FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON

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ADDRESS OF HONORABLE LEO T. CROWLEY, CHAIRMAN OF THE BOARD, OF THE FEDERAL DEPOSIT INSURANCE CORPORATION, AT THE ANNUAL BANQUET OF THE MINNEAPOLIS CHAPTER OF THE AMERICAN INSTITUTE OF BANKING, MINNEAPOLIS, MINNESOTA, WEDNESDAY, MAY 22, 1935:

Introduction

I consider this opportunity which you have so generously given me, not only an occasion to discuss with you certain problems of the Federal Deposit Insurance Corporation, but also an opportunity to hear your views and to consider your solutions to these problems. Particularly do I address these remarks to the members of the American Institute of Banking. In the vigor and enthusiasm of your minds lies my belief that the banking problems of this country are solvable.

General Outline of Remarks

I wish to discuss with you, and very frankly, the problem of bank losses -- the losses which have been incurred by the banking system as a whole. This problem is the primary interest of the Corporation, and its significance to the banking fraternity likewise needs no emphasis. But I will point out that the problem of bank losses is also one of deep social import. Its effects are manifold.

Also in my discussion I wish to speak specifically on the subjects of loan and investment policy, and bank management. Their relationship to the question of bank losses and to one another is by their very nature most intimate.

Bank Losses

The passage of the Federal Deposit Insurance Act has necessitated a complete alteration in the significance of bank losses. Losses were formerly, almost purely a matter of local and individual concern. The slack was absorbed in the community by stockholders and depositors who bore separately and locally the resulting hardships, and the long and demoralizing periods of liquidation. Only insofar as a particular bank failure was a concomitant of more fundamental weaknesses was it a concern of bankers in general. The effect was decidely indirect. Now it is direct. Now, suspensions even in single instances, when they result in losses to depositors, are losses for the entire system and are of definite consequence to all of us. They affect the rate of assessment which you must pay. No longer are losses to burden individual depositors in individual and scattered communities. To the extent that this burden has been lifted through the medium of the Federal Deposit Insurance Corporation it has fallen, upon each contributing insured bank. The problem of losses is now a matter of dollars and cents to every banker.

Under these circumstances it would be well to visualize the extent of these losses in the past, bearing in mind the changed significance of losses in our banking system. During the past 70 years total losses incurred by our commercial banking system have totalled more than $14,000,000,000. Of this enormous sum, $3,300,000,000 have been lost by depositors in suspended banks, and $1,700,000,000 by stockholders in suspended banks. About $8,000,000,000 represent write-offs of depreciated assets in active banks, and the remainder, more than $1,000,000,000, the amount of loss or depreciation in assets of active banks that has not yet been written-off. The estimates of losses in commercial banks are based upon available data which clearly minimizes the facts. The figures for national banks are fairly complete and reliable, and are taken from the reports of the Comptroller of the Currency. The figures for other commercial banks, however, are incomplete, particularly for the period prior to 1920. All failures have not been reported. Bank depositors as well as stockholders, therefore, have suffered losses which have not been recorded. Many records of voluntary liquidation by banks ignore the fact that depositors have not been paid in full. Then again, bank reorganizations in later years have been based upon the waiving of depositors' claims, while in other cases, depositors have voluntarily reduced their claims or made contributions to capital as a means of absorbing losses.

Before passing I would emphasize that of the total losses only about 25 per cent represents the depositors' loss, and it is the depositors' loss in which the Corporation is directly concerned. Nevertheless, the remaining 75 per cent which represents the loss of stockholders has a real significance to the Corporation. Huge losses to stockholders, the constant write-off of depreciated investments, both represent reductions in net invested capital, and to that extent represent a curtailment of the margin of protection to depositors. Therefore, losses to the stockholders are also of great importance to the Corporation.

Further, it is pointed out that should the rate of loss to depositors and stockholders continue, it would necessitate on the average the absorption of nearly one-fourth of the total gross earnings of all commercial banks. This constitutes a charge upon banks and upon the users of bank credit which cannot be justified. Either losses in the future must be greatly reduced, or changes of a radical nature and a complete reappraisal of our banking system will become not only necessary but warranted.

Losses in Future

Bank losses in the future as in the past will be subject to the influences of changes in business activity. However, there are ascertainable weaknesses in our banking structure aside from business depressions which have contributed in large measure to bank failures and losses. These weaknesses are steadily being eliminated. Likewise the past two years have witnessed the addition of many elements of strength to our banking system. I have no doubt that the period ahead will be one of marked improvement.

One of the most insidious sources of weakness has been the overbanked situation. The past few years have seen a substantial elimination of this condition. A drastic reduction of over 14,000 banks has occurred during the past 14 years. In Minnesota alone we note that between the years 1921 and 1934 there was a reduction from 1,536 operating banks to 686.

The competitive lowering of banking standards, the competitive payments of dividends, and the competitive raising of interest rates on deposits, all of which are counterparts of an overbanked situation, can no longer be tolerated. It is imperative that this condition does not return. Let us not consider, however, even at this stage, that our problem has been fully solved. A further purging of those parts of our structure whose weakness detracts from the strength of the whole will be necessary. It will mean the elimination of those banks whose opportunities for profit do not justify existence. Let it be clear, however, that I do not mean by this elimination, the removal of the very cornerstone of our banking system - the strong and independent unit bank. The unit bank has a definite place in a fully developed banking system and can contribute greatly to its social usefulness. Nevertheless, the unit bank must be able to stand upon its own feet and it must be able to move forward with the times. I would point out that the unit banks which now remain have a greater opportunity to operate on a profitable basis than ever before, to increase their powers of resistance, and to justify their economic worth.

The recapitalization program of the Reconstruction Finance Corporation and its strengthening effect is common knowledge. The April 30th figures reveal that the Reconstruction Finance Corporation is the owner of over $900,000,000 worth of preferred stock, capital notes and debentures. Of this $900,000,000 slightly less than $16,000,000 has been placed in 224 Minnesota banks. When we add to this tremendous investment of the R. F. C. the large volume of preferred stock sold to others, new common issues, capital contributions, and the amounts contributed by depositors in waiver plans and otherwise, the magnitude of the capital rehabilitation in our banking system is realized. Over two billions of dollars have been added to the net sound capital of our banking structure.

The higher quality of bank supervision exercised by both State and Federal agencies during the past three years is not the least of those factors which augur well for the future. Common problems and common purposes have brought about a friendly cooperation between these agencies and have added to the effectiveness of their work. In addition, the giant strides made in the field of bank management and personnel, and the increased sense of responsibility on the part of bank directors are of paramount significance.

With these important evidences of strength in our banking system the Federal Deposit Insurance Corporation faces the future. We are not under the illusion that any deposit insurance agency can withstand losses comparable with the losses sustained in the past; losses must and will be less.

The banking problems in this country have often been handled in a manner not unlike Mark Twain's comments on the weather, "Everybody talks about it, but no one does anything about it." The Corporation's liability and responsibility to the banks and to the depositors is real and definite; it demands that we be realists and that we do something about it. And so we understand our responsibilities to mean not only the assuming of losses to depositors, but also the combating of future losses with every energy at our command.

Loan and Investment Policy

I have emphasized the changing significance of bank losses since the advent of the Corporation. It seems to me that a significant change has also taken place in the nature of loan and investment policy — a change which is not, in my opinion, consciously realized by many bankers, and a change which must and should be realized if sound credit conditions are to be maintained and losses curtailed.

The commercial bank has been conceived of as an institution which lends on a short time basis to individuals and enterprises which are engaged in the manufacture, production, and marketing of goods and commodities. This orthodox definition of bank credit is reflected in the language of the Federal Reserve Act which at the present time allows rediscount privileges upon "notes, drafts, and bills of exchange arising out of actual commercial transactions, that is, notes, drafts, and bills of exchange drawn for agricultural, industrial, or commercial purposes," and which have a "maturity at the time of discount of not more than 90 days." It is doubtful whether 20 per cent of the total loans and discounts in the commercial banking institutions of this country at the present time conform to this theoretical ideal of short term self-liquidating paper.

The reason for this lack of demand for pure commercial credit is related to the fact that the business of this nation is, in fact, being conducted more and more each year by large business units and to the fact that the financial practices of business have been changing. There has been an increasing tendency to obtain funds through the issuance of securities rather than through commercial bank borrowings. The demand for credit by small and medium-sized merchants and industrialists has become correspondingly less. This demand for credit formerly supplied banks, particularly in the smaller centers, with an outlet for their funds which was distinctly commercial in nature. The important point is that this curtailment in the demand for commercial loans has forced banks to employ their funds elsewhere. I do not argue the efficacy of this change. I merely urge cognizance of its reality, because it has brought new problems to banking.

This change has been evidenced by the increased importance of investments in securities as an outlet for bank funds and as a source of earnings. Whereas during the past five years there has been a marked decrease in the volume of loans and discounts, there has been an increase in the security holdings of banks.

From the standpoint of bank losses this increase in the proportion of investment securities to total loans and discounts has brought with it new problems. Losses on loans and discounts for national banks during the past 15 or 16 years have been about $1.00 per year for each $100 of loans and discounts. On the other hand, losses on bonds and securities, exclusive of obligations of the United States Government, have averaged approximately $2.00 per year for each $100 of investments. Thus we see that the losses on investment securities have been approximately twice as great as the losses on loans and discounts. The proportion of write-offs subsequently recovered seems to be about the same for both classes of investments. There is no reason to believe that the experience of state banks has been substantially different from that of national banks. The obvious deduction to be made from these figures is that banks on the whole have been better able to appraise the credit risk involved in a loan or discount than in an investment in bonds or securities.

The fact that banks have incurred relatively more losses in their investment accounts than in loans and discounts is now of increasing significance to bankers. The curtailment of losses in this group of assets, particularly demands the attention of bankers. The solution will lie largely with bankers themselves and in the use of men trained and skilled in the analysis and study of investment portfolios. I point this out to the members of the American Institute of Banking as a field of endeavor which holds great opportunities. The increased pooling of investment counsel by banks and the work which is being carried on by the Securities and Exchange Commission in Washington will undoubtedly become of added assistance and significance in this field.

Bank Earnings

Bank earnings in the future must be sufficient to charge-off losses currently or to provide annually reasonable reserves against potential losses. Losses should rightfully be met only from earnings. In the past banks have been prone to allow worthless paper and deadwood to collect in their portfolios without currently meeting this contingency. The result has been that in times of substantial readjustment, a large scaling down of capital structure has become inevitable, and not infrequently suspension with consequent loss to depositors. But losses can no longer be charged against depositors. They are now a charge against the whole system, and it is absolutely necessary that individual bankers protect themselves and the Insurance Fund by providing for these losses as they occur.

The period ahead will undoubtedly be one of substantial improvement and with it will come increased earnings. It will in all probability be a period of sustained low interest rates, and it will therefore be essential that interest expense on account of savings deposits be correspondingly curtailed. There is no reason to believe, however, that it will be a period which will not allow a substantial and fair return to stockholders from their investment. But I emphasize again that this return will be conditioned to a greater degree than ever before upon the skill and soundness of the management.

Undoubtedly the tremendous deflation in loans and discounts which has characterized the recent depression has occasioned both a reticence on the part of the bankers to lend and a tardiness on the part of borrowers to return to the banks. There is already evidence that this stage is passing and that increased earnings from this source will be available, but neglect and unwillingness on the part of bankers to meet legitimate demands may create weaknesses in the banking system. There is as much to be lost by the refusal of loans and the resulting failure to increase earnings as in the granting of loans and the assumption of a reasonable risk.

Personnel and Management

Recently while discussing certain banking problems with a friend in Washington, the remark was proffered that perhaps there were not too many banks, but, too few bankers. And this brings me to the most important of all considerations, not only in banking but in every line of endeavor -- intelligent management and man-power. For this, there is no mechanical substitute; it cannot be created by legislation; it cannot be created by the most judicious supervision. It can be created only by training and education and by an understanding of the social trust which is an integral part of banking.

The responsibility for the sound management of a banking institution rests principally with the local board of directors. Directors must take a more active part in the conduct of their business. They must go to greater lengths to assure themselves that the executives of their banks are competent and that the business is being soundly managed. Not only the directors but also the entire management and each employee must realize in the future more concretely than in the past, that banking is more than an individual business, it is a public trust; that it affects at every contact the public interest, and that it is a public utility in the highest sense. Perhaps we in this country have been somewhat lax in developing and demanding a true sense of responsibility in our bank directors. There can be no effective substitute for this responsibility.

For those of you who are only a short distance within the portals of the banking fraternity, the heritage is many problems. Let it be borne in mind that these problems are not constant or static, but are as dynamic as the nation itself. Let it also be borne in mind that banking is not an easy road to riches, it is a method of life, and a profession. It is for you to add to the sound traditions of that profession.

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