

IMPROVEMENT OF FEDERAL SUPERVISION OF BANKS

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Improvement of Federal Supervision of Banks

This argument is addressed to the inadequacy and inefficiency of existing Federal supervision of banks, the room or necessity for improvement therein, and the means whereby such improvement can be effected.

Before suggesting a remedy, it would appear necessary to determine whether there is a need for one. Accordingly, it may be well first to take stock of the existing machinery not only with respect to how it is being presently operated but as well with respect to its potentialities. Thus, it is proper to inquire: What is the present machinery? How many engineers are there? Within what limits is it possible for them to operate their respective machines at different speeds or even in different directions? Then, having determined the potentialities of the existing machinery, it is proper to inquire: How is existing machinery being operated?

Existing Machinery and its Operation

There are in this country approximately 15,000 commercial banks, of which approximately 5,300 are national banks, 1,000 are State member banks of the Federal Reserve System, 7,500 are nonmember banks of the Federal Reserve System, the deposits of which have been insured by the F.D.I.C. and 1,200 are nonmember uninsured banks.

Federal supervision in some matters extends to all banks and under the existing Federal statutes is vested to some extent in the Secretary of the Treasury and the R.F.C., but mainly it is vested in the Comptroller of the Currency, the F.D.I.C. and the Board of Governors of the Federal Reserve System. The supervisory powers of the Secretary

of the Treasury flow from the provisions of the Emergency Banking Act and regulations thereunder whereby the Secretary licenses national and member State banks, and from the Secretary's discretionary powers in connection with requests for the purchase by the R.F.C. of preferred stock or capital debentures in banks. Those of the R.F.C. result from contract and are largely incident to its proprietary interest in the banks from which it has purchased preferred stock or capital debentures.

The exercise of supervision by the three principal agencies is apt to be thought of as being by the Comptroller of the Currency with respect to national banks, by the Board of Governors of the Federal Reserve System with respect to State member banks and by the F.D.I.C. with respect to nonmember insured banks. Speaking in broad generalities, this may be said to be the case, but, even assuming that such a division of responsibility would be desirable, subsequent discussion will demonstrate that the line of demarcation within which each of these agencies operates is by no means so well defined or so fixed as to accomplish that result. Indeed, the very contrary is true and it may well be doubted if it could be otherwise.

The machinery by which Federal supervision is attempted is that provided by Congress by the enactment of legislation. In taking stock of that machinery, it is proper, therefore, remembering that in the case of State banks Federal supervision is superimposed on that already being exercised by the State, to inquire into the broad purposes of supervision for which each of the agencies was created and the powers delegated to each such agency to accomplish that result.

The office of the Comptroller of the Currency, when created, was "charged with the execution of all laws passed by Congress relating to the issue and regulation of a national currency secured by United States bonds", and in addition, after the passage of the Federal Reserve Act, "with the execution of all laws passed by Congress relating to the issue and regulation * * *, under the general supervision of the Board of Governors of the Federal Reserve System, of all Federal Reserve notes, etc.". It is in pursuance of this general mandate that the Comptroller is concerned with the safety and sound operation of national banks and has been charged with the various supervisory duties which he now exercises.

At the same time, one of the avowed purposes of the Federal Reserve Act was "to establish a more effective supervision of banking in the United States", and the F.D.I.C. was created as part of an act which, among other things, was "to provide for the safer and more effective use of the assets of banks".

Enumerating some of the powers and thereby taking stock of the existing machinery, it may be noted that:

1. Having once chartered the bank or having once admitted it into membership in the Federal Reserve System and to the benefits of insurance by the F.D.I.C., the most drastic measures available to each agency are as follows: The Comptroller of the Currency with respect to national banks may institute suits to forfeit the charter of a bank; may appoint a conservator; and, may appoint a receiver. The Board of Governors of the Federal Reserve System may expel a State member bank

from the System and the F.D.I.C. may institute proceedings for termination of the insured status of a bank.

Suits by the Comptroller of the Currency for the forfeiture of the charter of a national banking association have been extremely rare and must be predicated on stated violations of law. He may appoint a conservator "whenever he shall deem it necessary in order to conserve the assets of any bank for the benefit of the depositors and of the creditors thereof" and there are many statutory grounds for the appointment of a receiver, but the one most generally resorted to is insolvency.

The Board of Governors, upon its own initiative, may, after hearing, forfeit the membership of a member State bank at any time it shall appear that a member bank has failed to comply with the provisions of certain statutes, principally section 9 of the Federal Reserve Act or the regulations of the Board of Governors.

To terminate the insurance of a national bank the F.D.I.C. must notify the Comptroller of the bank's violation of law or continued unsound practices and if the Comptroller does not obtain correction in 120 days the F.D.I.C. may hold a hearing and terminate the bank's insured status, in which event the Comptroller must appoint a receiver. In the case of State member banks, the F.D.I.C. must notify the Board of Governors and if the Board does not obtain correction in 120 days, the F.D.I.C. may hold a hearing and terminate the bank's insured status, in which event the Board must terminate the membership of the

subject bank in the Federal Reserve System. In the case of nonmember insured banks the F.D.I.C. must notify the appropriate State authority and if such authority does not obtain correction in 120 days, the F.D.I.C. may hold a hearing and terminate the bank's insured status.

2. In addition to the visitorial powers of State supervisory authorities in the case of State banks and certain rights of examination retained by the R.F.C. in the field of its relationships, each of the three agencies, with respect to one or more of the classes of banks involved, has the right of examination.

In the case of national banks the Comptroller of the Currency is directed to examine each bank twice yearly and "oftener if considered necessary". In addition, the Board of Governors in its discretion may cause a national bank to be examined; a Reserve bank, with the approval of the Federal Reserve Agent or the Board of Governors may provide for a special examination; and the F.D.I.C. may examine it with the written consent of the Comptroller of the Currency.

In the case of State member banks the Board of Governors or a Reserve bank may cause the bank to be examined as may also the F.D.I.C., with the written consent of the Board of Governors.

In the case of nonmember insured banks the F.D.I.C. may examine. If such bank happens to be an affiliate or holding company affiliate it is also subject to examination by the Comptroller of the Currency or by the Board of Governors as the case may be. Likewise, as to all banks, including even non-insured banks, the Board of Governors

may make "inspections" in connection with its functions under the Securities Exchange Act.

It also may be observed that the Comptroller of the Currency and the F.D.I.C. are authorized to publish their reports of examination if recommendations contained therein are not complied with in 120 days and provided 90 days notice of intention to publish is given.

3. With respect to reports which can be required:

National banks must make not less than three reports of condition yearly to the Comptroller in form prescribed by him, which must be published in a local newspaper. In addition, the Comptroller may call for special reports. Within ten days after declaring a dividend they must report the amount thereof to the Comptroller, together with the amount of net earnings in excess of each dividend. They must on July 15th and January 15th of each year file with the F.D.I.C. certified statements showing the "assessment base", such assessment base depending upon "deposits" and "uncollected items" each defined partly by statute and partly by the F.D.I.C. They must make such reports as the Board of Governors may require in enabling it to perform its functions under the Securities Exchange Act. If a national bank has an "affiliate" or a "holding company affiliate" it must furnish and publish reports in accordance with the applicable statutes and the Comptroller is authorized to call for additional reports. If it maintains a foreign branch the Comptroller may require it to furnish information concerning the condition of such branch and if it has invested in the capital of a

foreign bank the Board of Governors may require it to furnish information concerning the condition of such corporation.

State member banks must make reports of condition to the Reserve banks on dates fixed by the Board of Governors at least three times yearly in form prescribed and published as required by the Board. They must report payment of dividends to Reserve banks. They must on July 15th and January 15th of each year file with the F.D.I.C. certified statements showing the "assessment base", such assessment base depending upon "deposits" and "uncollected items" each defined partly by statute and partly by the F.D.I.C. They must make such reports as the Board of Governors may require in enabling it to perform its functions under the Securities Exchange Act. If a State member bank has an "affiliate" or a "holding company affiliate" it must furnish and publish reports in accordance with the applicable statute and the Board of Governors is authorized to call for additional reports. If it has invested in the capital of a foreign bank the Board of Governors may require it to furnish information concerning the condition of such corporation.

Insured nonmember banks, in addition to the reports showing the "assessment base" required to be filed on or before July 15th and January 15th of each year, must make and publish such reports as the F.D.I.C. may require in such form and at such time as it may prescribe. They must make such reports as the Board of Governors may require in enabling it to perform its functions under the Securities Exchange Act.

4. The Comptroller of the Currency charters all national banking associations based upon standards partly fixed by law and partly fixed by the Comptroller in the exercise of his judgment. Automatically, such banks become member banks of the Federal Reserve System and their deposits become insured by the F.D.I.C. State banks are, of course, chartered by the State of their location in accordance with standards fixed by the law of the particular State or by the particular supervising authority or by both, but standards for admission of such banks to the Federal Reserve System are fixed by Federal statutes and by the Board of Governors of the Federal Reserve System, by means of the imposition of conditions of membership. Deposits of such banks are automatically insured by the F.D.I.C. Until July 1, 1942, the F.D.I.C. may permit any nonmember insured bank to become insured and after that date may permit a nonmember bank with deposits under \$1,000,000 to become insured. Irrespective of the granting and issuance of a charter by the Comptroller of the Currency or by State, as the case may be, national banks and State member banks, under existing regulations, must obtain a license to operate from the Secretary of the Treasury.

The approval of the Comptroller of the Currency is required for a reduction in capital by a national bank and the written consent of the F.D.I.C. is required for reduction or retirement of common or preferred stock or capital notes or debentures of insured nonmember banks except in the District of Columbia, but there is no Federal control over a reduction in capital by a State member bank unless some control has been retained by the Board of Governors as a condition of membership.

The Comptroller's approval is required for the consolidation of national banks and, for certain purposes, is required for the consolidation of a State bank with a national bank. The written consent of the F.D.I.C. is required for an insured bank to consolidate with a non-insured bank, assume liability for a non-insured bank's deposits, or transfer assets to a non-insured bank in return for assumption of deposits.

5. Notwithstanding the fact that national banks are chartered by the Comptroller of the Currency, they may exercise trust powers only when permission has been granted by the Board of Governors and the regulation of the exercise of such power is vested in the Board of Governors. There is no express supervision of the exercise of trust powers by insured nonmember banks and in the case of State member banks there is only such control as the Board of Governors may exercise through the imposition of conditions of membership.

6. The Comptroller, subject to the requirements of statute, must approve the establishment of branches of national banks, except foreign branches which are approved by the Board of Governors; the Board of Governors, except as to intra-city branches, must approve the establishment of branches by State member banks; but consent of the F.D.I.C. is required for any insured nonmember bank to establish "any new branch" or to move any branch.

7. Section 5136 of the U.S.R.S., among other things and subject to certain restrictions, permits national banks to purchase for their own account investment securities under such limitations and

restrictions as the Comptroller of the Currency may by regulation prescribe. In addition to the definition therein contained, the section provides for such further definition of the term "investment securities" as may by regulation be prescribed by the Comptroller of the Currency, and paragraph 19 of section 9 of the Federal Reserve Act provides that State member banks shall be subject to the same limitations in this respect as national banks.

8. The power to broaden the limit of the amount of acceptances which a bank may accept for one person is vested in the Board of Governors with respect both to national banks and member State banks.

9. Congress has seen fit to prohibit the payment of interest on demand deposits; to limit the interest payable on time and savings deposits; and to regulate the payment of time deposits before maturity. National and State member banks are prohibited by statute from, directly or indirectly, by any device whatsoever paying any interest on any demand deposit. In the case of such banks, the Board of Governors is authorized to define certain terms, to determine what shall be deemed to be a payment of interest, to prescribe such rules and regulations as it may deem necessary to effectuate the purposes of the law and prevent evasions thereof, and to limit the rate of interest which may be paid by such banks on time and savings deposits. In the case of nonmember insured banks the F.D.I.C. is directed to prohibit by regulation the payment of interest on demand deposits and authorized to define "demand deposits". It is directed to make such exceptions from the prohibition as are permitted to member banks by Federal Reserve Act and

the Board of Governors' regulation. It is also directed to limit the rate of interest payable on time and savings deposits, to prohibit payment of time deposits before maturity except under regulation of the F.D.I.C., to prohibit waiving of requirement of notice before payment of savings deposits except as to all savings deposits having the same requirement, and to define what constitutes time and savings deposits in an insured nonmember bank.

10. Congress has seen fit to make provision for the removal for cause of officers and directors of member banks. In the case of national banks the proceeding is initiated by the filing of a certificate of the facts warranting removal with the Board of Governors by the Comptroller. In the case of State member banks the proceeding is initiated by the filing of a similar certificate by the Federal Reserve Agent. In both cases the hearing is before and the decision is by the Board of Governors.

11. Congress has seen fit to prohibit, with certain exceptions, any director, officer, or employee of a member bank serving any other bank. The Board of Governors, as provided in the Clayton Act, is authorized to enforce compliance with this section both in the case of national banks and in the case of State member banks.

12. Congress has seen fit both as to national and State member banks to forbid a director, officer, or employee of a security company serving such a bank except in limited classes of cases as may be permitted by a general regulation of the Board of Governors.

13. Congress has seen fit to forbid executive officers, with certain exceptions, to become indebted to their banks and to forbid banks to make loans to their executive officers. The effectuation of this statute by regulation and the defining of the term "executive officer" is delegated to the Board of Governors with respect to both State member and national banks.

14. Congress has seen fit to provide that in the case of a sale of any security or property to a bank by a director or by a firm of which any director is a member, the Board of Governors may, by regulation, require full disclosure of the commissions when the director or firm sells for others and of the profits when the sale is made for the director or firm. This applies as well to national as to member State banks.

15. Congress has seen fit to forbid the affiliation of a member bank with a security company and has provided that a penalty of \$1,000 per day may be assessed by the Board of Governors and collected by the proper Federal Reserve bank. This applies alike to national and State member banks. In the case of a national bank, after six months' violation the bank's charter may be forfeited in a suit brought by the Comptroller in his own name at the Board's direction. In the case of a State member bank, its membership may be terminated.

16. Congress has seen fit to regulate the relations of banks with so-called "holding company affiliates" and has vested the question of certain determinations thereunder as well as the granting to them of voting permits to the Board of Governors in the case of national as well as member State banks.

17. Congress has undertaken to prevent the excessive use of credit for speculative purposes and for such purpose has empowered the Board of Governors to regulate the extension and maintenance of credit for the purpose of purchasing or carrying securities registered on national securities exchanges. This power extends to all banks.

18. The F.D.I.C. may require any insured bank to insure against burglary, defalcation and other insurable losses.

19. The Comptroller of the Currency is charged with supervision of the liquidation of banks for which he has appointed a receiver. Nevertheless, when he shall have closed a bank on account of its inability to meet the demands of its depositors, he must appoint the F.D.I.C., receiver, and it liquidates the affairs of the insolvent bank under the supervision of the Comptroller of the Currency who, in turn, is authorized to waive and relieve the F.D.I.C. from complying with any regulation of the Comptroller with respect to receiverships where, in his discretion, such action is deemed advisable to simplify administration.

The F.D.I.C. must also accept appointment as receiver in the case of State banks if such appointment is tendered by the authority having supervision of such banks and is authorized by State law.

The public interest naturally is the basic interest underlying all Federal supervision, but it must be remembered that while one is apt to think of supervision only in the broad sense of the security of the public in its dealings with banks, there is also involved supervision and control of the use of credit, as well as, supervision relating to the Government's status as a capital investor, as a creditor and

as an underwriter. To the extent that any of the agencies is engaged in supervision based upon considerations relating to one or more of the above objectives, but not relating to all of them, there is planted the seed from which may spring conflicts of viewpoints, conflicts in the exercise of similar powers, and resulting waste and confusion.

It is little wonder, therefore, that this hybrid system of supervision has produced:

1. Duplicate corps of review examiners maintained in Washington by the Comptroller of the Currency, the F.D.I.C., and the Board of Governors, as well as the R.F.C. Duplicate corps of field examiners maintained in 12 separate districts by the Comptroller of the Currency, the F.D.I.C., and the Board of Governors, as well as the maintenance of a corps of examiners in the many agencies of the R.F.C.
2. Duplication of examination avoided only to the extent of the exercise of mutual cooperation between the agencies and even then resulting in dissatisfaction at the methods and standards employed by the examining agency selected.
3. Inability to agree upon uniform examining standards and resulting application of different standards in the classification of assets; in the appraisal of real estate loans; in the treatment of depreciation in bonds and the values at which they should be carried; in the treatment of valuation reserves; and in the determination of losses.
4. Examination of one class of banks at the expense of others.

National banks are assessed for each examination, but the F.D.I.C. which, in examining only nonmember banks, examines more banks than any other agency, makes no charge for examination, although the greater part of the assessments upon which it operates is paid by member banks which it does not examine.

5. Duplication and multiplicity of reports provoking admissions and statements along following lines:

"Reports of condition now being issued to the public are confusing because of their inadequacy and lack of uniformity." (Chairman Leo T. Crowley to House Committee on Banking and Currency, February 1935)

"Calls for information from banking institutions have increased in recent years. The number of Governmental offices interested in obtaining information from banking institutions has increased substantially in recent months. At the present time the R.F.C., the Securities Exchange Commission, the Treasury Department, the Comptroller of the Currency, the F.D.I.C. and the Federal Reserve Board are all asking for information, and recently the Department of Agriculture and the Federal Housing Administration have requested us to obtain information for them. This has increased the work of the member banks considerable. Many of them resent quite vigorously the extra work that is thrust upon them." (Edward L. Smead, Chief of the Board's Division of Bank Operations, at the conference on Call Report Standardization, May, 1935)

" * * * the bank - a trust company member of the Federal Reserve - was called on to make about 50 condition reports, of one sort or other, each year to external agencies. The time periods covered were divided as follows: daily, 1; weekly, 5; monthly, 4; bi-monthly, 1; quarterly, 10; semi-annually, 1; annually, 28. A few calculations on a scratch pad provided the astonishing information that in carrying this routine through a year the bank had to prepare about 700 reports, several of which contained multiple schedules. * * * It would be hazardous, for one example, to attempt an estimate of how much the supplying of supervisory information costs all banks, but it might be fair to assume that this is a fair sample, proportionately, for

trust companies operating in the state in which the bank is located. And it also seems fair to say that many of the regulatory authorities have realized the enormous duplication of effort, the needless expense, and other features of the burden. The task of simplification, started last May at a conference in the Washington offices of the Federal Deposit Insurance Corporation, is receiving the cooperation of such Federal agencies as the Reserve Board, the Comptroller, the Reconstruction Finance Corporation, the Treasury, and the F.D.I.C., as well as the Reserve City Bankers Association, National Association of Bank Auditors and Comptrollers, American Bankers Association, and National Association of Supervisors of State Banks. Completion of the work may mean that the number of reports required from the bank referred to in this article can be reduced by 80 per cent."

(Article in "Banking", March 1936)

6. Recognition of need for correction as evidenced by the following statements:

"The most essential factor, in my opinion, for a continuance of a sound banking system is a unification and standardization of supervisory policy and procedure. It is necessary that we use uniform standards with all problems concerning supervision and that we use the same standards in determining the soundness of individual banks; otherwise it will be impossible to determine their position in the system with any degree of accuracy."

(Chairman Leo T. Crowley, September 1936)

"I believe it would be highly desirable if we could have centralized examinations."

(J. F. T. O'Connor, in answer to a question before the Senate Committee on Banking in April, 1935)

But inability, nevertheless, to agree upon standard forms which would reduce the multiplicity of reports. For instance, in 1935 the F.D.I.C. initiated a movement to standardize reports and some progress was made with respect to standardization as between the various states and the F.D.I.C. Repeated conferences were held between the technicians of the F.D.I.C., the Board of Governors and others representing states

and private interests. Some progress was made as between some of the states, the F.D.I.C. and the Board of Governors but it has proved impossible to effect standardization between the three Federal agencies. The press has reported the incident as being a controversy between the F.D.I.C. and the Comptroller of the Currency and has quoted the Comptroller as saying that he "had no prior notice of the meeting" and that "the forms of Call Reports under the Federal law are required to be prepared under the direction and authorization of the Comptroller of the Currency for national banks". (Herald Tribune, March 14, 1936)

7. Public confusion and inability of those concerned to determine to which of the several agencies a particular matter should be referred as evidenced by the following statement:

"We have been in frequent communication with the Board of Governors of the Federal Reserve, the officers of the Federal Reserve Bank of Cleveland, the Comptroller's office, our Chief National Bank Examiner, Mr. Leyburn, at Cleveland, the Federal Deposit Insurance Corporation at Washington, as well as Chief Examiner Stroefel at Columbus, and Mr. Squire, our State Superintendent of Banks, in regard to interpretations and methods of operation under the new legislation. We have had their cooperation in interpreting the meaning of various provisions and have passed this information along to our members, who found this service very helpful."

(John H. McCoy, President, Ohio Bankers Association, 1936 Annual Convention)

8. Enforced acceptance of members into the Federal Reserve System and enforced insurance of deposits by the F.D.I.C. through the exercise of chartering powers by the Comptroller of the Currency and, in the case of insurance, both through the exercise of chartering powers by the Comptroller of the Currency and the acceptance of State

member banks by the Federal Reserve System. This on one occasion has resulted in public charges that the Comptroller of the Currency, against the judgment and recommendation of both of the other agencies, has chartered a national bank, thereby forcing it upon the Federal Reserve System as a member bank and upon the F.D.I.C. as an insured bank. (New York Herald Tribune, 11/13/36, reporting the Case speech)

In this connection it may be noted that in the annual report of the F.D.I.C. for the year 1936 the following comments are made:

"In the Federal establishment, greater coordination than has hitherto obtained is essential to the various agencies which charter and supervise deposit, savings, loan, investment and other credit institutions;"

and

"The Corporation believes that no bank should be permitted to become insured without its approval"

9. Application of different requirements in the admission of State banks as members of the Federal Reserve System from those applied by the Comptroller of the Currency in the chartering of national banks.

10. Application of different standards as between member State banks and national banks in the granting of voting permits to "holding company affiliates". For instance, in weighing requests for such permits it was the Board's practice to apply the same standards and in some cases higher standards than those imposed as an incident to membership by State banks but, with respect to national banks, requirements were lessened, due, apparently, to the insistence of the Comptroller that such matters as determinations of losses to be charged off by national banks are solely within the province of his office.

11. Different definitions of the same term. - For instance, the F.D.I.C.'s definition of the term "deposits", for the purpose of computing assessments, is different from the definition of that term by the Board of Governors for the purpose of computing required reserves.

12. Two agencies unable to agree in the execution of a common mandate of law. - Member banks are prohibited from paying interest on demand deposits and the Board of Governors is authorized to prescribe such rules and regulations as may be necessary to effectuate the purposes of the law. The F.D.I.C. is directed by law to prohibit by regulation the payment of interest on demand deposits by nonmember insured banks. No one would argue that a correspondent bank absorbs exchange charges on items which it collects except in consideration of the use of someone's funds. However, because the absorption of such charges by other than the correspondent bank and, in the last analysis, by the public, might result in the inability of certain nonmember insured banks to make such charges because of the public's unwillingness to pay them and because of differences of opinion as to the law's intent, whatever its letter, the F.D.I.C. and the Board of Governors were never able to bring their respective regulations into substantial conformity, until, by force of necessity and as a matter of expediency, uniform general language was agreed upon declaratory of what everyone knew the law to be. Until there is found some means of applying the agreed language to a particular case however, and until uniformity in its application to particular cases is obtained, the public and the banks are left in confusion as well as in the unfair position of some banks following one practice and others another.

13. The maintenance by each of the agencies of large staffs other than examiners engaged in the same or similar activities, such as the collection of statistics and similar lines of endeavor.

14. Petty inter-agency jealousy of prerogatives and resulting hesitancy to take desirable action lest prerogatives be surrendered.

15. Permitting the continued operation of allegedly insolvent and admittedly weak banks desperately in need of reorganization, while the agencies involved have unsuccessfully tried to agree upon a plan, failure to do which, may in some part be attributed to motives of self interest upon the part of one or more of the agencies concerned.

16. The Comptroller of the Currency issuing regulations relating to investments by which both national banks and State member banks are to be governed and, in the view of the Board of Governors, interpreting the regulations and applicable statutes in some respects beyond the scope of the authority conferred by the statute. The inevitable result of this state of affairs is one standard for national banks and another for State member banks - the standard in both cases however, resting upon identical legal wording.

17. Each of the agencies, within its own sphere and upon its own consideration, independently and without coordination, instituting remedial action of some character. Thus, it is that in one national bank the F.D.I.C. instituted proceedings to terminate the bank's insurance, the probable results of which will be the appointment of the F.D.I.C. as receiver. During the course of consideration of the advisability of such

action by the F.D.I.C., of which Board the Comptroller of the Currency is a member, he, by certificate filed with the Board of Governors instituted proceedings against the president of the bank to remove him from office. The Board promptly initiated an expensive hearing but during the timely course of its deliberation, it became necessary for the Comptroller to appoint a conservator. The result is that the Board of Governors has removed an officer from a bank in which the Comptroller of the Currency has already appointed a conservator, who in turn, unless effective corrections are made in the bank, will be supplanted by the F.D.I.C. as receiver.

18. Threats upon the part of some banks to denationalize in order to escape regulation and supervision by the Comptroller of the Currency; threats upon the part of other banks to retire from the Federal Reserve System in order to escape regulation and supervision by the Federal Reserve System; and threats upon the part of still other banks to join the Federal Reserve System in order to escape regulation and supervision by the F.D.I.C.

19. And, finally, the extraordinary situation of one supervising agency liquidating a bank subject to the supervision of another supervisory agency.

Under these circumstances, therefore, can the conclusion be escaped that the existing machinery has developed inefficiency for which corrective measures should be employed?

Improvement by Elimination of Divided
Responsibility and Consolidation of Functions

Simply as a matter of good organization it would appear undesirable to establish a division of labor or authority in connection with

Federal supervision of banks subject thereto. As well may it be argued that there should be one Interstate Commerce Commission for railroads and another one for trucks. Divided responsibility is likely to produce a failure to act because of the lack of full responsibility to act.

Moreover, while the degree or extent of such reliance may not be the subject of definite ascertainment at least it may be stated as a fact that public reliance and dependence is put upon Federal supervision. That feeling may be with respect to the Comptroller of the Currency or the F.D.I.C. or the Federal Reserve System, but more likely it is with respect to a vague and hazy idea of some comprehensive Federal authority. That is the very point - To illustrate, the following is quoted from the Commission on Banking Law and Practice of the Association of Reserve City Bankers-Bulletin of July 24, 1933:

"As nearly as we can appraise the opinion of the man on the street, it is something like this. He knows that a bank charter cannot be obtained except from a Government agency. He knows that when the sign 'Bank' is put over a door that a Government agency has endorsed that establishment and permitted it to accept deposits from any man or woman who may choose to enter. It is a further fact, that the average small depositor has no basis for discriminating between a safe bank and an unsafe bank. If we were to provide him with a statement of the bank and all the supporting documents he would still be unable to form a correct judgment as to the safety of the institution in question. When, in these circumstances, thousands of banks close, involving heavy losses to depositors, the average man feels that a severe injustice has been perpetrated. A man's savings are almost as important to him as life itself, and if, through no fault of his own, his deposits are lost, he cannot be expected to do otherwise than raise a clamor against this injustice. It is a public menace like unsafe grade crossings, or fire hazard, or reckless automobile driving, from which the small depositor has a right to expect protection from those in authority. From millions of men and women in this situation a demand has arisen that their deposits should be protected. As long as bank failures are permitted to continue, this demand will exist."

It follows therefore, that if the public is to hold the government responsible for effective supervision - there should be some place where that responsibility can be fixed. He indeed is an optimist who, when a bank has failed, can forsee the Secretary of the Treasury, because he licensed it; the Comptroller of the Currency, because he chartered it and exercised general supervision, the Board of Governors, because it was a member bank, and the F.D.I.C., because it was an insured bank, vying with each other in an effort to assume responsibility for inadequate supervision contributing to its failure. More likely the case will be similar to the one reported to the Senate Committee on Banking by one of its examiners in connection with the Senate hearing on stock exchange practices, as follows:

"As stated previously, we cannot help but feel that the break-down of the Guardian Trust Co. can in a large measure be traced to State bank examiners and the State superintendent of banks of Ohio. Had examinations been made as specified by law and conducted in a more thorough manner, many of the evils which resulted in the bank's closing would have been eliminated before serious damage was done. However, unwarned and uncriticized, the bank management continued to conduct the affairs of the bank in such a manner that by February 28, 1935, its condition was such that there was no alternative save liquidation."

In this same report it was said relative to examinations by the Federal Reserve bank:

"The National Government recognizing its responsibilities in this respect has embodied in section 9281 of the Federal Code the following in regard to banks coming under Federal supervision, as a result of being member banks of the Federal Reserve Bank System:

"The Comptroller of the Currency with the approval of the Secretary of the Treasury shall appoint examiners who shall examine every member bank at least twice in each calendar year and oftener if considered necessary. Provided, however, That the Federal Reserve Board may authorize examination

by the State authorities to be accepted in the case of State banks and trust companies and may at any time direct the holding of a special examination of State banks or trust companies that are stockholders in any Federal Reserve bank.'

"The above section, while eliminating the necessity of a Federal Reserve examination in years during which an examination has been conducted by the State banking authorities, does not excuse the Federal Reserve examiner from making examinations as specified in other years. The Federal Reserve examiners with too much confidence in the ability of the Ohio State banking department examiners, failed to conduct examinations of the Guardian Trust Co. during the following years: 1923, 1925, 1927, 1930, and 1931.

"Legally they were not excused from examining during these years as the State superintendent of banks for Ohio also failed to conduct an examination and the law is clear on this point. We feel that the Federal Reserve examiner is subject to grave criticism for the failure to follow the law in this respect, as the thorough examination made by Federal Reserve examiners would have revealed the precarious position of the Guardian Trust Co. early in 1930 and undoubtedly many of the evils existing could have been corrected. As to the efficacy of Federal Reserve examinations, no criticism is made as we have found them to be thorough, critical and corrective."

Another factor to be considered in connection with the question is that of cost. The best estimate obtainable as to the present cost of Federal supervision would indicate that it amounts to approximately \$9,000,000 per year, divided as follows: Comptroller of the Currency \$3,800,000; F.D.I.C. \$2,500,000; Board of Governors \$1,400,000 and Federal Reserve banks \$1,300,000. The foregoing figures include, for the Comptroller of the Currency, the 12 district offices, and are based upon the Comptroller's annual report for 1935 but do not include expenses in connection with the issuance and redemption of currency. Of this total, \$216,000, representing regular salary roll, is paid from appropriation

and the balance is assessed against banks. The estimate of \$2,500,000 for the F.D.I.C. represents the estimated total of the annual administrative expenses of the corporation, including its district offices, as indicated by its annual report of June 30, 1936. The estimate of \$1,400,000 for the Board of Governors includes the total salaries and expenses of the Board of Governors of the Federal Reserve System except expenses in connection with the issuance and redemption of currency, and the expenses of the Federal Reserve banks are represented by the expenses of other bank examination departments without any allowance for overhead.

Obviously no one can estimate with exactness the extent to which the foregoing cost could be reduced if the functions of the three agencies were consolidated. However, in the light of what is known with respect to the existing duplication of effort and duplication of personnel, common sense dictates that the ultimate cost could be materially and substantially reduced.

Last and perhaps most important of the many considerations favoring consolidation of the supervisory functions is the resulting facility with which such functions could then be coordinated and correlated with national credit policies.

As was pointed out by Dr. Jacob Viner in an article entitled "Recent Legislation and the Banking Situation" appearing in the American Economic Review, Vol. XXVI, No. 1, Supplement, March 1936:

"* * * The examiners, through the qualitative credit standards which they impose on banks, indirectly influence the quantity of bank credit. When business is prosperous and optimism prevails, examiners, like the bankers themselves, must

tend to appraise credit risks in terms of the favorable conditions of the moment. The bankers, and especially the small bankers, confident that what is good enough to pass the scrutiny of the examiners should be good enough to meet their own standards, persist on their career of credit expansion. Later, when the tide of business turns, when banks begin to fail and loans which were passed without criticism during the boom days have to be written off as bad debts, the examiners are blamed. Reacting in a perfectly natural manner, they become stricter and more exacting in the standards they apply, and they press the banks to liquidate loans and investments which the banks, if left to their own devices, would be happy to keep in their portfolios. The process of bank examination thus tends to encourage credit expansion during the upswing of the business cycle and, more seriously, to intensify credit contraction during the downswing.

"There is an obvious cure for this perverse effect of bank examination, requiring three innovations in the administration of the examinations: unified control of bank supervision and examination; co-ordination of examination policy with credit control policy; and systematic and continuous supervision and instruction of the examiners in terms of a uniform and flexible policy. Fully to attain all of these objectives would require the centralization of all bank examining functions under the direction of the Federal Reserve Board."

One has but to remember the pressure upon banks by various supervisory authorities for and the resulting disaster in connection with so-called "secondary reserves" of bonds and investments to realize the force of this point.

Should consolidation be effected then it would follow that examiners could be schooled along the same lines and trained and directed to apply uniform standards in the classification of assets, the appraisal of management, the development of sound practices and discouragement of unsound practices all along basic and fixed policy lines correlated with existing national policies.

As a proposition, therefore, in order to secure more efficient supervision at less cost it appears desirable to consolidate all supervisory functions in one agency.

Consolidation of Functions in the
Board of Governors of the Federal Reserve System

In the light of its present responsibilities, its availability, and its equipment, it is submitted that that agency should be the Board of Governors.

Of the three agencies, it is the Board of Governors which is charged with responsibility for monetary and credit policies of the United States. This responsibility is met largely through the exercise of control and regulation over discount rates, reserve and margin requirements, and the activities of the Federal Reserve banks in the open market.

With respect to the influence of supervision by examination upon the quality and quantity of credit in banks much has been said that need not be repeated. It may be pointed out, however, that had the Board had complete control of the examination and supervision of banks subject to Federal supervision in 1928 and 1929 it could, through its influence in making examinations, have made its direct action policy more effective and could have further discouraged the use of bank credit for speculative purposes.

As a matter of fact this period is graphically illustrative of the necessity of coordinating and correlating examining standards with existing national policies. If the responsibility of examining is in one body and the responsibility to formulate national policies is in another,

the opportunity for differences of opinion is ever present and, as in the past, unless responsibility is fixed in one body, the time may come when the Board of Governors will establish one credit policy and the examining authority will encourage a diametrical one.

It has been and may be argued with considerable force that examining functions should never be vested in an agency in which there exists the possibility of a conflict of interest as between the status of such agency as a creditor or underwriter and its status as a supervisor. Typical of this viewpoint is the following statement of the Comptroller of the Currency appearing in the American Banker of July 15, 1936, as follows:

"If we are to have a national banking system over which the Government exercises supervisory control, that control must be in the hands of an independent executive and not the representative of a preferential creditor.

"This subject was again brought up following the 'Banking Holiday.' With the calming of the hysteria, however, following the stunning blow of the depression, the agitation seems to be overwhelmed with the logic that our major banking system should be supervised by an independent bureau and not one having a direct or indirect monetary interest in the banks under supervision, or required by law to extend them credit or assume responsibility for their liabilities. It appears, therefore, that the Bureau (office of the Comptroller of the Currency) with its history of 73 years is, through the evolution of our financial structure, more firmly entrenched today than ever as a public necessity."

The efficacy of this argument depends upon the assumption that in no case can self-interest be divorced from public interest and that where self-interest is involved inevitably it will be favored. This is, of course, a factor to be considered but when weighed against the desirability of coordinating supervision with national policies and the evils

from failure to do so, it appears as a relatively unimportant one. Moreover, as an effective answer it may be pointed out that the whole philosophy of the Federal Reserve System is based upon subordination of the profit motive to the public good and in weighing this factor the public character and duties of the Board of Governors must not be disregarded. It can as well act in the public interest and against any possible selfish interest of the Federal Reserve banks in the supervision of banks as it can in directing the purchase or sale of securities in the open market in the public good but at a loss to the Federal Reserve banks.

With respect to the availability and equipment of the Federal Reserve System to undertake the task, it need only be pointed out that already the System has a seasoned and trained staff of technicians in Washington, 12 banks and 25 branches blanketing the nation, manned by officers and employees having long and broad experience and an intimate knowledge of the banking problems of their respective districts. Through this long experience they have acquired a personal knowledge of past and current policies and activities of most of their member banks and many of the nonmember banks and, with added responsibility, this feature could be expanded. They are constantly brought in touch with the banks in their daily operations either with respect to reserves, borrowings, transit operations or other matters and through this they have the opportunity to and do often acquire knowledge not available to an examiner in his short and periodic visits. Such information is useful and, with entire responsibility for supervision consolidated in the Board of Governors, it could be more effectively availed of.

Of less importance, but nevertheless a consideration, is the fact that the F.D.I.C. was capitalized on funds of the Federal Reserve System aggregating \$139,000,000 and \$150,000,000 contributed by the Government theoretically as a return to the banking system for \$149,000,000 paid by the System as a franchise tax. Hence the System already has a large stake in the F.D.I.C.

Therefore, it is offered as a proposition that Federal supervision of banking should be consolidated in the Board of Governors along the lines of the following discussion.

The desirability of fixing undivided responsibility should not be confused with the desirability of decentralizing activities to the extent possible. The important factors in consolidation are the fixing of undivided responsibility and the coordination of activities along uniform and standard lines. Centralization of all activities in Washington, even if not impossible, would seem highly undesirable and, correspondingly, decentralization to the extent that it can be accomplished without destroying the application of uniform standards would seem to be a desirable thing. In the first place, the task is simply too much to be undertaken at one point and, in the second place, there are obvious advantages in personal association and in the accumulated information and background of information obtainable through activity in the field. That, in certain cases, delegation of authority is desirable seems to be a principle recognized by section 507 of the pending bill to reorganize Government agencies, which permits the delegation of functions vested in and imposed upon a head of an agency.

Accordingly, after consolidation of all supervisory functions in the Board, it would be the purpose of the Board to decentralize activities in so far as possible by the establishment of district supervisory authorities, whose field of activities would be co-extensive with Federal Reserve district lines. He would serve at the pleasure of the Board and correspond somewhat to the present chief national bank examiner. To him would be entrusted:

1. The examination and supervision of commercial banks and their affiliates in the district, in accordance with general policies and standards fixed by the Board.
2. The approval or disapproval of applications for charters, permits, changes in capital, etc. subject to the applicant's right to appeal to the Board in particular cases in accordance with uniform standards fixed by the Board.
3. The approval or disapproval of plans of reorganization, consolidation and liquidation, subject to the right of appeal to the Board in particular cases.
4. The initiation of removal proceedings under section 30 of the Banking Act of 1933, of capital requirement proceedings, and of expulsion from the insurance fund or from membership in the Federal Reserve System.
5. The receipt, review and tabulation of statistics from call and other reports.
6. The duty to furnish the Board with examination reports or analyses thereof, or such other information as might be required from time to time.

One objection often heard to the delegation of supervisory powers to the Board of Governors and particularly to the Federal Reserve banks arises out of the fact that six of the directors of a Federal Reserve bank are elected by commercial banks in the district and to that extent the banks would be subjecting themselves to supervision by their associates and even competitors. This, it is recognized, may be both objectionable and undesirable. For that reason it would be the Board's purpose in decentralizing examining activities to delegate supervisory authority to someone responsible only to it and not in any wise responsible to the Federal Reserve bank, except for cooperation and willingness to cooperate.

The Board, in addition to its present functions with respect to the direction of credit policies and general supervision of the twelve Federal Reserve banks would:

1. Establish uniform policies of general application to the chartering, examining and supervising of commercial banks.
2. Coordinate activities to the end that uniform and standard policies would be uniformly applied.
3. Handle the appeal of all matters wherein the decision of the district supervisor is not final.
4. Determine the date, form and conditions of all reports and give direction to the review and analyses of the same.
5. Appoint conservators and receivers for banks.
6. Appoint district supervisors and their assistants.

Under this plan it would be the hope that those regulated would be able to submit their problems to one authority in one office within

their own district and receive an answer. At the same time it would be the hope that having granted authority commensurate with the responsibility and having established means whereby uniform standards consistent with basic national policy could be fixed and applied, there would result a higher degree of efficiency in supervision with less disturbance to the banking system and at less cost to it as well as to the national economy.