"WINDOW DRESSING" IN BANK REPORTS

HEARING

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON GOVERNMENT OPERATIONS HOUSE OF REPRESENTATIVES

EIGHTY-EIGHTH CONGRESS

FIRST SESSION

OCTOBER 2, 1963

Printed for the use of the
Committee on Government Operations

U.S. GOVERNMENT PRINTING OFFICE
24 624 WASHINGTON : 1963

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"WINDOW DRESSING" IN BANK REPORTS

WEDNESDAY, OCTOBER 2, 1963

House of Representatives,
Legal and Monetary Affairs Subcommittee
of the Committee on Government Operations,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:45 a.m. in room 100–B George Washington Inn, Hon. Dante B. Fascell presiding.

Present: Representatives Dante B. Fascell, Richard E. Lankford, Torbert H. Macdonald, John B. Anderson, and Robert McClory.

Also present: M. Joseph Matan, staff administrator; Charles Rothenberg, counsel; and Millicent Y. Myers, clerk.

Mr. Fascell. The subcommittee will come to order.

It is the responsibility of the Legal and Monetary Subcommittee of the House Committee on Government Operations to examine and evaluate the efficiency and economy of the operations of certain executive branch departments and agencies, including those of the Federal bank supervisory agencies.

This hearing will examine the particular operations of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation dealing with the setting of call dates for bank reports.

In our inquiry we will look into the bases on which bank call dates are to be selected, and whether the Federal bank supervisory agencies are applying the same standards and criteria to the statutes involved.

We shall also look into the extent to which window dressing is practiced; whether anyone is thereby deceived; whether the practice lessens the validity and usefulness of condition reports as a supervisory tool, and what, if anything, needs to be done to curb the practice.

I am very pleased to have before the committee this morning, Mr. J. L. Robertson, member of the Board of Governors of the Federal Reserve System, accompanied by Mr. David B. Hexter, Assistant General Counsel and Mr. Gerald M. Conkling, Assistant Director, Division of Bank Operations. If the gentlemen who are accompanying you, Governor, will step up to the table, we will be delighted to have them with you.

I understand you have a prepared statement. If you desire, you may proceed with that. If you want to put it in the record at this point, you may summarize orally, if you like—either way.

STATEMENT OF J. L. ROBERTSON, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY DAVID B. HEXLER, ASSISTANT GENERAL COUNSEL; AND GERALD M. CONKLING, ASSISTANT DIRECTOR, DIVISION OF BANK OPERATIONS

Mr. Robertson. Mr. Chairman, thank you very much.

I think it might be well, since I endeavored to cover the whole subject in this, I think it might be even better if I do it by reading this statement, then answering any questions you might have. I think it would give us a better background for us to work with.

Mr. Fascell. All right. Go ahead.

Mr. Robertson. "Window dressing" is a convenient and colorful expression and undoubtedly will continue to be used to describe the problem that concerns this committee, but we should be aware that it is a misnomer. A merchant dresses his show window to display attractively the merchandise that is for sale in the store. If the window contains Paris gowns and only inferior copies are for sale inside, in time the merchant would lose the public's confidence and its patronage.

What is called window dressing in the case of banks' reports of their condition is also deceptive, I am afraid. However, it is less easily detected than the merchant's pretense, and some banks seem to be satisfied that the practice will attract more business and that the deception will be noted by only a few. But although its ill effects on banks may be less direct than on merchants, eventually it would cause erosion of the banking community's most valuable asset: public esteem and trust.

Window dressing by banks has two aspects. It involves, first, deceptive transactions that have no genuine business purpose, and second, a deceptive balance sheet resulting from those transactions. The main purpose of window dressing is to display to the public a report of condition—in other words, a balance sheet—that presents the bank more favorably than its normal condition warrants.

For those who are interested in the devices employed in window dressing, there is being submitted, attached to my statement, for inclusion in the hearing record, an outline of procedures that have been used. The actual results, however, can be described very briefly. Occasionally a bank uses window dressing to hide the fact that it is in debt, but usually the bank's purpose is simply to look bigger than it is. By various arrangements, a bank with real deposits of $900 million for example can plausibly inform the world that its deposits are more than a billion dollars, and that consequently it is the largest bank in the city or State. Naturally, this distresses its rival with bona fide deposits of $950 million, so the next time it understandably is tempted to window dress, just to present the true relative picture. This is why window dressing tends to spread; in fact, it is surprising to me how many bankers have earned our praise by refusing to climb on the merry-go-round.

The impression apparently has been created, in some quarters, that window dressing relates only to reports of condition that banks publish pursuant to requirements of law—the so-called call reports. If that were true, the problem of minimizing or eliminating window dressing would be relatively simple. But the facts are otherwise, and much harm has been done by intimating that bank supervisors could end the practice simply by suitable call report procedures.

This point is crucial, and I want to explain it as clearly as I can. As long as a bank skirts the criminal false-entry laws, it is free to publish a balance sheet—a report of condition—whenever it wishes, as of any date it selects, and in whatever form and size suits its purpose. Most banks are required by law to publish their balance sheets several times a year in a form and as of a date specified by their governmental supervisors. But these required publications may be compressed into a few square inches in an obscure corner of a newspaper of small circulation, while the bank's voluntary advertisements may be, and often are large and striking displays, as of dates selected by the bank itself, published in journals with immense circulation among the class of readers the bank is most anxious to reach. Does this begin to suggest the fallacy of the contention, recently advanced, that the window-dressing problem can be readily solved by issuing all calls on a surprise basis?

Perhaps I should make clear that a "call" is issued by a bank supervisor to all banks under its supervision, for a report as of a prior date. For example, the Comptroller of the Currency may inform every national bank, on March 5, that it must promptly submit to him, and publish in a local newspaper, a report of its condition—a balance sheet in prescribed form, as I said before—as of March 3. That date having already passed, the bank cannot retroactively juggle its accounts or engage in specious transactions to hide any weaknesses in its actual condition. Unless the bank was able to anticipate the date of the call, this produces an accurate report of its normal condition.

Real understanding of the situation requires knowledge of the origin, the history, and the functions of call reports. The practice of requiring banks to submit reports of their condition to governmental supervisors, and to publish such reports for public scrutiny, began over a century ago. It began against a background of so-called "wildcat" banking of a kind that is difficult for us to envision today. Both internal and external controls were scanty; banking standards were high in some areas but extremely low in others. A bank's condition might vary greatly from month to month, and bank insolvencies were frequent as a result of overextensions of credit, other unsound policies, and runs.

In these circumstances, unexpected calls for reports of condition served two principal purposes. The supervisor received information that enabled him to decide whether any dangerous trends were developing; if they were, he might dispatch an examiner to make a special examination of the bank or to discuss the facts of life with its board of directors.

Equally important was the information available to the banking public in the report of condition published in the local newspapers. In this connection, two facts must be remembered. Fifty or a hundred years ago commercial banks' customers were almost exclusively people of substance, to use a phrase of the time. Wage earners and white-collar workers rarely had accounts. Typical customers were manufacturers, well-to-do farmers, and wholesale and retail merchants. This was long before the days when 49 of every 50 bank depositors were completely covered by deposit insurance. In that era, the majority of bank customers could, and probably did, read reports of condition to decide whether the bank looked safe or whether it might be advisable to shift to a stronger institution. It is important to bear in mind also that in those days the bank statements so published in accordance with law were practically the only statements that were published at all.

In our lifetime the significance of required reports of condition has changed greatly. Today, I venture to assert, only a tiny fraction of bank customers pause to read items headed "Report of Condition of XYZ State Bank * * *" published in accordance with call made by whomever it would be; instead, they relax calmly in the shelter of Federal deposit insurance. Those who are interested in the condition of a bank—such as the treasurers of corporations with millions on deposit—are seldom misled by window dressing. They know it exists and make necessary allowances, checking against the surprise reports, and often they can directly ask banks for the information they want. They are not fooled.

For bank supervisors also, call reports are less important today as instruments of supervision. With extremely rare exceptions, the general condition of a bank does not alter substantially from month to month. Furthermore, supervisors have developed better alternative sources of information. Reports of examiners today are much better than they used to be. During my 30 years of bank supervision, I do not recall a single instance in which a dangerous trend calling for corrective action first came to our attention through a call report.

But reports of condition today serve one important purpose that hardly existed in 1900. In economic analysis and planning and particularly in the formulation of monetary policy, reliable bank statistics are a principal tool. Reports of condition, I venture to say, are the No. 1 source of these statistics for the American banking industry.

For statistical information of this kind, standardization of reporting dates is of great value. In many bank asset and liability categories, seasonal, even intraweekly, variations are astonishingly large. If reports were called for as of December 26 in one year, December 6 in the second, and December 16 in the third, even our own skilled statisticians would not be able to measure, with reasonable accuracy, movements in such basic items as deposits, business loans, and many others. Moreover, since most nonbank statistics to which banking data must be related are end-of-month figures, variable bank reporting dates detract considerably from the suitability of banking data for analyses of this character. Even the accuracy of the actual data reported would be better under fixed-date reporting than under surprise calls. Bankers have repeatedly informed us that it is most difficult to reconstruct an accurate report of condition retroactively for items not regularly covered in their daily trial balances. Because of these difficulties, many banks resort to estimating procedures that are often subject to a troublesome margin of error. With fixed-date reporting at the midyear and yearend, banks could arrange in advance for an accurate tally for each reported item as of the reporting date.

Against this background, I return to the fallacy that might be called the surprise call panacea. Plainly stated, this is the argument that all the benefits of call reports would be retained and perhaps even enhanced and the evils, particularly window dressing, would disappear, if all calls were made on a surprise basis. What I have already said suggests some of the weaknesses of that argument. However, to evaluate it effectively, understanding of the actual call report situation is essential.

Under section 7 of the Federal Deposit Insurance Act, almost all banks in the United States are required to make four reports of condition annually to their Federal supervisors. The date of such balance sheets is the same for all banks. In actual practice, the regular custom has been to call for two of these reports, each year, on unexpected dates, usually in the spring and fall. The remaining two ordinarily are called for on or about June 30 and December 31 of each year. The latter are the principal source of the financial statistical series that I have mentioned. We see, then, that ordinarily there are two surprise calls every year. To the extent that publication of reports of condition called for unexpectedly are of benefit to the public, such benefit is derived from these calls. (However, in the opinion of at least one Federal supervisor, it appears, publication of those surprise call reports is of little benefit to the public. The Comptroller of the Currency has authorized national banks to omit current publication of those reports, requiring publication only as an adjunct to the reports that are customarily called for as of June 30 and December 31.)

The surprise call fallacy amounts to a contention that all benefits of call reports would be retained and all detriments eliminated if June 30 and December 31 were avoided as dates for the remaining two calls. Actually, however, this is far from the case. As I mentioned, a "call" as of December 18 would not prevent banks from window dressing, if they cared to, in preparation for a widely publicized yearend voluntary statement. In other words, even if the supervisors called for a report as of December 18, and in that report—because of its unexpected date—there was little or no window dressing, the report that actually comes to the public's attention, and which is the basis of the semiofficial size rating of the bank, would be a voluntary yearend statement, which would contain just as much or as little window dressing as the bank might wish. From that viewpoint, the only result of the December 18 call would be to impose upon all banks (including the vast majority that do not indulge in window dressing) the work and expense involved in the preparation and publication of two yearend statements instead of one.

Occasional issuance of an end-of-year call as of a date other than the last business day of December has at least one advantage, however. It helps to reveal to supervisors and other interested persons the extent of window dressing. This was demonstrated in 1962. Reports of condition were called for as of Friday, December 28, which, for most banks, was just 1 business day before the end of the year. It can be assumed that since banks are accustomed to December 31 calls, the December 28 figures were not appreciably inflated by window dressing. Most banks, particularly large banks, published not only their call reports as of December 28, 1962, as required by law, but also voluntary reports as of December 31, and the latter were in more eye-catching form.

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Comparison on the figures of these two statements, just 1 business day apart, was instructive. The hundred largest banks in the country, according to a compilation published in the American Banker, furnish a striking example, although similar conditions exist in smaller banks as well. Those hundred banks showed total deposits of $121 billion on December 28, and by the end of December 31, 1 business day later, this had increased to almost $129 billion, a difference of more than 6 percent. Among the hundred, nine banks showed deposit increases, in 1 business day, of more than 10 percent. Individual figures ranged up to a high of 34 percent expansion. It is obvious that most of these increases were due to window dressing. Not all of them; some of them. Consequently, last year's experience provided a good picture of the magnitude of the problem.

Although window dressing sometimes has been attacked for the wrong reasons—mainly the loss of benefits to the supervisors—the undesirability of the practice must not be underestimated. It is not a negligible problem. The aggregate volume of window dressing, I suspect, does not vary so greatly, from year to year, as to distort seriously the bank statistics we need, but I have no doubt that, although allowance may be made for window dressing, the figures on which we depend would be more realistic and reliable if window dressing could be done away with. In addition, there is inequity in a system that enables a bank to pretend to the public that it is the largest in the community or State, when in fact it is not. Personally, I do not believe banks gain or lose much by this "numbers game," but some banks take it very seriously indeed, and that is why window dressing sometimes threatens to get out of hand as banks try to outmaneuver each other. One is reminded of what the Red Queen said in "Through the Looking Glass":

> * * * here, you see, it takes all the running you can do to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that.

Window dressing, then, is an undesirable practice—an untruthful, unfair, wasteful, and misleading device. There is little doubt as to how a good banker would react to a borrower's statement that was inflated to show a more liquid position or a larger volume of business than in fact existed. To the degree these efforts succeed, they result in deceiving the public. And, to the degree they are recognized and discounted, they result in raising doubts as to the reliability of bank statements and of bankers' statements.

I must apologize for quoting from myself here. This is a part of the statement which I made to the Illinois Bankers Association earlier this year.

All bank supervisors, and most banks as well, would like to see the last of window dressing. But the "all surprise call" approach clearly is not the answer. As I have said, it would impose additional burdens on banks, would not materially improve public understanding, and might weaken essential statistics rather than improve them. In fact, an all-surprise program actually would eliminate the only existing penalty for window dressing. At present, a bank that window dresses its yearend report pays a larger deposit insurance premium, and this deterrent to window dressing, for whatever it is worth, would be lost if the required reports, on which the insurance assessment is based, were called for as of December 18, let us say, rather than December 31.

As the committee may know, a number of efforts actually have been made to diminish window dressing. Perhaps the most effective has been moral suasion—efforts to convince bankers that the practice is morally unworthy, that it could be injurious to the prestige of the banking industry—that is, to public confidence in the ethics of banks—and that the game simply is not worth the candle, in the long run.

In my judgment, moral suasion is not only the most promising avenue toward the elimination of window dressing, but also the most desirable. Because of the complicating factors I have described, I am inclined to believe that the problem could not be solved by governmental fiat without an excessive degree of regulation and control.

Actual experience indicates that bankers are prepared to stop this practice "if the other fellow will." Many are convinced that competing in window dressing is an unprofitable tug of war, but each participant hesitates to let go for fear that his opponent will carry off the prize. I believe that if the bank supervisory authorities, acting vigorously and simultaneously, would request banks throughout the country to quit window dressing, the likelihood of success would be excellent. But I emphasize that such an effort would certainly fail unless it was based on complete cooperation and coordination, most careful preparation, and determined face-to-face discussion with the bankers, State or National, in every city where the practice prevails. And after intial success, the supervisors would have to remain alert to chop off any new sproutings of this unhealthy growth.

A supplementary line of approach would be to require call reports to include daily average figures for important items. This might also be helpful from the statistical viewpoint, although it would add to the reporting burdens of banks—including the majority which do not window dress—and it would not, by itself, prevent window dressing in the yearend balance sheet, and that is where it is principally used.

I should like to summarize my ideas on this subject. Window dressing is an undesirable practice. Every reasonable effort should be made to eliminate it. Calling for all reports of condition on surprise dates is not a satisfactory answer. I believe that bank supervisors are in a position to develop a program, based on moral suasion, that will enable American banking to rid itself of this detrimental practice. If that is the answer, or if some other effective answer is found, it will be transmuted from a hope to a reality only through painstaking study of this complex question, with full and frank interchange of ideas and criticisms leading to cooperative action, among bank supervisory agencies and the industry itself. I hope that these conditions will prevail, so that efforts to solve this problem, and the many other problems that confront bank supervisors, can take place under conditions that offer the greatest likelihood of success.

(The attachment follows:)

Devices Employed To "Window Dress" Bank Condition Statements Called for by Supervisory Authorities

1. Roundrobin exchange of interbank deposits among three or more banks which increases both deposits and cash-equivalent assets to make the bank appear larger and more liquid than it normally would. At least three banks must participate, since reciprocal deposits between two banks are required to be reported "net" in official condition reports.

2. Short-term reductions in borrowings, which member banks may offset by larger borrowings on other days of the reserve-computation period to maintain the required level of average reserves. This does not inflate the report's figures, but it does show a debt-free condition in published statements of the borrowing bank, although the payoff of the borrowing may be in the mail on the statement date and the loan account of the lending bank may not be reduced.

3. Arrangements with large depositors to increase their deposits temporarily by drawing drafts against their accounts at other banks. These drafts are credited to the customer's account immediately but are in the process of collection on the statement date and are not charged against the account at the other bank until after the statement date. This transaction may be reversed immediately after the statement date, so that there is no change in the allocaion of the depositors' balances in the long run.

4. Very short-term loans to cooperating customers, the proceeds of which are credited to the customers' accounts on the statement date and repaid immediately afterward. Similar results may be obtained by purchase of bank acceptances or open-market paper from brokers or nonbank dealers or by shifting of loan participations among banks. Payment is credited to the seller's account and the drafts used in payment are in transit on the statement date so that both loan and deposit totals are inflated.

5. Delayed processing of items presented for collection, or of interoffice clearings in a branch system. This is a simple and practically undetectable way of inflating total deposits and liquid assets and can be accomplished by holding back only a relatively few large checks without disturbing normal processing arrangements and without resorting to collusion with other banks or with customers.

INFLATION OF FIGURES IN VOLUNTARY PUBLISHED STATEMENTS BY METHODS THAT ARE NOT PERMITTED IN OFFICIAL CONDITION REPORTS

1. Voluntary statements may include reciprocal interbank balances which are required to be reported "net" in official reports of condition.

2. Voluntary statements may incorporate the assets and liabilities of foreign branches, which must be excluded from official condition reports.

3. Loan and investment totals and capital accounts may include bad debt reserves and other valuation reserves. They are required to be excluded from totals in the official condition reports of most banks.

Now, Mr. Chairman, I would be very glad to try to answer any questions that you or the members of the committee might have.

I have with me not only my lawyer but my statistician and they can provide any help.

Mr. FASCELL. I am going to nominate you the modern man, Mr. Robertson, since you are accompanied by the right people.

Mr. ROBERTSON. That always helps.

Mr. FASCELL. Thank you, Mr. Robertson. Your statement has been very candid, and you are certainly clear enough in your position.

I think as far as moral suasion is concerned, it is always nice to think that everybody is going to police himself, but I am afraid the facts of life are that that usually does not happen; whether it is in the banking industry, in Congress, or some place else. So, it seems to me, although moral suasion is, of course, the primary method, you may need a little help.

Mr. ROBERTSON. May I give you an example, Mr. Chairman, of moral suasion that I think has worked in this field?

Mr. FASCELL. Yes, sir; by all means.

Mr. ROBERTSON. I might just say that over the years, and I have had a lot of experience in this supervisory field, there has never been a time, when determined interest on the part of the various agencies of the Federal Government was focussed on the same problem at the same time. One agency would be interested at one particular period, and the other one could not be bothered.

Mr. FASCELL. Yes, sir. We have that problem up here all the time.

Mr. ROBERTSON. I am sure you do; but a few years ago, just a very few, this window-dressing problem was most active in a given section of the country. The president of the Federal Reserve bank in that district called in all the big bankers, those that were really engaging in this problem; laid it out on the table; established to their satisfaction that it was not in their own best interests—it was certainly not in the public's interest, it was a futile sort of thing to do—and asked them to stop it. They stopped.

Now, the difficulty is, you see, that all agencies don't do this at the same time and the same place. You must work up a coordinated program, where you get all of the agencies pushing in the same direction at the same time. If we can just do that, we can whip this without any difficulty.

Mr. FASCELL. Well, maybe you are right. I am not sure that this committee can put all the supervisory agencies in the same hat and make them do the same thing at the same time. Maybe that is part of the problem.

Just saying that this is the way to do it, really does not accomplish anything, because we are right back where we were.

Mr. ROBERTSON. I think that is right.

Mr. FASCELL. I am not sure that I can get you to do anything or the Comptroller or that you can get him to do anything, or that he can get you to do anything.

Mr. ROBERTSON. This is the answer, though.

Mr. FASCELL. If you gentlemen want to get together and solve this problem, that is fine. We can quit holding hearings and forget the whole thing.

Mr. ROBERTSON. Oh, I am delighted to have the interest of Congress in this matter. I think the more we can point up the differences between agencies, and the need for concentrated, coordinated action, the better off we are. You only get this brought out——

Mr. FASCELL. All bankers are intelligent. All they have to do is quit doing something which they know is not right.

Mr. ROBERTSON. I hope that is right; but you have to focus attention on the problem. That is what this committee is doing, and I am grateful.

Mr. FASCELL. Fine. Maybe we can take this kind of an approach. See what you think of it.

Supposing we were to decide that the size of an institution is a matter for official determination and that an institution could not itself make that determination. It therefore, could not claim that it is larger than others. Would that take away the incentive for window dressing? Is the purpose of window dressing simply to advertise?

Mr. ROBERTSON. My answer is "Yes"; but does one advocate legislation keeping an individual from stating what is a fact?

Mr. FASCELL. Only if it is not a fact, Mr. Robertson. I mean, we have all kinds of agencies that deal with that. The Federal Trade Commission; the Security and Exchange Commission; and I would hope the supervisory agencies for financial institutions.

Mr. ROBERTSON. You see the difficulty with this is that bankers would contend that on December 31 they were the biggest one; that these were deposits in their bank that raised their total, and they were; but you see, the extra deposits were not for a genuine business purpose. They were just put there for show, but they can truthfully say that they did have deposits in their bank of $1 billion on December 31. This is not a false statement. This is a true statement. I don't see how you can have legislation which tells them they cannot do it.

Mr. FASCELL. I was not thinking about legislation.

Mr. ROBERTSON. Or even a regulation of agencies. I don't see how that could be handled, either.

Mr. FASCELL. In other words, what you are saying is that you don't see any value in a regulation which would say that an institution cannot advertise its size.

Mr. ROBERTSON. No; I don't. I would be reluctant to have any regulation which says an individual institution cannot state a truth to the public.

Mr. FASCELL. Would you have a regulation that would say that thev could not state an untruth?

Mr. ROBERTSON. I would; but the trouble is, you see, that there is not an untruth. This is a truth, but it is a deceptive device to make them look bigger than they are normally.

Mr. FASCELL. Well now, let's use your words, "a deceptive device." If it is deceptive, is that wrong?

Mr. ROBERTSON. I think it is wrong. I think it is also not in their own interest.

Mr. FASCELL. Can we regulate the wrong in any way?

Mr. ROBERTSON. That is what I have been trying to devise a way to do; and I don't know a sure way to do it; and I don't know of anyone else who has come up with a sure way. If we can find it, that is wonderful.

Mr. FASCELL. I haven't read all of your list of devices that are used to window dress, but are the five which you identified unlawful by regulation?

Mr. ROBERTSON. No.

Mr. FASCELL. Are they unlawful as a result of an examination?

Mr. ROBERTSON. Not at all.

Mr. FASCELL. Where an examiner finds any one of these conditions is present, does he do anything about it?

Mr. ROBERTSON. No; these are truthful statements which they put out.

Mr. FASCELL. Yes; I know. I understand that they are truthful.

Mr. ROBERTSON. And the particular transactions should be discouraged, but you cannot—in my opinion, there is nothing in the regulations or the rules, that can prevent it.

Mr. FASCELL. The question is, Should they be outlawed? If you cannot outlaw the whole thing, can you outlaw the practices, one by one?

Mr. ROBERTSON. This might be possible to outlaw them one by one, but new ones would develop all the time—of doing this sort of thing.

Mr. FASCELL. That is the reason you have an examiner, though, isn't it?

Mr. ROBERTSON. What is the examiner going to do?

Mr. FASCELL. I don't know. You tell me. You are the expert.

Mr. ROBERTSON. I can tell you exactly what they do, but I cannot tell you just how he would stop this sort of window dressing when the banker contends that this is a true statement of the conditions of his bank and the size of his bank on a certain day.

Mr. FASCELL. Well of course, he could say, "We don't like this particular practice, and we are going to do something about it." What control do you have over an institution now?

Mr. ROBERTSON. If it is a false entry, we can, of course, do something about it. If it is a cooperative arrangement, entered into with another individual or a corporation or several of the banks, which is not by itself a violation of law, a false entry of any kind, this becomes a very difficult problem to deal with.

Mr. FASCELL. Well now, you are saying that this is a bad thing; that it is deceptive; it ought to be stopped; we ought to do it by moral suasion; and that there is no way of identifying it by regulation so that you can stop it.

Mr. ROBERTSON. Oh, no. I am not saying any such thing, I hope.

Mr. FASCELL. Then I misunderstood you. I am sorry.

Mr. ROBERTSON. No. What I am trying to do is to spell out what the problem is; how it arises—and no one in the banking industry has any misunderstanding about this—to get cooperation among the supervisory agencies, applied simultaneously throughout the country; by calling in all the bankers that are engaging in this practice, and we know which ones are doing it; convincing them that this is wrong and not in their best interest, because they are the ones who really suffer from this, rather than the supervisor or the banking public.

What this does is to cast doubts upon the reliability of bank statements themselves, which in my opinion can in the long run, destroy public confidence in banks. That is what ought to be stopped; but you see this is a matter of self-discipline on the part of banks themselves. If the agencies would work with them on this, in this respect, on a coordinated, cooperative basis, it could be done.

Mr. FASCELL. Well, in other words, you say that what should be done is that the supervisory agencies ought to indicate their displeasure at this point?

Mr. ROBERTSON. Absolutely. Absolutely.

Mr. FASCELL. And they are not doing that now.

Mr. ROBERTSON. Not sufficiently, no.

Mr. FASCELL. Therefore, if you put enough heat on the bankers, this would really stop?

Mr. ROBERTSON. The contention has been made that this is not the fault of the banker, this is the fault of the supervisor; with this, I quarrel drastically.

Mr. FASCELL. It seems then, you don't have to have a meeting of the agencies to coordinate anything at all. Each agency just ought to put the heat on.

Mr. ROBERTSON. That would be true, I would say, but I would think that would be more effective if all the agencies put the heat on and endeavored to stop it simultaneously.

Mr. FASCELL. You keep emphasizing "simultaneously." I don't know how we are going to get it—but we will get back to that subject.

Mr. Anderson?

Mr. ANDERSON. On that question, Mr. Chairman, that you just raised, I see that the different agencies do get together do they not, to decide on the date that is to be the date for this?

Mr. ROBERTSON. Yes, they do. This is for the past few years, since the statute was enacted putting the decision in the heads of the three agencies on a majority basis. They now do, you see, set the date.

Mr. ANDERSON. So you can cooperate and coordinate your efforts as far as picking the date. I would think they ought to be able to get together to coordinate a program.

I have one other question. I understand your objection to window dressing—that it may distort the bank's statistics, and so on; but actually, what are some of the evils that flow out of this practice, other than it is not nice, of course, to do things that are unfair to your competitors?

But are there any—can you visualize any situation where any harm comes to the depositors of an institution?

Mr. ROBERTSON. No, no. That is what I was trying to point out. The banking public ordinarily is not injured by this practice.

Mr. ANDERSON. I remember a while back, one of the airlines was advertising nationwide ads, that it had the fastest planes, and so forth; and the other airlines were mad at them because that was not very accurate, I guess, and there was some talk about that. We have a lot of this puffing that goes on in various industries.

Mr. ROBERTSON. That is right.

Mr. ANDERSON. I was just wondering what evil consequences flow from that?

Mr. ROBERTSON. In my view, the evil consequences are the reaction with respect to public confidence, as to the whole banking industry itself. That is really the big issue here. The banking public is not fooled. The sophisticated corporate treasurers do not pay any attention to this. They are not fooled. They get the information. They know what the status is. The supervisors are not fooled either. We know. So that you cannot say that anyone is really put in jeopardy by this at all.

Now, I think the banking industry of America ought to have the highest degree of integrity. I think it will lose prestige because a few people engage in this sort of puffing, simply in order to put themselves up higher on the American Bankers' list of the largest banks in the country.

Mr. ANDERSON. Do you think the practice has grown perceptively in recent years?

Is it getting worse?

Mr. ROBERTSON. Yes, I do.

Mr. ANDERSON. Is it about the same?

Mr. ROBERTSON. I do think it is growing.

There was a time maybe 10 years ago, when I think I could count on the fingers of both hands the banks that were really engaging in this. This is not so today. Now other banks find, "Well, we are not going to be put down when we are really bigger than that other bank. We are not going to be put in second place." You see, so much emphasis has been placed on the size of the institution by virtue of the publication of the list of the top hundred banks; the second hundred banks; and the third hundred banks; and everyone wants to climb up a rung or two on the ladder and they use this as a means of doing it, but this is not in any sense a practice which jeopardizes the safety of the depositor of any bank.

Mr. ANDERSON. That is all I have.

Mr. FASCELL. In my judgment, Mr. Robertson—I am really not quarreling—it seems to me that you are saying that this affects only the banking industry, but we are really talking about the entire public of the United States. I cannot think of any greater damage than to say, "This is bad practice. It is really deceptive. It has a tendency to destroy the confidence in the banking institution." What we are really saying is that we want to recognize this as a practice which we know is deceptive, which is really immoral. As you yourself pointed out, if I go into a bank for a loan, and to inflate my financial statement I borrow $50,000 from some friend, which I have to pay back the next day, that certainly is not moral. Yet a bank can do that, and inflate its yearly statement. I don't see anything right about that. It will take more than moral suasion, in my judgment, to stop the practice. If it does, I think we ought to examine it very critically.

Mr. ROBERTSON. I could not agree with you more. You are just carrying it one step beyond my point. I had it related to the banking industry, but the eventual effect upon the Nation, as a result of a loss of confidence in the banking industry could be great.

Mr. FASCELL. Well more than that: If the bank can do this, why can't I? Why should I be subjected to the criticism of a banker, when I go up with a puffed-up or a window-dressed financial statement, but the banker can do it—and advertise it to hundreds of thousands of people—and nothing happens to him. I don't see it.

Mr. McClory.

Mr. McCLORY. Mr. Robertson, some banks publish their—circulate widely, their statements that are made after the surprise call, don't they, without resorting also to voluntary calls? It seems to me I have seen banking statements which reflect an unusual date and give a great detail of their particular condition.

Mr. ROBERTSON. They have to publish, the call reports—as a matter of fact, all banks have to publish such reports. But voluntary reports—on which these alinements are for ranking among top hundreds of banks—are only the end of the year and midyear reports.

Mr. McCLORY. But there are some banks that only publish the surprise call statements?

Mr. ROBERTSON. Oh, yes. Yes. Many. Especially the smaller institutions.

Mr. McCLORY. Is there any window dressing which banks indulge in, which you feel you, as a supervisory authority, are unable to detect?

Mr. ROBERTSON. Well, I don't think it is possible. I don't think it is possible for any bank to window dress to any significant extent, in a way that supervisory authority, through the examination process, could not detect.

Mr. McCLORY. How would you regard authority in the Federal Reserve Board, or the FDIC, or some other agency, or all of you—authority to comment with regard to the voluntary statements which bear window dressing, with a requirement that the comment be included as a part of any published statement?

Would that be helpful to resolve the difficulty?

Mr. ROBERTSON. At one time we considered requiring a statement to be inserted in the report to the effect that the figures were free from window dressing. However, this idea was dropped because it would apply to all banks rather than the few engaging in the practice and possibly cast doubt on all bank financial statements. Nevertheless, this is one way in which you could do it. This is one possible way.

Mr. McCLORY. Well, the only time for a comment would be a comment where you are aware of a window dressing, and you tell me that you are able to detect window dressing in every case so there would not be any doubt in your mind as to the ability to fairly and accurately comment, would there?

Mr. ROBERTSON. No, I don't think there would. I think the matter of getting the information so quick—you would need it before the publication date—would present a real problem.

I am not sure about that, but this is something that ought to be explored.

Mr. McCLORY. And the presence, or the authority to make this comment, or the threat or recognition that this comment might be included, would tend to discourage window dressing; would it not?

Mr. ROBERTSON. Yes, of course. That was the hope of the surprise calls near the yearend: that that in itself would discourage it, because it would make it so obvious that they were building it up, but that did not have that effect.

Mr. McCLORY. That is all.

Mr. FASCELL. Mr. Macdonald?

Mr. MACDONALD. I have one short question, sir. If it is so basic, it is only because I am not a banker; but in answering Mr. McClory, you said it was impossible, in your judgment, to have any of these window-dressing-type things go on without your being able to detect it; and I am referring to your department. I was wondering what methods you used to make this detection.

Mr. ROBERTSON. Oh, you use—in the first place, you can compare reports, but that isn't the primary way. The primary way is that the examiners go in and check over these items from the bank's own books, at the time of the examination. And, therefore, you could determine what the situation was.

Mr. MACDONALD. Which banks are selected? Is it done at random, or is it an annual thing?

Mr. ROBERTSON. Oh, no. It is not an annual thing. My point was it could be done. You could send examiners in to examine the books and records of a given institution, to see which of these transactions were not genuine business transactions.

Mr. MACDONALD. My question is not what could be done, but what is being done.

Mr. ROBERTSON. What is being done is nothing. Nothing. You see, we are not fooled about this. We have the reports of condition; we know that. We have additional information in the reports of examination. So that we are not laboring under any misapprehension; but when you throw all of these things into the computer for example, in order to get your all-bank statistics, you have to make adjustments, and allowances, and you do; but since no one has been seriously injured, there has been no all-out effort to try to weed out those that are puffed.

Mr. MACDONALD. Is it your opinion—I am not trying to put words in your mouth—is it your opinion that something should be done more than is currently being done in this area?

Mr. ROBERTSON. Yes, sir.

Mr. MACDONALD. But you have made the suggestion earlier——

Mr. ROBERTSON. I would be very glad to tell you what I really think should be done.

Mr. MACDONALD. Right. I would like to hear it.

Mr. ROBERTSON. I think all the Federal bank supervisory agencies, and the State agencies, ought to make a concentrated effort by calling in the bankers engaging in this process, showing to them this is not the thing to do; that it is not worth the candle; that they ought to stop it; and I think they would stop it. The trouble has been that we have not been able to get cooperative action along the same lines, among all the supervisory authorities, and it is going to be difficult to get this sort of thing until you get a single Federal Banking Commission, for example, as I have recommended.

Mr. MACDONALD. That's right; but don't you have a lot of power already in this field? Doesn't the Federal Reserve have power to look at these things?

Mr. ROBERTSON. As I pointed out earlier, we have done this in one area, where this practice really started on a big scale. We called in all the banks that were engaging in this and they have stopped it.

Mr. MACDONALD. Would not just word-of-mouth among—I know it is a fairly tight fraternity—the banking circles; if you would just put out the word that you were about to crack down on this, do you think that would have a salutary effect?

Mr. ROBERTSON. If all the agencies did it; but if we did it for example, as far as the State member banks are concerned, and the Comptroller did not do it in the case of national banks, this would just give the national banks an advantage over the others, or vice versa.

Mr. MACDONALD. You are pointing out the lack of coordination.

Mr. ROBERTSON. That is exact what I am pointing out.

Mr. MACDONALD. Thank you.

Mr. FASCELL. Mr. Matan.

Mr. MATAN. Are there any other reasons why banks window dress than just the prestige reason for self-aggrandizement?

Mr. ROBERTSON. I don't think so, really.

Mr. MATAN. How extensive is window dressing?

Mr. ROBERTSON. Well——

Mr. MATAN. We don't have any figures in the record here. How many banks would you say practice it? Can you give an estimate?

Mr. ROBERTSON. Can you give that?

Mr. CONKLING. I would say the top 200 probably half of them. When you get down below the top 200, a much smaller percentage, except in certain areas. You see it in certain towns, that all the banks in that town are; but it is a small percentage of the small banks.

Mr. MATAN. What areas would they be, sir, where all the banks engage in the practice?

Mr. ROBERTSON. There is no area at all. That is not what you are saying. There is no area in which all the banks practice it.

Mr. CONKLING. Oh, no. No, no.

Mr. ROBERTSON. He was thinking in terms of, I am sure, a small community, say, where there are three banks, and they are all about the same size but one of them gets the idea it wants to puff itself up, and appear to become the biggest. Then the other two engage in it.

Mr. FASCELL. Mr. Robertson, it is a fact that actually has happened, is it not?

Mr. ROBERTSON. That is certainly true.

Mr. FASCELL. That is a fact?

Mr. ROBERTSON. That is true.

Mr. FASCELL. So then his statement is correct.

Mr. ROBERTSON. I was thinking in terms of areas and he was talking in terms of communities.

Mr. FASCELL. Well——

Mr. ROBERTSON. If there is no difference——

Mr. FASCELL. It is a nice game of semantics.

Mr. ROBERTSON. Not intentionally.

Mr. FASCELL. I understand. I think it is clarified for the record. A community is an area.

Mr. ROBERTSON. Absolutely.

Mr. MATAN. Do banks in the large areas, like New York, Los Angeles, and San Francisco, engage in it more than banks in other areas?

Mr. ROBERTSON. The banks in the larger cities engage in it to a much greater extent than the banks in smaller communities. Generally, the banks in smaller communities do not put out a voluntary yearend statement. They just use the regular call report publication; but in the larger cities, in these larger banks especially, this is much more prevalent.

Mr. MATAN. Is it extremely prevalent for instance, in the emerging financial centers like Dallas?

Mr. ROBERTSON. It was in Dallas. It is not today. Dallas is really where this grew up. It started fast, but it stopped. And this was by virtue of moral suasion.

Mr. MACDONALD. How about Boston? It always has a big advertising campaign going on as to who is the biggest bank.

Mr. ROBERTSON. I am sorry, I cannot give you the information about Boston.

Do you know?

Mr. CONKLING. It is not a window-dressing town.

Mr. MACDONALD. Happy to hear that.

Mr. MATAN. Have any cooperative efforts between the Federal supervisory agencies ever been attempted in the field of moral suasion?

Mr. ROBERTSON. Not satisfactorily. There have been times when both agencies, the Comptroller and the Federal, for example, would be of one mind. And this is when we started our Dallas operation. There has never been a time however, when it has been possible in my judgment to whip up interest on both sides of the fence at the same time. But I hope this hearing will serve that purpose.

Mr. MATAN. One more question, sir. The reports of the Federal Reserve System indicate that banks make great efforts to pay off their loans and debts outstanding to the Federal Reserve banks at the yearend, particularly December—the end of December—and then within a couple of days later, they reborrow.

Is that a factor in window dressing?

Mr. ROBERTSON. Yes; it is a factor in window dressing.

This is based upon a longstanding tradition, among banks, that they prefer not to show indebtedness. Banks are very reluctant to show borrowings from the Federal Reserve, for example. This attitude, in my judgment, has no foundation, no meritorious foundation, but it is true, it is a fact, and so they try to get out of debt as of the time of the call report, so it is not shown on the call report. Sometimes they are not successful but sometimes they are.

Mr. FASCELL. Mr. Robertson, do you think we ought to do away with the two surprise calls?

Mr. ROBERTSON. I think it would do no great harm to do away with the two surprise calls. We get most of the information we need from the yearend and the June 30, but there must be supplemental information-gathering facilities. We have these, you see, in the Federal Reserve. We get them, some on a daily, some on a weekly, basis, so that we have constant information. This we could not dispense with.

Mr. FASCELL. I was not talking about reducing the number of calls; just doing away with the surprise calls.

Mr. ROBERTSON. Oh, no; I would keep the spring and the fall for whatever purpose they serve on a date that is not a fixed date. I don't think it makes too much difference one way or the another.

Mr. FASCELL. If it is of no value to the supervisory agencies and it does not fool anybody and it does not particularly help the public, what good is it?

Mr. ROBERTSON. This is just one of those things that stayed in the statutes over the years.

Mr. FASCELL. We have had too much of that in the statutes.

Mr. ROBERTSON. I would not be opposed to dropping those two requirements and giving the supervisory authorities the power to make special calls.

Mr. FASCELL. That is what I was getting at.

In other words, if it is not of value to the public and it is of no value to the supervisory agencies, why continue an archaic practice?

Mr. ROBERTSON. We use some of these figures on the surprise calls for comparative purposes, but not sufficient to warrant a retention of those two calls, if we have the power to make special calls whenever we thought it was necessary.

Mr. FASCELL. One final thing.

We were talking about coordination between supervisory agencies, and I want to be sure that I understood it correctly. You said that we would never get the kind of coordination you envision as being necessary unless we adopted the single banking commission which you advocate.

Is that correct?

Mr. ROBERTSON. I am sorry to say, in my opinion, this is generally true.

Mr. FASCELL. So in other words, you will never get coordination to apply moral suasion to do away with window dressing—in your judgment?

Mr. ROBERTSON. Not necessarily. I think on this particular phase, it may be possible, if the agencies can be made aware that there is an interest in this matter; the matter is brought out to the fore; put into the public limelight.

This, I think, would serve the purpose.

Mr. FASCELL. At least, we ought to try it?

Mr. ROBERTSON. That is right.

Mr. FASCELL. Thank you very much.

Mr. MATAN. One more question

There will be testimony, perhaps by the next witness, that the Comptroller's Office will propose to Congress an amendment to the existing laws, which would provide for calls on the fixed dates of the last business days of the months of June and December, and also for daily-averages-for-a-quarter or random-date reports.

Are you familiar with that bill, sir?

Mr. ROBERTSON. No, I am not.

Mr. MATAN. Has that ever been discussed with you?

Mr. ROBERTSON. No. This is not a new proposition. The bill has not been discussed with me. I never heard of it until this moment, but the idea is not new at all. It has been considered for a very long period. As a matter of fact, the averaging process, we tried to get accepted many, many years ago. We were unsuccessful in getting that idea accepted.

You see, the members of our staff and the members of the Comptroller's staff and the FDIC do have joint meetings, frequently, with the idea of trying to perfect the content of the call report. The call report itself is a result of a compromise, and this is as it should be; but the averaging process can serve a purpose. It is a helpful sort of device. It does not prevent window dressing, if the call is on a surprise date near the end of the year.

Mr. FASCELL. Thank you, sir. We appreciate very much your very fine contribution to the study of this committee. Thank you and those who accompanied you this morning.

Mr. ROBERTSON. Thank you very much.

Mr. FASCELL. Now, we would like to hear from Mr. Watson, Deputy Comptroller of the Currency.

Mr. Watson will you come up and bring those accompanying you to the table.

STATEMENT OF J. T. WATSON, DEPUTY COMPTROLLER OF THE CURRENCY; ACCOMPANIED BY R. COLEMAN EGERTSON, CHIEF NATIONAL BANK EXAMINER; ROBERT BLOOM, CHIEF COUNSEL; AND DR. SHERMAN SHAPIRO, SENIOR ECONOMIST

Mr. WATSON. Mr. Chairman, my name is J. T. Watson. I am a Deputy Comptroller of the Currency. Accompanying me from this Office are Robert Bloom, chief counsel, on my right; R. Coleman Egertson, on my far right, the chief national bank examiner; and Dr. Sherman Shapiro, on my left, the senior economist for the Comptroller.

Mr. Chairman, you have requested elaboration of the Comptroller's statement of July 3, 1963. This letter noted:

> It is the opinion of this Office that the legislative history of the call report laws clearly indicates a design to employ these reports as a supervisory device and on a surprise basis. In practice, however, this design has not been followed. During the past 25 years, calls were made on the last business day of June, 21 times, and on the last business day of December, 24 times. As a consequence, the supervisory purpose of call reports has fallen into disregard. This default from sound bank supervision has brought about the widespread practice of window dressing.

(The complete letter referred to above follows:)

COMPTROLLER OF THE CURRENCY,
U.S. TREASURY,
Washington, D.C., July 3, 1963.

To the Presidents of all National Banks:

As shown in the enclosed request, June 29, 1963, was selected by the majority of the Federal supervisory agencies as the date for the second call report for 1963. This Office would have preferred a date other than June 29.

It is the opinion of this Office that the legislative history of the call report laws clearly indicates a design to employ these reports as a supervisory device and on a surprise basis. In practice, however, this design has not been followed. During the past 25 years, calls were made on the last business day of June, 21 times, and on the last business day of December, 24 times. As a consequence, the supervisory purpose of call reports has fallen into disregard.

This default from sound bank supervision has brought about the widespread practice of window dressing. Although the banking industry generally regards this practice as undesirable, no justifiable criticism can be lodged against the banks for window dressing in view of the failure of the bank supervisory agencies to take the steps necessary to prevent this practice.

The practice of end-of-month calls has been defended by some as a means of providing statistical information on a comparable basis for analytical purposes. We recognize the usefulness of such data for these purposes, but it is our view that the practice of window dressing has impaired the validity of these figures. Although surprise calls do not provide strict comparability of data, this would be less serious from a statistical viewpoint than the consequences of window dressing. Thus, the procedure of surprise calls would serve our supervisory responsibilities more effectively without impairing, and perhaps improving, the statistical worth of the data.

Sincerely,

JAMES J. SAXON,
Comptroller of the Currency.

Going back as far as 1914 there were only six occasions when the call report was made other than on the last business day of June and only two on other than the last business day of December. Because these dates have become standard, banks can prepare for these calls, if they are so inclined. Consequently, window dressing has become widespread. The use of traditional call dates of the bank supervisory agencies aids and abets this practice and, in our opinion, is not in harmony with the intent of Congress.

The legislative history of the 1960 amendment to the Federal Deposit Insurance Act—Public Law 86–671—indicates that it was the intent of the Congress that requests for call reports be made on a surprise basis. The Senate Report No. 1821 of June 30, 1960, and the House Report No. 1827 of June 14, 1960, stated the following under the heading "What the Bill Would Do":

> Also, basing deposit liabilities on surprise call dates will eliminate any tendency which may now exist among banks to resort to window dressing to create artificial assessment deductions for the assessment dates fixed in the statute.

It is further noted on page 47 of the hearings conducted by the House Banking and Currency Committee that Congressman Multer asked Mr. Loeffler, then Controller of the Federal Deposit Insurance Corporation, whether reports had been called for at fixed times. Congressman Multer was assured that they would not be at fixed times but would be surprise calls. I quote Mr. Loeffler:

> No, sir; they are not at fixed times. They are surprise calls. The calls are not announced until after the date as of which they are going to ask for it.

Window dressing is a practice of inflating deposits and resources. Some of the more common devices to window dress a call report are:

Example 1. (1) Bank A deposits x dollars with bank B. (2) Bank B deposits x dollars with bank C. (3) Bank C deposits x dollars with bank A.

Assuming that $1 million was the amount of the so-called deposit in each instance, banks A, B, and C will show an inflated deposit structure in the amount of $1 million.

Example 2. (1) Bank A has a "due to" balance for the account of Bank B. (2) Bank B deposits a portion of this balance, say $500,000 with bank C. (3) Bank C then redeposits $500,000 with bank A.

In this instance bank B derives no benefit, but banks A and C receive a temporary benefit to the extent of $500,000.

Example 3. Bank A draws its own cashier's checks payable to its own order or to the order of bank B. The checks are then sent to bank B for deposit to the credit of bank A. When the cashier's checks are returned to bank A for payment, bank A remits by means of a draft drawn against its account at bank B.

Example 4. A customer is granted a temporary loan with the proceeds being credited to his account. After the call date the transaction is reversed through payment of the loan.

The above transactions are not uncommon just prior to or immediately following the traditional call dates. This practice exists because of the natural desire of bankers to maintain or improve the public conception of their relative size. The banking industry generally regards these practices to be undesirable. But, singly, bankers are in no position to stamp out these practices.

Our first effort to deal with the problem of window dressing was in December 1962. The Comptroller proposed a call date as of December 28. The Federal Reserve and the Federal Deposit Insurance Corporation agreed to this date.

To give the committee an idea of the extent of window dressing over the 1962 yearend, I cite the following figures: Total deposits of all commercial banks which were members of the Federal Reserve System rose 4.7 percent ($10.3 billion) between December 30, 1961, and December 28, 1962, the last call report of each year. Based on reports submitted to the Board of Governors of the Federal Reserve System in connection with their compilation of required reserves, total deposits on December 31, 1962—3 days after the December 1962 call—were 7.6 percent above December 30, 1961. Hence, between December 28, 1962, and December 31, 1962, reported deposits rose by $5.7 billion or 2.6 percent. This increase in deposits in the 3-day period represented 55 percent of the total deposit increase for the year 1962. It thus appears that a very substantial amount of window dressing took place over the yearend. The source for this information was the 100th Annual Report, Comptroller of the Currency, 1962.

In June 1963 the Comptroller in the interest of moving against the practice of window dressing proposed a call date of June 14, which would have been a surprise. He was outvoted and the call was made for June 29, the last business day of the month.

It is understood that the Federal Reserve and the Federal Deposit Insurance Corporation felt the main purpose of the call is the statistical analysis of banking trends. In their view, the undesirability of window dressing was overbalanced by the need for statistical banking information that could be precisely comparable from year to year. We do not dispute the need for comparable statistical information. Even with call dates as of the last business day of June and December, the data are not strictly comparable because of the impossibility of correcting for window dressing.

The Comptroller will propose to the Congress an amendment to the existing law which would provide for fixed dates of June 30 and December 31, or the last business days in these months. The Comptroller's authority with respect to special reports as provided in title 12, United States Code, section 161 will be retained. If the law is amended to provide for fixed call dates we will take steps to preserve the function performed by surprise calls. This could be done by requiring national banks to submit and publish averages of net deposits, loans and investments, or selected data, at random dates during the interim period between call reports. The Advisory Committee on Banking to the Comptroller recommended that an averaging method would discourage any efforts at window dressing as it would be ineffective in the average figures.

We strongly believe that it would be in the public interest that banks be required to publish statements which are reliable. It is the responsibility of the bank supervisory agencies to employ every means to see that this is done.

The call report is a useful tool for bank supervision as it provides the Comptroller's Office with information necessary to assess the effect regulatory policies have upon the lending and investing decisions of national banks. Also, the information contained in these reports is helpful in charting our policy with respect to merger, charter, and branch applications, and the proposing of bank legislation designed to enable the national banking system to respond promptly to the growing and changing needs of our industry, commerce, and Government.

We recently began a series of meetings with representatives of the Federal Reserve System and the Federal Deposit Insurance Corporation to discuss revisions in the call report. We are hopeful that by the June 1964 call a uniform report will be devised which will provide the necessary banking information and eliminate as much as possible the practice of window dressing, while at the same time making the report more informative to the public.

Mr. FASCELL. Thank you, Mr. Watson.

The first thing that strikes me at this point is that I got the impression from Mr. Robertson that, as far as the Reserve Board is concerned, window dressing is a negligible item no matter how distasteful it might be. Yet I gather from your analysis of statistics that the position of the Comptroller is that window dressing is not negligible and that—as you pointed out in your statement—it represented 55 percent of the total deposit increase for the year 1962.

If that is accurate, based on your reports, I would certainly have to concur with you that this is not negligible, but substantial.

Mr. WATSON. We are not trying to state that this $5.7 billion deposit increase is all window dressing but we surmise that a substantial portion of it would be.

Mr. FASCELL. Well, if the 3-day increase accounts for 55 percent of the whole year's increase——

Mr. WATSON. It would appear so.

Mr. FASCELL. I cannot imagine a lot of people depositing a lot of money in the 3 days of the holidays. It is possible, but——

Mr. WATSON. It would appear——

Mr. FASCELL (continuing). But it would seem reasonable to assume otherwise.

I notice you say you are hopeful you are going to get a uniform report. Does that raise a presumption that it now is not a uniform report?

Mr. WATSON. For the third quarter call of this year, we are using a different report form than the Federal Reserve and the FDIC is using. One of the reasons that it was necessary for the Comptroller to amend the call report form was that we issued the Comptroller manual here a few months ago which contained different interpretations and, in addition, permitted the banks to expand their powers particularly in the direct leasing field. As a consequence, we had to provide for that item on the call report.

In addition, the Comptroller felt that the call report would be more informative if the banks were required to publish their valuation reserves.

Mr. FASCELL. In other words, the Comptroller is going on the basis of a different report.

Mr. WATSON. For this particular period, out of necessity.

Mr. FASCELL. Now, Mr. Watson, I notice that you point out in your statement the legislative intent of Congress with respect to surprise calls, and what they hoped it would do. Yet the Comptroller proposes an amendment to do away with surprise calls but to retain an otherwise interim authority to get the effect of a surprise call.

Mr. WATSON. That is right.

Mr. FASCELL. Now, do I understand correctly, that this means that you agree with Mr. Robertson, or the Comptroller, that really there is very little reason for the surprise calls that are now provided?

Mr. WATSON. Yes. We don't feel that there is great reason to continue the surprise call.

Mr. FASCELL. It does not help the public any, and it has no value to the supervisory agencies?

Mr. WATSON. It is a relative value at most.

Mr. FASCELL. Notwithstanding the good intent that Congress had at the time it passed the amendment, the fact is it doesn't work that way and we better do something else?

Mr. WATSON. Yes, sir.

Mr. FASCELL. Why can we not in some way provide by regulation or otherwise that the determination of the size of the financial institution shall be an official one by the supervisory agency?

Mr. WATSON. Well, then, that would pose the problem each supervisory agency presumably would have to go in and make a determination to the extent of the window dressing in each bank and then make an adjustment.

Is that correct?

Mr. FASCELL. I don't know. I don't know whether it would eliminate window dressing or not—or whether window dressing is going to become a daily practice. If the Comptroller of the Currency made the official determination as to the actual size of the financial institution, would that not remove a great deal of the incentive that now exists with respect to what I would call simply puffing practices with dangerous consequences.

Mr. WATSON. Well, that would place a burden upon the Comptroller to ascertain that there was no window dressing in the statements presented to him.

Mr. FASCELL. It seems to me that the Federal supervisory agencies have that burden now. All we are trying to do is to give them a tool which would be effective beyond that which they now have. The Reserve Board—you heard Mr. Robertson—wants to do it with moral suasion, by some kind of a coordinated effort—which he admits is not working—so he is advocating a single banking commission.

Now, the Comptroller wants to amend the law to fix the call dates but retain his interim rights, and use an averaging system in order to stop the practice.

Maybe it will; maybe it won't; but if the incentive for window dressing is simply to establish size for the purpose of advertising, then it seems to me that what we ought to do is to remove the incentive. Either that, or make the practice you described here—which is simply a rotating kiting proposition—illegal. Frankly, I don't see any purpose in the practice except to be completely deceptive. Either we ought to remove the incentive, or by regulation we ought to make the practice illegal.

Is that unreasonable?

Mr. BLOOM. My name is Robert Bloom; Chief Counsel to the Comptroller of the Currency.

Addressing myself to your first question, Mr. Chairman, on the possibility of a statute giving the supervisory agencies the task of assessing the actual size of all of the commercial banks, if I were assigned the task of drafting such a bill, Mr. Chairman, I envisage some formidable problems such as, of course——

Mr. FASCELL. I did not think of drafting a bill, Mr. Bloom. I cannot see why this would have to be put in a Federal statute.

Mr. BLOOM. Then, do I take it, your inquiry is directed to possibly doing this by regulation?

Mr. FASCELL. Or doing it without regulation. I don't care how you do it.

Mr. BLOOM. Well, with the dual system and the different agencies involved, the job of ranking the banks which is now done on an informal basis, I believe, by one of the banking publications, would be a formidable thing and of course, I think it would be an injection into the, well, competitive aspect of the industry and of the advertising aspect, which would be rather unique.

Mr. FASCELL. Well, how about something that said that no financial institution shall advertise its size in relation to other financial institutions, unless that size determination has been made by the supervisory agency.

I mean, that is an example. I don't know that it is good. I have not examined the law on this. I do not know all the problems of the industry, but there is a way to get at it. What about the other one now?

Mr. BLOOM. As I recall your other question goes to possibly outlawing by regulation some of the specific practices which enable the yearend deposit figure to be inflated.

Mr. Fascell. Like phony deposits and phony loans and phony paybacks, because that is what these are in the examples that Mr. Watson has presented to us as typical cases of window dressing.

I don't think that is negligible. I don't think it is the kind of thing you brush under the rug. It is just as phony as anything can be.

Mr. Bloom. I certainly agree that the practice is highly undesirable.

Now, the distinction—drawing the distinction between the completely bad faith situation where there is absolutely no business purpose at all to the deposit—and drawing that distinction, in comparison with the usual flow of funds between banks, might pose some nice questions because of the fact that one would presume that these are banks which do have a continually corresponding relationship—that are doing this; and there is, of course, a normal flow of funds.

Mr. Fascell. In other words, what you are saying, Mr. Bloom, is that it may be tough to find; but the fact is that you fellows find it.

Mr. Bloom. Our examining people tell me that they have full command of the manner in which banks are indulging in this practice, so they do find it.

Mr. Fascell. Yes. In other words, they won't indicate that the motive is fraudulent; but they know it is going on without regard to what the motive is.

Mr. Bloom. That is exactly correct.

Mr. Fascell. I see. Thank you very much.

Mr. Anderson?

Mr. Anderson. I have no questions.

Mr. Fascell. Mr. Macdonald?

Mr. Macdonald. Yes. I am rather confused in your example that you gave sir, on page 3, the banks A, B, and C. It seems to me a bit of an old shell game here, but I could see where someone would engage in that sort of a game. But, why, if it is as general as Mr. Bloom said, a highly competitive business, you see, what is in it for the three banks to work together in this way and still, if they are doing it in coordination, who really benefits? Why would they bother going through this type of operation?

Mr. Watson. Well, first of all——

Mr. Macdonald. If there is true competition.

Mr. Watson. First of all, these banks would probably do it with out-of-city banks. You see they would not do it with their competitor.

For example, a bank on the east coast might do it with a bank on the west coast and a bank in the Midwest.

Mr. Macdonald. We had an exchange before about what an area is and what a community is. I understood that this happens in areas and in communities as well.

Am I correct?

Mr. Watson. Yes, but assuming there are two banks in the same community, bank A will be doing it with a different group of banks than bank B.

You see, there would be no point in two banks in the same community engaging in it because they would both be inflating their resources by the same account. So more than likely they would take the banks which are not in, say, their primary service area or trade area.

Mr. MACDONALD. That brings me to the second and last question. If the auditors and examiners know that this is going on, and we have just been assured that they do know it is going on, why don't they stop it?

Mr. WATSON. Well first of all, it is not considered an illegal practice.

Mr. MACDONALD. Well, we all agree, I thought, that was the one thing everyone in the room agreed to, that it serves no real purpose in building up a bank, and leads only, in the long run, to misleading the public. Therefore, if it is not illegal, it gets mighty close to being illegal.

Mr. WATSON. Another thing, too, if an examiner would stop it in one bank, and there is not a concerted effort for all examiners to stop it, in effect, the examiner who takes a tough position on this matter is really penalizing the bank he is examining.

Mr. MACDONALD. Isn't that the whole point of examiners? That if they are doing something that is not exactly ethical or legal, that that is what the examiner is getting paid for—to correct that situation?

Mr. WATSON. Yes.

Mr. MACDONALD. Well, I don't understand why, even if it is happening in another area, that the examiner is not charged with the duty of handling it. I still don't see that relieves him from the duty of stopping it in the area that he is charged with examining.

Mr. WATSON. Well, I think before an examiner would do that he would probably want direction from his head office.

Mr. MACDONALD. Why doesn't the head office give it to him?

Mr. FASCELL. Because they are waiting on the other head office.

Mr. WATSON. Well, there would be considerable merit, I would think, if the three agencies would attack it.

Mr. MACDONALD. In the meantime why doesn't the agency—your agency for a concrete example—who just said they know this is going on, why don't they stop it?

Mr. WATSON. We feel if we did it on an individual basis, we would be penalizing our national banks.

Mr. MACDONALD. Why? For being illegal? I thought that was the whole point of examiners.

Actually, you are condoning it, are you not, if you don't stop it? I mean, you should not choose up sides because you are examining the national banks. That does not mean that you are on their side, I hope, because the whole point of examination is just the opposite.

How friendly can you get?

Mr. BLOOM. Mr. MacDonald, I will address my self at least to the legal aspect of the question.

Of course, that is the big question—are these practices illegal?

There is serious question and there always has been, or else I am sure that action would have been taken long before now to stop the individual practices which lead to the inflated account.

As to the more general aspect of your question, why have they not done something about it, of course, in recent months, it has been the action of the Comptroller which has brought about, I believe, this whole interest in the problem, in resuscitating the nature of the call.

Mr. MACDONALD. My question is not said in any argumentative way. I am just curious. I am not casting aspersions on anybody. As an outsider, I just don't understand it.

Mr. Bloom. As far as the authority of the examiner, of course, he, in his duty, I am talking about the actual examiner who goes into the bank and renders his report as to the condition of the bank; and this is a problem which would have to be handled on a much larger, much higher level than the examiner and, of course, the problem there has been that it is useless to do it on an individual basis unless it is done across the board. And also, the serious question is just how you would enforce this thing with the present statutory setup that we have.

Mr. Macdonald. My last question is: Don't you think that under the present setup, if you just tell the bank to stop putting themselves in a false position; it is advertising to the general public, which actually misleads the general public, it perhaps doesn't do any definitive harm to the public, unless the bank fails—don't you have authority to stop them from doing something that is not a good, ethical banking practice?

Mr. Bloom. Well, I think the Comptroller has made it very well known, in no uncertain terms, his views toward this practice; and all of the banks, I am sure, are aware of it.

Mr. Macdonald. I know I said that would be my last one; this will be my last one.

Have they done anything about it now that they know he is against this sin?

Mr. Bloom. Well, I have not, of course, at this early date, any way of knowing what the banks' reaction to the Comptroller's statement has been; the real test I suppose, comes in the next year.

Mr. Macdonald. I thought you were going to get away from that. That you thought the yearend practice served no purpose. I thought it was a wonderful brief, in which these people, if they know you are coming in on a certain date, they can always fix it.

Mr. Bloom. Exactly.

Mr. Macdonald. So why wait until the end of the year to find out if you know they will fix it by the end of the year? Why doesn't somebody do it now?

Mr. Bloom. As I said, we would not know whether our efforts had been successful until the yearend.

Mr. Macdonald. Thank you.

Mr. Fascell. Mr. Lankford?

Mr. Lankford. You are talking about the voluntary yearend statements or the call report?

Mr. Bloom. Well, the comparison of both.

Mr. Fascell. Go ahead.

Mr. Lankford. That is all.

Mr. Fascell. OK. Mr. Matan?

Mr. Matan. Mr. Bloom, going back to your statement that examiners know which banks window dress, I wonder if you could develop that a little more?

How do they know that?

Mr. Bloom. Well, this gets in on an area——

Mr. Watson. May I answer that?

Well, by examining the books they can see substantial increases in deposits over the call dates, substantial increases.

Mr. Matan. How can they tell whether those increases are due to bona fide practices, normally engaged in, by banks?

Mr. WATSON. They would have to make an analysis to determine that.

Mr. MATAN. Do they do that, sir?

Mr. WATSON. Not normally, no.

Mr. MATAN. Do they ever do it?

Mr. WATSON. It has been done on occasions, and reported to this office, but it is not a normal practice for the examiner to review all the transactions which might take place several days before and after a call date.

Mr. MATAN. Had examiners ever stopped a bank from window dressing?

Mr. WATSON. I believe there have been occasions when they have stopped them. It would be only in rare instances, I believe.

Mr. MATAN. Has any consideration ever been given to the prosecution of particularly flagrant cases of window dressing?

Mr. WATSON. To my knowledge, there has not.

Mr. MATAN. Mr. Bloom, I think you expressed a statement that it would be difficult to regulate window dressing in interbank transactions.

Would that hold true too, in your example No. 4 where a customer is granted a temporary loan, and deposits the proceeds to his account. As I understand it, in those cases, bank deposits are increased by the amount of the loan and the loan account is also increased by that amount. Where those transactions are entered into solely for call report statements, to be repaid—washed out a day or two later—could those not be regulated against by regulations?

Mr. BLOOM. Insofar as a loan is initiated by the bank, for this purpose, I would think that this is an easier, more vulnerable practice for our regulation.

Mr. MATAN. How were the call dates chosen before the 1960 amendments to the Federal Deposit Insurance Corporation Act?

Mr. WATSON. The Comptroller selected his own call dates but I believe that the other agencies used the same date. I may be wrong on that.

Mr. BLOOM. I am sorry, Mr. Matan, I don't have that answer with me but I could get it for you readily enough.

(After the hearing Mr. Bloom added the following:)

Before 1960, the Comptroller set the call date; he would notify the other agencies beforehand and they would coordinate with the State authorities to issue their call as of the same date.

Mr. MATAN. Your statement shows that, going back as far as 1914, there were only six occasions when call reports in June were made on other than the last day, and in December on only two dates other than the last day. Those report dates would have been selected by the Comptroller of Currency?

Mr. WATSON. For the case of the national banks, yes.

Mr. MATAN. That brings me to asking when it was that the Comptroller's Office first realized something should be done about the window-dressing problem?

Mr. WATSON. Well, I think in the 1950's, the Comptroller had meetings with the Federal Reserve people, relative to the situation that Governor Robertson described.

Mr. MATAN. What resulted, if anything, from those meetings?

Mr. WATSON. I believe Governor Robertson stated the president of the Federal Reserve in Dallas called in some of the Texas bankers, to request them to eliminate window dressing.

Mr. MATAN. What year was that, sir?

Mr. WATSON. I am not certain. I think it was 1955. Either 1954 or 1955, I believe.

Mr. MACDONALD. It was before Billy Sol Estes, I take it?

Mr. WATSON. Yes, sir; a few years before.

Mr. MATAN. Is there anything in the call report law particularly section 7(a)(4) of the Federal Deposit Insurance Corporation Act, as amended in 1960, which apparently would permit window dressing in certain interbanking arrangements?

Mr. WATSON. I believe you are referring to that section of the law where the wording says "may"; is that correct?

Mr. MATAN. That is right, sir.

Mr. WATSON. Well, I think the instructions to national banks covering the call reports, would more or less supersede that section. In other words, these particular instructions, in referring to the reciprocal bank account arrangement, I believe the instructions say, should be netted out, rather than may, as it might indicate in the law; if I can find that.

Mr. MATAN. We won't take up your time with that, Mr. Watson. We will check it out.

Mr. WATSON. All right.

Mr. MATAN. Who is it that the Comptroller's Office believes is deceived by window dressing?

Mr. WATSON. Well, to a large extent, the public. Of course, the bankers are deceiving each other here.

Mr. MATAN. And the supervisory agencies too; are they deceived?

Mr. WATSON. No; I would not say so, because we rely on our examination report to determine the soundness of the bank. We seldom would refer to a call report, as you might say, as a bank supervisory tool.

Our basic instrument in determining the condition of the bank is the report of examination.

Mr. MATAN. Well, do you use it then chiefly for statistical purposes?

Mr. WATSON. Chiefly, yes.

Mr. MATAN. I am thinking for example, of the Comptroller's statement, in which he said the validity of call reports as supervisory tools has been rendered of less value.

Mr. WATSON. Yes.

Mr. MATAN. Of less value.

Mr. WATSON. Well, we feel that it is a supervisory tool, in this respect. It provides the Comptroller with information, as I state in my statement, to assess the effect of regulatory policies; the effect they have on bank lending and investing activities. We also make reference to call report statistics in connection with approving of branches and mergers and charters.

Mr. FASCELL. Mr. McClory?

Mr. MCCLORY. Mr. Watson, I just want to ask one question which I asked Mr. Robertson.

Do you have an opinion as to the efficacy of comment or the requirement or authority to make comments on a statement of conditions, in order to discourage window dressing?

Mr. WATSON. You are speaking now of the certification of the officers of the bank, that there have been no nonpurpose practices engaged in?

Mr. McCLORY. No. No. I am thinking of the authority of the Comptroller of the Currency, for instance, or other Federal agency to be authorized——

Mr. WATSON. To make——

Mr. McCLORY. To make comment with regard to the voluntary or the special call statement.

Mr. WATSON. Well, I believe under the law the Comptroller would have the power to do that now because he has the power to publish any report of the examination which he sees fit to do and if the examiner uncovered the transactions in the report of examination the Comptroller could go ahead and do it.

Mr. McCLORY. What if the authority was expanded to require that such comment, if made by the Comptroller of the Currency, should be included in the published statement of condition?

Mr. WATSON. It would be a burdensome task, I would say, for our examiners to analyze each bank and then make the determination after much discussion with the officers, as to how much window dressing there is in each individual bank.

My personal opinion would be it might be more effective if the officers and directors of the bank signed a certification that there were no nonpurpose transactions in the call, because I think when you sign the statement you do some thinking before you would sign a statement such as that.

Mr. McCLORY. Do you think that would be an effective alternative suggestion to discourage it?

Mr. WATSON. I think it would be easier to handle than to place the burden on us to go in to determine what the window dressing is.

Mr. McCLORY. Thank you.

Mr. WATSON. Because we are having a problem meeting our statutory requirements on bank examinations now.

Mr. FASCELL. Mr. Watson, Mr. McClory has raised a very good point and it ought to be examined one step further.

Might it not be a good idea to require the financial institution, once a determination has been made by the examiner that some window dressing exists, to publish with its financial report a statement that "this statement includes window dressing, a practice which has been determined to be improper and highly undesirable by the financial supervisory agencies"?

Mr. WATSON. I don't think a banker would be inclined to want to put that at the bottom of his statement.

Mr. FASCELL. I don't think he might, either. You know, it might even stop window dressing.

Mr. WATSON. It might.

Mr. MATAN. Going back to the statement of the Comptroller, he refers to the widespread practice of window dressing.

Does your Office have any data on how widespread window dressing is?

Mr. WATSON. We don't have any specific data but we say it is widespread.

Mr. MATAN. The statement also says that most bankers believe the practice is not desirable.

On what do you base that statement?

Mr. WATSON. From discussions with bankers. A banker says, "I would like to cut it out if the banker across the street will do it." He is in the swim with him.

Mr. MATAN. Well, the word "most" is used, and I was wondering to what basis you attribute that.

Mr. WATSON. Well, mainly from discussions with bankers and from the suggestions which were received by the Comptroller's Advisory Committee.

Mr. MATAN. Now, the Comptroller has characterized as the "failure" of the bank supervisory agencies, to take steps to prevent the practice. What steps has the Comptroller's Office taken other than the recent attempts to get calls on surprise dates, and the Comptroller's statement of July 3?

Mr. WATSON. Well, the Comptroller in December proposed a date other than the 31st. That was really the first step taken.

Mr. MATAN. I say other than that, and other than the June proposal of a surprise date, and other than his statement of July 3 to the presidents of all national banks. Has he taken any other steps?

Mr. WATSON. No. Of course, the Comptroller has only been in office——

Mr. MATAN. I don't mean the existing Comptroller. I mean the Office of the Comptroller.

Mr. WATSON. The previous Comptrollers? None, to my knowledge.

Mr. FASCELL. Any further questions?

Well, Mr. Watson, I want to inquire about these meetings that you talked about in your statement.

Mr. WATSON. Yes, sir.

Mr. FASCELL. Is this some kind of an interdepartmental committee on this question?

Mr. WATSON. Yes. Dr. Shapiro, Mr. Egertson, and myself have met with representatives of the Fed, and the FDIC. We just had one meeting to discuss the yearend call report, and we plan a series of meetings to discuss proposed revisions in the call report, and, of course, we will cover this matter of window dressing, to see what steps can be taken to minimize the practice or eliminate it.

Mr. FASCELL. So you have three items under discussion; is that correct?

The question of the report itself.

Mr. WATSON. Yes.

Mr. FASCELL. The date?

Mr. WATSON. Well, as far as our meetings are concerned, and the date, we have to go on the assumption as to what the law provides now—four call dates a year.

Mr. FASCELL. Yes.

Mr. WATSON. The actual selection of the date, of course, is arrived at by discussion between the Comptroller, the Chairman of the Fed, and the FDIC.

Mr. FASCELL. I see. That won't be a purpose of this committee?

Mr. WATSON. No. Our committee does not select the dates.

Mr. FASCELL. Right; and then, you will be discussing the problem of window dressing?

Mr. WATSON. The problem of window dressing, yes.

Mr. FASCELL. Well, Mr. Watson, I certainly appreciate your coming here, with those who have accompanied you. I want to commend and compliment you and the Comptroller for your current interest and continuing interest in this problem of window dressing.

The thought occurred to me that perhaps the thing to do, from the standpoint of the Comptroller, is to just keep right on doing what you think is right. You might stop window dressing, and, all of a sudden the burden will descend upon the other Federal agencies. They will have to be called to account to do that which they ought to be doing, but which they say they are not doing because you are not doing it.

Maybe that is the best thing to do about this thing, after all. Maybe Mr. Robertson is right.

Mr. WATSON. We plan to proceed as best we can to minimize this. We don't know whether we will accomplish that goal or not.

Mr. FASCELL. Thank you very much, gentlemen.

Mr. FASCELL. Gentlemen, now we would like to hear from the representatives of the Federal Deposit Insurance Corporation: Mr. Raymond E. Hengren, Assistance Chief, Division of Research and Statistics; who is accompanied by William D. Allen, Assistant Chief, Division of Examination; Robert H. Cresswell, Chief of the Statistics Section, Division of Research and Statistics; Leslie H. Fisher, Assistant General Counsel, Legal Division; and Harold W. Kefauver, Fiscal Agent.

STATEMENT OF RAYMOND E. HENGREN, ASSISTANT CHIEF, DIVISION OF RESEARCH AND STATISTICS, FEDERAL DEPOSIT INSURANCE CORPORATION; ACCOMPANIED BY WILLIAM D. ALLEN, ASSISTANT CHIEF, DIVISION OF EXAMINATION; ROBERT H. CRESWELL, CHIEF OF THE STATISTICS SECTION, DIVISION OF RESEARCH AND STATISTICS; LESLIE H. FISHER, ASSISTANT GENERAL COUNSEL, LEGAL DIVISION; AND HAROLD W. KEFAUVER, FISCAL AGENT

Mr. HENGREN. Thank you, Mr. Chairman.

By way of preface, it should be noted that in accordance with law, pending the appointment of a successor to Mr. Erle Cocke, Sr., the former Chairman, whose term expired August 4, 1963, Mr. James J. Saxon, the Comptroller of the Currency and a Director of the Federal Deposit Insurance Corporation, has been Acting Chairman. With respect to the subject matter of your hearings, the views of Mr. Saxon are available as Comptroller of the Currency. Owing to these circumstances, the Corporation does not have an official position to present for your consideration. However, this statement has been reviewed and approved by Director Wolcott as an expression of his thoughts on the subject.

The chairman of your subcommittee has voiced an interest generally regarding the operations of the Federal bank supervisory agencies in respect of call dates for bank reports. In a communication dated

September 24, 1963, and addressed to the Chairman of the Corporation, your chairman expressed concern "* * * that making calls on the last business days of June and December is contrary to congressional intent, disregards the supervisory purpose of call reports and results in widespread 'window dressing'."

Two quotations from the pertinent statutes deserve careful attention in considering the aspects of call reports within the range of your present interest. Section 5211 of the Revised Statutes, as amended, includes language as follows:

> Each report shall exhibit in detail and under appropriate heads the resources and liabilities of the association at the close of business on any past day specified by the Comptroller * * * (12 U.S.C. 161).

And in the amendment to the Federal Deposit Insurance Act, approved July 14, 1960, which provides for the use of call report data in calculating the assessments for deposit insurance, these words appear:

> (3) Each insured State nonmember bank (except a district bank) shall make to the Corporation, each insured national bank and each insured district bank shall make to the Comptroller of the Currency, and each insured State member bank shall make to the Federal Reserve bank of which it is a member, four reports of condition annually upon dates which shall be selected by the Chairman of the Board of Directors, the Comptroller of the Currency, and the Chairman of the Board of Governors of the Federal Reserve System, or a majority thereof. The dates selected shall be the same for all insured banks, except that when any of said reporting dates is a nonbusiness day for any bank, the preceding business day shall be its reporting date * * * (12 U.S.C. 1817(a)(3)).

The foregoing provision of the statute does not require prior or advance notice to the banks of the date selected for the call report, nor does it specifically prevent such prior notice. Nevertheless prior notice of the dates fixed for condition reports has not developed as a practice over the long history of this reporting system. Accordingly, it is important to give consideration to the legislative history of the provision. Both Senate Report No. 1821 of June 30, 1960, and House Report No. 1827 of June 14, 1960, set out the following statement under the heading "What the Bill Would Do":

> Also, basing deposit liabilities on "surprise call" dates will eliminate any tendency which may now exist among banks to resort to "window dressing" to create artificial assessment deductions for the assessment dates fixed in the statute.

So by enacting the statutory provision quoted from the 1960 amendment to the Federal Deposit Insurance Act, it seems reasonable to conclude that the Congress intended reports of condition to be continued on "surprise call" dates. Prior notice of such dates would surely facilitate "window dressing." Furthermore, if the Congress had contemplated prior notice to the banks of call report dates, it would have fixed them in the statute.

In recent years, the call dates for reports of condition have in fact varied considerably. Thus, since 1960, 4 of the 10 call dates have prescribed reporting for the last business day of June or December; whereas various other dates have been set for the remaining 6 calls. Moreover, the call for a report is always made on a day subsequent to the specified report date and it seems reasonable to believe that every one of these call dates was in the nature of a surprise to respondents. Notwithstanding the variety of report dates, comment in the financial community has persisted that "window dressing" is prevalent, at least in certain geographical areas.

The Corporation administers reporting in response to calls by upward of 7,300 State banks, not members of the Federal Reserve System, whose assets account for about 25 percent of the total assets held by approximately 13,000 insured banks. With relatively few exceptions, the banks reporting directly to the Corporation are small commercial institutions. For obvious reasons, small commercial banks are not likely to engage in "window dressing."

The bank examination process furnishes a means for detecting a report of condition that presents an unrealistic picture of an individual bank. All federally insured banks are examined by a Federal bank examining authority—the Comptroller of the Currency examines all national banks, the respective Federal Reserve banks examine their State-chartered members of the Federal Reserve System, and the Federal Deposit Insurance Corporation examines all insured State-chartered banks not members of the Federal Reserve System. Under standard procedures, bank examiners are required to satisfy themselves that the data in the accounting records are properly reflected in the report of condition. With respect to call reports, bank examinations could be expected to reveal any departures from proper accounting or acceptable banking practices which overstate bank size or conceal adverse features.

The amendments to the Federal Deposit Insurance Act in 1960 would seem to discourage the "overstatement" of deposit liabilities by insured banks on their reports of condition. In accordance with the provisions of the statute, the data presented on these reports furnish the basis for calculating the amount of deposit insurance assessment for each bank. If the total amount of deposits is increased in some manner unrelated to the ordinary course of business—presumably for competitive reasons—one immediate result will be an increase in the amount of the assessment.

As matters now stand, Federal agencies charged with the supervision of banks have wide latitude under existing statutes so that full advantage may be taken of the surprise element in fixing dates for the reports of condition. In addition, these agencies have bank examiners who are trained to discover, among other things, departures from sound banking practices and accounting procedures. Accordingly, it would seem that the means are at hand for detecting reports of condition that do not reflect the true condition of individual banks. To be sure, that would require close coordination in the processing of condition reports as they are filed and bank examination work in the field. Though the task may be difficult, the bank examining authorities now have adequate power to cope with window-dressing situations.

In conclusion, Director Wolcott has expressed the thought that to obtain the most reliable information, minimize the possibility of distortions, and at the same time fully comply with the intent of Congress, call dates should be surprise dates. Furthermore, the so-called conventional dates should be utilized infrequently.

Mr. Fascell. Thank you, sir.

Mr. Macdonald?

Mr. Macdonald. I just have one question. I don't know if you can answer it, sir. As you spell out the number of examiners for the various agencies, I was wondering if you had any idea how many examiners there are, examining the various types of banks in the United States?

Mr. HENGREN. Well, now, for our own staff, Mr. Allen can give you an approximate figure.

Mr. ALLEN. We have approximately 900 men on the examining staff. A number of them are in a supervisory capacity, but I would say that there would be approximately 800 of them in the field, regularly examining the banks.

Mr. MACDONALD. Roughly, how many banks?

Mr. ALLEN. 7,300 approximately.

Mr. MACDONALD. 7,300?

Mr. ALLEN. Yes, sir.

Mr. MACDONALD. If the chairman would not mind—the gentleman who testified before—I was wondering how many you have, sir?

Mr. WATSON. We have approximately 1,200 fieldmen; that is, personnel engaged in the actual examination of banks.

Mr. MACDONALD. How many banks do you have?

Mr. WATSON. We have about 4,500 banks, sir.

Mr. MACDONALD. How about the Federal Reserve. Do you have any idea of how many they have?

Mr. HENGREN. No; I would not. There would be a staff in each one of the Federal Reserve banks. Perhaps Mr. Watson would have a better idea of staff size, or Mr. Allen.

Mr. ALLEN. There are approximately 1,500 banks that they would be examining.

Mr. HENGREN. But the staff?

Mr. ALLEN. I don't know about the staff. It would vary.

Mr. FASCELL. We will supply that for you, Mr. Macdonald.

We will have our staff get it and put it in the record at this point.

Mr. MACDONALD. Thank you. I think it might have some bearing on the conclusions which you draw.

(The numbers of examiners employed by the bank supervisory agencies at present were stated by the agencies to be as follows:)

Agency	*Examiners*
Comptroller of the Currency (for commercial banks)	997
Federal Reserve System	500
Federal Deposit Insurance Corporation	800

Mr. FASCELL. Mr. Anderson?

Mr. ANDERSON. Is it a fair assessment of your statement that, really, this problem of window dressing that we have been discussing this morning is not much of a problem, as far as the banks that report directly to, are examined or supervised by the FDIC?

Is this largely a problem of the larger banks that would be under the examining authority and reporting jurisdiction of either the Comptroller of the Currency or the Board of Governors of the Federal Reserve System?

Is that a fair import of your statement?

Mr. HENGREN. I think that would be correct.

My conversations with Director Wolcott suggest that he feels that the Congress intended surprise calls and that an effort is being made to use surprise in making calls and that, furthermore, our examiners in the field are endeavoring to review each condition report as a regular part of the examination process and to satisfy themselves that the individual report fully reflects the condition of the bank. If it did not, there is machinery for carrying that information back to the corporation.

That is substantially what we are doing about window dressing.

Director Wolcott feels we are doing something very definite bearing on the subject right now.

Mr. ANDERSON. But there is a little difference of opinion, as I understand it, between this witness and the previous witness, on the general usefulness and applicacy of these surprise call dates.

Do you feel that surprise dates are useful in preventing this practice?

Mr. HENGREN. From my discussions with Director Wolcott, he feels, I think it is fair to say, that the intent of Congress was to insure that the calls would have a surprise element; that surprise is helpful to some extent, but how much is not too easy to measure.

Mr. ANDERSON. Just one last question.

How come the Comptroller gets outvoted? Two out of three seem to agree on this. I am curious as to why he lost out in that election.

Mr. HENGREN. There is a fact that should be mentioned; namely, that Mr. Wolcott is now the Director and there have been some changes over the years.

Mr. ANDERSON. I see. I see.

Mr. LANKFORD. No questions.

Mr. FASCELL. Mr. McClory?

Mr. MCCLORY. The point I have been trying to explore here, is the validity of comments with regard to the bank statements.

I notice in the reports of CPA's and audit reports, that if there is anything which is irregular or does not coincide with recognized accounting principles, that there is a comment which is made by the auditor or the CPA, and I am just wondering whether you feel that there is any validity to the requirement or authority which would authorize or require such a comment where there is window dressing.

Mr. HENGREN. To clarify your question, as I understand it, you would contemplate something comparable to the auditor's certificate which would appear as part of the financial statement.

Mr. MCCLORY. Yes.

Mr. HENGREN. This is not a proposal that I have heard Director Wolcott comment about. I shall be very happy to bring this back to the Corporation if you so desire.

Perhaps you would like to have a letter returned to the committee, with his expression of views.

Mr. MCCLORY. I would appreciate that.

Mr. FASCELL. All right, Mr. McClory. Mr. Hengren, we would appreciate very much getting a letter of opinion on the proposal made by Mr. McClory.

Mr. HENGREN. Yes, sir. You shall.

Mr. FASCELL. And submit it to us at your earliest convenience for the record.

Mr. HENGREN. We shall.

(The letter is as follows:)

FEDERAL DEPOSIT INSURANCE CORPORATION,
Washington, October 16, 1963.

Hon. DANTE B. FASCELL,
Chairman, Legal and Monetary Affairs Subcommittee of the House Committee on Government Operations, House of Representatives, Washington, D.C.

DEAR CONGRESSMAN FASCELL: In the course of a hearing with respect to the setting of call dates for bank reports, conducted by your subcommittee on Wednesday, October 2, 1963, Mr. Raymond E. Hengren of the Federal Deposit

Insurance Corporation agreed to obtain an expression of my views on a question posed by Congressman McClory. The question was concerned with the desirability of requiring the publication of a statement as a part of the condition report that no element of window dressing was reflected in the document. Although the proposal was not spelled out in detail, it would seem that the suggestion contemplates substantially the equivalent of the auditors' certificate normally accompanying financial statements prepared by a certified public accountant.

Users of financial statements attach great importance to the audit certificate and study it carefully for guidance in the interpretation of the figures. As in the case of the conventional audit certificate, however, to have any real significance the certificate accompanying the report of condition would need the signature of some person whose competence was established in the financial community, who stands in an independent relationship with a reporting bank, and who has thoroughly examined the reports and the supporting books of account. In the absence of these safeguards, a certificate actually could do more harm than good by engendering a false security in the minds of the readers.

Thus, it is apparent that a certificate such as the one proposed for the condition report would require a rather thorough audit of the relevant accounting information. To be sure, the Federal Deposit Insurance Corporation has always encouraged the insured banks to follow a sound audit program. Nevertheless, there has been no attempt to impose auditing by certified public accountants on all insured banks. Such a program, in my opinion, would be unduly burdensome.

The banks examined regularly by the Corporation are with few exceptions small institutions, and window dressing is rarely encountered in this size group. Any evil that results from window dressing as part of competitive rivalry between two small banks may easily be controlled through the effort of our examiners, and that is precisely what we are doing now.

Based upon my observations over the years, I am persuaded that the window dressing problem tends to localize in a few areas where banking rivalry is intense and among a handful of large banks. The Federal Deposit Insurance Corporation stands ready to cooperate with the other Federal and State supervisory authorities in any endeavor to correct window dressing, and, in my opinion, well-timed cooperative efforts would be effective.

Sincerely yours,

JESSE P. WOLCOTT, *Director*.

Mr. FASCELL. Mr. Matan?

Mr. MATAN. Do your examiners actually examine the call reports for window dressing?

Mr. HENGREN. The best way to answer the question would be to ask Mr. Allen, who has been an examiner in the field, and who now supervises the work of the examiners, to explain just what examiners do when they are in the bank and what they are expected to do.

Mr. ALLEN. The examiners review each call report prepared and made between examination dates. They check them back against the records of the bank to determine that the reporting is accurate and agrees with bank records.

Now, in cases where they find that deposits have expanded considerably on the particular call date and prior to that time have been less than that and have run off rather rapidly afterward, it is their responsibility to check further into the matter.

Generally speaking, however, it would be an aggravated case of obvious window dressing before the examiner would make a real issue of it. He might discuss with the executive officer the possibility that there was window dressing involved and suggest that such would not be in the best interest of that bank, because if they were doing it this time, to try to boost their figures over what last year's, or the last call reports were, that condition would continue to haunt them. On each subsequent call date, they would be faced with it. Usually, through discussion with them, the banker will be persuaded to recognize that window dressing is not in the best interests of the bank or of the public, so that it will be discounted and discontinued.

As Governor Robertson has pointed out, the question of what is legitimate entry and what is window dressing is difficult at times to determine. The motive behind it seems to be the important thing. There will be legitimate reasons why banks make deposits in other banks, maybe around the call date, but if the deposit is primarily for the purpose of window dressing it can be recognized. But, at times, it is a question that the banker will defend.

Mr. MATAN. Do you have any idea how often banks have been criticized by your examiners for window dressing, say, in a particular examination period?

Mr. ALLEN. We have no such statistics. If you will permit me to give my personal experience there have been very few occasions, when I examined banks, that I found any evidence of window dressing.

The smaller banks have not as much to gain from being among the first hundred in the country, and the prestige and the advertising which they can point to is not as strong.

Now, small banks may want to get ahead of their neighbor across the street, their competitor in the banking business, and, at times, they may encourage their depositors to bring in funds at a call period. It is rather difficult in such cases to determine true window dressing.

Mr. MATAN. Is there any instance where a bank examiner attempted to dissuade a bank from further window dressing and the banker refused; are there any sanctions or administrative action which your agency can impose on that bank?

Mr. ALLEN. The banks we examine are supervised by the State authorities. We would endeavor to work through the State authority to try to get the practice corrected.

Mr. MACDONALD. You can lift their policy, can you not?

Mr. ALLEN. Their insurance coverage?

Mr. MACDONALD. Yes.

Mr. ALLEN. The Congress gave that recourse to the Corporation, to be used rather sparingly, as we understand it.

Mr. MACDONALD. But you have it?

Mr. ALLEN. We have it.

Mr. FISHER. The question would be whether it reached the point that that Board felt it constituted an unsafe and an unsound practice. If they made such a finding, then the bank would normally be given 120 days in which to correct it. If they did not do so, there would be a hearing, and they might eventually lose their insured status.

Mr. MACDONALD. I just want to ask one question.

The one light motif that goes through everybody's testimony is that everybody knows that everybody is doing this thing. It is a bad thing, but it is not really a very bad thing.

Mr. FISHER. We do not believe that it is prevalent in the banks that report directly to us, in any major degree at all.

Mr. MACDONALD. The examiner just said an effort is usually made in the community to have one of these small banks be larger—the largest in the community.

Mr. FISHER. I don't think he meant to say that it was a general practice.

Mr. MACDONALD. After the call period, to bring in funds so that it will look as if it is the largest bank in the community.

Mr. ALLEN. On occasion, banks will solicit their customers to get deposits for a particular period. I would not say that practice is very prevalent. It is quite isolated.

Mr. LANKFORD. What this boils down to then is that in your opinion the window dressing is carried on only by the bigger banks, is that correct? The banks of national reputation?

Mr. ALLEN. I would say that the advantages of window dressing rested with the larger banks, and the means by which they could accomplish it are more readily available.

Mr. FASCELL. Any further questions?

Mr. MATAN. Just one.

Has your Corporation ever found unsafe conditions and cracked down on the banks because of window dressing?

Mr. FISHER. Well, I am familiar with the last 47 cases where they have cracked down and I would say that each of them involved a number of things. I don't recall this being the real motivation for a section 8(a) case.

Mr. FASCELL. Let me ask you a question.

Supposing a bank in a small community, one of the types of banks regulated by the FDIC, were to advertise in one way or another that it was the soundest institution in that particular area of three or four, when in realitv on examination it was not—it was the shakiest.

Would this be considered an unsafe and unsound practice, or would this be considered a nonacceptable banking practice, or what would it be considered?

Mr. FISHER. Would that be illegal?

Mr. FASCELL. Do you mean it is illegal, or it is puffing?

Mr. FISHER. Well, it would seem to me that would be a little beyond puffing, to say that it is the soundest, when in fact, we know that it is the shakiest.

Mr. FASCELL. Is there any difference between that and saying that you are the largest, when you know very well that you are not? If the idea of size means anything any more to anybody who is going to deposit money—I don't know whether it does or not.

Mr. FISHER. In most of our banks, I do not believe the depositors in the smaller communities pay too much attention to the statements. I think in the last 30 years, they have come to rely pretty much on deposit insurance. Most of them have less than $10,000 in the bank.

Mr. FASCELL. Then it simply boils down to a question as to whether or not the managers of a financial institution ought to get away with it or think they ought to get away with it as an acceptable practice.

Mr. FISHER. I am handicapped somewhat because of our position here today.

Mr. FASCELL. You can make it personal if you like, and the record will reflect it.

Mr. FISHER. Well——

Mr. MACDONALD. Mr. Wolcott will read it.

Mr. FISHER. I am sure he will.

I was going to say that what is, and what is not, an unsound practice under a given set of circumstances is a matter that the Board has never delegated. The Board makes the determination each time.

Mr. FASCELL. Based on an examination of the examiner's report?

Mr. FISHER. Based upon the reports of examination, and irregularity reports, if any, and on a memorandum prepared in the Division of Examination which is passed through the Legal Division for recommendations. The Board goes into all these pretty carefully themselves because such a proceeding is a very drastic remedy, and once you start it, the effect may be to put a bank out of business. It is something that is not delegated to the staff.

Mr. FASCELL. Thank you very much, gentlemen.

We appreciate your coming down and appearing before the subcommittee and giving us the benefit of your views.

The meeting will adjourn.

(Whereupon, at 12:10 p.m., the meeting was adjourned.)