FEDERAL DEPOSIT INSURANCE CORPORATION

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ADDRESS OF

HONORABLE LEO T. CROWLEY

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE

MINNESOTA BANKERS ASSOCIATION

ST. PAUL, MINNESOTA JUNE 17, 1937

ADDRESS OF HON. LEO T. CROWLEY, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, BEFORE THE MINNESOTA STATE BANKERS ASSOCIATION AT THEIR ANNUAL CONVENTION

ST. PAUL, MINNESOTA JUNE 17, 1937

"CURRENT BANKING PROBLEMS"

Mr. Chairman, distinguished guests, and members of the Minnesota Bankers Association:

I am indeed happy to meet with you today. Circumstances have made it impossible for me to accept the invitations which your officers previously were gracious enough to extend to me. Because of my many friendships and associations in the Northwest, I have looked forward to this opportunity to renew my contacts after a three-year absence.

Much has happened during the three years just past. Our thoughts and our ways of life have altered considerably. Many of the doubts and fears which harassed us during the early part of 1934 have disappeared, permanently we hope. The energy and effort we then directed toward stopping the depression and stemming the tide of deflation have turned now to applying brakes to a boom and to preventing inflation. Where in 1934 we saw widespread unemployment, we now hear constantly about the serious shortage of skilled and semi-skilled labor. Surpluses of raw materials and commodities which then filled our warehouses and storage bins have been exhausted and in many cases it is now difficult to meet the demand for these goods. Bank deposits have grown from the low of $41.5 billion in 1933 to an all time high of more than $61

billion as of December 31, 1936. Increased business activity is reflected in available figures of bank debits which indicate that the activity of deposit accounts was 65 percent greater in 1936 than in 1933. Recently released figures indicate that our banks have emerged, temporarily at least, from the lean years of large deficits.

It is good to see these signs. They indicate a return to what we like to think of as normalcy. We take personal pride in them because they represent real achievement in overcoming the tremendous force of an unprecedented depression. We look forward to a fuller realization of their promise since they indicate we may expect soon to regain a fair amount of leisure to devote to outside interests.

Yes, it is good to see these things. I share your joy and your sense of relief at their occurrence. But at the risk of seeming pedantic and a killjoy, I should like here to interpolate a word of caution. May we enjoy to the fullest the fruit of these changes, but may we escape being lulled into a sense of false security. May we not fail to recognize that the conditions we like to think of as normal recently proved highly vulnerable and volatile, indicating that our standards of normalcy need to be raised. May we remember that inimical economic forces have been beaten back before only to return again with even greater destructive force; and may we be farseeing enough to rebuild and reinforce our barricades in anticipation of the next attack.

Let some of our new-found leisure be devoted to restful and complacent musing on the more abstract aspects of our existence. That

is only right. We are tired. It has been too long since we had an opportunity for such relaxation. Let us devote the lion's share of this leisure, however, to clear-headed planning and vigorous application of the plans so that when the business cycle begins its next downward glide our banks will be in shipshape order, sails trimmed, and hatches battened, ready and able to ride out the storm.

By way of approach, let me immediately clarify the background of the remarks I propose to make. My sympathy with the banking situation in Minnesota extends much farther back than my connection with the Federal Deposit Insurance Corporation. I happen to be from a State which, like Minnesota, has a preponderance of State banks. As a member of our Banking Board I lived, ate, and slept the difficulties of State banks during the trying period of the early thirties and the days of reconstruction after the banking holiday. I favor perpetuation of our traditional banking system, and I share your desire to do whatever may be necessary to preserve that system.

I believe, too, that I can understand the sentiments and the point of view of you Minnesotans. I grew up in a frontier State, and I appreciate fully the impetus given to our national economic development by those courageous pioneers, the country bankers.

Unfortunately, though, the record of State banks during the past seventy years has placed the State system on the defensive. And however much it may distress our own cherished memories, the younger generation has forgotten completely the pioneering tradition, and damns the dissipation of its deposits quite without regard for sentimental considerations.

Because I am, as is the Federal Deposit Insurance Corporation, a friend of our traditional banking system, because I believe that proper and timely application of the principles underlying Federal deposit insurance will assure a prosperous future for that system, and because I believe that each of you is really interested in my subject, I propose to talk to you frankly -- as friend should talk to friend. I intend to tell in full detail what we are doing and what we think should be done in the interest of sounder banking. In an equally plain-spoken fashion I shall outline what the banker himself must do to make our efforts bear fruit.

Certainly the record of the last decade and a half constitutes a challenge to the bankers of America. There can be no justification for the shameful fact that during the thirteen-year period from 1921 to 1933, inclusive, 16,800 of this country's banks ceased operations because of financial difficulties, and that of the more than $9 billion of deposits in these banks at the time they closed more than $3 billion have never been recovered by depositors. In your own State of Minnesota during this period 816 banks with deposits in excess of $240 million were suspended. If we can assume that the loss ratio for the country as a whole applied to the situation in this State, it means that from 1921 through 1933 more than $80 million of depositors' funds vanished into thin air. No nation, no State, and no community can long withstand such a continuous seepage of its wealth; nor can any people be expected to bear placidly the suffering and bewilderment of having its funds, whether working

capital or savings, disappear through the workingsof economic forces which are difficult to comprehend.

It requires only ordinary vision to realize what will happen to our banking system in the event this loss record is repeated. Everyone of you here today is to be commended for his courage, because every person who enters the banking business today and every person who has managed to remain in that business throughout the recent purge assumes responsibility not only for his own economic survival, but also for the survival of American banking as it is now and traditionally has been constituted. That, my friends, I consider a real challenge. You and I, as bankers, have assumed a tremendous responsibility. I hope we are capable of carrying the load.

As representative of the Federal Deposit Insurance Corporation I meet with you today more as your partner in the banking business than as a governmental authority. You who pay the bill, whose employees we are, should realize that the Corporation's large financial stake makes its interest in the sound and successful operation of the banking system and of each of your institutions not only the moral and paternalistic interest of a governmental agency, but also the hard, cold cash interest of a stake-holder in your business venture.

In its capacity as insurer of bank deposits the Federal Deposit Insurance Corporation has potential liabilities in excess of $21 billion.

If the loss record I cited above is to recur, the Corporation's ultimate failure is inevitable. The legal provisions for the Corporation's capital, its revenue, and its backlog of emergency borrowing power, all were based on the assumption that the loss record for the future will be considerably less appalling. I am certain that every banker wants to keep at a minimum the cost to him of deposit insurance. Clearly then, the only way out of our dilemma lies in a mutual effort to strengthen the banking system to a point where it can withstand shocks which previously have cracked its foundations. It is inconceivable that our interest in improving the banking system should be at all at variance with the interests of each of you in maintaining a strong institution. Deposit insurance was not created for the purpose of collapsing one day. Neither did any of you enter the banking business with the idea of failing. Our aims are identical. I fail to see that the means to your individual ends can possibly be different in the long run from the means leading to the success of deposit insurance.

The really good banker is eager to raise the standards of his profession -- to purge from the business those men who, through indulging in unsafe and unsound practices, have previously brought the profession into disrepute. The really good banker, therefore, has no better friend than the Federal Deposit Insurance Corporation, which is determined to accomplish the same end. Intelligent bankers look at the broad picture and realize that in the long run the

fortunes of their individual institutions are determined by the fortunes of the whole banking system. You see, Federal deposit insurance is a cooperative plan. The Corporation's success or failure is only incidentally the responsibility of its managers. This responsibility rests primarily upon the bankers themselves. If what the Corporation is trying to accomplish is worthwhile -- and I consider the development of sound banking a praiseworthy goal -- then we deserve not only the tolerance but the active support of every banker in America.

It would probably be appropriate at this time to report briefly upon our stewardship as managers of the Federal Deposit Insurance Corporation. The Corporation recently distributed to insured banks a report of its activites to December 31, 1936 and of its condition on that date. The surplus of the Corporation, representing an excess of income over total expenses and losses from the beginning of deposit insurance, was more than $54 million on December 31. Our income from assessments and from our investments now amounts to about $45 million a year. So far the income from our investment has more than covered both administrative expenses and deposit insurance losses and expenses.

To the general public the principal benefit of deposit insurance is the knowledge that a bank closing in a community no longer brings individual suffering or want or the economic paralysis which formerly was a by-product of the lengthy process of liquidation. To this public I am proud to report that in the seventy-five cases where it was found necessary or desirable to place insured banks in receivership,

between January 1, 1934 and December 31, 1936, the claims of each depositor up to a maximum of $5,000 were made almost immediately available. The 88,912 depositors of these banks, with total deposits of about $22 million, were protected to the extent of $18 million by insurance, off-set, pledge of security, or preferment. All but 446, or one-half of one percent of the depositors, were fully protected against loss.

In an additional twenty-eight cases the Corporation thought it desirable to purchase or loan upon the assets of insured banks in difficulty rather than to let the institutions drift into receivership. In these cases the subject banks were merged with other insured institutions or were reorganized as new banks without interruption to the banking facilities of the towns in which they were located and without loss to any of the banks' depositors.

To you and to me, whose primary interest is preserving the soundness and good health of the financial structure the most important of the Corporation's functions is its power to strengthen that structure, to minimize losses from bank failures, and to protect bank stockholders from assuming more than the ordinary risks of an entrepreneur. You or I would be foolish to believe that bank failures could be eradicated completely. There is nothing unique about banking institutions which will exempt them from susceptibility to the economic forces that control the destinies of other commercial enterprises. The banker deals chiefly with funds belonging to others than stockholders, however, and for this reason there has come to be accepted as a legitimate function of government close supervision of the banker's

exercise of his functions. By undertaking this supervisory duty the government assumes an obligation which it can not ignore, and I can state positively that it is the intention of the Directors of the Federal Deposit Insurance Corporation to exercise vigilantly the supervisory duties that have been delegated to the Corporation. I am confident that the intelligent use of our authority will result not only in increased safety for depositors, but also in a greater degree of security for the investment of bank stockholders.

It is the importance of this supervisory function which leads me to urge careful appraisal of the present state of the banking system and intelligent planning for the future of that system. I should like now to discuss with you a few of the factors which will determine that future.

It would be quite impossible to cover at one sitting all of the contributory causes underlying the suspension and loss records which I cited earlier. The Board of Directors of the Federal Deposit Insurance Corporation is convinced, however, that chief among those causes were two against which an unremitting vigilance must be maintained if a repetition of the recent disastrous period is to be prevented. I refer, of course, to the indiscriminate granting of bank charters and to insufficiency of bank capital.

It is possible that the 30,000 banking institutions which existed in this country in 1920 were really needed, but the disappearance of half that number during the intervening years makes any such assumption

far-fetched. In any event, the popularization of the automobile, the extension of paved roads, changes in financing habits, and similar progressive steps in our economic evolution, all have combined to minimize the need for maintaining banking facilities on a next-door basis. To these facts can be attributed the determination of the Directors of the Corporation to approve only charters which can be justified on the basis of real need, which have reasonable earnings prospects, which are adequately capitalized for their probable volume of business, and which are to be managed by men of proven ability. We are definitely opposed to the chartering of institutions which are economically unsound and likely to fail. Our efforts have received the hearty cooperation of most supervisory and chartering authorities. It is only reasonable to suppose, however, that there will be an increasing pressure for the creation of new banks as, with improving conditions, the banking business becomes more profitable and therefore more attractive for investors. Not only the danger of weakening the system but also the desire to protect his own vested interests should lead every thinking banker to support State and Federal authorities in their drive to place bank chartering on a reasonable basis.

I believe further that no bank should be chartered unless it is admitted to insurance at the time it begins business. However strong and however lucky the management of an individual institution may be, it is absolutely unfair to depositors and to stockholders unnecessarily to accept risks which are beyond the control of the bank manager concerned. The sins of our neighbors can react powerfully upon our own institutions.

Of equal importance with the regulation of new institutions is the problem of insuring profitable operations for banks already in existence. No bank can operate successfully unless it is a profitable enterprise. This fact means, of course, that every banking institution must have a sufficient volume of business to permit it to realize a fair profit from conservative operations. Otherwise the profit must be sought in speculative loans and investments which almost certainly will result in heavy losses.

The development of an adequate volume is an acute problem for many Minnesota banks. Let me remind you that the average deposits of the 816 Minnesota banks which failed between January 1, 1921, and December 31, 1933, were less than $300,000. Classified on the basis of average deposits for 1936, 33 percent of Minnesota's 627 banks had deposits of less than $250,000. An additional 35 percent of the banks had deposits of $250,000 to $500,000, and only 13 percent of your institutions had deposits in excess of $1,000,000.

~~I have before me figures concerning the earnings of insured Minnesota banks not members of the Federal Reserve System for the calendar year 1936. Comparable data for banks members of the Federal Reserve System are not available. I feel genuine concern over the story told by these figures. Twenty-seven percent of all insured nonmember banks in the State ended the year with no net profits or with deficits which represented deductions from their capital accounts. For the country as a whole only 14 percent of nonmember banks fell into this category. This, remember, is the record for 1936, a year of~~

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rising values and large recoveries, following the wholesale elimination of bad assets which occurred during 1934 and 1935. It should be immediately evident that banks can not hope to survive when their operations result in deductions from their total capital account even in good years. To protect what remains of their investment bank stockholders themselves should realize this fact and act accordingly. The Corporation is eager to do all in its power to help insured banks in difficulty to work out their individual situations. In cases where an attempt at remedial action is not forthcoming, however, the Corporation must act before depositors' claims become impaired.

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I do not mean to infer that we believe all small banks unsound and without a place in the banking system, or that the problems of supervision are confined to small banks. That would be far from the truth. Any bank that can afford capable management and can operate profitably without impairing the safety of depositors is a good bank in the eyes of the Federal Deposit Insurance Corporation, no matter how large or how small that bank may be. Natural growth is helping many banks to accomplish this end. It is to be hoped that this growth will continue and that through it many banks will be able to develop an adequate earnings record.

Where the limit of growth has been reached, where the possible margin of growth is insufficient, or where adequate management can not be afforded, I can see only one alternative to ultimate failure. That alternative is some form of merger with one or more neighboring institutions. I realize that suggesting a merger is asking a lot of

a banker. None of us likes to see his own creation pushed into obscurity. Bank managers, however, must subordinate selfish considerations to the best interests of both depositors and stockholders, and I believe that those interests can best be served in the majority of questionable cases by a consolidation or relocation of bank facilities based upon a thorough survey of the banking needs of the State.

My intention in prescribing control of chartering and consolidation of existing facilities, where necessary, is certainly not to deprive a deserving community of banking facilities, but rather to insist that proposed banks must prove that the chances for successful operation are heavily in their favor. There is no doubt that some communities, now bankless, could support and should have banks. On the other hand, many communities even today are seriously overbanked. There are still 16,000 banks in the United States and I should prefer to have the necessary recession in this number accomplished in an orderly managed way.

The mushroom growth of various types of thrift and credit institutions outside the commercial banking structure gives me much concern. I do not doubt that cooperative banks, building and loan associations, credit unions, personal finance companies, and many other types of institution have a legitimate place and serve a useful purpose in many communities. I consider it imperative, however, that the creation and operations of these institutions be subject to as strict regulation as is the case with banks. Our efforts to strengthen banks can be seriously hindered or even defeated by a lax attitude with

respect to the chartering and the competitive activities of financial institutions other than banks. I suggest, therefore, that it is to the advantage of bankers to campaign for the legal regulation of all types of thrift and loan organizations. Those regulatory powers must be delegated to the officer or board that supervises banks in order to ensure a unified financial policy within a State.

Let us assume now that each bank has built up an adequate volume of business, that it is well managed, and that an over-all picture of the banking system, a snapshop as it were, taken today or tomorrow, leaves nothing to be desired from a current, or static, point of view. Shall we rest then, sigh with satisfaction, and announce that a prosperous future for the banking system is assured? I say emphatically not. Ours is a dynamic economy and unpredictability is its outstanding characteristic. Our plans for the future must include adequate provisions for the contingencies which the ebb and flow of business will force upon us. The best preparation a bank can make for these contingencies is to maintain constantly an adequate ratio of capital to assets and to take his losses as they develop.

We know from sad and bitter experience how fickle is that illusive attribute of value by which we measure the worth of our assets. We all hope fervently that values will never again become inflated to their 1928 and '29 levels and that they will never become deflated to the extent we experienced in the early 1930's. Values must fluctuate, though, in a competitive business system and since

we all hope just as fervently for a continuation of that system our best bet, as bankers and bank supervisors, is to attempt to narrow the range of fluctuation and to maintain a capital cushion sufficiently large to absorb unfavorable shifts in values up to a reasonable limit.

To my mind the most disturbing trend in bank balance sheets during the past several decades has been the steady decrease in the ratio of capital funds to either assets or liabilities. The views of the Directors of the Federal Deposit Insurance Corporation on the question of an adequate capital cushion are, I believe, quite generally known. Suffice it here to say that we are now doing and shall continue to do everything in our power to remedy capital deficiencies where they exist and to insist upon the building up and the maintenance of an adequate ratio of net sound capital to net sound assets in every bank for whose well being we are responsible.

Many banks, upon the strength of high liquidity and improved earnings, are now attempting to retire their outstanding preferred capital obligations. I should like to make clear the Corporation's attitude on this issue. In the first place liquidity is not now, has never been, and I hope never will be a proper measure of the adequacy of a bank's capital structure. I realize as well as you that banks are of necessity now more liquid than they ever have been before and that there is less possibility of loss or depreciation developing in these liquid assets than would be the case with what we like to look back on as a normal asset distribution. We cannot assume, however, that this high liquidity will continue indefinitely. You bankers will be the

first to admit that the present condition has its disadvantages and that the sensible thing to do, insofar as capital is concerned, is to plan for future contingencies. We are determined to discourage any reduction in a bank's existing capital structure until the management of that bank has demonstrated not only its willingness but its ability to build and to maintain an adequate capitalization without outside help.

Now, as to the question of dividends. I realize fully that after the long period of famine just past, bank managers are eager to reward the patience of stockholders by resuming the payment of dividends. Rising operating income, appreciation of asset values, and profits taken in the investment portfolios look mighty good to you after so long a period of writing with red ink. I admit readily the right of the owners to a fair return on their investment, and no one will be more pleased than will I when reasonable dividends are the order of the day. I do insist, though, that the bank's condition must at all times be such as to justify beyond question the payment of any dividend. Our examinations of banks have revealed hundreds of cases where worthless assets were allowed to accumulate while dividends were paid during the boom period with the result that when supervisors finally did force their elimination banks faced huge capital impairments or insolvency. The prescription I propose, then, is this: take depreciation regularly and losses as they occur; reserve out of profits a sizeable addition to capital account in anticipation of the next period of deflation; then, and then only, consider

the distribution of dividends.

Let me emphasize that charge-offs should be taken or reserves established as soon as possible after losses have been determined by examination. If a banker can't take his losses as they occur, how can he hope to remove the accumulated deadwood of years when a crisis finally forces action. I would imagine that the experience of 1933 had taught us all a lesson in this respect. I do not claim, mind you, that our examiners are infallible, but I do urge that if there is to be any error, let it be on the side of conservatism. I am old fashioned enough to believe that a banker's first responsibility is to his depositors and that that responsibility is best served by conservative banking. To the few bankers who might not agree with the primacy of the depositors' interests, who think that it is quite all right to bamboozle the depositors, and even the stockholders, by concealing the facts, I say that quite apart from the ethics of the question, it is pretty shortsighted to try to fool yourselves and that is precisely what a refusal to face the facts amounts to.

The greatest single drawback to effective action by a united front of bankers now is the diversity of controlling legislation among the several States. To my mind the National Association of Supervisors of State Banks could make no greater contribution to the well-being of the banking system than the development and enactment of a uniform banking code for State banks. Such a code, in combination with the uniform improvement of banking practices it is possible to accomplish through the Federal Deposit Insurance

Corporation, and uniform call and examination reports and procedure, will ensure to State banks the benefits of a unified working basis without endangering the future of the dual system.

I could go on indefinitely without exhausting all the phases of our mutual problems. I believe, however, that I have covered the points which are most fundamental. It is true that these fundamentals are, or should be, familiar to all of you, but I consider them sufficiently important to bear frequent repetition. Adherence to proper basic principles will almost certainly place our banks in a position to cope successfully with unfavorable economic trends.

In conclusion, I should like to express to Mr. Berry, Minnesota's Commissioner of Banks, my appreciation for the splendid cooperation the Federal Deposit Insurance Corporation has received from his office. I can assure you that the State Banking Department is working untiringly in the interest of State banks and bankers, and that the officers of that Department deserve your confidence and support.

To you bankers of the State, too, we are grateful for the reception you have given deposit insurance and for the earnest effort I believe you are putting forth to operate sound banks. I am sure that you are willing to apply to your own situations the fundamentals with which I have dealt this morning, and I am confident that you will work fearlessly, both as individuals and through your professional associations, to develop in Minnesota banks that will deserve the trust of citizens of the State and that will contribute at least their share to the enduring health and soundness of the nationwide system.

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