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Remarks of J. L. Robertson  
Vice Chairman of the Board of Governors  
of the  
Federal Reserve System  
at a Meeting of Member Banks of  
Metropolitan St. Louis and the Boards of Directors  
of the  
Federal Reserve Bank of St. Louis  
and Its  
Little Rock, Louisville and Memphis Branches  
St. Louis, Missouri  
April 10, 1969

## Back to Brandeis

While to the best of my knowledge Chairman Martin has never undertaken to visit, much less speak in, my home town, Broken Bow, Nebraska, it is certainly my pleasure today to be once again in his, and it is a pleasure doubled by the opportunity to pay public tribute to him and to a distinguished career in the city where it began. My remarks, however, will concern another career which has St. Louis roots, namely, Mr. Justice Brandeis, who was admitted to the bar a few hundred yards from this very spot little less than a century ago.

As you know, Louis Brandeis was more than a judge and a lawyer. Both on and off the bench, he was pre-eminently a public philosopher to whom a legal brief, a judicial opinion, and an article for the popular press were equally available modes of safeguarding the public interest by an unflagging insistence on the highest standards of commercial and financial ethics. And it is from his most popular writing on this subject, the basic "OTHER PEOPLE'S MONEY and How the Bankers Use It" that I take my text for today.

It was a work which sent a shock wave through the America of the gaslight era, and in fact was one of the forces which led to the establishment of the Federal Reserve. In one sense, the book now is anachronistic and even antiquarian, for the specific abuses which moved Brandeis to write have long been corrected. In another sense, however, the overall philosophy captured in its title has a continuing, and even a timeless, validity. In fact, it has an extraordinarily apt relevance and application to two distinct but related public questions of today - on one hand, the bank holding company issue and on the other, the problem posed by the current wave of congeneric and conglomerate expansion.

If I may briefly shift my authorities and borrow a phrase from Brandeis' great colleague, Mr. Justice Holmes, these two questions are ones which could stand more emphasis on the obvious and less elaboration of the obscure. Certainly the root issues involved are neither complex nor

difficult, but rather are simplicity itself and turn on the three simple points of prudence, fairness, and experience.

On the issue of prudence, I return to Justice Brandeis and an injunction which he made a chapter title in his book. The injunction was "Serve One Master Only". It is as valid to the banking of 1969 as it was to the banking of 1913, and its validity consists in this - applications for bank credit are to be granted on their merits, not on the influence nor even the possibility of influence of some other considerations.

Its most topical application is on the question of whether the salutary constraints which the Bank Holding Company Act of 1956 lays on inter-organization dealings should be extended to one bank holding companies. On this point there is certainly room for debate, but I must confess my failure to comprehend the relevance of the argument that the great majority of such organizations have comported themselves with honor and integrity in such dealings. That point can be disposed of almost out of hand, for virtually every law on the statute books has resulted not from the conduct of the many but the misbehavior of the few. Hence, any invocation of a general pattern seems to me to miss the point completely.

Rather, what we are talking about here is the reasonable possibility of regrettable consequences which can come to pass when a conflict of interest is present. When this happens, when a banker tries to serve two masters, indeed, when he merely has two masters, there arise invidious implications which cut two ways. More obvious is the possible out-and-out favoritism that may be accorded to the applications of subsidiaries and affiliates or to the customers of either. More subtle, and I think really more corrosive, is the possible negative discrimination - the loans not made, or even the double standard of judgment which may be applied to the competitors of subsidiaries and affiliates. Again, to my mind it is absolutely no answer to either situation to assert that the recipients of such potentially favored treatment, whether positive or

negative, are subject to examination ex post facto or that only a limited percentage of bank assets may be illegally misapplied.

What we are dealing with here, as the very title of the Brandeis book reminds us, is a situation very close to the law of trusts. For both trusts and banking by definition involve other people's money and the analogy common to both comes down to this - a banker should not only resist temptation, but like a trustee, he should not even let himself be led into it. Or to put the matter another way, any evil inherent in allegiance to two masters is not to be punished after the fact, but the very possibility of its commission is to be forbidden at the outset. Hence, as the Board of Governors has repeatedly recommended, there is a powerful case for extending the salutary restraints of the Bank Holding Company Act against self-dealing to their logical conclusion - i.e., to one bank holding companies.

Actually, there seems to be no serious dispute on this issue, and most of the public debate has proceeded on the nature and extent of the constraints rather than the necessity of constraints themselves. Yet this very general recognition is paralleled by a surprising lack of attention on a related front and this concerns my second, and even more basic, point. This is fairness.

To be sure, this issue of fairness has not gone completely undiscussed. To the extent I have been able to follow the matter, however, such public utterances as I have read seemed singularly irrelevant. So let me make a point as emphatically as I can. In addition to the obvious violation of prudence, any alliance of banking and nonbanking enterprise - other than that permitted under the most rare, rigorous, and regulated exceptions - offends the elementary principle of fairness in not one but two particulars. Both derive from a common root, the distinctiveness of banking. For banking is unusual in being a business of highly restricted entry, and it is unique in its monopoly of demand deposits. From these distinctive aspects two inequitable advantages are afforded, actually or potentially, to a

bank-allied business over its independent competitors. The first, as I have mentioned, is the risk of adverse odds, or even the double standard, which the latter may meet in seeking bank credit. The second is the possibility - thanks to the indispensable business need of checking account facilities - of actually having to furnish a competitive adversary with the financial sinews of war by using the deposit services of his banking affiliate.

This point has another application, it seems to me, in an area where, again, much argument has a high degree of irrelevance. This concerns what is - or should be - the business of banking, and this applies whether or not the bank involved is affiliated with a bank holding company operation. Now the proper business of a bank is not an issue to be resolved by analysis of nineteenth century court decisions which were written in a day of virtually unlimited market entry and of distinctions, as yet uncomprehended, between financial and nonfinancial operations. Rather, it is to be answered in a context in which banking has become a business of restricted entry, and one possessing a monopoly of an indispensable resource. The consequence is that the most elementary fairness demands that a bank stick to the business of banking, as the latter twentieth century understands it, with such facilities and powers as are necessary to provide banking services to the public efficiently and economically, and not foray from a protected sanctuary to compete (either directly or via an affiliate) with enterprises which operate in a free-entry environment and which must use banking services.

However, the issue of fairness does not stop here. Bound up in the current debate is the whole vexed question of permitting, via grandfather clauses, the continued existence of certain alliances of banking and nonbanking business. Certainly the invidious double standard and the ongoing special privilege of grandfather clauses seem self-evident. In the holding company context, the special unfairness of a grandfather clause seems particularly manifest, for here we have witnessed the scramble - I am almost tempted to

say copycat stampede - to achieve special status, under the foreknowledge of almost certain Congressional action on one hand, and on the other, the resulting consequence of the arbitrary and completely fortuitous character of any exemptions accorded.

To me, the "fairness" doctrine is perhaps the most basic in law. Its strength is its simplicity, as the child's complaint - "That's not fair!" - tellingly reminds us.

There are some other issues in the holding company arena which are neither simple nor self-evident and which must be mentioned. I have previously addressed myself to them. One is the ominous parallels, obvious to anyone who cares to look, between the corporate pyramiding of the twenties and that of the present time. In mentioning any parallel between the sixties and the twenties, neither I nor any of my colleagues on the Board are to be understood as asserting that the current situation is either a mirror image of what is gone before or that the past will play out its pattern once more, complete as to every minor detail. Yet the past is not without its merit as a guide to the future, and as the St. Louis Post-Dispatch\* has noted, we have had a long history - "predominantly unsatisfactory" of holding company pyramiding of regulated and unregulated enterprise.

We have also had a history, not so long perhaps but certainly unsatisfactory - of the effects of a fragmented jurisdiction and perverse cross-purposing of authority among the federal bank supervisory agencies. I would make only one point here - this unsatisfactory experience did not arise because the several agencies were staffed with inept or evil men. Rather it arose because the very structure of supervision was faulty, and the wonder is that we did not have more trouble. To try to put that structure to rights is a Herculean task, I can testify, and it is a task we cannot accomplish overnight. But what we certainly can do now is to avoid any step, in solving the holding company problem,

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\*Corporate Life among the Pyramids, February 5, 1969.

which would deliberately extend the supervisory muddle to new fields, and particularly to do so at that critical juncture of banking and nonbanking activities where the possibility of divided decisions, competition in laxity, and inequitable distinctions seem so manifestly probable.

Having spoken at length on both points previously, it is unnecessary to do so here. I might, however, close by noting their similarity with a return to the wisdom of Mr. Justice Brandeis and his injunction that experience is the best teacher. This is my final point and it applies to both corporate pyramiding and bank supervision. Both are products of history, and we should learn something from that history. For while I am not saying that the past will repeat in every detail, I do ask you to remember that in those fields as elsewhere, the price of ignoring the lesson of history is to be fated, in some way or other, to repeat it.