BANK CREDIT AND BANK SUPERVISION

A Plan for Improving the Present Regulatory Machinery

Submitted by the Board of Governors of the
Federal Reserve System

Introduction

In its Annual Report for 1938 the Board of Governors of the Federal Reserve System presented to Congress its views about the defects in our present banking and monetary mechanism. The Board stated that the proper functioning of our banking mechanism was "a matter of public concern both because of the importance of safeguarding deposits and because of the part that the banks play in maintaining the flow of goods and services through the channels of production and distribution from the farm, the forest, and the mine to the ultimate consumer."

In that report the Board described the existing situation and raised fundamental questions for the consideration of Congress. The Board now wishes to present to Congress a plan for changes in the banking and monetary mechanism that in the Board's judgment would go a long way towards remedying the defects that were pointed out in the report. This plan is the result of ten years of study and the accumulation of a wealth of material covering the whole range of banking and monetary problems. All this material will be placed at the disposal of Congress if so desired.

Specific recommendations, together with the principal considerations on which they are based, are presented in subsequent pages of this statement.

The fundamental purpose of the Board's plan is to enable our banking and monetary mechanism to contribute more effectively to the maintenance of economic stability and to the fullest sustainable employment of the nation's human and material resources. In order to serve this objective the Federal Reserve System must have additional powers. The Board proposes that as a preliminary step to the granting of such powers private ownership of the Federal Reserve banks be terminated and that no active banker serve on the boards of these banks.

The plan would extend the privilege of using the facilities of the Federal Reserve banks to all the banks insured by the Federal Deposit Insurance Corporation, regardless of whether they are national banks or State banks, and regardless of the size of their capital and without depriving small banks of the revenue derived from exchange charges on checks.

Since all insured banks are to have the privileges of using Federal Reserve facilities, it is proposed that they be subject to the requirement of maintaining in cash or on deposit with the Federal Reserve banks a prescribed amount of reserves against their deposits. The percentages of these reserves to the banks' deposit liabilities would be stated in the law. In order to enable the Federal Reserve authorities to discharge their responsibilities in preventing an undue credit expansion or contraction, however, the Board recommends that it be given power to increase the reserve requirements of the banks when conditions demand, provided that such requirements shall at no time result in reducing unused or excess reserves of the member banks to below $1,000,000,000. Such a provision would enable the Board when necessary to absorb unused reserves arising from gold inflow or silver purchases, but would prevent the possibility of a deflation through an increase in reserve requirements to a point where banks, in order to meet the requirements, would have to borrow or to liquidate some of their loans and investments.

The Board also recommends that it be given power to require special reserves against deposits held by foreigners in this country in order to reduce the disturbing effects of the movement of foreign funds in and out of the country.

As a means of avoiding the confusion and overlapping of authority and responsibility in bank supervision that now exists, the Board recommends that Federal supervision over banks be concentrated in one agency of the Government. In the Board's judgment this responsibility cannot be separated from the responsibility of monetary management. Such a separation makes possible the conditions that have occurred in the past, when the policies pursued by the supervisory authorities consciously or unconsciously worked in the opposite direction from monetary policies adopted by the Administration and the Federal Reserve System. The Board proposes, therefore, that all examination be concentrated in the office of the Comptroller of the Currency, as the oldest and most experienced organization for bank supervision and regulation in this country. In the interest of unified policy, however, the Board proposes that the Comptroller of the Currency become once more a member of the Board of Governors and that ultimately the Board have authority to appoint the Comptroller. By this method bank supervision will be in the most experienced hands and at the same time supervisory policies will be coordinated with credit policies.

In order to make this mechanism work efficiently, the Board proposes that the actual supervision of banks be decentralized and authority be given to national bank examiners located in the twelve Federal Reserve banks to handle the problem in each Federal Reserve district, subject to general policies laid down by the Comptroller. By this method banking supervision will be kept in close touch with local conditions, and the supervisory authorities will have the benefit of the existing plant of the twelve Federal Reserve banks and twenty-four branches and of the experience which the Federal Reserve banks have accumulated over a period covering a quarter of a century and the current information which they obtain from their daily contacts with the banks in their districts.

The plan includes a provision for the creation of an Industrial Loan Corporation to provide capital funds for smaller business enterprises which, as a class, have had difficulty in obtaining funds from the usual sources.

The Board believes that this plan would result in a better organization of our banking and monetary systems and enable it to be conducted in the interest of all the elements of the country's population.

The Board is convinced that reorganization of our mechanism for regulating credit and for bank supervision along the lines proposed in this plan would put the banks of the country in a far better position than they are today to serve the public interest and to withstand stresses and strains to which they may be subjected in the future as they have been in the past.