

For release on delivery

**Statement of J. L. Robertson, Vice Chairman
Board of Governors of the Federal Reserve System
before the
Committee on Banking and Currency
House of Representatives
on
H. R. 12754**

September 14, 1967

The first section of H. R. 12754 would extend for two additional years the authority provided by Public Law 89-597, enacted September 21, 1966. Unless extended, this statute will expire one week from today. In addition to provisions raising the statutory ceiling on reserve requirements applicable to time deposits for member banks and authorizing open market operations by Federal Reserve Banks in direct or fully guaranteed obligations of Federal agencies, Public Law 89-597 confers upon supervisory agencies flexible authority to establish maximum rates of interest that may be paid by commercial banks, mutual savings banks, savings and loan associations, and similar institutions that are Federally insured or members of the Federal Home Loan Bank System.

If Public Law 89-597 should expire, the Federal Reserve System's legal authority would be modified in three ways. First, the Board's authority to establish maximum rates payable by member banks on time and savings deposits would continue, but would be less flexible, and consultation with the FDIC and the Federal Home Loan Bank Board would no longer be required. The imposition of rate ceilings on time and savings deposits would be mandatory rather than discretionary, and the bases for differentiating among classes of deposits would be more rigid. The Board would no longer be authorized to differentiate on the basis of amount of deposit--which it found advisable to do immediately

after the 1966 amendments became law. The statutory range within which reserve requirements on time and savings deposits may be fixed by the Board would be narrowed, by lowering the statutory maximum from ten per cent to six per cent. And the Federal Reserve Banks would no longer be authorized to engage in open market operations in all obligations issued or guaranteed by agencies of the United States.

The Board favors extension of Public Law 89-597 as provided in H. R. 12754. Fortunately, the need for the authority provided in the Act is not quite so pressing as it was a year ago. Thus far in 1967 there has been a strong flow of savings funds into commercial banks, mutual savings banks, and savings and loan associations, in contrast to the difficulties experienced in the comparable period of 1966. In consequence, total outstanding mortgage commitments at savings and loan associations climbed from a low of \$2.7 billion at the end of 1966 to \$5.1 billion at the end of July 1967; the comparable figures for all reporting lenders are \$10.5 billion and \$13.7 billion (estimated). And in the first eight months of 1967, commercial banks have also been able to attract sizeable inflows into certificates of deposit of \$100,000 or more, reversing the outflows that occurred in 1966, and eliminating their incentives to offset these losses by offering higher rates on smaller, consumer CD's.

In the first four months of 1967 many of the larger commercial banks--which hold more than half of the time deposits under \$100,000--reduced their highest offering rates below the 5 per cent ceiling. But this tendency was reversed between the end of April and the end of July, as the offered rates moved back to the ceiling at virtually all of the banks involved. This development parallels movements in interest rates on various types of credit market instruments that have occurred despite a stimulative monetary policy.

As of the end of July nearly four-fifths of all commercial banks with total deposits of \$100 million or more and one-half of all smaller banks were offering the 5 per cent ceiling rate on time deposits under \$100,000. Nine-tenths of the larger banks and almost two-thirds of the smaller ones were paying the 4 per cent ceiling on savings deposits. Interest rates offered on longer-maturity CD's of \$100,000 or more are generally higher, with a few money market banks recently having offered the 5-1/2 ceiling rate. Thus if the authority granted last year to the FDIC and the Board to differentiate on the basis of amount of deposit in establishing maximum rates were allowed to expire, we could face much the same dilemma we faced last year in relating ceilings to the different markets for these different types of deposit.

Under these circumstances, extension of Public Law 89-597 would be useful in the event of a possible recurrence of some of the stresses experienced a year ago, even though we may hope that with a better balance of monetary and fiscal policies these stresses will not recur. And since this statute provides the basis for establishment of ceiling rates for savings and loan associations, its continuation would provide assurance that the Federal Home Loan Bank Board, the FDIC, and the Board of Governors could continue to work together to cope with any developing threat of unsound competition for savings.

Section 2 of H. R. 12754 provides for an annual audit of the Board of Governors and the Reserve Banks by the General Accounting Office. This provision would reverse a decision made by the Congress in 1933, when the only part of the System ever subject to GAO audit--the Board of Governors--was freed from such audit in order, in the words of the House and Senate Committee reports on that legislation, to leave "to the Board the determination of its own internal management policies."

Over the years, spokesmen for the Board and the Reserve Banks have tried in varying ways to express the reasons why we believe audit of the System by the General Accounting Office would be unwise. A former Chairman of the Board, Marriner Eccles, in a letter to your Chairman in 1952 referred to GAO audit as "the kind of encroachment which, if carried to its logical conclusion, would ultimately hamstring and destroy the independence of judgment and

action by the Reserve System." In the course of hearings presided over by Mr. Patman in that same year, the late Malcolm Bryan, then President of the Reserve Bank of Atlanta, put it this way:

"Now, the Federal Reserve System in its management of the Nation's money supply is the repository of what is probably the greatest trusteeship in the world's history. It has certainly the greatest fiduciary responsibility ever granted by the Congress. If this System, established and articulated with scrupulous care, which itself possesses the highest sense of money accountability, with auditors and independent counter auditors checking each other, cannot now be trusted in the management of its privy purse, so that it must be set upon by still further auditing, then we have, in a sickening plunge, descended from the sublime to the ridiculous."

The subject was examined again in 1964 by the Subcommittee on Domestic Finance of this Committee. Excluding the testimony of Federal Reserve and GAO officials, most of the witnesses who addressed themselves to the subject at those hearings opposed GAO audit of the System. In the thought that it may be helpful to the many Members of this Committee who did not participate in those hearings, excerpts from this testimony are attached.

Let me try briefly now to set forth the present procedures for audit and examination of the Board and the Reserve Banks, and add a few comments as to why section 2 of H. R. 12754 is unnecessary and unwise.

Manifestly, Federal Reserve operations should be conducted with maximum efficiency and economy. To that end Congress has placed upon the Board of Governors, an arm of the Congress, direct

responsibility for general supervision and periodic examination of the Reserve Banks. The Federal Reserve Act also provides that each Reserve Bank shall have a board of nine directors chosen from its district. They are outstanding in their communities; many have had broad experience in business and professional life, and are therefore able to apply to the Reserve Banks the high standards of efficiency prevalent in private enterprise. Thus the Federal Reserve combines advantages of Governmental control with advantages of private business management.

Since 1952, the Board has been audited annually by independent public accounting firms, and their audit reports have been submitted to the Banking and Currency Committees of both Houses of Congress. We have endeavored to select topflight auditing firms for this work. The firms selected have been Arthur Andersen & Co., Price Waterhouse & Co., Haskins & Sells, and, most recently, Lybrand, Ross Bros. and Montgomery.

The Federal Reserve Act provides that the Board "shall, at least once a year, order an examination of each Federal Reserve bank." The Board maintains a staff of examiners who devote themselves exclusively to this work. The Board's instructions to its examiners require, briefly, that the examination shall look to (a) each bank's financial condition through appraisal of its assets and verification of its assets and liabilities; (b) its proper discharge of all its responsibilities; and (c) its compliance with all applicable provisions of law and regulations. Each year,

an outside commercial auditing firm (Haskins & Sells for 1967) is engaged to accompany the Board's examiners on their examination of one of the Reserve Banks, to review, observe, and submit recommendations for improving, the examination procedures. Also, each Reserve Bank has a resident auditor, responsible directly to the Bank's board of directors and not dependent on any of the Bank's officers for security of position. Throughout the year, he and his staff make comprehensive audits of all phases of the Bank's operations, reporting directly to the board of directors of the Bank. Copies of these reports are reviewed by the Board of Governors of the Federal Reserve System.

In sum, then, we have in each Reserve Bank an internal audit program conducted the year round by the Bank's resident auditor and his staff, who, by a deliberately established plan of organization, are directly responsible to the board of directors and independent of the Bank's operating management. In addition, a staff of examiners directly employed by the Board of Governors in Washington examines each Bank every year and reports directly to the Board of Governors. We have the statements of certified public accountants of national repute that the examination procedures employed by the Board's staff conform to generally accepted auditing standards. This combination of internal and external scrutiny provides an objective audit coverage of the Reserve Banks that is unexcelled in any other organization.

In addition, the System is subject to Congressional scrutiny, a responsibility which this Committee and its distinguished chairman take very seriously indeed, as you know. But some of the newer members of the Committee may not fully appreciate how thoroughly the Committee and its staff, including the capable and conscientious investigators who have been on loan to the Committee from GAO in recent years, have examined into expenditures by the Reserve Banks. Not only have the reports of examination of the Reserve Banks been furnished to these investigators, but when they asked to see the working papers used in the course of the examinations these, too, were furnished, including the contents of our examiners' locked work trunks. Detailed breakdowns of expenditures in each of four categories were requested and furnished, together with descriptive material and justifications for thousands of items selected from these categories by the Committee's investigators. They have visited several of the Reserve Banks, where, they reported, they "were courteously received and given all reasonable cooperation by bank personnel in accomplishing their work." (The quotation is from page 317 of this Committee's 1964 Hearings on the Federal Reserve System After Fifty Years.)

The Board of Governors, then, stands ready to provide any information you seek concerning expenditures by the System. We take our responsibilities seriously, too, as the Government

agency designated by the Congress to make sure that the Reserve Banks are carrying out efficiently the duties assigned to them by law. Direct expenditures for audit and examination of the Reserve Banks in 1966 totalled approximately \$4 million. What GAO does for the Post Office, we do for the Reserve Banks, reporting directly to you. This seems to us a sensible arrangement, since we have the particular expertise related to Reserve Bank operations. If another arm of Congress were directed to do the same job, the end result would be duplication and overlapping of responsibilities, with attendant increases in costs and deterioration in operating efficiency and no apparent offsetting benefits.

Let me add a few comments about the wording of section 2. It provides that GAO "shall have access to all books, accounts, financial records, reports, files, and all other papers, things, or property belonging to or in use by the entities being audited, including reports of examinations of member banks." This provision raises serious questions about whether the System would be able to maintain relationships such as those presently in effect with foreign central banks, which depend on our ability to assure others that we can maintain confidentiality when they request it. As to one particular aspect of this problem, section 2 is crystal clear: it specifically requires that we make available to GAO the reports of examination of member banks. As I have indicated before, the System stands ready to answer any question about its

own expenditures. But we believe that the long-established tradition that reports of examination of commercial banks should be kept confidential is not only essential to maintain effective supervision, but also to protect the privacy of customers of the member banks in their personal and business affairs.

The Board therefore believes there are compelling reasons to omit section 2 from the bill. This is particularly true because Public Law 89-597 is scheduled to expire in a few days. Consequently there is insufficient time for consideration of the issues involved by this Committee, and no time at all for hearings by the Senate Committee.

COMMENTS ON GAO AUDIT BY ECONOMISTS DURING HEARINGS ON THE FEDERAL RESERVE
AFTER FIFTY YEARS

". . . I am not clear as to whether the purpose of the proposed audit is to uncover possible waste or subject the system to more congressional pressure. I feel certain the waste, if any, is trivial, so that I would oppose an audit for this purpose unless perhaps GAO audits are applied uniformly to all Government expenditures, including those of congressional committees. As I have already made clear that I do not believe that the Congress is well equipped to make short-run decisions on economic policy in general or monetary policy in particular, I am also opposed to more congressional pressure on the system either indirectly through a GAO audit or directly by insisting on annual appropriations, as is provided in H.R. 9685." (Statement of Prof. Henry H. Villard, College of the City of New York, Hearings on The Federal Reserve System After Fifty Years, pp. 1022-1023)

"I believe the present arrangements for audit of the Federal Reserve Board and the Federal Reserve banks are satisfactory, and I do not favor provision for audit by the General Accounting Office, as proposed in section 4." (Statement of Harold Barger, Chairman, Department of Economics, Columbia University, *ibid.*, p. 1355)

"Section 4 would make the Federal Reserve banks subject to audit by the General Accounting Office. It is my conviction that the American central bank should have a certain freedom of expenditure not vouchsafed to other Government agencies, the reason being that its officers must necessarily entertain both businessmen and foreign dignitaries in a traditional and customary manner. It is my personal observation that Federal Reserve banks are managed with restraint and great consciousness of the necessity to conserve resources.

I might add, Mr. Chairman, that the work of this committee has certainly impressed upon the several Reserve banks the necessity for watching expenditures and in my opinion there is no excessive expenditure at the moment. Moreover, officers of the Federal Reserve System are invariably men of the highest integrity. Finally, I can vouch for the fact that the accounting departments of the several Reserve banks are as apprehensive of a Federal Reserve audit as they would be of an audit by the General Accounting Office. It is my judgment that the Federal Reserve need not be made subject to official scrutiny of its affairs by the Comptroller General." (Statement of Ross M. Robertson, Professor of Business Economics and Public Policy, Graduate School of Business, Indiana University, *ibid.*, p. 1360)

"The issue as to whether there should be an audit from within the Government seems to be an issue of principle. My answer is I do not believe there should be for the following reason: In establishing the Federal Reserve in its present form the Congress has said to the Fed, we want a group of men who stand apart from the day-to-day pressures of the Congress, the President of the United States, and the Secretary of the Treasury. To establish an audit in the sense that I believe you are suggesting would, it would seem to me, be an entering wedge to remove that degree of separateness of degree of independence that I think the Congress wanted to establish in the Fed." (Statement of Dr. G. L. Bach, Stanford University and Carnegie Institute of Technology, *ibid.*, p. 1421)