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Address of J. L. Robertson, Member of the
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"THE OUTLOOK FOR BANKING"

One cannot contemplate the outlook for banking without taking into account much more than banking alone. Every generation of Americans has had its problems, but those we face today - now that this nation has become the leader of the free world - seem even more complex and intractable than those which beset our forefathers. Never have the spiritual, ethical, and moral values which are the foundations of the civilized world, or the institutions of free men, which give expression to those values, been so threatened. Never has any generation had greater need to protect and preserve those standards and institutions. Never has the banking community had a greater responsibility for playing its full part, in leadership and enlightenment, so that our economy may continue to be strong and flourishing.

The difficulties must not be underestimated. At the same time, they should not be looked upon as hopeless. We must appreciate the magnitude of the job which faces us, decide what part each of us can best play in solving it, and then start working harder than we have ever worked before - always aiming toward greater reliance on individual thought, initiative, action, and responsibility, and less dependence on governmental aid and governmental controls.

The part the banker must play is twofold, I think, one role involving what may be termed self-interest, and the other public duty. Dealing with them in that order, let me mention just three phases of his "self interest" role:

1. Defalcations

We all agree that experience is a valuable thing, but often it is acquired at too high a price. In many circumstances it is a much better bargain if it can be obtained secondhand.

When I appeared on this same platform a few weeks ago, I mentioned to another group of bankers that one of the duties of bank directors was to insist on a vigilant internal audit system in their banks. At that time I commented on the tendency of some directors, who are "too busy" to come to the bank during an examination, to blame examiners for failing to discover shortages. I pointed out that if those same directors were to take the time to discuss the matter with an examiner, they could readily ascertain that bank examiners are not auditors, that bank examinations are not audits, and above all, that they, the directors, have the responsibility for seeing that a good internal audit system is maintained.

At that meeting I was introduced by a good friend of mine who since then has discovered that for five long years he had worked side by side with a Vice President who had systematically embezzled nearly a half million dollars from his bank. All of us can appreciate the jolt of such an experience - the sudden discovery that one of our associates (often the one least subject to suspicion) had been dishonest. There never was a better example of how dear an experience can be, and how much better it would be to get it secondhand.

Pennsylvania bankers have not been free from such experiences. But out of it all comes one beneficial aspect. There have been bank defalcations as long as there have been banks, but there has never been a time when so many banks and bankers' associations have tried so diligently to see that their experience henceforth comes secondhand. The discovery of an unrespectable number of embezzlements in a fairly concentrated area has awakened bankers all over the country to the need for establishing adequate internal audits and for making them effective, not only for the large banks, but also for the small ones - where the job is much more difficult.

The Pennsylvania Bankers Association, along with the American Bankers Association and others, is entitled to commendation for its activities in this field. I can remember when it seemed as though just a few of us were soloing on this theme, but now a whole chorus has warmed up, and the results are certain to be beneficial. It is refreshing to see this development after the initial lifting of eyebrows (and worse) at bank supervisors, as though they had been accomplices, and the allegations that the supervisors were attempting to pass the buck whenever they emphasized the responsibility of officers and directors to prevent and detect dishonesty. Now, for practically the first time, we are buckling down to the task ahead of us - irrespective of who is to blame - and woe to the defaulter! In these efforts you will have the wholehearted cooperation of the entire Federal Reserve System.

2. Loans

Turning to the field of loans, one bumps headlong into another example of how much better a "buy" experience can be if it is obtained secondhand. Many lending officers today have operated only under fair weather conditions. They did not go through the harrowing experience of those who operated our banks in really trying times. But if they are alert enough, they can get the benefit of that experience secondhand, and the price they pay in time and effort will be modest indeed. They can acquire a great deal from colleagues with a generation of

executive experience behind them - and perhaps even a little from the slowly accumulated wisdom of bank supervisors. To utilize it properly calls for self-discipline and the exercise of a high degree of prudence in making loans, in setting their terms, in selecting and perfecting the instruments, and above all, in policing them.

Loans are almost never bad when made. They become bad after it is too late to reset the terms, redraft the instruments, redetermine the potential ability of the borrower to repay. Any banker who went through the late twenties and early thirties is painfully aware of that fact. Add to it the fact that there isn't any man living today who can with certainty tell you what the economic conditions of tomorrow will be - the best he can do is to say that the economy may swing up or may swing down, and whichever way it goes, someone is going to be hurt.

Certainly this is a time that calls for the exercise of wisdom and care, to be prepared for whatever the future may hold. Now is not the time, if ever, when bankers should be granting or buying consumer loans which are amortized more slowly than the depreciation of the article purchased. Now is not the time to make loans for the purchase of things in which the purchaser has no equity. Now is not the time for increasing loans for nonproductive purposes.

No longer can a prudent banker conduct his operations on an isolated basis, without regard to what is going on around him in the rest of the country. Today the activities of each individual bank play a significant part in determining the course of the economy itself - in determining the value of the dollar in your pocket and mine. The banker must gear his activities accordingly. For example, he must assure himself that the loans he grants will make for economic health in the long run. He must not let his natural and proper desire for profit lead him into the position of trying to get people into debt beyond their depth - on the theory that a beneficent government will not let him fail.

Consumer debt, especially, is being ballyhooed to the point where many families have loaded up with televisions, radios, electrical devices of all kinds, not because they could afford it, but because not to do so has even been stigmatized as a sign of "failure". Just the other day I heard an announcement on the radio like this:

"Dad, you are not playing fair with your children if you don't buy them a television - and a twenty inch one, too. You want them to know you are as good as your neighbors, don't you? If you have a television set now, you can use it as a down payment. If you don't, you don't need a down payment. And if you feel burdened down already by debts and taxes, well don't let that bother you either. Just drop in to _____'s and they'll see that you get one - the very best - for as little as 25¢ a day. Now hurry, hurry, hurry down."

I wonder who will hold Dad's note? Well, about 41% of all consumer installment paper is held in our commercial banks. And if you bankers don't care about terms or ability to pay, you can be very sure many sellers won't.

One more word on this phase of your role. Everyone knows, I suppose, that the most successful banker keeps his customers by giving that extra measure of service that the competitor down the street does not give. He cannot give that service unless the return on loans is realistic - unless it covers costs and permits a reasonable margin of profit. If he cannot see his way clear to match a competitor's low rate of charges on loans or high rate of interest on deposits, he does not try to follow. He concentrates on the development of high-quality service and intelligent banking and sees that his customers are made aware that that type of banking service costs money and that his interest rates are fair and reasonable.

Any examiner worthy of his commission knows that the easiest way for a bank to lose out in the competitive race - still the keystone of our economy - is to charge too little, pay employees too niggardly, let equipment run down and service diminish. Few people want to deal with an unprogressive, worn-out institution - especially one in which there is no evidence of competent young men and women being trained to replace those at the top, and thus provide continued effective management.

3. Capital

As long as I'm speaking of bankers who have benefited from experience and who consider that secondhand experience often can be the "best buy", I should mention that they number among their ranks those who realize the necessity of maintaining adequate capital structure and have consistently done so - notwithstanding all the difficulties and obstacles. Too many bankers are viewing the problem from the wrong angle. They are devoting too much of their energy to trying to prove

(1) that bank capital isn't as important today as it was prior to the F.D.I.C. and the acquisition of a sizable portfolio of government bonds, (2) that the supervisors have no authority to require the replenishment of capital, even in grossly undercapitalized banks, (3) that the supervisors employ the wrong methods of determining capital adequacy, (4) that the present market for bank stocks makes it impossible to sell new common stock, and (5) that taxes are inequitable and are too high anyway.

I have gone through enough recapitalizations - voluntary and otherwise - to be cognizant of the pro's and con's of most of the arguments on each of these points. No one can deny the existence of obstacles, or of the difficulties involved - they are real. However, the fact remains that many bankers (hundreds of them) who have placed foremost the need for getting new capital (now, rather than when it is too late) have obtained that capital. That would indicate it may be better to accentuate the positive and minimize the negative. The need for more capital and the means of raising it should be studied on an individual case basis. Decisions should be made in the light thereof, rather than on the "say-so" of any so-called expert who, while talking down bank stocks, is simultaneously buying them up for personal profit.

One final word on this subject of capital. Much to do has been made about capital ratios, and about definitions of "risk assets". Ratios as such have nothing to do with determining capital adequacy. They are simply a system devised to facilitate the selection of the reports of examination to look at first - and longest. Capital adequacy is an individual bank problem; it depends on the kind of assets in your bank, the probable risk inherent in them, the nature of your deposit liabilities, and the quality of your management.

Representatives of the supervisory agencies with which I have been associated attempt to determine the amount of risk inherent in a bank's assets and operations before formulating definite views with respect to the adequacy of the bank's capital cushion. They do not form their judgment on the basis of any mechanical rules or ratios. You may disagree with their judgment, but you can also take it for granted that if your ratios are superficially favorable and those agencies still think you need additional capital, they believe the degree of risk in your loans or investments is inordinately high or that your management is not as good as it should be. And bear in mind that their opinions are formed in the light of a comparison of your bank with many others.

Much has been said to the effect that the agencies should define risk assets with precision. As every banker knows, the degree of risk is not the same in any two loans or any two investments. Consequently, specific classifications of risk assets would likely be more misleading to the uninformed than helpful to the well informed.

Furthermore, as I said, today adequacy of capital is treated as an individual bank problem. No responsible supervisory authority will tell anyone outside of your official bank family whether he thinks your capital position is adequate or inadequate. However, if the supervisor were required to define the exact degree of risk in each kind of loan and investment - assuming he could do it - capital adequacy might soon be a matter of arbitrary public rating for all banks and then a "ratio" would be a determinant of your bank's standing, irrespective of the quality of your management.

Before I leave this aspect of your role, I want to make one last comment. Of late there has been considerable talk, in some quarters, about the lack of authority of bank supervisors. Surely the Congress had some purpose in mind when, for example, it said that one of the objectives of the Federal Reserve Act was to make bank supervision more effective; when it vested in the Board of Governors the power to remove officers and directors of member banks for continued violations of laws and regulations or for unsafe and unsound practices; when it empowered the Board to bar from access to the credit facilities of the Federal Reserve System any member bank which overextends credit; and when it gave the Board the power to oust a State bank from membership for violations of laws and regulations, one of which requires maintenance of adequate capital.

I believe the Congress intended that the Board should exercise its powers to the end that membership in the Federal Reserve System would constitute a badge of distinction. And the Board recognizes that it has an obligation to exercise its supervisory powers in a manner which will, to the fullest extent possible, protect soundly-managed, soundly-capitalized banks from the devastating effects of failures of poor ones. While widespread membership in the Federal Reserve System is highly desirable, we believe it is more important to have the System composed of good banks than to have the largest possible membership.

Today the Federal Reserve System is in a better position than ever before to lend its assistance to member banks in times of need,

but member banks must earn the right to that assistance by the exercise of prudence in times like the present.

So much for the self-interest aspect of the banker's role - the operation of a sound bank. Let me turn to his public-duty role - the public responsibility of the banker to set the economic tone of the community in thought and action, by both precept and example.

The formation of an enlightened public opinion in this field - without which neither democracy nor a free enterprise system can long endure - calls for a combination of banking efficiency and a high concept of public service. It requires the development and use of sound local credit policies, which will promote economic growth and stability - which will neither contribute to a resumption of inflationary forces, nor unduly abet deflationary forces. It requires, as well, a widespread recognition of the fact that local use of credit facilities, when viewed in the aggregate, vitally affects the economic well-being of the nation. This necessitates an informed public understanding of the nature and quality of both commercial banking and reserve banking operations.

Given the cooperation and understanding of the bankers of the country, the Federal Reserve System can, through credit and monetary policy, influence the volume of the main element of our money supply - bank deposits. But that is not, by any means, the sole factor in maintaining economic stability. Bankers know that the velocity of the turnover of our money supply is extremely important. They appreciate the fact, too often overlooked by others, that a ten dollar bill spent five times represents not ten but fifty dollars of purchasing power, which when multiplied by billions becomes obviously significant. The banker also knows that while, through the exercise of general credit controls, the Federal Reserve System can influence that velocity to some extent, the attitude and activities of the public also have an important influence thereon. For that reason it is up to him - more than anyone else in the community - to bring about a broader public understanding of credit and monetary matters and their bearing on the course of our economy.

Much depends upon each individual in the community, on how much he saves, how much he spends, how fast, when, and for what. That is one of the reasons I am concerned over the careless remarks a few bankers are making about United States Savings Bonds. I do not know what the dollar would be worth today if the \$57 billion now invested in savings bonds had been poured into the spending stream. But I am

certain that all of us are far better off than we would have been if, instead of that money having been saved, it had been spent for commodities. Fortunately, or unfortunately, those who haven't bought and held savings bonds have also benefited by this saving, to the extent that it eased inflationary pressures and hence affected the value of everyone's dollars.

Our present money supply turned over at the present rate of velocity has tended, over the past year or so, to move goods off the market with little change in prices; hence the neutral position in which we find our economy - a delicate but salutary state of balance between inflation and deflation. During this period, savings have been increasing. If the velocity of turnover should be drastically curtailed, if people should stop buying altogether, we could be faced with a serious downturn, and if the velocity of turnover should be drastically increased, through a buying spree like that which followed Korea, we could be in danger of another surge of inflation. Therefore, it is extremely important that people understand the significance of their aggregate action upon the value of the dollar.

The bankers of this country have the knowledge, experience, and ability to take the lead in forming enlightened public opinion and wider understanding of financial matters. There are many areas in which a better public understanding is needed, but let me exemplify by referring to just one: the respective parts which general and selective credit measures play in helping to maintain stable economic progress.

The general measures are, as you know, discount policy, open market operations, and reserve requirements. They could be called indirect controls. The selective controls are those which operate to restrict specific types of borrowing, such as consumer installment and real estate credit. They directly affect the individual and require policing. You will remember that suspension of the Voluntary Credit Restraint Program and Regulation W in quick succession by the Board of Governors led to newspaper comment to the effect that "all credit curbs had been suspended except on new homes". That reflects a widespread lack of realization of the fundamental changes which have taken place in the environment in which monetary and credit policies operate today, in contrast with the situation existing prior to the Treasury-Federal Reserve accord.

Prior to the accord, the general credit controls were largely ineffective because the support of the Government bond market by the Federal Reserve System made it dangerously easy for the banking system

to replenish reserves as a basis for loan expansion and for other financial institutions to obtain funds at will, through the conversion of their holdings of government securities into cash at a supported price. Prior to the accord, selective credit controls had come to be looked upon as substitutes for general controls, rather than as supplementary measures. Since the accord, we have reverted to reliance upon the traditional methods, the general control measures, and thereby restored to the Federal Reserve System the initiative in expanding or contracting reserves and hence in moderating monetary and credit swings in either direction.

In using this example, I do not wish to be understood as deprecating selective credit controls. I merely wish to have them publicly understood for what they are: useful supplements rather than complete substitutes for basic general credit controls. Like many of today's wonder drugs, they have their place in the arsenal of remedies in times of need. But they should not be regarded as panaceas. When used properly they can be extremely helpful in dealing with emergencies. The use of these drugs will often carry a patient through a crisis, but once this has been accomplished, continued use of them - my doctor tells me - may do more harm than good.

Similarly, timing is of the essence in the use of selective credit measures, not only in their imposition, but in their withdrawal as well. Holding on to some of these measures too long might prove just as harmful as using them too soon. Consequently, when judging motives for suspending or relaxing a selective control, one should bear in mind the fundamental principle of a democratic free enterprise system, that the extension or retention of governmental control over individuals and institutions should be kept to the minimum consistent with the safety and well-being of the nation.

You bankers, as the leaders of financial and economic thought in your communities, can do much to foster a broader understanding of the functioning of our monetary and credit system, of the significance of sound fiscal and monetary policies, of the importance of the activities of the individual, and of the part which each of us must play if we are to preserve for ourselves and our children the kind of life we cherish. Only through leadership of this nature, which takes into consideration both aspects - the self-interested operation of a system of strong and vigorous banks and the public duty of providing intelligent community guidance - can we make certain that the outlook for banking is what we want it to be. We are not puppets, helpless in the grasp of overwhelming forces. We can control our destiny, if we will. Actually, the outlook for banking is not in the stars, but in ourselves.