FEDERAL DEPOSIT INSURANCE CORPORATION
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ADDRESS OF

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BEFORE THE

BANKERS FORUM, NEW YORK CHAPTER

AMERICAN INSTITUTE OF BANKING

NEW YORK CITY APRIL 13, 1938

EXCERPTS FROM THE ADDRESS OF HONORABLE LEO T. CROWLEY, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, BEFORE THE BANKERS FORUM, NEW YORK CHAPTER AMERICAN INSTITUTE OF BANKING

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Mr. Chairman, members of the Bankers Forum:

I greatly appreciate the opportunity of meeting with so representative a group of New York bankers. Large metropolitan banks have always been an important force in moulding the opinions and guiding the practices of smaller institutions throughout the country. Representatives of these banks should, therefore, be currently informed of developments in fields which affect all banks. I am confident that you will listen with interest this evening to a resume' of the FDIC's activities and to its plans for the future for another reason. Banks in New York State hold about thirty percent of the nation's total deposits. Consequently, these banks, many with a relatively low ratio of insurance coverage, pay thirty percent of the assessments which go to build up the fund constituting the Corporation's resources. This preponderant interest in the financial basis of the Corporation should add to your interest in a report of our operations and plans.

Deposit insurance came into existence because more than $3,500,000,000 of depositors' funds were dissipated during the years between 1865 and 1933. No banking system with the weaknesses this record indicates can expect to maintain the confidence of bank depositors. When the collapse of the system in 1933 demonstrated that public confidence in financial institutions had been destroyed, there were two alternatives open to Congress as means to its restoration. First, the banking function could have been taken out of the realm of private enterprise, all banks nationalized, and the safety of banks made directly dependent upon the soundness of the Nation's credit. Despite the system's weakness, it was thought inadvisable to subject it to such drastic revision at that time. Instead, the second alternative was chosen. Federal insurance of deposits was adopted as a legislative measure to restore popular confidence in the banks and to maintain that reborn confidence through progressive correction of the weaknesses in the existing system.

Now I believe that when Government assumes responsibility for the supervision of banks and for the safety of deposits, depositors have a right to expect that their insured claims shall be safe and liquid at all times. As a governmental supervisory agency, the FDIC has this responsibility. As insurer of the safety of more than $20 billion of depositors' funds, its responsibility is unique and unprecedented.

I believe further that Congress chose wisely between the possible alternatives. I believe that the virtues of our system of independent banking by private enterprise outweigh its weaknesses. I believe that deposit insurance, properly administered and properly supported by bankers, can perpetuate that system. And I say that if deposit insurance does fail that failure will be due not to anything fallacious in the idea of deposit insurance, but rather to those of the system's weaknesses we are unable to correct. Confidence has been restored; it will be maintained only so long as depositors can be certain that their banks are well managed and that they are thoroughly examined and adequately supervised by governmental authorities.

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It is a matter of common knowledge that the silent runs of so-called "wise money" precipitated most of the larger metropolitan bank failures. I believe, however, that in their analysis of the subject metropolitan bankers have not given sufficient importance to certain factors which preceded the larger metropolitan failures. "Wise money" did not become fearful and large banks did not fail until many years of continuous disintegration and loss in agricultural sections of the country furnished grounds for apprehension. It is both easy and informative to follow statistically the wave of bank failures from its inception in agricultural districts through smaller urban centers and into the large cities. I believe that proper supervisory attention to the predicament of country banks during the period of disintegration could have broken that wave and would have helped greatly to maintain confidence, even of the "wise money", in the banking system.

Deposit insurance has now been effective for more than four years. The Corporation is past its trial stage. There is much talk in banking circles of appraising our accomplishments so far. I am sure that the end-product of any such appraisal will demonstrate that the FDIC has done much in this short time to strengthen the banking system. The Corporation and the RFC were instrumental in rehabilitating the banks with more than $1,000,000,000 of new capital. Effective control of the banking structure has become possible for the first time and the record bears witness to the success of our efforts to prune the system of its dead timber. Basic improvement in the asset and capital positions of thousands of banks has come about largely as the result of the Corporation's insistence upon remedial action. A cooperative approach to supervisory problems has been encouraged by the fact that the FDIC is an agency interested in the welfare of banks of every class in every part of the country. Members of the National Association of Supervisors of State Banks, headed by your own William White as president, come to us regularly with their problems, just as we seek their advice on matters affecting State banks. The Corporation is particularly indebted to Mr. White and his associates in the State Banking Department for their splendid cooperation and advice in the solution of problems which have arisen in New York State. No finer or more careful supervision than that given your State banks by these men is available anywhere in the country.

This partial statement of what <u>has</u> been done leads naturally to the question suggested as my topic tonight: "What does the FDIC <u>propose</u> to do about the banks?" There has been no recent change in our responsibilities. Everything we "do about the banks", therefore, will continue to be aimed primarily at safety for depositors and, indirectly, even at protecting the investment of stockholders. Further, we hope, with banker cooperation, to "do" everything that depositors' safety will require. I am convinced that achievement of our aims will require no very revolutionary actions. The basic problem has not changed a bit during the years. Neither has the direction of the road to its solution, though that road, thanks to improved techniques and to the existence of a clearing house like the Federal Deposit Insurance Corporation, is now comparatively a six-lane express highway.

All of our plans for the future rest upon the fundamental proposition that neither legislation nor supervision can ever replace good bank management. Under no circumstances do we aspire to run the country's banks. Our function is rather one of counsellor and friendly critic; our aim is the achievement of needed reforms by the voluntary action of enlightened bank managers so that exercise of our police power will be necessary only in the few cases where managers either fail to recognize or openly neglect their primary responsibility, the safety of depositors' funds.

It will continue to be essential that supervisors formulate their policies on a long-range basis and that these policies be administered consistently and courageously. If the Corporation is permitted to go ahead with its program, plugging away steadily at its objectives and taking its losses as they arise, improvement of the banking system can be expected to proceed rapidly. There is not likely to occur a better time than the present to make what changes are still necessary in the way of improvement. The existence of deposit insurance, the recent rehabilitation of bank capital, and the fact that the vast majority of banks are in excellent financial condition make it desirable to keep moving aggressively toward our goal.

In recent addresses before bankers associations I have dealt in considerable detail with our plans for the banking structure. I have emphasized the need for care in chartering new institutions. I have sketched our plans for consolidation, relocation, or elimination of hazardous banks before their losses constitute a serious drain upon the Corporation's resources. I have stressed the need for co-ordinating the chartering and supervision of miscellaneous financial institutions with bank supervision in the interest of uniform and workable financial policies.

Structure, however, is not a primary concern in New York State.

Consequently, I prefer this evening to confine my discussion to the Corporation's plans for improving the position of "going" institutions. Among the principal objectives we have set in this respect are the improvement of both the ability and the conscience of bank management, progressive improvement of bank assets, proper provision for depreciation and losses, and building an adequate capital cushion.

Before going into a detailed discussion of these objectives let me emphasize that our approach to them is entirely realistic. The nub of our whole problem lies in the difficulty of reconciling the need for safety and liquidity, which we insist upon, and the need for profitability. For the problem of risky assets, which was of paramount importance in 1931 and 1932, there has been substituted in most instances a problem of earnings. Yields on assets of bank quality have found and are staying at new low levels. Increases in some expense classifications have accompanied this decline in income. Taxes have risen in most jurisdictions and the FDIC assessment represents a sizeable outlay for most banks. We realize fully that inadequate earnings will make achievement of our specific objectives difficult. We know from experience that the frantic search for profits can lead to inferior management, to speculative assets, to a relatively high volume of losses, to the payment of unwarranted dividends, and to removal of the incentive to invest in bank capital obligations.

The Corporation has supported several measures designed to ease this pressure. The payment of interest on demand deposits has been prohibited. Maximum rates allowable on time and savings deposits have been prescribed. We have encouraged insured banks to levy adequate charges for the services they render customers. Banks for the most part have taken intelligent steps to meet the emergency. Agreements entered into by members of most clearinghouse associations have fixed even lower rates on time and savings deposits than our regulations provide. Stockholders have cooperated by endorsing conservative dividend policies. A majority of the banks have adopted schedules of service charges formerly incurred through service activities. Most institutions have over-hauled their internal organizations with a consequent increase in efficiency and reduction of expenses.

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The past few years have seen a notable improvement in the quality of the assets held by our banks. Nearly two billion dollars of bad assets have been eliminated since 1933. This house-cleaning was made possible largely by the injection of a nearly comparable amount of new capital into our banks by the RFC and by local investors. The revival of values and improved bank earnings likewise helped clear the banks' books of a large part of their accumulated debris. For the most part sound and acceptable assets have been taken into our banks to offset the growth in deposits which has occurred during the past four years. Cash and due from banks at the end of 1937 constituted 27.5 percent of the assets of the insured commercial banks of the country. United States Government securities constituted another 25.2 percent. Bank loans appear on the whole to be sound. Only a relatively small proportion of the securities held by the banks are of a low credit status.

The chief danger to consummation of this program of progressive improvement of bank assets lies in the speculative tendencies of a sizeable minority of bankers. It will be recalled that during the early part of 1937 the Corporation warned repeatedly against the dangers of speculation in medium and low-grade securities with a view toward taking profits on a rising market. I believe that subsequent events have proved the timeliness of that warning. We have likewise emphasized on many occasions that trading in and out of the securities market is absolutely inconsistent with the investment function of a bank. I should like here to stress that this rule applies just as much to large institutions as it does to small banks. No matter what the size of an institution its securities should be bought from the investment point of view, to be held to maturity. The basic principle of any investment policy should be that safety of principal and certainty of income are the factors to be sought. We maintain that shifts in bank security holdings should be made for one purpose only; namely: To improve the quality of the bank's portfolio.

Fortunately, most bankers realize the necessity for conservative management of their portfolios. These men, who have been guided by the accepted principles of institutional investment should find no cause for alarm in temporary market drops. Most of the current concern about the effect upon banks of recent drops in bond prices is unwarranted. The Corporation is not concerned about and does not criticize market depreciation in securities of investment quality. A recent survey made by us shows that about 87½ percent of the securities held by insured banks are of Baa or better quality. Seventy-three percent of the securities held by these banks are of A or better credit quality. Market depreciation of securities bought for investment, with a credit standing that indicates payment at par at maturity and continuity of dividend payments, is of no practical significance in a well-run bank.

I am glad to see that legislation is currently being proposed to facilitate the marketing of fixed capital obligations by small business concerns which do not have ready access to the country's large capital markets. The need for some such facilities has long been recognized, and in their absence banks and bank supervisors have frequently been criticized for withholding bank credit from these channels. The belief that bank supervisors are unwilling to let bankers assume legitimate risks is quite erroneous. Those holding the belief in the present instance lose sight of the fact that no risk can be considered legitimate that endangers the safety of depositors' funds. Long-term equity financing is quite inconsistent with the short-term nature of a bank's obligations. The Corporation has always insisted that the proper order of a banker's responsibilities requires consideration first, of his depositors' rights, second, of his stockholders' interests, and only then of his borrowers. We shall continue to insist upon that order.

I urge, however, that banks do all in their power to join with and to aid the Reconstruction Finance Corporation and the Federal Reserve banks in their effort to meet the demand for working capital. There will be many of such loans in which banks may properly participate. Furthermore, banks can cooperate by advising their customers and aiding them with an intelligent presentation of their cases both as to past record and as to requirements.

It would seem, on the face of it, that no institution worthy of the name "bank" would have to be reminded of the necessity for current provision against depreciation and losses. Unfortunately, this basic principle of bank management is either unknown or ignored in some banks. I mentioned earlier the important part played by accumulated losses and depreciation in precipitating bank failures. This fact makes understandable the Corporation's insistence upon regular and reasonable allowances for depreciation of fixed assets, upon the necessity for eliminating known losses as they arise, and, particularly, upon the short-sightedness of considering as earnings available for dividends profits which are realized through the sale of assets at a price greater than cost. There can be no quarrel with those principles. They are among the very fundamentals of business and banking management and they must be observed.

The Corporation's campaign for an adequate capital cushion in each insured bank has been opposed on a number of varied grounds. This objective from the Corporation's point of view is inseparable from our primary concern, the safety of depositors' funds. If depositors, and in their stead, the Corporation are to be assured payment at par of the banks' contractual obligations, the banks' capital accounts must represent cushions sufficiently large to absorb fluctuations in value which are likely to occur during the normal run of the business cycle. As of a given moment some allowances can be made for the liquidity of an individual institution in measuring the adequacy of its capital. Liquidity, however, is a relatively fickle and fleeting quality. The Corporation cannot ignore the fact that the make-up of a bank's assets can readily and rapidly be changed. Considerations of safety require that liquidity be used as a complement of adequate capital rather than as a substitute.

The Corporation has so far been called upon to aid the depositors of 204 insolvent insured banks during the four-year period. More than $117,000,000 or 95 percent, of the $122,000,000 of deposits in these banks was made almost immediately available to depositors, and only about 600, or less than one-fourth of one percent of the 365,000 depositors were not fully protected.

The Corporation's surplus increased by about $40,000,000 during 1937, including more than $1,000,000 which represented an excess of investment income over all losses and expenses for the period. Our surplus has passed the $100,000,000 mark. Our income is now about $49,000,000 a year. It seems likely, therefore, that some time will elapse before the Corporation even touches its accumulated assessment receipts, let alone exhausts them and has to turn to its capital or to borrowing.

As a matter of fact, the financial aspects of the Corporation must be viewed in the light of its functions. Congress has given us a job to do--preventing losses to depositors of insured banks. Fulfillment of that task will depend upon our success in strengthening the banking system through elimination of hazardous units and through improvement of going banks. Neither the accomplishment of the job nor the means to its accomplishment can properly be measured in dollars and cents. If we can do our work and do it in an orderly fashion, taking our losses currently, deposit insurance will succeed, and at a nominal cost.

It is true that accomplishment of our purpose will require adequate powers of control and supervision over insured institutions as well as capable administration of those powers. There can be no quarrel, however, with granting the requisite powers, since they are indispensable to a permanently sound banking system. Further, the self interest of banks, based upon their sizeable financial investment if not upon more social considerations, will lead them to insist upon proper administration of the Corporation's duties and privileges. To me, the road to better banking and to successful deposit insurance seems clearly mapped. I shall never be able to blame failure to reach our destination upon anything other than the human weaknesses of selfishness and short-sightedness.

Execution of the Corporation's program has required and will continue to require determination, persistence, and courage. The program of closings and consolidations incident to our policy of taking our own losses currently as they develop and attempting to anticipate the development of hazardous situations has naturally been protested bitterly by some of those who institutions were involved. Yet it is essential that we keep abreast of problem cases and that we prevent an accumulation of cases that would result in a concentration of the losses we are called upon to bear. Suggestions for corrective action in going banks are likewise frequently difficult for us to deliver and for bankers to swallow. Recommended changes of management sometimes involve the casting adrift of middle-aged men of splendid character but of mediocre banking ability; suggested changes in internal system and recommended charge-offs represent drains upon the profits of individual institutions which often are hard to spare; criticisms of bank assets are, by their nature, criticisms of the judgement of the banker who acquired the assets.

Yet our recommendations for going banks must be heeded if those banks are to be kept from deteriorating into problem cases. No, ours is not an easy task, but it is a necessary task if the banking system is to grow stronger and if deposit insurance is to succeed. Consequently we will continue its prosecution as vigorously and as consistently as is possible.

We hope, too, that we can depend upon you bankers to meet your responsibilities. We realize the difficulty of always weighing properly the claims of depositors, stockholders, and borrowers upon your institution. It is not always easy to travel the middle road. Yet that road must be followed if your banks are to fulfill their intended function. Bankers themselves realize, I believe, the importance of their managerial decisions. If we could depend upon all members of the profession consistently to follow the dictates of their judgment, supervisory cares would be greatly reduced, and all banks would be in a healthy position to ride out any economic development.

What has been accomplished toward permanently strengthening the banking system during the past four years has come about as the result not only of improved management or of more consistent and thorough supervision. The mixture of these two ingredients in a cooperative attack upon our basic problems has been the most significant factor in our progress. Only so long as this cooperation supplements improvement in the two separate fields can we hope to obtain maximum results. The greatly strengthened position of most banks shows what can be accomplished and encourages continued cooperative effort.

From time to time during my remarks this evening I have drawn certain distinctions between metropolitan banks and country banks. May I here point out that all of my distinctions had to do with immediate rather than with ultimate problems. Basically, and from the long-range point of view, what holds for banks of one size is equally true for those of any other size. There have been countless evidences of the inter-dependence of our rural and urban banking institutions. The well defined path of failures from rural areas to Wall Street during previous periods of crisis will serve as an example. Possibly, as has been claimed upon occasion, the metropolitan banks are not their country cousins' keepers. Experience has demonstrated, however, that at least the converse is true and that the health of large banks depends in astonishing measure upon the well-being of country banks. We all would benefit from a more general realization of this fact. We must look past the four walls of our own bank and admit that the problems of all banks are our problems and that the combined effort of all concerned will be required for their satisfactory solution.

I know that the rate at which the Corporation's resources are growing leads bankers to ask when they can expect adjustments of some of the items now making up our assessment base, and perhaps, a reduction in the rate of assessment. I think it likely that certain of the moot points, such as duplicate payment upon deposits of certain types, can be eliminated in the very near future. As to a reduction in rate, however, an answer in terms of months or years can not be given yet. <u>If</u> the Corporation can proceed steadily with the program I have outlined and <u>if</u> bankers will support our efforts and continue to improve the position of their own institutions, I believe that our reserves will, within a few years, have reached a point where a reduced annual assessment income will permit us to take care of current requirements. I believe I am ending on an optimistic note, since I believe that the conditions I enumerate will come to pass. Actual developments, however, are in your hands. Remember, it is not deposit insurance that is on trial, it is the American banking system. Upon you rests responsibility for the fate of that system.

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