

Statement on Behalf
of the
Board of Governors of the Federal Reserve System
by
Chairman Thomas B. McCabe
on
S. 2822 A Bill
"To Amend The Federal Deposit Insurance Act"

JANUARY 1950



ISSUED BY THE
BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM
WASHINGTON

**STATEMENT BY THOMAS B. McCABE, CHAIRMAN
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
ON S. 2822 A BILL
"TO AMEND THE FEDERAL DEPOSIT INSURANCE ACT"**

I am happy to have the privilege of submitting to this Committee the views of the Board of Governors of the Federal Reserve System on S. 2822. The Board is in essential agreement with the general purposes of this proposed legislation and is gratified that the bill is receiving careful study and consideration by your Committee.

The insurance of bank deposits is today an integral part of our banking organization and its efficient functioning is a matter of vital interest to the Federal Reserve. The System is charged with primary responsibility for monetary and credit policy in the national interest and this responsibility affects the entire banking system as well as the non-banking financial community. Furthermore, the Federal Reserve has a direct concern for the welfare of its member banks which hold 85 per cent of the deposits of the commercial banking system and support to a corresponding degree the deposit insurance program.

Responsibility for monetary and credit policy in our American tradition cannot be discharged effectively without a strong and profitable private banking system. Deposit insurance contributes to confidence in our banking mechanism by the assurance it gives to small depositors of the availability of their funds.

We believe that the Federal program of bank deposit insurance has made a notable contribution to banking stability. We further feel that the principal provisions of S. 2822, if enacted, will constitute a distinct improvement in the program.

During the past year, your Committee has on several occasions requested the Board's views on bills dealing with the insurance of bank deposits. In response to a request relating to S. 80, a bill to increase deposit insurance coverage from \$5,000 to \$15,000, the Board in March, 1949, advised your Chairman that the questions of insurance coverage, reduction of assessments and revision of the basis for assessments were interrelated and that a change in coverage should not be considered without re-

gard for the other aspects of the program. The Board also reported that it had instituted a study of the insurance program for bank deposits with a view to placing itself in position to respond to such further inquiry as the Committee might wish to make.

During the period in which the Board's study was conducted, we received requests for views on bills S. 2094, S. 2300, and S. 2307. In addition, we were asked by Senator Douglas, Chairman of the Subcommittee on Monetary, Credit, and Fiscal Policies of the Joint Committee on the Economic Report, for our views on what changes in the bank deposit insurance program would further the effectiveness of general monetary and credit policies. With respect to such requests, we stated that in view of the primary responsibility of the Federal Deposit Insurance Corporation in this field, the Board of Governors was hesitant about offering specific suggestions without having the benefit of the Corporation's views concerning desirable changes.

A preliminary draft of the Board's study was completed by its staff in late August 1949. In early September, the Board circulated copies of this draft for review and comment to the Presidents of the 12 Federal Reserve Banks, the members of the Federal Advisory Council (the membership of which consists of one active banker from each of the 12 Federal Reserve districts), and the Chairman of the Federal Deposit Insurance Corporation. Following this circulation, a number of comments and suggestions were received from the Federal Reserve Banks and the Federal Advisory Council. A revised draft was prepared in the light of these comments and suggestions. A copy of this draft was sent to the President of the American Bankers Association.

The comments received from the Federal Reserve Banks and the Federal Advisory Council indicated some difference in judgment as to the desirability of increased insurance coverage but a strong con-

sensus as to the desirability of reducing the assessment burden on banks.

The Board reviewed the revised staff study* and was in general accord with the suggestions therein presented with respect to increased insurance coverage, reduced assessments, and simplification of procedure by which individual banks compute assessment liabilities. The revised study was then circulated again to the interested parties mentioned above for further suggestion or comment. Replies recently received from the Presidents of the Federal Reserve Banks indicate general concurrence with the Board's position. However, we did not have the benefit of an expression of the views of the Federal Deposit Insurance Corporation before we received a copy of the bill.

At this point, I should like to offer for the record a copy of the Board's study. The study is primarily directed to a review and analysis of the coverage and assessment aspects of bank deposit insurance. I hope that it will be useful to your Committee in its further consideration of S. 2822. You will note that the conclusions of the study, arrived at independently, agree in principle and objective with the proposals set forth in this bill with respect to insurance coverage and assessments. In making the study available, it is not my thought to present an alternative approach, but merely to give your Committee the benefit of our painstaking examination of this complex subject.

The bill, S. 2822, would modify the insurance program in two principal ways by: (1) increasing deposit insurance coverage from \$5,000 to \$10,000, and (2) reducing the net cost of deposit insurance to insured banks. It would also simplify the manner in which the assessment liability is computed. In the light of the conclusions reached in the Board's study, I am pleased to say that the Board feels that these proposals are a step in the right direction and urges that they be given prompt consideration. I have a few comments to make on the proposals.

Bank deposit insurance coverage—SEC. 3(m). There are arguments for no increase in insurance coverage as well as arguments for a much more substantial increase than is proposed. Those favoring an increase in coverage are not in agreement as

* This study was presented to the Senate Banking and Currency Committee and is available upon written request to the Board of Governors of the Federal Reserve System, Washington 25, D. C.

to the desirable amount of the increase. Extending coverage from \$5,000 to \$10,000 appears to the Board to be reasonable and a good compromise of the conflicting views.

Assessment burden—SEC. 7(e). The Board believes that experience, the size of the deposit insurance fund, and the financial condition of the banking system justify a reduction in the burden on banks of insurance assessments. We would suggest that consideration be given to determining the dividend in a manner which will make it less subject to fluctuation from year to year.

The use of average loss experience over five or more years instead of the loss experience of the preceding year for assessment purposes would moderate fluctuations in the dividend rate. This would keep the net assessment burden on banks more stable and would avoid the adverse effect of a sharp increase in the net assessment burden in the event of widespread banking difficulties concentrated in a period of economic reaction.

A more stable net assessment rate would also reduce any tendency, on the part of the speculative elements of the financial community, to use changes in the dividend rate as an index of the soundness of bank stocks as well as the banking system.

Size of fund. We have noted that the bill does not indicate in any way what a desirable size of the fund might be. If the size of the fund is not to be increased indefinitely without regard for probable adequacy, there should be some provision designed to retard its further growth after it reaches a desired magnitude in relation to total deposits or, even better, in relation to total deposits minus cash assets and Government securities.

Amount of assessment relief. The Board believes that relief from the existing assessment burden should be more liberal than is provided for in this bill. Investment income should be included in computing net income and the dividend rate should be higher than 60 per cent of the combined net income. We have come to this conclusion on the basis of the present size of the insurance fund, the availability of other resources to supplement it when necessary, and the potential losses which may be realized from bank holdings of risk assets. Respecting the availability of other resources, it should be borne in mind that the existing authority of the Corporation to borrow up to 3 billion dollars from the Treasury is continued in the bill. Furthermore, the broad powers of the Federal Reserve Banks to

provide credit to the commercial banking system will make it easier for banks to meet the demands of their depositors if a period of strain should arise in the future.

The suggestion was also made during the hearings on the bill that the authority of the Corporation to set up reserves be more carefully defined, and the Board is in agreement with that suggestion.

We think that the various changes which have been outlined above would improve the provisions of the bill which relate to deposit coverage and assessment.

There are two other provisions of the bill, however, to which we take particular exception, namely, section 13(b) relating to loans and section 10(b) relating to examinations.

FDIC loan and asset purchase powers—SEC. 13(b). The bill proposes to eliminate the requirement in the present law for a merger or consolidation in those cases in which the Corporation believes that a distress situation can best be taken care of by loans or by purchasing assets. The loan or asset purchase approach is frequently preferable to the more involved and at times more costly process of receivership and liquidation. The restriction in the present law may at times prevent effective action in relieving distressed situations without liquidation. The Corporation should certainly have adequate powers to deal with distress cases and the Board favors the removal of this restriction.

The provisions of the bill with respect to the circumstances under which such loans may be made, however, are not altogether clear, and the language might at some future time be interpreted to permit the Corporation to embark upon the general business of lending to banks. It is understood that this power is intended to pertain only to distress cases which could not be handled by normal banking processes. In order to make clear that this is the case, we recommend that the provisions of section 13(b) be revised as follows:

“In order to reopen a closed insured bank or, when the Corporation has determined that an insured bank is in imminent danger of closing, in order to prevent such closing, the Corporation, in the discretion of its board of directors, is authorized to make loans to, or purchase the assets of, such an insured bank upon such terms and conditions as the board of directors may prescribe.”

Examinations—SEC. 10(b). Section 10(b) would give the Federal Deposit Insurance Corporation power to examine, without the consent of the Board of Governors, the State member banks of the Federal Reserve System. It would, however, continue the requirement that the Corporation obtain the written consent of the Comptroller of the Currency in order to examine any insured national bank.

The Board opposes this change. It is unnecessary and no sound reason has been advanced to indicate its need. It would lead to confusion and to increased overlapping and duplication in the examination and supervision of banks. It would act as a deterrent to State bank membership in the Federal Reserve System. It would be an inappropriate way of dealing with the realignment of Federal bank supervisory authority.

Lack of necessity. If the Committee were to study the practices of the Federal bank examination and supervisory agencies it would find, I am sure, that the proposed extension of power is not necessary to the effective discharge of the insurance functions of the Federal deposit insurance system. As indicated in replies to the Douglas questionnaires, the Federal bank supervisory agencies now follow substantially uniform examination practices and standards and use similar report forms. As a matter of course, Federal Reserve examination reports are made available freely to the Corporation.

On the first work day of each week the Federal Reserve Board's Division of Examinations, which reviews and coordinates the examination work of all the Federal Reserve Banks, sends to the Examination Division of the Federal Deposit Insurance Corporation a memorandum giving the names of State member banks whose examination reports have been received by the Board during the previous week. The Corporation calls for these reports as it wants them, extracts from the reports such information as it wants for its own files, and then returns the examination reports to us. It is our understanding that a similar procedure is followed in the case of insured national banks examined by the Office of the Comptroller of the Currency. Thus the Corporation has the most recent information on every insured bank in detail.

Unusual deterioration in asset condition, defalcations, and like adverse matters developed by our examining representatives are brought by our review examiners, informally and promptly, to the attention of the review examiners of the Federal

Deposit Insurance Corporation. The review of such reports is given priority by us so as to make them available to the Corporation as promptly as possible. The Corporation furnishes to the Board's Division of Examinations periodic lists of State member banks classed as problem cases by the Corporation. Significant information concerning such banks, received between examinations, is transmitted to the Corporation.

The Corporation also furnishes the Board's Division of Examinations with copies of memoranda setting forth the analysis by its review examiners of the condition of State member banks considered as problems on the basis of current examinations. Despite the fact that the reports involved have been analyzed and reviewed at the Reserve Banks and by the Board's Division of Examinations in Washington, photostatic copies of such memoranda received from the Federal Deposit Insurance Corporation are sent to the vice president in charge of examinations in the appropriate Reserve Bank with the request that the Board be advised of further developments. As previously indicated, when any such information is received it is relayed to the Federal Deposit Insurance Corporation either by telephone or memoranda.

In view of the foregoing, I feel that the Federal Deposit Insurance Corporation is currently informed on the condition of State member banks and, therefore, that nothing would be accomplished by any change in the law giving the Corporation power to examine such institutions without the consent of the Federal Reserve Board.

Whenever the Corporation has felt that special circumstances have warranted a separate examination of a State member bank it has requested permission of the Board of Governors to make such an examination. A review of the cases reveals that the present provision of law has not hampered the Corporation in the discharge of its insurance responsibilities and that the proposed extension of power is unnecessary.

A statement was made to your Committee by a representative of the Federal Deposit Insurance Corporation that there have been several instances in which the Corporation has requested consent of the Board of Governors to make examinations of State member banks and in which the Board's consent has not been forthcoming. We do not know of any instances of this kind and, accordingly, on January 25, we requested the Corporation to

furnish us with a list of such cases. Up to this time, however, we have not been furnished with any such information.

The Board's records show that 115 requests for consent to make examinations of State member banks were received from the Corporation. Of these not one was refused, 110 were granted, and in five cases the requests were withdrawn or dropped.

Increased overlapping and duplication. We have 48 State and 3 Federal bank supervisory agencies. Among them they supervise about 14,500 banks. In spite of the existence of so many agencies remarkable success has been achieved in coordinating and standardizing bank examination procedures and supervisory policies so as to minimize duplication and reduce the burdens and costs of examination.

In order to minimize duplication, Congress provided for examination by the Federal Deposit Insurance Corporation of only those insured banks not otherwise subject to Federal examination and supervision, and for the requirement of written consent from the appropriate Federal agency before the Corporation could examine independently any bank otherwise subject to Federal examination. The bill would eliminate this provision with regard to the 1,900 State member banks with less than \$40 billion of deposits but not with regard to the 5,000 national banks with nearly \$80 billion of deposits.

Such a change after 16 years of experience with existing law could be interpreted as Congressional approval of increased activity in this field. By the very nature of the bureaucratic process the change would lead to more Federal examiners, more examinations, more conflicts, more confusion, and more burdens on State member banks.

While the Federal Reserve has authority with respect to national banks comparable to that being requested for the Insurance Corporation with respect to State member banks, for years the Federal Reserve has relied exclusively on the examinations of the Comptroller of the Currency. We have not found it necessary to exercise this authority. In fact, if the purpose of this section of the bill is to assure "parity" among Federal supervisory agencies, as has been suggested in testimony before the Committee, this can best be achieved by requiring the written consent of the Comptroller of the Currency for examination of national banks by the

STATEMENT BY THOMAS B. MCCABE ON S. 2822

Federal Reserve, instead of by providing for duplicate Federal examination of State banks.

Deterrent to State bank membership. The proposed change would expose State member banks to examination by two Federal agencies in addition to examinations by State authorities. The addition by the Congress of another independent Federal examining authority would constitute an obstacle to State bank membership in the Federal Reserve System and I have been advised by Presidents of the Federal Reserve Banks would lead to withdrawals from the System. As a result, the effectiveness of Federal credit and monetary policies would be weakened.

Inappropriate way of realigning Federal supervisory authority. I should like to emphasize the Board's opinion that realignment of bank examination and supervisory functions of the three Federal bank supervisory agencies is not a matter which should be dealt with in a piecemeal fashion or as an incident to a bill designed primarily for other ends. The Board feels that, should the Con-

gress wish to deal with the problem of organization and functioning of the Federal bank examination and supervisory establishment, it should do so only after a careful study by the Banking and Currency Committees for the specific purpose of determining the advisability of legislation in this field.

Concluding comment. In conclusion, I should like to re-emphasize the Board's strong sympathy for the objectives of this proposed bill relating to the insurance coverage, the payment of dividends, the assessment base, the simplification of the assessment computation, and the liberalization of the loan and asset purchase powers of the Corporation. We question whether any of the other provisions of this bill are essential at this time. There has been only a very short period within which to examine all of the provisions in detail. It is quite possible that, on further study of the detailed provisions of the bill, we would have additional suggestions to make and, if so, we hope the Committee will permit us to do so.