



FEDERAL DEPOSIT INSURANCE CORPORATION
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BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

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ADDRESS OF

HONORABLE LEO T. CROWLEY

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE

THIRD ANNUAL CONFERENCE ON BANKING,
UNIVERSITY OF ILLINOIS

CHAMPAIGN-URBANA, ILLINOIS NOVEMBER 23, 1937

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"STRENGTHENING THE BANKING SYSTEM"

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- *Likely lead.

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"STRENGTHENING OUR BANKING SYSTEM"

Mr. Chairman, Ladies and Gentlemen:

It is a far cry from the days of the old apprentice system, when men in business learned only by doing, to the days of gatherings such as this, which finds bankers from several States, both masters of the art and apprentices, come together to learn of recent developments affecting their profession. The spirit which your presence here today attests is a good omen for the future of American banking. It is one thing to realize that each of us has much to learn if we are properly to serve the people of America as custodians of their wealth and providers of their legitimate credit needs. It is another and more laudable thing to acknowledge this need publicly by your attendance at this conference.

I consider it significant, too, that your meeting should be held under the sponsorship of the College of Commerce and Business Administration of the State University. Despite their recent origin, Colleges of Commerce have already proved themselves an indispensable part of our educational system. I doubt that there is one of us who has not benefitted in some way from the excellent training given by these institutions to the youth of America during the last thirty years. Neither should we underestimate the part played by these colleges and their able staffs in gaining for this country the commercial and

financial leadership of the world.

The purpose of my own presence here today is two-fold. Like you, I come to learn. In addition, I come in an official capacity to report to the bankers of Illinois and surrounding States upon the activities of the Federal Deposit Insurance Corporation and upon the efforts of that organization to build for better banking in America.

"Deposit insurance, by lulling depositors into a sense of false security will encourage bad and irresponsible banking. Deposit insurance is no substitute for good banking." Do those statements have a familiar ring? In them are summarized the chief objections put forth by bankers and others at the time Federal insurance of deposits was proposed. What validity do they retain after four years of practical operations by the FDIC? The constant aim of the Corporation's management has been certainly not to substitute deposit insurance for good banking, but rather to build through deposit insurance for a stronger banking system than the country ever has had. I believe we are succeeding. Let's look at the record and see if you agree.

First of all, what task was set the Federal Deposit Insurance Corporation. Briefly, we were charged to protect the depositors of insured banks from loss. Losses suffered by bank depositors in years gone by reached staggering proportions. Of the \$9,000,000,000 of deposits in the 16,800 banks which closed in this country between 1921 and 1933, more than \$3,000,000,000 have not yet been recovered by depositors. More than 1,100 banks, with deposits of \$654,000,000, suspended in Illinois during this period. It is estimated that \$220,000,000 of these deposits have never been repaid to depositors.

An additional \$50,000,000 were poured into Illinois banks which did remain open or reorganize, in the form of stock assessments, contributions, or deposit waivers. An end to this wholesale dissipation of wealth was imperative. Federal deposit insurance was conceived and enacted by Congress as the most likely means of ending losses to depositors.

To make possible execution of its assignment the Federal Deposit Insurance Corporation was given certain resources and certain powers of supervision over insured banks. An initial capital of \$289,000,000, subscribed by the United States Treasury and the twelve Federal reserve banks, and a regular income from assessment upon the deposits of insured banks were provided to enable the Corporation to reimburse depositors in insured banks which it was found necessary or desirable to close. The Corporation's supervisory powers are designed to reduce the claims on our resources arising through insured bank failures. These powers fall into three broad classes: first, control of the admission of banks to insurance; second, supervision of the activities and practices of insured institutions; and third, power to terminate the insured status of banks found to be violating law or consistently indulging in unsafe and unsound practices.

We must look for the answer to those objections to Federal deposit insurance I cited earlier in the uses made by the Corporation of these tools during its first four years of existence. From the beginning of deposit insurance to October 31, 1937, 160 insolvent insured banks were placed in receivership or merged with the aid of loans by the Corporation. The 254,000 depositors in these banks,

whose deposits totaled \$66,993,000, were protected to the extent of \$63,460,000, 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 587, or less than one-half of 1 percent of the depositors in the suspended banks, were fully protected against loss. Of the 160 banks, 112 with deposits of \$33,155,000 were placed in receivership and 48, with deposits of \$33,838,000 were merged with other banks with the aid of loans and purchases of assets by the Corporation amounting to \$15,909,000.

Should the loss record of the last few decades recur, however, neither the Corporation nor the banks could bear the outlay that insurance of deposits would involve. Consequently, the Corporation is directing its most earnest efforts along the likeliest route to successful deposit insurance. That route is a long, uphill climb directed toward 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 hoped that intelligent exercise of its supervisory powers by the Corporation, with the cooperation and understanding of bankers, will give this country a strong banking system and will give to depositors the protection and sense of security they deserve, but have seldom had.

While the FDIC has no direct control over the chartering of banks, it does have power to pass upon the admission of banks to insurance. In effect, this power discourages the organization of banks which cannot qualify for insurance. The Directors of the Federal Deposit Insurance Corporation are convinced that careless and indiscriminate chartering policies contributed to the losses suffered by

depositors in past years. We therefore 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.

I believe there is general agreement that the Corporation's supervision of the activities of insured banks has been constructive, and that banking practices, standards, and management are improving, due in part, at least, to our supervisory and educational efforts. It has been our aim constantly to approach the problems of individual institutions sympathetically and with a real desire to work out whatever difficulties may be encountered to the best advantage of both depositors and proprietors. Charges that our examiners are unduly severe are heard from time to time, but almost without exception investigation has disclosed that the complaints came from banks which most needed thorough scrutiny and constructive help. Thinking bankers everywhere realize that if the Corporation is to help build a strong banking system it must occasionally injure the feelings of individuals; but they realize also that no question of personalities is involved. The Corporation's interest in sound and safe banking requires frequently that it controvert the established habits and fetishes of individual bankers. Building for a strong banking system implies that policies must transcend even the factitious barriers of class and geographic location.

It has fortunately been necessary for the Corporation to use its power to terminate a bank's insured status in only a very limited

number of cases. Most insured banks promptly correct objectionable practices which are brought to their attention by the Corporation's examiners. In obstinate cases the intervention of the State or national supervisory authority has generally sufficed to hasten corrective action. The power of expulsion is essential, however, if the Corporation is to protect both itself and well managed insured banks from the losses which follow unrestrained indulgence in unsafe and unsound practices.

The record to date, then, shows little to support the contention that deposit insurance has encouraged bad and irresponsible banking. On the contrary, four years of deposit insurance have convinced me that in the Corporation bankers have an actual and a potential force for good which, with their cooperation, can do more than ever has been done to give the United States a strong banking system.

Lest I seem too enthusiastic and optimistic, let me say immediately that I recognize the unusual circumstances surrounding the Corporation's first few years, and that I am aware that our efforts and the efforts of bankers must continue or even increase along many lines if the objective we hope for is to materialize. Federal deposit insurance was inaugurated immediately after the purge of the banking system which culminated in the banking holiday of 1933. Insured banks have benefitted greatly since that time as a result of rising prices, and increased production and trade. In military parlance, it is imperative that we consolidate our gains as we progress, building defenses upon which we can rely for the protection of those gains, should the need arise.

Several factors have combined during the past several years to reduce the likelihood of another rapid over-expansion of banking facilities such as occurred during and after the World War. Nearly every State supervisor of banking has acquired discretionary authority over the issuance of new charters in his jurisdiction. Higher requirements for beginning capital and the prolonged scarcity of dividend payments on bank stocks have lessened the incentive for opportunists to promote new institutions. As conditions improve, however, and as the business of banking again becomes profitable, it is only reasonable to assume that there will be an increasing demand for the issuance of new charters. It is incumbent upon the Corporation and upon you bankers to make certain that accessions to that demand stay within the bounds of reason.

I do not endorse an arbitrary approach to charter applications. 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 propose merely that action upon charter applications shall be taken only after a thorough investigation of the adequacy of existing banking facilities, and that changes in the banking structure, whatever their nature, shall be approached carefully. The issuance of new charters should occupy a place on the program of bank supervisors quite subordinate to their efforts to strengthen and make profitable the institutions already in existence. In many cases there are alternative solutions to the problem of bankless towns which would work to the advantage of all concerned. Frequently, existing banks can be moved to neighboring towns where

better earnings prospects improve their chances to succeed. Moves of this sort have a double advantage: they provide service for the bankless town, and they rescue institutions that are drifting into insolvency. In other cases, the plans of paying and receiving stations or part-time offices now in force in several States might prove to be the proper solution to the problem of bankless towns. Whatever the solution, let care and reason prevail, let concessions to political and personal expediency be taboo in this important respect, and let us avoid a repetition of the excesses which precipitated our recent collapse.

Characteristic of our times has been the mushroom growth of thrift and loan institutions other than banks. I shall not attempt to guess to what extent voluntary or involuntary curtailment of their thrift and credit facilities by banks led to the outcropping of building and loan associations, cooperative banks, credit unions, and similar institutions. I am concerned not so much by the competitive threat which these organizations present to the banking system; it is rather the fact that their organization and operations are largely unregulated which disturbs me. Formulation and execution of effective financial and banking policies is difficult when any considerable portion of the country's private financial transactions are carried on outside the field of banking regulation. I believe, therefore, that immediate steps should be taken to correlate with the supervision of banks both the chartering and the supervision of these miscellaneous institutions.

I spoke earlier of the importance I attach to gatherings such as this. Conferences on this order have been inaugurated already to

my knowledge in more than a half-dozen States, and the plan is gaining popularity every year. Regional meetings such as the New England Bank Management Conference and the regional conferences of the American Bankers Association are additional evidences of our bankers' thirst for knowledge and their earnest desire to become better bankers. The American Institute of Banking, the Graduate School of Banking, Colleges of Commerce all over the country, scores of evening schools, and many home study courses cater to thousands of individuals in the banking business. They all contribute to the improvement of bank management and banking standards.

Much remains to be done by all of us, however. Banking is a noble and a worthy profession. It behooves us to do all in our power to keep it so. Self-improvement is only half the battle. There unfortunately always will be in every profession some few individuals who, either through ignorance or for selfish ends, abuse their positions of trust and so bring disrepute upon the whole profession. Good bankers must assume responsibility for instructing the ignorant members of their fraternity and for drumming out of the profession the unscrupulous few.

Improvement of banking practices cannot gain full momentum until we have awakened in every banker a keen awareness of his responsibilities as manager of an institution of loan and investment. For various reasons--among them the low earnings records of the last few years, and in your own State, the fact that many banks have pledged earnings for some time to come to retire outstanding certificates of beneficial interest--there has been a tendency among bankers recently to seek profits through speculative transactions. It should hardly

be necessary to point out again the impossibility of reconciling speculation with sound banking. Needless to say, the Corporation cannot and will not tolerate any attempt by insured banks to accumulate profits at the sacrifice of safety for depositors.

The traditional conservatism of bankers has made them the butt of many jokes, and occasionally even of the wrath of some irresponsible applicants for credit. Let us not doubt for a minute, though, that this conservatism is precisely what the vast majority of bank customers look for and admire and trust. A joke or two and the displeasure of a few are infinitely to be preferred to shame and disgrace and the distrust of a whole community. And be not deluded. The inevitable consequences of speculation with depositors' funds and similar abuses of trust are shame and disgrace and the distrust of your community--distrust not of yourself alone, unfortunately, but of the whole banking system.

There is another tendency shown by many bankers which I cannot condone. This tendency was given expression during the discussion following one of my recent addresses. "How, Mr. Crowley," said a banker, "do you expect us to do justice by the farmers in our community when your examiners are continually criticizing our extensions of credit? Don't they realize that our country has had drought and no crops for five years now? Our farmers not only can't pay their old debts; they need new advances to enable them to carry on until they do hit a crop." Here, plainly, there was need for restating the order of a banker's responsibilities: first, to his depositors, second, to his stockholders, and third, to his borrowers. This banker not only had completely forgotten the first two groups, he had a grotesque idea of what constituted

service to his borrowers. Can it be called service when a banker loans upon the security of a farmer's only team of horses and forecloses when things become tight. Is it service in any sense for a banker to loan during good times without making provision for amortization of the loan, so that when bad times roll around he must either pyramid his extension of credit or wipe out the borrower, usually not without loss to the bank. I say that every banker would do well to keep constantly in mind the true order of his responsibilities and to define those responsibilities in terms that weigh carefully the best interests of his customers and his bank.

I have spoken in previous addresses of the importance the Corporation attaches to the current elimination of losses and depreciation by insured banks. Maintenance of a constantly clean institution must be a primary concern of every banker. I also have discussed the unsoundness of paying unearned dividends, and the necessity for retaining as reserves profits realized from the sale of assets at a price greater than cost. These factors are innately important as individual banking principles, but their principal importance arises from their influence upon the sound capital position of insured banks.

It is imperative that each insured bank maintain a sound capital sufficient to absorb shocks to which it may be subjected. Experience has shown that ability to meet deposit withdrawals which arise in the normal course of business is not sufficient for most banks. Frequently unexpected shrinkages in community incomes precipitate extraordinary withdrawals. It is rarely possible for bankers to forecast at what time they will be forced by these emergency demands to liquidate some of their holdings. My points, therefore, are: first, that a bank's

capital cushion should be ample to protect it through the ordinary contingencies of the business cycle; and second, that bankers should not confuse that fickle concept, liquidity, with an adequate capital structure--liquidity may supplement, but never replace, an adequate capital.

It seems to me, too, that a movement of private capital into the country's banks is long past-due. Increased local participation seems called for not only in cases where additional capital is needed to build an adequate ratio, but also to replace large blocks of the preferred capital sold to the RFC during the period of reconstruction. RFC aid was necessary and welcome in a time of emergency when it was impossible to obtain needed capital locally. Continuous Government participation in ownership of the country's banks, however, is quite inconsistent with the theory and practice of private capitalism. Independent unit banking is predicated upon the assumption that local problems can best be solved locally. Does it not follow that the greater the local participation in bank ownership, the broader that bank's appeal to the community and the better its chances of enlisting the services of capable directors and officers?

Most important of the steps I consider requisite for permanent strengthening of our banking system is the development and enactment of a set of minimum operating standards which will apply to all insured banks. I can hear already the horrified cries that will arise to greet this proposal, based on the charge that the Corporation is attempting to usurp States' rights. In anticipation of this criticism, may I say that we have no such intention. The Corporation has worked satisfactorily and

in close harmony with the several State departments of banking and we prefer to continue working on that basis. The loss records of the State systems have placed them on the defensive. There can be no doubt that the disparate aims and controls of the various State systems were largely responsible for this record. The purpose of our proposal is to remedy the competitive disadvantage of State banks.

Deposit insurance is essentially a mutual proposition, aimed at safety for depositors through the soundness of the whole banking system. Mutuality implies that all participants shall play according to the same rules. It is unfair that banks in States with high standards and strict controls should have to pay for the mistakes and losses arising in banks in States with lax regulations. It is not right that sound, well managed banks should be called upon to bail out incompetent bankers and unjustifiable banks as a result of speculative losses and poor investments. If these inequities are to be remedied, the working program of the several classes of banks must be strengthened and placed on a basically uniform basis.

There are also inequitable features in the present plan of assessment upon insured banks for purposes of deposit insurance. At the present time the assessment bears no relation either to relative risk or to concentration of risk in individual banks. If these inequities are to be remedied we must develop some reliable measure of risk. Further, any reduction in the total annual assessment payments by insured banks must await definite proof that banking standards have improved, that the ability and integrity of bank managers are above suspicion, that supervisors are willing to enforce laws and policies consistently and

courageously, and that the 15,000 banks of this country are working as a group, towards common ends, rather than as isolated individuals.

The banks of Illinois currently enjoy an asset position which compares favorably with those of most States in the country. Your banks, on the whole, are sound and well run institutions. The Corporation has benefitted from the full cooperation of your Auditor of Public Accounts, Mr. Edward J. Barrett. Though it may seem paradoxical, these are precisely the reasons I detail our problems and solicit your support today. Single-handed, our efforts are likely to be barren. With the good bankers and the forward-looking departments of banking on our side there is no limit to what we jointly can accomplish to strengthen the banking system.
