

October 10, 1945.

Dear Abe:

Attached is a perhaps overlong memorandum for your own personal information which gives a general background of the reasons why the three Federal banking agencies ought to be reorganized. It is an extremely difficult subject to cover briefly or simply because the problem is of long standing and complex.

Because of your special interest as a member of the Banking and Currency Committee, you might, if you have the opportunity, look over the excerpts, which I also attach, from the Board's Annual Report to Congress of 1938, in which I have underlined some of the examples of conflicts, overlapping jurisdictions, duplications, etc., which ought not to exist and can only be cured by a practical reorganization bill.

I do not know of anyone more able than you are to present the case. I think you know me well enough to know that I am trying to look at this matter objectively without the slightest desire for more responsibility so far as I am individually concerned. The present setup is wholly unsatisfactory.

You asked for examples of conflict, and aside from repenciling the attached report which deals with the matter in detail, I am also attaching a separate memorandum which lists the principal duplications and overlapping functions.

One of the most discouraging aspects of the present unsatisfactory situation is the virtual campaign that FDIC has made to dissuade insured non-member banks from joining the Reserve System, the motive seemingly being due to fear that influence of the FDIC would be diminished and that of the Reserve System increased.

Always with best regards,

Sincerely yours,

The Honorable Abe Murdock,  
United States Senate,  
Washington 25, D. C.

If there is no reason for reorganizing the three Federal banking agencies, then there is no reason for passing any reorganization bill at all. There is no governmental area in which reorganization is more urgently needed than in Federal banking supervision. It is replete with conflicting, overlapping, discriminatory authorities affecting different classes of banks that make for delay, confusion, waste and inefficiency.

There are two sources of opposition to any reorganization of these agencies; one, the entrenched bureaucrats who are fearful of their jobs or prestige, second, the bankers who throughout history have opposed every forward step. They fought the National Banking Act which created the office of the Comptroller of the Currency. They fought the Federal Reserve System. They fought the Federal Deposit Insurance Corporation. They are always against any change from the status quo. And they prefer divided authority on the divide-and-conquer theory.

All the reasons for the reorganization that led, for example, to the creation of the Home Loan Bank System and the Farm Credit Administration are present in the case of the Federal banking agencies. The Home Loan Bank setup, for instance, has worked far more efficiently under unification which provides for chartering, examinations, memberships and insurance, all under one authority, direction and policy. No one today would think of proposing to break that up again into separate and divided units. Reorganization of the Federal banking agencies would by no means be a cure-all of the hodge-podge of the legislation, State and national, affecting all banks, but it would be a long step forward in putting the Federal Government's house in order so far as its supervision of banks subject to Federal jurisdiction is concerned.

As of the end of last June, there were 14,500 banks in the United States. They held at that time nearly 95 billions of Government securities. These Government securities constituted nearly two-thirds of their total loans and investments. By far the most important factor in the Government's relations with the banks of the country today is the management of the public debt, of which the banks hold and will continue to hold so large a share. Government supervisory and examination policy with particular reference to Government securities has become of crucial importance. Even if there were not and if there had not been in the past sharp cleavages among the three Federal banking agencies regarding bank examination policy, the fact that there are three different authorities with differing conceptions of public policy inevitably makes for uncertainty and confusion and always potential discord.

Only one of the three agencies, the Federal Reserve System, is charged by Congress with responsibility over the supply and cost of credit, which is directly affected by reserve requirements, rate policy and, under modern conditions, chiefly by open market operations. Thus the Reserve System views the economic scene principally from the standpoint of national credit conditions as affected by monetary, fiscal and other governmental

policy. The Comptroller of the Currency, whose present day function consists mainly of examining national banks, does not have these broad responsibilities. Similarly, the FDIC is chiefly concerned with accumulating and safeguarding an insurance fund and is likewise without responsibility for broader policies. These inherent differences of interest inevitably lead to conflicts in policy conceptions and make it difficult and often impossible to reach agreements.

On the initiative of the Reserve System an effort was made in 1938 to bring about some degree of uniformity in bank examination policy, recognizing that in the past rule-of-thumb and arbitrary rulings had served to intensify both deflation and inflation. While a voluntary agreement was worked out among the three Federal agencies, the permanence of this arrangement depends upon continuous agreement among the agencies on the policies involved and, above all, the effectiveness of the agreement depends upon uniform interpretation of the policies adopted. The interpretation, however, is bound to vary from time to time in accordance with the differing fundamental viewpoints of those responsible for policy in the three agencies. There is agreement on paper only. In practice, old procedures that have worked badly in the past are hard to eradicate so long as authority is divided and basic policies differ. Bank examination policies assume new and far-reaching significance today in the light of the vast holdings of Government securities by the banks. These policies cannot be separated from broad credit and monetary policies. To have examination policies operate in diverse directions, under divided authority, can be extremely detrimental to the management of the public debt and the Government's credit. Too often in the past, when credit and monetary policy was aimed at offsetting deflationary forces, bank examination policy became tighter as conditions grew worse, intensifying the deflation. Conversely, examination policy tended to accentuate inflationary forces by relaxing at the very time when caution should have been observed.

This country has spent more on bank examination with worse results than any nation in the world. Bank examination has not and cannot by itself protect depositors, stockholders or customers of banks. The health of the banking system is determined by far more basic factors and is closely bound up with broader Government economic, fiscal and monetary policies in general, to which bank examination should be a subordinate corollary. This Nation's record of bank failures is scandalous beyond anything in the history of the world. In the early 20's there were more than 30,000 commercial banks in this country. More than half of them have disappeared, mainly through failures that bank examination did not and could not prevent. To make that policy separate from fiscal, monetary and other broader policies and to have it aimed either at rule-of-thumb routine examinations or at protection of an insurance fund is a narrow and, in fact, dangerous policy today.

The most recent striking example of the inability of the Federal banking agencies to agree upon policy was in connection with the law prohibiting banks from paying interest on demand deposits "directly or indirectly, or by any device whatsoever." While the Comptroller's office avoided open conflict, the FDIC fought against interpreting this law to prohibit the

practice of some banks of absorbing exchange for correspondent banks as a device to obtain their deposits. The question at the moment is not whether the law is good or bad or the interpretation sound or unsound. The fact is that the spectacle of two of the three banking agencies publicly at loggerheads over what should have been a unified policy, tested out if need be in the courts, is intolerable. It took much of the time of committees and on the floor of Congress to shelve this issue, which so vividly exemplifies the inherent difficulty, needless confusion and waste of time resulting from the present setup.

Similarly, the acute problem of grave abuses resulting from certain bank holding company operations go uncorrected because the separate Federal banking agencies cannot agree upon a remedy to propose to the Congress.

Even if there had been no publicly advertised differences to date, the situation would still call for correction by putting these agencies together under one tent so far as policy-making is concerned. There would be no reason for disturbing the corporate entity of the FDIC, for example, or in any way impairing the insurance of deposits, which today has general public support notwithstanding the efforts the bankers once made to prevent it.

The major difficulties so far as the Federal agencies are concerned could be remedied, however, by a merger under one authority. There is no sense in having three separate examination, legal, research and other staffs housed in three different headquarters in Washington and scattered through multiple field offices all over the country. There should be one final Federal banking authority, whether it be a board or some other form which accomplishes the same result -- in any case, any change from the present divided setup is almost certain to be for the better.

In its Annual Report to Congress of 1938 (copy of text attached), the Reserve Board described the "crazy quilt of conflicting powers and jurisdictions, of overlapping authorities and gaps in authority," etc. (see page 3). The picture so far as Federal banking agencies is concerned is replete with difficulties that could be largely eliminated and substantial economies brought about by an objective and practical reorganization such as the President, with the aid of experts in the Budget Bureau who have been working on the problem for several years, may be expected to present to Congress if the President's hands are not tied by exempting any one of the three agencies.

Attachment

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## Duplicated and Overlapping Functions of Federal Supervisory Authorities

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There are approximately 14,000 commercial banks which are subject in greater or less degree to some form of authority exercised by the Board of Governors, the FDIC, the Comptroller of the Currency and the Secretary of the Treasury. At least 86% of the deposits of all commercial banks are in members of the Federal Reserve System.

The Federal Reserve System lays down the requirements for admission of State banks to membership and it has authority to supervise and examine all member banks. However, charters for National banks are issued by the Comptroller, and they become members of the Federal Reserve System without any action by the Board of Governors. All member banks must be insured by the FDIC upon certification by the Board in the case of State member banks and by the Comptroller in the case of National banks. The fact that a State bank is insured by the FDIC does not entitle it to membership in the Federal Reserve System, as it must meet certain additional requirements before it can be admitted. All member banks must have licenses issued by the Secretary of the Treasury, which are still subject to revocation by him.

The Comptroller issues regulations defining and governing the investment and purchase of Government securities by National banks. These regulations are applicable also to State member banks but not to insured nonmember banks. The Comptroller enforces the regulations with respect to National banks and the Reserve System enforces the same regulations with respect to State member banks.

Although the Comptroller issues charters to National banks, they can exercise trust powers only when granted by the Board of Governors, which issues the regulations governing the exercise of trust powers. Supervision over the exercise of trust powers and compliance with the Board's regulations as to National banks, however, is in the hands of the Comptroller.

The Board of Governors issues regulations defining demand, time and savings deposits for member banks and relating to interest on such deposits. Payment of interest on demand deposits is prohibited by Federal law for all insured banks whether National, State member, or nonmember. But the regulation of the Board of Governors applies to National and State member banks only and the FDIC has separate authority which it exercises with respect to nonmember insured banks. The two sets of regulations are not identical and policies of administration are in conflict. While the Federal Reserve authorities enforce the Board's regulations as to State member banks, the Comptroller administers the Board's regulations with respect to National banks.

The Federal Reserve System is charged with the administration of the law regarding holding company affiliates of member banks; but the same holding

company sometimes controls National banks, supervised by the Comptroller of the Currency; State member banks, supervised by the Federal Reserve authorities; and nonmember insured banks, supervised by the FDIC.

National banks make reports of condition and earnings and expenses to the Comptroller of the Currency; State member banks to the Board of Governors; and insured nonmember banks to the FDIC. It has required much labor and negotiation to bring these reports into reasonable harmony but the information derived from them is tabulated separately by each of the three Federal authorities for the class of banks from which it receives the reports. Each agency obtains from the other the comparable information derived from its reports and all three, to some extent, publish the same information.

The Board of Governors has jurisdiction over all banks, regardless of whether they are insured or not and whether they are members or not of the Federal Reserve System, under Regulation U, relating to loans by banking institutions on stock exchange securities. This is also the case under the Board's Regulation W, issued pursuant to an Executive Order relating to consumer credit. Nevertheless the examinations necessary to carry out these regulations are administered as to each class of bank by the Federal authority to which it is primarily responsible.

All member banks, whether National or State, are subject to the reserve requirement regulations of the Board of Governors and to the Board's regulations governing discounting facilities of the Federal Reserve Banks. All member banks also have the check clearing and currency facilities of the Federal Reserve Banks and are subject to the instructions of the Federal Reserve Banks relating thereto. Member banks have certain preferential advantages with respect to discounting at Federal Reserve Banks; they can borrow on any sound assets and they obtain the lowest rates. However, nonmember banks may also borrow from the Federal Reserve Banks to a limited extent on somewhat higher rates. In their capacity as fiscal agents of the Federal Government the Federal Reserve Banks deal with all classes of banks without necessary regard for membership in the System.

Although the fundamental policy of bank examination and supervision should be governed by National credit policy which is the primary responsibility of the Board of Governors, and although, as will be seen from the foregoing, examinations should carry out the objectives of regulations most of which are issued by the Board of Governors, the actual performance of the examination function is distributed among the three Federal agencies. The Federal Reserve Banks, under the direction of the Board of Governors, examine all State member banks; the Comptroller directs the examination of all National banks; and the FDIC directs the examination of all nonmember State insured banks. National banks are examined at least twice a year and pay assessments to cover the cost; State member banks and nonmember insured banks are not subjected to such requirements by the Board or the FDIC. Although there has been an agreement by the three agencies upon uniform bank examination procedure, that agreement is not carried out uniformly by the three agencies.

The three supervisory agencies, both in Washington and in the field, are largely housed separately in different locations, whereas if they were reorganized joint housing accommodations could be provided and the contacts of banks with the agencies greatly simplified in Washington as well as elsewhere.

As a result of the diverse Federal supervisory policies, banks may leave one jurisdiction in preference for another; a National bank may give up its charter in order to become a State nonmember insured bank; a State member bank may withdraw from membership for the same reason; and an insured bank may obtain a National charter or State bank membership in order to gain the advantages that it sees in such action. Such conditions are not conducive to respect for Federal supervisory authority.