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"OUR STATE BANKING SYSTEM -- PAST AND FUTURE"

ADDRESS OF

H. EARL COOK
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE

STATE BANK DIVISION
AMERICAN BANKERS ASSOCIATION

ATLANTIC CITY, NEW JERSEY OCTOBER 18, 1954

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It is an honor, and most pleasant to appear before you this morning. The fact that this is the 80th convention of the American Bankers Association testifies to the heritage of cooperation and mutuality of purpose which is yours as American bankers. Today I want to talk of the contribution of the State banking system to the building of this heritage. For although you each operate under one of 52 different governmental authorities, your banks nevertheless constitute a system with an historic past and a challenging future.

This American system of State banking is unique in structure; it is imposing in strength, and it is dynamic in performance. Comprising more than 9,000 banks, State banking extends into every section of the Nation -- meeting the daily requirements of millions of farmers, manufacturers, merchants and consumers. With assets totaling about $85 billion, State banks account for almost two-thirds of the number of all commercial banks; in many States the proportion is still higher, and in 10 States four-fifths, or more, of all commercial banks are operating under State charter.

Probably there is no better testimonial to the inherent vitality of State banking than the history of its progress to its present stature. The beginning was not easy, for a movement to abolish banking appeared early in our history. When the earliest bank failures occurred -- at about the time of the War of 1812 -- the fact that they were unexpected immediately brought to life an anti-bank sentiment which was to be of great significance for the next few decades. This feeling was intensified as the Nation's fickle currency supply began to bewilder the average citizen. Each bank issued its own notes, choosing its own size and color. Counterfeiting flourished, while raised and mutilated notes, as well as the notes of non-existent banks, added to the confusion. No businessman could be sure of the value of his currency until he consulted the "banknote table", published daily in the local paper.

The wave of anti-bank feeling which swept the country did not consist merely of criticism or dislike -- of which we all have occasionally been the victims -- but instead took the form of insistent demands for the outright abolition of all banks. "Destroy the banks" was the cry heard in many quarters, and not a few of these were heeded by State legislatures.

At one time no fewer than nine States forbade banking. Several incorporated such prohibitions in their constitutions. Other States, while permitting the operation of banks previously started, placed great obstacles in their paths n an undisguised effort to eradicate them. There have come down to us many stories of those who understood the importance of banking to the growth of the Nation and therefore fought to preserve and improve the banks.

As we look back upon this period it is evident that one of the basic difficulties was the very novelty of banking. It was a time when both the bankers and the public were learning how banks operated and what they could, and could not, do. Some of the abuses were undoubtedly the result of ignorance, rather than design, while some of the opposition was an understandable reaction to a new and misunderstood business.

The deep depression of the late 1830's and early 1840's had at least one favorable consequence: it eliminated many banks which had flagrantly violated the canons of sound banking and left the way clear for the State banking system to enter what we might term its "golden age". Anti-bank feeling gradually subsided and, for 20 years beginning in 1845, the system flourished and introduced many of the great improvements which ever since have been hallmarks of American banking.

We can cite first in this connection the development of the clearing house. It is not likely that today's highly complex business of banking could operate without a clearing mechanism. For a long time clearings were conducted on a primitive basis, even in the largest cities. Messengers from each bank would make the rounds daily -- or sometimes weekly or monthly in the western and southern States -- returning notes, checks, and other obligations. It was recognized quite early that a change was necessary but it was difficult to accomplish this in such a highly individualistic industry. The forerunner of the modern clearing house was established in Boston in the middle 1820's when the Suffolk Bank made arrangements to redeem the notes of New England "country banks" permitting each "country bank" in turn to redeem by offsetting, in whole or in part, with notes of other "country banks" received in the course of business.

The first modern clearing house was established in New York City in 1853. In the beginning there was strong opposition to the idea that one central office handle daily clearings. However, this opposition, which came largely from the older bankers, gradually subsided, disappearing entirely when it became apparent that the clearing house was fulfilling a long-needed function. The idea soon spread to other cities and at the time the national banking system was established clearing houses were in operation in Boston, Philadelphia, Baltimore and New York.

Deposit insurance represents another contribution of the State banking system prior to 1860. In 1829 Joshua Forman, a public spirited merchant from central New York State, proposed to the then Governor, Martin Van Buren, that the disastrous consequences of bank failures might be mitigated by a system whereby the banks provided an insurance fund for the redemption of the obligations of failed banks. Mr. Forman, incidentally, conceived this idea while visiting Canton, China, where the so-called "Hong Merchants" made themselves mutually responsible for the debts of a failing member. New York immediately adopted his insurance plan, which in some ways was quite similar to Federal deposit insurance, and within the next thirty years five other States followed this example.

The record of these early State insurance plans shows that depositors and noteholders of failed banks received, in most instances, a degree of protection never before available. Most successful were the systems of Indiana, Ohio, and Iowa. Substantial protection was also received by creditors of failed banks in New York and Vermont during this period. Eventually most of these systems came to an end because the charters of the participating banks expired or because of their conversion to national banks.

A third significant improvement in banking, originating under the State banking system, was the development of modern techniques of bank supervision. When banking began in this country supervision was virtually nonexistent; it was not even considered within the authority of the State! What supervision there was took the form of reports of condition, but this was done only because, in most instances, the State was a stockholder. For example, as late as 1837 the right of the State of Louisiana to exercise supervisory authority over two banks was denied by the bankers on the grounds that the State held no stock in their banks.

In many States it was found that the early reports of condition to the legislature were both inadequate and irregular. Consequently, members of the legislature were sometimes appointed to determine the accuracy of these statements. These were the first bank examiners, but it should be noted that their examinations were limited to an investigation of the correctness of the totals shown on condition reports; examiners were rarely permitted to appraise the actual condition of bank assets.

When New York was considering adoption of its pioneer insurance program in 1829 the charge that insurance would place a premium on reckless banking -- to the detriment of the well-managed banks -- was soon raised. It became obvious that if the banks were to be mutually responsible for each others' actions then, at the same time, there would have to be developed some method of preventing unsafe and unsound banking. Consequently, in the same act which provided for insurance the New York legislature introduced a revolutionary concept of bank supervision; first, examiners would be appointed to devote full time to, and receive adequate compensation for, the examination of banks; second, they would be given unrestricted access to bank records and could recommend the closing of a bank for unsafe and unsound banking practices; third, examinations would be made at regular intervals.

As we would expect, there was considerable opposition to this proposal. Most of the opposition to the insurance legislation was directed not against insurance itself, but against the hitherto unheard-of idea that banks should be examined by trained individuals specifically appointed for that task. However, the merits of such a policy soon became evident and, without exception, every State which adopted bank-obligation insurance made provision at the same time for a system of bank supervision. Many other States which did not provide for the insurance of bank-obligations also adopted similar supervisory programs.

There were many other advances made during this aptly-termed "golden age" of State banking. Among them: management techniques were improved; capital positions were strengthened; State participation in banking largely disappeared and, in many States, banking systems were developed which, to this day, have been unsurpassed in strength and integrity. Needless to say, all the problems had not been solved -- particularly in the frontier States - but the progress which had been made justified the fondest hopes of State banking enthusiasts.

In 1861 the period I have just reviewed came to an abrupt end with the outbreak of war between the States. There was a fear that the State banks would not be equal to the task of assisting in its financing. And although the problem of a currency supply consisting of many varieties of notes was gradually lessening, there were many who felt that there should be a more uniform currency. Consequently, a system of banking under Federal charter was proposed, and finally adopted in 1863.

At the beginning of that year all of the chartered banks in the country were operating under State sanction, but within about five years the number constituted less than 15 percent. As a matter of fact, toward the end of the 1860's there were less than 300 State banks and few doubted that they were witnessing the death of a great State Bank System.

The State bankers did not stand idly by at this seeming break-up of their system. The contest was marked with bitterness, since it was common knowledge that many supporters of the national banking system hoped through this new Act to eliminate the State banks forever. Actually, for the first two years after passage of the National Bank Act the State banking system seemed to be waging a winning fight. At the end of 1863 there were only 66 national as compared with 1,466 State banks; by the end of the following year there were still relatively few national banks although the number was now 467. It was becoming clear to the proponents of the national banking sustem that their act had to be revised and additional measures adopted to encourage acceptance of the new system.

In 1865 the national banking act was thoroughly rewritten to make it more attractive to State bankers. But more important, a Federal tax of 10 percent was levied on the notes of every State bank. Except for the larger cities, where the State banks had developed a large deposit business, this seemed to be tantamount to a prohibition of State banking. In areas of the country where banknotes were essential to the operations of farmers and businessmen the typical State bank had either to close or join the national banking system.

We can see the effects of these 1865 measures in the cold statistics of banking. By the end of that year the number of national banks had increased from 467 to 1294 while State banks declined from well over one thousand to only 349. This trend continued during the next few years until it appeared by the end of the decade as though the State banking system was about to disappear entirely.

We all know what saved the State banking system: deposit banking began to grow in giant strides. In the years prior to 1860 deposits had been smaller than the volume of circulating notes but their subsequent growth was so rapid that by the middle 1880's deposits were more than four times as large as circulating notes. The State banking system took a new lease on life beginning in 1870 and in about twenty years the number of its banks once again exceeded the number of national banks.

When we reflect on the numerous developments which have occurred in American banking, one of the most important was emergence of our dual banking system; for the outcome of that contest between two great banking systems was a victory of neither one nor the other. It was another step in the ladder of America's economy. It was not realized at that time that there was room for both systems, and even more important, that free-enterprise banking would actually be more effective with two healthy systems, rather than with only one.

How can we best sum up the heritage of the State banking system? I would say that it is the ability to adapt to changing requirements and conditons without sacrifice of the essential function of meeting the financial needs of the local community and the Nation. Of course, we are all interested in making sure that this heritage is not dissipated. We want it passed on with even greater luster to those who will follow. Consequently it is appropriate now to suggest an important way in which this can be done.

This history of the State banking system emphasizes the significant role of bank supervision. Not only is it an essential ingredient to the success of Federal deposit insurance but, more important, good bank supervision is vital to the basic interests of each individual banker. The rules under which examiners operate are merely a summation of preventive measures developed out of an experience of 150 years of banking.

As officers of State banks you have every right to be proud of your State systems and of the men who, throughout the years, have helped to hold your standards high. I believe that it is time for all of us to give these faithful public servants renewed support so that they may do the job which they know they should do -- the type of job you want them to do.

It may surprise some of you to know that in a number of States part of the money you pay for bank examinations and bank supervision does not go to building up the Department but, instead, to the general fund of the State, where it is used for purposes never intended by you. You pay your State taxes: ad valorem real estate and capital stock taxes and, in some states, deposit taxes. You are all in the forefront of support for worthy civic enterprises. You are therefore justified in seeking to assure that the money you pay to support your State banking departments be used for no other purpose.

There are many other things which can be done to help your State banking department do its most effective job. All that is required is your determined and enthusiastic support. Here are a few suggestions which come to me as the result of my experience as a State bank supervisor and from my more recent observations of the problems faced by bank commissioners in other States.

Discretion over the chartering of new banks should be broadened. In some States it is almost mandatory that a charter be granted when the proper forms have been filed and minimum capitalization requirements have been met. Yet there are other factors which are always vitally important to the making of a correct decision. For example, consideration should be given to the ability of the community to support a bank, for if earnings prospects are poor the bank is not likely to be sound. Another factor to be considered, for obvious reasons, is the character of the proposed management. I am confident it is not necessary for me to extend this list in order to make my point that the chartering of new banks is a function which should never be permitted to become routine or the creature of political pressures.

Broader authority to check unsound banking practices is also needed by supervisory authorities in some states. Surprisingly enough, there are still a few States in which supervisory authorities cannot compel a bank to discontinue unsound practices. In some other States the authority actually held does not permit sufficiently prompt action or suitable penalties. The ability to act promptly and decisively in instances of mismanagement may well mean the difference between maintenance of banking stability and financial crisis.

The Bank Commissioner in too many of our States is not adequately compensated for the responsibility with which he is charged, nor is his term of office of such length as will permit him to do the best job.

I regret to say that ;there are a number of States which pay their Bank Commissioners -- who frequently perform other duties as well - a salary no more than that received by examiners with minor responsibility in other supervisory agencies.

As State bankers you can lend your authority and assistance to efforts which will attract to the important business of bank supervision men of high caliber and qualifications. Such positions should be available on a merit basis only -- free from political interference. Salaries should be sufficient to attract highly capable men, and the salary scale should recognize the value of experience. Advanced training programs should be made available and fringe benefits -- particularly those bearing on the health and security of examiners -- initiated or increased. All or most of these things you do with respect to the staffs of your banks -- it is equally in your best interest to see that they are done for those charged with such an exacting and highly specialized job as bank examination.

I am confident that there is no one in this audience who would feel that these suggestions run counter to the long-run interests of bankers. All of us in banking are dedicated to a mutual goal: that of making ever stronger that confidence in the American s stem of dual banking which is so essential to the welfare and economy of the Nation. Neither the heritage of the State banking system nor its present condition of vigorous health should permit us to relax for one moment our efforts in this direction. Trust will be ours only so long as trust is deserved.

Permit me to urge that you take these thoughts home with you, think them over thoroughly in a spirit of reflection, and then undertake to do something about them. I predict that you will derive immense satisfaction from the results which will stem from the attainment of any part, or all, of these goals.

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