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Statement of J. L. Robertson, Vice Chairman

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions

of the

Senate Banking and Currency Committee

on

S. 3158

April 5, 1966

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On behalf of the Board of Governors, I appreciate the opportunity to appear before this Subcommittee and testify in support of S. 3158, the proposed Financial Institutions Supervisory Act of 1966.

This bill relates to supervisory and regulatory functions and powers of both the Federal Home Loan Bank Board and the three federal banking agencies - the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Board of Governors. My testimony will be confined, in general, to the need for legislation of this nature in the area subject to the Board's supervision and regulation.

Commercial banking is vested, to an extent unparalleled in any other field, with a public service responsibility. This responsibility is met in three major ways, all of which are vital to a strong and vigorous free-enterprise economy:

(1) By providing the principal monetary mechanism of the nation.

(2) By providing safe repositories for savings and other liquid funds.

(3) By providing credit facilities for all sectors of the economy, including both households and businesses.

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Proper discharge of these responsibilities requires that banks follow constructive and prudent policies in all their operations, in order that "other people's money", with which banks carry on their business, is adequately safeguarded. The nation's banking laws were designed with this same end in view. For the most part, banks realize that any act in violation of law, or practice contrary to the public interest is _a fortiori_ contrary to the bank's own enlightened self-interest. Hence, the vast majority of banks operate in accordance with specific legal requirements and sound practices. In most cases little difficulty is encountered by supervisory authorities in obtaining compliance with directives or suggestions for corrective action in instances where infractions of law or departures from sound banking practices are brought to the attention of a bank's officers and directors.

In situations where persuasion by supervisory authority is insufficient to bring about cessation of unlawful acts or unsound practices, the Board of Governors presently has available to it two basic enforcement procedures, both of which are too severe and too cumbersome for use in any but the most extreme cases. Under section 9 of the

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Federal Reserve Act (12 U.S.C. 327), the Board is authorized to terminate a state bank's Federal Reserve System membership, with a resulting loss of its deposit insurance, upon determination by the Board, after hearing, that the bank has failed to comply with provisions of the Federal Reserve Act. Under section 30 of the Banking Act of 1933 (12 U.S.C. 77), the Board may remove an officer or director of a member bank for a continued violation of law or a continued unsafe or unsound practice only after warning the officer or director involved to discontinue the violation or practice and finding, after a hearing, that the specific violation or practice cited has continued. (Where a national bank is involved, this warning must be issued by and at the discretion of the Comptroller of the Currency, but the determination is to be made by the Board of Governors.) Disclosure of different violations of law or unsound practices would require a similar warning, a delay for a period adequate to ascertain whether there was a continuance of such violation or practice, a hearing, and a determination, prior to the issuance of a removal order.

Experience has demonstrated that the remedies presently available to the Board are not only too drastic for use in most cases, but are too cumbersome to

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bring about prompt correction - and promptness is often vitally important. In this regard, it is to be noted that section 30 of the Banking Act of 1933 would be repealed by S. 3158.

As you may know, I have repeatedly urged unification of all federal bank supervisory powers in a single agency. Pending such unification, however, I strongly support legislation, along the lines of S. 3158, that would provide existing federal agencies with adequate powers to effectuate remedial supervisory action.

S. 3158 provides, in my judgment, appropriate and effective intermediate sanctions that can be suited to the act or practice requiring correction. Through the use of procedures therein provided for cease and desist orders, suspension and removal of bank officers and directors, and the preclusion of a person's participation in the conduct of a bank's affairs, the banking agencies should be able to cope more selectively and effectively with wrongful conduct or imprudent practices that may occur.

I have stressed the need for supervisory power to require more prompt and effective cessation or correction

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of unlawful, unsafe, or unsound conduct with respect to financial institutions. The deficiencies in the Board's supervisory remedies, while for some time a source of difficulty and frustration, have only in the relatively recent past assumed a serious posture. In my judgment, two developments are principally responsible for this occurrence: first, the emergence of an increased aggressiveness in operational policies and practices - an aggressiveness reflected in the widening scope of commercial bank activities, in the substantial increase in the number of bank mergers and consolidations, and in the noticeable trend toward higher risk operations; second, an increased attraction into the field of banking of unscrupulous individuals, incompetent as bankers but highly skilled in operational tactics designed to conceal activities aimed at sapping the resources of a bank.

For years, banking was considered to be so staid and conservative that it offered little attraction for those interested solely in a "quick dollar". Recently, however, it has attracted not only an increased number of legitimate and necessary operating personnel and investors, but at the same time an increased number of

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ill-purposed individuals whose aims are contrary to the best interests of the banks and the public. Working behind the scenes and through other persons, they gain control of banks, ransack them, and then move on to other banks or financial institutions, oftentimes with funds obtained from the first victim. Because of the easy transferability of bank assets and liabilities, and the ever-increasing complexity of financial dealings that are an every day part of banking business, unscrupulous operators, and other ill-intentioned persons involved in the affairs of a bank, can make it extremely difficult to trace their activities. Fraudulent practices have been facilitated in recent years by the rapid development in systems of communications and transportation, making it increasingly easier to disguise illegitimate transactions as legitimate ones and to quickly imperil the solvency of a bank by inundating it with unsound assets.

Clearly, the speed with which a bank thus can be endangered requires equally prompt, flexible, and effective means of coping therewith. S. 3158 will provide substantial help in this regard. At the same time the bill assures affected parties reasonable and adequate safeguards

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against arbitrary or capricious agency action by establishing procedures for notice, hearing, and judicial review - both intermediate and final - all of which conform to the requirements of the Administrative Procedure Act. At all stages of possible agency action, the rights of institutions and individuals affected thereby will be protected.

In endorsing and urging enactment of S. 3158, on behalf of the Board of Governors, I speak on the basis of personal experience in the field of bank supervision dating back to the banking holiday of 1933. In my judgment, we are facing a prospect of an upsurge in the number of problem bank cases. These problems are increasing in seriousness, complexity, and innovation of concept. There exists a compelling need to halt unlawful, unsafe, and unsound practices at their inception. The available statutory sanctions for the effectuation of bank supervision need to be strengthened in the face of existing and potential threats to bank solvency and the soundness of our financial system. The banking industry and the public have every reason to appreciate and welcome the strengthening of bank supervision that would result from the enactment of S. 3158.

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