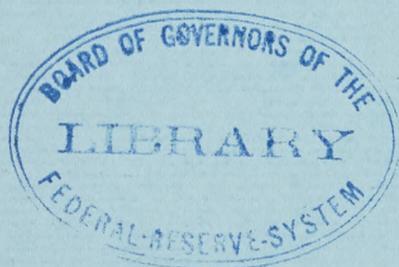


CURRENT BANKING PROBLEMS

An Address Delivered By

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NEBRASKA BANKERS ASSOCIATION
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Mr. Chairman, ladies and gentlemen:

I was gratified to receive an invitation to meet with you today. Not only is it a pleasure for me to be in Nebraska and to visit with you bankers; I appreciate, too, the opportunity to discuss some of our mutual problems and to bring you up to date on what the Federal Deposit Insurance Corporation is trying to accomplish. I have long felt that bank supervisors were far too secretive about their problems and their policies and that as a consequence bankers either lost all interest in the aims of supervision or attached to supervisory moves an air of mystery. It is my hope, therefore, by a frank presentation and a free discussion of our problems to remove any cloak of mystery that still may surround the activities of the Federal Deposit Insurance Corporation, to give you a clear conception of the problems which face the Corporation, and to ask your help in the solution of these problems.

Federal deposit insurance compared with old State guaranty plans

The existence of your Deposit Guarantee Fund in Nebraska from 1911 to 1930 indicates an early realization in this State that something had to be done to prevent losses to depositors. It is true that the Fund was not as successful as had been hoped, but its creation showed a desire to end the economic waste and the individual suffering which the loss of depositors' funds had caused through the years. Further, as was the case with other Statewide attempts at deposit insurance or guaranty, the experience with the Nebraska plan served as a guide to framers of the Federal deposit insurance scheme and enabled them to avoid many pitfalls which had worked to the detriment of Statewide plans.

There can be little question but that the localization of risk, discrimination among classes of banks, insufficient powers of control over banking practices, the lack of discretion over bank chartering, inadequate income, and untimely assessments, were the chief causes for collapse of the State insurance or

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guaranty systems. An attempt has been made in creating the Federal Deposit Insurance Corporation to overcome these fundamental sources of weakness.

The Statewide plans were vulnerable to the effects of such local catastrophes as drought, flood, and insect plagues. In every instance the plans were inaugurated in States which had suffered severely from similar disasters and which, being predominantly agricultural, were most likely to suffer again. By encompassing in its membership banks throughout the entire nation the Federal Deposit Insurance Corporation is better protected against the calamitous effects of these local catastrophes and of the regional economic recessions which occur periodically. The Corporation has been and should continue to be able to meet these occasional emergencies as part of its routine operations and so to keep the country's banking structure as a whole constantly healthy and capable of withstanding adverse movements of the business cycle.

A further source of weakness in the State plans lay in the inability of national banks to cooperate. As a consequence of this discrimination, it was not unusual for State banks to participate in the benefits of the plans until the going became difficult and the benefits expensive, when they converted to national charters and so increased still further the load upon the banks which had to pay the bill. Federal deposit insurance is predicated upon the participation of all banks all of the time. Although membership is not required of State banks not members of the Federal Reserve System, the vast majority of these banks have joined the Corporation voluntarily. Efforts to avoid responsibility in times of stress by withdrawing from insurance will be discouraged by the provision that insurance of deposits in withdrawing banks shall continue for two years after their withdrawal and that the banks must continue to pay assessments during this period.

There can be no insurance on a sound basis without the power to select the insured risk. In Nebraska, as in most of the other States which attempted deposit guaranty, the Superintendent of Banks had, during most of the life of the plan, no discretion with respect to the chartering of new State banks. He was required by law to grant charters to all applicants who complied with the minimum provisions set up by law. As a consequence, there occurred between the inception of the plan

and the agricultural collapse of 1920 and 1921 an unwarranted and a thoroughly unhealthy expansion in the number of State banks. While the FDIC has no direct control over the chartering of banks, it does have the power to pass upon the admission of banks to insurance. In effect this power discourages the organization of institutions which cannot qualify for insurance. This situation has been further improved through the acquisition by nearly every State banking supervisor of discretionary authority over the issuance of charters.

The actual corrective powers of bank supervisory officials have always been somewhat less than is commonly believed. For the most part, the only statutory weapon granted supervisors to enforce observance by banks of legal requirements and sound banking practices has been to place the offending bank in liquidation. Naturally, authorities have hesitated to apply so drastic a measure. The obvious results of this lack of corrective power were the abuses perpetrated by a few unscrupulous bankers, the accumulation of unsound assets, the payment of unearned dividends, and similar practices which made so many of our institutions vulnerable and sent them to the wall when economic developments took an unfavorable turn. The Federal Deposit Insurance Corporation does have power to influence the banking practices of its members through its authority to terminate insurance for cause. We are exerting that influence with notably beneficial results.

The arrangements for financing the various State insurance or guaranty schemes varied widely but were generally inadequate and illogical. In cases where a regular income from assessment upon insured banks was provided, the assessment bore no relation to previous loss experience or to the ability of banks to pay. In all of the guaranty States except one the only means provided for meeting unusual demands upon the funds was by levying special assessments upon participating banks to meet losses as they arose. Naturally, the losses were greatest following catastrophes or periods of declining values when banks were uniformly hard pressed and therefore least able to bear an additional drain upon their profits or reserves. It is quite likely that this method of financing pushed into insolvency many banks which otherwise might have been able to pull through. It is true that the Corporation's assessment income is only one-third as great as would have been required

to cover losses occurring during the seventy years preceding its creation. Congress has felt, however, that the improved condition of the banking structure and higher standards of bank supervision will compensate for this difference. In case of necessity arising from an accumulation of deposit insurance losses the Corporation is empowered to issue its debentures to a maximum of more than one billion dollars, with a par market for \$500,000,000 of these obligations guaranteed by the Treasury and the Reconstruction Finance Corporation. Exercise of its borrowing power, should the need arise, will enable the Corporation to avoid placing a heavier load upon insured banks during difficult times.

Current FDIC payoff and loan statistics

As you all know, the Federal Deposit Insurance Corporation is charged by popular and Congressional mandate with responsibility for protecting from loss the funds of depositors in insured banks. From the beginning of deposit insurance to October 1, 1937, 151 insolvent insured banks were placed in receivership or merged with the aid of loans by the Corporation. The 210,219 depositors in these banks, having total deposits of \$59,237,000, were protected to the extent of \$55,786,000, or more than 90 percent of their claims by insurance, offset, pledge of security, preferment, or through loans and purchases of assets by the Corporation. All but 574, or less than one-half of 1 percent of the depositors in the suspended banks, were fully protected against loss. Of the 151 banks 108, with deposits of \$31,050,000, were placed in receivership and 43, with deposits of \$28,187,000, were merged with other banks with the aid of loans and purchases of assets by the Corporation amounting to \$12,709,000.

Need for building and maintaining sound banking system

Should the loss record of the last seventy years recur, however, neither the Corporation nor the banks could bear the cost that insurance of deposits would involve. The alternative lies in building and maintaining a strong, well managed banking system, capable of withstanding adverse turns of the business wheel and sound enough to keep losses at an irreducible minimum. It is towards achievement of this alter-

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native that the Corporation is directing its most earnest efforts. It is only through achievement of this alternative that deposit insurance can succeed at a reasonable cost to banks. Finally, since the collapse of deposit insurance would almost certainly result in drastic revision of our present system of banking, I do not hesitate to say that it is only through achievement of this alternative that you bankers can hope to perpetuate the system of independent unit banking which you profess to hold so dear.

The channels through which the Corporation is directing its efforts to build for better banking are shaped by our three broad supervisory powers, namely: control of the admission of banks to insurance, control of the activities and practices of insured institutions, and the power to terminate a bank's insured status for cause.

Admission of new banks to insurance

The Directors of the Corporation are determined to approve for insurance only institutions 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 unalterably opposed to the chartering of institutions which are economically unsound and likely to fail. There is no doubt that some communities, now bankless, could support and should have banks. On the other hand, many communities even today have more banks than they can support. I believe that the issuance of new charters should occupy a place on the agenda of supervisors quite subordinate to their efforts to strengthen and make profitable the institutions which are already in existence.

I am confident you will agree with the desirability of restricting the number of new institutions chartered, and I believe you will endorse the factors upon which we base our approval or disapproval of proposed new banks for insurance. It is essential for the welfare of our banking system that the excesses of the past be not repeated. Certainly no deserving community should be deprived of banking facilities, but just as certainly no new institution should be chartered unless the chances for successful operation are heavily in its favor.

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Provision for unprofitable existing banks

The Corporation is equally concerned with the problem of existing institutions which are operating unprofitably and drifting steadily into an unsecure position. In cooperation with the several State supervisors of banking we are undertaking a survey of the banking needs and of the banking facilities of each State. We propose, when this survey is completed, to use its findings as a basis for recommending consolidation or relocation of unprofitable banks in an effort to strengthen the structure within each State and so to serve the best interests of both depositors and stockholders.

Branch banking no answer

It might be pertinent to state here that I do not believe the sort of branch banking which is currently so general a topic of conversation and resolutions represents a solution to the problem of our bankless and marginal towns. Any town that can support a full-time branch can support a unit bank. Iowa, Wisconsin, and several other States have found a partial answer to this problem through the installation of paying and receiving windows which can be operated at a nominal cost or part-time banking offices, which serve bankless towns two or three times a week. Whatever the proper answer may be, I firmly believe that the extent of branch or bank office banking is a matter for determination by each State, and that regulations adopted by a State should govern the status of all banks within its boundaries.

So much, then, for the Corporation's interest in changes in the banking structure.

Supervision of insured institutions

Supervision of the operations and practices of its membership is naturally a vital concern of the Corporation. Bankers would have little respect for a fire insurance company which did not periodically check the condition of buildings it insured. It is just as necessary that the Corporation follow closely the condition and the trends of institutions composing its membership.

Our supervision of insured banks is predicated upon fundamental principles which the years have proved sound and with which bankers can have no quarrel.

We contend that losses should be taken as they arise and that strong capital cushions should be provided to absorb losses and fluctuations in value which cannot be anticipated. Look at the thousands of institutions which failed during the last fifteen years because they refused to follow this fundamental rule. We assert that there is no justification for banks distributing as dividends profits they may have made on the sale of assets at a price greater than cost, and that all such profits should be set aside as reserves against the time when it may be necessary to dispose of assets at a price less than cost. Is there one of you who would countenance a write-up of his inventory by one of your borrowers? We insist that unsafe and unsound practices have no place in the business of banking. Show me a good banker who thinks otherwise.

These **are** fundamental principles, the very rudiments of sound banking, and they should form part of the credo of every banker in this country. The bank that cannot operate profitably by following these rules and by investing only in sound assets has no place in our banking system. The banker who speculates with the funds of his depositors and stockholders or who otherwise abuses his position of trust is directly responsible for the unpleasantly notorious reputation of bankers in recent years. I say that every such man should be drummed out of the profession. There is no reason why sound banking and profitable banking cannot be reconciled. Neither is there any reason why sound and profitable banking should not become the rule in this country. The cooperation of you bankers is indispensable, however, if we are to reach this goal.

An address I delivered recently before the Kentucky Bankers Association stressed the desirability of keeping the supervisory structure of laws and regulations governing bank operations at a minimum. I favor leaving as wide a field as possible open to the exercise of their judgment and discretion by bankers. Yet, as I pointed out in Kentucky, the boundaries of this field are actually determined by the results of this exercise of initiative by bankers, as reflected in the soundness of their institutions and the safety of their depositors' funds. More stringent regulation of the banking business has been brought about principally through misuse of their privileges by bankers. The course of future regulation will depend chiefly upon how bankers meet their responsibilities.

Termination of insured status

It has fortunately been necessary for the Corporation to use its power to terminate a bank's insurance in only a very limited number of cases. Most insured banks promptly correct objectionable practices which are discovered by the Corporation's examiners. In obdurate cases the intervention of the State or national supervisory authority has generally sufficed to hasten corrective action. The power of expulsion enables the Corporation to protect both itself and well managed insured banks from the losses which follow unrestrained indulgence in unsafe and unsound practices. This power rounds out the prerogatives granted the Corporation in order that its insured membership may constantly be maintained at a quality consistent with the principles of insurance, and in order that depositors may be adequately protected against loss at a reasonable cost to insured banks.

Some aspects of banking situation in Nebraska

Turning now to the banking situation in your own State, I should like to discuss with you a few of the problems which seem to me most vitally to affect the course of banking improvement in Nebraska. By way of approach, let me say immediately that my sympathy with the problems of Nebraska extends much farther back than my connection with the Federal Deposit Insurance Corporation. I believe I can understand the sentiments and the point of view of your Nebraskans. 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. I believe that the merits of our dual system of independent unit banking by private enterprise outweigh its weaknesses, and I shall support that system so long as it functions with the safety of depositors' funds as the primary controlling factor.

I should like also to draw your attention to the fact that no other agency or group of people has so great a financial concern with the wellbeing of the banking system as has the Federal Deposit Insurance Corporation. The Corporation's potential twenty billion dollar liability in insured banks ranks it far ahead of stockholders and individual depositors as the principal beneficiary of soundness for this country's banks. Our concern

with the banking problems which still exist in various States is therefore, easy to understand. It is logical that this concern should be shared by you bankers who, in the last analysis, pay the bill when our liabilities become payable as a result of bank closings.

The Corporation's experience in Nebraska has been characterized by splendid cooperation on the part of your Department of Banking. To your Superintendent of Banks, Mr. Saunders, to his very capable Deputy, Mr. McLain, and to the other members of the Department's staff I voice our thanks for their invaluable aid and our hope that this friendly relation will long continue.

Recent chartering history

The principal problem of banks everywhere is that of profitability. No bank can long survive unless it is a profitable enterprise. I have stated already our determination that profits shall be obtained only through sound bank operations which do not imperil depositors' funds. Speculative ventures cannot be tolerated. Neither can we look with favor upon the tendency of many banks to capitalize upon their local monopoly by charging exorbitant rates of interest upon extensions of credit to their customers.

In order to protect their opportunities for legitimate profit, Nebraska banks should encourage extreme care in authorizing additional banks in the State. New banks will generally aggravate an already thin situation. A total of sixteen new State charters were granted in Nebraska between January 1, 1934 and October 1, 1937. Three of these institutions have already ended their brief careers through voluntary liquidation.

Two points seem to me worthy of comment in connection with recent chartering history in Nebraska. In the first place seven of the sixteen institutions I mentioned came into being as noninsured banks. I believe 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 to accept risks which are beyond the control of the bank manager concerned. The sins of our neighbors can react potently upon our own institutions, and it behooves bankers to provide all available protection for their depositors.

Second, I must express my extreme regret that it was found expedient in 1934 to lower the minimum capital required for the establishment of a new bank in Nebraska from \$25,000 to \$10,000. I had imagined that the frantic efforts in 1933 to obtain additional capital and to reorganize, usually at the expense of depositors, had demonstrated clearly the difficulties that can be encountered even by banks with large capital accounts. When State banks in Nebraska required \$2,000,000 of capital from the RFC, another \$500,000 through the sale of preferred stock to the public, capital contributions, assessments, and deposit waivers aggregating another \$6,000,000, reduction in the beginning capital of new banks seems the very last course indicated. I hope that an upward revision of these requirements will be forthcoming at an early date, since the Federal Deposit Insurance Corporation cannot, in justice to the sound banks composing its membership, admit to insurance new banks which are inadequately capitalized.

Nebraska banks enjoy sound asset position

It is pleasant to be able to report that State banks in Nebraska currently hold an asset position which compares favorably with the record of any other State in the country. The portion of total assets of Nebraska State banks classified by our examiners as loss and doubtful is less than half as great as for the country as a whole. The capital ratios of these banks likewise compare favorably with the nation's average, though some banks still require additional capital if they are to be adequately cushioned against unfavorable developments.

Attainment costly, however

Let me urge, however, that you not forget the sacrifices that were necessary to attain this strong position. I reviewed previously the capital rehabilitation that Nebraska State banks underwent to repair their shaky positions after the banking holiday. National banks in the State sold an additional \$6,000,000 of preferred obligations during this period of reconstruction. During 1934, 1935, and 1936 State Banks in Nebraska wrote off losses and depreciation totaling more than \$5,000,000, while national banks in the State eliminated assets with a carrying value of about \$15,000,000 during the same period. This was truly a great price to pay for the privilege of continu-

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ing in business. When we add to it the \$240,000,000 of deposits in Nebraska banks which failed between January 1, 1921 and the inception of Federal deposit insurance on January 1, 1934, the figure assumes staggering proportions.

Repetition of outlay can be avoided

I believe that a repetition of this wholesale dissipation of wealth can be avoided. Certainly it must be avoided if our present system of banking is to continue. All bank supervision today is aimed at safeguarding bank depositors from loss. But the efficacy of supervision is seriously impaired if bankers do not cooperate whole-heartedly in the attempt to create and to maintain a sound banking structure. In retrospect, it is possible to trace the losses I cited above to their sources in the practices supervision is now trying to combat. Losses were allowed to accumulate during good times. In hundreds of cases dividends were paid regularly when the bank's earnings' record forbade any at all. Individual bank capital accounts were allowed to shrink or to remain static, so that even nominal fluctuations in values could result in severe impairment or even insolvency for these institutions. Finally, and not least important, the courage and consistency of supervisory policies in most jurisdictions was not above criticism.

Through improved supervision

I believe it is generally agreed that supervision today is more constructive and more consistent than has ever before been the case. I can assure you that the FDIC's liability in the nation's banks makes it incumbent upon that agency to continue its policy of thorough surveillance of the activities of insured banks, making no concessions to political or personal expediency, building constantly for a sounder banking system, and giving to depositors the protection and sense of security they deserve but have seldom had.

And improved standards of bank management

Good bankers can have no quarrel with our objectives, since they are identical with the aims of good bankers. The conscientious banker can analyze his own institution and remedy defects in its organization or procedure quite as effectively as a

bank examiner, if he will take the time and retain an open mind. Curiously enough, the complaints we receive about the severity of our examiners come almost without exception from banks which most need severe scrutiny and constructive help. Fortunately, most bankers are as conservative as our most critical examiners. I have not yet given up hope that this majority will someday approach unanimity.

I stated earlier in my remarks that I favored continuation of our traditional system of independent unit banking. I neglected then to remind you that the destiny of that system is entirely in your hands. Deposit insurance will, I believe, help to perpetuate the system, but even with deposit insurance a keener awareness of their responsibilities by bankers and a more deserving tenure of their stewardship will be required. I hope we may rely upon each of you to support our efforts to promote sound banking. If you will abjure guesswork, work as a part of the system rather than as isolated units, strive constantly to improve the quality of your assets and the ability of your managements, I am confident that the system will survive and that it will prove worthy of the trust of depositors.

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