REMARKS ON MUTUAL SAVINGS BANKS

BY

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We are here interested in mutual savings banks as banks of deposit for two principal reasons, first, the risks the Corporation already has in the presently insured mutuals and, secondly, the potentialities involved in uninsured mutuals and savings and loan associations contemplating conversion to mutuals. It is in the light of our experience with the mutuals that we judge the prospects of the future in similar institutions. It will be my purpose to highlight, as best I can, in a very brief manner the background upon which, it seems to me, we must operate.

At the outset it seems fitting to state that this paper is not intended as a brief for or against mutual savings banks as preferred insurable risks. In the darker days preceding the Banking Holiday the mutuals were outspoken and positive that their institutions represented less of a risk from an insurance point of view than did the commercial banks. Whatever the argument or the evidence advanced at that time we do know that the Federal Deposit Insurance Law gave cognizance to possible differences between mutuals and commercials by providing authority for the creation of a separate Fund for Mutuals with the stipulation that the assessment rate could be lowered at the discretion of the Board below the 1/12 of 1% applicable to commercial banks. A separate Fund for Mutuals was opened and operated from July 1, 1934 to August 22, 1935 but was not reopened or established thereafter as a permanent plan. A sizeable exodus from membership in the Corporation was made on June 30, 1934 headed by the mutuals in New York state but these and others have returned to the fold and we now have a membership of 192 as contrasted to the all-time high of 214 as of January 1, 1934. There appears to be no present desire to create a separate Fund for Mutuals and little is being said just now as to either the risk status or the preferred assessment rate.

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In a broad and general way, commercials and mutuals are alike in two respects, namely, that they both require an operating capital or surplus cushion consistent with the risk in the assets and an investment program synchronized with the deposit behavior. From a narrower but more nearly operational point of view, mutual savings banks are unlike the commercials principally in ownership, in deposit type and behavior, and, in some lesser degree, in statutory limitations on investments. Nevertheless, like or unlike, whether you have stockholders or depositors mutually contributing the capital, neither type of bank can successfully operate without a capital cushion commensurate with the risk in the assets; and, surely neither type of bank would invest its assets wholly without regard to the nature and character of its deposit liabilities. Both of these types of banking institutions require a balanced financial set-up. Both types are equally sensitive to, and are influenced by, public opinion.

Now let's get down to some specific facts which we face in mutual savings banks. In the 192 insured mutuals we have two-thirds of all the deposits of the 532 mutual savings banks in the country. The aggregate deposits in mutuals approximate the total deposits of all the six thousand odd insured nonmember State banks, or $17 billion. Insured mutuals will average slightly more than $50 million against slightly less than $3 million for commercial nonmember insured banks. All mutual savings banks but fifteen lie in the industrial Northeastern States, or from Pittsburgh to Maine. They are located in seventeen states with thirteen states having some members in the Corporation. Massachusetts has the largest number of mutuals and the second largest in amount and none of these is insured by F.D.I.C.

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Mutual savings banks are primarily thrift institutions with an average deposit account approximating $1,000 and the depositors numbering 17 million. Our stake in the insured mutual savings banks, and their depositors' dependence upon us, may be illustrated by the fact that on October 10, 1945, 92% of all their deposits was insured while in the instance of the insured commercial banks the coverage was 43%.

I think it is of more than passing interest to note the deposit behavior of the mutual system as a whole. Since the time of the Civil War and through 1945 there have been only seven years in which the aggregate volume of savings deposits in the States of New York and Massachusetts (which embrace two-thirds of the total deposits in mutuals) have registered a decline over the previous year and in no one of these years did the decline exceed 5%. For the country as a whole the record is even better. Over the same period there have been only four years (1877, 1878, 1933, and 1934) in which the aggregate has declined at all - and mind you - these computations also include the deposits of the suspended banks in the reductions. Such stability must surely be a favorable and rather all-important factor in the process of investments.

Reasonable deposit growth is also as desirable as stability. As to the growth, just prior to war activities, the record is not as good. In the ten years from 1934 through 1943 the aggregate growth in deposits of the mutuals in New York was approximately 20% or an equivalent of the dividends or interest credited to the accounts. In Massachusetts the rate of growth was equal to one-half of the dividends or interest credited, or 10% for the ten-year period. This lack of growth caused consternation and led some to think that maybe the cause of thrift and the need for the strictly

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mutual savings bank had passed. But this was not for long as deposits started to expand in 1943 and the system again has taken on the prosperous attitude last known to them in the booming 1920's and 1945 was the banner year of the 130 years of the system with deposit aggregates enlarged by 15%.

The fact is that this presently rapid growth is a cause of concern to us for several reasons. One reason is that these institutions were originated and conceived as small banks with very limited deposit potentialities and with a very minimum of initial capital contributed by able and altruistic citizens and no other provision is made for subsequent capital augmentation except from earnings. This latter limitation may not be so serious if deposit expansion is reasonably steady and of moderate proportion. It is fortunate, or possibly a credit to management or to the statutory requirements as to capital augmentation from earnings, that these old institutions laid aside sizeable increments to capital during their more stable and, apparently, prosperous period. As to the younger mutuals or those now contemplating organization the lack of capital or ability to accumulate it except from earnings is a definite hazard which management and ourselves must face. Our principal and present capital problems for the newly organized or converting institutions lie in the low initial statutory requirements, the presently large deposit potentialities, and the limited source of capital augmentation. We have little doubt but that we are being, and will be, faced with applications for insurance for proposed mutual savings banks because of these very factors. Converting Federal savings and loan associations are cases in point and provide the problems now faced specifically by Bill Funsten where conversions of such associations to insured mutual savings banks are in contemplation. There have been no mutual savings banks

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organized in New York since 1929 and the latest one that I know of was organized in Oregon in 1931. However, the present movement among savings and loan associations presents keen possibilities of chartering mutual savings banks through conversions. In these conversions and in newly organizing mutual savings banks we are faced with implications which we can solve only in the light of our experience with existing and insured mutual savings banks. I want to emphasize right here that the subject of capital adequacy is just as hard a nut to crack in respect to mutuals as it is in respect to the commercials. If we could be assured the same stability and growth of deposits that prevailed in the early years of the system and a continuing preponderance of good mortgage loans, with the prevailing statutory requirements for capital augmentation from earnings, we might be reasonably satisfied with the old and moderate initial capital requirements. However, few of these characteristics or attributes can be assured in the newly organizing mutuals and we must face the fact that the operations of most of these institutions have changed appreciably in recent years. Changing circumstances, accordingly, prescribe different rules.

In respect to current operating earnings we find that the ratio to average assets approximates 1% for the mutual system or about 50% larger than that for the commercials. The proportion rises and falls with the volume of real estate mortgage loans which have been the traditional investments. A mortgage portfolio approximating two-thirds of the assets is usually accompanied with a net current operating earnings ratio of about 1.50% which declines to about ½ of 1% when mortgages constitute a quarter or less of the assets. Starting with stable deposits it is no wonder that we find these banks investing in long-term credits bearing higher interest

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rates and, accordingly, producing larger gross income.

Until 1930 strong earnings produced larger dividends for the depositors in mutuals; provided sizeable loss-absorbing power; and created regular capital increments. Since 1930 it has been necessary to gradually reduce dividends to depositors to the present all-time low in order to maintain the loss-absorbing power of earnings and to prevent rather drastic invasions of capital. These all-time lows are indicated in the rate of 1½% in the case of the Manhattan mutuals and 1% for all mutuals in New Jersey.

There is little question in my mind but that the stable deposits, the better than average capital funds and stronger than average earnings - all normally attributes - have had the effect, unfortunately, of diverting attention from the true quality of the assets. As you will see in a minute the condition of these banks generally would likely have suffered a sad plight in the ten years from 1934 through 1943 had not these three factors been as dependable as they were.

You will remember that I stated in the beginning that I was to cover the bare highlights of the situation in respect to our presently insured mutual savings banks and some of the implications which could be drawn therefrom in respect to prospective members. I promise to cut the most outstanding picture - that of assets - to the bone.

When the squeeze of 1929-1930 began, the mutual savings banks had slightly better than 60% of their assets in real estate mortgages and another 15% in railroad securities. Today the composition of the assets is roughly 30% in mortgages, 60% in Governments and practically no rails. What that squeeze has cost the system and the depositors may be gleaned from the fact

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that losses have been such as to entail practically all operating and all non-operating income for the last fifteen years and necessitated the reduction in dividends from 4½% to 1.68% as a present average. The gross of losses, already taken, exceeds the amount of total capital as at the beginning of this period. Asset reconditioning has been reasonably well completed in respect to the holdings of rails and other real estate owned although the aggregate of these approximates $100 million. However, this amount is small in contrast to the $1 3/4 billion of remaining fixed and substandard assets as reflected in our latest reports of examination. These classified assets are almost exclusively mortgages and predominately potential other real estate. The total of adversely classified assets in the insured mutuals approximates nine times the amount of the total of classified assets of all the six thousand odd insured nonmember commercial banks in the country. The commercials started house cleaning sooner and have made an excellent record. The mutuals started later, have reconditioned a lot of assets satisfactorily, particularly securities, and now have left a volume of classification II which is 50% larger than the aggregate of similar classifications in the seven thousand odd insured nonmember commercials when the Corporation started, - - and this in only 192 insured mutual savings banks. Most significant is the fact that these conditions have come about in banks with stable deposits, better than average earnings, and presumably adequate capital. On the face of it - this is not a very encouraging outlook to say the least.

But real estate experiences cycles, and as a result, we are now worrying generally about the present and anticipated inflation in the allowable "value". The figures I just quoted represent appraisals largely

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in "problem" mutuals examined in 1944 and 1945. We haven't yet assembled the data on all these banks as the report of the first field examination on the last of the 121 becoming members on July 1, 1943 was just received last week. Real estate inflation probably hit New York City later than most other places but it has "gone to town". Whereas, sales realization for institutionally owned real estate reached its low at 57.6% of assessed values in early 1943, the latest figure is 80.9% or a 40% gain predicated on this one relationship. The reports coming to us from the more recent State examinations indicate that their appraisals have caught the fever. Adjusted capital in some instances has doubled between examinations and the aggregate of fixed and substandard has been reduced by a half in other instances - in both instances the major and controlling factor producing the change was the appraisal - most of the same assets are still present. It took us ten years to record the depths of distress in the mortgages - can it be possible that a true and full rebound has occurred in just the last two years? I do not believe it and, even if I did, I would vote to hold back my enthusiasm in the classifications. If it was logical and desirable to temper the classification of other real estate as we did in declining and distress times, is it not equally logical and desirable that we temper classifications conversely in a run-away market? I, personally, believe to do otherwise is to invite a recurrence of the "boom-and-bust" experience of the 1920's. And, last but not least, we should remember that the mortgages in these banks are not all "open" mortgages that can be revamped and reconditioned right away. There will be all to many instances where the mortgagor will be the only one to realize on some of the present cream and will leave only blue milk to succor the mortgagee. While we are in an upswing, we have a long way to go before

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we are back again in the clear on that large group of mortgage assets originated principally in another boom period of twenty years ago. When we remember that practically all of these substandard mortgages originated prior to 1930 it seems to me that an appraisal yardstick leaning toward the pessimistic would pay better dividends to the mortgagor in this period of inflation.

The presently allotted time forbids that I discuss some the major problems we have faced in creating objective and reliable standards of mortgage quality and what we are attempting in the way of instituting a program of asset reconditioning. Some phases of these matters may be discussed subsequently.

At times I have heard the remark and opinion that the mutuals were "sitting pretty" or that we had little to fear because they had no dividends to pay on capital stock and therefore could not dissipate earnings. That opinion sounds logical but I ask if asset dilution is not one of the worst, and most subtle, forms of income dissipation. The principal problem of the mutuals in 1946 arises from the asset dilution of the late 1920's. Another possible dissipation arises in the fact that, the country over, mutuals pay on the average at least ½ of 1% more interest (or dividends) on their total deposits than that paid by the commercials on their time and savings deposits. Would we not consider it an earnings dissipation in a commercial, if that bank had fixed and substandard assets in an amount two to four times the size of its capital, say of 5%, and such bank paid 10% cash dividends? Contrary to the original conception of a mutual, I think, some savings banks may be using their dividend rate with a view to acquiring or holding deposits. This is a bad time for any misuse of such competitive factor and we might

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remember that the Corporation to date has established no control over interest or dividends paid by mutual savings banks. And, I might add that, if and when we do exercise some control over dividend or interest payments by the mutual savings banks, we likely shall then be faced with the problem of ascertaining the degree of asset dilution which is practiced for competitive purposes. It seems to me that the control of interest payments on deposits has had a salutary effect upon bank operations but, I believe, we must be aware that it has been utilized in a period of increasing deposits. Any leveling off or decrease in deposits will very likely be accompanied with competitive pressures resulting in the lowering of asset quality. Control of any one angle of banking certainly produces the possibility of greater strain on another angle.

I will close with these remarks: We are prone to criticize the mutuals for spreading their asset reconditioning and loss absorption over so many years. It is highly possible that those very attributes of stable deposits, strong earnings and high capital, for which we strive, have been exploited and have had the effect, all too often, of producing in these banks a complacent and self- satisfied management. Those banks which have utilized stable deposits, strong earnings and high capital as attributes are strong and sound today. Those banks which have viewed these conditions with smugness still include a lot of unsoundness. You probably are not surprised to know that we have forty-four of these insured mutuals with deposits in excess of $3.6 billion which we are now classifying as "Problems". There are no "Potential Pay-offs" and I believe that pay-offs in these mutuals can be avoided by good supervision employing the maximum of pressures

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to get asset reconditioning done in these times and additional reserves created constantly against those low-grade assets which for any reason can not be fully returned to soundness just now. As voluminous as are the substandard assets, I believe their workout is possible and quite likely provided we extend ourselves toward improving examination technique and toward raising managerial sights. Everywhere we are doing just these things now and I have high hopes that we can produce a sounder outlook among this old and sizeable segment of our banking structure.

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