage in banking. In fulfilling this task of bank supervision you are doing what is required of you by virtue of the office which you hold. That office was created by your State legislature. It was created to implement and enforce the laws which govern banking in your State. The definite legal responsibilities of your office are outlined in those statutes. Your official actions are regulated by them and your decisions are made in accordance with them.

The statutory frame-work within which you operate is not confined to State departments of banking. Individual directors of all banks have definite legal responsibilities, just as you have specific responsibilities for administering the banking laws of your respective States. The Board of Directors of the Federal Deposit Insurance Corporation has comparable legal responsibilities delegated to it by the Congress. As defined by the Congress and, in some instances, delegated by the Board of Directors to the Supervising Examiners in the different districts, these statutory responsibilities are definite and explicit. More than that, they incorporate the results of fruitful experience and considered judgment.

Conditions for Success of Deposit Insurance

When the frame-work of the Federal Deposit Insurance Corporation was being laid out in 1933 and 1935, its architects were able to draw upon over a century of experience with previous measures to protect bank creditors. From both the successes and the failures among these early guaranty systems came valuable lessons. The basic dilemma which confronted the architects of this new attempt to protect bank depositors was clearly stated by Chairman Crowley during the course of hearings on the revision of the Act in 1935. Replying to a question of Senator Glass, Mr. Crowley stated:

> "Senator, you cannot hope to keep this Corporation solvent unless you give it either tremendous income, or unless you give it supervisory powers and the right to correct unsound practices . . ."

The soundness of this logic cannot be refuted. The losses of the Corporation can be kept within the limits supportable at a reasonable cost to the banks only if the Corporation is given specific implements to minimize its losses. When the Congress formulated the permanent insurance plan in 1935, it could have provided a larger income, more in keeping with the actual losses experienced during the preceding decades of banking; or it could have provided a lower income predicated upon smaller losses and the means to keep them small. The Congress elected to give the new Corporation specific powers to supervise its risk. That is the most significant single characteristic of Federal deposit insurance.

The obverse side of power is responsibility. When the Congress empowered the Corporation to do certain things to minimize its risk, it simultaneously imposed upon the Corporation's Board of Directors a responsibility to take prescribed legal measures. The different actions set forth in the statutes vary in importance and in consequence. Yet irrespective of their significance, they are equal in that all are mandatory obligations laid upon the Corporation's Board of Directors.

Insurance of New Banks

One of the most important ways to reduce the insurance risk, and certainly the first in terms of sequence, is to accept for insurance only those banks which have a reasonable prospect of success. When Federal deposit insurance began existing banks were accepted upon a show of solvency only. But definite and more rigorous standards for admission to insurance were set in 1935. The Corporation gained greater freedom and at the same time accepted greater responsibility in admitting new banks to insurance.

The actions of the Corporation in considering applications for deposit insurance are carefully governed by statute. Sections 4, 5 and 6 of the Federal Deposit Insurance Act prescribe the manner in which a new bank may qualify for deposit insurance. New national banks are

certified to the Board of Directors of the Corporation by the Comptroller of the Currency. Newly organized State banks which initially become members of the Federal Reserve System are certified to the Board of Directors of the Corporation by the Board of Governors of the Federal Reserve System. Other State chartered banks, newly organized or operating, which desire to be insured are admitted upon application to and examination by the Corporation and approval by the Board of Directors.

The law requires certain factors to be enumerated in the certification of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System, and the same factors must be considered by the Board of Directors of the Corporation. Section 6 of the Federal Deposit Insurance Act, which enumerates these factors, reads as follows:

> "SEC. 6. The factors to be enumerated in the certificate required under section 4 and to be considered by the Board of Directors under section 5 shall be the following: The financial history and condition of the bank, the adequacy of its capital structure, its future earnings prospects, the general character of its management, the convenience and needs of the community to be served by the bank, and whether or not its corporate powers are consistent with the purposes of this Act."

I invite your special attention to the language of Section 6. It is unequivocal. "The factors . . . to be considered by the Board of Directors . . . shall be the following:....". The Act makes clear that the responsibility of the Board in this matter is mandatory and not discretionary.

We may be sure that this language was deliberate and not accidental. By defining the responsibility of the Directors of the Corporation in considering new risks, it sought to bring those risks within reasonable bounds.

Termination of Deposit Insurance

The determination to insure only acceptable risks was reflected also in the specific power and responsibility to terminate the deposit insurance of any bank found to be operating in an unsafe and unsound manner. The power to terminate insurance was quickly recognized as a corollary of the Corporation's responsibility to have some measure of control over its risk. Some of the preceding State systems of deposit guaranty failed for lack of authority to expel defiant and unsound banks, thus giving particular point to the need for authority in this area. Testifying before the Senate Committee on this matter in 1935, Mr. Crowley stated, and I quote:

> "We also believe that the insurance Corporation should have the right to terminate the insurance of any bank if, after a hearing and after notice to depositors, such action is in

> the best interest of both depositors and the Corporation. In establishing deposit insurance, Congress has assumed not only a definite responsibility to bank depositors, but also a moral obligation for the sound management of banks."

To carry out this important responsibility the Congress set forth in Section 8(a) of the Federal Deposit Insurance Act a clear mandate to the Directors of the Corporation. Here is the language of this Section:

> "Whenever the Board of Directors (of the Corporation) shall find that an insured bank or its directors or trustees have continued unsafe or unsound practices in conducting the business of such bank, or have knowingly or negligently permitted any of its officers or agents to violate any provision of any law or regulation to which the insured bank is subject, the Board of Directors shall. . ."

and there the section lists specific courses of action to be taken.

Again you will note that the Act provides no alternative. The sense of the language is obvious. The words "when the Board shall find" impose upon the Board the duty to be alert to find forbidden practices. When such findings are made, the Act defines the course of actions which must follow.

To protect sound insured banks insofar as possible from paying for the errors of incompetent and self-serving managements is a basic supervisory responsibility. The authority to terminate the insurance of the few banks which engage in unsafe and unsound practices and violations of law permits the Corporation to guard against intolerable burdens and gross injustice.

Establishment of Branches

Control over the establishment of branches is not of the same degree of importance as the authority to grant and terminate insurance. I might even mention that in England banks may establish branches at will without the prior approval of a supervisory agency. However, we have a different tradition and a different situation in this nation, for the number and character of branches vitally affect our banking system.

Section 18(d) of the Federal Deposit Insurance Act requires the consent of the Corporation to the establishment of branches by State non-member insured banks. It also requires the consent of the Corporation to the change of location of such branches or the change of location of the main office of a State non-member insured bank. Comparable authority with respect to national banks and State banks members of the Federal Reserve System vests, respectively, in the Comptroller of the Currency and in the Board of Governors of the Federal Reserve System. The scope

of authority in regard to the establishment of branches and changes of location varies considerably among the several States, and the Corporation's actions in individual cases are, of course, governed by the laws of the respective States.

Retirement of Capital

Consent of the Corporation for an insured non-member State bank to reduce the amount or retire any part of its common or preferred capital stock is required by Section 18(c). The withdrawal of capital funds in connection with the consolidation, merger, or conversion of insured banks is also governed by this subsection. Authority over the withdrawal of funds in merger cases is vested in the Corporation if the resultant bank is to be an insured State non-member bank.

Display of Federal Deposit Insurance Signs

The display of information to the effect that the deposits of banks are insured by the Corporation is governed by Section 18(a). Specifically, the law provides that the Board of Directors shall prescribe by regulation the forms of window signs, the manner of display and the substance and manner of use of such statements.

The purpose of this provision was to place the depositing public on notice as to whether or not an individual bank is insured by the Corporation. With this knowledge each depositor would be permitted to exercise his own discretion in choosing between a bank insured by the Corporation and one not so insured. Unfortunately, this intended safeguard has not fully served its purpose. There have been several instances where non-insured banks failed and where the majority of the depositors did not realize until after their rude awakening that they were not protected by Federal deposit insurance. Each instance of this kind impresses upon the Board of Directors of the Federal Deposit Insurance Corporation its responsibility under the law to enforce its advertising regulations strictly. It is not immodesty but a deep concern for the protection of depositors which prompts these regulations.

Approval of Bank Employees Convicted of Dishonesty

Making its first appearance in the 1950 revision of the law, Section 19 of the Act reads as follows:

> "Except with the written consent of the Corporation, no person shall serve as a director, officer, or employee of an insured bank who has been convicted, or who is hereafter convicted, of any criminal offense involving dishonesty or a breach of trust. For each willful violation of this prohibition, the bank involved shall be subject to a penalty of not more than $100 for each day this prohibition is violated, which the Corporation may recover for its use."

This provision of the law applies to all insured banks, whether State or national.

The background of this particular provision of the law shows how the hard school of experience has played its role in the evolution of deposit insurance. In the early days of the Corporation a certain individual promoted the organization of a bank in one of our States. Investigation of the proposal disclosed that several years previously this individual had been convicted of serious irregularities in connection with his management of a bank in another State. It was therefore required by the State authority and the Corporation that he be disassociated from the proposed bank. When this was done the bank was duly chartered and insured. However, as soon as the bank opened, this individual re-entered the scene as Executive Officer of the bank. The State statute did not permit the Commissioner to remove him and the Corporation could remove him only through threatened termination proceedings. In less than a year a shortage of several thousand dollars was discovered in this small new bank, placing it in a very precarious position. Section 19 of the present Act is designed to prevent the repetition of such circumstances.

Fidelity Bonds

The architects of Federal deposit insurance visualized the Corporation primarily as a fortress against honest mistakes of financial judgment and economic distress, and only secondarily as insurance against dishonesty. Long before 1933 protection against losses due to the dishonesty of employees was available at moderate cost. In keeping with this distinction the Corporation has encouraged the banks themselves to take out adequate fidelity bonds, keeping in reserve its full authority to require insured banks to carry such bond.

Section 18(e) of the Act authorizes the Corporation to require any insured bank to provide protection and indemnity against burglary, defalcation and other similar insurable losses. Whenever any insured bank refuses to comply with such requirements the Corporation may contract for such protection and indemnity and add its cost to the assessment otherwise payable by the bank. Not yet having had to resort to this extreme procedure, the Corporation has cooperated actively with other supervisory authorities in the encouragement of more adequate fidelity and indemnity coverage by banks. In these efforts it has met with a high degree of success, the benefits of which have accrued not only to the Corporation but in even greater measure to the stockholders of banks.

Protection of Depositors

Let us turn now to the chief beneficiary of Federal deposit insurance--the depositing public. To depositors the Federal Deposit Insurance Corporation means one thing and one thing only. It is the agency of Government which was established to maintain the liquidity of their deposit funds at all times and to make them readily available up to the maximum insurance limit. The law provides that whenever an insured bank shall

have been closed by action of its Board of Directors or by the appropriate supervisory authority, payment of the insured deposits in such bank shall be made by the Corporation as quickly as possible. The alternative methods of discharging this obligation are specifically set forth in the law.

The Corporation has made every effort to comply with both the letter and the spirit of this mandate. In absorption cases made possible by the financial assistance of the Corporation, there has ordinarily been no disruption in the depositor's normal business relations with his bank. In receivership cases depositors ordinarily have been able to claim their funds within two weeks following the closing of the bank. In the few instances when the Corporation has not been able to perform with this normal degree of promptness, the delays have been occasioned by local statutory technicalities over which the Corporation had no control. Promptness has been achieved at no sacrifice of substance, as over 99 percent of all depositors of closed insured banks have been fully protected against loss.

Liquidation of Assets

Federal deposit insurance does more than assure protection for depositors. It recognizes and respects the interest of debtors when an insured bank finds itself in difficulty. The Federal Deposit Insurance Act directs the Corporation "to realize upon the assets of such closed banks, having due regard to the condition of credit in the locality."

The intent of this provision is obvious. It enables the banks' debtors to discharge their obligations to the bank in an orderly manner without being forced to sacrifice asset values on a depressed market. This disposition has also been advantageous to the Corporation in its role as creditor. Despite the adverse selection of assets obtained from closed insured banks the Corporation has so far recovered about nine-tenths of its total disbursements. These recoveries have been many times greater than could have been realized from a hasty liquidation program.

Liability of Stockholders and Directors

Questions have sometimes been raised about the propriety, or possible impropriety, of the Corporation's actions against directors of a closed bank for damages resulting from these directors' failure to discharge their statutory responsibilities. The language of the law as it applies to this situation is unequivocal. The very sentence which directs the Corporation to realize upon the assets of a closed bank with due regard to the condition of credit in the bank's locality includes this following clause, and I quote: "to enforce the individual liabilities of the stockholders and directors."

This provision of the law was designed to discourage careless and reckless individuals from imposing unjustified obligations on the insurance fund at the expense of prudent and conscientious bankers. Apart from its

deterrent aspects, it has also encouraged many stockholders and directors to take a more active interest in their banks, and has thus contributed greatly to the improvement of banking practices.

Summary

Criticisms which sometimes follow specific actions of the Corporation convince me that there exists some confusion of the purposes sought to be accomplished by deposit insurance. And even more, there seems to be a lack of understanding of the relation between those purposes and the instruments which the Congress made available to the Corporation for their accomplishment.

It is, in fact, an understatement to say that Congress made these tools available; rather, they directed the Corporation to use them. We have not alone the power but equally the responsibility to withhold insurance from unworthy banks; to terminate the insurance of banks which persistently violate sound banking practices; to control the establishment of branches and the retirement of bank capital; to regulate advertising of the fact of deposit insurance; to prevent the employment by banks of persons convicted of dishonesty and breaches of faith; to require banks to carry adequate fidelity bonds; to protect depositors; to be mindful of debtors as well as creditors in the liquidation of assets; and to enforce the liability of bank directors.

In discharging these responsibilities we are just a group of ordinary individuals trying to fulfill an assignment. A highly important task we think it is, too, for upon the conscientious performance of our mandate from the Congress depends in large part the welfare of our banking community.

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