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Remarks of J. L. Robertson

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An Inside Look at Federal Bank Regulation

When I was invited to address this meeting, I believe it was expected that I would endeavor to defend the Federal Reserve against a variety of complaints - complaints that included such words as "dilatory", "inflexible", "old-fashioned", and "unprogressive".

The Federal Reserve needs no defense from me. Its record speaks more eloquently than I can of its meritorious performance over the years - not perfect, not beyond improvement, but good.

However, I will say a few words about the complaints, although I wish to deal mainly with some of the basic problems, the underlying conditions which have produced the conflict and criticism that has troubled the banking community for the past several years. I refer especially to the well known differences of opinion among the bank regulatory agencies.

The fact that these agencies have not always been in step with each other has been a source of considerable concern both to the regulators and to those regulated. For a time it became the focus of attention, virtually to the exclusion of everything else. The situation reminded me of the young man who did not seem to take any interest in girls. This worried his father, who tried a variety of things to develop his son's interest in the opposite sex, but all to no avail. Finally, he suggested that he join the Marine Corps, thinking that close association with the manly Marines would do the trick. After the lad had gone through boot camp, he came home on leave. He and his father were sitting out on the front porch, when they saw three attractive girls in mini-skirts coming up the street. The father nudged his son - "Pretty nice, eh?" The boy eyed the girls carefully, and said, "Okay! But the one on the left is out of step."

I cannot say that I blame the banking community for having noted that the regulatory agencies were out of step. I am sure that at times all of us have felt a bit like Molly Peabody back in my home town, Broken Bow,

Nebraska. Molly and her husband, Jake, used to have some pretty hot disagreements. I am sure he was hard to get along with under the best of conditions, but he had his softer side. After one especially bitter row, when they both said things they shouldn't, Jake was standing by the window looking out, and called, "Molly, come here! I want you to look at something." Molly joined him at the window. "Look," he said, "at those two horses pulling that load of hay over the hill. Why can't we pull together like a couple of horses over the hill of life?" "Well," Molly explained, "the reason we can't pull together like a couple of horses is because one of us is a gee-haw mule."

Far be it from me to suggest that there are - or ever have been - any gee-haw mules in the banking business, much less the bank regulating business. But certainly there have been strong differences of opinion about policies and procedures. I am pleased to have this opportunity to state my own position and to advocate a promising solution for problems that have caused so much friction, confusion, and damage.

A few of us are old enough to recall the events that led to the adoption by Congress of the rules and regulations under which our banking system has operated for more than a third of a century. You will recall that a decade marked by great "permissiveness" - the 'twenties - brought almost unrestrained expansion followed by a collapse and a depression that caused untold suffering. In the light of the disclosures of the Pecora Investigation, Congress adopted certain controls and limitations to safeguard the vital functions that the banking system performs for our economy.

Laws were enacted to separate commercial banking from investment banking. The affiliate system of the 1920's - bank ownership of other corporations, and joint ownership of banks and other corporations - was severely curtailed. Banks were effectively restricted in their financing of certain related interests. The same principles that resulted in this legislation - the famous

Glass-Steagall Act and others - also prompted the legislation of 1956 which barred bank holding companies from engaging in nonbanking businesses, either directly or through subsidiary corporations.

I happen to take the view that principles that have been derived from experience should not be abandoned lightly. Admittedly we are living in a "go-go" era. Permissiveness has again become pervasive in our society. Our young people are impatient with those who look at the past and see alarming similarities with the present. Our economy has enjoyed a remarkable period of expansion. Most Americans alive today have no recollection of the depression and the closing of all banks in the early 'thirties. This tends to breed impatience with old-fashioned notions about the need for restraint and controls that were born of those harsh experiences.

George Bernard Shaw once said, "The one thing we learn from experience is that we don't learn from experience." One reason for this may be that history moves too slowly for us. Experience may warn us what is going to happen if some past errors are repeated, but we are seldom able to tell when it will occur. A decade or two is not long when viewed in historical perspective, but the only prophets we heed are those who tell us what is going to happen in the next six months or, at most, in the next year. We have no time for those who are concerned about what might happen in ten or twenty years.

This is a lesson I learned from my concern with our balance-of-payments problem. I gave my first public warning about the need to pay attention to this problem in a speech ten years ago. Many of the things I then warned against have since come to pass, but they came so gradually that they did not shock us enough. We would have been galvanized into action to avoid the deterioration that has taken place if it had occurred at a dramatically rapid pace, but few men have the confidence or the courage to take drastic action on the basis of long-term forecasts.

The same holds true with respect to the rules of sound banking. We can turn our backs on the lessons of the past, confident that the new activism will not bring us to the brink of disaster in the next six months or the next year or two. This is precisely what is happening. You know as well as I that more and more banks are becoming parts - sometimes the principal part - of a conglomeration of activities, some of which are related to banking only remotely, or not at all.

Not very many people have noticed, but we appear to be drifting toward a repetition of serious errors that the banking industry fell into in the 1920's. For example, the one-bank holding company loophole threatens to take us back into the kind of situation that only students of history and a few old fogeys remember.

I do not intend to speak here of the implications for the public interest of this tendency in our banking system - implications that are indeed grave, for a system whose existence is uniquely dependent on the use of other people's money. But I think that the leaders in the banking industry might want to ponder the lessons of the 'twenties and 'thirties before they plough that ground a second time. If nothing else, they might recall the tremendous drop in prestige and influence that their predecessors suffered as a result of the public reaction when the houses of cards they had erected collapsed.

We should not allow the tendency to get caught up in a general euphoria to blind us to the fact that ten or twenty years from now we may look back with regret upon decisions that have permitted banks, for example, to become subsidiaries of enormous conglomerate holding companies, to establish nation-wide systems of loan offices, to engage in business activities quite unrelated to banking.

If we are on the wrong road - and I believe we are - we must ask ourselves how we got started on it and whether there is any turning back before the road

disappears in a swamp. Clearly the problem has its roots in the accidental and irrational system of bank regulation and supervision that this country has been saddled with. During the past five years the delicate balance of the banking industry has been upset, the dual banking system endangered, and the development of banking on sound lines impeded by the divergent policies, procedures and interpretations emanating from the three federal supervisory agencies. Surely there is only one way to achieve and maintain the competitive equality that we want in our banking system. That is by insisting on uniform standards of regulation as far as federal law is concerned, and by modifying the rules and the laws on the basis of careful study of experience and thoughtful analysis of the likely consequences. I regret that this is not always the way things are done.

During the past few months we have seen important decisions made under pressures that are directly traceable to the irrational structure of our supervisory system. As you all know, my own agency recently reversed its position on two fundamental matters. In doing so, it was trying to correct a competitive imbalance, brought about by the decisions of another agency, which threatened the very existence of a strong dual banking system. Competition among the regulatory authorities was breaking down not only the legal barriers to banking practices which had previously been judged unsound, but also our traditional banking structure. To preserve the structure, the law was bent to permit what it seemed clearly designed to prohibit.

Is the law nothing more than a set of ambiguous expressions that are to be "adjusted" to meet the preferences of the moment, as some have claimed? Or is there something called "the rule of law" which requires the official as well as the citizen to respect and obey the statutes which have been duly enacted, altering them when alteration is desired by the procedures prescribed by law?

I believe that an important element in the malaise and turmoil of our times is the reduced importance that

many of our people, including some who are leaders, have attached to the rule of law. This is the cement that binds a democratic society together and makes it workable. As pointed out by the former Prime Minister of Great Britain, Sir Alec Douglas-Home: "Some people are suspicious of law and order, as though the rule of law was a mere trick to freeze the status quo. It is quite the opposite. Its observance is the sine qua non of peaceful change. The rule of law is a lesson learned from centuries of human experience, from many mistakes and much suffering. It amounts simply to this: that only by submitting ourselves to obey the law can we reconcile conflicting ambitions and serve the interests of mankind as a whole. Without the rule of law we destroy one another."

For nearly two centuries Americans have adhered to the principle of majority rule, subject to the limitations of the constitutional protection of individual rights. If we ever reach the point where any substantial number of our citizens take the position that they have the right to choose which laws they will obey and which they will disregard, we will have to ask, more fearfully than Abraham Lincoln did in 1863, "Can such a nation long endure?"

And if our government officials, our law enforcement officers, our regulatory authorities, and even the courts are thought by the citizens to be deciding which laws they will observe, which they will enforce, and which they will interpret out of existence, we should not be surprised if this generates widespread disrespect for the rule of law. Here again, we must look ahead at the consequences that will emerge in one, two or three decades. We know, as the Chinese say, that a journey of a thousand miles begins with a single step. And that is as true of a journey on the downhill road as it is of a journey upward.

It is easy to see why officials sometimes are tempted to short-circuit the law. As Winston Churchill pointed out, "democracy is the worst form of government except all those others that have been tried..." It is

often slow and cumbersome in its operations. Sometimes years pass before the apparent will of the majority can be translated into law. In this NOW generation we have little patience with cumbersome procedures. We are keenly aware of immediate evils that call out for correction, but we may overlook the far greater evils that will ensue if we encourage or even tolerate the idea that members of a society may disregard the mandate of the law and act in accord with their own individual views and desires. To break or bend the law to fit one's personal convictions, and to uphold this as a right, is to add in some degree, even though it may be imperceptible at the moment, to the forces that would push our civilization over the precipice into chaos.

Those who contend that the law is nothing more than a set of ambiguous principles that can be twisted to help achieve desired ends should ponder the words of one of our country's most profound legal scholars, Paul Freund, who warned the graduating class at Cornell College earlier this year that "to jettison principles of law because your aims are pure, or holy, or patriotic, denudes you of defenses against those who are just as certain of their rectitude."

It may be said that Paul Freund had something in mind more important than the overgenerous interpretation of a provision of our banking laws by a regulatory body. He was urging the young students not to succumb to the doctrine that the end justifies the means and not to defy the law as a means of achieving political objectives. We of the older generation who do not like to see college buildings taken over by mobs of students, who do not like to see the President of the United States and the members of his Cabinet taunted and harassed by ill-mannered young rowdies, can lecture the young on the importance of the rule of law with great vigor and sincerity. But our own failures to uphold the rule of law can be - and frequently are - thrown back at us. We find ourselves criticized for our inconsistencies, if not our hypocrisy. The criticism is not always well-founded or just, but it does point up the fact that all of us, acting in our own little spheres of influence, have a weighty responsibility to not only preach the rule of law, but to practice it as well.

In striving to improve our laws and their administration, we must, of course, give due weight to forward-looking ideas that seem logical. But we should also remember the words of that great jurist, Oliver Wendell Holmes, Jr., who said, "The life of the law has not been logic; it has been experience." Pure reason can never substitute for the lessons of experience.

When I first looked upon the world of banking from the inside, over thirty-five years ago, there was universal agreement, based on recent experience, that certain legally prescribed standards and limitations should be imposed on the banking industry. It was agreed by all that supervision by regulatory bodies was essential. Even today, there is rarely any explicit questioning of this need, but I sometimes wonder how many bankers secretly harbor the view that the industry would be better off without governing laws and regulations, free of bureaucrats periodically nosing into their affairs.

In my view, bank supervision and regulation is desirable and necessary in the public interest, to insure the soundness of our banking system. But the system we now operate under is far from perfect. Action to correct its faults and to rationalize the structure of federal bank supervision is long overdue. I recognize that there are those who say that what is needed is not so much a thorough overhaul of the machinery, but merely a good tune-up job. There have been a few suggestions that the Federal Reserve, for example, could improve its procedures in supervising and regulating state member banks. Let me turn briefly to some of these complaints.

First, it is suggested that some of our procedures need to be "modernized". Applications are processed too slowly. They go through too much consideration at too many places. This results in excessive delay, on top of which the application may be denied without the applicant having an opportunity to appear before the agency to rebut adverse arguments.

No one would condone needless bureaucratic delays, and we have taken these suggestions to heart. For example, in July of 1967 the Board of Governors delegated some of its duties, in order to expedite action. During the following twelve months, a thousand items were disposed of under those delegations of authority - over 400 by the Reserve Banks and almost 600 by the Board's officers.

But careful analysis and thorough consideration do take time. We take pride in the fact that our decisions have held up well in the courts. Our record is so good that decisions are rarely challenged. Without doubt, this owes much to the fact that each case receives thoughtful consideration. Failure to do this would be a disservice not only to the national economy generally but to the banking community particularly, because it would leave the banks more vulnerable to attack.

Another complaint - and this one seems to conflict with the first - is that the Federal Reserve is not sufficiently interested in bank supervision. I give you my assurance, based on a lifetime of experience in bank supervision, that no agency performs its supervisory duties more conscientiously than the Federal Reserve System. As you know, there is a category of what we call "problem banks" - not many, I am happy to say - and I imagine that the president of any one of those would say, perhaps in colorful language, that the Federal Reserve is <u>too</u> involved in its supervisory functions! Occasionally, however, institutions that have relinquished the doubtful honor of "problem bank" status acknowledge that the meticulous interference of the Federal Reserve may have been worth while, after all.

A third complaint is that the Federal Reserve has not displayed enough vigor in attempting to correct competitive inequalities between classes of banks. I have already made it clear that in my view the proper way to do this is to propose and support appropriate legislation. That is not only our duty, but yours, too. None of us -

bankers or supervisors, state or national - can plead innocent to this charge. All of us should start putting our shoulders to the wheel, for it is not only the rogues who feel the restraints of law. There are, indeed, bad laws and bad systems, and it should be our aim to protect the rule of law by constantly seeking to improve and perfect the law.

These complaints and others that might be mentioned reflect the frustrations that the banking community now suffers, primarily because of competitive inequalities. I am for a structural overhaul of bank supervision that will eliminate the competitive inequalities that arise whenever one agency gets behind in the race of laxity and that cause some banks to begin shopping for more lenient supervisors.

My answer is the adoption of a plan that will give us unified supervision at the federal level - the Federal Banking Commission plan, now pending before the Congress. This plan would (1) eliminate wasteful duplication, overlapping, and never-ending efforts to coordinate the actions of the supervisory agencies; (2) end much friction and conflict among banks and bank supervisors; (3) enable the banking industry to operate under a single set of rules, in an environment of competitive equality - as far as federal supervision is concerned; and (4) do away with the dangerous tendency toward laxity in bank supervision. In addition, it would enable the Federal Reserve to devote its time and attention more exclusively to the formulation and implementation of monetary policy for this great nation of ours.

We should not forget that the present jerry-built structure of federal bank supervision, divided as it is among three different agencies, is an historical accident that does not rest on any defensible foundation of efficiency, equity, or economy. Its effect is to deprive banks of a reliable and competitively fair basis for the development of their plans and policies. It also leads, as we have seen, to "lowest common denominator" supervision in which the most permissive interpretation or policy tends to become the standard.

Events this year have revealed clearly that state-chartered banks have much to gain from unification of federal bank supervision. Despite valiant efforts to prevent a race of laxity in the interpretation and enforcement of federal banking laws, seriously divergent interpretations and policies apparently are unavoidable when the same laws are applied to competing banks by different supervisors. When one bank, acting under its supervisor's rulings, embarks on a new and potentially profitable course, competitors subject to different supervisors find themselves in a difficult position. One tempting solution is to apply pressure on the other supervisors to relax discipline, even when this involves a distortion of the meaning of laws - a course only slightly less dangerous, and no less reprehensible, than an open flouting of the laws. If that approach is closed, the conversion path from one system to another provides a convenient way to regain competitive equality - at least until the next race begins, when the process repeats itself.

The present unfortunate arrangement, as events have shown, has resulted in ever greater concentration of banking resources in national banks. The ranks of the state-chartered institutions are threatened with decimation, resulting not only in loss of prestige for the remaining state banks, but in loss of revenue to state bank supervisors, with consequences unpleasant to contemplate. The Federal Banking Commission plan would halt this trend. It would, as you may have forgotten, include financial arrangements that would enable the states to strengthen their supervisory organizations. Indeed, the Federal Banking Commission bill looks forward to an environment in which state examinations would be adequate for all purposes, eliminating the need for federal examination of state banks.

Let me ask: do you have a better solution for the problems gnawing at our dual banking system today?

Our nation is confronted with many grave and dramatic problems. We are in the midst of an election

campaign that centers around such important issues as the war in Vietnam, a soaring crime rate, the behavior of alienated young people, and active dissatisfaction on the part of many Negro citizens. While we face some difficult and complex problems in the area of bank supervision, they lack the drama inherent in these other issues. But each of us must cultivate his own field with care, intelligence, and self-discipline. Even though the world may seem to be in turmoil around us, we have a responsibility to put our own house in the best possible order. Let us be an example of an industry that looks at its problems honestly and dispassionately, and attempts to solve them in a constructive manner.

We can perform a valuable service for our country. By rededicating ourselves to the rule of law and by pressing for the adoption of the legislative changes needed to improve banking and bank supervision, we can demonstrate that representative democracy is not too cumbersome to meet the needs of a modern, dynamic society. Changes may not always come as rapidly as we would like, but come they will, if a need exists and sensible and promising remedies can be found. I think the proposed Federal Banking Commission is such an answer to a very clear need. I realize that many of you have taken a different view of the matter. It is not surprising that there should be conflicting views about a reform of such magnitude. But it has been said correctly that out of conflict comes change. We have the conflict. Let us work together to insure that the inevitable changes are of the type that will strengthen rather than weaken the banking system and will reduce to a minimum the undesirable tensions and conflicts that have plagued the industry in recent years.