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PROBLEM SOLVING IN BANK SUPERVISION

An address by

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Washington, D. C.

before the

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of the
NATIONAL ASSOCIATION OF SUPERVISORS OF STATE BANKS

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PROBLEM SOLVING IN BANK SUPERVISION

It is always a great pleasure to be invited to address a meeting of the National Association of Supervisors of State Banks.

We have had an excellent working relationship in the past and I intend that it will continue. The common interests that we share demand that we work closely together. Bank supervisory authority, at both the Federal and State level, are continually confronted with new problems and new situations. This is inherent in the evolvement of the nation's banking system. We have tried to meet these challenges effectively and constructively. It might be particularly appropriate on this occasion to look at the record -- your record and our record. Let us take a broad, over-all view of what we have done together. Then, let us look at what the future might hold.

A strong and efficient banking system is our cooperative goal. It is an essential requirement of a modern, dynamic economy. It is one avenue through which the thrift of the nation is channelled into productive use. If economic progress can be conceived as moving on wheels, the banking system is thetrack on which it moves. Banks serve a unique function because they are the sole source of our money supply. At the same time, they share with other financial institutions the responsibility for meeting the credit needs of the economy.

Above all, a banking system must work. This is the essential meaning of the often used phrase "viable banking system." Symmetry and economy are to be desired but viability is essential. If bank regulatory authorities do nothing else, they must insure that the system remains operative. In a country as large and diverse as ours, any bank -- no matter how big -- has only a limited impact on the overall course of economic development. But, economic development, itself, at home and abroad, influences every aspect of our economy. Development means growth, and without growth the economy must stagnate and fall.

Banks exist, ultimately, to foster economic development. They always must measure their activities against this requirement. They always must adjust and adapt their policies and postures to meet changing situations. Their individual reactions are never uniform. Some banks find it easy to adapt while others, often through no fault of their own, find it difficult. But the sum of their reactions, the reaction of banking as an industry, dictates whether or not the economy moves. Bank regulatory agencies, to some extent, can assist the industry to shorten its reaction time. In this area bank regulatory agencies can make a real contribution in the public interest.

I might illustrate my point by relating the problem to recent developments. In order to achieve and maintain the healthy 4.3 percent rate of economic expansion, monetary and fiscal policies (including debt management policy) have been imaginatively designed and pursued to solve those problems which impinge upon continuing economic growth. Notably, recent economic policy has been tailored to achieve a reduction in unemployment, in excess plant capacity, and in our payments deficit. The policies adopted have been responsible for changes in the interest rate structure, in capital flows, both internally and externally, and in income flows.

Banks have reacted to these various stimuli with imagination as well as responsibility. They have developed new ways of maintaining or increasing their share of the credit markets through issuance of negotiable time certificates of deposit and short-term notes, and they have made more efficient use of existing resources through recourse to the Federal funds market. On the asset side, portfolio policies have reflected bank adaptation to changing conditions through increased bank participation in real estate mortgage financing, lower liquidity ratios, and larger holdings of higher yielding tax-exempt securities. Banks have also expanded the range of banking services to the public. These are but a few of the innovations or changes that have occurred in the recent past in response to changes in the general economic environment.

The dynamic nature of the U. S. economy is responsible for the ever-changing scene. The coordination of detailed activities falls within the purview of the bank regulatory authorities. The supervisory agencies are charged with the task of adapting to the changes brought about by progress within the banking system with minimum disturbance and maximum benefit to the public interest. Because the banking system is an essential element of a nation's economy, the supervisory authorities maintain close surveillance over individual banks. This supervision, nevertheless, is carried out in a manner that leaves as much as possible to the initiative and discretion of the banks themselves. History has demonstrated clearly the virtues of a strong, competitive and privately owned banking system.

How has the FDIC responded to these developments? A brief account of our experience since 1933 might give us some perspective. Because the FDIC was organized with the primary purpose of restoring the depositors' confidence in the nation's banking system, the immediate focus of our operations in the early days of the Corporation was on our responsibility for insuring bank deposits. Consequently, the Corporation's efforts and resources in the 1930's were largely devoted to the extension of insurance coverage to eligible banks and to the urgent need to re-establish public confidence. This task was largely completed by the time World War II broke out. Because of the initial magnitude of the task facing the Corporation, the number of bank failures in the 1934-1940 period averaged around 60 per year but subsequently dropped off sharply.

During 31 years of operation, 454 insured banks have required disbursements by the Corporation; 342 of these banks each held $1 million or less in deposits at the time of failure. A total of $648 million has been paid out to depositors at a net insurance cost to the Corporation of only $37 million in the 32 years of its entire history. Nevertheless, no matter how good the loss record is, any bank failure tends to introduce elements of doubt into the minds of the public. The Corporation has worked to reduce these fears and to maintain the public's confidence in the stability and safety of their banks.

Since the war and with the strengthening of the banking system, the Corporation's view of its duties and responsibilities has broadened -- legitimately and as a logical outgrowth of its insurance function. An insurance system is viable only as long as the insured remain strong and constitute good insurance risks. The scope of the Corporation's influence has expanded, moreover, as insurance coverage has been extended to cover most of the nation's banks. At the end of 1964, all but 461 of the nation's 14,281 banks were insured by the FDIC, compared with 1,574 banks -- or about 10 percent of the total -- which remained outside the insurance system at the end of 1934 after one year of Corporation operations.

The Corporation is thus concerned not only with insurability but with the well-being of banks and the banking system as a whole -- with somewhat more attention paid to the nonmember insured banks under our immediate jurisdiction. Accordingly, our interests center on matters such as the maintenance of competition among banks and between banks and other financial institutions, the asset and liability structure of banks, capital adequacy, the quality of bank management, and so on.

As the nation's banks have adapted to changing circumstances, so has the Corporation had to adapt. There are new problems arising out of the over-all economic situation as well as changes in bank practices and policies in response to the new environment in which banks find themselves. I might just point out briefly a few areas in which changes have taken place -- and the nature of the Corporation's response.

There have been major changes in the financial structure of the United States. Not only do banks compete with each other, but they face intense competition in many areas from other financial intermediaries. Banks have had to vie with other financial institutions for funds and have had to seek new and profitable uses for the substantial savings generated by an expanding economy. This competition is taking place against the background of changing interest rate patterns, of larger demands for credit, and demands for new types of credit accommodation. Their methods of adjustment to changing demand and supply situations have in turn created a new set of responsibilities for the bank supervisory agencies. The banking authorities must be prepared to assess and deal with the impact and implications for banks and the economy as a whole of negotiable time certificates of deposit, of capital notes and convertible debentures, of short-term unsecured notes, of greater recourse by banks to the Federal funds market, and of bank expansion into new areas of banking services (such as computer services, leasing, and so on), to name only a few examples.

The need to keep abreast of current developments has rendered obsolete the stereotyped image of a "typical" bank examiner -- who marches into a bank with briefcase in one hand and a portable typewriter in the other. The bank supervisory authorities must employ personnel that are trained to evaluate these developments and to anticipate to some extent new developments. The Corporation has tried to keep in step with the times by stepping up its recruitment program for qualified personnel and by instituting various types of training programs for their employees -- such as examiners' schools, attendance at various specialized banking schools, and by organizing and conducting seminars in the newest automation techniques. In many of these programs, we have cooperated with state and Federal bank supervisory agencies -- to our mutual profit.

Closely related to the problem of personnel is that of obtaining the essential information with which to carry out effectively the Corporation's responsibilities. The Corporation is continually developing additional data sources, improving those that are available, and launching projects in areas not yet fully explored. I might mention specifically here the major program underway at our Washington office to put the voluminous data relating to commercial banks on computers. The information that can be distilled from this mass of statistics -- emanating from the field as well as from the banks themselves -- should help to shed additional light on many aspects of banking. Hitherto, much of this information has not been readily accessible or easily applied in solving day-to-day problems. Current information collected in the field will also be processed by the computer and the results fed back to the field examiners as well as retained for use in Washington. Some interesting results have already been obtained from preliminary and pioneering studies. This program promises significant dividends to us and to other bank supervisory agencies, researchers, the courts, and others with interests or responsibilities in the field of banking. A greater degree of precision can be injected into our deliberations, which have at times been handicapped by the paucity of relevant data.

The commercial banks themselves have been rapidly automating their operations and thus are in a better position to produce meaningful data. Better costing procedures will contribute greatly to the improvement of bank performance and to a more economic banking system. Such developments are all the more important because banks are branching out into new and oftentimes untried fields. A better idea of the costs and benefits of these services or or alternative ways of increasing bank capital, for instance, would be helpful also to the bank regulatory agencies.

Another development, in the public interest, that promises important dividends is the moves by the various state bank supervisory authorities to update and strengthen their banking laws. Your familiarity with the conditions and problems of your own states is the best means of ensuring sound legislation.

These then are but a few of the ways that all of us have tried to meet the new problems that are continually appearing. We have attempted to maintain a flexible posture and an open and inquiring mind. The Corporation has been greatly assisted in this task by the support received from each of you.

Our record is one that can stand on its own merits. Nevertheless, much remains to be done. The effectiveness of the Federal deposit insurance program to date can be measured by the confidence that the public has in its banks.

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