Statement Concerning H. R. 107 and H. R. 6885
by J. L. Robertson, Member of the Board of Governors
of the Federal Reserve System, before the Banking and
Currency Committee of the House of Representatives

April 12, 1965

Mr. Chairman and Members of the Committee:

Like many government officials in these frantic times, I have learned that it is essential to retain perspective and a sense of proportion if one hopes to perform his duties effectively - or to retain his sanity, for that matter. Consequently, I am aware that the Republic will not stand or fall solely as a result of what emerges from these hearings. Nevertheless, I am strongly reminded of Victor Hugo's epigram: "No army can withstand the strength of an idea whose time has come." The idea that federal bank supervision should be unified was brought forward (although not for the first time) just three years ago. The idea faced an opposing army then and it does today.

The most hostile and hard-hitting battalions of that entrenched army consist of those who actually do not want bank supervision to be effective. They fight under a banner bearing the motto "Divide and Conquer" - and they have done pretty well along those lines! These people <u>want</u> federal

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

bank supervision to be fragmented; they believe - and there is strong evidence to support their belief - that in such a situation supervisors can be maneuvered into competing <u>with one another</u>, and that kind of competition takes the form of a race of laxity that defeats the fundamental purposes that should be served.

More numerous, if less aggressive, are the members of that opposing army who temperamentally prefer the status quo to <u>any</u> change, however beneficial, and those who simply like to be aligned with the majority opinion of the moment.

The idea of unified federal bank supervision has had no such allies. When this Committee held hearings on the Federal Banking Commission bill two years ago, a whole chorus of voices clamored against the proposal. Almost all of the witnesses were in agreement that the bill should not be enacted, although there was little agreement as to just what was wrong with it.

But when a serious problem really exists, and a sound and practical solution has been advanced, it seems to be impossible to keep the problem - and the solution - under the rug. Month after month, as the basic structural weaknesses of federal bank supervision have become more apparent and

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

their evil effects more conspicuous, the idea of unification has been advanced again and again - by high government officials and commissions, by bankers, in newspaper editorials, and in the statements of legislators.

True, we must anticipate desperate last-ditch resistance from those who believe they can benefit from the existing chaotic situation. Nevertheless, it is fair to say that the focus of inquiry now has shifted from Whether federal bank supervision should be unified to How this shall be accomplished.

Two years ago, at the hearings on the predecessor to H. R. 107, which would "establish a Federal Banking Commission to administer all Federal laws relating to the examination and supervision of banks', it was brought out that this bill would put an end to the existing hodgepodge in federal supervision of the banking industry. It would do this in a very simple and practical way - by unifying in a single agency, concerned exclusively with the supervision of banking, functions that are now, by unfortunate historical accident, scattered among three authorities: the Bureau of the Comptroller of the Currency, the Federal Reserve System, and the Federal Deposit Insurance Corporation.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

As I mentioned a moment ago, in 1963 the question that principally concerned this Committee was whether federal bank supervision should be unified. The hearings revealed how the fragmentation of this responsibility of our government came about almost accidentally, the built-in vices of the existing structure, and the serious and cumulative damage that would continue to injure supervisory effectiveness, the welfare and serviceability of the banking industry, and - perhaps more important - respect for law and government, unless these functions of the national government were reorganized on a rational basis.

I shall not take the Committee's time - unless you wish - to describe again the crippling inconsistencies and conflicts that afflict federal bank supervision as now constituted. Instances were enumerated at the earlier hearings. I shall mention just one shocking example, since it occurred only a few months ago.

Last year - following the "established", although unfortunate, pattern of fragmentation - Congress vested in the three separate agencies the task of applying to banks the public-disclosure provisions of the Securities Exchange Act of 1934. The purpose, of course, was to have banks with

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

numerous stockholders make available to the investing public the facts they need in order to exercise intelligent investment judgment with respect to bank stocks. Unless investors have ready access to comparable information about stocks of national and state banks, they are not in a position to evaluate their relative investment merits.

I wish you could undertake the task, difficult though it would be, to compare the regulations applicable to state member banks with those applicable to national banks. They approach the subject in entirely different ways, and information regarding different classes of banks is not even available for public inspection at the same places! As a result, investors are deprived of the benefits that Congress attempted to confer.

Both regulations, it must be borne in mind, were promulgated pursuant to the same federal law - but by different federal supervisors! Such diverse administration by different agencies of the federal government simply defeats the salutary purposes of our country's laws.

Today, it is accepted by thoughtful, disinterested, and responsible opinion that the unbalanced, dangerous, and injurious three-way structure of federal bank supervision must

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

be replaced by a rational, unified system that will enable the federal government to perform this function effectively, economically, and constructively in a manner that will not discredit our nation. The principal question before the Committee today is how this essential unification shall be effected, and that question gives rise to the only significant difference between the two bills that are the subject of this hearing.

It should be emphasized again that both bills under consideration are designed to do, and would do, just one thing - unify federal supervision of banking. Neither would expand governmental powers over banking. But simply by effecting unification, enactment of such legislation would accomplish much more. It would end much friction and conflict among banks and bank supervisors. It would eliminate wasteful duplication and overlapping among agencies. It would abolish the existing "triple standard" and enable the banking industry to operate under a single, consistent set of rules, as far as federal supervision is concerned. It would do away with a dangerous tendency toward a "race of laxity" in bank supervision that leads to disregard of legal requirements and to deterioration of the standards of sound banking

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

which it is a function of bank supervision to enforce and maintain. And it would enable the Federal Reserve Board, of which I am a member, to devote its time and attention exclusively to its most vital - and increasingly difficult - function: the formulation and execution of monetary policy for the leading industrial nation of the world.

H. R. 107 would transfer the bank supervisory functions that are now performed by the Comptroller of the Currency, the Federal Reserve System, and the Federal Deposit Insurance Corporation to a Federal Banking Commission consisting of five members appointed by the President. That body would have no duties other than the administration of federal laws and regulations relating to the banking industry.

H. R. 6885 would result in the same unification. It differs from H. R. 107 in placing the responsibility for federal bank supervision in the Secretary of the Treasury rather than in a Federal Banking Commission.

It would be unfortunate, indeed, if we failed to achieve the main objective - unification - because of differing views with respect to method and procedure. In my judgment, enactment of either bill would constitute an enormous improvement over the existing situation. But it would

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

be a grave mistake to dismiss the matter of locus of the unified responsibility as a negligible matter, so long as unification is brought about.

In 1913 attention was centered on the patent merits of creating a central bank for the United States, and in 1933 the obvious virtues of federal deposit insurance occupied the center of the stage. As long as these substantive benefits were gained, Congress may have thought, structural arrangements are relatively immaterial. But later - in actual operation - the evils of those structural defects became painfully apparent. As a consequence we have suffered decades of ineffectiveness, waste, and recently, I fear, diminished respect for the integrity and good sense of government. This is why I hope the Committee and the Congress will consider with utmost seriousness the administrative structure that would result from enactment of one or the other of these bills.

I favor enactment of H. R. 107. To qualify as an expert on this matter, I will mention that, in the thirty-odd years during which I have been involved in bank supervision, almost twenty were spent in the Office of the Comptroller of the Currency, including years as the principal administrator

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

of the internal affairs of that bureau and its relations with the banking industry and with other supervisors. I saw the establishment of the Federal Deposit Insurance Corporation and the growth of that agency. I believe I have participated intimately in every important development and problem of bank supervision for over thirty years, working not only with and within the federal structure but also with bankers throughout the country, their associations, and the state supervisors of banks.

The work that would be made the responsibility of a single agency by these bills - whether that agency is the Secretary of the Treasury or the Federal Banking Commission - covers a wide area. It is work that is important to the national economy and work that is inherently complex. It involves administration of the National Bank Act, the bank supervisory provisions of the Federal Reserve Act, the Federal Deposit Insurance Act, the Clayton Antitrust Act, the Securities Exchange Act in its application to banks, the Bank Holding Company Act, and the Bank Merger Act, to name the most conspicuous statutes. The administration of these and other laws requires intricate coordination of efforts with the Department of Justice, the Securities and Exchange

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Commission, the Federal Reserve System, and supervisors of fifty state banking systems.

H. R. 6885 would place these responsibilities in the hands of the Secretary of the Treasury, although he would be authorized to delegate any function to others in his Department. In operation, the Secretary could either make the important decisions himself (many hundreds every year) or - more likely - place the problems in the hands of a subordinate official. In either event, in my judgment, the arrangement would be subject to the same major criticism, in that it would centralize federal authority over the nation's banking system in one individual.

It cannot be questioned that one-man administration is usually swifter and more immediately effective than administration by a board or commission. Under Mussolini, the railroads of Italy ran on time, and unemployment disappeared in Hitler's Germany. In many areas of government, the vesting of authority in one individual is even appropriate in principle. But this is not true, to a peculiar degree, with respect to federal bank supervision - administration of the laws I enumerated a moment ago. On the basis of continuous observation of individual and group administration of this

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

work - not infrequently involving dealing with identical problems - it is quite clear, in my judgment, that it may be anticipated, year in and year out, that the relatively cumbersome deliberations of a body composed of five commissioners are more likely than the swift conclusions of an individual to develop policies and to reach decisions that will enable the banking industry to make its greatest possible contribution to the national economy, which is so dependent upon adequate sources of credit and other financial services.

The wisdom of this principle has been recognized by Congress again and again, in the establishment of the independent regulatory agencies that characterize twentieth-century government. In the formulation and application of a bank merger policy for the United States, to mention one example, one-man administration would be as difficult to justify as a one-man Supreme Court to pass upon the questions that come before that tribunal.

A second point of contrast between the approach of these two bills has to do with orientation. Under existing law, it is true, the Comptroller of the Currency is empowered to regulate the national banking system "under the general directions of the Secretary of the Treasury". To

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

my knowledge, the Secretary has rarely dictated policies that the Comptroller was to follow. Nevertheless, it is only realistic to recognize that the area of major interest to the head of the Treasury Department necessarily is the financing of our national government. In times of stress, the temptation would exist to ease this difficult task by enforcing policies, in the supervision of banks, that were calculated to facilitate government finance.

Under either of these bills, the job will be to regulate, in large measure, the American banking system. To me it seems clear that the importance of this job at least equals the importance of regulating an arm of the transportation industry, or communications, or the securities markets. The job is one that requires continuity of policy and expertness at the top, concerned exclusively with the ability of the banking industry to perform its services to the economy, which are unmatched in their importance in our economic system.

I should like to emphasize that point. Federal bank supervision should be dominated by one, and only one, objective - the strength and serviceability of the American banking system. To the extent that this paramount objective

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

might be affected by other considerations - for example, the management of fiscal affairs - the effectiveness of bank supervision would deteriorate and the economy would suffer, in the long run. A responsibility of this magnitude should be vested in a continuing commission made up of persons who possess outstanding qualifications for the job and are able to devote their time and abilities solely to the promotion of the health and usefulness of the commercial banking structure of our nation.

Because of my position as a member of the Board of Governors of the Federal Reserve System, it is appropriate to comment on another proposal that has been made, although it is not embodied in any pending bill. This suggestion is that the functions of the three existing agencies should be consolidated under that Board. In my judgment, there are convincing reasons for concluding that this course would be less beneficial than that offered by H. R. 107.

In the first place, the Board of Governors is fully burdened with functions relating to domestic and international monetary matters. It hardly has enough time, over and above that which is needed to deal effectively with this principal responsibility, to carry on supervisory

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

activities with respect to the 1500 state member banks alone. How it would find time to discharge, effectively, supervisory functions covering over 13,000 insured banks - including primary responsibility with respect to chartering, branching, mergers, and basic regulation of the national banking system of some five thousand institutions - is beyond my imagination!

Some witnesses may tell you that bank supervision is a necessary adjunct to the Federal Reserve's responsibilities in the field of money and credit. In response, I would say that bank supervision is too important in the public interest to be treated as an adjunct to any other function. But, even more important, the basic contention is fallacious. The Federal Reserve could function as a central bank at least equally well - in my judgment, better - if it were to devote its full time to the formulation and execution of monetary policy and were not engaged in bank supervision at all. The data used in monetary policy formulation is drawn only in relatively small part from banks (most of the information we use is voluntarily furnished by business concerns over which the Federal Reserve exercises no supervisory authority whatsoever); but

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

in any event better statistical data concerning banks could be obtained from a unified banking commission than is now available from the supervisory agencies, because the reporting system would be uniform for all banks and the long and wearisome debates on whether to call for this or that item of information would be ended. If the Board needed to supplement that material, it would have power to make a direct call upon member banks. And, of course, it would be obliged, as it is now, to get pertinent information concerning their operations from all banks that borrow from the Federal Reserve.

In my judgment, the views of those men who engage in the formulation of monetary policy are not affected in the slightest by the fact that the man who examines a given bank happens to be on the pay roll of the Federal Reserve rather than some other agency.

The point has been made that a Banking Commission might deprive the Federal Reserve System of needed information by refusing to make available reports of examinations and reports of condition of banks. Under the arrangement contemplated by H. R. 107, this would be a remote danger indeed. However, to avoid debate that might divert the

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

Committee's attention from the serious issue before it, I would recommend that section 306(a)(2) of the bill be amended simply to require (rather than authorize) the Commission to furnish those reports to the Federal Reserve System.

The problem that confronts the Committee and the Congress grew out of the built-in faults of our supervisory system; it has obtruded itself increasingly upon our awareness and compelled us to face it, whether we wished to or not. Either of the bills before the Committee would end the destructive fragmentation of authority and would achieve the unification that is the principal need in this situation. In my judgment, however, the structural plan embodied in H. R. 107 - an independent five-man commission devoted solely to maintaining the soundness and enhancing the usefulness of the American banking system - is preferable to the arrangement proposed in H. R. 6885 and is, in fact, the best available solution.

Three years have gone by since I first proposed this reform. I hope it is clear why I continue to urge its adoption. While some have been looking the other way in the hope that the problem would disappear, it has actually

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis

grown worse. Few informed people today doubt the seriousness of the situation or the urgent need for a solution. Unfortunately, some still cherish the illusion that it can be corrected by changing faces or by knocking heads together. Such wishful thinking is wholly unrealistic; it overlooks the fact that the defect is in the structure.

Failure to keep pace with the times, to adopt reforms when needed, and to devise workable means of coping with developing problems can be disastrous. For many years events have called for a reform of the federal bank supervisory structure, but never more urgently than now.

Digitized for FRASER
http://fraser.stlouisfed.org/
Federal Reserve Bank of St. Louis