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"TWENTY-FIVE YEARS - PAST AND FUTURE"

Address of

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FEDERAL DEPOSIT INSURANCE CORPORATION

Before the

AMERICAN BANKERS ASSOCIATION

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TWENTY-FIVE YEARS - PAST AND FUTURE

To the historian, preoccupied as he often is with periods measured in centuries, twenty-five years may seem very short indeed. However, for most individuals a quarter of a century represents a substantial segment of his working lifetime. Twenty-five years ago this month the first Board of Directors of the Federal Deposit Insurance Corporation held its initial meeting. This was truly a momentous occasion, for upon those Directors and their successors fell the responsibility for shaping the policies of an organization charged for the first time in our history with the duty of assuring the safety of deposits in banks throughout the country. We are grateful to them and to their successors for their wisdom and their devotion to the cause of strengthening the banking system. During the years which followed it was my privilege, as a member and as Chairman of the Committee on Banking and Currency of the House of Representatives, to follow rather closely the activities of the FDIC, as well as those of the American Bankers Association, which have contributed so much to the improvement of banking.

Many events of the past quarter of a century have been of great significance to banking. I will mention only a few: recovery from the depression of the early thirties; a global armed conflict and other military operations; a decade of cold war; mounting Federal expenditures, debt, and taxation; changes in the distribution of income and wealth; and a population increase of unusual proportions. Economic conditions throughout the Nation are now vastly different from those of twenty-five years ago. There have been many changes in the banking structure and in the functioning of our banking and other financial institutions. The deposit insurance law under which the Corporation operates is in many respects very different from the law which its first Board of Directors was appointed to administer.

There is a natural temptation, on the occasion of this anniversary of deposit insurance, to dwell at some length on the changes which I have just described and perhaps to point with some justifiable pride to the manner in which the Federal Deposit Insurance Corporation has fulfilled the expectations of its founders. I do not intend to do that today, preferring rather to devote most of my time to a consideration of problems which we can see arising during the next quarter century - a quarter century which I am sure will be as momentous as the one we have just concluded.

Before doing this, however, I cannot refrain from directing attention to one facet of this deposit insurance story which has some current relevance. During the past year we have been undergoing a recession of somewhat greater severity than the other downturns since World War II. Recently there have been quite encouraging signs of an upturn and the recession of 1957-58 will, I am confident, go down in the history books as one of those mild cases, soon to be forgotten. Many people have written articles on the reasons for the mildness of this decline and I am sure that all of you here are familiar with most of these reasons. I would simply like to direct attention to the fact that one of the basic reasons - seldom mentioned - has been the existence of deposit insurance.

There is no question that prior to the establishment of the Federal Deposit Insurance Corporation economic downturns were aggravated and magnified by bank failures. Even in good years - years of prosperity -

there were numerous bank failures, while in bad years the number increased distressingly. In serious depressions such as 1930-33, the number of failures became catastrophic.

It would take a far more competent analyst than I to measure precisely the effects these failures had on the respective downturns, but there can be no doubt that they were serious. It is even quite probable that, at the beginning of an economic downturn, public anticipation and fear of bank failures and bank difficulties had a seriously depressing effect.

During this recent recession, bank failures have been very few, and they have been largely of the same kind with which we have had to deal in each year since World War II. No bank closing has been caused by depositor panic. Neither bank failure nor fear of failure has aggravated the decline. I am convinced that the accumulated effect of years of good bank supervision, combined with the truly amazing degree of public confidence in the banking system, have been significant factors in this development - and both factors are closely linked to deposit insurance.

I should like to tell you of a little incident which illustrates the changed public attitude with respect to bank failures. In the course of paying the insured claims of the depositors of one of the few banks which failed during the past year, we found that the claims were coming in quite slowly. Our claims agent, anxious to conclude his business, was a little distrubed over this, and one day he mentioned to one of the former employees of the bank that a particular depositor, with approximately $5,000 in his savings account and over $1,000 in a checking account, had not yet appeared to make claim. The claims agent asked if the employee knew this person. The answer was, "Yes, as a matter of fact, he lives across the street, and if you look out of the front window of the bank you can see him standing there now. He probably will drop in for his money in the next week or two."

I am sure you will all agree that such a situation would never have occurred prior to 1934, when even a small rumor of impending bank difficulty could bring hordes of frantic depositors, demanding immediate payment of their balances. We hear a lot today about so-called "built in stabilizers," by which people mean such things as social security payments and unemployment benefits. I maintain that one of the most important "built in" stabilizers is Federal deposit insurance, and the fact that it is working so well testifies to its success during this first quarter century of operation.

Enough of the past. What can we foresee for the future? Looking ahead to the next quarter of a century we can be confident that, so long as we are able to maintain peace, our economic system will continue its remarkable record of growth. If our output continues to grow at an average annual rate of approximately four percent a year, we may expect that deposits will grow at about the same rate. Any faster rate of deposit growth would, of course, be inflationary - a development we must make every effort to avoid - while any slower rate of growth in deposits could be deflationary. Assuming, then, a four percent growth rate of deposits, we can estimate that our banks in 1983 will have more than $600 billion of deposits, compared with approximately $230 billion today, and that there will be a corresponding growth in bank assets. Growth of this order of magnitude is not only quite probable but desirable. Nevertheless it may give rise to certain new banking problems and perhaps accentuate some old ones. It is to a discussion of these that I would like to turn now.

The bank capital problem comes first to mind. With the deposit and asset expansion I have indicated, we will need to have approximately $30 billion of new capital added to our banking system by 1983 if we are merely to retain the present ratio of capital to total assets. Judging from the record of recent years, which indicates that banks have been able to maintain, and even slightly improve, capital ratios, it would appear that there is no serious problem in store, so long as our goal is limited and so long as present practices do not change. In other words, we must continue our present rate of additions to capital if we are to remain in approximately the same relative position we are in today.

The difficulty is that the present capital level is not sufficient, and is likely to become even less satisfactory as years go by. The reason for this is that the banking system will have to participate vigorously in the financing of the economic growth which this Nation must and will have during the next quarter century. The present level of capital relative to bank assets would be reasonably satisfactory in a situation similar to that which existed just after World War II, in which a large proportion of bank assets was invested in securities of the United States Government. This is not the case today and it is even less likely to be the case in years to come.

A rapidly growing economy will bring a multitude of opportunities, which banks must be alert to grasp, and increased responsibilities, which banks must be quick to serve. If this is not done we will find that the non-bank financial institutions, which have already enjoyed a remarkable rate of growth, will continue to attract much of the business that banks are capable of doing. In addition, we may find new financial institutions appearing on the scene. Banks cannot let these opportunities and responsibilities go by default, but if they are to take advantage of them there must be an adequate capital base.

I am not prepared at this time to say that there should be any specific goals, or any precise ratio of capital to assets for the banking system as a whole. As a matter of fact, ratios based on aggregate figures have a limited usefulness, since the amount of capital each bank needs depend on circumstances peculiar to that bank. There are many banks today which are adequately capitalized and whose officials are sufficiently alert to the problem to assure that new capital requirements, when they appear, will be met. On the other hand, there are many banks with insufficient capital even by today's standards, and there is too large a number of banks with dangerously little capital. An illustration of this last kind of bank is found in a survey we recently completed, measuring bank capital relative to assets at risk. Assets at risk were defined as those assets remaining after deducting cash and cash balances, United States Government obligations, and all loans insured or guaranteed by agencies of the Federal Government. We found that there were 200 banks with capital ranging from 5 to 9 percent of these assets at risk. These banks had total deposits of over $3 billion, of which about $2 billion was insured. Notice what this implies. Even a two or three percent loss on just risk assets would seriously impair the capital of these banks, whereas a five or ten percent decline in the value of these assets would undoubtedly result in their closing. Of course, I do not want to imply by this that the only proper measure of the adequacy of bank capital is that which relates capital to risk assets. The figures I have cited are simply intended to illustrate one aspect of the capital problem.

In this next quarter century we anticipate that the deposit insurance fund of the Federal Deposit Insurance Corporation will continue to grow, both in dollar amount and in relation to total deposits in insured banks. The latter growth will come quite slowly and may be interrupted if at any time there is more than the usual number of bank failures. As most of you may know, the amount of the deposit insurance fund relative to total deposits is no larger today than it was at the end of the first year of operation of the Corporation; and relative to insured deposits the fund is considerably smaller than in 1934.

My point in mentioning the anticipated growth in the deposit insurance fund is to remind you that the fund does not serve, and was never intended to serve, as a substitute for bank capital. As I have pointed out on other occasions, only so long as the banking system shoulders the main burden of protecting depositors against loss can the fund be as small as it is, and the assessment rate remain as low as it is. Losses which occur in the ordinary business of banking are absorbed by bank capital. The deposit insurance fund stands as a kind of mobile capital, to be used speedily and at the point needed whenever there is a breakdown in the banking system. In this way it is intended that banking difficulties be stopped before they can grow to catastrophic proportions. Thus the deposit insurance fund is a second line of defense, standing behind the capitalization of the banking system; it supplements that capitalization but it can never replace it.

The past 25 years have seen a truly remarkable growth in both the number and assets of the so-called non-bank financial institutions. I refer, of course, to such institutions as private life insurance companies, savings and loan associations, credit unions, and personal finance companies. Many of these institutions are doing a business and meeting needs which could be done as well, if not better, by banks. There is no question that to a certain extent their growth has reflected the fact that in one way or another they are not subject to the various restrictions applied to banks. However, another reason for their growth is almost certainly the failure of banks to meet the financial needs of the public as rapidly or as conveniently as these institutions have been able to do.

I am willing to concede that overly-cautious bank supervision may have been a factor in this development, in the sense that supervisors have been concerned for so long with the possibility of a return of an overbanked situation, similar to that of the 1920's, that we may have overlooked the fact that, in some areas of the country at least, we have today what amounts to an underbanked situation.

Banks must also shoulder a part of this blame. Take the question of savings deposits, for example. Institutions such as credit unions and savings and loan companies have aggressively sought the surplus funds of individuals, and succeeded well in their efforts. The failure of banks to compete in this area was only partly a consequence of regulation, since for a long time many banks actively discouraged savings deposits.

Economic growth during the next quarter century, and the attendant increase in bank opportunities, will increase the already heavy volume of paperwork done by banks. In the past this type of work has required the time of a large proportion of bank employees and a considerable amount of space has been devoted to activities such as check sorting and record keeping. It appears that within a few years much of this will be changed through the application of electronics to bank accounting. We cannot foresee just what this will require in the way of equipment, which is still being developed, nor how the smaller banks will be able to make full use of these electronic marvels, but within a few years present accounting methods will doubtless appear very old-fashioned.

With the application of electronic equipment to bank accounting, both space and personnel will become available for rendering more and better service to the banks' customers. Employees will be released from many of the most tedious tasks, and persons with the necessary technical training will be required in order to secure the maximum benefits from the new equipment. Officers will find that more information can be made available to them with less time lag. The need will be great for well trained, alert officers who can correctly interpret and act on the data provided.

I have been pleased to observe the interest shown in recent years by a number of banks in the problem of management succession. I only wish that every bank would recognize and deal with this problem. Management succession involves more than simply attracting to the bank a few promising young men and, as the years pass, advancing them to positions of progressively greater responsibilities. The bank must first determine the qualifications - professional, technical, and administrative - which will be needed by bank officers in the future. These men must then be properly motivated, given the opportunity to develop the qualities needed by top officers, and their achievements recognized and adequately rewarded. Every bank should have such a program.

On-the-job training alone is not adequate for bank officers of the future. Organized professional education must play an important part in this program. In this respect the banking industry has been truly a pioneer. American Institute of Banking courses, along with the various facilities offered by graduate banking schools, have been of immense value to bankers and to the public. The American Bankers Association deserves great credit for this far-seeing educational development. And, of course, one can hardly mention this aspect of banking without paying tribute to the late Dr. Harold Stonier, who served for many years as national educational director of the American Institute of Banking, and who established the Graduate School of Banking at Rutgers University, serving over the years as its director and then as its dean. I cannot improve on some words included in a resolution adopted by the American Bankers Association at the time of Dr. Stonier's retirement from the Association: "Few men over the years contributed more to the present soundness and high public esteem of the banking structure of this country. American banking, for years to come, will carry the deep impress of Hal Stonier."

The problem of management succession concerns me because it is quite apparent that one of the major causes of the large number of bank mergers and absorptions within recent years has been the failure of bankers to provide for their successors. In a survey made of the number of applications for bank mergers received over a six-year period, we found that in approximately one-fourth of the cases, death, age, ill health, or retirement of the leading officer of the bank was the chief motivation underlying its sale. This suggests that many mergers might not have taken place had there been a qualified management available to continue operating the bank.

Mention of bank mergers brings me to another problem which will be accentuated during the next quarter century - that involving the basic structure of our banking system. It is apparent to any observer that fundamental changes are taking place and will continue. Except for a few years after World War II when there was a flurry of new bank organizations, the number of banks in this country has had a downward trend which has persisted now for almost 40 years. There were approximately 30,000 banks operating in 1920 but this number declined during the latter 1920's because of the large numbers of mergers and of failures, fell precipitously from 1930-33 during the banking collapse, and has been declining slowly but more or less steadily ever since. The decline in recent years has been due primarily to the large numbers of mergers and consolidations. Today there are fewer banks in this country than operated in 1904.

Partially offsetting this downward trend in the number of banks has been the rise in branch banking, from about 1,500 in the early 1920's to 3,000 in the early 1930's, to about 8,800 in 1957. Today branches comprise about 38 percent of all banking offices, whereas they made up only 16 percent at the time the Corporation began operations, and only 4 percent of the total in 1920.

One interesting development in this connection is that, despite the growth in branch banking, a growth which in recent years has made possible regular increases in the total number of banking offices, these increases in banking facilities have not kept pace with the growth in population. In 1920 there was one banking office for every 3,000 people in this country; by 1933 there was one for every 7,000 people, and today there is one office serving 7,500 people.

In view of the duration and persistency of the trends I have just described, it is reasonable to anticipate their continuation during the next 25 years. Yet if this is to be the case, it is clear that we may have a number of difficult questions to answer. For example, should the merger trend be slowed, and if so, by what means? Many mergers are due to quite natural circumstances, such as the desire of banks to expand and thereby improve facilities, make feasible the utilization of new techniques and equipment, and in general offer better service to the public. Often, competition is strengthened, rather than weakened, through a merger. However, it is also true that some mergers can reduce competition unduly, without offering much if any additional benefit to the banking public. The line here is very difficult to draw, but if it is to be drawn it must be by those thoroughly familiar with all aspects of the banking situation. The Corporation has supported, and continues to support, legislation which will place in the hands of the bank supervisory agencies more effective tools for preserving the competititve nature of our banking system.

I wish that with respect to this question, as well as to the other problems described earlier, it would be possible to make a precise prediction of what will happen, and tell you the specific manner in which the Federal Deposit Insurance Corporation will react. I can not do this. Therefore I should like to close this talk by leaving this thought with you. Tremendous changes are in store for the next quarter of a century; of that we may feel certain. We must be prepared to accept and encourage changes which will contribute to the maintenance and growth of our free economy. Great skill and judgment on the part of bankers will be required if the banking system is to play its proper part in our expanding economy. We count upon all of you to face, accept, and master the challenge.