

NEWS RELEASE



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MAINTAINING A HEALTHY BANKING SYSTEM

An Address By

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Washington, D. C.

before

GROUP EIGHT

PENNSYLVANIA BANKERS ASSOCIATION

Pittsburgh, Pennsylvania

Dinner Meeting
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MAINTAINING A HEALTHY BANKING SYSTEM

Some of you may remember that old poem about the blind men and the elephant:

It was six men of Indostan
To learning much inclined,
Who went to see the elephant
(Though all of them were blind),
That each by observation
Might satisfy his mind.

You may recall how each of them touched a different part of the elephant and concluded, on the basis of his touch, that the elephant was like anything else but an elephant. And each one had a different idea. When I hear some of the preoccupations with specific aspects of our banking system, I wonder if we too have not fallen into the error of the blind men of Indostan.

Our banking system is described in various ways. The "dual" banking system has become a virtual article of faith elevated to a doctrinal status that transcends its definitely substantive merits. Its two components, the "national" banking system and the "State" banking system, have their separate characteristics. The "independent" banking system has its counterparts in the "branch" banking system, and in the different "group" and "chain" banking systems. The "correspondent" banking system embraces the task of welding together different banks into a voluntary network of cooperating units. Viewed from the standpoint of function, there is the "commercial" banking system and the "mutual savings" banking system. Considered along supervisory

lines, banks insured by the Federal Deposit Insurance Corporation are classified as "member" or "nonmember" banks, by which is meant their membership in the Federal Reserve System.

Looked at another way, our banking system is also a bundle of paradoxes. For example: Oriented to serving local needs, it is nevertheless responsive to national controls. While entry into the banking business is on virtually a franchise basis, sharp competition prevails among banks in given market areas. Though perhaps the most intensively supervised of all industries, banking cherishes its independence with a justifiable pride. Venerable and seemingly sedate, it is yet one of the most dynamic businesses in our economy. Exhibiting great diversity in size, function, and powers, it may nevertheless be accurately described as "a banking system."

It is hardly surprising that an observer of this welter of descriptions and puzzling paradoxes might be disposed to condemn the disarray. Given the prerogative of correcting the situation, he might prefer to erase what he sees and start all over. In fact, his predicament might be like that of the motorist who got lost in the hills of Kentucky while on his way to Louisville to see the Derby. Stopping at a crossroads cabin, he asked an ancient native the direction to Louisville. "Well," said the old man, pointing with his arm, "Louisville is that-a-way. You could go down that there road, but it ends at the river. There's another road a piece back that goes in the right direction, but it ends smack up in Okey Watson's pasture. Mister," said the old man, scratching his head in perplexity, "if I was a-goin to Louisville, I wouldn't start from here."

That, I suspect, is the attitude which many people have when it comes to making sense out of our banking system. To them it is beset with confusions and contradictions. This very disarray, however, reflects what to me is the peculiar genius of our banking system. The diversity of its parts is essential to its ability to meet the widely varying needs of all our citizens. The joining of these parts into an efficient and harmonious unit does indeed make a banking system. The key characteristic of this system is its diversity. And if I had but one adjective to use in describing it, I would call it our "diverse" banking system.

All of the parts of this system, working together, give our people a breadth and depth of banking services unequalled in any other nation. The system is the result of 180 years of trial and effort. It has evolved slowly, and sometimes painfully, in response to a popular desire for a system which serves everyone. The occasional historical relapses in the system have served as a prod to build a better system. Within the system, diversity of its elements provides a built-in flexibility which facilitates adjustment to a steadily changing kaleidoscope of demands. The fact that it serves diverse needs makes it subject to diverse controls, a wholly rational relationship whose logic appears to escape those who focus on the untidy structure and give less consideration to what the structure is designed to accomplish.

There are undoubtedly many ways of defining the purpose of our banking system. I think of it as an instrument dedicated to realizing those economic goals to which we as individuals and as a nation

aspire. The goals themselves undergo changing emphasis, but an admixture of full employment, improving productivity, and price stability represent about as concise a way of describing them as I know. Realization of any one of these objectives, and of them concurrently, requires the enlistment of a host of measures involving government, industry, business, labor, agriculture -- all the forces which together have given us the world's highest living standard. Banking is but one of these forces, but certainly it is a strategic one.

By the process of passing upon their customers' applications for credit, bankers in effect vote for or against the allocation of resources in particular ways. These decisions are made, not on the basis of individual sympathies or social predilections, but according to the banker's judgment of whether the particular loan will be repaid and whether it represents for the long run the most profitable use he can make of his current reserves. This is done in the setting of national and community responsibilities; but profit-oriented enterprises can seldom allow those responsibilities to be overriding. The making of decisions which thus affect individual fortunes and carry great import for the direction of economic development is a sobering responsibility. It calls for enlightened and dedicated bankers; and it further calls for public policies which permit an ample but not excessive volume of credit.

Great opportunities for creativeness are inherent in the banker's position. He stands at the cross-roads where new technology and fresh ideas challenge the present ways of doing things.

Often he has the high privilege of translating yesterday's discovery in the laboratory into tomorrow's new product. Over our long history, and particularly during our westward movement, he served as the catalyst in the development of countless communities. There was a period when banks forfeited some of their leadership, and other financial institutions grew rapidly in filling particular needs. Many banks have taken this lesson to heart; aggressively alert to emerging opportunities in every area, they have made the most of their unique character as department stores of finance, and have shown a creative flair in their development of new types of loans and new services.

Nowhere is their enterprise more evident than in their contribution to the creation of our consumer-oriented economy. Banks have achieved undisputed leadership as the source of the instalment loan which unlocks the avalanche of goods forthcoming from our ingenuity as a people and the abundance of our resources. Growth in this type of bank credit has been phenomenal, rising from \$1 billion at the end of World War II to some \$28 billion now. Taking into account the funds which banks furnish to finance companies and retailers, they provide over half the funds used in consumer instalment credit.

Though some people still look askance at instalment debt, and it is true that individuals can over-extend themselves, it is nevertheless a technique which has contributed immeasurably to our higher living standard. Not only are younger families enabled to enjoy material comforts sooner than otherwise would be possible; all of us, through this device of forced savings, play a significant part

in creating the efficient economic machine which supplies automobiles and stereos in never-ending variety. For it is through savings and their use in roundabout and specialized production processes that we have built our efficient economic system. Realization of the efficiencies of this system is impossible without mass sales and, human nature being what it is, this mass market depends upon the extensive use of consumer credit.

Homes, too, are purchased on what amounts to an instalment basis and, along with their furnishings, give Americans the means for comfortable and graceful living that is unequalled elsewhere. The need for funds to finance home purchases is so great that banks can concede a substantial chunk of the market to other lenders and still hold \$85 billion of real estate loans themselves.

It is in their role as lenders to business and industry, however, that banks have achieved their primary distinction. In the early days of our country, bankers were the innovators who lent money to build the factories, to buy the land, and to finance the tradesmen. These things they still do; but as our economy has become immeasurably more complex, new and imaginative lending techniques have been developed to finance the myriad of new industries. Equipment-leasing, accounts-receivable financing, mortgage-warehousing, and export credit are evidence that the spirit of innovation has not died. The age of electronics and space exploration has opened up new horizons; the giant businesses of tomorrow may be today's struggling new operation on a side street launched on a whisper and a prayer. To spot and nurture

such enterprises is a never-ending opportunity which banks are meeting in the best tradition of the industry.

Though banks have achieved their eminence primarily as suppliers of credit, the most dynamic phase of their operation is in the expanding range of services which they offer. Financial counseling for customers has become ever more sophisticated, and includes the maintenance of staff specialists who, on the basis of intensive studies, advise customers on specific projects which may require bank financing. Banks are serving increasingly as middle-men in introducing customers to each other and to the different segments of the money market. Trust services have risen in importance with the greater affluence of our citizens, a larger proportion of whom seek the expert advice and conscientious assistance of bank trustees. The management of corporate and union pension funds has grown apace with the proliferation of plans to provide retirement income. Yet all these services are overshadowed by banks' functioning as the clearing-house which settles accounts for the millions of checks written every day.

As the principal source of money used in transacting the nation's business, banks perform a critical role. Along with the desire to protect depositors themselves, it was largely to prevent the immobilization or loss of deposits in failing banks and the impact of that loss upon economic activity that the Federal Deposit Insurance Corporation was established. This protection has

been an important element in fostering the confidence which permits bank obligations to serve as money. As the convenience and recordkeeping attributes of this method of paying debts has commended itself to more and more people, the practice has threatened to swamp the banks with more check clearings than they could handle. This spectral prospect has now been averted, barely in time, by the development and installation in many of the larger banks of computer systems. The magnitude of this rescue may be appreciated by one eye-opening statistic: this source estimates that, to process without computers all the checks that will be circulating in the United States by 1970, banks would have to hire all the American women between the ages of 21 and 45.

The advent of computers, with their infinite capacity for work and their adaptability to tasks so far barely touched by their magic, provides banks with yet another tool for serving business. Already they have been enlisted in the preparation of payrolls, in the provision of check reconciliation services for customers, and in various other activities. Various other applications of computers are being developed. People whom an earlier age would call visionary look confidently to the day, and that not far distant, when computers will take care of the routine check-depositing, bill-paying transactions of the average individual. Then will come the day of reckoning for those of us who relish the two or three days it ordinarily takes a check to arrive at the paying bank.

The different methods of access to computers illustrate further disparities in the banking system. It is mostly, but not exclusively,

the larger banks which have installed their own computers. Other banks which do not have their own may secure computer services from different sources. Some have arrangements with correspondent banks; in other cases, banks have joined together in establishing computer centers to serve their respective needs; and in still other instances banks buy computer services from businesses which supply them generally.

One measure of the disparities within the banking system is so obvious as almost to escape mention. There are large banks, and there are small banks. A recent count showed that more than one-half of the total number of banks (7,170) had deposits of less than \$5 million. At the other end of the size scale, 34 banks had deposits at least 200 times greater, each in excess of \$1 billion. Banks so disparate in size obviously provide for different types of customer needs, and face different kinds of problems.

A banking system of this type, characterized by diversity and decentralization, may at times have elements that are unstable. In other nations like Canada or France, where a few large institutions dominate the banking scene, failures are seldom if ever permitted, for even failure can be banished at the price of centralized controls. In this country, on the contrary, it is recognized that the exercise of individual judgment may lead to failure as well as success. A bank failure is more serious than the failure of another business of comparable size, for by tying up or destroying the community's money supply, it can paralyze the economic life of the whole community. It was to avert a repetition of this type of paralysis that the Federal Deposit Insurance Corporation was established in 1933.

Deposit insurance adds important elements of security and confidence to a banking system in which diversity and freedom might sometimes produce failures.

Other elements of support for confidence and security are provided through supervision by the banking agencies, both Federal and State. Sound banking is promoted by examinations and through a variety of other supervisory activities. These include the chartering or insuring of banks, approval of mergers and branches, and reporting requirements. All of these activities have undoubtedly contributed much to the generally healthy condition of our banking system.

The relationship of the supervisory agencies to individual banks may be likened to that of the family doctor to his patient. If the patient eats a proper diet, misses none of his vitamins, takes daily exercise, gets 8 hours of sleep a night, and resists assorted temptations, he has little need of medical ministrations. So it is with banks. They too require periodic check-ups and treatment for occasional fevers; and surgery may sometimes be necessary, but by and large, the inherent vitality of the system is the best assurance of its continuing health.

One of the ironies of the current banking scene is the profusion of proposals to change, in one way or another, the bank supervisory structure. It is ironic, because there is little manifestation of the kinds of weaknesses or concern which ordinarily inspire proposals for change. Instead, the motivation appears to be more a desire to build something that may be architecturally pleasing rather than a structure to accommodate a family

of financial institutions with widely disparate functions. Improvement in the supervisory structure may be possible. But it impresses me as a structure which faithfully reflects the diversity of our banking system.

For 25 years or more, thoughtful proposals have been made for revising the bank supervisory structure. The great differences among the proposals and the fact that no major legislative action has been taken suggest to me that tinkering with the structure is recognized as only superficial. If changes are really desired, one must first start with the banking system. And that, for reasons abundantly manifest in its support of our economy and in its service to our citizens, is a change which many people are loath to make.

I cannot allow my first address to the banking community as Chairman of the Federal Deposit Insurance Corporation to pass without expressing my deep appreciation of my predecessor. It was a real privilege to work with Joe Barr. Though he served as Chairman for little more than a year, his dynamic personality leaves an indelible imprint upon the Corporation. Along with providing leadership of the highest competence and calibre, he engendered an atmosphere that was warmly personal, deeply cooperative, and scrupulously non-partisan. It is my hope to continue what he has started, and to preserve the sense of continuity that has become important to the Corporation and to the banking system it serves.