U. S. BANK SUPERVISION AND MONETARY POLICY

Address of

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The Federal Deposit Insurance Corporation is one of three U. S. Government agencies with supervisory responsibilities over commercial banks. The last of the three to be established at the Federal level, the Corporation was created in 1933 to help restore public confidence in banks after the "Bank Holiday" through the provision of limited insurance coverage for bank deposits. By protecting bank deposits -- the largest component of the money supply -- the Federal deposit insurance system was destined to contribute to the stability of the economy.

The other two Federal agencies concerned with bank supervision are the Office of the Comptroller of the Currency -- which is part of the Treasury Department -- and the Federal Reserve System. The Office of the Comptroller of the Currency was established under the provisions of the National Bank Act of 1864, which set up a system of Federally-chartered banks. This national banking system was designed to promote the development of a sound currency -- by authorizing national banks to issue national bank notes, backed by U. S. Government securities. The currency so issued by national banks provided a more dependable medium of exchange than the notes of state banks in circulation up to that time. The national banking system was also intended to encourage the development of strong banks and, at the same time, provide a convenient means for the Federal Government to finance the demands of the Civil War.

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The Federal Reserve System, established in 1913, was initially an effort to fill the need for a centralized pool of liquid funds which would facilitate the operations of banks in times of money stringency. The original powers and resources of the Federal Reserve were significantly strengthened by the Banking Act of 1935, following the massive pressures leading to the Great Depression of the 1930's and the banking crisis in 1933. This legislation augmented materially the Federal Reserve's powers of monetary control and its ability to supply liquidity to member banks.

The present Federal bank supervisory structure thus evolved largely in response to crisis situations. Each of the three agencies oversees banks from a somewhat different viewpoint -- and each has immediate supervisory jurisdiction at the Federal level over particular groups of banks. The Comptroller of the Currency is the chartering authority for national banks -- and is the counterpart of the chartering authorities in each of our fifty states. Thus, the Office of the Comptroller of the Currency provides an alternative as to choice of chartering authority; and the banks chartered by the Comptroller are supervised by his Office.

The Federal Reserve's involvement in bank supervision derives primarily from its responsibility for the conduct of an effective monetary policy. In certain matters the scope of its supervisory authority is enlarged by the statutory membership requirement for all national banks. The Federal Reserve also exercises supervisory authority over state-chartered banks that choose to be members of the Federal Reserve System.

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However, these state member banks are also subject to supervision by their respective state-chartering authorities.

The Federal Deposit Insurance Corporation supervises banks from yet another viewpoint -- as an insurer of bank deposits. All banks that are members of the Federal Reserve -- national banks and state-chartered members of the system -- are insured pursuant to Federal deposit insurance law. Other state-chartered banks may apply and qualify for insurance. With respect to the insured banks, the Corporation endeavors to forestall the development of situations within banking that might threaten public confidence in banks. When troubles occur, the Corporation chooses among the alternative methods for the protection of depositors the one deemed to be most appropriate in the circumstances. The Corporation liquidates assets acquired from failed or failing banks in a businesslike manner and with concern for the economic well-being of the community. In this manner, the Corporation strives to confine the adverse repercussions of individual bank failures to the affected bank alone.

Within the broad reach of the Corporation's responsibilities for all insured banks, its supervisory efforts -- implemented by the examination of individual banks -- are mostly limited to state-chartered banks that are not members of the Federal Reserve System. The Comptroller of the Currency and the Federal Reserve likewise center their efforts -- including the examination of banks -- on national banks and state-chartered members of the Federal Reserve System, respectively. Thus, a division of bank supervisory responsibility is achieved at the Federal level of Government.

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Because it was created by the Congress, the Federal Deposit Insurance Corporation is responsible to the legislative arm of the Government. Operationally, it functions as an independent agency within the executive branch. Management of the Corporation is vested in a Board of Directors consisting of three members, two of whom are appointed for six-year terms by the President, by and with the advice and consent of the Senate. The Comptroller of the Currency, who is also a Presidential appointee, is an *ex officio* Director. One of the two full-time Directors is designated as Chairman of the Board. Not more than two of the Directors may belong to the same political party.

The Corporation has at present about 2,000 employees, three-fourths of whom are assigned to the Examination Division. For purposes of administration, particularly in the examination of banks, the country is divided into 14 Federal Deposit Insurance Corporation Districts.

Turning now from this brief outline of Federal banking agencies, I would like to trace the development of deposit insurance in the United States and describe the operations of the Federal deposit insurance system.

The concept of guaranteeing bank obligations had long been recognized in the United States, when Federal deposit insurance was established in 1933. Fourteen states had tried various forms of insurance or guaranty plans, some with fair success. Six of the state systems operated prior to 1866 and there were eight insurance plans adopted by states between 1907 and 1917. However, all of these state systems had become inoperative by 1933. In addition, the Federal Government had undertaken the

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guarantee of national bank notes as far back as 1863. Although helpful, this guarantee came to cover an increasingly smaller segment of the money supply as bank deposits grew in importance.

State plans generally tended to be inadequate because the state boundaries afforded too narrow a geographic and economic base to carry the risks involved in a comprehensive protection program. The Federal system made accessible on a nationwide basis sufficient resources to assure a substantial measure of safety.

Initially, when deposit insurance became effective on January 1, 1934, insurance was limited by law to $2,500 per depositor. Coverage was increased to $5,000 on July 1st of that year and remained unchanged until raised to $10,000 by the Federal Deposit Insurance Act of 1950. In 1966, the amount of insurance afforded each depositor was increased to its present maximum of $15,000. This coverage applies to demand accounts, to time or savings accounts, or to any combination of such accounts in each insured bank. The number of accounts fully protected within the insurance limitation has always been high. An estimated 99 percent of all accounts in insured banks -- aggregating about 200 million -- are within the $15,000 maximum. These accounts comprise a little more than half of the deposits held by the insured banks.

The Federal deposit insurance system has demonstrated its value for a banking system such as we have in the United States. Approximately 97 percent of all the commercial and mutual savings banks in the United States are insured -- 13,850 institutions with 18,724 branches. About two-fifths

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of the insured banks have less than $5 million in deposits; two-thirds of them have less than $10 million in deposits; and nine-tenths of all insured banks have less than $50 million in deposits!

With this type of banking structure, the availability of Federal deposit insurance has provided support to the small institution that might in the past have been adversely affected by any general weakening of public confidence in banks. The larger institutions which provide correspondent services for small banks as part of their activities in turn have prospered because Federal deposit insurance and other banking legislation enacted since the Great Depression have contributed to the stability of the nation's financial structure. Over this same period the enactment by the Congress of other economic stabilization programs, including the Employment Act of 1946, have materially strengthened the economic environment and thereby contributed to the success of deposit insurance.

The initial capital resources of the Federal Deposit Insurance Corporation of $289 million were provided by the U. S. Treasury ($150 million) and the Federal Reserve Banks ($139 million). Supplementing the original capital, provision was also made initially for regular assessments upon insured banks and for borrowing from the U. S. Treasury. In 1947, legislation was enacted which provided for retirement of the Corporation's capital out of accumulated surplus. Retirement of capital was completed in 1948 -- 20 years ago -- along with payment of retroactive interest on the original capital funds. Also the Corporation's authority to borrow from the U. S. Treasury was increased to $3 billion, but this power has never been used.

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The basic assessment for Federal deposit insurance has been at an annual rate of one-twelfth of one percent of total deposits since the original plan was amended in 1935. This uniform rate is applied to the deposit base of each bank irrespective of variations in the estimated "risk" inherent in different financial exposures to potential loss. Deposit insurance was designed to protect depositors against a spectrum of financial disasters broad enough to include catastrophies. As a consequence it was not feasible to adjust the assessment rate to the condition of individual banks or prevailing economic conditions. In short, deposit insurance provides a safeguard against hazards that cannot be appraised by the techniques of actuarial science.

In 1950, the basic formula -- still applicable uniformly to all banks -- was modified by a statutory provision for a credit to be applied against future assessments, the amount of the credit depending upon the expenses and losses of the Corporation. The 1950 amendment provided in effect that 60 percent of the amount remaining after deducting losses and expenses from the calculated assessments be made available as a credit against future assessments. This credit was increased to 66-2/3 percent of the remainder in 1960. Currently, the effective assessment rate is about one-thirtieth of one percent of assessable deposits.

Since the repayment of capital and accumulated interest, the deposit insurance fund has been built up from assessments on insured banks and income from investment of the fund in U. S. Government securities. By 1961, income from investments exceeded the Corporation's income from assessments. During 1967, net income from deposit insurance assessments

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totaled $121 million and net income from the Corporation's portfolio of U. S. Government securities totaled $142 million. Administrative expenses and insurance losses of the Corporation continued to be moderate. Over its lifetime the Corporation has been able to retain about 90 percent of its income for additions to the deposit insurance fund, which amounted to $3,613 million on June 30, 1968. The size of the deposit insurance fund and its immediate availability for the protection of depositors have contributed importantly to the confidence of depositors and to the stability of the banking system.

Deposit insurance comes to the aid of depositors in distressed banks in a number of different ways. The Corporation can pay off depositors up to the insured limit after a bank has been closed by the chartering authority. Also, it can advance funds to facilitate a merger or absorption of a distressed bank by another insured bank in cases where Corporation losses would be minimized. Finally, the Corporation has the alternative of organizing and operating "deposit insurance national banks" to provide limited banking services in areas deprived of banking facilities through a bank closure.

Since the beginning of Federal deposit insurance, the Corporation has made disbursements to protect depositors in 473 banks experiencing financial difficulties. By way of contrast, this total over a period of thirty-odd years of Federal deposit insurance is less than the average number of failures annually during the "prosperous" 1920's -- climaxed by some 4,000 failures in 1933.

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A deposit insurance system, such as we have in the United States does not seek the complete elimination of bank failures. In a strong, private enterprise banking system, banks must -- and should -- be exposed to the forces of the marketplace. Deposit insurance attempts to reduce bank failures to a minimum and to mitigate any adverse effects. Success in these efforts has been achieved largely as a result of preventive and remedial measures by the state and Federal supervisory agencies in fostering sound banking practices.

Much of the Corporation's activities in the early years of its history were devoted to the problem of failed or failing banks and the restoration of the public's confidence in the banking system. With changing times and circumstances the Corporation in recent years has tended to concern itself more with the broader problems of the adaptability of the banking system to the contemporary economic environment and the system's ability to meet effectively and efficiently the emerging financial requirements. Many of these are both new and troublesome to the banking community.

Major elements in the changed environment faced by banks include the greater importance of international balance of payments considerations in the formulation of economic policy and the growing complexity of business relationships between the United States and other nations. Banks must be acutely aware of developments abroad and of the possible impact on their own operations. Another factor that demands attention is the steady expansion of the domestic economy since 1961. The fuller commitment of resources accompanying this growth has limited the options for adjustment available to banks.

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In banking itself, the number of banking offices has increased sharply, the kinds of financial services offered by banks are expanding, and the new deposit arrangements -- such as the large, negotiable certificate of deposit and, more recently, the so-called consumer-type time deposit -- have presented new problems and new challenges to bank management.

To carry out this broader overview of our responsibilities, the Corporation has been working to strengthen and update the traditional and principal tool of bank supervision -- bank examination. Our examination policies and procedures are constantly being reviewed to maintain a high quality of bank supervision, and our training program for examiners is based upon up-to-date techniques and practices in banking.

The introduction of automation and computerization within the past few years has been one of the most important developments in banking and bank supervision. Initially, banks tended to use their computers for routine bookkeeping and housekeeping chores. Once this task was mastered, however, the computer could be assigned to more sophisticated management uses -- to analyze costs, markets, and other strategic variables in bank operations.

Similarly, bank supervisory agencies are taking advantage of computer techniques to assemble and analyze banking data and to develop new methods of utilizing current information. The objective of this endeavor is to upgrade the quality of bank supervision and to assemble data that can be returned to banks in a form relevant to the analysis and improvement of their operations.

The major contribution that the Corporation and the other bank supervisory agencies make to the conduct of monetary policy is to promote the

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kind of institutional framework in which policy determinations can be effective. An essential element in this structure is the confidence of depositors in the soundness of the banks holding their deposits. Supervisory activities by the banking agencies help to maintain conditions in the financial community which facilitate the successful operation of monetary policy. The monetary and fiscal authorities will operate more effectively to the extent that they are supported by a strong, vigorous, and viable banking system able to meet the changing financial requirements of the economy.

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