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Chief Div. of Research & Statistics

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Mr. President, members of the Midwestern Conference of the National Association of Bank Auditors and Comptrollers, Ladies and Gentlemen:

It is a great honor to be able to address you on this the final meeting of the first Midwestern Conference of this association. I am deeply indebted to Mr. Schalk for the invitation which he so kindly extended. You are tonight concluding a conference which I understand has been eminently successful. It inaugurates a feature which is both highly valuable and constructive and, I hope, will be continued in the future. I hope that your membership can become wider and more comprehensive in the coming sessions.

Our contact with your association has been brief but already it has been exceedingly beneficial and we are greatly indebted to many of the worthy members of this organization for constructive suggestions and patient help. I wish to take this opportunity of extending our thanks to the many auditors and comptrollers who have assisted and who, I hope, will continue to assist us in solving our problems.

Mr. Schalk has asked me to discuss some phases of Federal deposit insurance. I would like in response to this request to make a few comments about the present set-up ~~in~~ and work of the Federal Deposit Insurance Corporation and about the problems with which the Corporation has been dealing during the past year and a half.

<u>Set-up of the Organization</u>. As you know the Corporation is directed by a Board consisting of Mr. Leo T. Crowley, Chairman;

Mr. J. F. T. O'Connor, Comptroller of the Currency; and former Senator Philip T. Goldsborough, who recently was appointed to fill the place left vacant by the resignation of Mr. E. G. Bennett.

The formal organization of the Corporation consists of eight divisions and offices. Five of these - the Legal Department, the Secretary's Office, Controller's Office, Public Relations Division and the Accounting and Auditing Division - perform functions corresponding to those of similar offices in a business corporation. It is the three remaining divisions - the Examining Division, the New and Closed Bank Division and the Division of Research and Statistics - which perform the special duties entrusted to the Corporation by Congress.

<u>Division of Examinations</u>. The Examining Division may, I think, be ranked first in importance since it constitutes the eyes and the ears of the Corporation. It is through the Examining Division that the Corporation maintains contacts with the banks whose deposits it insures. The Division includes a Chief Examiner with 17 assistants in the Washington office and 12 supervising examiners in the 12 district offices throughout the country. The entire personnel of the Division numbers 153 examiners, 190 assistant examiners, and 156 clerks and stenographers, or a total of 529. This is nearly three-fourths of the entire personnel of the Corporation.

Examinations are made of all State nonmember banks applying for admission to the Insurance Fund. In each case the supervising examiner makes recommendation as to admission based on the condition of the bank. Unusual cases are presented to the Board of Review of the Corporation, which is composed of two directors and various other executives.

Besides these admission examinations the Division plans to make one regular examination each year of all insured banks which are not members of the Federal Reserve System, and such supplementary examinations as may be required. The Federal Deposit Insurance Corporation examines only nonmember banks since the Comptroller of the Currency and the Federal Reserve System examine national banks and State member banks respectively. The Corporation does not review the examinations of Federal Reserve member banks but when needed the examination reports of these banks are made available to the Corporation. All three of these agencies use approximately the same examination forms and conduct the examinations on practically the same basis. The number of insured nonmember banks which the Corporation examines is nearly 7,800, which is more than half of all insured banks.

New and Closed Bank Division. When an insured bank fails the payment of its depositors is in charge of the New and Closed Bank Division. This Division organizes a new national bank to pay off the depositors in the failed bank and to handle the necessary records. As soon as an estimate can be made of the amount which will be necessary to pay off the insured deposits the Federal Deposit Insurance Corporation makes this sum available to the new national bank and also sufficient funds to cover its operation expense. The insured depositors of a failed bank file proofs of their claims, assign these claims to the Federal Deposit Insurance Corporation and are paid at once in cash or in checks upon a Federal Reserve bank.

The new bank may accept deposits and honor checks but it may not make loans nor carry on other functions of banking. All of its funds must be deposited with the Federal Deposit Insurance Corporation or a Federal Reserve bank or invested in direct obligations of the United States Government. If capitalized by local interests within two years the new bank may conduct a normal banking business and may become a regular national bank. A deposit insurance national bank also acts as liquidating agent for the Federal Deposit Insurance Corporation when the Corporation is appointed receiver of a failed bank. ~~Up to the present time~~ The Corporation has been appointed receiver for only two banks, one national and one State bank.

Up to the present time 17 insured banks have failed. These banks had total deposits of three and a half million dollars. Of this amount more than one million dollars were secured or subject to off-set and the Corporation's liability to depositors amounted to two and a half million dollars. Of this amount $2,154,000 has already been paid to 17,731 depositors. There remains $311,000 to be paid to 6,521 depositors. All of these failed banks were small and had only a few depositors with accounts in excess of $5,000. The loss to these depositors, should the liquidating value of the assets prove to be inadequate to cover the Corporation's liability, will not be more than $180,000.

All of the 17 new deposit insurance national banks organized to pay off the depositors in these failed banks are still being operated under the supervision of the New and Closed Bank Division of the Corporation. There is no indication that any of these banks will be capitalized by local interests and it is assumed that all will be liquidated at the expiration of the two years operation required by the law.

Division of Research and Statistics. The Division of Research and Statistics has the duty of collecting statistical information required by the Board of Directors for the intelligent direction of their responsibilities and of engaging in such research as will aid the directors and Congress in making decisions pertaining to deposit insurance. The Division has recently completed a study of losses to bank depositors during the past 70 years for the purpose of providing the best possible actuarial basis for the rate of assessment charged insured banks. It is now engaged in an analysis of the experiences of the various State guaranty funds for the protection of depositors and of the reasons why these funds proved to be inadequate. The Division obtains reports of condition from all insured banks which are not members of the Federal Reserve System twice a year. The tabulations from these reports are combined ~~compiled~~ with those from member banks, thus providing statistics regarding the deposits, other liabilities and assets of nearly all the banks in the country.

Balance sheet of the Corporation. The capital stock of the Corporation is owned by the United States Treasury and 12 Reserve banks, the Treasury subscribing to $150,000,000 of stock and the Reserve banks to $140,000,000. Insured banks have paid assessments to the Temporary Insurance Fund of approximately $~~1~~40,000,000. The only other important items on the liability side of the balance sheet of the Corporation are approximately one million dollars of reserves for deposit insurance losses and expenses and suspense items, and two million dollars of surplus derived from an excess of income over expenses during 1934. The asset side of the balance sheet included on December 31, 1934 - $16,000,000 of cash, $315,000,000 of United States Government obligations and $2,000,000 of advances to the depositors of closed banks and subrogated claims of such depositors.

Income and Expense. As has been suggested the income of the Corporation from its investments has exceeded its expenses by more than $2,000,000. The budget for the year 1935 provides for current expenses not in excess of two and a half million dollars while the present rate of income on investments is well over $7,000,000 a year. The largest item of expense of operation of the Corporation in the future will, of course, be the losses incurred in paying the claims of depositors in banks which fail. The size of this item of expense is unpredictable and is likely to be erratic from year to year.

Bank suspensions during the years 1934 and 1935 have been unusually few in number and the amounts involved abnormally small. This is due to several factors. A great deal of liquidation of bank assets of doubtful value is being ~~liquidated~~ accomplished through such agencies as the Farm Credit Administration and the Home Owners' Loan Corporation. The Reconstruction Finance Corporation has made large sums available not only in the form of capital but also as direct loans. Further, the liquidation which occurred prior to the Banking Holiday has eliminated a large proportion of the weak banks. Periods of recovery subsequent to banking crises have in the past been characterized by relatively few bank failures. The low rate of failures since the organization of the Corporation cannot be expected to continue and it is a wise policy for the

Corporation to build up reserves at the present time as a safeguard against the large number of failures which are likely to occur in the future.

The foregoing remarks have been concerned with the present structure and activities of the Federal Deposit Insurance Corporation. I would like to add a few words about ~~the~~ its background, the banking situation at the time it was established and the aid it has rendered in improving that situation.

Establishment of the Federal Deposit Insurance Corporation. You are familiar with the creation of the Federal Deposit Insurance Corporation by the Banking Act of 1933. The Congressional hearings and discussions of this Act had been conducted during and immediately after the Banking Holiday. The adoption of the principle~~s~~ of deposit insurance was undoubtedly the direct result of the exceedingly large number of banks which had just been closed and the lack of confidence in the banking system of the country. The Congressional committees which reported the Banking Bill of 1933 to the Houses of Congress stressed two reasons for the inclusion of the insurance of deposits in the Bill. On one hand there was the desire to extend to all bank depositors a protection which would immediately reestablish and maintain the confidence in the banks. On the other hand there was the desire to provide a method ~~for~~ of advancing to depositors of failed Banks the funds which were tied up and to eliminate the inconveniences to which the depositors had been subject and the disturbance to business caused by the inability of bank depositors to use their money.

At the time ~~In June when~~ the Banking Act was passed in June, 1933, the Secretary of the Treasury and State banking authorities were engaged in the licensing of the banks which had been closed during the Holiday. The urgent necessity of reopening the banks made it imperative that all banks which had a reasonable chance of continuing their business should be licensed. The examinations preliminary to such licensing were necessarily made with tremendous speed and under unusual conditions. It was natural that some banks were licensed which did not have adequate support really to warrant their continuance as banking institutions. During the summer and autumn of 1933 a diligent effort was made by the Federal authorities working primarily through the Federal Reserve banks to determine the actual capital status of the banks of the country. It was felt that while deposit insurance would reestablish confidence in the banking system it was necessary to replace the capital of many banks which had been impaired if the reestablishment of confidence in the banks was to be justified. The real situation in respect to the non-member State banks first became known when the examinations of banks applying for admission to the Insurance Fund were completed. The deposit insurance law provided that all banks found to be solvent were to be admitted to insurance. Since solvency was defined as the ability to meet the deposit liability of a bank many banks were admitted to insurance which had had their entire capital or most of it wiped out through losses. In fact more than 1,400 banks among those admitted to insurance were found to have capital funds which were decidedly inadequate. These weak banks were admitted to insurance benefits on the condition that their capital would be rehabilitated through local aid and funds from the Reconstruction Finance Corporation.

The Reconstruction Finance Corporation had not made material progress in the reconstruction of bank capital prior to September 1933. From September 1933 to February 1934 an intensive campaign was carried on to recapitalize the banks which had been admitted or were applying for admission to insurance. Emphasis was at first placed on the State banks which were not members of the Federal Reserve System because of the active interest which the Federal Deposit Insurance Corporation took in these banks. Toward the latter part of the period the authorities concentrated their efforts on Federal Reserve member banks believing that many of these banks required capital rehabilitation prior to the inauguration of the Permanent Deposit Insurance Fund on the first of July 1934.

This program of capital rehabilitation has now been nearly completed. The most recent examination shows that at the end of February of this year there were only 200 banks remaining in the list of those inadequately capitalized. Many difficulties have been encountered in carrying out the program. The Comptroller of the Currency and the Federal Reserve Board have sufficient power to require banks under their jurisdiction to remove capital impairments and increase their capital if necessary. The Federal Deposit Insurance Corporation had no such authority and could only resort to the powers of persuasion with the aid of the State banking authorities. The credit for the success of the recapitalization program is to be shared with the Reconstruction Finance Corporation whose cooperation made it possible and to the various State banking authorities who also in most cases gave us their hearty cooperation.

Capital rehabilitation of the banks made it possible to write-off from the books of the banks a tremendous volume of losses which had accumulated during previous years. The amount written off during 1933 and 1934 by all commercial banks has exceeded two billion dollars or more than one-third of the book capital of the banks. We estimate that there are about one billion dollars of losses which still remain to be written off the books of the banks. It is our policy to do everything possible to accelerate the completion of this housecleaning. It is hoped that hereafter banks will charge off their losses currently and will not again allow them to accumulate.

Extent of Insurance Coverage. There are 15,300 banks which are licensed to conduct the usual banking functions. This number does not include mutual savings banks or private banks of which there are approximately 800. Of the licensed commercial banks 14,207 have the benefits of deposit insurance. The banks which are members of the Insurance Fund have aggregate deposits of $39,000,000,000, of which more than $17,000,000,000 are protected by the insurance extended by the Corporation. Ninety-eight per cent of all the depositors have accounts with not more than $5,000 to their credit and are therefore protected in full. The aggregate amount of deposits of the 49,000,000 depositors which are fully protected is between 13 and 14 billion dollars. The remaining three or four billion dollars of insured deposits represents the first $5,000 in the accounts of depositors with larger balances.

Seventy per cent of all the insured banks have total deposits of less than $750,000 each. These banks have an insurance protection covering at least 80 per cent of their total deposit liability. The Federal Deposit Insurance Corporation thus has a very real and tangible interest and responsibility in practically all of the licensed banks in the country and in the great majority ~~larger~~ of these banks that interest is equal to or greater than 80 per cent of their total deposit liability.

Bank Losses Under Deposit Insurance. Deposit insurance has radically changed the significance of bank losses. Formerly local depositors and stockholders bore the burdens resulting from bank failures and the long demoralizing period of liquidation which followed. Now losses which have accumulated in any bank until it fails are shifted to the entire banking system since such losses affect the rate of assessment which must be paid. A bank failure now effects every bank directly in dollars and cents. The Federal Deposit Insurance Corporation considers it one of its chief responsibilities to do everything possible to reduce losses from bank failures. It is not possible, however, for the Corporation to take much specific action which will eliminate bank failures. It can only encourage bankers to conduct their business in such a way as to keep losses at a minimum. This is now your concern as much as ours and there is perhaps no other single group of people with as much actual power to curtail bank losses in the future as the group of men assembled here this evening. It is our hope that through your influence on the banks with which you are directly associated and your influence upon correspondent banks with which you have periodic contacts you will be instrumental in preventing bank failures, reducing the losses therefrom, and in keeping the insurance assessments upon banks at the lowest possible figure.