FEDERAL DEPOSIT INSURANCE CORPORATION
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ADDRESS OF

HONORABLE LEO T. CROWLEY

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

BEFORE THE

MIDWINTER MEETING - WISCONSIN BANKERS ASSOCIATION

MILWAUKEE, WISCONSIN JANUARY 23, 1940

NOTE

ADDRESS DELIVERED IN MR. CROWLEY'S ENFORCED ABSENCE BY MR. FORBES CAMPBELL, SPECIAL ASSISTANT TO THE BOARD, FEDERAL DEPOSIT INSURANCE CORPORATION, WASHINGTON, D.C.

ADDRESS OF HONORABLE LEO T. CROWLEY, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION, BEFORE THE MID-WINTER MEETING OF THE WISCONSIN BANKERS ASSOCIATION

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SUMMARY

I. The bulk of losses suffered by bank depositors during past years resulted from shrinkage in values of assets acquired in good faith, not from dishonesty. (p. 1)

II. Many measures--among them deposit insurance--have been instituted recently to lessen chances of loss from factors beyond banker's control. (pp. 1, 2)

III. The banker's principal problem is management of earning assets in a manner that will produce adequate income without any sacrifice of soundness or safety. (p. 3)

IV. With respect to securities, bankers should be governed less with a view towards liquidation in time of crisis and more by consideration of factors which make the assets fundamentally sound investments. (p. 4)

V. Steps have been taken to minimize forced liquidation in the future. (pp. 4, 5)

VI. Examination standards are now consistent with this philosophy. (p. 5)

VII. Supervisors can dictate neither acquisition nor disposition of individual assets by banks; can only insist upon fair valuation. (p. 6)

VIII. There should now exist no deterrents to full application of individual talents to problems of bank management, either for hope of profit for individual banks or for common welfare of the system. (p. 8)

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Mr. Toastmaster, ladies and gentlemen:

I have stated many times that there is no experience more pleasurable for me than to meet with my friends on home ground. That statement holds equally true tonight.

It is good to see so many of you gathered for a conference devoted to discussion of the many problems connected with management of bank assets. During my several years as chairman of an agency charged with protection of the liabilities of banks, it has become increasingly clear to me that the billions of dollars of losses to bank depositors which led to creation of Federal Deposit Insurance Corporation resulted in only an infinitesimal part from defalcations, misappropriations, and other forms of dishonesty. By far the bulk of those losses stemmed directly from shrinkage in the value of assets that were acquired in good faith and that went out of the banks, if at all, in strictly legal fashion.

The relative values of hindsight and foresight long have been recognized in principle. As we look back on what really transpired to bring about the enormous volume of losses our banking system has known, it seems evident that both the human equation and factors beyond human control were to blame. Legislators have done much to lessen the chances of loss through developments that are beyond the control of bankers themselves. Archaic statutes have been revised to fit modern conditions; new additions to the statute books have been designed to restrict the swings of the business-cycle pendulum and so to lessen the chance for loss through liquidation at deflated prices; facilities for the conversion of earning assets into cash in time of need have been greatly broadened.

In my own opinion the most generally beneficial product of this hindsight has been Federal deposit insurance. Forced liquidations at deflated prices is not likely to assume serious proportions simply to meet the ordinary increase in withdrawal demand that reduced incomes occasion during periods of deflation. Banks did not fail because of the 'rainy-day' withdrawals that depositors were required to make during the lean years. The real damage came about through periodic resurgence of that fearful epidemic, public panic. The emotion of fear lies close to the surface in each of us. The record of the banking system during periods of stress down through the years did little to substitute confidence in the system's soundness and durability for that fundamental emotion. Consequently, the sight and the sorrow of one bank failure set human glands to working at a rate that not only was destructive but that increased in geometrical progression as unreasoning demands sent to the wall institution after institution, quite without regard to their relative intrinsic soundness.

It was imperative that something be done to still that emotion--to stop that fruitless waste of the country's wealth. I believe that Federal Deposit Insurance Corporation is doing that job.

Only last week we concluded in Philadelphia one of our largest operations for the elimination of a hazardous insured bank. Philadelphia is a big city, with a large proportion of excitable, foreign-born residents; the bank in question was large--$35,000,000 in deposits to the credit of 65,000 depositors; our plans were announced in newspapers almost two weeks before the transaction took place. Yet there was no panic, no hysteria anywhere in the city at any time during negotiations or preparations for the change. Deposits of the bank did not syphon off to an appreciable degree, and what seepage there was resulted largely from the refinancing of their obligations at other banks by debtors of the institution.

That is only the most recent instance of the degree to which deposit insurance has instilled confidence in our people, though it happens also to be one of the largest. In all, we have aided financially the depositors of more than 300 banks in all parts of the country during the six years of our existence, and I have yet to see public fear arise to plague either the closing bank or the other banks in its neighborhood.

So much for the measures which, although primarily curative in origin, should help pave a smoother path and write a better record for our banks in the years to come. As always, however, our chief reliance still must be placed upon the guideposts that foresight will outline--upon lessening the chances for disaster as a result of human error. Here certainly the most fertile field for planning and effort is that of bank management. And the most likely corner of that field to start tilling is devoted to the knotty problem of managing earning assets in a manner that will obtain maximum returns without any sacrifice of soundness or safety.

In view of the primary dedication of this conference to a study of problems arising in connection with the bond portfolio and in deference to the many experts in aspects of that subject who are listed on your program, my own observations on the topic of bonds will be brief, general, and mingled with remarks on the broad principles of management of earning assets of all kinds. After all, the principles governing selection of securities for a bank's account do not differ substantially from the standards that determine make-up of a note pouch or a mortgage portfolio. Special problems in the selection and the management of securities arise principally from the usual remoteness of the obligor and from the difficulty of verifying and inspecting collateral underlying the obligation and operating figures published by the obligor.

Because of their presumed marketability, or convertibility, it has long been a practice for banks to accumulate high-grade, short-term securities as a 'secondary reserve' to their cash and bank balances. The use of a secondary reserve is probably valuable in individual banks or in groups of banks in a locality that has marked seasonal fluctuations in deposits. In the event of deposit drains that affect the system as a whole, however, the secondary reserve is likely to fail of its purpose.

Our banking system, and the credit currency it produces are so constructed that general liquidation of the system is impossible. Liquidation of even a sizable segment of the system's assets has never been accomplished without loss. I believe, therefore, that the banker's choice of assets should be governed less with a view towards liquidation of the assets in time of crisis, and more by consideration of factors which make the assets fundamentally good investments if held to maturity.

This statement naturally arouses speculation as to what steps can be taken to make forced liquidation unnecessary and so to avoid penalizing those who give only secondary thought to the emergency liquidating possibilities of bank assets. In previous addresses and in different contexts I frequently have outlined the steps I believe necessary to this end. They are responsibilities of both bankers and government. Government must undertake to minimize crisis demands by deposit insurance and by measures designed to limit inflationary and deflationary influences; it must supervise banks in a way that will keep the system constantly cleared of its deadwood and constantly mindful of the need for quality in assets; it must provide facilities that will accept all sound assets at par or face values as collateral for cash advances in order to permit banks to meet occasional emergency demands without loss to them and without accelerating deflation through liquidation. With the banker rests responsibility for the selection of assets of good quality, adequately diversified, and for management of those assets in a way that will insure their eligibility as collateral should an emergency arise. Clean houses, stocked with assets that are dusted off and sorted out regularly, should never again have to fear being dragged to ruin by their less careful and tidy neighbors. Those slovenly neighbors, unmindufl of their debt to the system as a whole, can be sure of unremitting attention from supervisors.

The examination standards followed by Federal supervisory agencies and by most State banking departments during the past year and a half are thoroughly consistent with the fundamental philosophy I have outlined. Assets of high quality are valued at cost or book, whichever is lower, regardless of market prices at the time of examination. Penalties upon bankers for temporary shrinkage through causes beyond their control thus are avoided. Securities of questionable quality are valued in the examination on the basis of an eighteen-month moving average of their market prices, thus levelling the ups and downs of these obligations into some semblance of their intrinsic worth. The only departure from this method of valuing speculative securities occurs with respect to questionable issues that have been purchased since the standards were made effective. We cannot condone speculation in any form in banks we insure. The speculative issues acquired by banks consequently are penalized by being valued on the date of examination at market, book, or cost, whichever is lowest. Defaulted issues and obligations held illegally all are likewise valued at the lowest of market, book, or cost on the date of examination.

I have heard it charged that present examination standards actually increase the pressure for liquidation by so penalizing undesirable assets. Our instructions to examiners are clear. Supervisors have no more right to dictate the disposition of any bank asset than they have to dictate its acquisition. The supervisor's province ends when he has succeeded in getting assets valued on a fair basis on the bank's books. We do insist that book values should reflect accurately the intrinsic values of assets--in other words, we urge the writing off of values that no longer exist. But once the asset is fairly valued, we neither have nor want to have authority to say what the bank shall do with it. As a matter of fact, the position of Federal Deposit Insurance Corporation is hurt, rather than helped, by sales of substandard assets of one bank to another bank. In a time of rising markets, bank to bank shifts of substandard securities on a large scale results in a wholesale write-up of the securities, a practice that bankers would not tolerate if it occurred in a straightforward way. Each instance of such bank to bank shifting complicates our task of supervision and delays our program for cleaning the deadwood out of all insured banks. Our interests are immeasurably better served if the bank that holds the substandard asset in the first instance retains that asset, taking on its own books such adjustments of carrying value as may become necessary. The practice of unloading the mistakes of one institution upon other banks has done much to increase our loss record through the years and to lessen the feeling of mutual trust and regard that should exist among entities so closely interwoven as those making up our banking system.

I have referred to our program for weeding out the deadwood from insured banks. That is a continuous program, framed in the light of conditions in various regions of the country, designed to care for emergencies that result from local or regional catastrophes, and to rehabilitate or eliminate institutions that have been operating under difficulties since the banking holiday. We have been able, during the past six years, not only to keep up with current developments that demanded our attention and our resources, but also to revitalize stagnant and hazardous banking situations in several sections of the country where rehabilitation without financial aid and without a definite program was a definite impossibility. As would be expected, the greatest number of such cases has occurred in agricultural sections of the country, while the dollar outlay has been greatest in industrial areas of the Middle Atlantic region.

It is my pleasure to be able to report that all but a few of the known cases of concentrated hazard within the system already have been cared for, and that plans are in process that will lead to early solution of the problems presented by the few cases that remain. I confidently believe that the end of 1940 will find the banking system in the soundest structural position it ever has enjoyed. There should now exist no deterrents whatever to the full application of individual talents to problems of bank management, either for hope of profit for the institutions you represent or for the common welfare of the system. I can pledge you that it will be the constant aim of the organization I represent to prevent a return of any such deterrents.

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