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EVALUATING TODAY'S BANKING STRUCTURE

An Address by

K. A. RANDALL, DIRECTOR
FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D. C.

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EVALUATING TODAY'S BANKING STRUCTURE

Questions are being raised, in part because of the failure of a bank in this city, which challenge the health of the banking system and the soundness of the supervisory stucture. Suggestions and innuendos have been presented to the public which are unwarranted, unhealthy, and potentially dangerous. The vital, and sensitive, confidence the American public has in the banking system -- and which is, in my view, fully merited -- is being tampered with, for no good reason and to no good effect. So I hope you will permit me to use this program as a forum for addressing, through you, bank customers all over the nation, that vast group of American citizens who use the American banking system to an extent unknown in any other country on earth.

I can think of at least four areas in which unfounded rumors are circulating. Perhaps today we can examine these, and place recent developments in a more accurate perspective, as related to the whole banking structure of the nation.

There are suggestions that recent bank failures represent a serious increase in failures over past periods.

There have been extensive rumors concerning FDIC actions relating to certificates of deposit.

Concern has been voiced over suggestions that credit standards of the banking system have slackened.

Finally, there are widespread reports that the Federal banking agencies are involved in serious differences of opinion and of operational standards.

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I would like today to state, flatly and without qualification, that none of these are true.

The American banking system today is probably as healthy, and as prosperous, and as able to serve the public, as at any time in its past. Indeed, the banking industry's resources are at all time highs and continue to mount. The banking industry's earnings are at records, and, while there is a certain squeeze on earnings, the banking industry as a whole is meeting this challenge with admirable skill. The industry offers more services, better services, to more Americans than it ever has before, and far more than any other banking industry in any country ever did for its people. I think it would be fair to say without qualification that the only possible setback to the banking industry would come as a result of a complete general economic setback to the nation as a whole. Over the past thirty years many safeguards -- not the least of which is the depositor protection afforded by the Federal Deposit Insurance Corporation -- have been built into the banking structure.

Before we examine in more detail the five areas outlined above, I would like to make two other points.

In the first place, the banking industry over the past thirty years has gradually developed strong public confidence which is one of its greatest assets. Each year of improving banking service develops this confidence/ further, and it becomes more and more the base supporting not only the banking system but the whole American economy.

This confidence is, I am convinced, well merited by the banking system.

At the same time it is a misservice to the nation to voice inaccuracies

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about this system.

The second point I would like to make deals with a necessary task of any competent supervisory agency and its personnel. Of necessity, supervisors must be teachers, and of necessity, they must serve as the warning system which keeps the industry from possible errors. The supervisor cannot assure elimination of mistakes, errors, or dishonesty. But he can point out potential dangers, setting the industry on guard against them.

Most bankers must, if they are to do their jobs properly, concern themselves with the day-by-day operations of their banks. The banker's overwhelming duty is to his institution, his community, and his customers. Few bankers have the time, or the staff, to keep abreast of all trends within the industry.

The supervisor, on the other hand, if he is to do his job properly, must keep abreast of the latest developments in the field. It is a proper and necessary task for the supervisor. The supervisor who is not able and willing to talk to bankers about such potential problems as misuse of certificates of deposit, or a slackening of credit standards, is not fulfilling his duties.

But where the supervisor is properly discharging his duties in sounding such warnings, he is doing this as a means of preserving a sound banking structure. His objective is to eliminate fringe happenings before they become dangerous. His duty is to warn the system as a whole of minor happenings which potentially could cause harm. In doing this he is helping the overwhelming majority of good sound bankers to resist pressures and to continue sound operations.

With these points in mind, we can examine the areas in which problems have arisen. If these problems are examined in the total context of the banking system

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today, it will become apparent that they are only fringe problems.

There have been suggestions that the number of bank failures in the past 24 months is up dangerously from previous experience. This is not so, and the amount of losses has been very small, proportionately to the system as a whole. Of course, no one wants even a single loss, with its impact on a community. The supervisory agencies, and the bankers themselves, would prefer that every bank continue healthy and prosperous. But a few failures is the price paid for a free, flexible, vital system which serves the public, and proof that the system works within a relatively free enterprise environment. A system could be constructed without failures, I am sure, but it would be a system so hamstrung by regulation, so restricted in its operations, that the public would get only restricted service and the nation's economy as a whole would suffer thereby.

The figures show just how minimal these failures have been. In the past 24 months there have been 13 failures -- two in 1963, 7 in 1964, and 4 this year to date. Compare this figure of 13 with the June 30, 1964 figure for all insured banks. On that date there were 13,728 insured banks in the United States. The failures represent nine one-hundredths of one percent. Examining the assets of these failed banks against the assets of the all insured banks system points this up even more. As of June 30, 1964, the insured banks had assets of $366 billion. The failed banks had assets of some $114 million. This is approximately three one-hundredths of one percent.

This figure would have been half that much if the San Francisco bank had not failed.

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Seven insured banks were lost in 1964, the largest number of insured banks to be lost since 1942. However, in 1943, 1947, 1949, 1955, and 1961 five insured banks failed each year. The difference between five and seven is nominal, in the context of a banking system of some 14,000 banks.

There have been suggestions that some of these closings were unnecessary. No supervisor closes a bank without a devoted affort first to save it, yet no supervisor should allow a bank to remain open when its capital has veen wiped out and its deposit structure is threatened. Deposits are not capital, and when deposits are threatened, the supervisor must protect depositors.

FDIC actions concerning certificates of deposit have been distorted, and too many holders of perfectly good certificates of deposit have been unnecessarily concerned.

These questions concerning the insured status of certificates of deposit have been prompted by reports concerning the two banks recently closed in California and Colorado and the suits in Federal courts in Texas and California where the Corporation has submitted the question of the insured status of certain claims.

It must be borne in mind that the Corporation is in effect a trustee of the insurance fund which is held for the benefit of the depositors in almost 14,000 insured banks in the United States. The Corporation is directed by Section 11 (f) of the Federal Deposit Insurance Act "that in any case where the Corporation is not satisfied as to the validity of a claim for an insured deposit, it may require the final determination of a court of competent jurisdiction before paying such claim." Therefore, in order to protect the interests of all insured

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depositors, it is the duty of the Corporation to submit facts in a questionable situation to the court for decision.

The Corporation has repeatedly emphasized that deposits in an insured bank, made in the usual course of business and for which there is no arrangement whereby the depositor receives compensation in excess of the rate permitted on deposits under Federal regulations, are and have been at all times, and continue to be, insured to the statutory maximum of $10,000 for each depositor.

On the other hand, for many years before Congress established the Federal Deposit Insurance Corporation, bank supervisory authorities strongly criticized any practice which concealed borrowings of a bank by the issuance of certificates of deposit or other evidence of an alleged deposit. The Comptroller of the Currency before the turn of the century pointed out that such a practice mis-represented the condition of the bank. At least thirteen of the States enacted laws prohibiting, and some even making a criminal offense of, the issuance of certificates of deposit for borrowed money. Certificates of deposit issued by State banks under an arrangement whereby the holder was paid compensation in excess of the maximum rate permitted by State laws were denied recovery from State guaranty funds which existed long before Congress established the Federal Deposit Insurance Corporation.

The Corporation itself has repeatedly warned in public statements and press releases, as well as in its supervision of State non-member banks, that arrangements for the payment of compensation in excess of maximum rate permitted on deposits, created a borrowing instead of a deposit, and that such borrowings were not insured under the provisions of the Federal Deposit Insurance Act.

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It is the position of FDIC that where a bank accepts funds under any arrangement whereby the one placing money with the bank is to be compensated in excess of the maximum interest permitted on deposits, the funds placed in the bank constitute a borrowing of the bank rather than a deposit of funds in the usual course of business, and hence are not entitled to deposit insurance.

However, reports that holders of these certificates will lose all their funds, that they will be "heavy" losers, are exaggerated. In the instance of the First National Bank of Marlin, for example, 60 percent of all common claims have already been paid by dividends. Further dividends can be expected. That obviously does not suggest in any way that the Corporation is trying to prevent repayment of these funds. The only issue is whether or not these few certificates are <u>insured</u> deposits or general claims against the receivership of the bank.

The total amount of certificates of deposit involved in our suits is under $25 million. Yet the total amount of certificates of deposit outstanding today is approximately $30 billion. The misuse of certificates of deposit represents only a minute portion of this large market.

Speaking of losses, I might add that reports that bank failures represent heavy losses to depositors are not justified. In the closing of failed insured banks since 1934 there were $637 million in deposits. Yet losses to the depositors in those cases totalled only $2.3 million through 1962 (the latest available figure) less than half a percent of the total deposits involved.

There has been a good deal of concern expressed over deteriorating credit standards within the banking system. The Federal agencies have themselves discussed these possibilities -- acting in their role of cautioning against any

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excesses.

Much of the concern, we feel at FDIC, stems from the public's desire for new types of banking service, especially in the shape of longer term loans. Auto loans, for example, are commonly made for 36 months now, where only a few years ago the 24 month auto loan was standard, and the 30 month loan looked upon with disfavor. Yet the public sought longer terms, and the banking industry has given them what they sought, supported for the most part by continued observance of normal credit standards.

This tendency of the American public, to seek a posture of longer credits, has forced an adjustment in the banking system, which now finds itself in large part "borrowing short and lending long." But there is a rather new, and dramatic, safeguard to this system, little discussed but of at least equal importance. That is the tendency of more and more of the loans that banks make, even to businesses, to amortize over the life of the loan. Put in simple terms, this means that more and more loans are being written on an installment basis, with payments starting immediately. The result is that while many bank loans are being written for longer periods of time the cash return to the bank actually is starting sooner and coming back in a more even flow. This gives the bank a major protection against possible credit deterioration. This also means that banks get funds back for needed future loans sooner. This permits the banker to serve more of the public with the same lendable dollar and provides a smoother bank operation.

The final item we must examine is the report of serious disputes between the supervisory agencies. Of course there are differences of opinion between the supervisory agencies -- that is, in my view, one of the great strengths of

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the diverse supervisory structure. Out of these divergent opinions will often come new and fresh thinking. These differences are the natural outcome of a system which is flexible enough to not only work in such an environment but to develop new tools, new methods, to serve the public.

Out of this ferment between the various agencies have emerged some constructive new approaches which today are a commonplace in banking life -- and which are of great benefit to the public. Today's difference of opinion may be tomorrow's new approach to a better banking system.

There is no "war" between any of the Federal banking agencies. All adhere to the same broad national goals. Those goals are, simply put, the continued health and continued development of a banking system created to serve the general public, within the framework of the free enterprise system. These goals are to preserve as much as possible of the free right of a bank's ownership and management to run its own shop, within rules and regulations designed to protect the nation's currency mechanism and the depositor whose funds are placed in a bank in a relationship of trust.

I do not beleive that any Federal agency or Federal administrator, seeks to depart from these broad goals. Nor does the Congress. Such differences as do exist are in details, in methods for accomplishing objectives which are our common goals. And such differences as do exist can be resolved by men of good will sitting down and hammering out solutions, and by the passage of time. Undoubtedly when these current problems are resolved new ones will arise. I hope so. That is a clear proof that the banking system is still seeking ways to grow, to serve the nation better.

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Summarizing this discussion into one broad statement, the American banking system as a whole is sound, safe, and serving the public admirably. There are, of course, problems, but this is the price which must be paid if we are to preserve our present system, and that is a system which gives the public a quality and quantity of banking services unavailable to any other nation. There have been some differences of opinion and of detail planning among the supervisory agencies, but on the whole these agencies pursue the same goals, and in a broad fashion, operate under similar ground rules. The net result is that American credit needs are met, the public has a healthy banking system to serve its needs, and the agencies continue to do all in their power to maintain this most excellent posture.

To the public, I can only say, your banks are in better shape, and provide you with better service than at any time since this nation was founded. And all efforts of bank supervisors, state and Federal, plus the efforts of the banking industry and its associations, in the long run are aimed at preserving this present status and improving upon it.

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