

Statement by J. L. Robertson, Member of the Board of
Governors of the Federal Reserve System
Concerning Crimes Against Banks
before the
Legal and Monetary Affairs Subcommittee of the
Committee on Government Operations of the
House of Representatives

October 15, 1963

Mr. Chairman and Members of the Committee:

The problem of crimes against banks is one that has been of real concern to banks, bankers' associations, bank supervisors, and law enforcement agencies over the years and it is heartening that this Committee is holding these hearings. The problem can never be completely eliminated. There will always be crimes committed against banks - both internal and external. The task before all of us is to find ways and means of lessening the role of crime - making its perpetration and concealment more difficult, and its detection quicker.

While the problem deserves the best efforts that can be devoted to its solution, it should be emphasized that most losses from crimes against banks, in recent years at least, have been absorbed by commercial insurance or surety bonds, by stockholders' funds, or - in a few instances - by the Federal Deposit Insurance Corporation. These protections are intended to shield depositors against loss, and they have generally been adequate to prevent crimes from causing loss to bank customers.

In the perspective of history, the principal causes of bank failures have not been crimes against banks. The principal causes have related to the abilities of management and the quality of loans and investments. Therefore, the examiner's work is focused on assets and operations. His chief duty is to ascertain that the statutory and administrative requirements are being complied with and that the lending and investing policies of the bank are such as to minimize the dangers inherent in excessive and hazardous loans, speculative investments, et cetera. The relatively low rate of bank failures in recent years is due at least in part to the better job that bank examiners and supervisors have been doing in this respect.

There is no question that undiscovered shortages exist in some of our banks today. Shortages will always exist in banks to some degree. It is certain that at least a few of the many thousands of bank employees will not be able to resist the temptation to "borrow with the intent of repaying" a little of the money which passes through their hands. It is also certain that there will always be some professional or amateur robbers who will try to "get rich quick" through burglaries and armed attacks on banks.

Even though there is no major problem in so far as depositors are concerned, the situation is one that cannot be lightly dismissed. The losses that result from crimes against banks are a burden on banks' operations; they weaken the ability of banks to provide maximum service to the community at reasonable cost. Although insurance protection can prevent a particular loss from being disastrous to the bank involved, it can only spread the burden over the whole banking industry and, ultimately, the banking public. Insurance rates must be high enough, in the long run, to cover the risks. As losses increase, insurance rates must rise. Everyone suffers when funds that should serve the community must be paid out in higher insurance premiums to cover losses resulting from crimes.

The officers and directors of each bank have the direct responsibility for preventing and detecting crimes against the bank. Fortunately, methods and techniques are readily available to the individual bank to help it in preventing losses. Training manuals and educational facilities are made available by the American Bankers Association; NABAC, The Association for Bank Audit, Control and Operation; and other industry organizations. The Federal Bureau of Investigation and the Post Office Department also have made major contributions in educating bank

officers and employees in ways of preventing various types of crimes that may be committed against banks and aiding in their detection. In addition, manufacturers of vaults and protective equipment have been active in developing and marketing many types of equipment to aid in preventing and detecting crime.

What is the appropriate role of bank supervision? The detection of crime is not the principal duty of bank examiners. Defalcations are often discovered by them, as a result of their tendency to react with suspicion to circumstances that would pass unnoticed by others, and perhaps this is the basis of a popular misconception of the main function of bank examinations.

A bank examination is a fact-finding process designed to verify assets and appraise their value, determine liabilities, measure the adequacy of capital structure, analyze earnings and expenses, ascertain compliance with applicable laws and regulations, and assess the competence of management. A bank examination is not an audit, since as a general practice it does not include detailed checking of entries relating to transactions or direct verification of individual loan and deposit balances. However, as a part of the examination process the examiner reviews the accounting and operating systems of the bank and its

program of audit and other internal controls, judges the adequacy of its fidelity bond and other insurance coverage, and makes recommendations for the correction of any deficiencies in these aspects of the bank's operations. The responsibility for providing protection against crimes lies with the bank itself, with such assistance as it may be able to obtain from bank supervisors and other law enforcement authorities.

Bank examiners and supervisors do make intensive efforts to have banks follow sound practices. They urge the adoption of appropriate internal controls and audit programs, rotation of employees, compulsory vacations, and adequate surety and insurance coverage. Basic training in this area is an important part of the curriculum of the Bank Examination School established by the Federal bank supervisory agencies in 1952 and currently conducted cooperatively by the Board of Governors and the Federal Deposit Insurance Corporation. Four 4-week sessions for Assistant Examiners and two 4-week sessions for more experienced examiners are held each year. To date more than 2100 State and Federal examiners and assistant examiners have attended the school. Also in cooperation with the FDIC, seminars to train examiners in the use of appropriate techniques and procedures in the examination of banks utilizing electronic data processing systems were introduced in 1962 with beneficial results and are being continued.

The Board of Governors of the Federal Reserve System has responsibility for the supervision and examination of State member banks of the Federal Reserve System. Supervisory examinations are conducted by Federal Reserve Bank examiners, approved by the Board, and are made jointly or independently through cooperative arrangements with the Banking Departments of the several States. It is the Board's established policy to have each State member bank examined at least once in each calendar year. These institutions range from small-town banks with a total staff of three or four and less than \$1 million in total assets to large organizations with many branch offices, several thousand officers and employees, and total assets measured in billions.

At one extreme are banks that have small resources and offer a few banking services to their relatively few potential customers; at the other end of the scale are large, highly departmentalized banks that provide a wide range of general and specialized banking and fiduciary services on a national and international basis. The circumstances surrounding the operations of these different institutions necessarily vary widely. It would be extremely difficult to provide uniform rules or regulations that would be suitable to such a variety of conditions. The best means of protecting a particular bank against

crimes necessarily must be decided in the light of the circumstances existing in that particular institution. The management of that institution should be in the best position to select and apply suitable protective measures. The supervisory authorities can best aid in this process by reviewing the job done by the bank's management and by offering helpful advice or suggestions. Since the problem is largely one of alerting and educating bankers to the importance of the problem and the means of meeting it, there is no simple or easy solution. Anything that helps in the process of alerting and educating can be helpful, and hearings such as this can serve a useful purpose in that direction.

Under the Financial Institutions Act of 1957, which was passed by the Senate but not reported out of the House Banking and Currency Committee, the Federal bank supervisory authorities would have been authorized, whenever deemed necessary, to require banks under their supervision to provide audits by qualified independent firms. This Committee may wish to give consideration to a similar provision of law at this time. While such a law would be helpful, the ultimate protection must necessarily lie in the field of education and training, since even independent audits can vary widely in their effectiveness, depending upon the skill with which they are performed.

The Board of Governors and other supervisory agencies have for many years encouraged banks to strengthen their protection against crime. One example of this is found in a booklet entitled "Direct Verification for Smaller Banks" issued by the American Bankers Association in 1961 and sent to banks throughout the United States. This booklet was issued with a Foreword, signed by the then heads of the three Federal bank supervisory agencies and the National Association of Supervisors of State Banks, urging bank officers and directors to consider the desirability of adopting a program of direct verification of the accounts of depositors and borrowers. Additional useful materials have been prepared by other organizations - for example, the booklet entitled "Your Bank and Armed Robbery" issued by NABAC, and the FBI's booklet on "How Banks Can Help the FBI". Such cooperative educational efforts, suitably brought to the attention of banks and utilized by them, are the best means of dealing with the problem.

As the Committee is aware, the Board of Governors has previously submitted material on this subject under date of May 3, 1963, and September 17, 1963. If agreeable to the Committee, I would like to suggest that this material be included in the record of this hearing.