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FEDERAL BANK REGULATORY REFORM

Remarks

of

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The subject of bank regulatory reform is hardly one that a bank supervisor can raise without a degree of trepidation--perhaps temerity is the better word--in a forum like the present. However, since design or destiny or both have me here--and you there, let me proceed on a topic that merits our attention. I think all of us would agree that our dynamic and competitive market economy exposes our banking system to multiple strains and contingencies that place a premium upon sound bank management. I think we can all agree that appropriate safeguards are necessary to preserve the interests of depositors, while meeting the needs of borrowers and assuring an adequate return to stockholders. All three groups have legitimate claims whose mutually satisfactory resolution is essential in order to maintain the vigor, responsiveness, and soundness of our banks. If I stress the obvious, it is to underscore the point that there is no basic disagreement in this room with regard to overall objectives. There may be disagreement, however, on the need, and certainly on the means, of improving the regulation and supervision of our banks. The vast majority of banks have met the test of soundness under the very trying circumstances of the past few years. Nevertheless, I as a bank regulator and you as dedicated bankers cannot take for granted the maintenance of a sound and effective banking system and we must be concerned with the early identification and prompt correction of problem situations. Specific problems of banking supervision, the subject of one study after another over the years, are now emblazoned on the financial pages of our newspapers.

Today, I will outline some thoughts on bank regulatory reform. In doing so, I want to make it clear that I am speaking for myself, and not for my colleagues on the Board.

If banking supervision and regulation is on the wrong road, we need to find out where we are and "whether there is any turning back before the road disappears into a swamp." I am, in part, quoting from J. L. Robertson, former Vice Chairman of the Board of Governors of the Federal Reserve System, who in 1962, proposed unification of Federal bank supervision in a "Federal Banking Commission." Under this proposal, the bank supervisory powers now exercised by the Comptroller of the Currency and the Federal Reserve and all powers and functions now vested in the Federal Deposit Insurance Corporation would be transferred to a new independent agency, consisting of five members who would be appointed by the President, with the advice and consent of the Senate, on a non-partisan basis for staggered ten-year terms.

At the time Vice Chairman Robertson offered his proposal, unification of Federal bank supervision was not a new idea. It was proposed in bills introduced in Congress as early as 1919 and was the subject of reports by the Brookings Institution in 1937, the Federal Reserve in 1938, the Hoover Commission in 1949, and the Commission on Money and Credit in 1961. These and other studies have recommended worthwhile possibilities for altering and improving the structure of federal-level bank regulation and supervision. Among the options suggested have been: (1) consolidation under the Federal Reserve Board, the Secretary of Treasury, Comptroller of Currency or F.D.I.C.; (2) change the Comptroller's Office to a three man board and give each federal-level bank supervisor representation; (3) create a sub-board to the Federal Reserve Board to administer all federal-level supervision and regulation of banks with the Federal Reserve Board acting as a "Court of Appeals;" (4) establish a separate Commission assigned all federal-level examination responsibilities. More recently, the Hunt Commission recommended moving toward greater federal-level unification by proposing the creation of an Administrator of National Banks, an Administrator of State banks and a single Federal Deposit Guarantee Administration. This listing is by no means exhaustive, but permits you to have an impression of the range and scope of alternatives.

The reason I cite this history is because I believe that, along with other options, serious thought should be given to the "Federal Banking Commission" concept in today's environment. In other words, I am suggesting that Governor Robertson's proposals--some thirteen years old--should be dusted off and given careful consideration along with other proposed reform alternatives in light of the environment in which the banks and their regulators presently find themselves.

In the 1930's we blamed the collapse of our banking system, at least in part, on insufficient regulation. This may have been unfair in view of the impact on banking of national and international economic conditions. In any event, our response as a nation made banking a very heavily regulated business. Banking became highly protected against competition and paid the price through a substantial loss of power to innovate and expand. During the late 1960's, trying to break out of this regulatory imprisonment and find a life on its own, banking turned from asset to liability management. In the first half of the 1970's, by depending more and more for funds on increasingly volatile liabilities, many banks were caught short when--for reasons that probably should have been anticipated--sources of funds such as Federal funds and certificates of deposit, which can be shut off almost overnight, were in some instances shut off almost overnight. The perils of "Go-Go" banking became even more apparent when confidence was shaken by foreign exchange losses in a world of floating exchange rates and bank failures abroad, two-digit inflation, and the associated enormous increases in demands for funds and interest rates. These events and a number of jarring domestic bank failures have resulted in the growth of skepticism about bank regulators, who the public thought were busy keeping banks from doing imprudent things. In other words, I think what needs restoration in the present environment even more than the confidence in bank management is confidence in the dependability and practicality of bank regulation and supervision.

Furthermore, Congress has clearly heard this message and will probably hold hearings this spring for the purpose of considering the need for legislation in the bank regulatory area.

In the Federal Reserve there is a long history of dissatisfaction with bank regulation and supervision. As early as 1939, this unhappiness broke through into the Board's Annual Report. It said Bank supervision is "a crazy quilt of...authorities and gaps in authority, or restrictions making it difficult for banks to serve their communities and make a living, and of conditions making it next to impossible for public authorities to apply adequate restraints at a time and in conditions when this may be in the public interest." I have quoted at some length because this statement reflects the note of honest indignation at being asked to exercise major responsibilities without clear authority. The bill of particulars has never been more plainly put: the existing system of bank regulation is not only overlapping and confusing--but, in many respects, fails sufficiently to serve the public interest.

I doubt that any member of the Board in facing up to his responsibilities as a bank regulator, has failed to feel a sense of dismay upon looking at a field of endlessly intersecting lines of authority--not only hung with thick fogs of conflicting histories of Congressional intent--but occupied by quicksands of public and private policy differences. These differences, looked at from the regulator's viewpoint as he tries to administer bank regulatory laws, appear as conflicting claims to justice among various groups in the economy. They include the claims of consumers to maximize their interest returns on time and savings deposits against the ability of some financial institutions to pay such rates without making extreme, and possibly imprudent, adjustments in their lending policies or failing to live up to their commitments; they involve the claims of housing, resting on a mass of legislation intended to give special support to housing as against the recurrent national need for monetary restraint which imposes a particularly heavy burden on housing and some other sectors of the economy; they incorporate the need to give banking all legitimate scope under The Bank Holding Company Act to innovate and compete as against the need to assure the safety and soundness of the banking system and the separation of banking and commerce; they place the need to underwrite public confidence in our banking system by regulatory safeguards against the belief that strong and unfettered competition best serves free enterprise. Finally, a central banker who is also a regulator is faced with the need to preserve the integrity of the examination and supervisory process while at the same time pursuing monetary policies that affect all financial institutions in the economy.

A final example of the conflicting claims to fairness that the regulator must reconcile in his mind is the collision of our wish for efficiency in our financial system with our desire to preserve in the structure and regulation of our financial system the State-Federal pluralism that serves us so well in so many other ways. Only last October, Chairman Burns noted that in recent times American banking has gone through a profound evolution that has multiplied banking's exposure to the dangers inherent in excessive leveraging, reliance on volatile deposits, heavy loan commitments relative to resources, rapid expansion of bank holding companies into diversified holdings, and increased foreign exchange risks. Dr. Burns described the present regulatory system as exceedingly complex, fostering a "competition in laxity" as regulators are played off against one another by banks with power to choose their regulator. The principle of checks and balances, he said, need not mean that banks should continue to be free to choose their regulators. He added that building up the present regulatory system might not be adequate, but that a substantial reorganization might be required to overcome problems inherent in the present regulatory structure.

The problem, as I see it, does indeed arise partly from the very structure of bank regulation as it now stands. At a time like the present, every effort should be made from both managerial and regulatory standpoints to reduce the risks caused by unsound banking practices such as the potential dangers of pushing liability management so far that banking finds itself cantilevered over a capital void.

Without unequivocally endorsing all of the reasons which I have stated earlier for change in the bank regulatory structure, there are certain facts which I believe are at the present time inescapable. First, the present Federal bank regulatory structure is far from perfect and therefore can stand a certain amount of improvement and possibly restructuring. Secondly, there is, not only in Congress but elsewhere, strong sentiment for a serious reevaluation of the manner in which banks are presently regulated, particularly at the Federal level.

This brings me then to a discussion of the "Federal Banking Commission" concept, which, as I stated earlier, I believe should be one of the alternatives seriously considered if some type of change is to be made. In this connection, let me elaborate on the objectives which a unified plan for Federal banking supervision was designed to accomplish. As I perceive the "Federal Banking Commission" plan, it proposed (1) to eliminate wasteful duplication and difficulties in coordinating actions among several Federal supervisors; (2) to minimize such friction and conflict as may, from time to time, arise among banks and bank supervisors; (3) to enable the banking industry to operate under a simpler set of Federal rules, and in an environment of competitive equality as far as Federal supervision is concerned; and (4) to lessen the possible tendency toward laxity in bank supervision both at the Federal and State level. In addition, the Commission would enable the Federal Reserve to devote its attention more exclusively to monetary policy--the primary concern of the central bank.

As originally proposed by Vice Chairman Robertson, the Commission would be established as a new agency of the Government. All supervisory and regulatory functions of the Comptroller of the Currency, and the Federal Reserve Board and the entire Federal Deposit Insurance Corporation would be completely absorbed in the new Commission.

The Commission would have all the jurisdiction now exercised by the existing agencies over charters, branches, mergers, holding companies, fiduciary and foreign banking activities, as well as disciplinary actions such as termination of "insurance" or removal of officers or directors. It would also promulgate all regulations excluding those dealing with monetary policy which are now required or authorized to be issued by any of the three supervisory agencies and it would otherwise administer and interpret the Federal banking laws.

The new Commission has been pictured as being almost exclusively concerned with quasi-judicial functions calling for a high degree of knowledge of the banking industry, as well as the ability to analyze both facts and law. Consequently, its membership should be selected with great care. Decisions of the Commission would be final and conclusive unless found by a reviewing court to be wholly without evidentiary support or clearly arbitrary and capricious.

The Commission would be organized along functional lines with each subdivision headed by a career person appointed by and accountable to the Commission. One unit would handle the deposit insurance and related functions now performed by the FDIC. Another subdivision would be charged with bank examination and assume those particular duties formerly undertaken by the Comptroller of the Currency, the FDIC, and the Federal Reserve System. In addition to the existing examination function, the Director of Examinations would be authorized and required to examine State member and nonmember insured banks to the extent deemed necessary for any reason by the Commission, the director of insurance, or the Federal Reserve Board, and of course all reports of examinations would be made freely available to all three.

The director of examinations would be required to submit to the Commission reports and recommendations and to act as an advocate of the public interest in connection with quasi-judicial proceedings on charter, branch, merger, and holding company applications. Thus, the Commission would have before it not only the facts and arguments advanced by the applicant but also the arguments of those representing only the public interest. The director of examinations would also carry-out other supervisory responsibilities like reporting unsound banking practices or questions involving legal interpretations to the Commission.

This sort of an arrangement could achieve greater uniformity and effectiveness as well as reduce the cost of Federal bank supervision, eliminate conflicting interpretations of law, and lead to greater consistency in bank regulatory policies. For example, all merger applications now passed upon by one or another of the three Federal bank supervisory agencies, would be dealt with instead by the new Commission, producing a more consistent result. Greater consistency would serve to eliminate a substantial part of the temptation for banks to switch from State to national charter or vice versa, member to nonmember or vice versa, depending upon which group appears to receive the most generous or lenient treatment from the Federal supervisor.

As a former banker, upon hearing this proposal, there was an issue which immediately came into my mind and I venture would concern most of you as regards the "Federal Banking Commission" concept. This is the issue of centralization of the bank regulation structure and its effect on the dual banking system. For example, it could well be suggested that the basic objective of the dual banking system is to protect the public against the concentration of Governmental control of banking in one person or group. I share this concern but I also believe that the "Federal Banking Commission" plan is not inconsistent with dual banking. Each insured State bank would remain subject to supervision by both a State and a Federal agency. A national bank which is principally under the supervision of one administrator today would become subject to the supervision of a commission of five members. In concept, the creation of the "Federal Banking Commission" would tend to strengthen the states' positions rather than jeopardize them in the dual banking system. In this connection, one might remember that with only rare exceptions are any bank's powers derived solely from the government that granted its charter. Numerous Federal laws limit a State-chartered bank in the exercise of its powers particularly if it wishes to have the benefits of Federal deposit insurance or membership in the Federal Reserve System. Thus, State bank supervisors and state chartered banks would find it possible for the first time to solve problems common to State and national banks, member and nonmember banks of the Federal Reserve System by working with a single Federal agency.

Unification of the Federal bank supervisory agencies would have no effect whatsoever on state-chartered banks' powers other than those powers already preempted by Federal law or limited through voluntary associations with Federal agencies. Furthermore, it is doubtful that a new "Federal Banking Commission" would be apt to display favoritism towards the Federal banking system to the detriment of the State banking systems. In interpreting a law that limits the activities of both national and State-chartered banks, it is inconceivable that the Commission would apply one interpretation to one class and a different interpretation to the other, any more than either the FDIC or the Federal Reserve System has discriminated between State and national banks in their regulatory determinations. As a matter of fact, the State banking systems would arguably be in a better position in this respect than they are today, because a Federal agency which has responsibilities with regard to both systems of banks would be less likely to show favoritism than one which exercises supervisory functions over a single system and may seek to advance the interests of that system alone.

The Commission would make its advice and financial assistance available to the states during an initial period of three years as they worked to perfect their own supervisory staffs and procedures. The program would anticipate that within the three year period the states could develop staffs and establish supervision of their banks in a manner that would satisfy the Commission.

Since the Commission's supervisory program would be a federal program, Federal financial assistance would be offered to the states to augment other funds available to the State bank supervisor to meet the conditions necessary to become the sole examining authority for state chartered banks. These conditions would relate to the need of various federal laws and programs to be monitored through the bank supervisory process, for example, the federal deposit insurance program, the reserve requirements imposed on Federal Reserve System members and other federal laws now enforced by the existing federal bank supervisory agencies. During this period the Commission would make every attempt to remove itself from State bank supervision as expeditiously as possible. Thus, the plan contemplates a gradual move toward much more complete supervision of State Banks by state authorities assuming they develop staffs that can perform their functions satisfactorily. This proposal should spur more of the states to provide the amount of funds necessary for adequate State bank supervision including adequate compensation of examiners. As a general rule, the Commission would examine State banks only upon State request or for occasional spot checks or where State examinations needed to be supplemented for Federal supervisory purposes. Although on a much less complex scale, the Board's experience with the Truth-in-Lending Act shows the states are able to develop and administer regulatory and enforcement programs in compliance with a set of Federal standards.

In addition to the question regarding centralization and dual banking the "Federal Banking Commission" proposal also raises in one's mind the issue of whether this type of regulatory activity could best be performed by one person or, a board, as the proposal suggests. For instance, one might argue that since increased efficiency is one of the purposes of unification, why not centralize the authority in one person? Admittedly, a single authority's administration is usually swifter and more immediately effective than a board of, say, five members. On the other hand, it has been argued, and I think persuasively so, that the relatively cumbersome deliberations of a body composed of several members is more likely to develop policies and the resulting decisions that will enable the banking industry to make its optimum contribution to the economy.

But, if a board-type of administration is preferable to a one-person administration, it may be asked, "Why not centralize authority in the Federal Reserve--which has had over sixty years of experience in bank supervision?" Over the years many proposals for unification have favored the Federal Reserve as the locus and one would expect that a member of the board of an existing agency would tend to look favorably upon proposals to expand the agency's jurisdiction. Nevertheless, it is my belief that should any form of restructuring of Federal bank supervision be given serious consideration, it would be detrimental to place in the Board these additional responsibilities. There are limits to man's ability effectively to perform his assigned duties. In our complex society merely keeping informed of what is going on in the national economy is becoming more and more difficult. Developing and implementing appropriate monetary policy at a given time require considerations and evaluation of the significance of an enormous volume of available data and their inter-relationships. The responsibilities are of such magnitude that the Board should not also be burdened with the performance of bank supervisory functions. Supervision is too important a function in itself to be the Federal Reserve's part-time job. For example, during 1974, the Board issued 434 orders on bank holding company applications alone, not to mention numerous deliberations on other regulatory matters both under the Bank Holding Company Act and other laws and regulations.

Another reason for arguing that bank regulation should be moved to an arm's length from monetary policymaking is where the same agency has both the responsibility for monetary policy and a major role in bank regulation and supervision conflicts of objectives may arise that result in contradictory claims upon the agency. The regulator and supervisor need to apply consistent standards to bank examinations and to provide a stable regulatory environment for banks, while the monetary authority must respond to changes, sometimes rapid and dramatic in economic conditions. The policies of a monetary authority and a bank regulator may even collide depending on conditions in the economy. In this connection, it is my strong conviction that bank examiners should be always allowed to function in an environment where their decisions are based entirely upon their perception of the quality of the management and asset and liability structures of the banks for which they have examination responsibility and are not influenced by considerations of a broader scope. Examiners should be insulated from any possible temptation of the monetary authority to use supervisory powers to implement monetary policy and they should be at all times free from evaluating certain loans differently than others, notwithstanding the broader economic issues that may be involved if particular credits are allowed to be classified or written off.

This exemplifies the kind of collision that could undercut either monetary policy or regulatory objectivity or both.

Separating the Federal Reserve from bank supervision would not, in my opinion, diminish its ability to keep abreast of banking developments. Information about banking practices would be just as available to the Board if supervision were unified in the "Federal Banking Commission." To assure that the Board of Governors would have access to all reports of examination and reports of condition accepted by the Commission, it has been recommended that the law require the Commission to furnish each report to the Federal Reserve System. Also the suggestion has been made that one member of the Federal Reserve Board be designated one of the Commission members as a means of safeguarding information flows between the Commission and the Federal Reserve.

My intention today has not been to support any specific plan for the reform of the bank regulatory structure, whether at the Federal or State level. I am satisfied that our banking system is in a fundamentally sound condition at the moment, but elementary prudence dictates continuous vigilance and to me the experience of recent years strongly suggests a need for improved bank regulation. The "Federal Banking Commission" plan may not be the best means to achieve our common objective but I believe it should be included among the reform proposals being given careful study.