Union Calendar No. 392

88th Congress, 1st Session - - - - - House Report No. 920

"WINDOW DRESSING" IN BANK REPORTS

SIXTEENTH REPORT

BY THE

COMMITTEE ON GOVERNMENT OPERATIONS

NOVEMBER 22, 1963.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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LETTER OF TRANSMITTAL

House of Representatives,
Washington, D.C., November 22, 1963.

Hon. John W. McCormack,
Speaker of the House of Representatives,
Washington, D.C.

Dear Mr. Speaker: By direction of the Committee on Government Operations, I submit herewith the committee's sixteenth report to the 88th Congress. The committee's report is based on a study made by its Legal and Monetary Affairs Subcommittee.

William L. Dawson, *Chairman.*

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88TH CONGRESS *1st Session* } HOUSE OF REPRESENTATIVES { REPORT No. 920

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MR. DAWSON, from the Committee on Government Operations, submitted the following

SIXTEENTH REPORT

BASED ON A STUDY BY THE LEGAL AND MONETARY AFFAIRS SUBCOMMITTEE

On November 20, 1963, the Committee on Government Operations had before it for consideration a report entitled " 'Window Dressing' in Bank Reports." Upon motion made and seconded, the report was approved and adopted as the report of the full committee. The chairman was directed to transmit a copy to the Speaker of the House.

INTRODUCTION

All banks whose deposits are federally insured are required to make reports of their condition four times a year to the Federal banking agency under whose supervision they operate. Thus, each insured State bank which is not a member of the Federal Reserve System reports to the Federal Deposit Insurance Corporation; each State bank which is a member of the Federal Reserve System reports to the Federal Reserve bank of which it is a member, and each national bank and each insured District of Columbia bank reports to the Comptroller of the Currency.

The reports disclose the conditions of banks as of dates selected jointly by the Chairman of the Board of Directors of the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Chairman of the Board of Governors of the Federal Reserve System, or a majority of them. By law, two of the dates selected must be within the January through June period, and the other two between July and December.

On July 3, 1963, the Federal bank supervisory agencies announced a call for reports of bank conditions as of June 29, 1963 (a Saturday, and the last business day in June).

The Comptroller of the Currency, in a letter dated July 3, 1963, to the presidents of all national banks, stated that his office would have preferred a date other than June 29; that the legislative history of the call report laws clearly indicates a design to employ such reports as a supervisory device and on a surprise basis, but that in practice that design had not been followed; that the supervisory purpose of call reports has fallen into disregard, and that this default from sound bank supervision has brought about the wide spread practice of "window dressing,"

A principal responsibility of the Legal and Monetary Affairs Subcommittee is the examination into, and the evaluation of, the economy and efficiency of the operations of the Federal bank supervisory agencies. The Comptroller's statement amounted to a charge that these agencies had failed to fulfill their supervisory responsibilities. and the subcommittee undertook an inquiry into the matter.

On October 2, 1963, the subcommittee heard the testimony of Mr. J. L. Robertson, member of the Board of Governors of the Federal Reserve System; Mr. Justin T. Watson, Deputy Comptroller of the Currency, and Mr. Raymond E. Hengren, Assistant Chief, Division of Research and Statistics of the Federal Deposit Insurance Corporation, and members of the staffs of those agencies.

FINDINGS AND CONCLUSIONS

1. Call reports stating the conditions of banks supervised by agencies of the Federal Government originated with the National Currency Act of 1863, and since 1869 have been required to be stated as of some past date specified by the supervising agency, so as to reflect the actual running conditions of the banks.

2. "Window dressing," as applied to a bank's reports of condition, is the use of temporary non-business-purpose transactions to enable a bank to state a more favorable financial showing on a particular date than would normally be the case.

3. There are no valid statistics on the extent of "window dressing." It is generally known to supervisory agencies to exist in about one-half of the 200 largest banks, with decreasing percentages of prevalence among the smaller banks.

4. Almost the sole reason for window dressing by banks is their desire to appear, and to be rated, larger than they really are.

5. Banks which engage in the practice often give but limited publication to the call reports required by law, but widely publicize voluntary statements in which their reported condition is inflated through window dressing.

6. Window dressing is a deceptive, uneconomical practice which has a tendency to undermine public confidence in the banking industry, with possible resultant adverse consequences to the economy of the Nation.

7. The banking industry as a whole regards window dressing as an undesirable practice which should be stopped; however, individual banks which window dress would be reluctant to stop the practice unless all were required to do so.

8. The supervisory agencies claim to have the means, through their examination staffs, of detecting, or even coping with window dressing; however, utilization of their staffs for that purpose is curtailed because of the difficulty of objectively distinguishing normal trans-

actions from nonpurpose transactions, and lack of an adequate number of examiners.

9. Window dressing in bank reports is not illegal under Federal law, nor have the supervisory agencies issued any rules or regulations forbidding or limiting its practice.

10. The wider use of surprise dates for calls rather than traditional month-end or year-end dates would aid in reducing window dressing in call reports; however, it would not stop the practice in call reports, and would have no effect on the voluntary bank statements.

11. Efforts to effectively eliminate window dressing must run not only to call reports but to the voluntary statements as well.

12. Although the problem of window dressing is common to all, the supervisory agencies have not made any coordinated, concerted, overall effort to deal with it.

RECOMMENDATIONS

In order to eliminate the practice of "window dressing" and at the same time to preserve the statistical and supervisory value of call reports, it is recommended:

1. That the Federal bank supervisory agencies make a coordinated concerted, continued use of their powers of moral suasion to have the banking community refrain and desist from the use of nonpurpose transactions and from window dressing of bank reports and statements.

2. That the Federal bank supervisory agencies adopt uniform rules or regulations under which, commencing with the second call date in 1964:

(*a*) Every bank shall be required (1) to include in every required and voluntary report and statement of condition a certification that no window dressing is contained therein, and (2) to file with its Federal supervisory agency as many copies of such reports and statements as such agency shall require.

(*b*) Any supervisory agency which finds through bank examination or otherwise that contrary to such certification a bank has engaged in window dressing shall give public notice of its findings by publication of the name of the bank, the extent of the window dressing and other details thereof in the Federal Register and by press release; and shall refer the matter to the Attorney General for possible prosecution under the false statements statutes.

BACKGROUND

The practice of requiring banks to submit reports of their condition to governmental supervisors, and to publish such reports, began more than a century ago. The origin and early function of such reports was thus described by Governor Robertson:

> 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 there 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.

WINDOW DRESSING

The deceptive device

"Window dressing," as the term applies to a bank, is the practice of entering into temporary non-business-purpose transactions solely for balance sheet (statement of condition) enhancement. The practice has two main purposes: To qualify the bank for an upper listing in bank-size statistics, and to display to the public a balance sheet that presents the bank more favorably than its normal condition warrants. This it achieves, in brief, by temporarily adding deposits and temporarily repaying loans just before a call date or a month- or year-end statement, the transactions having no geniune business purpose and being "washed out" right after issuance of the statement for which they were fabricated.

Examples of typical arrangements and devices employed in window dressing where related at the subcommittee hearings and are appended hereto. The following example is illustrative of the kinds of deceptive techniques used by some banks to formulate the entries in their condition reports:

(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. (See app. 1, par. a.)

This roundrobin exchange of interbank deposits makes a bank appear larger and more liquid than it normally is, although the entire exchange is nothing more than an outright sham, no-business-purpose arrangement.

"Window dressing," in the words of Governor Robertson, is "an undesirable practice—an untruthful, unfair, wasteful, and misleading device." However, so long as the banks which resort to the device steer clear of the false-entry statutes they commit no offense under existing Federal criminal laws. No crime is committed where the window-dressing transactions—regardless of how contrived or how fully without business purposes—actually took place, and were exactly entered by the bank.

A persistent problem

The problem of window dressing in bank reports is an old one. In fact the first effort to deal with it on a national level, through legislation, occurred in 1869, just 6 years after passage of the National Currency Act, and when some 1,500 national banks were in operation. At that time not only the number of reports then required by section 34 of the National Banking Act was changed to five per year, but the provision was added that the reports were to be as of the close of business of "any past day" specified by the Comptroller of the Currency. In explanation of the reason for such retroactivity of reporting, Senator Sherman stated that under then-existing laws the reports—

> * * * are required to be made at periodical times, and the banks are generally doctored up or prepared for these reports, so that now a contraction occurs just before the reports are made, and after that an expansion, creating a palpable and visible fluctuation of the currency at these times. This amendment requires five reports during the year, and authorizes the Comptroller to call for them at a day past, so that they will not be prepared to doctor up their reports. * * * (Congressional Globe, Feb. 23, 1869, p. 1482).

To the same effect, Senator Cattell stated:

> * * * As the law at present stands the banks are required to make four quarterly statements upon given days in the year. They are advertised of the time when these statements are to be made, and consequently can make their arrangements so as to make favorable statements and not give the actual running condition of the banks (Congressional Globe, Feb. 26, 1869, p. 1643).

Now almost a century later, the mischief persists. In fact, it is spreading. Ten years ago, according to the testimony, the number of banks practicing window dressing could be counted on the fingers of both hands of a bank supervisor; today, probably half of the top 200 banks in the country do it, with smaller percentages among those below the top 200. Banks in larger cities engage in it to a greater extent than those in small communities. However, even among the small banks, in some communities all do it. The practice progresses through the desire of banks to compete with others and to maintain, or even enhance, their relative apparent sizes.

The erosive effect on public confidence

The practice of inflating condition reports is not limited to the call reports which banks, by law, are required to publish. Banks are permitted freely to publish balance sheets or reports of condition at any time, in any place, and in any form or size they desire, so long as they also comply with the call report laws. Small banks usually restrict their publication of statements of condition to the call reports required by the law. Some of the larger banks, however, virtually hide their call reports from public gaze by inconspicuous publication in newspapers of limited circulation. Their voluntary reports, however, often take the form of large, expensive advertisements in large-circulation media, and it is often in those that the most puffed-up statements may be found.

Occasionally (according to the testimony) a bank will use window dressing to hide the fact it is in debt. Usually, however, it has no purpose other than to have itself appear bigger than it normally is. Some banks believe they will attract more business by inflating their relative sizes, and that the deceit in their swollen figures will be little noted.

However, there is already substantial public cognizance of the practice, and writers on banks and banking are bringing it further to public light. Thus in "Money and Banking" (Richard D. Irwin, Inc., 1961, seventh edition) author Charles L. Prather comments that the commercial bank statements of condition most widely distributed to the general public are those published at the end of the year, and that banks window dress those by repaying loans so that they do not appear on the statements, and by padding deposits and other items.

In the same vein, in discussing how some banks window dress end-of-year statements by very temporarily squaring their obligations to Federal Reserve banks, in "Money, Prices, and Policy" (McGraw-Hill, 1961) the author, Walter W. Haines, states (p. 183) that there is one figure on the Federal Reserve bank balance sheet for December 31 that needs to be taken with a grain of salt. Because commercial banks usually publish their balance sheets on that date (and also at the end of the other quarters) and because they consider it somewhat degrading to have any debt appear on such published statements (he says), they will move heaven and earth to pay off their debt to the Federal Reserve (discounts and advances) on this one date although they may have sizable debts outstanding on December 30 and may borrow again on January 2; and that this sprucing up of published balance sheets is known as window dressing and is almost universal.

While there is public awareness of the practice, nevertheless the public is deceived by the practice, for it is impossible for anyone to look at a bank's balance sheet and say whether or not it is window dressed, or which, if any, items are inflated, or to what extent. As was testified, to the degree that the practice is recognized and discounted, it results in raising doubts as to the reliability of "bank statements and bankers' statements." In longrun effect this erosion of the banking community's most valuable asset—public esteem and trust—can eventually destroy public confidence in banks, with consequent great harm to the Nation.

That a bank, the very epitome of respectability, truthfulness, exactitude, and reliability should willfully and needlessly resort to fabrication of its statements of financial condition is so incongruous as almost to defy belief. And particularly so when the prime reason for such misconduct approaches vapidity: to be listed as being larger than it really is.

CALL REPORTS

Development of statutory requirements

Reports calling for the conditions of commercial banks which are subject to Federal regulation have been required since 1863, when the Congress enacted the National Currency Act (12 Stat. 665). Section

24 thereof provided for verified quarterly reports to be made to the Comptroller of the Currency on the first day of each quarter in the form prescribed by the Comptroller. Publication of specified abstracts of the reports was required to be made by the Comptroller in a newspaper in the cities of Washington and New York, and the separate report of each bank was required to be published in a newspaper in the locality of its establishment. In addition to the quarterly reports, every bank in Boston, Providence, New York, Philadelphia, Baltimore, Cincinnati, Chicago, St. Louis, and New Orleans was obliged to publish a monthly statement, under oath, showing the bank's condition as regards "average amount of loans and discounts, specie, deposits, and circulation."

In the next year, 1864, the National Bank Act was passed (13 Stat. 99). Its section 34 enlarged the reporting requirements, so that in addition to the quarterly reports all national banks were required to file with the Comptroller, and publish, monthly statements showing "average amount of loans and discounts, specie, and other lawful money belonging to the association, deposits, and circulation." By the end of 1864 there were about 600 national banks in operation.

In 1869 the reporting requirements laws were again changed (15 Stat. 326). Monthly reports were eliminated, and banks were required to make not less than five reports annually, on any past date specified by the Comptroller of the Currency. The Comptroller was also authorized to call for special reports from any bank whenever in his judgment such reports were necessary to a full and complete knowledge of its condition. In substance the special reports provision has been carried over into present law (title 12, U.S.C., sec. 161).

In 1922 the minimum number of national bank calls was reduced from five to three (42 Stat. 1062).

The Federal Reserve Act (38 Stat. 259) gave the Federal Reserve Board authority to make calls for reports of condition of all State banks which were members of the Federal Reserve System. The Banking Act of 1935 (49 Stat. 713) provided that State member banks must make not less than three reports annually on call of the Federal Reserve bank on dates to be fixed by the Board of Governors of the Federal Reserve System. This act also required each insured State nonmember bank (except a District bank) to make reports of condition to the FDIC in such form and at such time as its Board of Directors may require.

By a 1960 amendment to the Federal Deposit Insurance Act (title 12, U.S.C., sec. 1817(a)) each insured bank is required to make four condition reports annually to its Federal bank supervisory agency, as of dates selected by a majority of the heads of the agencies.

Both Senate Report 1821 and House Report 1827 (86th Cong., 2d sess.), which preceded that amendment noted under the heading "What the Bill Would Do":

> * * * 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.

Calls prior to 1961

The 1869 provision required five reports of condition per year at the close of business "on any past date" specified by the Comptroller of the Currency. For the next 45 years it appears that the Comptroller made nothing but surprise calls. Calls were seldom on the same date 2 years in succession. Usually calls were made during the months of June and December, but only infrequently on the last business days of those months.

Beginning about 1914, it became an almost invariable custom to have calls on the last business days of June and December, although call dates in other than those months followed no such pattern.

During the past 25 years 21 calls have been made on the last business days of June, and 24 times on the last business days of December; and between 1914 and 1961 only 6 June and December calls were made on other than the last business days of those months. Those dates were set by the Comptrollers then in office. The procedure followed was for the Comptroller to notify the other agency or agencies beforehand, to permit coordination with State authorities to issue their calls as of the same date.

A tabulation of all call dates between 1914 and 1962 appears in the 1962 Annual Report of the Comptroller of the Currency, at page 190.

Calls since the 1960 amendment

Since January 1, 1961, the effective date of the 1960 amendment, all three June calls have been for month-end dates. The December call for 1961 was for its last business day, but in 1962 that call was for Friday, December 28.

Total deposits of all commercial banks which were members of the Federal Reserve System had risen 4.7 percent ($10.3 billion) between December 30, 1961, and December 28, 1962. 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 28 call) were 7.6 percent above December 30, 1961. Thus, in the 3 days between December 28, 1962, and December 31, 1962, deposits reportedly had risen $5.7 billion, or 55 percent of the total deposit increase for the year 1962.

Many, particularly the large banks, published both their call reports as of December 28, 1962, as required by law, and also voluntary reports as of December 31, 1962. Comparison of the figures in those two statements of the hundred largest banks in the country (according to a compilation published in the American Banker) showed that they had total deposits of $121 billion on December 28, but by the end of December 31 their deposits had increased more than 6 percent, to almost $129 billion. Nine of the banks showed deposit increases of more than 10 percent, and some ranged up to a high of 34 percent. The supervisory agency witnesses were agreed that most of the increases were due to "window dressing."

In June 1963 the Comptroller "in the interest of moving against the practice of window dressing" proposed the call date of June 14 as a departure from June month-end calls. He was outvoted by the heads of the other two agencies and the call was made for June 29, 1962, the last business day of that month.

Immediately on announcing the call date to national banks the Comptroller issued his charge that the supervisory purpose of call reports has fallen into disregard through the failure of the agencies to call for them on a surprise basis; and that the widespread practice of window dressing has resulted from such default in bank supervision.

Present functions

Call reports have long had two functions additional to that of advising the public of the financial conditions of the reporting banks: They have been used by the supervisory agencies as supervisory tools and as sources of statistics for the analysis of banking trends. The 1960 amendment of the Federal Deposit Insurance Act added still another purpose; data contained in the reports is used in calculating the amount of assessments on banks for deposit insurance.

Call reports remain the primary source of statistics for the American banking industry, which are required in economic analysis and planning, and in the formulation of monetary policy.

The reports have lost some of their importance as instruments of supervision, for the agencies have alternative means of obtaining information they need in the performance of their supervisory functions, and bank examination reports have been so improved that the information they contain can in large measure supplant that of the call reports. However, such reports remain useful tools of the bank supervisor in assessing the effects of regulatory policies on the lending and investing activities of banks, and in connection with matters such as the approval of charters, branches, and mergers. Quite obviously, if window dressing were removed from the reports, the data they contain would be more realistic and reliable.

According to the testimony, for statistical purposes the call reports of the several agencies should be comparable. In that connection, the Comptroller's call report forms have been revised to include data resulting from rulings of the Comptroller in such matters as Federal funds transactions (ruling 1130), bank real estate (ruling 3005), direct lease financing (ruling 3400), and interpretations pertaining to valuation reserves. The report forms of the other agencies were not changed. A series of meetings is planned between the agencies to discuss revisions of the report forms. The Deputy Comptroller expressed hopefulness of the agencies' devising a uniform report by the end of June 1964.

At least insofar as deposit insurance assessments are concerned, the Congress in the 1960 call report amendment to the Federal Deposit Insurance Act sought to base deposit liabilities on "surprise" call dates, to eliminate window dressing by insured banks as a means of creating artificial assessment deductions. Whether all call dates need, or should, be "surprise" dates is a matter of difference between the Comptroller and the Federal Reserve. The FDIC witnesses stated, in substance, that a call for reports as of any past date is a "surprise" call; that prior notice of call dates would surely facilitate window dressing; and that if the Congress had contemplated prior notice to the banks of call report dates it would have fixed them in the statute.

RELIANCE ON THE EXAMINATION PROCESS

In varying degrees witnesses for the supervisory agencies sought to minimize the inefficacy of window-dressed call reports by asserting that their examiners could be sent to "examine the books and records of a given institution, to see which of these transactions were not genuine business transactions" (Federal Reserve); that their examining people say "they have full command of the manner in which banks are indulging in this practice, so they find it" (Comptroller); and that "the bank examining authorities now have [the means for detecting and] adequate power to cope with window dressing situations" (FDIC).

Conceivably the bank examination process could lead to the identity of the banks which window dress their statements, and the extent thereof. Implicit in the record, however, is the fact that the examiners do not have the time to fully deal with window dressing, because they are too hard pressed to carry out their other responsibilities. The FDIC has only about 800 examiners to examine 7,300 banks; the Comptroller of the Currency about 997 to examine 4,583 commercial banks; and the Federal Reserve about 500 to examine 1,515 banks. In consequence "nothing" is being done by the Federal Reserve examiners to detect window dressing. It "has been done on occasions * * * but it is not a normal practice" for the Comptroller's examiners. The FDIC examiners check for window dressing but only make real issues of aggravated cases.

In the circumstances some means other than the examination process needs to be found to deal with the window-dressing problem.

ELIMINATION OF WINDOW DRESSING

The impracticability of self-regulation

While bankers and their industry on the whole regard window dressing as undesirable, its practitioners are not prepared to stop it unless others also do so. But no one wants to be the first, lest the competitors obtain some advantage, particularly the ephemeral distinction of being rated as larger.

That attitude seems shared by the supervisory agencies. At least none has taken any action to stop or limit the practice. The reasons therefor seem evident from the Deputy Comptroller of the Currency's testimony, to the effect that if a bank examiner were to stop the practice in one bank, and there was no concerted effort to stop it in other banks the examiner who took the "tough position" on the matter would really be penalizing the bank he was examining. Further, that if the Comptroller stopped the practice without similar action by the other supervisory agencies "we would be penalizing our national banks." The Federal Reserve's position was to the same effect.

In that posture of the problem it is evident that the practice of window dressing of bank statements will not be stamped out, or even controlled, except on some across-the-board basis which is made applicable alike to all banks responsible to the Federal supervisory agencies.

Agency-suggested remedies

From the subcommittee's review of the problem two facts are unassailable: (*a*) It is in the public interest that bank financial statements be reliable; and (*b*) it is the responsibility of the bank supervisory agencies to employ every possible means to see that they are. The public interest in this regard has not been served. Window-dressed bank statements are unreliable; and the responsible agencies have virtually condoned the practice through inaction.

The incumbent Comptroller of the Currency indicates the spread of window dressing is attributable to the preponderance over the years of calls on June-end and December-end dates. It is significant to note that it was the predecessors in the office he now holds who set those dates, and that no definitive action to deal with the problem (except for a limited situation several years ago in Dallas) was taken until last year, when efforts were made to avoid use of the "traditional" month-end call dates in December 1962 and June 1963. Governor Robertson characterized as the "surprise call fallacy" the contention that such action would readily solve the window-dressing problem. For one thing it would not prevent banks from window dressing their widely publicized voluntary statements.

The Comptroller intends to propose legislation to amend existing law, so as to provide for fixed call dates as of the last business days in June and December of each year. The authority the Comptroller now has under section 161 of title 12, United States Code to call for special reports would be used to preserve the purpose of surprise calls, by requiring national banks to submit and publish averages of net deposits, loans, discounts, and selected items at random dates between the fixed calls. Limiting such procedures to national banks would not solve the problems other agencies might have with window dressing, however more accurate the information the Comptroller might derive thereby about national banks. Also permitting two fixed call dates without provision for the reliability of information in those reports would not overcome the problem of window dressing in them. It would seem to perpetuate that problem. It would also not deal with the problem of voluntary statements.

The Advisory Committee to the Comptroller recommended that an averaging method would discourage window dressing efforts. The Federal Reserve, according to its testimony, believes it to be a helpful device, and tried, unsuccessfully, many years ago to have it adopted in call reports used by the supervisory agencies.

The difficulties of solving the window-dressing problem are reflected in this exchange at the hearings:

> 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.

Governor Robertson gave as his judgment that the most promising avenue toward elimination of window dressing is moral suasion. This would require the convincing of bankers that the practice is morally unworthy, that it could be injurious to the public confidence in the ethics of banks, and that "the game is not worth the candle, in the long run." He stated his belief that if the bank supervisory authorities, acting vigorously and simultaneously, would request banks throughout the country to quit window dressing, their likelihood of success would be excellent. He emphasized that such an effort would certainly fail unless based on complete cooperation and coordination, most careful preparation, and determined face-to-face discussion with the bankers in every city where the practice prevails.

He alluded to solution of a "most active" window-dressing problem in Dallas a few years ago through the coordinated efforts of the supervisory agencies, and expressed his belief that the present problem could be whipped without any difficulty if the same kind of coordinated effort were exerted now. He expressed delight at the subcommittee's interest in the problem, saying that "the more we can point up the differences between agencies and the need for concentrated, coordinated action the better off we are."

The FDIC witnesses advanced no suggestions for dealing with window dressing.

Other remedies considered

Various other methods for eliminating the window-dressing problem were discussed in the subcommittee's hearings, among them the suggestion that since most of the practice is bottomed on aspirations for size status, the determination of the relative sizes of banks should be made officially by the supervisory agencies; and the desirability of requiring a certification on each condition report of whether or not the report contains any non-business-purpose transactions. Agency comment on these was principally to the effect that these would present large administrative problems and the need to examine and analyze each bank statement.

Problems similar to window dressing have occurred where broker-dealers wish to dress up their balance sheets filed with the Securities and Exchange Commission so as to improve their apparent capital or to give the appearance of financial solidity. The Securities Exchange Act of 1934 requires that such statements not be false or misleading with respect to any material fact. In *Associated Underwriters, Inc.*, SEC release No. 7075 (1963), $2,000 cash was reported in a financial statement. On investigation the cash was found to have been but a loan, and that it was withdrawn within several days after the statement was filed. The SEC's public release reports the Commission's finding that such statement was false and misleading under the act, and the act's sanctions could be imposed.

To the extent that window-dressed reports are reflective of actual transactions their makers are not punishable under title 18, United States Code, section 1005, which, so far as pertinent provides:

> Whoever makes any false entry in any * * * report or statement of such (i.e. Federal Reserve Bank, member bank, national bank, or insured bank) with intent * * * to deceive * * * the Comptroller of the Currency, or the Federal Deposit Insurance Corporation, or any agent or examiner appointed to examine the affairs of such bank, or the Board of Governors of the Federal Reserve System, shall be fined not more than $5,000 or imprisoned not more than five years, or both. * * *

However, window-dressed reports, to the extent they are puffed up, defeat the purposes for which they are intended, i.e., for statistical purposes, as supervisory tools, and for deposit insurance assessments. The supervisory agencies are entitled to condition reports which are meaningful, exact, and reflective of normal and usual conditions. Certification by banks to their supervisory agencies that their condition reports and statements contain no window dressing would assure the agencies they are getting reports of that kind. Any certification which was false would seem clearly to fall within the proscriptions of the quoted criminal provision.

The subcommittee does not believe that resort to any specific legislative action is necessary at this time, particularly in view of agency witness statements that the bankers desire to be rid of the practice.

APPENDIXES

Appendix 1—Devices Employed To Window Dress Bank Condition Statements Called for by Supervisory Authorities

a. 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.

b. 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.

c. 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 allocation of the depositors' balances in the long run.

d. 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.

e. Delayed processing of items presented for collection, or of interoffice clearings in a branch system. This is a simple and practically undetectible 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.

Appendix 2.—Inflation of Figures in "Voluntary" Published Statements by Methods That Are Not Permitted in Official Condition Reports

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

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

c. 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.